ASSET PROTECTION PLANNING:

PLANNING STRATEGIES
FOR THE PROTECTION OF FAMILY ASSETS
FROM CLAIMS OF CREDITORS AND OTHER PREDATORS

ESTATE PLANNING
DEBTORS RIGHTS PLANNING

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By

Frederick J. Tansill

I. WHY ASSET PRESERVATION PLANNING?

A. The Great Recession of 2008-2010 and the Earlier Recessions of 1989-1992 and 2000-2003 Made Many People Feel Financially Vulnerable and Afraid, and They Will Not Forget the Feeling.

B. The Collapse of the Stock Market and Collapse of the Housing and Commercial Real Estate Markets in 2008-2009, and the Overnight Evaporation of Many Giant Public Companies – Lehman, Bear Stearns, Washington Mutual –Severally Damaged the Balance Sheets of Almost Every American. Clients Are More Vulnerable Than Ever to Lawsuits and Claims. Are They Personally Liable For Loans on Commercial Real Estate Which Is Underwater/Underdeveloped? Can They Walk Away from Homes Underwater With No Further Liability?

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II. APPROPRIATE AND INAPPROPRIATE CANDIDATES FOR ASSET PRESERVATION ESTATE PLANNING.

One of the fascinating aspects of asset protection practice that one comes to notice is that every new economic crisis, every new economic cycle in the U.S., creates new classes of potential asset protection clients. Let's look at the new classes of prospective clients created by the Great Recession, the economic crisis which began with the collapse of Lehman Brothers in September.

In the current economic crisis, there are staggering levels of home mortgage defaults (there were reports at that time that 50% of the homes in the U.S. were "underwater," i.e., the mortgage exceeded the equity), credit card defaults, commercial real estate mortgage defaults (commercial real estate is highly deflated and there have been news reports that 40% of all commercial mortgages are due for refinancing in the next 24 months), defaults on business and personal loans and lines of credit. What lenders are going to refinance all of those underwater commercial properties? Many lenders experiencing these defaults have taken TARP funds from the federal

government that they are obligated to repay, have found the values of their own stock depressed to historic lows, and are operating at losses. Bluntly, I believe insufficient attention has been paid to the fact that creditors will not be able to aggressively pursue, let alone hire attorneys to sue with elaborate discovery, most of the defaulting borrowers. So they will do cursory investigations of borrowers, look for "low hanging fruit" – assets and income streams easily and clearly subject to lien and garnishment and judgment execution -- and pursue a few vulnerable creditors and accept quick and frequently unfavorable settlements with most.

Those debtors who have thoughtfully and aggressively pursued asset protection strategies, even late in the day "uglification" strategies, will be rewarded and will retain more assets and repay less of their debts.

Reciprocally, those debtors with exposed "low hanging fruit" who are not proactive in protecting themselves will retain less of their assets and income and repay a greater percentage of their debts.

Lenders simply are not going to have the resources to pursue fraudulent conveyance claims in most cases. Asset protection strategies that might have been seen to be highly risky in an earlier economy where there were fewer defaults and more lender resources and determination to pursue those defaulting, will serve debtors effectively in the current environment. And if a debtor who has implemented asset protection strategies is pursued, the chances of achieving a favorable workout/settlement of the debt should be much greater than in a stronger economy.

A. Examples of Appropriate Candidates:

Highlighted By Recent Events

(1) Those adversely affected by the current economic crisis, including
   (a) residential real estate brokers and agents
   (b) residential mortgage lenders
   (c) title companies and closing lawyers
   (d) home builders and subcontractors
   (e) home inspectors and appraisers

(f) residential investors and speculators as well as homeowners who overpaid

(g) Wall Street wizards involved in developing, packaging and marketing layoffs as a result of losses in Subprime lending, e.g., Bear Sterns, Lehman Brothers, AIG, investment bankers, equity and debt specialists

(h) commercial real estate owners, operators, investors, e.g., the last 2 years having not been good times to bring condo or timeshare projects on to the market

(i) board members and officers of the above for negligence in derivative suits

(j) individual trustees of family trusts which suffered 40-50% losses or more because of over-concentrated positions in undiversified equities or even over-concentration in diversified equities whose investment practices, in hindsight, were not prudent

(k) fiduciaries and feeders who invested or directed investments to Bernie Madoff or other ponzi scheme operators or hedgefunds which cratered with catastrophic results for their clients.

(l) Big law firm lawyers, especially these living over their heads, who have been laid off, e.g., 200 at White & Case, 140 at Cravath.

(m) HNWIs (High Net Worth Individuals) with inappropriately large stakes in failed hedge funds or Madoff funds who find themselves with “lifestyle debt” they cannot afford.

(n) Individuals at Wall Street firms who may be charged with securities fraud.

(o) Those with undisclosed (to the IRS) offshore bank accounts who turned themselves in or will be caught by the IRS.

(2) Directors and officers and accountants and lawyers of public companies with Enron/MCI-type accounting problems in large banks (Lehman) and mortgage lenders (Washington Mutual) and syndicators of mortgage-backed securities (Goldman), who may be sued in class actions for breach of duty (negligence in supervising the company or its auditors).

(3) Lawyers and accountants involved with companies with accounting or stock price shenanigans or abusive corporate tax shelters, who may be subject to suit by shareholders for negligence.

(4) A senior executive of, or major investor in, a technology company or investment bank or mortgage lender or Ford or GM or AIG or Bear Sterns or homebuilding company with a highly concentrated and/or illiquid position in the company, whose stock may be publicly traded and subject to wild stock price fluctuations or whose stock may be privately held pre-IPO or pre-takeover, worried that 90% plus of his or her net worth tied up in such speculative stock which may tank and diminish radically in value,

who may have a lifestyle and debt, such as mortgage debt, based this high, but somewhat shaky, net worth. And this can be true of senior executives of billion dollar tech companies with highly concentrated net worth in the event of collapse of the stock price. These clients may want to protect their few million of diversified portfolio assets, so that only the highly concentrated speculative position is at play and at risk in the event of such a disaster with the concentrated position.

(5) Someone with a lot of margin trading or a substantial investment in private equity or hedge funds which could

- collapse in value
- trigger a call to satisfy margin debt
- trigger a cash call

As above, they may want to protect their conservative diversified portfolio.

(6) Professional high net worth day traders and real estate speculators might have the same concerns.

(7) Founders/key executives/directors of a company which may go public or involved with a public company with a speculative run-up, who may be concerned about shareholder derivative suits and SEC suits if the stock price collapses.

NOTE: Be on the lookout – who will be tomorrow's debtors? Clearly, investigation and pursuit of high net-worth individuals committing tax fraud with elaborate over-the-line tax shelters and particularly with off-shore trusts and corporate and foundation accounts is going to be targeted and aggressively pursued by President Obama's IRS. Under the Bush IRS, offshore tax fraud was not aggressively pursued.

(8) With Barack Obama as the President, and with the Democrats having working control of the House and Senate, certain industries will suffer with new regulations, scrutiny, federal investigations, and changing federal policy. Those investing in or serving as officers or board members of such companies may be the next asset protection candidates.
Do you think Halliburton and its spinoff Brown & Root and oil (BP after Gulf oil disaster) and coal mining companies (Massey Energy – owner of West Virginia coal mine which collapsed with massive loss of life) and Blackwater (Xe) stocks will go up or down?

<u>Generally</u>

(9) A physician concerned that he or she cannot have enough malpractice liability insurance to protect himself or herself from potential future claims, or who is considering going partially or totally "naked" (without liability insurance coverage) because of the prohibitively high cost of the premiums.

(10) Another professional, such as an accountant, lawyer, architect or engineer, who has similar concerns.

(11) A present or former outside member of a corporate board of directors who is concerned about potential directors' liability for which he or she may not be adequately insured or indemnified.

(12) An individual with substantial net worth or notoriety who is concerned that his or her wealth or notoriety may make him or her a target for vexatious claims in our litigious environment.

(13) A person engaged in a business from which personal liability could arise, or in a business representing the greater part of his or her net worth, where the inherent nature of the business is such that the potential for serious future claims is sufficient.

(14) Someone seeking to avoid forced heirship provisions of state law, e.g., to limit the rights of a surviving spouse to inherit.

(15) A married person concerned he or she may someday be facing divorce or alienation from his or her current spouse, seeking to posture his or her assets to limit his or her exposure to an expensive divorce property settlement in the event he or she may someday divorce.

(16) An entrepreneur who has recently sold or expects to sell a closely-held business who is concerned to preserve the proceeds of sale from potential claims for indemnification by the buyer, who may be disappointed with the performance of the business.

(17) Someone who presently owns or previously owned real estate with potential environmental liability associated, who is concerned that some day there could be a gigantic environmental liability imposed upon him or her.

(18) Wealthy East Asians, e.g., Chinese and Indians, who will seek the benefits of these arrangements. To Wit: At the November 2009 STEP Conference on international trusts scheduled for Singapore, a Hong Kong trust banker from JP Morgan spoke on asset protection trusts. What does JP Morgan's interest in touting this in the East Asian market say?

B. Inappropriate Candidates for Use of Foreign Asset Preservation Trusts: There are many of these after the Great Recession.

(1) Individuals for whom the financial picture is bleak: where there are substantial loan defaults, contract defaults with severe potential penalties, apparent business tort liabilities.

(2) Individuals who are, for all practical purposes, insolvent.

(3) A lawsuit has been threatened or filed against the individual or his or her business, or an adverse judgment against the individual or his or her business is threatened.

(4) Bankruptcy of the individual or his or her business appears imminent.

(5) The individual's net worth is negative.

(6) A substantial judgment has been entered against the individual or his or her business.

(7) The individual or his or her business is bankrupt.

Even the offshore centers which have recent statutes tailored to attract APT business want "clean business," and subject potential grantors of such trusts to substantial due diligence screening to determine their current solvency and the status of any current creditor problems. For example, despite numerous petitions, as of a few years ago Gibraltar had cleared and approved fewer than twenty (20) APTs.

III. ASSET PRESERVATION PLANNING SHOULD BE AN INTEGRAL AND INTEGRATED PART OF THE OVERALL ESTATE AND FINANCIAL PLAN

A. PROPERLY USED, FOREIGN AND DOMESTIC ASSET PROTECTION TRUSTS ARE AN INTEGRAL AND INTEGRATED PART OF THE OVERALL ESTATE AND FINANCIAL PLAN

Asset Preservation Planning in general and particularly using foreign and domestic APTs should be integrated into the overall financial and estate planning for the client, and should complement it. Structuring such asset protection planning in this manner is not only sensible, it provides the best argument possible to rebut the suggestion that the planning was motivated by intent to defraud, hinder or delay creditors. Be prepared to offer some justification for any asset protection strategy, but particularly for establishing domestic or foreign APTS in the nature of a business purpose OTHER THAN asset protection. Its purpose should be to plan against a

possible future event that would result in economic and financial devastation to the grantor's estate.

The law recognizes the right of individuals to arrange their affairs to limit their liability to potential future creditors. In re Heller, 613 N.Y.S. 2nd 809 (N.Y. Sur. Ct. 1994). This is analogous to Judge Learned Hand's famous opinion that everyone has a right to organize his affairs to minimize his taxes.

Asset preservation planning can and should foster accomplishment of the following general estate planning and financial planning goals, which would constitute other business purposes:

- X Probate Avoidance.
- X Confidentiality of Value and Nature of Assets.
- X If Offshore, As a Vehicle for Global Investing.
- X Ease in Transferring Assets to Family Members.
- X Avoidance of Possible Monetary Exchange Controls.
- X Will Substitute/Avoid Multiple Wills in Various Jurisdictions Where Assets Are Held.
- X Privacy for Estate Plan.
- X Facilitate Handling of Affairs in the Event of Disability or Unavailability.
- X Flexibility.
- X Minimization of Taxes
- X Preservation of Assets for Dependent Family Members
- X Diversification of Asset Management by Using U.S. or Offshore Trust Company
- X As a Justification for an Offshore Trust, Desire for Diversification of Investments into Overseas Securities Markets

To do this sort of asset preservation planning the lawyer must know his clients,

screen them with some level of due diligence investigation,[1] and obtain Affidavits of Positive Net Worth/Solvency with satisfactory disclosure of details to ensure that the grantor is not engaged in a fraudulent conveyance.

B. OAPTs and DAPTs ARE USEFUL OTHER THAN FOR ASSET PROTECTION: FOR CENTRALIZED, CONFIDENTIAL, TAX-HAVEN MANAGEMENT FOR INTERNATIONAL CELEBRITIES, ATHLETES AND OTHER FAMOUS HNWIs

An APT should not simply be considered for use in the narrow circumstances of a U.S. citizen or resident seeking protection from potential future creditors.

An asset protection trust may have the following benefits which should attract the wealthy, including entertainment, sports and other celebrities from around the world.

- Confidentiality. In many OAPT jurisdictions it is a criminal offense for a bank officer or court official to disclose even the existence, let alone the particulars, of a local trust arrangement. For obvious reasons the rich and famous will appreciate the confidentiality of such arrangements, particularly from the prying eyes of criminals, business rivals, spouses, ex-spouses, lovers, ex-lovers, children, alleged children, media, those with a grudge or claim. Even, perhaps especially, as to family member beneficiaries, many Settlors would like to keep the existence, text and operation of a trust confidential, and while that is virtually impossible under general common law fiduciary principals, it is permitted in OAPT jurisdictions. For a view that is bad public policy, see Professor Robert Whitman's article "Full Disclosure is Best" in the July 2004 issue of Trusts & Estates. In support of the value of confidentiality, see "Go Offshore to Avoid Transparency" by Ian Marshand, Michael Ben-Jacob in the March 2004 issue of Trusts & Estates.

- Non-Susceptibility to Spouse's or Child's Claim at Divorce or Death/Alternative to Prenuptial Agreement. Many OAPT jurisdictions do not recognize or enforce spousal claims arising out of divorce, "palimony" claims, paternity claims or marital or child's claims for forced heirship. Such claims are chronic concerns of the rich and famous. An OAPT may serve as a substitute for a Pre- or Post-Marital Agreement.

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[1]See *Steps in Investigating Potential Asset Protection Clients*, James Mintz, Journal of Asset Protection, January/February 1998, Vol. 3, No. 3 and May/June 1998, Vol. 3, No. 5., and *Completing a Due Diligence Investigation on a Potential Client*, John W.M. Chaud, Journal of Asset Protection, September/October 1997, Vol. 3, No.1.

- Tax Haven. The U.S. is said to be the only country on earth which imposes income tax and transfer tax on the worldwide income and assets of its citizens and residents. In contrast, citizens and residents of many countries may legally avoid income or transfer tax by their jurisdiction of domicile by using appropriate structures in tax haven jurisdictions. In other countries tax enforcement is lax or corrupt permitting the shrewd and well-informed to avoid carelessly or randomly enforced tax laws. Many OAPT jurisdictions expressly refused to recognize tax avoidance in another jurisdiction as criminal or penalties or remedies for tax avoidance as enforceable.

- Centralized Financial Coordination/De-Centralized Investment and Management/Global Accessibility. In the global electronic financial network of 2010, communication, investment commitment, management, record keeping and reporting are virtually instantaneous. The local branch of a sophisticated global financial institution in an API jurisdiction may serve as "host" for the locally sitused OAP which serves as a quarterback/general partner of the estate plan/financial plan/investment plan/asset protection plan/tax plan of the High Net Worth Individual (HNWI), which through local and multinational subsidiary LLCs, corporations, trusts and foundations manages the wealth using various other institutions for the skill and expertise and various other jurisdictions for the specialized advantages. Each of the various entities may be managed for its idiosyncratic advantage while each serves as a bulkhead which will contain "trouble" in any one venture within that entity, protecting the HNWI and his other investments from ancillary liability of any kind. Consider the opportunities now available to do this in one corporate entity, for examples, S G Hambros, the trust platform of Societe Generale with affiliates on every continent, and its recent acquisition of 10% interest in Rockefeller Trust Company the whitest of white shoe private banks in America. Through this global conglomerate HNWIs have access to the best investment advice available globally and trust and corporate and foundation entity management around the world.

  Moreover, the tiering and layering of various types of entities in various jurisdictions under various sets of laws around the world may serve it the further purposes of advancing the confidentiality which may be so important in our litigious world, making the structure and the assets virtually impenetrable to outside scrutiny.

- Asset Protection Planning. Add to all of these virtues the asset protection planning inherent in an OAPT, and those structures should have an irresistible appeal to HNWI's around the world. For U.S. HNWIs, the arrangement is tax neutral and no less attractive for its non-tax charms.

- Foreigners Are Using DAPTs in the U.S. Certain foreign countries, including Mexico, Venezuela, Argentina and Brazil, have blacklisted certain traditional tax havens such as Cayman Islands, Channel Island and Cook Islands and forced their citizens to disclose offshore structures in such jurisdictions. This has had the curious result of making U.S. DAPTs in Delaware, Alaska, etc. attractive hosts for offshore structures for citizens of such countries. The U.S. is not “blacklisted” by any of these countries. Typically these customers are looking to the estate planning, avoidance of forced heirship and possibly tax shelter advantages. See the article by Mark G. Holden, “Surprise: The U.S. is the New Tax Haven” in the December 2003 issue of Trusts & Estates.

C. USE OF AFFIDAVIT OF SOLVENCY

Attorneys consulting with and advising clients with regard to domestic or foreign APTs or other asset protection strategies involving donative transfers of assets should consider the use of an Affidavit of Solvency. Where the issue of asset protection arises in an engagement, obtain such an Affidavit from the client. In the Affidavit the client should represent, state and affirm that he or she has no pending or threatened claims; that he or she is not presently under any investigation of any nature, and that he or she is not involved in any administrative proceedings; that no situation has occurred which the client has reason to believe will develop into a legal problem in the future; that following any transfers the client intends to remain solvent and able to pay his or her reasonably anticipated debts as they become due; and that none of the assets which the client may transfer were derived from any of the "specified unlawful activities" under the Money Laundering Control Act of 1986. To the extent any legal disputes or other problems exist, they should be disclosed in the Affidavit and the Affidavit should provide that either sufficient assets will be retained with which to satisfy any liability arising from the problem, or the documents should be drafted with provisions requiring that any liability resulting from the disclosed problem(s) be satisfied by the foreign APT if the liability is finally and legally established and not otherwise satisfied.

The internet affords the opportunity for lawyers to do additional due diligence investigation of new asset protection clients, for instance lexis searches for judgments, liens, pending litigation.

The asset protection lawyer should maintain a file containing a memorandum explaining the facts of each case which the lawyer has refused to take. This may prove helpful someday if the integrity of the lawyer and the types of cases accepted are challenged. A sample Affidavit of Solvency is attached as Exhibit 1.

D. WHAT YOU SHOULD HOPE TO ACCOMPLISH USING A DOMESTIC OR FOREIGN ASSET PROTECTION TRUST

The domestic or foreign situs asset protection trust, or any other asset protection technique for that matter, is best seen as facilitating accomplishment of the following goals vis-a-vis creditors:

- Deter Litigation.
- Provide Incentive for Early and Inexpensive Settlement.
- Level the Litigation Playing Field.
- Enhance Bargaining Position.
- Provide Options if the Claim/Litigation is Pursued.
- To Completely (if possible) or Partly (at least) Defeat the Claim.

The grantor of such an APT and his attorney will frankly disclose the existence and character of the trust to any creditors who materialize, to discourage the creditors from bringing or pursuing a claim or to foster settlement.

Barry Engel claims to have settled claims against his clients with offshore APT arrangements at an average of fifteen percent (15%) of the initial claim. This figure highlights the important point that offshore APTs are best viewed as a way to minimize, rather than to eliminate, exposure to claims.

Consider why a lawyer advises corporations operating exclusively in Kansas to incorporate in Delaware:

- The law of Delaware is more protective of management, and management is the lawyer's client.
- Delaware law is clear and established with respect to the rights and duties of corporations, their officers, directors and shareholders.
- Delaware Chancery Courts hear exclusively corporate law cases, and the judges of that court understand the law they are interpreting.

The same approach would guide an estate planning attorney to suggest the appropriate domestic or foreign jurisdiction as a situs for a trust intended to shelter

assets from possible future creditors.

If an appropriate trust is established in an appropriate jurisdiction in a timely fashion and especially if multiple tiers of complex foreign entities are used, trusts and corporations in different jurisdictions, as a practical matter attachment may be impossible. See Suyfy v. U.S., 818 F.2d 1457 (9th Cir. 1987) for an example of intriguing planning ideas. To the extent that the creditor or his attorney lacks cleverness, money, staying power or tenacity, domestic and especially foreign situs asset preservation planning may prove effective.

E. DISTINGUISH LEGITIMATE ASSET PROTECTION PLANNING FROM ASSET PROTECTION RELYING ON BANK SECRECY OR PERJURY, OR RELATING TO TAX FRAUD OR OTHER CRIMINAL ENTERPRISE

Domestic or Foreign Asset Preservation Trusts and other asset protection techniques should NOT be seen as a means or excuse to defraud creditors, hide assets or evade U.S. or foreign taxes.

The grantor of an offshore APT will happily acknowledge the existence of the foreign trust and details about it in interrogatories, depositions and in sworn testimony. The grantor will pay U.S. tax on all income of the trust. It will be a grantor trust under Code § 679.

Liechtenstein and UBS have paid the price for helping clients commit tax fraud.

The grantor will be very careful to avoid transfers to domestic or foreign trusts which could be seen to be a fraudulent conveyance under state, Federal Bankruptcy, or foreign situs law. Failure to fully disclose and turn over all assets belonging to the grantor is a ground for not obtaining a bankruptcy discharge. 11 U.S.C. ' 727.

In any context in which a Federally chartered bank is a potential creditor, the grantor must be mindful of the Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990, which imposes severe criminal penalties for concealment of assets owed to the Federal Deposit Insurance Corporation or the Resolution Trust Corporation.

Grantors also should be aware of the Money Laundering Control Act of 1986, which imposes severe criminal penalties where funds involved in a financial transaction -- e.g., offshore deposits -- represent proceeds of certain unlawful activities if the intent is to promote the unlawful activity or evade income tax.

2008-2009 Scandals Highlight Risks of Attempting to Commit Tax Fraud Using Offshore Jurisdictions: UBS and Liechtenstein.

UBS Problems – UBS (Union Bank of Switzerland), one of the world's largest wealth managers, has a huge problem with the U.S. tax authorities. It recently became public that UBS was actively soliciting U.S. clients touting the virtues of "secret" offshore arrangements. UBS' problems came to light when Bradley Birkenfeld, a former UBS private banker, pleaded guilty on June 20, 2008, acknowledging that he and other UBS colleagues helped wealthy Americans hide money abroad, advising them, among other schemes, to put cash and jewelry in Swiss safe deposit boxes, buy or trade art and jewels using offshore accounts and setting up accounts in the names of others. Mr. Birkenfeld is expected to tell federal prosecutors what he knows in hope of lenient sentencing. Mr. Birkenfeld's boss, Martin Liechti, former head of UBS wealth management business for the Americas, has been detained in connection with the investigation. Another co-conspirator appears to be Mario Staggli, a Liechtenstein financial advisor, who owned New Haven Trust Company in that country.

U.S. prosecutors in late June 2008 asked a federal judge in Miami to let the IRS issue a summons to Zurich-based UBS for client information. Very recently the U.S. government, which had sought to obtain information on 52,000 Americans with UBS Swiss bank accounts, informed the judge it had settled with UBS in exchange for information on some 4,500, probably figuring that was enough to worry all 52,000 and cause many of them to turn in themselves under an amnesty program which expires in September of 2009. Under the amnesty program taxpayers who admit to the IRS information on previously undisclosed offshore accounts can limit their exposure to criminal penalties. If granted, this would be the first ever summons issued by the U.S. against an offshore bank. This case is a very ominous warning for U.S. tax cheats and other violators of federal law who have long attempted to hide assets in secret offshore trust and other accounts.

UBS clients caught in this dragnet may get off by paying back taxes, interest and penalties if they come forward early and voluntarily to the IRS. Those who do not will risk criminal prosecution, and any outside advisors in the U.S. who facilitated the secret, fraudulent offshore arrangements may face consequences from the IRS.

The U.S. is seeking to have UBS produce records identifying U.S. taxpayers with UBS accounts in Switzerland from 2002-2007 not declared to the IRS. Mr. Birkenfeld, cooperating with the U.S. Government as part of his plea arrangement, has told U.S. prosecutors that UBS held $20 billion in assets for U.S. clients in undeclared accounts.

In 2001 UBS entered into an agreement with the IRS to identify U.S. citizens among its account holders and to withhold taxes on their behalf. Subsequently UBS flaunted the agreement and bragged to the U.S. clients that "information relating to your Swiss banking relationship is as safe as ever." Reportedly as many as 20,000 UBS clients may be involved. Sources indicate that UBS frequently worked in tandem with a Liechtenstein bank, LGT Group to hide U.S. funds. Typically these arrangements

involved offshore corporations and occasionally trusts.

QUERY: As a result of this new aggressiveness of the U.S. government towards offshore tax cheats and the greatly increased scrutiny by the U.S. government of tax haven accounts, will such offshore centers be more reluctant to establish even legitimate tax-compliant trusts and accounts for U.S. clients, wary of the "hassle factor?" Apparently, yes according to anecdotal information the author has heard from offshore bankers.

Swiss courts may have thrown a monkey wrench in UBS' settlement with the IRS, questioning whether it was legal for UBS to turn over even 10% of the names of US account holders in violation of Swiss bank secrecy law. The matter has yet to be resolved, but Switzerland's problems with tax fraud will not go away, with Germany, France and Italy now seeking to punish their citizens avoiding taxes through Swiss accounts.

Liechtenstein Connections.

At least seven other countries are investigating their own citizens for allegedly hiding assets in Liechtenstein using the services of the same LTG Bank which worked with UBS as described above. This investigation began when data from LGT Truehand AG, which sets up "foundations" (frequently used like trusts with non-charitable beneficiaries) was stolen, apparently by Heinrich Kieber, a former employee of LGT. Mr. Kieber, now apparently living in Australia, has offered confidential client data to tax authorities on several continents. Reports say that about 100 Swedes, 100 Canadian, 20 Australians, several hundred French and about 1,400 Germans had such accounts reflected in Mr. Kieber's data. Apparently Germany paid Mr. Kieber $6-$7.5 million for the data.

LGT is owned by Liechtenstein's ruling family.

Tax cheats should be aware that a law enacted in 2006 authorizes the IRS to pay sharply higher rewards to informants in large cases, as high as 30% of what the IRS collects.

F. ETHICAL AND MALPRACTICE ISSUES FOR THE ATTORNEY; THE ATTORNEY'S EXPOSURE TO CIVIL LIABILITY AND CRIMINAL PROSECUTION

The general ethical rules governing lawyers practicing in asset protection following the law of fraudulent conveyance: if a client has no current or "contemplated" creditors (he is not known to intend shortly to enter into a transaction which will create creditors) but is only concerned about potential future creditors, it is clearly perfectly ethical to assist.

Examples:

An obstetrician concerned that she will eventually deliver a sick baby and will inevitably be sued.

A board member of a start-up company or even a public company concerned that if the stock price collapses (after public offering in the case of a start-up), he will be liable. Consider that all board members of MCI, including the impecunious Dean of Georgetown Law School, were “fined” by the SEC 10% of their respective net worths for negligence in overseeing the activities of Bernie Ebbers.

What is an example of a perfectly clean asset protection endeavor? Consider a tech entrepreneur who sold his small company to a big public company for $50 million right before, say in 2002, the tech bubble burst in 2003. He would have been required to provide contractual representations and warranties with a duration of 4 years.

When the tech bubble burst, and the value of the acquisition was seen to be much less than what was paid, probably many buyers referred the representations and warranties to their 1,000-lawyer Wall Street law firms with instructions: find a breach and get our money back. In such a situation, it does not matter what the facts or laws are, the buyer’s law firm can bully the seller into a large settlement. But if the proceeds were protected before there was any problem, for instance in an offshore APT, the seller would have been safe. There could be no question of challenging the ethics of a lawyer who suggested such a prophylactic strategy.

Evolution of Perception of Legal Ethics in Asset Protection.

The legal practice of asset protection arose out of the nationwide collapse of the value of commercial real estate in 1989-1992. When Denver’s real estate collapsed, a Denver lawyer with clients in trouble, Barry Engel, approached the Cook Islands and suggested the adoption of the world’s first asset protection trust statute. When it was adopted in the Cook Islands, Mr. Engel set up such trusts for many of his Denver clients and other offshore jurisdictions soon followed suit and developed similar statutes.

Initially, most lawyers were very uncomfortable with the ethics of helping clients “hide” assets from creditors.

Over the years, 60 plus offshore jurisdictions and 11 U.S. states have adopted such statutes, and it seems indisputable that a concept -- asset protection -- so widely endorsed and enacted into law by some 12 state legislatures and signed into law by 11 governors, is now comfortably within the public policy mainstream and can hardly in that light be seen as unethical.

Moreover, such luminaries as Duncan Osborne, who has chaired the International Planning Committee of the American College of Trust and Estate Planning, and Gideon Rotschild, who chairs the ABA Special Committee on Asset Protection, have authored articles suggesting not only is it not unethical to do asset protection planning, it may be civilly negligent – i.e., legal malpractice – not be recommend asset protection planning to clients for whom it is obviously appropriate.

So while, for many, you may be damned if you do asset protection planning – it is a grey/subtle area without bright ethical lines -- you may be damned if you do not.

Certain areas of asset protection planning are certainly thorny and require close examination and analysis. If a client asks you to help him avoid a child support claim, are you comfortable assisting morally or unethically? Some states permit it under certain circumstances. What about helping a client protect assets in the event of future divorce? Consider, has the other spouse been a client of yours? Is the property sought to be protected community property? Has a divorce action been initiated, is filing contemplated? What if the assets sought to be protected were earnings during the marriage in a non-community property state, where the spouse's interest in inchoate? These are dangerous, reef-filled waters in which to sail. See Exhibit 2, Island Castaways.

BEWARE: In the case of insolvent clients or clients with a clear intent to hinder, delay or defraud existing creditors, it may be unethical for an attorney to counsel or assist a client in a conveyance which perpetrates a fraud on the client's creditors. As an example, See Virginia Code of Professional Responsibility, Canon 1 generally, and Disciplinary Rule 1-102(A)(4) and 7-102(A)(7), Ethical Considerations 1-5, 7-3, 7-4, 7-5, 7-6, and 7-8, Virginia Legal Ethics Opinion 1140 (October 18, 1988).

1. Virginia Ethics Rules as an Example.

According to Disciplinary Rule 7-102(A)(7), a lawyer shall not counsel or assist his client in conduct that the lawyer knows to be illegal or fraudulent. To do so would not only expose the attorney to censure or disbarment, but also to suit for fraud as a co-conspirator or in malpractice.

Canon 4 deals with the obligation of the lawyer to preserve the confidences and secrets of the client. A "confidence" generally refers to information protected by the attorney-client privilege under applicable law, and a "secret" generally refers to other information gained in the professional relationship that the client has requested by held inviolate or the disclosure of which would be embarrassing or detrimental to the client. In actual practice the attorney-client privilege is not as protective as attorneys tend or want to believe. Courts seem increasingly willing to find a means, basis or exception to compel disclosure.

Moreover, according to Disciplinary Rule 4-101(D), a lawyer must reveal the intention of his client, as stated by his client, to commit a crime or information which clearly establishes that his client has perpetrated a fraud related to the subject matter before the tribunal with respect to which the lawyer is representing the client. If the client acknowledges to the attorney that he has committed a fraud, that clearly establishes it. Not to make the required revelation could subject the attorney to censure or disbarment.

Under Disciplinary Rule 4-101(C)(3) a lawyer may reveal information which clearly establishes that his client has, in the course of the representation, perpetrated upon a third party a fraud related to the subject matter of the representation. Recognizing the risk that the lawyer may well be sued as a co-conspirator in the fraud or for malpractice, the lawyer may want to avail himself of this opportunity, in which he is excused from breaching the attorney-client privilege.

If a client has committed a fraud using his attorney's services without the attorney's prior knowledge, the attorney may reveal his client's fraud to a damaged third party without breach of attorney-client privilege to protect himself from implication.

On the other hand, if a client consults with his attorney for advice as to whether an activity he engaged in without the attorney's involvement was illegal or fraudulent, and the attorney advises him that it was, and he thanks the attorney and terminates the professional engagement, the attorney's advice is clearly privileged, and the attorney may not disclose any information obtained in the engagement. The attorney is not thereby implicated in the illegal or fraudulent act.

2. Ethical Rules in Other States.

In South Carolina Bar Ethics Advisory Committee Opinion 84-02 it was held that unless there is an immediate reasonable prospect of a judgment being entered against the client, particularly one that would render him insolvent, the attorney can participate in a transfer of the client's property where the sole purpose of the transfer would be to avoid the possibility that a creditor would recover a deficiency judgment against the property conveyed. On the other hand, In re Pamphilis, 30 N.J. 470 (1959), is an example of a case where an attorney was disciplined for suggesting transfers of property to a relative in satisfaction of a non-existent debt prior to filing bankruptcy. See also Townsend v. State Bar of California, 197 P.2d 326 (1948). In re Greene, 557 P.2d 644 (Ore. 1976) sets forth the principle that if an attorney assists a client in making a transfer that any reasonably competent attorney should have recognized as fraudulent, or if the attorney should have reasonably discovered facts that would manifest the transfer as fraudulent, the attorney may have violated his or her ethical duty to provide competent representation. Cincinnati Bar v. Wallace, 700 N.E. 2d. 1238 (1998), In re Kenyon and Lusk, 491 S.E. 2d 252 (1997), and In re Hackett, 734 P. 2d 877 (1987, Oregon).

3. Planning Attorney's Liability.

Attorneys engaging in asset protection planning have certain unique liability issues of which they must at all times be mindful.[2]

[2] See *Minimizing Attorney Liability in Asset Protection Representation*, Parts 1, 2 and 3, William L. Siegel, Journal of Asset Protection, September/October 1997, Vol. 3, No. 1, and January/February 1998, Vol. 3, No. 3, and March/April 1998, Vol. 3, No. 4.

(1) Civil Liability.

In a recent federal case applying New Jersey law, Morganroth & Morganroth v. Norris, McLaughlin & Marcus, P.C., 331 F. 3rd 406 (3rd Circuit 2003) the Court held that persons -- lawyers -- who assist fraudulent transfers may have liability for various common law wrongs, even if they do not receive the property in question, and even if they commit no overt acts in support of the conspiracy. These common law liabilities may include the tort of creditor fraud, aiding and abetting, civil conspiracy to commit creditor fraud.

(a) And consider McElhanon v. Hing, 151 Az. 386, 728 P.2d 256 (Ct. App. 1985), aff'd. in part and vacated in part, 151 Az. 403, 728 P.2d 273 91986), cert. denied 107 S. Ct. 1956 (1987), which involved an attorney who was held liable ($286,120 in damages) for participating in a conspiracy to defraud a client's judgment creditor. The facts of this case are rather egregious and illustrate the point made above that while attorneys have the ethical obligation to zealously represent their clients, they should not be foolish. A disgruntled creditor may very well allege fraud by the planning attorney for a number of reasons, including as a means of obtaining discovery from the attorney. Lawyers in the Weese case discussed further below were very fortunate not to be sued as co-conspirators in fraud of creditors. The good news for lawyers engaged in asset protection planning today is that creditors have historically been reluctant to sue planning attorneys. Sooner or later, that may change. But see Bosak v. McDonough, 549 N.E.2d 643 (111.App. 1st Dist. 1989), in which the Court found that absent evidence that the attorney counseled the debtor to defraud the lender or agreed to participate in any fraud, the attorney is not liable for conspiracy. Another “good” case refusing to find a lawyer liable is Nastro v. D’Onofrio, 263 F. Supp 2d 446 (D. Conn. 2003), in which a Court refused to hold a lawyer civilly liable to a creditor of a client for whom the lawyer created an offshore spendthrift trust, citing the strong public policy of Connecticut in not imposing a liability on lawyers to third parties. As to a claim that an estate planning lawyer might have “aided and abetted” a tort, the seminal case is Haberstam v. Welch, 705 F. 2d 472 (D.C. Cir 1983, decided by a 3-judge panel including Judges Scalia and Bork).

(b) The other extreme involves the possibility of an attorney being sued by an estate planning client, or his heirs, successors and beneficiaries after his death, when the client or his estate subsequently suffers a judgment. The claim might be asserted that the attorney was delinquent in that techniques were in fact available to protect the estate

during the client's lifetime, but the attorney negligently failed to raise or otherwise explore them with the client in the estate planning process. See Duncan Osborne's article cited on page 22 infra., in 5. You may be damned if you do asset protection planning for your clients, and damned if you refuse to. See also Gideon Rothschild's article in the September 2003 issue of Trusts & Estates, Asset Protection Planning Ethical? Legal? Obligatory?

(c) Consider also F.D.I.C. v. Porco, 552 N.Y.S. 2d 910 (Ct. App. 1990), wherein the New York Court of Appeals held that "under long-standing New York law, a creditor has no cause of action against a party who merely assists a debtor in transferring assets where, as here, there was neither a lien on those assets nor a judgment on the debt."

(2) Criminal Liability

It goes without saying that an attorney assisting a client in asset preservation planning must scrupulously avoid conduct which could implicate the attorney himself in possibly criminal activity. See, for example, 11 USC Section 152, the Crime Control Act of 1990, Bankruptcy Crimes, and Internal Revenue Code Section 7206, as well as:

- Racketeering Influenced and Corrupt Organization ("RICO") statute, 18 U.S.C. section 1961 et seq.

- Bankruptcy Crimes --

  - 18 U.S.C. Section 152 for anyone "knowingly and fraudulently concealing from a trustee ... any property belonging to the estate of a debtor."

  - 18 U.S.C. Section 157 for anyone "having devised, or intending to devise, a scheme or artifice to defraud and for the purpose of executing or concealing such scheme files a [bankruptcy petition] or makes a fraudulent representation in a [bankruptcy] proceeding."

- Internal Revenue Code Section 7212(a) for anyone who "corruptly endeavors to ... impede any officer of the United States or obstructs or impedes the administration [of the tax law.]" See United States v. Popkin, 943 F.2d 1535 (11th Cir. 1991) in which Mr. Popkin, an attorney, was convicted for assisting a client in disguising the source of undeclared funds being repatriated from offshore.

- Money Laundering Control Act, 18 U.S.C. sections 1956 and 1957.
- Conspiracy to Defraud the U.S., 18 U.S.C. Section 371.
- Mail and Wire Fraud, 18 U.S.C. Section 1341.
- The Patriot Act signed into law by President Bush on October 25, 2001 designed to thwart the financial underpinning of terrorism.

4. No Available Malpractice Insurance.

Attorneys should be advised that virtually every legal malpractice policy excludes fraud from the scope of its coverage. If a lawyer knowingly gives advice that assists his client in perpetrating a fraud, he is liable to suit for fraud or malpractice without benefit of insurance coverage.

5. Planner Due Diligence is Required to Avoid Civil, Criminal or Ethical Liability.

See "What ACTEC Fellows Should Know About Asset Protection" (An article by Duncan Osborne and Elizabeth M. Schurig, published in 25 ACTEC NOTES at p.367 (2000) (Exhibit 3) and "Island Castaway" (an article by Debra Baker published in the ABA Journal October 1998) (Exhibit 2). At least six other articles have suggested that a lawyer engaged in estate planning may have a duty to clients to advise on asset protection planning in addition to more traditional trust and estate and tax planning advice. While there are risks in giving asset protection advice, you may be "damned if you do, damned if you don't." Duncan Osborne recently framed the matter in this way:

"The debate between advocates of creditors' rights and advocates of asset protection cannot … turn on whether asset protection planning is proper. Rather, the only meaningful debate is the determination of the lawful and proper scope of asset protection planning … Nowhere is it written that an individual must preserve his assets for the satisfaction of unknown future claims and claimants. The focus on causality -- a causal link between an asset transfer and the injury allegedly suffered by a creditor -- provides a means to distinguish between the actions that operate directly to prejudice a particular creditor and those actions that in some remote, not foreseeable way, have after the passage of time or the occurrence of an intervening cause, compromised a creditor's financial interest."

6. Asset Preservation for Attorneys Themselves. Can an attorney ethically engage in asset protection planning to protect his or her personal assets against the potential of an act of malpractice?

a. In general nothing appears in the Code Of Ethics which would either prohibit the attorney from personal planning of this nature, nor does anything exist in the Code to insure clients that their counsel will have assets against which they could proceed if something goes wrong. There is, for example, no ethical prohibition against an attorney filing for bankruptcy protection.

b. Rule 1.8(h) prohibits a lawyer from attempting to exonerate himself or herself, or from limiting his or her liability to the client, for acts of malpractice.

(1) This prohibition is aimed toward attorneys using release forms or like means of limiting liability.

(2) There is no requirement of practice that an attorney have an attractive balance sheet. Virginia Bar rules do not require malpractice coverage.

IV. FRAUDULENT CONVEYANCE ISSUES.

VIRGINIA LAW AS AN EXAMPLE OF TYPICAL STATE LAW

A. Overview. Virginia is a common law state and at common law a debtor has the absolute right to pay one creditor in preference to another and can, without the imputation of fraud, secure one creditor to prevent another from getting an advantage. Williams, et al. v. Lord & Robinson, et al., 75 Va. 390 (1881). Therefore, in the absence of a statute, state or federal, the debtor has the right to prefer one creditor to another. Giving such a preference to a bona fide creditor is not fraudulent, even though the debtor is insolvent and the debtor is aware at the time of the transfer that it will have the effect of defeating the collection of other debts. Preferring one creditor does not deprive other creditors of any legal right, for they have no right to a priority. Moreover, it is a fundamental principle of law that fraud must be alleged and proven, and every presumption of law is in favor of innocence and not guilt. These principles have long been recognized in Virginia law, see generally Johnson v. Lucas, 103 Va. 36, 48 S.E. 497 (1904), Hutcheson v. Savings Bank, 129 Va. 281, 105 S.E. 677 (1921), and have recently been recognized and reaffirmed. Mills v. Miller Harness Company, 229 Va. 155, 326 S.E.2d 665 (1985). The key is that the preferred creditors be bona fide creditors. Simply because a transaction is disadvantageous to creditors will not in and of itself cause it to be set aside as long as it was made in good faith, and unsecured creditors, in the absence of fraud, cannot question the contracts of their debtors and undo all that is not beneficial to them. Catron v. Bostic, 123 Va. 355, 96 S.E. 845 (1918).

B. Virginia's Fraudulent Conveyance Statutes. Modern fraudulent conveyance laws in English common law jurisdictions, including Virginia, have their origin in 16th

Century England, in the Statute of 13 Elizabeth (12 Elizabeth Ch. 5 (1571)). Virginia has enacted two fraudulent conveyance statutes:

1. Intentional Fraud. Every gift, conveyance, assignment or transfer of property, real or personal, made with the intent to delay, hinder or defraud current or anticipated future creditors of the transferor is voidable. Virginia Code ' 55-80. See Abbott v. Willey, 479 S.E. 2d 528 (1997), involving President Clinton=s friend Mrs. Willey.

   a. Regardless of the transferor's intent, a bona fide purchaser for value takes good title, assuming the transferee had no notice of the fraudulent intent. On the other hand, if the transferee had notice of the fraudulent intent, the transferor's creditors may attach the property transferred. The transferee will be deemed aware of the fraudulent intent if he or she has knowledge of such facts and circumstances as would have excited the suspicions of a man of ordinary care and prudence.

   b. "Hinder", "delay" and "defraud" are not synonymous. A transfer may be made with intent to hinder or with intent to delay, without any intent absolutely to defraud. Any of the three intents is sufficient.

   c. There may be a fraudulent transfer even if fair consideration is paid.

   d. Reference to "future" creditors in fraudulent conveyance law is not to every person who someday may become a creditor of the transferror. For example, the court in Oberst v. Oberst, 91 B.R. 97 (U.S. Bankruptcy Court, C.D. California 1988) distinguished between what it termed "bankruptcy planning" and hindering creditors. The court stated that "if the debtor has a particular creditor or series of creditors in mind and is trying to remove assets from their reach, this would be grounds to deny the discharge. If the debtor is merely looking to his future well-being, the discharge will be granted."

   In Klein v. Klein, 122 N.Y.S.2d 546 (1952) the court blessed prophylactic transfer to protect against a potential future hazard as "no more than insurance against a possible disaster," and not a fraudulent conveyance.

   In Tcheropnin v. Franz, 475 F.Supp. 92 (1979) the court stated that one of the requisite elements for finding a conveyance to be

fraudulent is that there must be an existing or contemplated indebtedness against the debtor.

2. Donative Transfer by Insolvent Transferror. As to existing creditors, gifts are voidable without any finding of intent to delay, hinder or defraud, but the attacking creditor must prove that the transferor was insolvent or was rendered insolvent by the transfer. Virginia Code ' 55-81.

a. Creditors of the transferor have no claim under this section --

X if they were not creditors at the time of the transfer.

X if fair consideration was paid.

X if the transferor was solvent after the transfer.

b. NOTE: This section did not have an insolvency test until a recent amendment.

A donor is insolvent when he has insufficient property to pay all his debts. Hudson v. Hudson, 249 Va. 335 (1995), Shaia v. Meyers, 206 Bankr. 410 (Bankr. E.D. Va. 1997).

C. Voiding the Transfer. A creditor's suit is necessary to void the conveyance. Virginia Code ' 55-82. The burden of proof is upon the one attacking the conveyance and the fraud must be proved by evidence that is clear, cogent and convincing, McClintock v. Royall, 173 Va. 408, 4 S.E.2d 369 (1939). Although the fraud must be proven and is never to be presumed, Land v. Jeffries, 26 Va. (5 Rand) 599 (1827), the evidence necessary to satisfy the court may be and generally is circumstantial, Witz, Biedler & Co. v. Osburn, 83 Va. 227, 2 S.E. 33 (1887), and courts have frequently held that there are certain indicia or badges of fraud from which fraudulent intent may be inferred, prima facie. The statute of limitations for actions under '55-81 to set aside a transfer not made for valuable consideration is 5 years. In re Massey, 225 Bankr. 887 (Bankr. E.D. Va. 1998).

D. Badges of Fraud. These include:

1. retention of an interest in the transferred property by the transferor;

2. transfer between family members for allegedly antecedent debt;

3. pursuit of the transferor or threat of litigation by his creditors at the time of the transfer;

4. lack of or gross inadequacy of consideration for the conveyance;

5. retention of possession of the property by transferor;

6. fraudulent incurrence of indebtedness after the conveyance;

7. secrecy about the transfer;

8. deviation from normal activities;

9. transfer of all (or substantially all) of debtor's property; and

10. transfer to family members (but cases of family transfers are surprisingly unpredictable, depending on the "flavor" of the facts).

NOTE: In asset protection engagements the badges of fraud are almost always present.

Armstrong v. United States, 7 F. Supp. 2d 758 (W.D. Va. 1998). Hyman v. Porter, 37 Bankr. 56 (Bankr. E.D. Va. 1984), Hutcheson v. Savings Bank, 129 Va. 281, 105 S.E. 677 (1921). When the evidence shows a prima facie case of fraud, the burden of proof shifts to the party seeking to uphold the transaction to establish that he or she intended to accomplish bona fide goals as a result of the transfer. If a conveyance is set aside under Section 55-82, the Court will put the parties to the conveyance in the same position as if the conveyance had never taken place. Judgment creditors may interrogate the debtor under oath about all matters involving his or her assets. Virginia Code ' 8.01-506, et seq.

E. Definition of Insolvency. Virginia Code ' 55-81, supra, uses the word "insolvent" but does not define it. But see cases cited at 2. B. above. The Uniform Fraudulent Conveyance Act (which Virginia has not adopted) provides that a person is deemed insolvent if, at the time of a transfer, the present fair salable value of the transferor's non-exempt assets is less than the amount required to pay his liabilities on existing debts. The Bankruptcy Code defines insolvency of an individual as the financial condition in which the sum of the person's debts is greater than all of the person's property, at fair valuation, exclusive of property transferred, concealed or removed with intent to hinder, delay or defraud creditors, and property that may be exempted from property of the estate under the Bankruptcy Code. 11 U.S.C. ' 101(31). This is generally known as the "balance sheet test." Insolvency is generally presumed if the debtor is not paying debts as they come due.

F. Limitations of Action/Statutes of Limitation. In Virginia a creditor may generally bring an action for damages from fraud under Virginia Code § 55-80 (for transfers with the intent to hinder, delay or defraud) for two (2) years from the date the cause of action accrues under Virginia Code § 8.01-243(a). In the case of a donative transfer by an insolvent donor as described in Virginia Code § 55-81, a creditor may bring an action for damages from fraud for five (5) years from the date of the gift's recordation; or, if not recorded, within five (5) years from the time the transfer was or should have been discovered under Virginia Code § 8.01-253.

G. District of Columbia Law. Conveyances made with the intent to hinder or defraud are voidable. D.C. Code ' 28-3101-3103. There is no special rule for donative transactions rendering the transferor insolvent, as there is in Virginia.

H. Maryland Law. Like Virginia, Maryland law provides a presumption that a transfer without full consideration is fraudulent if the transferor is or is rendered insolvent, without regard to fraudulent intent. Ann. Code of Maryland, Commercial Law Volume, ' 15-204. Conveyances made with the intent to hinder, delay or defraud present or future creditors are voidable. ' 15-207. There are similar rules regarding conveyances without consideration by persons in business or about to be in business with inadequate capital remaining or without fair consideration by persons about to incur debts beyond his/her ability to pay. ' ' 15-205 and 15-206.

I. Fraudulent Conveyance Under Federal Bankruptcy Law.

See VI. B. infra.

V. REAL ESTATE AS A LIABILITY CREATING OPPORTUNITY.

A. Joint and Several Liability. The most direct way of creating liability in a real estate investment, or any other type of investment, is to become primarily liable as the maker of a promissory note to a lender, whether the lender be a bank, other institutional lender, or individual. A promissory note, the debt instrument, will normally provide that the makers are "jointly and severally" liable, which means as to the holder of the obligation, each maker is primarily liable for the entire amount of the debt, although between the individual obligers, one would have the right of contribution against any other solvent obligor. The right of contribution, however, is somewhat of a hollow right because it only ripens after the obligor has paid the holder of the note the entire indebtedness.

B. Guaranties of Collection and Guaranties of Payment. Many people have had very expensive lessons in learning about the legal intricacies of the word

"guaranty." As a guarantor, an individual or entity becomes liable for another's debt. Since it is a suretyship relationship, and sureties are a favorite of the law, a guaranty is never presumed, but rather must be shown by clear and convincing evidence. Moreover, by Virginia statutory law, Code of Virginia ' ' 49-25 and -26, unless a contrary intent is clearly reflected in the documents, a guaranty is first construed as a guaranty of collection, meaning that the holder of an obligation must first exhaust available legal remedies against the maker of the obligation before resorting to any remedies against the guarantor, whereas a guaranty of payment makes the guarantor primarily liable on the obligation and a holder can proceed to enforce the obligation immediately against the guarantor without first resorting to remedies against the maker. However, most banking or financial institutions documentation is structured to create a guaranty of payment and not collection.

C. Case Law. Cases have reaffirmed the guarantor's direct liability, provided that the guaranty document provides for such direct liability, including the upholding of a confession of judgment provision in a guaranty agreement, overcoming the defense that the guarantor did not read the provisions of the agreement containing the confession of judgment language, and that right was not specifically discussed or bargained for during the negotiations between the guarantor and the lender. Atlantic Leasing & Financial, Inc. v. IPM Technology, Inc., 885 F.2d 188 (4th Cir. 1989). Similarly, the Virginia Supreme Court has upheld the liability of a wife pursuant to an unlimited guaranty for a loan made to her husband, noting that the Court has consistently held that a guaranty, unlimited as to time, but given in circumstances evidencing the guarantor's intent to cover a series of transactions, will be construed as a continuing one, and in this case, the language of the guaranty was plain and was enforced according to its terms. Bank of Southside Virginia v. Candelario, 238 Va. 635, 385 S.E.2d 601 (1989).

D. General Partners' Liability. General partners of a partnership are jointly, but not automatically severally, liable with other partners for partnership debts. Virginia Code ' 50-15(b). However, personal guaranties, which are usually required, make general partners severally liable on partnership loans.

E. Limited Partners' Liability. Limited partners in a limited partnership are only liable for their agreed contribution to the partnership, and not any debts of the partnership, provided they do not participate in the control of the business (Virginia Code ' 50-73.24), unless the limited partner knowingly allows his name to be used in the name of the limited partnership and creditors extend credit to the limited partnership without actual knowledge that the limited partner is not a general partner. Virginia Code ' 50-73.24D. See IX.C. below.

VI. OVERVIEW OF BANKRUPTCY CONSIDERATIONS, INCLUDING VIRGINIA AND FEDERAL EXEMPTIONS.

In the debtors rights arena, it is essential to have at least a rudimentary understanding of bankruptcy law and some of the important and ever changing developments and ramifications. The principal provisions of the Bankruptcy Code, 11 U.S.C. ' 101, et seq., relevant to this outline are Chapter 7 or Chapter 11 bankruptcy cases, both of which are available to a business debtor. Chapter 7 is a liquidation of the debtor's property by a trustee. Chapter 11 is designed to restructure the debtor's liabilities through a plan of reorganization which creditors and the court may confirm or reject, but Chapter 11 may also be used to liquidate the debtor's assets through a plan of liquidation. Usually, in a voluntary Chapter 11 filing, the debtor will remain a debtor-in-possession of its property and will continue to operate its property (11 U.S.C. ' 1107) subject to the other provisions of the Bankruptcy Code. A voluntary bankruptcy is commenced by filing a petition (B.R. 1002), which is accompanied by or soon followed by a list of creditors, schedules and liabilities, and statements of financial affairs on official forms specified with the Bankruptcy Code. The filing of a bankruptcy petition acts as an automatic stay applicable to all entities against virtually all actions against the debtor or against the property of the estate, 11 U.S.C. ' 362, until the property is no longer property of the estate, the case is closed, the case is dismissed, or if Chapter 7, the discharge is granted or denied. A creditor or other party-in-interest must move the court to grant relief from the stay to allow the creditor to proceed against the property, such as by foreclosure, and must show that the creditor lacks "adequate protection" of an interest in the property of such party-in-interest, or that the debtor does not have equity in the property or the property is not necessary to an effective reorganization. Such a discussion of the creditor's rights in getting a stay lifted is beyond the scope of this outline, but in such a proceeding the party requesting such relief has the burden of proof on the issue of the debtor's equity in the property and the party opposing such relief has the burden of proof on all other issues. A background understanding of the Bankruptcy Code as a minimum must include a familiarity of with the following Bankruptcy Code concepts:

A. Property of the Bankrupt Estate. The commencement of a case creates an estate and the bankruptcy estate is very broadly defined under ' 541. In relevant part, this very broadly worded section provides that the bankruptcy estate shall include each of the following:

1. All legal or equitable interests of the debtor in property as of the commencement of the case, except that a restriction on the transfer of a beneficial interest of a debtor in a spendthrift trust that is enforceable under applicable "non-bankruptcy" law (e.g., state law) is enforceable in bankruptcy ("spendthrift trust" exception). ' 541(c)(1).

2. All interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is in the sole, equal or joint management and control of the debtor, or liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and the debtor's spouse. ' 541(a)(2).

3. Fraudulent Conveyances. Property that is recovered by the trustee in bankruptcy which was the subject of a prior fraudulent conveyance.

4. Certain After Acquired Interests - 180 Day Property. Any interest in certain types of property that would have been the property of the estate if that interest had belonged to the debtor on the filing date and which the debtor acquires or becomes entitled to acquire within 180 days after that date:

   a. by bequest, devise or inheritance;

   b. as a result of a property settlement agreement with debtor's spouse or interlocutory final divorce decree; or

   c. as a beneficiary of a life insurance policy or of a death benefit plan.

   '541(a)(5).

5. Income and Revenue from Property. Proceeds, product, offspring, rents or profits of or from property of the estate, except as such are earnings from the services performed by an individual debtor after the commencement of the case. ' 541(a)(6).

B. Fraudulent Conveyances. Section 548 is the Bankruptcy Code equivalent to the state fraudulent conveyance statutes and provides for two classes of fraudulent transfer. While previously it provided that a transfer within one year of the bankruptcy filing is voidable by the trustee in bankruptcy if it can be shown to have been made with an actual intent to hinder, delay or defraud creditors. Bankruptcy Code ' 548(a)(1). BAPCPA (discussed further below) extended the look-back period for fraudulent conveyances to 2 years. Under § 548(a)(l)(B)(ii)(IV), the scope of fraudulent transfer has been expanded to include transfers to insiders under employment contracts and not in the ordinary course of business. The "badges of fraud" analysis, supra, is equally applicable to cases under ' 548. However, while ' 548 provides that the transfers made or obligations incurred within two years of bankruptcy are vulnerable to attack, the trustee in bankruptcy can use his general avoiding powers, ' 544(b), to permit him to exercise his remedies under state law to avoid fraudulent conveyances. In Virginia, this can prove advantageous to the

trustee, because of the longer statutory period for the recovery of a fraudulent conveyance under Virginia law than the two year limitation provided in ' 548. In Virginia, a trustee in bankruptcy could therefore bring an action for damages from fraud under Virginia Code ' 55-80 within two years of bankruptcy, Virginia Code ' 8.01-243(a), or within five years of bankruptcy if pursuant to Code ' 55-81 for a donative transfer by an insolvent donor, Virginia Code ' 8.01-253.

1. A transfer can also be constructively fraudulent under ' 548(a)(2) of the Bankruptcy Code if the debtor-transferor (1) received less than reasonably equivalent value, and (2) either (I) was insolvent on the date of the transfer (or became insolvent because of such transfer), or (ii) was engaged in business (or was about to engage in business) and had unreasonable small capital, or (iii) intended to incur debts beyond his ability to repay. Courts have recently held that the reasonably equivalent value "must be determined in view of all of the facts and circumstances." In Re Bundles, 856 F.2d 815 (7th Cir. 1988).

2. Under ' 548, even involuntary transfers have been attacked as fraudulent conveyances, Durrett v. Washington National Insurance Co., 621 F.2d 201 (5th Cir. 1980), as have leveraged buyouts, on the theory that because the corporation does not gain any direct benefit, as the proceeds go to the former shareholder, the encumbrance of its assets to effect the LBO is fraudulent on the corporation and its creditors. See Wieboldt Stores v. Schottenstein, 94 Bankr. 488 (Bankr. N.D. Ill. 1988).

3. Section 548 protects good faith purchasers for value. Accordingly, if a purchaser buys an asset from the debtor-transferor and pays fair and adequate consideration and has no actual or constructive notice of the debtor-transferor's fraudulent intent, then good faith transferee's obligations are enforced to the extent they gave value, or alternatively they are given liens for value so exchanged. Clearly, it is critical for a creditor to establish good faith, and certain indices of good faith would include advancing funds and taking security interests and accepting guarantees of payment. Further, documentary evidence regarding solvency analysis, cash flow projections, financial statements and valuations of assets and liabilities, together with strict compliance with verification of applicable state corporate laws and corporate by-laws, including representations, warranties and certificates, and compliance with state bulk sales laws will be important.

4. In bankruptcy the debtor must submit detailed schedules regarding pre-bankruptcy transactions and must undergo examination under oath by creditors and by the trustee. Section 341.

C. Preferences. A close cousin of fraudulent conveyances in the Bankruptcy Code is preferences, ' 547, which are defined as (I) a payment or transfer, (ii) by an insolvent debtor, (iii) to or for the benefit of a creditor, (iv) to satisfy an antecedent debt, (v) made within the 90 day period before bankruptcy, (vi) or made within one year of the bankruptcy, if made to or for the benefit of an insider of the debtor, (vii) which payment or transfer enabled a creditor to receive more than it would have received in a Chapter 7 liquidation. This section is cumulative and therefore, if any one element of a preference is lacking, then the payment or transfer is not avoidable as a preference. The preference is recoverable from the initial transferee, the entity for whose benefit such transfer was made, or any immediate transferee of such initial transferee. Bankruptcy Code ' ' 550(a)(1) and (2). Preference litigation is an ongoing emerging area and, while recently one court has held that unless a party has a direct business relationship with the debtor, has guaranteed the debtor's debt or has received payment directly from the debtor, it's receipt of payment is not avoidable, In Re Columbia Data Products, Inc., 892 F.2d 26 (4th Cir. 1989), another court has held that ' 550(a)(1), coupled with the provisions of ' 547(b), allow the recovery of avoidable transfers from non-insiders within one year of the bankruptcy petition when those payments benefitted insider creditors or guarantors, In Re C-L Carthage Co., Inc., 899 F.2d 1490 (6th Cir. 1990). Moreover, payments to a creditor within one year of bankruptcy on an indebtedness guaranteed by an insider of the debtor are subject to attack as preferences. Levit v. Ingersall Rand Financial Corp., 874 F.2d 1186 (7th Cir. 1989).

1. Preferential payments are not recoverable, however, if they are made in the ordinary course of business or are in the nature of contemporaneous exchanges. Bankruptcy Code ' 547(c). Payments or transfers to a fully secured creditor are not preferential because a secured creditor is not receiving more than he would receive under the Chapter 7 liquidation. However, such payments or transfers to a secured creditor are at risk as preferences if the secured creditor is undersecured. The Bankruptcy Court for the Western District of Virginia in 1989, considering the ordinary course of business exception, found no preference where the debtor had purchased supplies and services from a creditor for several years before bankruptcy and debtor's payments were erratic for the entire period. Because of the "ordinary course of business" between the debtor and its creditor, when the debtor paid creditor in full just prior to its petition, it was not found to be a preference. In Re Mahers, 99 Bankr. 314 (Bankr. W.D. Va. 1989).

D. Lender Liability. A great number of people are involved in real estate development and the concomitant land loan/construction loan/permanent loan

scenario so prevalent in both residential and commercial/industrial development. Often, multiple parties are involved in the loan, whether as makers, or more likely as guarantors. In difficult economic times, and especially coupled with a changing banking regulatory environment, the "workout" or "restructuring" of real estate projects is an emerging, dynamic and evolving area of legal opportunity. Such is not the topic of this outline, but many of the actions of lenders in the workout process, as well as the regular development process, have led to lender liability issues, which have a direct interplay in the background of bankruptcy for the planner. The bankruptcy court is a court of equity, see generally 11 U.S.C. ' ' 101(4), 502(c)(2), 541(a)(1), and the bankruptcy court has the power to subordinate any lien or other claim under the principles of equitable subordination. 11 U.S.C. ' 510(c)(1). Because of the equitable basis, the greater the factual inequities, the argument goes, the less important the terms of the loan documents. Lender liability does not encompass any particular new theory of liability, but the focus of most lender liability claims is the lender's failure to act in good faith and deal fairly with the borrower, guarantor or other lenders of the borrower. Lender liability cases may be brought by unsecured creditors against a secured creditor, or by the borrower against a lender. The cases have been based on such theories as fraud, breach of fiduciary duty, interference with or control of the debtor's business, securities violations, lack of good faith and fair dealing, and RICO violations. The equitable subordination provisions of the Bankruptcy Code have come into effect when the court has found that claimant has engaged in some type of inequitable conduct which results in injury to other creditors of the bankrupt or confers unfair advantage on the claimant, and the equitable subordination of the claimant's position of liability is not inconsistent with the Code. Lender liability suits frequently arise from failed workouts, and bankruptcy courts have found the conduct of the lender which drained financial resources of the debtor to lender's benefit warranted not only turnover of the preference, but also equitable subordination of the claim. Smith v. Associates Commercial Corp., 19 B.C.D. 558 (5th Cir. 1989).

E. Exemptions - State and Federal. An exemption is a law that immunizes property from all forms of creditors' remedies. It creates a legal shield around the property that is impenetrable. Generally, conversion of assets from non-exempt to exempt on the eve of bankruptcy is not fraudulent as to creditors; rather it permits the debtor to take full use of the exemption to which he is entitled to under law. S. Rep. No. 989, 95th Cong. 2d Sess. at 6. Accordingly, Virginia state law was recently revised to provide that conversion of non-exempt property into exempt property in contemplation of bankruptcy shall not be deemed to be in fraud of creditors. Virginia Code ' 34-26. All states have enacted exemption laws; however, the extent of those laws varies greatly. Exemptions in Virginia, Maryland and the District of Columbia can be categorized as rather stingy and, by contrast, the Florida exemptions, which are

completely at the other end of the exemption spectrum, as very generous. Bankruptcy Code ' 522 is extremely important, as it basically provides that, in the states which allow such an election, a debtor who has filed a petition in bankruptcy may choose between federal or state exemptions. Where the choice of federal or state exemptions is available, it will be very important for the debtor to elect the state exemptions when domiciled in a state with generous exemptions, such as Florida. A debtor may claim a state's exemption if he or she has been domiciled in the state for the greater portion of the last 180-day period preceding the filing of the bankruptcy petition. Bankruptcy Code ' 522(b)(2)(A). But see the new BAPCPA rules outlined below. Nevertheless, the scope of the exemption laws is not unlimited, and borrowing funds with the intent to turn these funds into exempt property has been found to be fraudulent, Miguel v. Walsh, 447 F.2d 724 (9th Cir. 1971), and where debtor's purpose has been found to go beyond mere conversion of non-exempt property to exempt property, but rather is an actual attempt to defraud, a fraudulent conveyance may be found. See Ford v. Poston, 773 F.2d 52 (4th Cir. 1985). While a discussion of tenants by the entirety is undertaken, infra at IX.A., whether converting non-exempt assets into tenants by the entirety is a fraudulent conveyance may sometimes apparently turn on when the conversion occurs. If the conversion is on the eve of bankruptcy, it may be characterized as fraudulent, In Re White, 28 Bankr. 240 (Bankr. E.D. Va. 1983). But the legislative history to Bankruptcy Code ' 522(b) provides that "[a]s under current law, the debtor will be permitted to convert non-exempt property into exempt property shortly before a bankruptcy petition .... The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemption to which he is entitled under the law." If the conversion occurs before the spouse gets into financial difficulty, the exemption should be protected. Vasilion v. Vasilion, 192 Va. 735, 66 S.E.2d 599 (1951).

F. Discharge. Obviously, while a short-term goal of many Chapter 11 filings is to "buy time" to allow either the sale of property or other assets, or refinancing, and the like, it is essential that any bankruptcy proceeding be conducted with an eye toward "discharge". In broad terms, the purpose of bankruptcy is to give a financially beleaguered debtor a fresh start, and in order to achieve that fresh start by having its obligations and debts relieved (subject to the non-discharge provisions noted below), consistent with the exemptions specified above, the debtor bankrupt must give up his assets to his creditors. The Bankruptcy Code provides in ' 727 that the court shall grant the debtor a discharge unless the debtor, with intent to hinder, delay or defraud a creditor or an officer of the estate charged with custody of property under this title (the Bankruptcy Code), has transferred, removed, destroyed, mutilated or concealed, or has permitted to be transferred, removed, destroyed, mutilated or concealed, the property of the debtor within one year from the date of filing the petition. The section also provides that discharge will be denied if the

debtor concealed, destroyed, mutilated, falsified or failed to keep information regarding financial conditions or business transactions, or acted fraudulently in other ways, all of which must be proven in the bankruptcy court. As the denial of a discharge is a severe penalty and punitive in nature, any objection to discharge is construed narrowly in favor of the debtor. In Re Schmit, 71 Bankr. 587 (Bankr. D. Minn. 1987). The courts are not in complete accord on what type of conduct would be considered sufficient, under ' 727, to manifest an intent to hinder, delay or defraud a creditor within the meaning of that section, thereby denying discharge.

If possible, the debtor may plan to wait two years between a suspect transfer and the filing of a bankruptcy petition. This will avoid the application of '' 727, 548 and 547 because under Federal bankruptcy law the trustee may only challenge a transfer on grounds of insolvency of the transferor or lack of fair consideration if the transfer occurs within one year of the filing. If possible, an analysis should be conducted to insure that all creditors in existence on the date of the transfer have been paid as of the date of the bankruptcy filing. The debtor may continue to pay creditors following the suspect transfer in an attempt to eliminate all creditors in existence on the date of the transfer.

G. Denial of Discharge/Loss of Attorney-Client Privilege. In an extreme case, where a bankruptcy court finds fraudulent conveyance, inartfully disguised as estate planning with the knowing participation of the planning attorney, the discharge may be denied and, by virtue of the crime-fraud exception, the attorney-client privilege may be lost. In that case, creditors= counsel may have complete access to the attorney=s file and notes, which could be very damaging as well as embarrassing. See, for instance, In re Andrews v. Riggs National Bank, 186 Bankr. 219 (E.D. Va. 1995). In the post-bankruptcy action against the debtor, Mr. Tansill served as expert witness for creditor NationsBank.

H. Exceptions to Discharge. As noted above, ' 727 provides that the court shall grant a discharge unless the above-noted elements prevent a discharge in its entirety. Notwithstanding the above, even when a discharge is granted, certain debts are not discharged and are called exceptions to discharge. Bankruptcy Code '523. Section 523 provides generally that the following debts are exceptions to discharge:

1. A tax or customs duty

(a) with respect to which a return is required, and the return was not filed or was filed after the date on which it was due, including any extensions, and after two years before the date of the filing of a petition (the tax year to which

the return relates is immaterial; this rule applies to late filings. See XIII.K., infra, for the general rule);

(b) with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax;

2. Money, property, services or credit of any kind obtained by false pretenses, false representations or actual fraud through the use of an instrument in writing that is materially false respecting the debtor's or an insider's financial condition on which the creditor to whom the debtor is liable for such money, property, services or credit reasonably relied, in circumstances in which the debtor caused to be made or published within intent to deceive. This subsection has come to known as the "false financial statement" exception;

3. Debts not listed in a bankruptcy proceeding;

4. Liability arising from fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny;

5. Obligations to a spouse, former spouse or child of the debtor for alimony to, maintenance for, or support of such spouse or child in connection with a separation agreement, divorce decree, or other order of a court of record. This is the so-called "alimony/child support exception";

6. Liability for willful and malicious injury by the debtor to another entity or to the property of another entity;

7. To the extent that such debt is a fine, penalty or forfeiture payable to and for the benefit of a governmental unit and is not compensation for actual pecuniary loss which has been imposed with respect to a transaction or event that occurred before three years before the date of filing the petition;

8. For an educational loan made, insured or guaranteed by a governmental unit which loan became due before five years before the filing of the petition, unless excepting such debt from discharge will impose an undue hardship on the debtor and the debtor's dependents;

9. A debt which arises from a judgment or consent decree entered in a court of record against the debtor wherein liability was incurred by such debtor as a result of the debtor's operation of a motor vehicle while legally intoxicated;

10. Any debt which could have been listed or scheduled by the debtor in a prior bankruptcy case concerning the debtor in which the debtor waived, discharged or was denied discharge.

Litigation involving exception to discharge is growing by leaps and bounds. Several cases are illustrative:

> The debtor's deceptive conduct inducing a creditor to forbear collection of a note until the applicable statute of limitations had run demonstrated actual fraud and therefore could serve as a basis for excepting the debt from the discharge, In Re Adkins, 102 Bankr. 485 (Bankr. E.D. Va. 1989). Collateral estoppel can be used as a basis of summary judgment in favor of a creditor under ' 523 when in a prior non-bankruptcy state court decision, the trial judge found as a fact that the debtor had breached a fiduciary relationship and express trust, In Re Becker, 100 Bankr. 811 (Bankr. E.D. Va. 1988), citing the relevant Fourth Circuit authority, Combs v. Richardson, 838 F.2d 112 (4th Cir. 1988). In the determination as to whether a $80,000 payment agreed to be made by a debtor husband to an ex-wife was a property settlement or alimony and thus non-dischargeable, the court ruled that the only significant issue for the bankruptcy court is the intent of the state court judge in entering the order in question, and such intent must be gleaned from the four corners of the record, and therefore the testimony on the issue by the wife, husband and others are irrelevant. In Re McCauley, 105 Bankr. 315 (Bankr. E.D. Va. 1989).

I. Tax Issues in Bankruptcy, Foreclosure and Workouts. There are many complex issues that are beyond the scope of this outline.

J. BAPCPA. In 2005, Congress re-wrote the bankruptcy laws in an act referred to as BAPCPA (Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 CRL 1109-8).

The re-write contained several provisions extremely important to debtor's rights/asset protection planning. In general the law was considered to be pro-creditor. It was successfully lobbied by banks and credit card companies. It is considered to be anti-debtor.

The most important provisions are as follows:

a. New Domicile Rule. Bowie Kuhn, former baseball commissioner and managing partner of a collapsed law firm, drew a great deal of attention to "forum shopping" for bankruptcy exemptions when he abruptly moved to Florida, claimed the unlimited homestead exemption and bought a very expensive home in Florida and filed for bankruptcy there.

The new bankruptcy law restricts debtors' ability to forum shop by moving to a jurisdiction with more favorable exemptions right before filing. BAPCPA § 522(b)(3) provides that in determining whether a state's bankruptcy exemptions apply, if the debtor has not been a domiciliary of that state for the past 730 days (2 years), then the debtor must use the exemptions of the state where the debtor resided for the largest portion of the 180 days preceding the 730-day period.

b. New Homestead Rule for Fraudulent Conveyance. Another provision influenced by Bowie Kuhn is the new rule of BAPCPA §522(o) which provides that the value of a residence or homestead is reduced if state exemptions apply to the extent that the value of the residence or homestead is attributable to property that the debtor disposed of with fraudulent intent ("hinder, delay or defraud") within 10 years prior to the bankruptcy filing. So, if property was sold in a fraudulent conveyance and the proceeds are used to acquire or improve or pay down the mortgage on a homestead, such funds may be clawed back into the bankruptcy estate. See In re Maronde, 332 B.R. 593 (Bankr. D. Minn. 2005), In Re Lacounte, 342 B.R. 809 (Bankr. D. Mont. 2005), and In Re Agnew, 355 B.R. 276 (Bankr. Kans, 2006).

c. Homestead Cap of $125,000 on Homestead Acquired Within 1215 Days The final anti-Bowie Kuhn rule is reflected in BAPCPA § 522(p)(l), which limits the homestead exemptions, for instance in Texas or Florida, to a maximum of $125,000 if a portion of the value of this homestead was acquired within 1215 days (40 months) of the bankruptcy filing, except to the extent that such value derived from a sale of a prior home in the same state. There have been cases too numerous to cite under this provision. A few are In Re Summers, 344 B. R. 108 (Bankr. D. Ariz. 2006) and In Re Buonopane, 344 B.R. 675 (Bankr. M. D. Fla. 2006).

A further refinement of this cap is found in BAPCPA §522(q), which limits the homestead exemption to $125,000 if the Court determines that the debtor was convicted of a felony and that the bankruptcy filing was an abuse of the bankruptcy code; or if the debts arise from violation of securities laws, fraud, deceit or manipulation in a fiduciary capacity or in the purchase or sale of any registered security, any civil remedy under RICO, or any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding five years. The broad language may lead to unexpected results. See, for example, In Re Larson, 2006 WL 891532 (Bankr. D. Mass. 2006).

d. IRA Exclusion. BAPCPA § 522(b)(3)(C) and (d)(12) provide a bankruptcy exclusion for IRA's and other qualified plans regardless of whether federal or state exemptions are used by the debtor. For IRAs, the exemption is $1 million. This is very important because ERISA plans – e.g., 401(k) plans and defined

benefit plans – were found exempt by the U.S. Supreme Court in Patterson v. Schumate, discussed below. But IRA's are not ERISA Plans and not all states provide statutory exemption for IRAs. The $1 Million limit does not apply to amounts attributable to qualified rollovers from ERISA Plans which are completely exempt even if more than $1 Million. The $1 Million cap does not apply to SEP-IRAs and Simple-IRAs.

e. 10-Year Look-Back Rule for Self-Settled Trust and "Other Devices". Relevant to state asset protection trust statutes, BAPCPA gives the bankruptcy trustees a 10 year look-back period in connection with alleged fraudulent transfers to self-settled trusts and "other similar devices," presumably including GRITS, GRATS, GRUTS, QPATS, CRTS, CLTS, ILITS, FLPs/FLLCs (§ 548(c)). Could a "device" include a high cash value/low death benefit life insurance policy or variable annuity in a state such as Florida with an unlimited exemption for life insurance policies and annuities? Expect creative arguments from creditors in the future with respect to "devices."

Accordingly, whatever statute of limitation period Delaware, Alaska and other U.S. asset protection trusts jurisdictions adopt to limit challenges to the trust, the federal government has preempted state law with a federal 10-year statute of limitations. This development certainly damages U.S. APTs in a comparative analysis vis a vis offshore APTs, because U.S. courts would have to enforce the federal limit, while offshore courts might not. It is worth noting that Senator Schumer proposed an amendment to this Bankruptcy Act which would have imposed a limit of $125,000 on transfers to offshore or domestic asset protection trusts, but Senator Hatch of Utah, whose state has a new asset protection statute, opposed the amendment, and it was defeated. This was a positive development for APTs, but especially for OAPTs.

VII. FRAUDULENT CONVEYANCE UNDER FEDERAL BANKING LAW.

Under the Crime Control Act of 1990, Public Law 101-647, '2701, concealment of assets from the Federal government (e.g., Federal Deposit Insurance Corporation, the Resolution Trust Corporation) serving as conservator, receiver or liquidating agent of a financial institution is punishable by fine or imprisonment to up to 5 years. Under '2711 fraudulent transfers by a debtor of a financial institution of which the Federal government serves as conservator, receiver or liquidating agent may be avoided by the Federal government within 5 years of its appointment if the debtor "voluntarily or involuntarily made such transfer or incurred such liability with the intent to hinder, delay or defraud the insured depository institution or any Federal agency. If the transfer is avoided, the Federal government may recover for the financial institution the property transferred or the value of it unless the transferee took it for value in good faith. The statute, in '2528(a), new paragraph (17)(D) provides that the Federal government shall have rights superior to any other party.

VIII. SUMMARY: HOW TO AVOID CLAIM THAT CREDITOR HAS BEEN DEFRAUDED.

A. Integrate asset preservation planning into the client's estate and financial planning, substantively, not just as window dressing. Conveyances and retitling should have a sound justification/"business purpose" other than creditor avoidance.

B. Obtain an Affidavit of Solvency, at least in doubtful cases.

C. Do asset preservation planning as early as possible, before the liability you are concerned about arises, or at least before it "ripens."

D. Take advantage of available exemptions from creditors claims.

E. Discourage greed. (Pigs get fat, hogs get slaughtered.) Be satisfied to materially improve the client's situation. Do not try to do too much. Discourage your clients from making unnatural transfers of too great a portion of their assets.

F. Resist pressure from clients for assistance in "borderline" transactions, whether the line is hiding assets, tax fraud, bankruptcy fraud.

IX. PRESERVATION PLANNING OPPORTUNITIES: HOW TO PROTECT FAMILY ASSETS FROM CLAIMS OF CREDITORS – THE “LAUNDRY LIST”

A. Tenancy by the Entirety Property. Debtor client may transfer property into tenancy by the entirety with his/her spouse or retain property held in that form of ownership. A tenancy by the entirety is defined by the following characteristics:

- X Each spouse has an undivided one-half interest in the asset.
- X Neither spouse may sever the tenancy unilaterally. Both must sign on any conveyance.
- X The property automatically passes outright at the death of the first spouse to the surviving spouse.

1. Federal gift tax. There is no Federal gift tax consequence when spouses transfer property, even previously separately-owned property, into tenancy by the entirety, or from tenancy by the entirety into separate ownership. I.R.C. ' 2523.

2. Federal estate tax/income tax. Tenancy by the entirety property passes at death tax-free to a surviving spouse who is a U.S. citizen. I.R.C. '2056. It is worth remembering that the surviving spouse will take tenancy by the entirety property with an income tax basis that is only stepped-up to fair market value at date of death as to fifty percent (50%) of the property. I.R.C. '2040(b). In contrast, property owned completely by one spouse which is inherited by the other spouse receives a stepped-up income tax basis at date of death as to one hundred percent (100%) of the property in the hands of the inheriting spouse. I.R.C. '1014.

3. Tenancy by the entirety property is immune from creditors of either owner, e.g., on contract or tort liability of either, but obviously NOT immune from creditors of both. Allen v. Parkey, 154 Va. 739, 149 S.E. 615 (1929); Vasilion v. Vasilion, 192 Va. 735, 66 S.E.2d 599 (1951); Ragsdale v. Genesco, Inc., 674 F.2d 277 (4th Cir. 1982); In re Sefren (Maryland), 41 B.R. 747 (Maryland 1984); State v. One 1984 Toyota Truck, 533 A.2d 659, 311 Md. 171 (1987); Warman v. Strawberry (D.C.), 587 F.Supp. 109 (1983). Proceeds of sale of tenancy by the entirety property is also held as tenants by the entirety. Bruce v. Dyer, 524 A.2d 777, 309 Md. 421 (1987); Potts v. U.S., 408 S.E.2d 901 (Va. 1991).

In Virginia a deed which conveys a marital home to husband and wife Aas joint tenants with full common law right of survivorship" created a tenancy by the entirety, and proceeds from the sale of the property are exempt from claims of non-joint creditors in Bankruptcy Court under '522(b)(2)(B). In re Zella (Mitchell), 196 BR 752, aff=d 202 BR 712 (1996).

See Lock, Key & Tenancy: Tenancy by the Entirety in the District of Columbia, Maryland and Virginia, by Brent R. Jacques and Paul D. Pearlstein, *The Washington Lawyer*, September/October 1993.

In Rogers v. Rogers, 257 Va. 323, 512 S.E.2d 821 (1999) the Virginia Supreme Court, in refusing to permit a creditor with separate judgments against husband and wife to levy on real estate held by them as tenants by the entirety, noted its previous statements, made Aclearly and without equivocation," that entireties property is exempt from the claims of creditors who do not have joint judgments against the husband and wife. Separate judgments against each do not qualify.

A 2000 Amendment to Virginia Code Section 55-20.1 confirms that a principal family residence that husband and wife own as tenants by the entirety will not lose its immunity from the claims of their separate creditors if they convey it to their joint revocable or irrevocable trust or in equal shares to their separate revocable or irrevocable trusts, so long as (1) they remain husband and wife, (2)

the trusts continue to hold title, and (3) it continues to be their principal family residence. This resolves the tension between desire to protect the home from claims of a creditor of one spouse and the desire to divide title for estate tax planning purposes, to fund the spouses= respective applicable credit amount bypass trusts. Now both goals may be accomplished.

A 4th Circuit opinion (Estate of Reno v. C.I.R., 916 F.2d 955 (1990)), interpreting Virginia's apportionment statute, Section 64.1-160 et seq., of the Code of Virginia, to allow a testator to direct that the entire burden of estate taxes be placed on a co-tenant by the entirety, was thought by commentators and many members of the Bar to indicate a breach in the doctrine cited above. The decision was widely criticized by many, including the Virginia Bar Association, which at the suggestion of the Wills, Trusts and Estates Section of the Virginia Bar Association, filed an amicus curiae brief in support of a petition for rehearing.

In an en banc review, the 4th Circuit reversed the panel decision and held that under Virginia law a decedent's will cannot apportion all estate taxes against tenancy by the entirety property. Estate of Reno v. C.I.R., 945 F.2d 733 (4th Cir., 1991). The Court held that Virginia law unequivocally forbids a testator from alienating entireties property by will, and that apportioning the taxes to this property would be the "functional equivalent" of this. In effect the Court refused to permit Mr. Reno from impairing at his death entireties property he could not have impaired during his lifetime.

4. Tenancy by the entirety property may be created in many but not all states, including Virginia, District of Columbia, Maryland and Florida, as to personal property, including intangible personal property (e.g., bank and brokerage accounts, securities and partnership interests). See landmark article in 64 A.L.R. 2d 8, Estates by Entirety in Personal Property. See also Oliver v. Givens, Trustee, 204 Va. 123, 129 S.E.2d 661 (1963) and In re Massey, 225 BR 887 (E.D. Va. 1998). Section 55-21, Code of Virginia. The author understands the Carolinas do not recognize tenants by the entirety property.

5. While creation of tenancies by the entirety in personal property is legal in Virginia, there are significant practical hurdles to doing so. For instance, bank and brokerage signature cards typically do not provide for that option, offering only a joint property designation. The employees charged with opening accounts at banks and brokerages are likely to be totally unfamiliar with the designation "tenants by the entirety with common law rights of survivorship" and its legal significance and are not likely to be flexible about opening an account with such an "odd" designation. It may be necessary to insist that the point of contact employee "check upstairs" with more senior management to confirm the

propriety of tenants by the entireties accounts. And some institutions may, as a matter of policy, refuse to establish such accounts.

Under Virginia law joint ownership by husband and wife is not deemed to constitute tenancy by the entirety. Virginia Code ' 55-20 (Repl. Vol. 1986) and ' 55-21 (Supp. 1991) abolish survivorship between joint tenants except when it manifestly appears from the tenor of the instrument that the parties intended survivorship. Accordingly, the tenancy by the entirety form of ownership must be clear and explicit. Pitts v. United States (unpublished, VLW 90-C-11). In the Pitts case, husband and wife sold entireties real estate. As a payment they took notes. After the husband pleaded guilty to tax fraud, the I.R.S. recorded a tax lien against him and levied against his interest in the installment note. The U.S. District Court held that since the note did not state on its face that it was held by the entireties, the couple held it as tenants in common. Pitts was appealed to the U.S. Court of Appeals for the 4th Circuit, which then certified to the Virginia Supreme Court the question of whether Oliver v. Givens, supra, was controlling. In Oliver, the Supreme Court had held that cash proceeds of the sale of entireties property is entireties property, but the Court had never ruled on notes received in similar circumstances. In Pitts, the Supreme Court reaffirmed its holding in Oliver v. Givens and rejected the I.R.S. position, finding the parties had intended survivorship. The Supreme Court held that the promissory notes were not instruments of conveyance that created a tenancy by the entirety; instead they were only memorials of a chose in action that arose by rule of law and were not subject to the rule of Virginia Code '' 55-20 and 55-21. Pitts v. United States, 242 Va. 254 (1991); answer conformed to, Pitts v. United States, 946 F.2d 1572 (4th Cir. 1991).

In 1999 the Virginia legislature added new Section 55-20.2 to the Code, to clarify that Virginia law is and has been that anyone may own real or personal property in tenancy by the entireties.

In the District of Columbia, when a depositor places his/her own money in a joint bank account, there is a rebuttable presumption that it was for the convenience of the depositor and not for the purpose of making a present gift of the right of survivorship. Murray v. Gadsen, 91 U.S. App. D.C. 38 (1952). With shares of stock there seems not to be any presumption against joint tenancy with right of survivorship (Vann v. Industrial Processes, 247 F.Supp. 14 (D.D.C. 1965)) at least where both tenants contributed toward the purchase. Horowitz v. Fainberg, 126 U.S. App. D.C. 242 (1961). As to real estate, per D. C. Code ' 45-216, every estate granted or devised to two (2) or more persons in their own right, including estates granted or devised to husband and wife, shall be a tenancy in common, unless expressly declared to be a joint tenancy. But see Warman v. Strawberry, 1587 F.Supp. 109 (1983), finding a presumption of tenancy by the entirety when real property is conveyed to husband and wife during marriage. It

appears a tenancy by the entirety in personalty would have to be created expressly, and it is certainly recommended to be explicit in creating such a tenancy in realty.

In Maryland, there is a presumption against joint tenancy. Md. Real Property Article Title 2-117. However, a joint tenancy or tenancy by the entirety may be created by an expression of clear intent. Gosman v. Gosman, 19 Md. App. 66 (1973). And Beall v. Beall, 434 A.2d 1015 (1981), finds a presumption of tenancy by the entirety when real property is conveyed to husband and wife during marriage.

QUERY: If a tenancy by the entireties bank (or brokerage) account is opened whereby either tenant may withdraw all funds -- an "either/or account" -- can such an entireties account be protected from the creditors of either tenant who has complete power to liquidate the account? Possibly not. The safest, albeit more cumbersome, practice will be to require both parties to evidence their consent to withdrawals or redemptions from an entireties account in intangible personality. As a result, it may not be worth titling a couple's basic checking account as tenants by the entirety, so long as the balance is kept to a relatively low level. This requirement should not be a substantial imposition for accounts holding medium- and long-term investment assets.

6. Rent proceeds held in a couple's joint bank account cannot be reached by the husband's creditor, when those proceeds came from property owned by the couple as tenants by the entirety. Rental proceeds are no different in character from sales proceeds from land held by the entireties. Putting the rental proceeds into a bank account held by the couple as joint tenants does not change the character of the proceeds. Kenbridge Building Systems v. David W. Love, (VLW 91-H-320, Circuit Court of Richmond). The decision did not indicate whether funds had been commingled in the joint account.

7. Conversion to tenants by the entirety on the eve of bankruptcy may be characterized as a fraudulent conveyance. In Re White, 28 B.R. 240 (Bankr. E.D. Va. 1983).

8. Property held as tenants by the entirety passes automatically to the surviving spouse at death, avoiding probate. Avoidance of probate may be cited as a legitimate motive for the transfer and as evidence that it was not intended to defraud creditors.

PLANNING OPPORTUNITY: Where only one spouse is facing a potential liability, and the marriage is secure, consider shifting property (including personalty) owned jointly or by the spouse facing the potential liability into tenancy by the entirety. In the case of

real estate, there is no need to go through a "straw man;" the conveyance may be from the fee owner spouse directly to himself or herself and his or her spouse as tenant by the entirety with common law rights of survivorship. Section 55-9, Code of Virginia. To put themselves in a position to use this opportunity, clients should strive to avoid having their spouses assume joint liabilities with them, e.g., to the extent possible avoid having spouse co-sign loans, loan guarantees, performance bonds, contracts, etc.

PLANNING DILEMMAS: If the client would not otherwise give his property at death to his or her spouse outright, the use of tenancy by the entirety distorts the client's estate plan, for instance if the client would otherwise leave the property to the spouse in trust or to his children or other family members. Moreover, putting separately owned property into tenancy by the entirety makes it much more likely the other spouse will be accorded a substantial interest in such property in the event of divorce.

B. Outright Gift. Debtor client may transfer property by gift, typically to family members or others who are the "natural objects of their bounty."

1. Federal Gift Tax. Unlimited gifts to spouse are permitted without gift tax consequences. I.R.C. ' 2523. Up to $13,000/year per donee ($26,000 if donor's spouse elects to split the gift) is allowed for gifts to a non-spouse without any gift tax consequence. I.R.C. ' 2503(b). Above those levels gifts to a non-spouse will use up the donor's estate tax exemption. In 2009 when the estate tax exemption was $3.5 million, $1 million of that could be given away tax free during life. The $1 million exemption for lifetime gifts remains in effective in 2010, even while the estate tax has been (temporarily?) repealed. The gift remains in effect, albeit at a 35% rate. Once the $1 million exemption is exhausted by lifetime gifts, gifts are subject to Federal gift tax. I.R.C. ' 2505. Federal Gift Tax Return Form 709 will be required for split gifts or gifts which take advantage of any portion of the Unified Credit. The return is due by April 15 of the year following the gift.

2. Federal Estate Tax. Property given away is removed from the donor's taxable estate. Future appreciation on the property obviously avoids tax at the donor's death.

3. Federal Income Tax. Income earned on property given away is thereafter taxed to the donee who may be in a lower income tax bracket. With today's compressed income tax brackets (the “kiddie tax” basically taxes unearned income of a child to age 19 at the parents’ rates), there is very little income tax savings from gifts to children or to trustee for children, but gifts to a child over 19 will save some income tax. Gifts carry over into the hands of the donee the donor's income tax basis. I.R.C. ' 1015.

4. Management Supervision. Parents or other donors will frequently want to make gifts during their lives so they may evaluate the donee's ability to manage the property before deciding how to handle additional transfers to the same donee.

5. Fraudulent Conveyance. Assets gifted are immune from creditors' claims if the donor is not insolvent at the time of the gift, if the gift does not render the donor insolvent and if the gift was not made with the intent to hinder, delay or defraud creditors.

   a. A gift given with intent to delay, hinder or defraud existing or subsequent creditors is voidable. Virginia Code ' 55-80.

   b. Virginia Code ' 55-81 makes voidable as presumptively fraudulent any gift made at a time there are existing creditors, regardless of the donor's actual intent, if the donor is insolvent. This section was expressly intended to defeat frauds perpetrated on existing creditors by the marriage of an insolvent debtor, accompanied by gifts to his or her spouse. Hyman v. Porter, 37 Bankr. 56 (Bankr. E.D. Va. 1984). Gift transactions between husband and wife are deemed fraudulent as to existing creditors as a matter of public policy. Morrisette v. Cook & Bernheimer Co., 122 Va. 588, 95 S.E. 449 (1918).

   c. A creditor's suit is required to void the gift under Virginia Code ''55-80 or 55-81. Virginia Code '55-82. IV. C., supra.

6. Legal Formalities. It is essential to follow legal formalities (e.g., in the case of real estate, execute and record a deed reflecting the change of title; in the case of corporate stock, cancel old certificate of donor, issue new smaller certificate to donor, new certificate to donee.)

7. Contributions to Virginia Educational Savings Trust (VEST).

Internal Revenue Code Section 529, which became law in 1998, authorized Qualified State Tuition Programs, and Virginia laws adopted such a program in Code of Virginia '23.38.81. Parents or grandparents may use this provision to establish college savings funds for children or grandchildren. Contributions to such funds may expand the annual gift tax exclusion by, in effect, accelerating five years of $10,000 annual exclusions to make a $50,000 contribution in one year for one child ($100,000 from a married couple). Merrill Lynch, for instance, is licensed to operate such funds. Virginia=s law in '34-4 and '23.38.81 E., provides an absolute immunity for such VEST Funds from claims of creditors of the donor or of the beneficiary. In this light it is interesting that individuals may use this program to set aside tuition for themselves. It does

not appear that a challenge based on fraudulent conveyance could prevail against a VEST fund.

C. Creation and Transfer of Interests in Family Partnership/Family LLC, Particularly for Purposes of Gifting Real Estate.

Low value publicly traded or pre-IPO tech stock and predevelopment real estate may present excellent opportunities for favorable tax valuations on gifts to children or trusts for children. If minority interests are given as part of the creation of a family partnership of which the donor/parent is the general partner, discounts below the already low fair market values should be available for minority and lack of marketability and possibly other causes, so that considerable property may be transferred with minimum gift tax consequences. Harwood v. Commissioner, 82 T.C. 23 (1984). However, consideration must be given to the intricacies of the Family Partnership rules of I.R.C. ' 704(e) and the 1990 Estate Freeze rules of I.R.C. ' ' 2601-2604. Use of a family partnership could permit the creator to retain control over the property by serving as General Partner, but that could cause more exposure of the interest to the creator's creditors.

1. Family Partnership Interest Created by Gift Will be Unappealing Target for Creditors. Even if a creditor obtains a judgment against a debtor partner, a partnership or LLC membership interest may not be a very attractive asset for the creditor to go after. The Uniform Partnership Act ("UPA"), the Uniform Limited Partnership Act ("ULPA"), and the Revised ULPA and state LLC statutes do not permit a court to make a creditor a partner in the partnership if the creditor levies on the partnership interest. All the court can do is give the creditor a "charging order" whereby the creditor may garnish future distributions from the partnership to the interest levied upon but not dissolve the partnership. This principal of Virginia law was reaffirmed in a 1994 Fairfax County case, First Union Bank v. Allen Lorey Family Ltd., VLW 094-8-328. But see Crocker National Bank v. Jon R. Perreton, 208 Cal. App. 3d.1, 255 Cal. Rpts. 794 (1989), which held that a creditor was not limited to a charging order and was able to attack and sell the debtor's limited partnership interest. If the debtor has the ability to see to it that no distributions will be made from the partnership, and the creditor knows it, the partnership interest will be an unappealing target for the creditor. Moreover, the creditor with a charging order may be subjected to tax on the phantom partnership income. See paragraph IX.C.2.c. below. Interestingly, the California cases flowing from Crocker were expressly cited in the recent Fairfax County First Union Bank case, and the court declined to follow those California precedents. See An Update on the Partnership Charging Order and Observations on Partnership Planning,

by J. Richard Duke and Patrick H. Davenport, Journal of Asset Protection, Winter 1999, Volume 1, Number 1.

Is an LLC as Good a Vehicle as a Family Limited Partnership? Yes, and probably better. See 4.d. infra. Typically today an LLP or LLC would be used to avoid the unlimited liability of the general partner in a traditional limited partnership. See Bankruptcy Implications of Member and Member-Managed Interests in Limited Liability Companies, by Jack F. Williams and Chink in the Armor: Piercing LLC Veil and Other Exposures of Members for LLC Obligations, David S.Newfeld, both in Journal of Asset Protection, Winter 1999, Volume 1, Number 1.

2. Tax Aspects of Family Limited Partnerships/Family LLCs.

a. Generally a family limited partnership may be formed without tax effects. I.R.C. ' 721.

b. Income splitting among family members may be achieved.

c. A creditor who obtains a charging order and obtains an assignment of a partnership interest by foreclosure may have to report the phantom income (not distributed) attributable to such interest. Rev. Rul. 77-137.

d. If the parent as general partner wants to manage the partnership by reinvesting significant amounts of the partnership earnings in new investments, there will be low cashflow distributions to the partners. This retained indirect power to affect the distributable cash income of the partners is not a power that will make any transferred partnership interest subject to the parent's estate taxes. See United States v. Byrum, 408 U.S. 125 (1972); TAM 9131006. This result is more difficult to achieve by transferring assets to a trust in which the trustee is the client. If the client has the power as trustee to determine the distributable income the trust beneficiary will receive, the transferred trust assets could be subject to the client's estate taxes.

e. New Tax Issues for FLPs. Recently the IRS has stepped up and broadened its attacks on discounted transfers to and through FLPs and some court rulings favorable to the IRS have caused new concern.

(1) Hackl v. Commissioner, 2003-2USTC & 60, 465, casts a cloud over the availability of this gift tax annual exclusion for gifts of limited partnership

interests, on the theory that the donee does not receive a present interest. The Seventh Circuit upheld the Tax Court=s view. If the availability of the annual exclusion to an FLP strategy is essential, the case should be reviewed carefully, and the partnership agreement should be drafted to give the limited partners sufficient rights that they will be seen to have present interests. But the expansion of the applicable credit amount to $1.5 million in 2004 and $2 million in 2006 may permit FLP transactions to be structured without reliance on the annual exclusion.

(2) Strangi v. Commissioner, T.C. Memo 2003-145 is the latest case in a series of IRS attacks on FLPs based on ' 2036, in which the IRS has argued and courts have agreed that minority discounts were not available because of substantial retained interests by the donors. Careful reading of these cases and careful drafting of partnership agreements, this author believes, will permit taxpayers to avoid this pitfall.

I do not think this case in any way Akills" family limited partnerships, but it does suggest certain ways of drafting family limited partnerships that will minimize the risks raised by this case.

One of the key issues is control. There is no question if the person=s whose assets are going into the family limited partnership (FLP) is willing to give up control of the family limited partnership and permit someone else to serve as managing partner (or in the case of a limited liability company (LLC), as managing member), the risks of inclusion of FLP or LLC assets in his or her estate are substantially diminished. In certain cases this will work fine and the transferring party will be willing to permit someone else to serve as manager, perhaps an entity, such as another LLC, in which he or she may have a controlling interest. In cases where it is not realistic or acceptable to the person transferring assets to the partnership or LLC to give up control, if the suggestions below are followed the author believes that the party can be the managing partner or managing member, and if circumstances change in the future in any way which suggest it is undesirable for that person to be the manager, whether because of further tax cases make it clear that such control causes a problem or because that party becomes subject to creditor claims, at that time the manager may resign and the operating agreement or partnership agreement should contain language permitting the succession to management by someone other than the transferring party, someone or an entity which is not related or subordinate to the transferring party.

For whatever it is worth, the Fellows of the American College of Trusts and Estate Counsel (an elite group of trusts and estates lawyers and tax lawyers from around the country), and particularly the Estate and Gift Tax Committee of that organization, at a recent meeting, took the view that while the taxpayer should have lost the Strangi case, the taxpayer should not have lost the case based on Section 2036. These lawyers believed the Judge was faulty in her application of Section 2036.

The Strangi case is relevant particularly to cases where the assets of the family limited partnership or limited liability company are going to be entirely or mostly marketable securities and other passive investments, and the issues raised by the case would not be so likely to apply if the assets were instead closely-held business interests or real estate, which in many cases are the assets typically used to fund such an entity.

Further suggestions to avoid the transfer tax implications of the Strangi Decision would include the following:

a. Refraining from making non-pro rata distributions to the owners, particularly non-prorated distributions favoring the person who funded the entity. Distributions should be made pro rata to partners or members, and made directly to them, not to creditors or taxing authorities.

b. The entity=s funds should not be commingled with personal funds of the person funding the entity.

c. Accurate books should be kept for the entity reflecting that the operating agreement or partnership agreement was followed carefully in the formation and operation of the entity.

d. Whoever is the managing partner or managing member of the entity should actively manage the assets.

e. The entity should comply with all the formalities imposed by state law scrupulously.

f. Meticulously retitling the assets purported to be transferred to the entity into the name of the new entity.

g. If an older or very sick person is transferring assets to the entity, it should not be such a great proportion of such person=s assets that they cannot provide for their own reasonable support without distributions from the entity.

h. The partnership agreement or operating agreement should confirm that the manager is subject to normal fiduciary obligations and agrees to abide by the normal fiduciary obligations imposed upon him or her. It has been suggested that the manager should only be liable for decisions that are outside of the Business Judgment Rule. It has been suggested that the partners or members be entitled to seek arbitration of disputed management decisions, but that the losing party in the arbitration would have to bear all costs of all parties associated with the arbitration action.

i. Do not transfer all or most of the individual=s assets into the partnership.

j. In general, do not transfer personal use assets into the partnership, such as homes and furniture and automobiles.

k. If you are going to give partnership or LLC interests to other family members or charitable entities, do not give them minuscule percentage interests: instead, give them more substantial interests so that the transferor=s loss of ownership is substantial.

l. Do not create the partnership or LLC on behalf of the transferor using a power of attorney. The principal himself should create the entity and effect the transfer.

m. Someone transferring assets to a family limited partnership or LLC should retain a substantial portion of his or her assets outside the entity.

n. ADeathbed" transfers will be more likely to be scrutinized.

3. Non-Tax Aspects of Family Limited Partnerships/Family LLCs.

a. The use of a family limited partnership has the following advantages:

- Simplifies annual giving, particularly of assets which are not easily susceptible of division into $13,000/$26,000 units. Partnership units may be given.

- To keep assets within the family by use of buy-sell provisions, restrictions on alienation, including assignments to creditors.

- Unlike an irrevocable trust, a family partnership may be amended, so it is a more flexible vehicle.

- Business judgment rule, rather than the stricter prudent man rule which governs trustees, applies to managing general partners.

- Arbitration can be required to resolve internal disputes, whereas beneficiaries may not be required to arbitrate disputes with trustees.

b. To most effectively preserve the partnership's assets from the creator's creditors, because the law is not completely settled in the area, a trusted

family member who is not the creator or the creator's spouse should serve as general partner. The creator may be a limited partner.

c. Regarding sales of limited partnership interests to children or trusts for children, see Section IX.H.2., infra.

d. Where the limited partnership contains only liquid investment assets -- marketable securities -- it is important to be able to demonstrate credible non-creditor avoidance business purpose to feel secure behind the "charging-order-only" shield, a credible non-tax business purpose to be able to claim a valuation discount. (Probably only a modest valuation discount, if any, will be available for partnerships holding only marketable securities.)

4. Why Is A Family Limited Partnership/Family LLC the “Holy Grail” of Estate, Tax and Financial Planning?

a. Using an FLP/FLLC, clients can give away assets for income and estate tax purposes but keep control over the assets. The parent or other donor may be general partner or may create an entity to be general partner/managing member over which the donor has direct or indirect control.

This contrasts with the normal tax rule, whereby the “price” of getting income off of your income tax return and an asset out of your taxable estate requires abandonment of control. Our clients almost always want to keep control over their assets, and loss of control frequently discourages them from giving assets away where that would otherwise make good estate planning, tax planning, financial planning sense. In this respect -- that they may give away assets for tax purposes but keep control -- our clients may have their cake and eat it too using an FLP/FLLC.

b. Using an FLP/FLLC clients can leverage lifetime gifts using the annual gift tax exclusion ($13,000) or gift tax applicable credit amount ($1 million) by taking discounts on partnership interests given, where they could not take discounts giving the assets held by the partnership. Discounts of up to 30% may be available on gifts of minority interests, up to 20% on majority interests.

c. Using an FLP/FLLC, clients may leverage testamentary gifts at death using the estate tax applicable credit amount ($3.5 million in 2009) by taking discounts on the partnership/membership interests remaining in their names at death. Even majority partnership/LLC membership interests held by the managing partner/managing member may be discounted, e.g., maybe by 20%. If the donor, through lifetime gifts gets to a minority

position, greater discounts may be taken, again maybe up to 30%. If, during his life, the donor gives up control, greater discounts may be taken. So a donor gets discounts on both partnership interests gifted during life and on partnership interests retained and passing at death. The IRS "invented" the minority discounts in this area when it issued Revenue Ruling 93-12, which held that minority discounts could be appropriate even for interests in a family controlled entity.

d. Assets held in an FLP/FLLC are generally protected from creditors. Under the Uniform Partnership Act and the Uniform Limited Partnership Act and under the LLC and LLLP statutes, creditors with a judgment against a partner in a partnership or member of an LLC have NO RIGHT to

- become substituted partner
- compel the general partner to make distributions
- compel the general partner to liquidate and distribute the partnership assets.

The only remedy of such a creditor is to get a "charging order" instructing the general partner/managing member, if the general partner/managing member makes a distribution with respect to the interest subject to the order, to pay it instead to the judgment creditor. This principle of Virginia law was reaffirmed in a 1994 Fairfax County case, First Union Bank v. Allen Lorey Family Ltd., VLW 094-8-328, which held that a creditor with a charging order does not have standing to ask a court to dissolve the partnership. (But see Crocker National Bank v. Jon R. Perreton, 208 Cal. App. 3d.1, 255 Cal. Rpts. 794 (1989), which held that a creditor was not limited to a charging order and was able to attack and sell the debtor's limited partnership interest.) If the debtor has the ability to see to it that no distributions will be made from the partnership, and the creditor knows it, the partnership interest will be an unappealing target for the creditor. Interestingly, the California cases flowing from Crocker were expressly cited in the recent Fairfax County First Union Bank case, and the court declined to follow those California precedents. Virginia law is unlikely to support this change in law in the foreseeable future.

But in a family context, why would a general partner choose to make a discretionary distribution to a family member subject to a charging order? He would not. In fact, it is even worse for the creditor: the IRS has ruled that a creditor with a charging order gets the K-I, and must report and pay income tax on the income not distributed to him. (Rev. Rul. 77-137) So, to a creditor, a partnership is an ugly asset.

There is an important distinction in the state LLC statutes between the 43 states whose statutes might be said to have "broad charging order" authority which might

permit a court to control the activities of the partnership or LLC and appoint a receiver where there is a charging order against a partner or member, and the "Magnificent Seven" states which restrict the court's authority. In this view asset protected LLCs should be established in one of seven states to have maximum asset protection against charging order remedies. These seven states with optimal statutory language are Alaska, Florida, New Jersey, South Dakota, Delaware, Virginia and Texas.

There is a second risk asset protection attorneys worry about, the risk of "judicial foreclosure" on a partnership or LLC subject to a charging order. The Magnificent Seven states are ideal in that regard as well.

Moreover, because uniform partnership laws import certain concepts from other laws, and LLC statutes do not, it is the considered opinion of experts giving close scrutiny to the matter that LLCs in the Magnificent Seven States may benefit from more thorough asset protection, in general, than partnerships.

See "Charging Order" in the April 2010 Trusts and Estates (page 47) by Marc Merric, Bill Comer and Daniel G. Worthington, and the cases and articles cited therein.

e. A partnership or LLC is a great vehicle for joint investments among friends, siblings, older parents and adult children, grandparents or parents and trusts for younger children. It is a great way for parents to teach children in their 20s and 30s how to invest, and to encourage active participation in the research, analysis and investment process.

D. Gift to Revocable Trust. Gifts to revocable trusts, whether for the benefit of the grantor or of a third-party beneficiary, are of little or no use in protecting assets from the claims of grantor/donor's creditors.

1. If the grantor is a permissible beneficiary, his creditors may reach the maximum amount the trustee could pay to him or apply for his benefit. Restatement (Second) of Trusts, ' 156(2). This is true even though the trustee in the exercise of his discretion wishes to pay nothing to the beneficiary or his creditors and even though the beneficiary could not compel the trustee to pay him anything. Vanderbilt Credit Corp. v. Chase Manhattan Bank, 100 A.2d 544 (1984). See also Virginia Code ' ' 55-19 A and C. The same rule should apply if the grantor procured the creation of a trust for himself, e.g., by creating reciprocal trusts with a family member. Bogert, The Law of Trusts and Trustees, ' 223 (1979). Similarly, creditors may reach trust assets which are subject to a general power of appointment created by the donor in favor of himself. Restatement (Second) of Property, Donative Transfers, ' 13.3 (1984). Because it is against public policy to allow a grantor to create an interest

for his own benefit in his own property that cannot be reached by his own creditors, it is immaterial whether there was intent to defraud creditors or not. Petty v. Moores Brook Sanitarium, 110 Va. 815, 67 S.E. 355 (1910); In re O'Brien, 50 Bankr. 67 (Bankr. E.D. Va. 1985). See generally Scott and Fratcher, The Law of Trusts, ' 156 (4th ed. 1987).

Under earlier case law courts generally would not automatically require a grantor of a revocable trust for the benefit of persons other than the grantor to revoke it for the benefit of his creditors or treat a grantor as the owner of such a revocable trust so his creditors could reach it. Scott, The Law of Trusts, ' 330.12 (3rd ed. 1967). But some recent cases have recognized the rights of creditors of the grantor to reach trust assets following the grantor's death where he held a right of revocation at death. See State Street Bank & Trust Co., v. Reiser, 389 N.E.2d 768 (Mass. App. Ct. 1979). And the trend in the law may be to permit creditors of the grantor to assert rights against revocable trusts during the grantor's life on the theory that a power of revocation is a form of general power of appointment. Restatement (Second) of Property, Donative Transfers, ' 11.1 comment c (1984); Johnson v. Commercial Bank, 288 Or. 675, 588 P.2d 1096 (1978). The Bankruptcy Code now permits a trustee in bankruptcy to exercise powers that the bankrupt could exercise for his or her benefit, including a power of revocation. By definition this excludes a special power of appointment. Bankruptcy Code ' 541.

2. The revocable spendthrift trust may, however, be effective and inviolable by the creditors of a third-party beneficiary. See Section XI.A., infra, "Planning for Claims of Creditors of Beneficiaries. Spendthrift Trust."

E. Gift to Irrevocable Trust.

1. A "spendthrift trust," according to Black's Law Dictionary, is

> a trust created to provide a fund for the maintenance of a beneficiary and at the same time to secure it against his improvidence or incapacity ... [A trust which provides a fund for a beneficiary] and places it beyond his creditors' reach.... Provisions against alienation of the trust fund by the voluntary act of the beneficiary or by his creditors are the usual incidents.

Such a trust will provide the beneficiary with few or no rights to reach the trust assets; distributions to or for the benefit of the beneficiary will normally be at the trustee's discretion.

2. Federal Gift Tax Law. Gifts to an irrevocable trust may be sheltered from gift tax by the $13,000/$26,000 annual gift tax exclusion; but as this exclusion is available only for gifts of a present interest, the trust must include appropriate Crummey withdrawal powers. I.R.C. ' 2503(b). Crummey v. Commissioner, 397 F.2d 82 (9th Cir. 1968); Rev. Rule 73-405, 1973-2 C.B. 321.

   Under Internal Revenue Code ' 2041(b)(2), if a Crummey power grants a beneficiary the right to withdraw an amount larger than the greater of (a) $5,000 or (b) five percent (5%) of the aggregate value of the trust in the year in which the beneficiary dies, the balance of the amount subject to withdrawal in excess of the greater of $5,000 or Five Percent (5%) of corpus may be included in the beneficiary's taxable estate.

   A gift to an irrevocable trust for the benefit of a spouse may be sheltered from gift tax by the unlimited marital gift tax exclusion, but only if the spouse's interest in the trust is not a "terminable interest." I.R.C. ' 2523(b). In other words, the price of taking advantage of the unlimited gift tax marital deduction for a gift to a trust is that all trust assets will have to be treated as owned by the spouse for estate tax purposes, so that when the trust assets pass per the trust at her death, they will be deemed included in her taxable estate. If a gift in trust for a spouse is a terminable interest, it will be subject to gift tax unless subject to a Crummey withdrawal power in the trust which qualifies the gift for the annual gift tax exclusion.

   In the absence of an appropriate Crummey power or qualification of a gift as a marital gift deductible under I.R.C. ' 2523, a gift to an irrevocable trust may be sheltered from gift tax only by use of the donor's unified credit.

3. Federal Estate Tax Law. Effective gifts to an irrevocable trust remove property and its post-gift appreciation from the donor's taxable estate.

4. Federal Income Tax Laws. Income earned on property given to an irrevocable trust is taxed to the trust as a separate taxpayer. At 2009 rates, the tax was 15% on the first $2,300.00; from $5,350 - $8,200, 28%; and above $11,150 the rate is thirty-five percent (35%). So there is some minor opportunity to save income tax by shifting income to an irrevocable trust.

5. Probate Avoidance. Property held in an irrevocable trust is not subject to probate in the donor's or grantor's estates.

6. Management/Spendthrift. In addition to the income tax and probate avoidance advantages of a transfer to an irrevocable trust for the benefit of individuals other than the grantor (e.g., grantor's spouse or descendants) such a transfer has the additional benefit of affording management of the assets and discretion over distribution in the event beneficiaries are youthful or improvident.

7. For the Benefit of Grantor: Generally. As seen above (IX.D.), a revocable spendthrift trust for the benefit of the grantor is ineffective to insulate the trust assets from the grantor/beneficiary's creditors. For the same public policy reasons, an irrevocable spendthrift trust for the benefit of the grantor is ineffective to insulate the trust assets from the grantor/beneficiary's creditors in Virginia, Maryland and D.C. Where a grantor having current creditors makes a transfer to a spendthrift trust of which he is either sole beneficiary or one of several beneficiaries, the transfer is void. Virginia Code ' 55-19.B and C. Under Section 541(c)(2) of the Bankruptcy Code, a restriction on a transfer not enforceable under non-bankruptcy law is not enforceable in bankruptcy proceedings. See also Section 156 of the Restatement Second of Trusts (1957).

   If the grantor is one of several beneficiaries, and his rights as beneficiary are clearly secondary and inferior to those of other beneficiaries, post-transfer creditors may not be able to assail the trust. This is more likely to be so in the case of an irrevocable trust. See IX.D.1., supra, re: the trend in the law regarding revocable trusts. A judgment creditor may not compel the trustee to exercise fiduciary discretion in favor of a debtor beneficiary of the trust. Of course, such a creditor could obtain any trust assets distributed to a trust beneficiary. See, for instance, Di Maria v. Bank of California National Association, 46 Cal. Rptr. 924 (1965), for one example of an effective discretionary spendthrift trust for the benefit of the Settlor.

8. For the Benefit of Grantor: Delaware, Alaska, Nevada, Utah, Rhode Island, Missouri, Oklahoma, South Dakota, Tennessee, Wyoming, New Hampshire. But in the states listed and in certain offshore jurisdictions (see below), such trusts may be established to effectively protect assets from Settlor=s creditors. For a summary of the asset protection laws of certain states and offshore jurisdictions, see Exhibits A and B.

9. For the Benefit of a Third-Party Beneficiary. A transfer by the grantor to an irrevocable trust for the benefit of someone other than the grantor may be effective to avoid the claims of the grantor's creditors so long as the grantor was solvent before and after the gift and the other badges of fraud are avoided, i.e., so long as the transfer was not a fraudulent conveyance. See IV. 1. A., supra.

10. Irrevocable Life Insurance Trust. Such a trust owns an insurance policy on grantor's life and is also named as beneficiary of the policy. After grantor's death, the proceeds may be held in further trust for family members or distributed. It may be used to provide liquid but untaxed assets for paying estate taxes. Such a trust can be effective and inviolable by the grantor/donor's creditors if it avoids the badges of fraud. Unfortunately for the grantor, its most effective use is to convert and leverage relatively small transfers during grantor's lifetime in the form of premium payments, into a much larger death benefit available free of grantor's creditors to grantor's heirs. For a client suffering from creditor woes, use of life insurance trusts may be a way of assuring his heirs will have the financial security which he could not enjoy while alive.

a. Life insurance proceeds retained under the terms of a policy establishing a spendthrift trust are not assignable by the beneficiary or susceptible to claims of the beneficiary's creditors except to the extent the premiums have been paid by the beneficiary. Virginia Code ' 38.2-3118. See Section IX. R., infra.

b. Estate taxes are avoided only if the grantor survives at least three years after transfer-ring existing policies to the trust. That fact suggests the desirability of contributing cash to the trust so that the trustee may purchase the policies. Policies initially purchased by an irrevocable trust will be outside of the grantor's taxable estate regardless of how long the grantor lives after funding the trust. See IX.G., infra.

11. Who Should Serve as Trustee. A trust as a transferee from a debtor will have the best opportunity to survive attempts by creditors to recapture the assets if at least one trustee is an independent third party unrelated to the grantor or the beneficiaries. For income, estate and gift tax reasons it is also desirable for the grantor to avoid serving as trustee. No beneficiary serving as co-trustees should have fiduciary power over distributions to himself or herself; these must be reserved to independent trustees. Under Bankruptcy Code ' 541(d) any property in which the bankrupt debtor holds legal title, arguably including title as trustee, becomes property of the bankruptcy estate.

12. The irrevocable spendthrift trust may be effective and inviolable by the creditors of a third-party beneficiary. See Section IX R., infra, "Planning for Claims of Creditors of Beneficiaries. Spendthrift Trusts."

F. Gift to Charity. Debtor may make outright or irrevocable trust gifts to charity.

1. Federal Gift and Estate Tax. There are allowed unlimited deductions from gift tax (I.R.C. ' 2522) and estate tax (I.R.C. ' 2055) for outright gifts to qualified charitable organizations.

2. Federal Income Tax. There is allowed a limited deduction from income tax (I.R.C. ' 170) for outright gifts to qualified charitable organizations.

3. Retained Life Estate/Remainders. There are special tax rules and tables for valuing the gift tax, estate tax and income tax charitable deductions where the grantor retains for himself or a family member a life interest or a remainder interest in property given to charities. Using such a technique, i.e., a charitable remainder trust, a donor can maintain a handsome guaranteed income stream for as long as he or she lives. For instance, if a client has anxiety about a prospective future creditor, he might diminish his net worth by making a charitable lead gift with a remainder to his children or grandchildren free of creditors= claims.

4. For such transfer to avoid the claims of the transferor's creditors, the general rules for fraudulent conveyance relating to gifts (see Section IV., supra) must be complied with.

G. Life Insurance. Debtor may purchase life insurance on his life or on the life of another payable to a third party.

1. If premiums are paid or a policy is transferred with intent to defraud creditors of the insured, the cash value of the policy may be liable to that extent to the claims of creditors.

2. Premiums paid in fraud of creditors may be recovered by creditors. Virginia Code ' ' 38.2-3122 and -3123.

3. Upon the demise of the insured, even if fraudulent conveyance may be proven by creditors of the insured as to the payment of the insurance premiums, they would have no claim to the life insurance death benefit except to recover the value of the premiums fraudulently paid. White v. Pacific Mutual, 150 Va. 849 (1928); Virginia Code ' 38.2-3122.

4. If the owner insured makes an irrevocable beneficiary designation, the cash value and the proceeds should be exempt from claims of creditors except in cases of and to the extent of transfers with intent to defraud the creditors. Virginia Code ' 38.2-3122-3123.

5. In Maryland, the cash value of life insurance payable to the insured's spouse and/or children is exempt from bankruptcy creditors of the insured by state statute. Md. Code Ann. Art. 48A, ' 385.

6. I.R.C. ' 2206 apportions the federal estate tax against the beneficiaries of life insurance to the extent of the portion of the taxable estate represented by the policy unless the decedent relieves the recipients of life insurance proceeds from the apportionment. Baptiste v. Commissioner, TMC 1992-198 provides further that any amount of unpaid federal estate tax owed by the insured's estate can be collected from the beneficiary of a life insurance policy includible in the decedent's estate, as a transferee. I.R.C. ' 6324(a)(2). Estate tax liability may not be apportioned to or collected from life insurance that is not included in the insured's taxable estate, for instance, insurance originally owned by an irrevocable trust or transferred to such a trust more than three (3) years before the insured's death. See IX.E.9., supra.

   However, the I.R.S. cannot assert a claim against life insurance proceeds if state law exempts life insurance proceeds from claims of insured's creditors, unless the lien was filed during the insured's lifetime. Stern v. Commissioner, 357 U.S. 39 (1957); Hampton v. Commissioner, 30 T.C. 708 (1958). If a lien is filed during the life- time of the insured owner, the government is limited to collecting the cash value of the policy at the time of the insured's death. The difference between the total proceeds and the cash value escapes the I.R.S.'s claim. United States v. Bess, 357 U.S. 51 (1957).

7. See Brackney, "Creditors' Rights in Life Insurance," March/April 1993, ABA Probate & Property Journal.

8. It is possible to buy life insurance in certain offshore jurisdictions, such as the Bahamas and Caymans, where the cash value is expressly not susceptible to claims of creditors of the insured.

H. Sale of Asset to a Child or to a Trust for a Child. If such a sale is made for a full and adequate consideration, creditors cannot challenge the sale unless they can show fraudulent intent. Obviously, fraudulent intent will be more difficult to prove where fair consideration is received.

1. Frustrating Creditors by Using Illiquid Consideration.

a. Private annuity payable by purchaser/child or trust to parent/seller bearing long fixed term or for life.

b. Note payable by purchaser/child or trust to parent/seller bearing long fixed term.

This is an example of "uglifying" an asset, which may be as effective or more effective an asset preservation technique than giving the asset away.

2. Sales of Limited Partnership Interests in Real Estate or Closely-Held Stock or Tech Stock to Children or Trusts for Children. For real estate developers/investors and owners of closely-held stock or tech stock expected to appreciate very substantially wishing to shift some future income and asset appreciation to children for both estate tax savings and asset preservation reasons, the sale of limited partnership interests in a family partnership to children or trusts for children presents a significant opportunity.

a. At the inception of an investment or development venture there is frequently an opportunity to fairly sell a significant interest in the venture for relatively nominal consideration, e.g., limited partnership interests in a limited partnership of which the transferor is the general partner to trusts for transferror's children. The transferor may give liquid assets to such trust in anticipation of this opportunity, so that the trust will have its own funds to invest.

b. Such an arrangement must be structured very carefully to comply with the rigorous Family Partnership rules of I.R.C. Section 704(e) and to avoid the new 1990 Estate Freeze rules of I.R.C. Sections 2601-2604.

c. Regarding gifts of limited partnership interests to children or trustee for children, see Section IX. B. and E., supra.

I. Life Interests and Remainders: Joint Purchases, Gifts and Sales. Under a typical joint purchase arrangement, a senior generation family member and a younger generation family member purchase an asset from an unrelated third party. The senior typically would purchase the life estate and the junior the remainder interest. Allocation of the purchase price between the life tenant and the remainderman is determined from actuarial tables published by the Internal

Revenue Service which assume a ten percent (10%) interest rate factor. The perceived tax advantage before the 1990 Tax Act was that at the senior's death none of the value of the property was taxed in his estate. For a relatively cheap price the junior was likely to have, in effect, acquired the entire interest. All appreciation in value after the purchase inures to the benefit of the junior. After the 1990 Tax Act, this approach will not work anymore, except for a personal residence or tangible property the use of which does not substantially affect its value. When two members of the same family acquire interests in property and one takes an interest for life or a term of years, that family member will be treated as having made a transfer of the entire value of the property to the remainder, adjusted only for any consideration paid by the remainderman. I.R.C. ' 2702(c)(2).

1. The creditors of both the senior and junior could levy upon their respective interests, although while both live the creditors might be frustrated by the illiquidity of such interests. Creditors of either could not levy on the interest of the other. If the transaction is handled carefully, at fair consideration with no fraudulent intent, the senior may have, in effect, shifted assets or value to the junior which are immune from the senior's creditors. But the transfer is not a gratuitous transfer, so it should not be easily subject to attack as a transfer in fraud. Typically the fair cost of the remainder interest to the junior will be small. If, however, fraudulent intent can be proven, the purchase can be void even though fair consideration was paid by both parties. To make a joint purchase asset as illiquid and unattractive to the creditors as possible, the agreement between the parties might provide that the joint property may not be sold without the consent of the remainderman. Under Bankruptcy Code ' 363(h) the trustee in bankruptcy apparently has no authority, without permission of the remainderman, to sell the entire interest to obtain the value of the life interest. In re Livingston, 804 F.2d 1219 (11th Cir. 1986).

   a. Beware of understating values.

   b. Present the purchase to the remainderman investor as a good investment.

   c. Remainderman might be given a right of first refusal to buy the life interest if sold. (If the property is sold for a low value, the remainderman gets the benefit.)

2. As another example of "uglification" of assets to save them from creditors, a gift of a life interest or reminder interest could be effective to shelter such interest from donor's creditors and to make the retained interest

illiquid and unattractive to creditors. See the general rules of fraudulent conveyance as they relate to gifts in Section IV., supra.

3. A sale of a life interest or remainder, if at arms length without intent to hinder, delay or defraud creditors, should withstand a challenge from creditors. Based on the application of the Internal Revenue Service's actuarial tables, the seller may be able to convey a life interest or a remainder at a price he considers to be inexpensive compared to "real value."

4. Under the 1990 Estate Freeze rules, a gift or sale of a remainder interest with retention of a life or term interest is subject to the same rules affecting trusts. In other words, unless the retained interest consists of an annuity or unitrust interest, or a personal residence, or tangible property the use of which does not substantially affect its value, the retained interest will be valued at zero for purposes of the transaction, thus creating a taxable gift or increasing the value of the taxable gift. I.R.C. ' 2702(c)(2). See IX.J., below.

J. Qualified Personal Residence Trusts (QPRTs), Grantor Retained Income Trusts (GRITs), Grantor Retained Annuity Trusts (GRATs) and Grantor Retained Unitrusts (GRUTs). The QPRT is a device in which older generations give away a future interest in up to two principal or vacation residences to younger generation family members, retaining for themselves for a fixed period of time the exclusive right to use the premises. If the donor outlives the term, he or she is able to give away a very valuable residence and all future appreciation at a substantially discounted gift tax value, maybe a discount of as much as 50-75%. The GRIT is a device whereby a senior generation family member makes a gift to a trust for younger generation family members under which the donor retains all of the income of the trust for a specified period no longer than ten (10) years with the remainder owned by the trust. If the donor outlives the trust term, the entire value of the trust is out of the donor's taxable estate. If the donor dies during the term of the trust, the entire value of the trust is included in the donor' estate. See I.R.C. ' 2702.

The GRAT is a similar device in which the donor retains the right to receive fixed amounts payable no less frequently than annually, with the remainder passing to another. The GRUT is another version in which the donor retains the right to receive not less frequently than annually amounts which are a fixed percentage of the fair market value of the property in trust determined annually, again with the remainder passing to another. If the retained interest is qualified under the GRAT or GRUT rules, the retained interest is valued and deducted from the total fair market value, the balance being the gift subject to gift tax. If the retained

interest is not so qualified, it is given a zero value, and the gift subject to gift tax is the entire fair market value of the property. I.R.C. ' 2702.

Under the new 1990 Estate Freeze rule a GRIT continues to be effective only if it involves a residence and if the person holding the term interest in the residence uses the residence as his personal residence.

1. The creditors of the senior generation family member creating a GRIT, GRAT or GRUT could levy on the grantor's respective interest, although while the trust is in effect, the creditors might be frustrated by the illiquidity of such an interest. Creditors of the senior generation family member grantor could not levy on the remainder interest in the trust. For the same reasons articulated under Section IX.I.1., supra, the trustee in bankruptcy apparently would have no authority, without permission of the remainderman, to sell the entire interest to obtain the value of the retained income interest.

2. The general rules of fraudulent conveyance as they relate to gifts set out in Section IV., supra, must apply for the transfer to withstand challenge by creditors.

K. Qualified Retirement Plans. A primary benefit conferred upon employee benefit plans by the Employee Retirement Income Security Act of 1974 ("ERISA"), and a requirement for qualification and tax-exempt status under the Internal Revenue Code (the "Code") is that benefits under qualified retirement plans (such as pension, profit-sharing, 401(k) plans) may not be assigned or alienated, and are consequently unreachable by creditors of the plan participants.

Background

Although ERISA and the Code's anti-alienation provisions usually work to prevent creditors from attaching the plan benefits of a participant, most bankruptcy courts and circuit courts of appeal which considered the matter before 1990 held that the anti-alienation provisions do not protect plan benefits from creditors of a participant who has filed for bankruptcy. Bankruptcy law provides that in order for such benefits to be excluded from the bankruptcy estate, the plans must qualify as spendthrift trusts. A number of the pre-1990 courts examining the issue held such plans not to qualify as spendthrift trusts because the settlor of the trust also served as a beneficiary, and possibly also as trustee. See Section IX.D. and E., supra. However, recent decisions in the Fourth Circuit, bankruptcy courts and finally the United States Supreme Court have clearly established the immunity of such plans from claims of creditors of plan participants.

1. Anti-Alienation Provisions In General

ERISA Section 206(d)(1) requires that all qualified retirement plans covered by ERISA include provisions prohibiting the assignment or alienation of benefits under the plan. ERISA Section 1021(c) further requires that all such plans include anti-alienation provisions as a condition of tax-qualification. This section of ERISA has been codified in Code Section 401(a)(13). As a result of the codification in the Code, certain retirement plans of self-employed individuals and partners (sometimes called Keogh Plans) that are eligible for tax qualified plan status under the Code, but not defined as pension plans under ERISA, are subject to the anti-alienation provisions. (However, Individual Retirement Accounts ("IRAs") are not subject to the anti-alienation provisions and are therefor not protected from creditors' claims by the ERISA preemption.)

2. Property of the Bankruptcy Estate

a. In General

Section 541(a) of the Bankruptcy Code of 1978 (the "Bankruptcy Code") provides that the bankruptcy estate "is comprised of ... all legal and equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. ' 541(a)(1). This extremely broad language is limited by Section 541(c)(2) of the Bankruptcy Code which provides that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under 'applicable nonbankruptcy law' is enforceable.." under the Bankruptcy Code.

b. Pension Benefits Not Included in Estate

In Patterson v. Shumate, 112 S.Ct. 2242 (1992), the Supreme Court held that ERISA benefits are excluded from the debtor's bankruptcy estate under Section 541(c)(2) of the Bankruptcy Code, which excludes from the bankruptcy estate property that is subject to a restriction on transfer under "applicable non-bankruptcy law." In so holding, the Supreme Court adopted the view of the 4th Circuit as expressed in In re Moore, 907 F.2d 1476 (4th Cir. 1990), and overruled several other circuit court decisions which had interpreted the phrase "applicable non-bankruptcy law" to encompass only state law and traditional spendthrift trusts. With this decision the anti-alienation provision in an ERISA qualified retirement plan will protect a participant's plan benefits from creditors both in and out of bankruptcy.

A spendthrift trust is a trust "in which the right of the beneficiary to future payments of income or capital cannot be voluntarily transferred by the beneficiary, or reached by his or her creditors. In re Graham, 726 F.2d 1268, 1271 (8th Cir. 1984). As a general rule, the settlor of a spendthrift trust cannot also be the beneficiary. McLean v. Central States, S.E. & S.W. Areas Pension Fund, 762 F.2d 1204, 1207 (4th Cir. 1985). The list of cases cited above generally involved either plans of a self-employed person thereby self-settled trusts (Keogh plans), or plans covering a debtor who was the sole officer, director or shareholder of the settlor professional corporation having the power to amend and terminate the trust. In addition, in some cases , there existed an unlimited power of withdrawal. Consequently, the plans were found to fail as spendthrift trusts under state law.

It is important to note that even where a debtor does not effectively control the settlor/corporation, many ERISA plans may not qualify as a spendthrift trusts under state law. For example, a common feature of many defined contribution benefit plans is a provision permitting loans to plan participants, such loans being secured by all or part of the participant's interest in the plan. Thus, the participant is permitted to assign his interest in the plan as collateral for a loan, thereby anticipating his distribution. These loan provisions are contrary to the very concept of spendthrift trusts, and such provisions could cause a plan to fail as a spendthrift trust under state law. See Wilkie, "Pension Benefits in Bankruptcy Proceedings: Are They Protected", P-H Pension and Profit Sharing Plans (New Ideas) &1255 (9/21/90).

3. Exemptions from Claims of Bankruptcy Creditors

Before the Supreme Court's decision in Patterson v. Shumate made it clear that ERISA benefits are excluded from the bankruptcy estate, debtors argued that even if such benefits were included, they were nonetheless exempt from the claims of creditors in bankruptcy. In this connection there are three potential avenues for exemptions: (1) Federal Bankruptcy Law; (2) exemptions under federal law other than the Bankruptcy Code; and (3) exemptions under state law.

a. Federal Bankruptcy Code Exemptions

Section 522(b) of the Bankruptcy Code permits a debtor to exempt certain property of the bankruptcy estate from creditors' claims. The debtor has the option to exempt property enumerated in Bankruptcy Code Section 522(d) unless the relevant state law precludes this option, in which case the debtor may exempt property specified in the state

exemption scheme. Virginia has "opted out" of the federal exemptions listed in Bankruptcy Code Section 522(d); therefore, debtors in Virginia may only claim the state exemptions or exemptions under federal law other than bankruptcy.

Section 522(d)(10)(E) under the Bankruptcy Code limits the exemption for pension benefits to an amount which the debtor can show is reasonably necessary for his and his dependents' support. While this provision may be useful in some cases, it does not respond to the needs of many clients who have amassed very substantial sums in their retirement plans, nor is it helpful to younger debtors in bankruptcy who are far from retirement and retain the potential for future earnings.

b. State Exemptions for Pension Benefits

(1) Many states exempt ERISA plans – 401(K) plans, defined benefit plans – from claims of creditors in bankruptcy. Fewer states exempt IRAs in addition to ERISA plans.

(2) Preemption of State Exemptions. Based upon a Supreme Court decision outside of the bankruptcy setting, several bankruptcy courts have invalidated state laws that purport to exempt pension benefits from claims of creditors in bankruptcy proceedings. In Mackey v. Lanier Collections Agency & Service, Inc. 108 S. Ct. 2182 (1988), the Supreme Court held that a Georgia statute exempting welfare benefit plans from attachment was preempted by ERISA's specific preemption provision which preempts "any and all state laws insofar as they may now or hereafter relate to any employee benefit plan covered by ERISA."

Compelled by the Supreme Court's decision in Mackey, an Arizona court set aside a state statutory provision that exempted benefits under any retirement plan that qualifies for tax exemption under Internal Revenue Code Sections 401(a), 403(a), 403(b), 408 or 409. (The language in this statute is similar to the statutory provisions in Virginia. See In re Komet, 93 Bankr. 498 (W.D. Texas 1988), aff'd, 104 Bankr. 799 (W.D. Texas 1989). Similar statutes have been invalidated in Oklahoma [In re Brown, 95 Bankr. 216 (Bankr. N.D. Okla, 1989)], Mississippi [In re McLeod, 102 Bankr. 60 (Bankr. S.D. Miss, 1989)] and Texas

[In re Komet, 93 Bankr. 498 (Bankr. W.D. Texas 1989), aff'd 104 Bankr. 799 (W.D. Texas 1989)].

(3) IRAs Exempt to At Least $1 Million Under BAPCPA. Recall that as explained supra in VI J., Congress in 2005 extended under Federal Bankruptcy Law a bankruptcy exemption to IRAs up to $1 million and possibly more under vague circumstances.

(4) Transfers to plans, even to qualified pension, profit-sharing and 401(k) plans, may be attacked as fraudulent conveyances under state law and Bankruptcy Code ' 548.

L. Business Interests/Liability Insurance.

1. Incorporation/Shareholders Generally. Of course the creditors of a corporation, absent legal grounds to pierce the corporate veil, can recover only against the assets of the corporation. This limited liability protects the shareholders, so that they are not exposed to personal liability on the corporation's debts except to the extent of their investment in the corporation or to the extent they have affirmatively guaranteed a corporate liability. This is the classic reason to incorporate a proprietorship or partnership. A 1988 article in the Catholic University Law Review (Vol. 37 at 605) reviews the case law on pierced corporate veils in D.C. Maryland and Virginia, finding the remedy rarely enforced in Maryland, occasionally enforced by Virginia courts and frequently enforced in D.C. Today LLCs are the closely-held limited liability business entity of choice, while S and C corporations are still used, but rarely used by small business enterprises.

2. Corporation/Directors and Officers. In recent years suits against officers and directors of business corporations have increased dramatically, with the result that director and officer liability insurance has become less available and more expensive. The recessionary economy of the past several years has no doubt accelerated both trends. Virginia, like a number of states which have responded to these trends, has adopted statutory amendments limiting the liability of directors and officers and increasing the powers of corporations to indemnify them.

Officers and directors, like agents, are liable to the corporation (or to those acting on its behalf, such as a trustee in bankruptcy or a stockholder suing derivatively) for breach of the duty of care or the duty of loyalty. Restatement (Second) of Agency, ' 401 (1957). They are also, like agents, liable to third parties for torts committed in the course of their duties. Restatement (Second) of Agency, ' 343 (1957). Generally

speaking, they are not liable on contracts made on behalf of the corporation. If the corporation incurs liability to third parties because of the wrongful conduct of an officer or director, the corporation will have a claim for indemnification against the officer or director. Restatement (Second) of Agency, ' 401, comment d (1957).

a. The directors' standard of care is "good faith business judgement of the best interests of the corporation." Code of Virginia ' 13.1-690. This is a very minimal standard, not even requiring "reasonableness." The director would have to be grossly negligent, rather than merely negligent, to be found liable.

b. Code of Virginia ' 13.1-692.1 imposes a statutory cap on the liability of officers and directors for damages "in any proceeding brought by a shareholder in the right of a corporation or brought on behalf of shareholders. . . . " The cap is equal to the greater of (I) $100,000 or (ii) the compensation received by the director or officer from the company in the twelve (12) months preceding the act for which liability is imposed. The cap only applies to suits brought by stockholders. The cap does not preclude equitable remedies, such as recision. The cap does not apply to willful misconduct. Articles of Incorporation or By-Laws may reduce the statutory cap to a nominal sum.

c. Directors and officers of tax exempt corporations are immune from civil liability in any proceeding. Code of Virginia ' 8.01-220.1:1. and ' 13.1-870.2.

d. Mandatory Indemnification. Under code of Virginia ' 13.1-698 a corporation shall indemnify for reasonable costs a director who entirely prevails in defense of a proceeding. Under ' 13.1-702 officers receive the same treatment.

e. Permissive Indemnification, General. Under Code of Virginia ' ' 13.1-697 and -702 a corporation may indemnify a director or officer who acts in good faith in the best interest of the company. There are some statutory limits on this indemnification. Code of Virginia ' 13.1-697.D and E.

f. Permissive Indemnification, Except for Cases of Gross Negligence. Under Code of Virginia ' 13.1-704.B any corporation may make a further indemnity to an officer or director except in the case of

willful misconduct or a known violation of criminal law by drafting the Articles of Incorporation so to provide.

g. Code of Virginia ' 13.1-703 authorizes a corporation to purchase directors and officers' liability insurance whether or not the corporation would have the authority to indemnify. Such liability insurance may supplement or replace the corporation's indemnification program.

SUMMARY: For maximum protection of directors and officers, the corporation's Articles of Incorporation should provide that the corporation will fully indemnify them in all events except in the case of willful misconduct or known violation of criminal law, and should provide that no director or officer shall incur more than $1.00 of liability in any shareholders' derivative suit. Directors and officers should insist that the most comprehensive liability insurance available should be purchased for their benefit. Directors and officers may purchase their own D&O policies and require the company to pay the premiums. Chubb, for one sells such a product. It could be important for a director to own his own policy because in the event of corporate bankruptcy the premium will not be paid by the bankruptcy trustee and if a suit is filed even for a period during which the premium was paid, there will not up coverage. But the director can continue to pay the premium on a personal D&O policy in that event.

3. Professional Corporation/Shareholder Torts. Whereas incorporation of a licensed professional practice (e.g., law, medicine, dentistry, accountancy, architecture, engineering) does nothing to shield the individual professional from personal liability on a malpractice tort claim for his or her own act, incorporation under the applicable professional corporation statute will generally (in some 47 states) protect the other shareholders from personal liability on malpractice torts of their fellow shareholders. Code of Virginia ' 13.1-547, D.C. Code ' ' 29-601 et seq., Md. Code, Corporations and Associations, ' ' 5-101 et seq. In contrast, a general partner in a typical professional partnership is jointly and severally personally liable for the malpractice torts of his partners. Code of Virginia ' ' 50-13, -14 and -15(a). As more and more malpractice actions are filed against all types of licensed professionals, more consideration is likely to be given to incorporation of professional practices. (Another factor encouraging incorporation of the professional practice is the increasing cost of medical insurance for shareholders and their families, the cost of which is a deductible tax-free fringe benefit to shareholder employees of a P.C. (I.R.C. ' 162(a)(1), '106), but taxable and only partially deductible to a partner. I.R.C. ' 213(a), ' 703. Onerous tax consequences of incorporation -- e.g., bunching of income for a more than 12-month period into one taxable year -- can make conversion to P.C. status expensive.

4. General Partners/Partnerships. See Section IX. C. and V.D., supra.

5. Limited Partners/Partnerships. See Section IX. C. and V.E., supra.

6. Limited Liability Companies and Partnerships. In 1991 Virginia adopted a Limited Liability Company ("LLC") Act. The LLC combines the corporate advantage of limited liability with the flow through tax advantages of partnership classification under the Internal Revenue Code. In Rev. Rul. 93-5 the I.R.S. ruled that a Virginia LLC will be taxed as a partnership for federal income tax purposes. It is more flexible than the "S" Corporation in accommodating various forms of ownership, e.g., you may have more than thirty-five (35) members, trusts or corporations or nonresident aliens may be members. Unlike a general or a limited partnership, an LLC provides limited liability for all members: none need be generally liable. Unlike a limited partnership or a corporation, an LLC allows all members to participate in management. In 1994 the District of Columbia adopted both an LLC statute and a Limited Liability Partnership ("LLP") statute, and Virginia adopted an LLP statute. Maryland also has adopted an LLC statute. There is a trend among professional service partnership firms, including apparently all of the Big 6 accounting firms, of which three have already converted, and Hogan and Hartson, the District's largest law firm, to convert to LLPs, especially where the professionals prefer partnership governance and culture to corporate. See Section IX. C.

7. Virginia Professional Limited Liability Company. In 1992 Virginia adopted the Virginia Professional Limited Liability Corporation Act to extend to licensed professionals the benefits of LLCs and to permit licensed professionals, professional corporations and professional LLCs to associate as members of Professional LLCs.

8. Insurance, Generally. It is frequently overlooked in a business setting that adequate levels of comprehensive insurance coverage may be essential to the long term viability of the business endeavor by protecting the business assets from unexpected and onerous claims which occur too frequently in our litigious society.

   X Property Insurance/Fire and Extended (all risk, replacement cost)

   X Business Interruption (frequently overlooked and underinsured)

   X Comprehensive (general liability with adequate limits, at least $500,000 per occurrence)

X Products/Completed Operations coverage (products liability)

X Excess Liability Umbrella (at least $1 million, preferably $3-$5 million)

X Business Auto Insurance

X Workmen's Compensation

X Appropriate Specialty Insurance for the Business and Industry (e.g., transit insurance on shipments, computer insurance)

X Fidelity Bond (for employee theft -- frequently underinsured)

X Bailee's Coverage

9. Umbrella Coverage for Professionals. Probably all high net worth individuals should consider a substantial umbrella insurance policy as an added layer of protection from general liability, auto accidents, and other hazards. It is very inexpensive, approximately $100/year for $1 million of insurance. This is generally available as a rider on your automobile insurance policy, but may not be available if you do not have a good driving record. Chubb is said to have the broadest high-end policy: it defended O.J. Simpson in the Goldman lawsuit, and President Clinton in the Paula Jones claim.

M. What Interests Can You Retain?

1. Interests in property subject to local bankruptcy exemptions. Recall that the purchase of an exempt item with non-exempt assets in contemplation of bankruptcy may not be deemed a fraud on creditors. Virginia Code ' 34-26.

2. In Virginia, the cash value of life insurance if it is subject to an irrevocable beneficiary designation and premium payments have not been in fraud of creditors. Virginia Code ' 38.2-3123.

3. In Florida, for example, a domiciliary may retain up to 160 acres of rural property, or one-half acre of city property, as a homestead exempt from claims of creditors in bankruptcy. There is no limit as to size of the home or the value of the property. Also, the cash value of life insurance and commercial annuities are exempt.

4. In Maryland, the cash value of life insurance payable to the insured's spouse and/or children is exempt from the insured's creditors.

N. Avoiding Inheritance.

1. Have spouse's bequest to a debtor spouse pass in spendthrift and/or Qualified Terminable Interest Property (QTIP) trust (I.R.C. ' 2056(b)(7)) form or by-pass the spouse completely.

2. Document debtor spouse's loan to non-debtor spouse.

3. A disclaimer of an interest in an estate valid under state law may preserve the assets within the family unit while protecting the assets from the creditors of the disclaiming party. In a recent Virginia case some commentators consider surprising, if not bad, Abbott v. Willey, 253 Va. 88 (1997). Mrs. Willey, confidant of President Clinton, while liable on a note, disclaimed her entitlement to her husband=s life insurance and let it pass to her children. The creditor claimed the disclaimer was a fraudulent conveyance, but the Supreme Court held that a disclaimer could not be set aside on those grounds. A Colorado court similarly held in Colacci v. United Bank of Boulder, 549 P.2d 1096 (1976). The disclaimer was held to cause the disclaimed assets to pass directly from the decedent's estate to the ultimate beneficiaries. If there is no transfer from the disclaimant, efforts to assert a fraudulent transfer should be unsuccessful. A testator/grantor might anticipate potential creditor problems on the part of beneficiaries by planning in contemplation of disclaimers by specifying to whom the disclaimed property would go. The well-planned will or trust document will provide a contingent trust for alternate takers in the event the primary beneficiary disclaims.

However, it should be noted that other states have found the right to disclaim equivalent to a general power of appointment, thereby subjecting it to scrutiny as an fraudulent conveyance. Arguably there is a trend in the law towards this result. California has now adopted a law to provide that a qualified disclaimer shall not be considered a fraudulent conveyance. Virginia's disclaimer statute is found in Code of Virginia ' ' 64.1-188 through 196. See also I.R.C. ' 2518. Virginia will now consider disclaimers by persons attempting to gain or retain Medicaid eligibility as an uncompensated transfer resulting in a period of ineligibility. See XI. R.B., infra.

4. If an adult child has present or potential concerns regarding creditors, his or her elderly parent might want to by-pass such adult child in his or her will, leaving the adult child's share to the adult child's descendants.

O. Uglifying Assets Otherwise Attractive to Creditors.

1. If one facing the possibility of creditor problems owns an unencumbered asset that might be an attractive target for his potential creditor, e.g., a marketable home, the anxious client might want to borrow a substantial amount of the equity out of the house to facilitate --

   - X Gifts of cash to family members.
   - X Investment in "ugly" assets unattractive to creditors.
   - X Purchase of cash value life insurance with irrevocable beneficiary designation to take advantage of the bankruptcy exemption.
   - X Contribution to qualified retirement plan exempt from creditors.
   - X Invest in offshore asset preservation trust.

2. Cash may be invested in an asset less susceptible to execution. For example, cash owned by one spouse with potential creditor problems may be used to invest in or pay down a mortgage on tenancy by the entirety property or to invest in stock of a closely-held corporation. Cash could be invested in exempt property such as qualified retirement plans or life insurance with an irrevocable beneficiary designation.
3. Real estate, closely-held business interests and other valuable assets may be "uglified" by any of the following techniques:

   - X Contribution to family limited partnership. See IX.C., supra.
   - X Charitable remainder gifts, retaining income interest.
   - X Installment sale or private annuity sale, e.g., to a child. See IX.H., supra.
   - X Sale or remainder, e.g., to child. See IX.I., supra.
   - X GRITs, GRATs, GRUTs. See IX.J., supra.

P. Marital Agreements As a Shield Against Unrelated Creditors. If a spouse wishes to be protected from liabilities of a mate's business, e.g., from liability on performance bonds in the mate's construction business or from any kind of co-guarantee of a business loan, a pre- or post-marital agreement may assure the spouse freedom from such potential liability. More specifically, such an agreement may provide the uninvolved spouse with contractual assurance that the family home held as tenants by the entirety will be held by husband and wife free and clear of encumbrance associated with the mate's business.

Needless to say, it may also be in the mate's best interest to protect the family home from contingent liability, to insulate the spouse's assets from potential creditor claims. Where a business owner and spouse have a marital agreement and structure title to their assets shrewdly, the business owner may well be able to secure adequate business credit while protecting his family home and his spouse's assets from exposure to potential liabilities arising out of the business. Bonding companies and banks will frequently extend credit without spousal guarantee or the home as collateral where there exists a marital agreement along the lines described above, and its terms are disclosed from the beginning of credit negotiations.

Regarding Marital Agreements, See Q. Planning for Spousal Claims, infra.

Equal Credit Opportunity Act as a Defense to Void Spousal Liability on a Guarantee. In Eure v. Jefferson National Bank, (VLW 094-6-111), a unanimous Virginia Supreme Court decision rendered in September 1994, it was held that a wife could void her liability on a guarantee of a loan made to her husband's company. Both husband and wife guaranteed the loan. She raised the defense of 15 U.S.C. ' ' 1691, et seq., the Equal Credit Opportunity Act, which makes it illegal to discriminate against anyone during a credit transaction on the basis of marital status. The wife demonstrated to the Court's satisfaction that she had been required to sign the guarantee "solely on the basis of her marital status as the wife of [the company owner]." She held no interest in the company, was not a joint applicant for credit, and the bank made no inquiry regarding her credit standing. At the time of the loan her husband was worth more than $2 million. One of the terms of the loan, pursuant to common bank practice, was that the wife would be a guarantor.

Q. PLANNING FOR SPOUSAL CLAIMS.

A. Protecting Assets from Spousal Claims at Divorce.

1. Premarital (Antenuptial) Agreements. Virginia has adopted the Premarital Agreement Act which applies to any premarital agreement executed on or after July 1, 1986. Code of Virginia ' 20-147, et seq. It is to a great degree formalization of prior Virginia common law cases regarding pre-marital agreements and it specifically provides that the parties to a pre-marital agreement may contract with respect to:

   a. the rights and obligations of each of the parties and any of the property of either or both of them, whenever and wherever acquired or located;

b. the right to buy, sell, use, transfer, exchange, abandon, lease, consume, expend, assign, create a security interest in, mortgage, encumber, dispose of, or otherwise manage and control property;

c. the disposition of property upon separation, marital dissolution, death, or the occurrence or non-occurrence of any other event;

d. spousal support;

e. making of a will, trust or other arrangement to carry out the provisions of the agreement;

f. ownership rights in and disposition of the death benefit from a life insurance policy;

g. the choice of law governing the construction of the agreement; and

h. any other matter, including their personal rights and obligations not in violation of public policy or a statute imposing a criminal penalty.

To be enforceable, an agreement must be voluntarily executed and each party must make a fair and reasonable disclosure of his or her property and financial obligations prior to its execution. This is the equivalent of the "full disclosure" requirement in many of the prior common law cases.

As a practical matter, notwithstanding the obvious planning advantage of premarital agreements, their negotiation has a tendency throw cold water on the flames of a relationship and, while often discussed, percentage wise, few actually get executed.

Maryland common law recognizes prenuptial agreements. Under D.C. law, a prenuptial agreement must be in writing to be enforceable. D.C. Code ' 28-3502.

Post-Marital Agreements. The Act also provides that married persons may enter into post-marital agreements with each other for the purpose of settling the rights and obligations of either or both of them under the same general parameters; provided, however, that the marital agreement shall become effective immediately upon its execution. Maryland law recognizes the enforceability of marital property settlement agreements. Ann. Code of Md., Family Law Volume, ' 8-101. So does D.C. law. Code ' 30-201. Under D.C. Code ' 19-113(f), a valid antenuptial or postnuptial agreement entered into by the spouses determines the rights of a

surviving spouse in the real and personal property of the deceased spouse.

Separate Representation for Spouses. The trend in malpractice cases and contract suits in this area strongly suggests that better practice is to avoid dual representation by one lawyer of both parties in pre- and post-nuptial agreements, even if that requires the wealthier spouse to pay the legal fees for the less wealthy spouse so that he or she may have separate representation. It can almost be said that a much wealthier spouse throws into question the enforceability of such a marital agreement unless he or she insists that the less wealthy spouse be separately represented.

2. Divorce/Equitable Distribution: Virginia. Divorce is a creature of statute and Virginia recognizes both fault (adultery, cruelty, desertion) and no-fault grounds of divorce (one year separation or, in any case where the parties have entered into a separation agreement and there are no minor children to either of them, six months). Code of Virginia ' 20-91. In any event, the court can award support and maintenance to a spouse, and in determining whether to award support and maintenance, the court considers the circumstances and factors which contributed to the dissolution of the marriage and takes into account the following factors:

a. the earning capacity, obligations, needs and financial resources of the parties, including, but not limited to, income from all pension, profit sharing or retirement plans of whatever nature;

b. the education and training of the parties and the ability and opportunity of the parties to secure such education and training;

c. the standard of living established during the marriage;

d. the duration of the marriage;

e. the age and physical and mental condition of the parties;

f. the contributions, monetary and non-monetary, of each party to the well being of the family;

g. the property interests of the parties, both real and personal, tangible and intangible;

h. the provisions made with regard to the marital property under the equitable distribution laws, discussed below; and

i. such other factors, including the tax consequences to each party as are necessary to consider the equities between the parties.

For almost 200 years, Virginia law prohibited awarding of support and maintenance (formerly alimony) from a spouse if there existed in that person's favor a ground of divorce for adultery. The law now provides that while no permanent maintenance support shall be awarded in such case, the court can make an award, notwithstanding the existence of such adultery, if the court determines from clear and convincing evidence that a denial of support and maintenance would constitute a manifest injustice based upon the respective degrees of fault during the marriage and the relative economic consequences of the parties; in short, based on a judicial evaluation.

3. In a domestic relations case where children are involved the court can also make orders regarding custody and support of the minor children. The judicial key is "the best interests of the child or children," taking into account all relevant factors. A full discussion of this issue is beyond the scope of this outline.

4. The division of property between the parties to a divorce is controlled by the far-ranging Virginia "equitable distribution" statute, Code of Virginia ' 20-107.3 (attached as Exhibit K). Due to the great power given the court under equitable distribution, since its initial adoption in 1982, as amended every year by the legislature, it has completely rewritten all prior concepts of property division. Due to the high incidence of divorce in today's society, it must be recognized as a major force in personal property planning, for no other statute gives the courts such broad powers over property division. Several highlights of the equitable distribution statute are:

a. property is divided definitionally into separate property, marital property, or part marital property and part separate property, and they can be commingled, which transmutes the property to marital property.

b. both parties have interests in marital property; however, legal title in and of itself is irrelevant and is only a factor to consider in determining equitable distribution awards.

c. The court determines the equitable distribution award, determines legal title as between the parties, the ownership and value of all property, real or personal, tangible or intangible, and such determination is made without regard to the maintenance and support award for either party, or for support of the minor children of the parties.

d. The statute provides ten factors to be taken into account by the court, which include:

(1) the contributions, monetary and non-monetary, of each party to the well being of the family;

(2) the contributions, monetary and non-monetary, of each party in the acquisition and care and maintenance of marital property of the parties;

(3) the duration of the marriage;

(4) the ages and physical and mental conditions of the parties;

(5) the circumstances and factors which contributed to the dissolution of the marriage, including grounds of divorce;

(6) how and when specific items of marital property were acquired;

(7) debts and liabilities of each spouse, the basis of such debts and liabilities and the property which may serve as security for such debts and liabilities;

(8) the liquid or non-liquid character of all marital property;

(9) the tax consequences to each party; and

(10) the open-ended catch all, such other factors as the court deems necessary or appropriate in order to arrive at a fair and equitable monetary award.

5. The court has the power to direct payment of a percentage of the marital share of any pension, profit sharing, or deferred compensation plan or retirement plan, whether vested or non-vested, as part of the equitable distribution award.

6. Equitable distribution litigation is expensive and time consuming, with tremendous consequences to the property of the parties. It is worthwhile to read the equitable distribution statute simply to get an idea of the breadth of the court's power therein. As a percentage, most divorce cases, however, settle through a property settlement agreement or similarly titled agreement settling all marital rights, including equitable distribution issues, support and maintenance, and child custody and child support. The tax and estate planning aspects of such property settlement agreements are more important now than ever and there is a continuing tension between what parties wish to achieve in the property settlement arena as opposed to what they wish to achieve when their ex-spouse potentially becomes a creditor at some time thereafter. For planning, the practitioner is well advised to ensure clients are aware of all consequences of such property settlement agreements in all eventualities.

7. Divorce/Property Settlement: Maryland. In dividing "marital property," Maryland courts will disregard property acquired before marriage by either party, property acquired by either party by gift or inheritance from a third party, property excluded by a valid pre- or postnuptial agreement, and property directly traced to any of these sources. Ann. Code of Md., Family Law Volume, ' 8-201(e). Generally, a Court may not transfer or order the transfer of real or personal property from one party to the other but may order a partition or sale of jointly owned property. ' 8-202.

After the court determines which property is marital property and its value, the court may transfer ownership of an interest in a pension, retirement, profit-sharing or deferred compensation plan from one party to either or both parties, grant a monetary award, or both, as an adjustment of the equities and rights of the parties concerning marital property, whether or not alimony is awarded. ' 8-205.

8. Divorce/Property Settlement: D.C. In the absence of a valid anti-nuptial or pre-nuptial agreement, D.C. courts will assign each party his or her sole and separate property acquired before marriage, and his or her sole and separate property acquired during marriage by gift, bequest, devise or descent, and any increase thereof or property acquired in exchange therefor. As to all other property accumulated during marriage, regardless of whether the title is held individually, as joint tenants or as tenants by the entirety, the court will distribute it equitably, after considering all relevant factors. D.C. Code ' 16-910.

9. Offshore Solutions. A number of offshore jurisdictions expressly immunize assets held in asset protection trusts from domestic relations judgments entered after the trust is

established. See Exhibit I.

10. Protecting Assets Received by Gift or Inheritance From Claims in Divorce. Assets inherited or received by gift by children should be kept by children in their own accounts under their own separate names to protect such assets from divorce property settlement claims. Tell your clients to make their children promise that they will keep inherited assets in their own names, will not put them in joint name with a spouse. If assets are kept in their own names, generally they may not need prenuptial agreements. Divorce courts generally will not award to another spouse assets received by one spouse by gift or inheritance. However, if gifted or inherited assets are put in joint name with a child or grandchild's spouse, that spouse is likely to be awarded 50% in divorce.

B. Protecting Assets from Spousal Claims at Death.

1. Pre-1991 Virginia Law. Under the pre-1991 regime it was possible to completely defeat the rights of a surviving spouse to claim a significant share of a deceased spouse's estate. Professor J. Rodney Johnson provided the blueprint in his landmark article: "Interspousal Property Rights at Death" (no citation available).

Since the spouse had a statutory right to elect against the will, that right could be defeated if there was no will and the entire estate passed outside of the probate process, e.g., by inter vivos trust. Spousal rights only applied to the probate estate, and it was easy enough for a determined testator to be certain he had no probate estate, or to take title to real estate in his sole name as his equitable separate estate, in which a spouse would have no rights.

2. Post-1991 Virginia Law: Augmented Estate. Effective January 1, 1991, Virginia came into a new legal era for spousal rights at death. The expressed legislative intent behind the new act is to reduce an individual's ability to disinherit the surviving spouse by owning property in forms that will not be subject to probate, but, on the other hand, to prohibit a surviving spouse who has already received substantial property from the deceased spouse during lifetime or at death by non-probate means, from electing an additional "unfair" share of the probate estate.

a. the surviving spouse may claim one-third of the augmented estate, or one-half if the decedent left no descendants.

b. the property subject to the election includes not only the probate estate; it also includes the following unless the transfer was made with the spouse's consent:

(1) Property transferred to a third party where the decedent retained an interest.

(2) Property transferred to a trust which the decedent could revoke or invade.

(3) Joint and survivorship property held by decedent and a third party.

(4) Transfers in contemplation of death.

(5) Annual gifts in excess of $10,000 per donee made within 5-6 years of death.

(6) Property <u>other than tangible personal property</u> received by surviving spouse from decedent during his life as a gift.

(7) Category (6) property that the spouse transferred to a third party.

Not included in the property subject to the spouse's election is:

(1) Property acquired by the decedent by gift, will or intestate succession from anyone other than the surviving spouse before or during the marriage and maintained by the decedent as separate property.

(2) Property irrevocably transferred to anyone except the surviving spouse before 1991.

(3) Tangible personal property gifted to the surviving spouse during the decedent's life.

(4) Real property transferred after 1990 by deed in which the spouse joined in the conveyance by signing.

NOTE: "Equitable separate estates" no longer exist in Virginia. A creature of the pre-1991 regime, such estates previously created in deeds, etc. no longer have any legal significance. Code of Virginia ' 55-47.01

NOTE: A spouse's augmented estate share is not to be reduced by state or federal death tax.

The statute contains complicated mechanisms for valuing the property, apportioning among the non-probate assets the liability to the spouse, and reacquisition of the property by the surviving spouse/transferee liability.

Absent a specific provision in a separation agreement between husband and wife, a surviving spouse separated from her husband at the time of death nevertheless may inherit under the terms of the decedent spouse's (perhaps obsolete) will. Blunt v. Lentz, 241 Va. 547 (1991).

One who wilfully deserts or abandons his or her spouse forfeits all interest in the spouse's estate if the desertion or abandonment continues until the spouse's death. Virginia Code ' 64.1-16.3 (Repl. Vol. 1991).

Under Virginia Code ' 64.1-69.1 a surviving spouse is protected from unintentional disinheritance under a will that testator executed before marrying said spouse. A spouse omitted in that situation will nevertheless take his or her intestate share of the testator's estate unless the will or pre-marital or post-marital agreement shows the decedent spouse intentionally omitted the spouse surviving.

Forfeiture by Slayer Spouse. A slayer spouse forfeits all rights in property owned by the decedent, property held jointly with the decedent with rights of survivorship, and contract benefits, e.g., life insurance, retirement plans, payable by reason of the decedent's death. Where an alleged slayer has not been convicted or acquitted, someone holding such property or desiring to challenge the alleged slayer's right to such property may attempt to establish that the alleged slayer "procured, participated in or otherwise directed" the spouse's death in a civil trial subject to the normal civil burden, preponderance of the evidence (as opposed to the criminal burden, beyond a reasonable doubt). Virginia Code ' 55-401, et seq.

R. PLANNING FOR CLAIMS OF CREDITORS OF BENEFICIARIES.

A. Spendthrift Trust. A transfer by the grantor to an irrevocable spendthrift trust for the benefit of one other than the grantor may be effective to avoid the claims of the beneficiary's creditors.

1. a. General Rule. Most states have long recognized that an individual is free to establish a trust for the support and maintenance of a beneficiary which prevents the beneficiary from voluntarily or involuntarily assigning or alienating his interest. Bogert & Bogert, The Law of Trusts and Trustees, ' 222 (2d ed.

1979) and cases and statutes cited therein. If the spendthrift trust is validly created, the creditors of a beneficiary will have no greater claim to the assets of the trust than the beneficiary could have. Accordingly, if the trust is a purely discretionary trust and the beneficiary has no right of withdrawal, the beneficiary's (beneficial) interest should be insulated from the claims of his creditors, and any attempt at alienating, pledging, or otherwise charging his beneficial interest in the trust should be void. Baker v. Vermont Bank & Trust Co., 342 F.2d 12 (2d Cir. 1965).

b. Possible Exception for Tort Claims. The interest of a spendthrift trust beneficiary may be reached by a judgment creditor on a tort claim if considerations of public policy so require. See Restatement Second of Trust, Section 157, comment a (1959); Scott, The Law of Trusts, Section 157.5, note 3 (3d ed. 1967).

2. Formerly, under Virginia Code ' 55-19.B., up to a cap of $1,000,000 could be sheltered from a beneficiary's creditors in a spendthrift trust. In 2001 the Legislature eliminated this cap, so now a Virginia spendthrift trust may shelter assets of unlimited value.

3. A spendthrift trust has three defining characteristics: (I) the trust must provide for the support and maintenance of its beneficiary; (ii) the grantor must intend to protect the trust from the beneficiary's creditors; and (iii) the grantor must intend to prevent the beneficiary's voluntary or involuntary alienation of trust property. Levy v. First Va. Bank, 845 F.2d 80 (4th Cir. 1988).

4. A spendthrift trust may be used to protect assets from waste by descendants, claims of a spouse of a descendant on divorce, and creditors of descendants.

5(a). Parents of minor or young children should make lifetime gifts to children using Irrevocable Discretionary Spendthrift Trust.

1. within $13,000/$26,000 Annual Gift Tax Exclusion

2. within $1 million Unified Gift Tax Exempt Amount

3a. normally such a trust is a separate taxpayer, and with the highly compressed tax brackets it is taxed at top brackets above $11,000 or so. Income distributed from a trust to a beneficiary is taxed to the beneficiary. Therefore, the investment policy of a trust must be coordinated with the tax law and the plan to distribute trust assets to avoid high tax brackets on trust income which will be accumulated and not distributed.

b. if trust is defective parents pay income tax on trust income whether distributed or not and the payment of such tax is NOT considered a gift.

4. trust may last for child's life with general testamentary power of appointment for child to exercise in child's Will.

5. or trust may last for child's life, and then go automatically to child's children (grandchildren) – generation – skipping transfer for which very careful planning is required.

6. or trust may distribute all income when child reaches mature age, e.g., 21-25, so child becomes accustomed to handling money before receiving any principal.

7. and trust may distribute principal in 2 or 3 installments, e.g., 1/3 at 25, ½ balance at 30, balance at 35, so if children are foolish when young, they cannot squander all funds in trust.

8. while held in trust assets are protected from divorce property Settlement, from any other creditor of child, from creditors of donor parents.

9. Consider '529 Plans and UTMA accounts.

5(b) At the Death of Parents Use Testamentary Discretionary Spendthrift Trust for Children to Protect Children's Assets From Themselves, Their Spouses, Their Creditors.

A. Hold assets until children attain mature age, then distribute income before principal, distribute principal in 2 or 3 installments OR

B. Hold assets for life of child

1. Subject to general testamentary power of appointment

OR

2. Then to child's children (grandchildren) in a generation-skipping trust

C. While in trust assets protected from

1. Creditors of child

2. Divorce property settlement

D. Particularly use trust where child is disabled or if there is a particular cause for concern: substance abuse, spendthrift, or unmotivated habits, unpleasant spouse. For a disabled child, consider having other non-disabled children as co-beneficiaries of the same trust. This makes it harder for a court to invade the trust to offset governmental programs for the disabled child.

E. A discretionary trust will always permit the trustee to accelerate distributions or terminate the trust with liquidating distribution early.

F. A typical testamentary plan for the very wealthy, net worth of $15 million or more: $1-$2 million to each child at age 35, balance in lifetime GST and non-GST trusts as a safety net.

5(c) Protecting Assets From Grandchildren, Their Spouses and Creditors.

A. Generally, same considerations as for children, lifetime or testamentary discretionary spendthrift Trusts.

B. As an alternative to a trust for minor grandchildren (or minor children), consider custodial account at a bank or trust company

C. Under the Uniform Transfers to Minors Act (UTMA)

D. Designate explicitly on account documents “Hold to Age 21”

E. Name someone other than parent of child as custodial, e.g., sibling or aunt or uncle, to avoid inclusion in parent’s taxable estate.

F. Do not accumulate in UTMA account more than can be spent on tuition, etc., before age 21. Whatever remains in the account at age 21 may be withdrawn.

G. Children pay tax on UTMA account; under 19, children are taxed at parents’ top bracket on income in excess of $1,500. Children 19 and older have regular individual brackets. Again, it is important to coordinate investment strategy with the tax law, to generate growth not income in UTMA accounts.

H. To accumulate more assets to older age, use custom trust drafted by lawyer.

I. For lifetime transfers and testamentary transfers, beware of generation-skipping transfer (GST) tax, but do take full advantage of $3.5 million generation-skipping transfer tax exemption

J. To leverage GST exemption and shelter much more than $3.5 million for grandchildren from estate and gift tax consider

1. Irrevocable Life Insurance Trust, especially second-to-die policy

2. may hold single life or second-to-die policy

3. may last 100 years or in perpetuity

4. Charitable Lead Trust: makes estate tax optional, even for billionaires

In very large estates GST planning may seem insignificant, but the effect can be huge. If the exemption goes to $3.5 million in 2009, and husband and wife combined put $7 million in GST trusts, if it grows at 12%/year after tax, it doubles every 6 years, in the 42 years that the children may survive parents. So the growth in the transfer tax exempt GST trust will be as follows:

6 years out	$14 million
12 years out	$28 million
18 years out	$56 million
24 years out	$112 million
30 years out	$224 million
36 years out	$448 million
42 years out	$896 million to grandchildren TAX FREE

If you assume only 8% growth, doubling every 9 years, in the 45 years that children survive parents, the growth in the transfer tax exempt GST trust will be as follows:

9 years out	$14 million
18 years out	$28 million
27 years out	$56 million
36 years out	$112 million
45 years out	$224 million to grandchildren TAX FREE

6a. Protecting Assets for Spouse, Spouse's Creditors, Spouse's Own Children (Not Your Client's Children), and From Subsequent Husbands and Wives. QTIP trusts may be used to protect assets from spousal waste, claims of a second spouse on remarriage, and creditors of a spouse. Classic Uses of QTIP Marital Trust:

i. If your client's spouse is not the parent of all of your client's children, provide for the spouse in a QTIP Trust, so your client can be assured that at the spouse's death the principal of the trust will pass to his/her children. Predeceasing spouse controls ultimate disposition of trust principal, not surviving spouse.

ii. If your client's spouse is a spendthrift, or cannot or does not want the responsibility of managing inherited assets or is in a business or profession where the threat of lawsuit is always present, e.g., where spouse is an ob/gyn, or where the spouse cannot be trusted to leave all such funds to the couple's children at the surviving spouse's death.

iii. If one spouse has plenty of assets to take advantage of the unified credit if he or she dies first, but the other does not, during life the wealthier spouse may create a QTIP trust for the less wealthy spouse in an amount sufficient to use up the less wealthy spouse's estate tax credit, so the QTIP Trust assets will pass at the beneficiary spouse's death to the wealthiest spouse's heirs tax-free.

6b. Advantages of a QTIP Trust

i. Spouse who sets it up controls where principal of Trust passes at beneficiary spouse's death. Beneficiary spouse does not.

ii. If beneficiary spouse remarries, that new spouse and the children of the new spouse cannot inherit deceased spouse's money.

iii. If beneficiary spouse has children of his or her own (not deceased spouse's children), those children will not inherit deceased spouse's money (unless the spouse establishing the trust wants them to).

iv. If beneficiary spouse has creditors, they cannot get at deceased spouse's money placed in the QTIP Trust, the principal of the trust (although they could attack the beneficiary spouse's income stream.)

v. Trustee of deceased spouse's choice manages the money, not the surviving beneficiary spouse.

7. Family/Bypass/Credit Shelter That As Asset Protection Vehicle.

Now we will turn our attention from exclusively marital trusts to a different type of trust, typically established for the benefit of the spouse and children and grandchildren for as long as the spouse lives, sometimes called a bypass trust because assets held in bypass estate tax at the surviving spouse's death, passing to the couple's children tax-free. This is sometimes called a Family Trust or Credit Shelter Trust. That the basic estate tax planning technique for couples with assets of $4 million and up is the Testamentary Unified Credit Shelter [Family] Trust which is typically a discretionary spendthift trust for the benefit of the surviving spouse and children of the deceased spouse, and possibly grandchildren of the deceased spouse. The amount of this trust is generally up to the exempt amount: $3.5 million beginning 2009.

i. If spouse remarries his or her interest can terminate.

ii. Spouse's creditors cannot attack his or her interest.

iii. If spouse remarries, the new spouse cannot get at trust.

iv. Children's creditors/grandchildren's creditors cannot get at the trust.

.

v. Spouses of children/grandchildren cannot get at trust.

vi. Trustee of deceased spouse's choice manages the money, decides whether and to whom to distribute income or principal.

vii. The balance in a credit shelter family Trust is NOT taxed when surviving spouse/beneficiary dies; the balance passes to children TAX-FREE. So the use of this trust may be dictated by the estate tax laws as they apply to that specific estate.

viii. A beneficiary of a trust is not, as such, personally liable to third parties arising out of the ownership or operation of trust property (Scott on Trusts, ' 277 (4th ed. 1988)), unless the trustee has incurred an obligation in the administration of the trust acting under the control of the beneficiaries as their agent. (Scott on Trusts, ' 274). Of course, trust property is exposed to liability incurred by the trustee in his capacity as such.

ix. 529 Plans. In Virginia and probably other states 529 Plans are protected from the beneficiary's creditors (and the donor's creditors as well).

B. Protecting Assets of the Aged\Disabled Family Member -- Medicaid Eligibility Planning.

Many elderly clients are concerned about preserving their assets for their spouse or

children, particularly against the hazards of potentially staggering long-term nursing home care. If the elderly client does not have this concern, their children frequently do.

The topic of financial planning for the elderly and Medicaid eligibility is well beyond the scope of this outline. But a very brief outline of Medicaid eligibility in Virginia is appropriate.

1. Medicaid in General. Medicaid is a federally sponsored, state funded program. Many older people (and their families) hope they can qualify for Medicaid funding of long-term nursing home care. Medicaid nursing home coverage is not just for the "poor." CAVEAT: an obvious problem with this strategy exists if either (a) there are no nursing homes in the area with vacancies for Medicaid patients, or (b) those that have vacancies are so bad you would not want to go there, or have your parents go there. Frequently the practical problem is that if the applicant has no money for private pay nursing care, there is no viable Medicaid alternative geographically convenient. Code of Va. ' 32.1-325, et seq.

2. Resources Test. There is no strict income limit for Medicaid eligibility for nursing home care. A person's income will affect the amount of "patient pay" required as to individual's contribution to the cost of care. There is, however, a resources limit: an individual may not qualify if he or she has more than $2,000 of countable resources (or if a couple has more than $3,000 of countable resources, if both apply). Certain resources are not counted, basically personal effects, household furnishings, one auto and burial plots. Income or resources to which a Medicaid applicant or applicant=s spouse is or becomes entitled will be considered Aassets" for eligibility purposes even though the individual or spouse does not receive them because of his or her own action or action on his or her behalf. Code of Virginia '32.1-325.02.

3. The Home as a Resource. The home and lot (one acre or zoning requirement) and up to $5,000 of adjacent contiguous property are exempt when the applicant, his spouse or his child resides in the home. Six months after institutionalization the exemption ends unless a specified relative continues to reside in the home.

4. Joint Accounts. When one spouse is institutionalized, their funds held in a joint account will be considered resources of the one institutionalized for purposes of the resources test. In the case of unmarried persons with joint accounts, the source of the funds and the parties' intentions will be examined.

5. Spouse's Obligation to Contribute. Virginia requires a non-institutionalized spouse to provide some financial support to an institutionalized spouse receiving Medicaid benefits to the extent the non-institutionalized spouse's income exceeds $1,700/month.

6. Spouse's Right to Support. Reciprocally, the non-institutionalized spouse of a Medicaid recipient is entitled to enough income from the institutionalized spouse for a basic spousal allowance and a housing allowance. (Recall: a Medicaid eligible client may have substantial income, e.g., pension or annuity, even though he or she may not have substantial resources.) The basic spousal allowance is determined by a formula, presently $1,149/month. The housing allowance is permitted to the extent the spouse's housing costs -- rent, mortgage, taxes, insurance, condo fee, and utilities exceed thirty percent (30%) of the basic spousal allowance, presently $345 ($1,149 x .3). Appeal can be made for a higher allowance.

If either spouse establishes that the non-institutionalized spouse's resource allowance is inadequate to raise that spouse's income to the minimum monthly maintenance needs allowance, additional resources can be allocated to the spouse in an amount adequate to produce income to provide the minimum monthly allowance. 42 U.S.C. See, 42 U.S.C. ' 1396r-5(e)(2)(c) (1992), Va. Manual Volume XIII., Part II., Chapter G, Sec. 4d(2)a) (2)(c, d).

7. Spouse's Resources. Both spouses' resources (however titled) will be considered available to the institutionalized spouse, except for one-half of the couple's resources at the time of institutionalization, but not less than $14,000 nor more than $70,000, if placed in the non-institutionalized spouse's sole name. Resources received by the non-institutionalized spouse after Medicaid eligibility is established will not be considered available to the nursing home spouse.

8. Transfers to Become Medicaid Eligible. The government has become aware that many families have been shifting assets by family gifts from older to younger family members. As a result assets transferred by applicants for less than fair market value bear a presumption that they were motivated by a desire to become Medicaid eligible.

9. 2006 Legislative Changes. The Deficit Reduction Act of 2005, signed by the president on February 8, 2006, contains major changes in Medicaid eligibility rules. The legislation aimed to reduce Medicaid entitlement expenditures by $10 billion. As approximately sixty percent of the nation’s nursing home residents are Medicaid recipients, the impact of this law will likely be widespread. A few of its more important provisions are summarized below.

Because Medicaid is intended as a welfare program for the truly underprivileged, a person must have assets below a certain threshold in order to be eligible for Medicaid assistance. (Certain assets, such as a home, are generally not taken into account in determining eligibility.) Both the new and the prior rules governing eligibility contained provisions designed to prevent individuals from transferring assets

to family members in order to reduce their assets below the threshold of eligibility. These eligibility rules were toughened considerably by the 2006 law.

Five-Year Look Back/Delayed Start of Penalty Period. Under prior law, a person applying for Medicaid was required to produce financial records dating back three years. If uncompensated transfers had been made within the period, the applicant would be ineligible for Medicaid assistance for a penalty period determined by dividing the amount of the uncompensated transfer by a number representing the monthly average cost of care at a skilled nursing facility in the area where the applicant resides. The penalty period began at the time of the transfer. To illustrate the application of this rule, if in January 2005 an individual applied for Medicaid, he would be required to produce financial records dating back to January 2002. (Uncompensated transfers which occurred prior to January 2002 would not be taken into account in determining the applicant's eligibility for Medicaid.) If the applicant had made a$40,000 gift to a family member in January 2004 and the applicable penalty divisor was $4,000, he would be ineligible for Medicaid for a period of ten months commencing with the date of the gift (i.e., through November 2004), and thus would be eligible for benefits at the time of his application in January 2005.

Under the new rules, however, the applicant would be required to produce financial records dating back five years from the date of the transfer (i.e. to January 2000) and his period of ineligibility, calculated in the same fashion using the amount of the transfer and the applicable penalty divisor, would begin with the date of his application for benefits. Thus, if the applicant below the Medicaid threshold, entered a nursing home and applied for Medicaid benefits, he would not qualify for those benefits for ten months following his application, or through November 2005.

Many commentators have suggested that those new rules will cause hardship for persons hat are truly needy and should qualify for Medicaid, as well as for nursing homes and hospitals. First, many Medicaid applicants simply will not be able to produce the five years of records now required to document their eligibility. And even if they are able to produce the required records, a relatively small transfer to a family member or charity within the past five years by an applicant who is essentially indigent at the time he seeks Medicaid benefits will result in his being ineligible for some period of time after he has applied for benefits. Nursing homes will have no means of being paid for their care for such persons for a time, and thus will not want to accept them as residents. Moreover, since nursing homes must provide care for their residents until they can be safely discharged, even if they are unable to pay, they will also be reluctant to accept residents who have modest assets at the time they enter the nursing home but are expected to exhaust those assets after a short period. If such persons cannot immediately qualify for Medicaid when their assets are exhausted either because they cannot produce the necessary records or because they have made a small gift within the five year period, the nursing home will be required to provide them with free care until they do qualify, which may be a lengthy period. Nursing homes may also be tempted to dump indigent persons in hospitals

for real or imagined medical services to get them out of their facilities, thus imposing hardships on hospitals.

10. Other New Provisions: The look-back and delay provisions discussed below are the most significant changes in the 2006 law, but other changes, such as limitations on the use of annuities to avoid Medicaid asset restrictions, and a new rule for calculating the income and resources that may be retained by the spouse of a nursing home resident, have also made eligibility more difficult. Whereas under previous law a Medicaid applicant's equity in his home was not considered available to pay for his nursing home care, home equity in excess of $500,000 is now treated as available (unless a spouse, a minor or a disabled child resides in the home). States will have the option of exempting up to $750,000 of home equity value at their discretion.

    The overall effect of the new law is to significantly toughen Medicaid eligibility requirements and make it very difficult to engage in planning designed to qualified oneself for Medicaid benefits. Most people, except those whose assets are substantial enough to pay for nursing home care for a long period, should strongly consider the purchase of long-term care insurance to provide for nursing home care or in-home care.

11. Transfers Between Spouses. These will not result in ineligibility unless the transferee spouse transfers the assets in turn for less than fair market value.

12. Transfers by Spouse. Transfers by the spouse of an applicant or Medicaid recipient are subject to the same restrictions as transfers by the applicant.

13. Ethical Issues. A tricky ethical issue arises for a lawyer approached by an adult child to engage in Medicaid eligibility planning for an elderly parent. In such a case the elderly parent is the attorney's client, and the attorney must be loyal to the parent's best interests. The parent may wish to hold onto assets the child wants him to give away; the parent may be willing or desirous of paying for high quality nursing home care, while the child might prefer to see the parent in a Medicaid facility; the parent's testamentary wishes may be different than those the child hopes for. The attorney must inquire into and be sensitive of the parent's mental capacity to execute a will or trust, to make gifts. See Bar Disciplinary Rule 5-106(A) and (B); Ethical Consideration 7-12; Legal Ethics Opinion 570.

14. Miscellaneous.

    a. Under Code of Virginia ' 32.1-326.1, the Department of Social Services has instituted an "estate recovery" program under which it attempts to

recover the costs of nursing facility care from the estates of deceased Medicaid recipients.

b. Under Code of Virginia ' 63.1-133.1 the Commonwealth may obtain liens against the real and personal property of recipients of (or applicants for) long-term nursing facility benefits.

c. Under Code of Virginia ' 55-19.5, certain so-called "trigger trusts" (which cut off trust benefits to the grantor if he applies for or requires long-term medical, hospital or nursing care) are void as against public policy.

15. Children Providing for Aged Parents. Where children want to provide a financial safety net for less financially secure parents who may survive them, the parents may be co-beneficiaries with spouse and children in discretionary Credit Seller Family Bypass Trust. If parents need funds, distributions may be made directly to the service provider – landlord, doctor – without putting assets in parents' hands which parents' creditors may attack or which may be subject to tax when parents die. Getting your elderly parents to give you all of their assets so they are Medicaid-eligible generally does not work; it is a bad idea.

S. PLANNING FOR CLAIMS AGAINST CLIENT'S ESTATE. The claims of creditors against an estate are superior to the rights of persons taking by intestate succession or under a will. First the validity of claims must be determined, if necessary at a Debts and Demands hearing. Code of Virginia ' ' 64.1-171 through -179. Once debts are determined, if the estate is not adequate to pay all creditors, they are paid according to statutory sequence. Code of Virginia ' 64.1-157.

a. If the will does not establish the order in which specific assets are used to satisfy the debts, state law will.

b. If assets have not been protected from the client's creditors before he dies, they will be vulnerable to claims of his creditors against his estate.

c. Code of Virginia ' 64.1-151.1 authorizes a Family Allowance of up to $6,000 without court approval, more with court approval, payable to the surviving spouse or, if none, to the minor children of a decedent. The Family Allowance has priority over all claims against the estate.

d. Code of Virginia ' 64.1-151.2 authorizes Exempt Property of $3,500 payable to the surviving spouse or, if none, to the minor children of decedent. Only the surplus of tangibles in excess of the security interests therein are available. Exempt Property has priority over all claims against the estate not secured on such assets except for the Family Allowance.

e. Code of Virginia ' 64.1-151.3 authorizes a Homestead Allowance of $10,000 payable to the surviving spouse or, if none, to the minor children of the decedent. The Homestead Allowance has priority over all claims against the estate except for the right to the Family Allowance and Exempt Property. However, whereas the former two pass in addition to any other share passing by will or intestacy, the Homestead Allowance is in lieu of any other share passing to the spouse or minor children by will or intestacy or by election to claim a statutory share of the augmented estate under Virginia Code '' 64.1-13 through -16.

f. Relief of Liability for Executor or Administrator. By calling a debts and demands hearing and following that up by filing a petition to show cause why the estate should not be distributed to beneficiaries and the personal representative discharged, the personal representative may be allowed to distribute the residue of an estate to the beneficiaries without personal liability for the claims of creditors. The personal representative may also avoid personal liability for the claims of creditors by distributing no sooner than six (6) months after appointment and by obtaining proper refunding bonds from the beneficiaries.

g. Beneficiaries' Transferee Liability. Beneficiaries of an estate may remain liable for up to five years for claims of creditors who were not parties to the debts and demands and show cause proceedings. Beneficiaries may be liable as transferees for unpaid estate tax, and not just for the portion attributable to their shares. Estate of Baptiste v. Commissioner, T.C. Memo 1992-198.

h. Tenancy by the Entireties Property. As noted supra in Section IX.A.3., the recent 4th Circuit case, Reno, confirmed that the will of a decedent cannot apportion estate taxes against tenancy by the entirety property. Creditors of one tenant may not obtain satisfaction from the entireties property in the hands of the surviving tenant by the entirety.

i. Mortgages on Real Estate.

1. Recourse. Recourse mortgages may be paid by the executor. Owen v. Lee, 185 Va. 160 (1946).

2. Nonrecourse. Nonrecourse mortgages may not be paid by the executor unless he is specifically directed to do so in the will.

3. Joint. If the liability is joint and several with a deceased joint tenant, a creditor can look to the personal representative for part or full payment.

j. Real Estate as a Source for Payment of Unsecured Debts. Real estate may be subject to the payment of debts. Virginia Code ' 64.1-181. However, the personal estate is the primary source of payment. Virginia Code ' 64.1-155. If the executor deems it necessary to charge real estate for debts, he may bring a suit in equity. Virginia Code ' 64.1-185. Any transfer of the real estate by an heir or devisee within one year of the decedent's death is not valid against the creditors of the decedent. Virginia Code ' 64.1-183. For that reason, such real estate will not be insurable by a purchaser within that period unless the title insurance company holds the proceeds of sale in escrow and subject to creditors' claims for the one year period.

k. Settlors' Creditors' Rights Against Revocable Trusts. The rights of creditors of deceased revocable trust settlors are uncertain in many states. See Clifton B. Kruse, Jr., Revocable Trusts: Creditors' Rights After Settlor-Debtor's Death, 7 Prob. & Prop. 40 (Nov/Dec 1993). However, it is generally recognized that a settlor's transferring his resources into a revocable trust should not impair the rights of the deceased settlor's creditors. See State Street Bank and Trust Co. v. Reiser, 389 N.E.2d 768, 771 (Mass. App. Ct. 1979). Statutory developments likely will clarify such creditors' rights against revocable trust assets.

T. THE INTERNAL REVENUE SERVICE AS A CREDITOR.

a. Assessment.

1. General. The I.R.S. may not initiate collection action against a taxpayer until (1) the tax has been assessed, (2) the I.R.S. has given notice and made demand for payment of the tax, and (3) the taxpayer has refused to pay the tax. Sections 6303 and 6331 of the Code. See ADevelopments in Taxpayer Protection from IRS Pre-Collection Actions," by Rosenbers, Hammer and Haight, Journal of Asset Protection, Volume 5, Number 1, September/October 1999.

2. Assessment Authority. The I.R.S. is authorized to make inquiries, determinations, and assessments of all taxes which have not been paid. Section 6201(a) of the Code.

a. The I.R.S. may immediately assess all taxes disclosed on tax returns prepared by the taxpayer. Section 6201(a)(1) of the Code.

b. The I.R.S. may immediately assess mathematical or clerical errors appearing on the return and certain overstated credits. Section 6201(a)(3) of the Code.

c. The I.R.S. may not assess a deficiency determined by the I.R.S. until the taxpayer has been provided with a notice of deficiency and an opportunity to file a petition with the Tax Court. Section 6212(a) of the Code.

(1) After the I.R.S. has conducted an audit of the taxpayer and determined that tax was understated, the I.R.S. will send a notice of proposed deficiency to the taxpayer. The notice of proposed deficiency (i.e., a 30-day letter) offers the taxpayer 30 days in which to file a protest letter with the Appeals Office of the I.R.S. If an agreement is reached with the I.R.S. at the appeals level, and a settlement of the tax owed is agreed upon, the I.R.S. may assess the tax.

(2) If the taxpayer ignores the 30-day letter or an agreement is not reached in appeals, the I.R.S. is required to issue a statutory notice of deficiency (i.e., a 90-day letter) which grants the taxpayer the option of agreeing with the deficiency or filing a petition with the Tax Court within the 90-day period. The statutory notice of deficiency must be sent by either registered or certified mail to the last known address of the taxpayer. Section 6212(a) of the Code. If the taxpayer agrees with the deficiency, the I.R.S. may immediately assess the amount. If the taxpayer ignores the 90-day letter, the I.R.S. may assess the deficiency at the end of the 90-day period.

(3) If the taxpayer files a petition with the Tax Court and the Tax Court determines the amount of the deficiency, then the I.R.S. may immediately assess the entire amount of the determined deficiency. Section 6215(a) of the Code.

3. <u>Method of Assessment</u>.

a. The I.R.S. assesses the tax (including assessable penalties) owed by the taxpayer by recording the liability in a summary record that contains the identification number of the taxpayer, the character of the liability assessed, the tax period, and the amount of the assessment. Section 6203 of the Code.

b. The date of the assessment is the date the summary record is signed by an assessment officer. Section 301.6203-1 of the Regulations.

c. The taxpayer may request a copy of the record of assessment. Section 6203 of the Code; Section 301.6203-1 of the Regulations.

4. Notice and Demand for Tax. The I.R.S. must give written notice to the taxpayer within 60 days after making an assessment of tax stating the amount of tax owed and demanding payment. Section 6303(a) of the Code.

b. Offer in Compromise.

1. The I.R.S. is authorized to compromise the amount of the liability in certain situations. Section 7122 of the Code; Section 301.7122 of the Regulations. Because an offer in compromise creates a contract between the taxpayer and the Treasury, the following elements must be present: the agreement must have a subject matter, the parties must have legal capacity to contract, there must be mutual assent (i.e., offer and acceptance), there must be consideration, there must be legal authority, and the parties must intend to be bound. Furthermore, the entire process must be in writing. Big Diamond Mills v. U.S., 51 F.2d 721 (8th Cir. 1931).

2. The I.R.S. may only consider offers in compromise which are based on (a) doubt as to liability, and (b) doubt as to collectibility. The I.R.S. may not consider hardship, sympathetic or appealing facts, or equity as a basis for an offering compromise. Opinions of the Attorney General of the United States, October 24, 1933, and October 2, 1934, O.A.G. 6, 7, XIII-2 C.B. 442, 445.

3. The taxpayer is required to reveal the amount and location of his assets to the I.R.S. on a detailed financial statement. If the I.R.S. rejects the offer in compromise, it may use the financial statement as a "road map" to access the taxpayer's assets.

4. The I.R.S. may ask the taxpayer to enter into a collateral agreement (discussed at C. below) in connection with the offer in compromise.

c. Collateral Agreements.

1. The I.R.S. may, prior to accepting an offer in compromise, require a taxpayer to enter into a collateral agreement. Section 57(10) 11, et seq.

of the Internal Revenue Manual. The purpose of a collateral agreement is to provide the I.R.S. with additional payments out of the taxpayer's future net cash flow.

2. The collateral agreement is often expressed as a percentage of the taxpayer's "annual income." Annual income is generally defined as adjusted gross income increased by bad debt deductions, long term capital losses, net operating losses, and worthless stock deductions. "Annual income" may also include nontaxable income.

d. Trust Fund Taxes.

1. General. Employers are required to withhold social security and income taxes from their employees' wages. Sections 3102 and 3402 of the Code. These amounts are held in trust for the government. Section 7501(a) of the Code. The I.R.S. must credit the employee for withheld taxes even if the employer fails to remit the "trust fund" taxes to the government. See U.S. v. Huckabee Auto Co., 783 F.2d 1546 (11th Cir. 1986). The I.R.S. may collect taxes from responsible persons (e.g., officers of the employer) if the employer fails to remit the withheld taxes. Section 6672 of the Code.

2. Collection from Responsible Persons. When a corporate employer files a petition under Chapter 11 of the Bankruptcy Act, it may propose a plan of repayment for any unpaid taxes over a period not to exceed 6 years. Section 1129 (a)(9)(C) of the Bankruptcy Code. If the plan is approved, the I.R.S. may (1) receive the payments over time, including interest or (2) attempt to collect the trust funds taxes from the responsible persons. There is no requirement that the I.R.S. first attempt to collect from the corporation. It is the I.R.S.'s stated policy to seek collection from responsible persons whenever trust fund taxes cannot be immediately collected from the corporation. I.R.S. Policy Statement P-5-60; Section 1218-157 of the Internal Revenue Manual.

e. 1. Tax Lien on "All Property Rights." As soon as the taxpayer neglects to pay taxes, a lien in favor of the U.S. arises on "all property and rights to property of a taxpayer." I.R.C. ' ' 6321, 6322 and 6331. The tax lien need not be filed to take priority over the taxpayer and most third party claimants. Code of Virginia ' 55-1142.1-9 provides the proper place for filing the tax lien against all forms of property in Virginia. If the lien is validly perfected before the bankruptcy filing, the I.R.S. is entitled to payment as a judgment creditor, not merely as a priority creditor.

2. Discretionary Trust Rule. If, however, the taxpayer has a beneficial interest in a trust that is subject to the trustee's discretion, the tax

collector can reach only what the trustee elects to distribute. First Northwestern Trust Co. v. Internal Revenue Service, 622 F.2d 387 (8th Cir. 1980).

f. In Virginia, tenancy by the entirety property is not subject to an I.R.S. claim or levy upon one spouse. Moore v. Glotzbach, 188 F.Supp. 267 (E.D. Va. 1960). See Estate of Reno v. C.I.R., supra, in IX.A.3., supra.

g. Gifts made before any tax problems arise should not be subject to challenge by the I.R.S. under fraudulent conveyance laws, i.e., Code of Virginia '' 55-80 and 55-81. Section V., supra,

h. The exemptions that may be claimed against creditors generally are not operative against the Government. United States v. Bess, 357 U.S. 51 (1958). I.R.C. ' 6334 sets forth the minimal exemptions permitted. As a result, for example. ERISA plan assets which are exempt under Patterson v. Shumate, supra, from claims of other creditors, are subject to claims from the IRS. ' 6334(c).

i. An I.R.S. levy on a joint bank account for taxes owned by one joint depositor is effective against the entire account because the taxpayer had an unlimited right to withdraw from the account. U.S. v. National Bank of Commerce, 472 U.S. 713 (1985).

J. Regarding life insurance, see Section IX.G.7., supra.

k. Not discharged in bankruptcy are:

X income or gross receipts tax liabilities arising within three years (from the date a return was last due to the date of bankruptcy filing): 3-Year Rule. (Recall that the normal statute of limitations for tax collection is 10 years under I.R.C. ' 6502(a)(1).)

X income or gross receipts tax liabilities assessed within 240 days prior to filing: 240-Day Rule. (This could include tax liabilities arising outside the 3-Year Rule, but such older taxes could be made dischargeable by waiting out the 240-day period before filing for bankruptcy.)

X withholding taxes for which debtor is liable in any capacity.

X tax due when no return has been filed.

X tax due where a fraudulent return has been filed.

X tax liabilities debtor willfully attempted to evade.

See 64, Am. Bankr. L.J. Spring 1990 Issue for an excellent explanation of the ramifications of non-dischargeable taxes in individual bankruptcies. The Bankruptcy Court has jurisdiction under 11 U.S.C. ' 505 to determine tax matters and to adjudicate tax liability unless the liability has been adjudicated by another court of competent jurisdiction. The I.R.S. may not levy under I.R.C. '' 6331 or 6332 during the pendency of a bankruptcy proceeding.

l. In In re Abernathy, 1993 Bankr. LEXIS 238, 93-1 U.S. Tax Cas. (CCH) P. 50108 (Bankr. N.D. Ill. 1993) a U.S. bankruptcy court granted a couple's motion for summary judgment in their request for attorney's fees, finding that the I.R.S. behavior in continuously attempting to collect discharged taxes was outrageous and completely unjustified. The court likened the I.R.S. to a "rogue elephant."

X. BRIEF SUMMARY OF TAX TREATMENT OF A TYPICAL ASSET PROTECTION TRUST

A. Typical Design.

For purposes of this discussion I assume that the typical design of an asset protection trust is an irrevocable discretionary trust established by a U.S. citizen or resident alien settlor in a jurisdiction whose law recognizes Aself-settled@ spendthrift trusts (i.e., for the benefit, inter alia, of the settlor), under and subject to the laws of that jurisdiction, with an institutional trustee which will have authority to make most substantial decisions. (There is an alternative scenario, not infrequently used, especially by non-resident aliens: the offshore bank serves as settlor and trustee. The name of the real settlor and principal beneficiary may appear nowhere in the body of the trust for extreme confidentiality.) The beneficiaries of the trust will include beneficiaries who are citizens of or resident in the U.S., i.e., members of the settlor=s family, including the settlor. (However, in this practice area a U.S. lawyer may be asked by a non-resident alien to establish such a trust, and in this case the trust may be established in a U.S. asset protection jurisdiction or offshore. If such a trust for a non-resident alien is established offshore, there will be no U.S. nexis at all unless trust funds are invested in the U.S. Wealthy foreigners may come to U.S. lawyers simply because the U.S. has a reputation for producing sophisticated, scrupulous trust lawyers. Unless there are U.S. investments such an engagement raises no U.S. tax issues.) The trust will frequently hold its assets in an offshore LLC or corporation owned and controlled by the trust, maybe established in the jurisdiction in which the trust is established. In turn that LLC or corporation will often create subsidiary LLCs to hold assets in any other jurisdiction in which trust assets are located, e.g., London or Zurich, Singapore or Wilmington.

B. Income Tax Treatment.

If the trust is established offshore (AOAPT@ -- offshore asset protection trust), because the trust is designed so that no U.S. court will exercise primary jurisdiction over the administration of the trust, and because U.S. trustees do not have authority to control all substantial decisions of that trust (which are reserved to offshore trustees), the trust will be considered a Aforeign@ trust for U.S. tax purposes. Code Section 7701(a)(30)(E) and (31)(B).

If the foreign trust will have U.S. beneficiaries, under Code ' 679 the trust is treated as a grantor trust. All income is taxed to the grantor.

If the trust is established in the U.S. (ADAPT@ -- domestic asset protection trust) in a jurisdiction which recognizes asset protection trusts, such as Delaware or Alaska, it will normally be designed to be Adefective@ for income tax purposes, i.e., a grantor trust under Code '' 671-678. Here again all income will be taxed currently to the settlor.

C. Tax Reporting Requirements of an Offshore Trust.

The creation and continued existence of an offshore trust must be reported to the IRS on Form 3520 within 2-1/2 months of the end of the first trust tax year (normally by March 15, as grantor trusts share the calendar year of settlors) following --

X the creation of the trust;
X the funding of the trust during settlor=s life or at settlor=s death;
X the death of the settlor;
X the immigration to the U.S. of a person who transferred property to a foreign trust within five years of establishing U.S. residency.

The trust must file an annual return/accounting on Form 3520-A within 3-1/2 months of the end of each trust tax year (normally by April 15).
NOTE: the difference between the dates represents a trap for the unwary, who may assume April 15 is the deadline for both filings.

I really want to emphasize that very substantial penalties are imposed for failure to comply with the tax reporting requirements. NOTE -- this is unusual, even unprecedented in the tax law for large penalties to be imposed without respect to whether tax is due.

D. Estate Tax Treatment.

Because asset protection trusts, domestic and offshore, are typically designed under the estate and gift tax law so that transfers to such trusts will not be completed gifts (the settlor will retain a power, such as the power with the consent of the Protector to name new beneficiaries or a special testamentary power of appointment), assets held in asset protection trusts are typically included in the taxable gross estate of the U.S. settlor at death, and the assets held in the trust at that time will receive a tax-free step up in basis. Therefore, normal U.S. testamentary estate tax planning will be included in an OAPT and DAPT for a U.S. settlor: (1) bypass trust planning to shelter the applicable credit amount; (2) marital deduction planning; and (3) generation-skipping transfer tax (GST) planning. The dispositive provisions effective at the settlor=s death will look like those in a typical revocable trust in the U.S.

E. 2004 Article and June 2007 and 2008 ALI-ABA Programs.

The July 2004 issue of Trusts and Estates contains a helpful article by Alexander A. Bove, Jr., ADrafting Offshore Trusts.@ Also see ALI-ABA=s program materials for the Asset Protection Planning Update, a teleconference broadcast June 26, 2007, which contain a number of relevant and useful articles relating to Domestic and Offshore Asset Protection Trusts, and Duncan Osborne's superb and comprehensive outline on "Planning for Asset Protection" at the ALI-ABA Program on Estate Planning In Depth presented at Madison, Wisconsin June 19, 2008.

SUMMARY

There is no tax Aangle@ when a U.S. citizen or resident establishes a typical asset protection trust. Its income is included in the Settlor=s taxable income; its assets are included in the Settlor=s gross taxable estate. Such a transaction is tax neutral. The 2009 crackdown by the IRS on tax fraud through undisclosed offshore accounts, and particularly the attack on UBS leading to a settlement in which the names of more than 4,000 U.S. taxpayers holding non-compliant accounts in Switzerland are supposed to be disclosed, highlight the increased enforcement of offshore tax fraud that may be anticipated by the Obama administration.

XI. SELECTING A SITUS FOR THE FOREIGN ASSET PROTECTION TRUST -- ISSUES OTHER THAN ASSET PROTECTION

A number of factors must be considered in selecting the situs for a foreign trust, which is frankly more of an art than a science.

A. Developed and Favorable Trust Law.

To belabor the obvious, it is impossible to establish a foreign trust in a nation which does not recognize the concept of a trust, which is a creature of British common law. Most civil law countries -- most countries in which English is not the official language -- do not recognize trusts as legal entities. This includes almost all of South and Central America, non-English speaking Europe, most of Asia and Africa. While some civil law countries have adopted the trust concept by statute, e.g., Liechtenstein which has “issues,” one should not necessarily equate the mere statutory adoption of the common law concept of a trust with the existence of a mature and developed law of trusts. Even if a prospective situs nation has a well-developed law of trusts, it is necessary to examine those aspects of its trust law that may be particularly important to the ease of management and the financial success of a trust with U.S. beneficiaries. Asset preservation issues will be discussed below. Even countries with strong common law ties may differ with respect to their perpetuities and accumulation rules, which may determine the trust's ability to establish a desired sequence of interests or to make the accumulations necessary for the financial success of the trust.

B. Burden of Taxes and Administrative Costs.

It is important to examine the tax burden of the prospective situs jurisdiction of the foreign trust. Of course, no general statement may be made with respect to the taxation of foreign trusts by the many jurisdictions around the world which recognize some version of a trust. For purposes of this section, which emphasizes foreign trusts which are grantor trusts for U.S. income tax purposes and therefore subject to income tax in the U.S., it should be sufficient to observe that the only attractive foreign jurisdictions to U.S. grantors will be the so-called "tax havens" which impose no material taxes on such trusts. In this sense Delaware is a tax haven; it imposes no trust income tax. In examining the local taxes, one should be aware that foreign jurisdiction may impose taxes, such as documentary or stamp taxes, which are unusual from the perspective of the U.S. practitioner. For example, until recently Bermuda imposed a stamp tax at the rate of 1/10 of 1% not to exceed $4,000.00 for any additions to trust principal, which was not insignificant. Normally, such taxes will be relatively nominal.

Typically a U.S. grantor will select an institutional foreign trustee, and the prospective institutional trustee's fees for establishing and maintaining the trust should be reviewed. The Trustee may charge a Aset-up@ fee, pass through legal fees from its outside Counsel to review a draft trust and charge the annual trustee=s fee in advance. If there is an outside investment manager, that fee will be in addition.

Unless U.S. counsel either has experience with drafting documents in the

foreign jurisdiction or is comfortable reviewing, revising and editing sample documents that the foreign fiduciary provides, it may be necessary to incur the costs of engaging local counsel (possibly in addition to paying the bank trustee=s counsel) for assistance on behalf of the U.S. grantor and his counsel.

C. Currency and Controls/U.S. Affiliates.

Careful consideration should always be given to the selection of the currency in which the trust will hold its assets and pay its expenses. Currency stability is important. The adoption of the Aeuro@ as the currency of the European economic community is an additional issue which must be considered. If the trust will have U.S. beneficiaries, consideration must be given to the complicated rules adopted under the Tax Reform Act of 1986 for determining gains and losses on transactions involving foreign currency.

Some countries impose significant restrictions on the investment of U.S. dollars within the country. Other nations may impose restrictions on currency withdrawals, which could limit payments to U.S. beneficiaries or the repatriation of trust assets.

If the trust is established in Europe, e.g. in Gibraltar, the Isle of Man, the Channel Islands of Guernsey or Jersey, or in Liechtenstein, will the investments be denominated in euros rather than in dollars?

Consider also that in 1989, a New York state court froze the account of a European bank at its New York correspondent (Goldman v. Goldman, New York Supreme Court, unreported decision). The foreign bank held an account in the name of a U.S. customer at its foreign headquarters. A third party who had brought a claim against such customer was able to successfully argue that since the customer=s account was denominated in U.S. dollars, the depository bank=s dollar funds held by its New York correspondent should be frozen until they were turned over to the U.S. state court in which the claim against the bank=s customer was pending. Even though the petition for the injunctive order was made on an ex parte basis, and even though the underlying claim had not been reduced to judgment or even tried in court, the New York court granted the request. Because an appeal of the court=s order would have taken several months, the plaintiff, whose claim was later determined in the underlying action to be wholly without merit, was able to achieve the upper hand in negotiating a settlement, and this probably wrong court decision ultimately cost the defendant/depositor millions of dollars.

Though most U.S. lawyers who review this case are in general agreement that the New York court=s action described above was beyond the scope of applicable law and would have been overturned on appeal, this fact would

provide cold comfort to the individual whose assets were improperly frozen. The case is illustrative of the belief of segments of the U.S. judiciary as to the extraterritorial reach of their judicial powers. Thus, the prudent planner would be wise to consider avoiding trustees and depository institutions with U.S. subsidiaries, branches or other affiliates, at least beginning with any point in time that the first hint of Atrouble@ in the form of a potential claim looms on the horizon. As the case described above demonstrates, it may even be prudent to avoid holding deposits in U.S. dollars.

D. Investment Media.

Related to the question of currency is the question of investment media for the foreign trust. On the one hand, the foreign trustee may maintain a general account with a New York institution through which the assets of numerous foreign trusts which it administers may be invested in publicly-traded American securities. (See the author's article, *No U.S. Connections Allowed with an Offshore Trust? Wrong! Use Onshore Contacts*, Journal of Asset Protection, Vol. 1, No. 5, May/June 1996, Exhibit 4) More typically, the offshore trustee may use an intermediary institution to hold assets on its behalf in the U.S., e.g., an offshore corporation and/or a U.S. LLC, e.g., a Bahamian Trust establishes a Bahamian IBC (International Business Corporation) which establishes a subsidiary U.S. LLC. On the other hand, in view of the global approach more and more Americans are taking to securities investment, it might make sense to take advantage of the foreign trustee's experience in foreign securities markets to invest at least some of the trust's assets offshore. In that case the intermediary entity owned by the trust will establish the investment account in London, Zurich, or Honk Kong. Large foreign trust institutions may have more experience in investing in European Community and Pacific Rim securities and exchanges than their American counterparts, and consideration should be given to using that expertise. The grantor may rely on the foreign institutional trustee for investment management, and some such institutions have performance records comparable to the best U.S. trust companies and investment managers. This approach has the additional virtue of providing a non-creditor-avoidance business purpose, which, in turn, will be useful in defeating a fraudulent conveyance claim. Or the grantor may direct or request that the foreign trustee engage the services of a U.S. or offshore investment manager trusted by the grantor for investment choices. The typical offshore institution is very comfortable with either arrangement, and may have a bifurcated fee schedule depending on the scope of responsibilities it will be asked to assume. This is a difficult concept to grasp because the typical U.S. trust company will generally insist on managing the assets. But the growing popularity of open architecture in U.S. trust companies is a step in this direction. Where the client has a need to preserve U.S. real estate from prospective future creditors, the foreign trust may hold title to the property, or more likely hold a 99% limited partnership interest in the property, with the

grantor holding the 1% general partnership interest and thereby retaining management control. Or the foreign trust bank may loan the Settlor the equity in the U.S. real estate, taking a deed of trust or mortgage on the U.S. property. The Settlor will then reinvest the equity removed in the OAPT, perhaps putting the cash right back into the bank trustee in the form of a C.D. issued by the trustee bank held by the trust. Large international financial institutions will be much more comfortable holding in trust only liquid investment assets. It may be difficult to persuade such established institutions to hold such exotic assets as limited partnership interests in partnerships holding U.S. real estate, at least unless it is also holding substantial liquid investment assets. Whenever the foreign trustee is asked to hold exotic or illiquid assets, the trustee=s fees with respect to such assets must be explicitly addressed in advance. Smaller boutique trust companies may be more likely to be willing to hold illiquid interests such as partnerships.

E. Stability/Reputation.

In a world of political, economic and social instability, the stability of the situs nation is an important factor. Consider that Lebanon and Panama were once known as investment havens for their favorable tax and non-tax laws. Today jurisdictions like Bermuda, The Bahamas, the Cayman Islands, Gibraltar, the Isle of Man and Jersey and Guernsey in the Channel Islands exemplify the desired stability. The Cook Islands and Liechtenstein will be seen by some to have a somewhat “shady” reputation.

F. Availability of Competent Trustees.

The financial success of any trust depends in large part upon the competence of the trustee chosen. This may be particularly true in the case of foreign trusts because of the general desire to direct trust investments towards growth at the expense of current income and because of the risk that injudicious actions of a trustee could cause the trust to become a U.S. trust. Obviously consideration should be given to the age and general reputation of the institution in the financial and legal communities, the amount of assets the institution has under management and the institution's historic performance. Coutts & Company, the world=s oldest trust company, Queen Elizabeth=s trust company, was founded in the 1780's. Southpac Trust Company in the Cook Islands has not been around quite that long. Caribbean and other offshore law firms often have their own trust companies and most typically those “captive” trust companies will use outside investment managers. A listing of selected trust companies and trust counsel in seven jurisdictions with asset protection trust statutes is found in Part II of this Outline. Sometimes a large institution, such as Swiss-based HSBC, or France-based SG Hambros, which recently bought 10% of Rockefeller Trust Company in New York City, or Swiss-based EFG Bank, will

have small outposts in jurisdictions known for favorable law regarding asset protection trusts, such as The Cook Islands. The sophistication of the home office may reassure potential customers anxious about the meager local presence.

G. Changing Situs, Governing Law, Institutional Trustee, Force Majeure Clause.

For various reasons, it may become desirable or necessary to change the situs and/or governing law and/or Trustee of a foreign trust -- e.g., to avoid deteriorating political stability or unfavorable legal developments -- by moving it to another country or repatriating it to the U.S. Therefore it is important to avoid being locked into any jurisdiction or governing law (or any trustee for that matter). The possible need for a future change of situs raises a number of tax and non-tax issues that should be considered in drafting the trust instrument and before making any such change. It has been previously noted that civil, economic and political stability should be considered in selecting the initial situs for a foreign trust. However, there is always the possibility that problems may arise in the future that would make the host country an undesirable situs for the trust. This possibility makes it important that the trust be able to alter its situs when necessary. Absent such a provision, known as a force majeure clause when it applies to dramatic unforeseen events such as political revolution or a devastating hurricane wiping out the banking infrastructure, the beneficiaries and trustee would always face the latent threat of unexpected developments such as an attempt to seize trust investments in the wake of civil disturbances.

Beware of the effect of an automatic flight clause under the U.S. tax rules, especially as they apply to non-grantor offshore trusts. Care should be taken to ensure maximum flexibility in the change of jurisdiction/change of trustee clause because of the potentially adverse income tax consequences in the event of an injudicious change in the situs of a foreign trust. The trust instrument should expressly permit a change to another offshore situs for the trust either by the trustee, with or without requiring the trustee's resignation, or by a "trust protector" named in the instrument. The instrument should also permit the trust's situs to be shifted to the U.S., but only if the trustee finds compelling reasons for such a change. The trust instrument might enumerate the factors that should be considered in determining whether to change the situs of the trust.

A trust's transfer to the U.S. may give rise to significant U.S. income, estate and gift tax consequences. Again this issue particularly applies to non-grantor offshore trusts. Generally the tax consequences of repatriation of a foreign trust depend on the form of domestication and how the I.R.S. or the courts view the transaction.

There are three methods for relocating a foreign trust.

(1) The trust can be liquidated, its assets distributed to the beneficiaries, and a new trust established in another jurisdiction.

(2) The trust may establish a subsidiary entity in another jurisdiction and transfer all or some portion of its assets to the subsidiary. This is sometimes accomplished by granting the transferee entity a protective option to acquire the assets of the foreign trust under certain circumstances.

(3) Another trustee may be appointed for the trust in a different country and the administration of the trust shifted to that new country with a wire transfer of title to securities.

Normally the Trust Protector in an asset protection trust is given the authority to –

- change trustees
- change jurisdictions
- change governing law.

H. Consider the Impact of OECD, FATF, FSC on Choice of Jurisdiction.

Anti-tax haven initiatives emanating from the Organization for Economic Cooperation and Development (OECD) and the Financial Action Task Force (FATF) must bear on a practitioner's advice to his client on choice of jurisdiction within which to establish an asset protection trust. Issues relating to the matters may also bear on the practitioner's evaluation of the motive of his client under the "know-your-client" principles that should guide even careful practitioners in this area.

The OECD has identified jurisdictions as "tax-havens" and three are particularly "uncooperative tax havens," Liechtenstein, Andorra and Monaco, and cautious practitioners should be particularly careful about encouraging a client to engage in any kind of banking or trust arrangement in these jurisdictions, not the least because these jurisdictions are red flags in a governmental review or reporting of client accounts.

The FATF seeks to inhibit money laundering, and identifies "Non-Cooperative Countries and Territories" (ANCCTs@) which refuse to comply with its recommended standards. Since its first listing of such countries in 2000 and 2001, when 23 NCCTs were listed, all have through improved practices found themselves removed from the list. Lately the NCCT evaluation process has been dormant, but it could restart.

For some time the FATF has been working on draft "Guidance for Designated Legal Professionals on Implementing a Risk-Based Approach" to anti-money

laundering. The merits review by a practitioner consider about the motivations of clients or prospective clients. Lawyers and accountants and others are characterized in these guidelines as "Gatekeepers."

The FATF in 2006 released a report on the "Misuse of Corporate Vehicles, Including Trust and Company Service Providers" which is worth reviewing by the scrupulous practitioner.

While Senator in 2007, Barack Obama introduced the Stop Tax-Haven Abuse Act, and his Treasury Department has clearly followed up on the initiative with its pursuit of disclosure from and recent settlement with UBS regarding offshore accounts of U.S. taxpayers. It is clear that one way this administration plans to close the huge budget deficit is to crack down on tax avoidance by U.S. taxpayers using offshore trusts, corporations, foundations, etc., and much closer scrutiny of offshore arrangements by American taxpayers may be expected in the future.

The OECD maintains a "grey list" of countries that have committed to meet OECD standards on tax information sharing but have not fully implemented the rules. There is a supposed March 2010 deadline. About thirty (30) countries remain on the list, including Switzerland. Most recently, in August of this year, the British Virgin Islands and Cayman Islands qualified to be removed from "The Grey List."

I. Choose a Jurisdiction Which Really Exists. What about the Dominion of Melchizedek? The Dutchy of Grand Fenwick? Cyber jurisdiction existing only as underwater reefs in the South Pacific? I don=t think so. See article in Exhibit 5, "The Ruse that Roared," by Richard Leiby and James Lileks, reprinted from The Washington Post.

XII. ADVANTAGES OF FOREIGN ASSET PROTECTION TRUSTS OVER U.S. TRUSTS ESTABLISHED UNDER GENERAL U.S. TRUST LAW

A. Advantages Of Foreign Asset Preservation Trusts

(1) Characteristics of Favorable Asset Preservation Jurisdictions.

A person concerned about potential future claims or creditors may arrange to transfer or establish the situs for some of his or her assets in another country, for instance through an asset preservation trust in that jurisdiction. While the location of the assets and the existence of the trust will be discoverable in a creditor collections proceeding or in bankruptcy (unless the grantor is prepared to perjure or expatriate himself or herself -- and under the 2010 tax law changes expatriation has its own tax consequences), a state court in which a judgment is awarded

against the grantor has no jurisdiction to enforce the judgment against assets in another jurisdiction. And while a federal bankruptcy court has national jurisdiction, it cannot enforce its judgments in an overseas jurisdiction. The judgments of U.S. courts will have to be perfected and enforced, if that is possible, in the foreign jurisdiction where the assets are located, which will involve time delay, trouble and expense in the form of local counsel fees, among others. Although a U.S. court may exercise jurisdiction over a U.S. grantor, the grantor, having established an irrevocable discretionary trust with an independent institutional trustee offshore, will be powerless to regain control of the assets which he or she has placed in trust. But see the Anderson and Lawrence cases discussed below.

A favorable foreign asset preservation jurisdiction will have three particular characteristics: (1) it will not recognize or enforce U.S. judgments, or it will be reluctant to; (2) it will countenance spendthrift trusts for the benefit of a grantor; and (3) it will have less stringent fraudulent conveyance laws than the U.S. Elaborate summaries of the laws of ten asset protection jurisdictions -- Bahamas, Bermuda, Cayman Islands, Cook Islands, Guernsey, Jersey, Liechtenstein, Gibraltar, the Isle of Man and Nevis -- and comparisons of their virtues are found in Exhibit A (courtesy of Duncan and Mark Osborne) of this Outline. It is virtually impossible to stay current on the laws of multiple offshore jurisdictions, or even one, because these laws are constantly evolving and changing to seek competitive advantage over rival jurisdictions. So you really need to rely on local counsel for the current state of the law.

To further assist you Exhibit C is a listing of what I understand to be competent and honest and sophisticated lawyers and trust companies in certain offshore jurisdictions.

(a) An Asset Preservation Jurisdiction Does Not Recognize or Enforce U.S. Judgments, or Is Reluctant To.

The courts of many foreign jurisdictions recognize U.S. judgments obtained by U.S. creditors against U.S. debtors and, as a matter of comity, will permit such judgments to be filed, recorded and enforced against assets of the U.S. debtor located in the foreign jurisdiction. In such a jurisdiction the U.S. creditor will not have to prove his case again in the foreign jurisdiction. The only action necessary in such a foreign court is, in effect, a collection action on debt which is deemed by the foreign court to have been

finally established. Assets held by a U.S. debtor in his own name in such a foreign jurisdiction may be seized by the U.S. creditor if it succeeds in the prosecution of the collection action, which should not be difficult. Normally the creditor's biggest problem will be locating the foreign assets, not obtaining the foreign court order to seize them.

Examples of such a jurisdiction are Bermuda, The Bahamas, the Cayman Islands, which recognizes U.S. judgments but requires a local action to enforce them. The creditor will, however, have to raise any claim to the assets in a trust sitused in such jurisdiction in the courts of such jurisdiction. For instance, if the creditor wants the trustee to disburse assets to the creditor, and the trustee refuses -- e.g., because the trust is an irrevocable discretionary spendthrift trust -- or if the creditor argues that assets in the trust were transferred to the trustee in fraud of such creditor's rights, the creditor will have to file suit against the trust or trustee in the court of the host jurisdiction. The host jurisdiction will apply its own trust law -- e.g., regarding the effectiveness of a spendthrift trust held for the benefit of the grantor and the use of a trust protector to delete the grantor from the class of permissible beneficiaries of the trust -- and its own law of fraudulent conveyance and its own burden of proof. But it should be recognized that jurisdictions that theoretically will enforce foreign judgments may in practice be reluctant or slow to do so and reluctant to let foreign creditors successfully attack trusts in their jurisdictions. Judges in the Bahamas want their grandchildren to be trust bankers, not cabana boys and waitresses.

In certain other jurisdictions, like Cook Islands, Nevis and Colorado, the local courts by law will <u>not</u> recognize foreign judgments in general, so that a judgment obtained in a U.S. court against a U.S. debtor has no legal consequence in such jurisdictions. In such jurisdictions there would have to be two legal proceedings, one to prove the Settlor of the trust had a liability to the creditor, and a second to prove that the transfer to the trust was a fraud on the creditor under local law, so that the creditor should have access to trust assets to satisfy the liability. If the U.S. debtor (or a trust established by the debtor) has assets in the foreign jurisdiction which the U.S. creditor wants to attach, the creditor must bring the entire principal case <u>de</u> <u>novo</u> in the

courts of the foreign jurisdiction. In other words, the creditor must engage local counsel, file suit on the merits, bring evidence and witnesses to the foreign jurisdiction, and deal with the procedural rules and substantive laws of the foreign jurisdiction, for instance as to causes of action and burden of proof, possibly deal with a foreign language and unfamiliar legal system, which may make it much more difficult to obtain the desired judgment against the debtor than it was or would have been in the U.S. This burden is in addition to whatever further problems the creditor will have in collecting on the judgment against assets in the foreign jurisdiction in the event he is able to obtain a favorable judgment from the foreign court on his underlying theory of claim.

Bringing the cause of action in a foreign jurisdiction obviously presents a daunting financial burden. In addition to other difficulties, there may be language barriers, concern over hostile judicial attitudes to foreign plaintiffs, and an exotic -- i.e., non common law -- legal system. For example, the Channel Islands, Jersey and Guernsey, to some extent recognize "Norman" law, which is observed nowhere else in the world. Liechtenstein is a civil law jurisdiction with statutory trust law written in a foreign language. In the Caribbean, a judge may be inclined to discourage foreign litigants by his desire that his descendants may have the opportunity to be international bankers rather than waiters, black jack dealers or lifeguards.

Needless to say, the intimidating burden of having to bring a cause of action de novo in a foreign jurisdiction may give the debtor much greater leverage in dealing with the creditor to avoid the claim altogether or compromise the claim favorably.

Examples:

Bermuda, The Bahamas, Cayman Islands. While Bermuda, The Bahamas and Cayman Islands are hospitable to asset preservation trusts in that they recognize spendthrift trusts for the benefit of the grantor and have Asset Preservation Trust ("APT") laws which impose less strict fraudulent conveyance standards than the U.S., these jurisdictions do recognize and will enforce U.S. judgments.

Cook Islands, Nevis, Barbados, Belize, Liechtenstein and Colorado. These jurisdictions do not recognize or enforce foreign judgments at all. While it is frequently promoted by Isle of Man financial professionals that their jurisdiction will not recognize or enforce foreign judgments, it appears that there is no clear authority on point. See commentary on that jurisdiction in Part II of this Outline.

(b) An Asset Preservation Jurisdiction Countenances Spendthrift Trusts for the Benefit of the Grantor.

Some foreign jurisdictions, including virtually all English common law jurisdictions other than the U.S., permit a grantor to establish a spendthrift trust for a class of beneficiaries including the grantor which is immune from claims of the grantor=s future creditors. The formerly universal public policy of the United States -- Alaska, Delaware, Rhode Island, Utah, Oklahoma, Missouri, Nevada and South Dakota are now exceptions -- supported by statutory and case law, is that a grantor may not establish a revocable or irrevocable trust of which he is a permissible beneficiary which is effective to insulate the trust assets from the grantor/beneficiary's creditors. In Virginia, for example, with respect to whose law I will allude because it is typical of most U.S. jurisdictions, a transfer by a grantor to a "spendthrift" trust of which he is a possible beneficiary is void vis-a-vis his existing creditors. Code of Va. ' 55-19 B. and C.

(i) General U.S. Law/Virginia Law

Putting aside for the moment the states which have adopted asset protection statutes in the last few years, including Delaware and Alaska, whose laws are discussed below, the general rule in the U.S. (and we will examine Virginia's law in some detail as an example of typical state law) if a grantor is a permissible beneficiary of a trust he created, is that his creditors may reach the maximum amount the trust could pay to him or apply for his benefit. Restatement (Second) of Trusts, ' 156(2). This is true even though the trustee in the exercise of his

discretion wishes to pay nothing to the grantor or his creditors and even though the grantor could not compel the trustee to pay him anything. Vanderbilt Credit Corp. v. Chase Manhattan Bank, 100 A.2d 544 (1984). See also Virginia Code ' ' 55-19 A. and C. The same rule should apply if the grantor procured the creation of a trust for himself, e.g., by creating reciprocal trusts with a family member. Bogert, The Law of Trusts and Trustees, ' 223 (1979). Similarly, creditors may reach trust assets which are subject to a general power of appointment created by the donor in favor of himself. Restatement (Second) of Property, Donative Transfers, ' 13.3. (1984). Because it is against public policy to allow a grantor to create an interest for his own benefit in his own property that cannot be reached by his own creditors, it is immaterial whether there is intent to defraud creditors or not. Petty v. Moores Brook Sanitarium, 10 Va. 815, 67 S.E. 355 (1910); In re O'Brien, 50 Bankr. 67 (Bankr. E.D. Va. 1985). See generally Scott and Fratcher, The Law of Trusts, ' 156 (4th ed. 1987).

Under earlier case law courts generally would not automatically require a grantor of a revocable trust for the benefit of persons other than the grantor to revoke it for the benefit of his creditors or treat the grantor as the owner of such a revocable trust so his creditors could reach it. Scott, The Law of Trusts, ' 330.12 (3rd ed. 1967). But some recent cases have recognized the rights of the grantor's creditors to reach trust assets following the grantor's death where the grantor held a right of revocation at death. See State Street Bank & Trust Co. v. Reiser, 389 N.E. 2d 768 (Mass. App. Ct. 1979). And the trend in the law may be to permit the grantor's creditors to assert rights against revocable trusts during the grantor's life on the theory that a power of revocation is a form of general power of appointment. Restatement (Second) of Property, Donative Transfers, ' 11.1 comment C. (1984).

For the same public policy reasons, if the grantor of an irrevocable spendthrift trust is also a

beneficiary of that trust, it is ineffective to insulate the trust assets from the grantor/beneficiary's creditors. Where a grantor having current creditors makes a transfer to a spendthrift trust of which he is either sole beneficiary or one of several beneficiaries, the transfer is void. Virginia Code ' 55-19 B. and C.

If the grantor of an irrevocable trust is a beneficiary of the trust, his creditors may reach any amount required to be paid to or for the benefit of the grantor as well as the maximum amount the trustee, in the exercise of discretion, could pay to or for the benefit of the grantor. On the other hand, if the grantor's rights as beneficiary are clearly secondary and inferior to those of other beneficiaries, and the trustee has no current discretionary authority to distribute to or for the grantor's benefit, it is possible that courts will not permit post-transfer creditors of the grantor to assail the trust. Of course, such a creditor could obtain any trust assets actually distributed to the grantor.

(ii) Foreign Law

In contrast to the general rule in the United States, some foreign jurisdictions permit a grantor to establish a spendthrift trust for his own benefit which is immune from claims of his creditors. Properly drawn, such a foreign trust may qualify as a U.S. trust for U.S. tax purposes, as a grantor trust, but as a foreign trust for other legal purposes.

Foreign Jurisdictions With Favorable Asset Protection Trust Legislation: Anguilla, Antigua, Bahamas, Barbados, Belize, Bermuda, Cayman Islands, Cook Islands, Cyprus, Gibraltar, Labuan, Marshall Islands, Mauritius, Nevis, Niue, St. Vincent, St. Lucia, Seychelles, Turks and Caicos Islands. These jurisdictions recognize the validity of irrevocable spendthrift trusts of which the grantor is a beneficiary as a shield from creditors of the grantor who did not exist and were not contemplated when the trust was established. The Channel Islands (Jersey & Guernsey) and the Isle of Man have statutes that

permit self-settled spendthrift trusts, and are sometimes used, but they do not have elaborate asset protection trust statutes.

(c) An Asset Preservation Jurisdiction Has Less Stringent Fraudulent Conveyance Law

(i) U.S. Law/Virginia Law of Fraudulent Conveyance

See IV. supra.

(ii) Foreign Law of Fraudulent Conveyance. Modern fraudulent conveyance laws in English common law jurisdictions, including Virginia, have their origin in 16th Century England, in the Statute of 13 Elizabeth (13 Elizabeth. Ch. 5 (1571)). Most common law jurisdictions have adopted either the Statute of Elizabeth or the concepts embodied therein. However, while virtually all foreign jurisdictions (even non-common law) recognize the concept of fraudulent conveyances as against public policy and to some extent susceptible to nullification, the general British common law view of fraudulent conveyance is broader than the U.S. view, is that a conveyance may be set aside even if it defrauds only potential future creditors. (This serves as a counterpoint to permitting spendthrift trusts for the grantor.) See Re Butterworth (1882) 19 Ch.D. and Cadogan v. Cadogan (1977) All E.R. 200. However, a number of small island jurisdictions take a more narrow view of what is a fraudulent conveyance than do U.S. jurisdictions and use certain objective tests to cut off rights of certain parties alleging fraudulent conveyance. These jurisdictions have adopted since 1989 asset protection trust statutes.

For example, the law of the Bahamas permits allegedly defrauded creditors to assail a trust for only two years after the trust's creation. U.S. statutes of limitation are generally longer than those in offshore asset protection trust jurisdictions. It will normally take a creditor more than two years to find out the debtor has put any money in a Bahamian trust. The laws of the Cook Islands in the South Pacific (near New

Zealand) and Nevis in the Caribbean permit creditors to allege fraudulent conveyance, but impose a criminal burden of proof -- beyond a reasonable doubt (prosecutors of O.J. Simpson for Nicole Simpson's murder could not meet this burden)-- on the creditors to show that the trust was funded or established with principal intent to defraud that creditor and that the establishment of or disposition to the trust made the settlor insolvent or without property by which that creditor=s claim (if successful) could have been satisfied. Nevis also requires every creditor initiating proceedings against a trust to deposit a $25,000 bond with the Ministry of Finance. Nevis law prohibits contingency fees and requires all legal proceedings to be undertaken by counsel licensed in Nevis. Nevis law is virtually identical to Cook Islands law. Interestingly SouthPac, one of the best known Cook Islands Trust Companies, also has a Nevis trust license and will serve as trustee of a Nevis trust, and the fees are cheaper than for a Cook Islands trust. And Nevis is not on any Awatch@ lists. Gibraltar has adopted legislation encouraging asset preservation trusts of which the grantor may be a beneficiary, and permits no challenge after recordation of the fact of the trust by creditors alleged to have been defrauded so long as the grantor who established the trust was not insolvent immediately after the transfer to the trust.

Asset preservation trusts, whereby the grantor irrevocably transfers assets to an independent fiduciary under the laws of the foreign jurisdiction, may be particularly immune from creditor claims of fraudulent conveyance. Foreign jurisdictions seek to establish a hospitable environment for asset protection trusts with U.S. and other foreign-domiciled grantors by enacting specific Asset Preservation Trust ("APT") legislation, the principal precepts of which may include:

1. allowance of recovery by a creditor only if the creditor's obligation existed at or before the time of the grantor's absolute disposition in trust;

2. creation of a malicious intent (to defeat

creditors) test with respect to the debtor grantor;

3. elimination of the void ab initio concept with respect to the insolvent grantor's trust in favor of a voidable concept;

4. preservation of the rights of trustees and non-collusive beneficiaries to costs and benefits enjoyed in advance of a set-aside; provided, in the case of the trustee, that it acted prudently in establishing the solvency of the grantor; and

5. limitation of any set-aside to the amount of the debtor's disposition necessary to satisfy the obligation of the petitioning creditor.

In 1989 the Cook Islands adopted the world's first APT Statute. While it was apparently drafted by John McFadzien, then of SouthPac Trust (now practicing law on his own in the Cook Islands), many people believe (although Mr. McFadzien firmly denies it) with the assistance of or encouragement by Barry Engel, a prominent attorney of Colorado, specializing in offshore asset protection planning whom many credit with Ainventing@ this practice in the U.S. (Incidentally, at one time a substantial portion of Barry Engel=s firm=s practice evolved into helping creditors attack offshore arrangements and eventually Ron Rudman left his firm, presumably recognizing the impossible conflict, to establish his own law firm specializing in representing creditors attack offshore trust arrangements.) Since the Cook Islands first exploited the growing market for asset preservation spurred by the impact of U.S. recession and the U. S. tort award explosion, a number of foreign jurisdictions have adopted statutory schemes particularly tailored for asset preservation. Some are rather broad, others rather narrow. There are now more than 60 offshore jurisdictions which have adopted some sort of asset protection trust statute.

Examples: Cayman Islands, Bahamas, Bermuda, Gibraltar, Turks and Caicos Islands, Belize, Cyprus, Labuan, Nevis and Mauritius.

Numerous other jurisdictions are considering such legislation.

SUMMARY: The evaluation of the attractiveness of a situs as an asset preservation jurisdiction must take into account not only the existence of the three factors discussed above and whether, and to what extent, the jurisdiction has asset preservation trust legislation. One must also consider the general factors which make an offshore jurisdiction an attractive trust situs discussed in Section II. above. For instance, the Channel Islands, Jersey and Guernsey, have many general virtues as a situs for an asset protection trust, but the Channel

Islands do not have an asset protection trust statute. Perhaps perversely, some practitioners like to establish asset protection trusts in the Channel Islands for just that reason. If challenged, they are in a position to argue that they had no intent to defraud creditors, and as proof of their clean heart note that they could have established the trust in a jurisdiction with an asset protection trust statute, but chose not to. And specific consideration must be given to the type of liability sought to be avoided and the contemplated means of avoidance.

A February 6, 2006 article in the Wall Street Journal highlighted Singapore=s almost overnight move into the stratosphere of offshore tax and trust havens, now being Credit Suisse=s largest private banking center after Switzerland. Singapore serves as a tax haven for both Europeans fleeing the stricter tax regimes imposed by the EU and Asia=s booming economy and demand for private banking services. In December 2004 Singapore adopted new trust laws permitting the avoidance of forced heirship regimes in other countries, such as EU jurisdictions. By 2004 over $50 billion was held in Singapore Trusts. See ASwiss Fight Against Tax Cheats Aids Singapore=s Banking Quest.@

Choose the jurisdiction considering the type of creditor sought to be avoided. For example, if avoidance of a forced heirship statute in the domiciliary jurisdiction is the motive, and assets are to be moved offshore for sophisticated management, Barbados, Bermuda or Jersey may be suitable. If the creditor to be avoided is a malpractice plaintiff and the asset to be preserved is a U.S. office building, the best strategy may be to put the office building into a U.S. family limited partnership with the grantor/debtor being a one percent (1%) general partner with management authority and a Cook Islands Trust having the ninety-nine percent (99%) limited partnership interest. Or pledge the U.S. real estate as collateral for a loan from the offshore bank trustee, and invest the borrowed capital in the offshore trust. An entrepreneur who has sold a business and has no current liabilities but wishes to protect himself from a "buyer's

regret" lawsuit may want to put the proceeds of sale into a Bahamian or Gibraltar Trust.

Characteristics of the asset protection trust statutes of 10 offshore jurisdictions – Bahamas, Bermuda, Cayman Islands, Cook Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Liechtenstein and Nevis – are summarized in detail in Exhibit A to this outline, which was prepared by Duncan E. Osborne and Mark E. Osborne and published as part of their handout for the program for ALI-ABA of April 26, 2010 in New York City, “Asset Protection: Trust Planning.” and is published with their consent. The full outline is available from ALI-ABA. The author of this outline gratefully expresses his appreciation to them for permitting him to use these materials.

Please see also AAsset Protection and Jurisdiction Selection.@ by Duncan E. Osborne, 33rd Heckerline Institute on Estate Planning.

To reiterate, the selection of the “right” offshore jurisdiction in which to establish an asset protection trust in a given set of circumstances is an art, not a science. In practice, US professionals typically get comfortable with two or three jurisdictions, perhaps with different virtues, with their laws, their lawyers, their banks and trust companies, and use and re-use those jurisdictions, lawyers and banks, over and over. This pattern of usage is subject, however, to the point made above: the need to vary the jurisdiction based on the type of creditor being avoided.

NOTE: An Isle of Man lawyer predicted at a June 2009 conference that no more that twelve (12) offshore international financial centers will survive the current crackdown by the OECD and European and American governments. He predicted many weaker offshore jurisdictions may not survive as viable financial centers. So pick a jurisdiction you believe is strong enough to survive. The current economic crisis has empowered wealthy nations to accuse tax haven jurisdictions of undermining global financial transparency and stability (notwithstanding any evidence of a casual connection).

B. <u>How a Settlor Retains Elements of Control Over a Foreign Asset Protection Trust</u>.

Common sense tells us that no settlor of an offshore trust is going to completely give up control of that trust and the property in it. There are two principal mechanisms whereby the settlor maintains “control” over assets in an offshore asset protection trust.

(1) <u>Letter of Wishes</u>.

The Settlor or the Settlor=s attorney will typically give the trustee of the Foreign asset protection trust a non-binding precatory letter of wishes

which might crudely be paraphrased as follows:

ADear Trustee:

While of course the trust which I have established is irrevocable and may not be amended or revoked by me, and recognizing, of course, that you have complete unfettered discretion to accumulate or distribute income or principal from time to time, and if you distribute it, you may or may not distribute any to me, nevertheless I thought you might find it helpful if I expressed to you in writing some thoughts I had on how you might administer the trust. Of course, my suggestions are precatory only, as you may do as you wish.

a. Under no circumstances should you give a dollar to any alleged creditor of mine;
b. If I do not have creditor problems, please give me whatever I want when I ask;
c. If I have creditor problems, give me nothing, but provide for me and my family and pay our expenses.
d. I may send you a new letter of wishes from time to time.@

An example of an actual Letter of Wishes is attached as Exhibit 6. Alexander A. Bove, Jr. recently authored a useful article, “The Letter of Wishes: Can We Influence Discretion in Discretionary Trusts?” published in the ACTEC Journal Volume 35, No. 1, Summer 2009.

To Americans and American lawyers obsessed with enforceable contract rights, reliance on a precatory letter of wishes seems “loosey-goosey,” but offshore bankers have a strong tradition of scrupulously honoring letters of wishes and their business is built on trust that they will do so.

(2) Trust Protector.

The Settlor will typically appoint in the document a trust protector with absolute authority to change trustees, change jurisdictions, and change governing trust law. Bluntly, if the trustee does not do what the Settlor wants, e.g., if the trustee fails to follow the letter of wishes, the Settlor will whisper in the protector=s ear, and, lo and behold, a new trustee will be appointed. If a creditor claim arises in the U.S., it is probably best if the Protector is not in the U.S. so the trust should contain a mechanism to replace the U.S. Protector and appoint one offshore in the event a U.S. claim looms on the horizon.

(3) Family Limited Partnership (AFLP@) of Which Settlor is

Managing Partner.

The Settlor may establish a FLP (or FLLP or FLLC) to hold assets, retaining the 1% managing general partner=s interest and all authority over the partnership and conveying to the foreign asset protection trust the 99% limited partnership interest. The Settlor then may convey to the FLP real estate, tangibles, cash, securities, etc.

If creditor problems loom on the horizon, the Settlor may first of all have normal creditor protection benefits of a partnership under U.S. law, i.e., a creditor=s only remedy is a charging order, creditor gets partnership K-1 for partnership income interests with respect to which he has a charging order. As a second alternative, the Settlor as general partner will have authority to liquidate the FLP, leaving himself with a 1% interest in partnership assets as tenant in common with the foreign asset protection trust, which holds the other 99% interest in what had formerly been partnership assets as tenant in common. The portable assets representing 99% of what were formerly partnership assets may then be moved offshore into the direct control of the foreign Trustee. The Settlor may also resign in favor of a third party as managing general partner.

(4) Retained Powers Authorized by Statute.

As noted below, Delaware and Alaska law expressly authorize certain powers to be retained by the Settlor without risk of forfeiting the asset protection features of the trust. Similarly, certain foreign jurisdictions expressly sanctioning foreign asset protection trusts authorize the Settlor to retain certain powers. For instance, Cook Islands law provides that a Settlor of an asset protection trust may retain (a) power to revoke, (b) power to appoint, (c) power to amend, (d) power to retain a beneficial interest, (e) power to remove or appoint trustees and trust protectors, (f) power to direct a trustee or protector on any matter.

(5) Domestic Trustee and Foreign Trustee.

One model has a U.S. Trustee, typically a non-beneficiary individual, family member, friend or attorney, as Co-Trustee with a Foreign Trustee, typically an institution, presumably on the assumption that the U.S. Settlor would appoint someone as U.S. Trustee over whom he felt he or she had more influence. However, the tax issues raised by having a U.S. Co-Trustee and the authority of the U.S. Co-Trustee must be carefully considered.

(6) (a) Selection of Cooperative Trustee/Trust Protector.

Typically in an OAPT the U.S. Settlor appoints a party he completely trusts, not infrequently his attorney, as Trust Protector with power to discharge a trustee, move the trust to another jurisdiction, and hire a new trustee and adjust the law of the new jurisdiction as the governing law of the trust. If trouble looms in the horizon for the Settlor in the U.S., the Trust Protector should be outside of the U.S.

See Exhibit 4, *No U.S. Connections Allowed With An Offshore Trust? Wrong! Use Onshore Contacts*, by Frederick J. Tansill.

(b) For further control, the settlor may require the trustee to use an investment manager/asset custodial known to and trusted by the settlor.

(7) Tension Between Protection and Control.

It is worth recalling the truism of asset protection planning: the more control a Settlor retains, the more vulnerable is the trust to the Settlor=s creditors. This principle resonates through all of the Abad@ cases cited below.

C. Multiple Structures.

To further discourage potential future creditors, multiple foreign asset protection trusts may be established with different, more and less safe structures, in different jurisdictions with different laws, with different trustees. AHot@ liability attracting assets -- Lear Jets, office buildings -- may be segregated from each other and from liquid investment assets. Trusts may hold as Asubsidiaries@ corporations, LLCs and partnerships established under the same or different laws than the trust.

XIII. COMPARISON OF FOREIGN ASSET PROTECTION TRUST TO TRUSTS ESTABLISHED UNDER DELAWARE OR ALASKA OR SIMILAR U.S. ASSET PROTECTION STATUTE

Recent legislation in Alaska and Delaware (1997) and, more recently, in Rhode Island and Nevada (1999), Utah and Oklahoma (effective 2004), Missouri and South Dakota (effective 2005), Wyoming (effective July 1, 2007) and Tennessee (effective July 1, 2007), and New Hampshire (2008) has modified two common law rules, the Statute of Elizabeth (regarding fraudulent conveyance) and the Rule Against Perpetuities. Undoubtedly more states are coming.

The author recommends David Shaftel's article in 34 ACTEC Journal 293 (2009) "Comparison of the Twelve Domestic Asset Protection Statutes Updated Through November 2008."

NOTE: With eleven of the fifty states (Sheflet counts one state – Colorado –

which other commentators do not) having passed trust statutes encouraging the protection of assets from prospective future creditors, it would seem to this author that public policy in the U.S. has shifted, at least slightly, in favor of debtor defendants, who might expect a more sympathetic hearing from judges than before this trend started in 1997. The author understands that an 11th State has adopted a DAPT Statute effective 1/1/09, and the trend will likely continue.

This trend should also cause lawyers who at one time believed that asset protection planning was “shady” to ask themselves this question: If 11 state legislatures and governors representing all areas of the country have effectively encouraged asset protection planning, how shady can it be? More than 20% of the states have officially sanctioned asset protection planning as appropriate public policy.

As previously noted, the Statute of Elizabeth (regarding fraudulent conveyance) is the source of modern fraudulent conveyance rules, and under the rule a creditor of a settlor of a trust may reach the trust property to the maximum extent that the trustee may distribute such property to the settlor. Most states limit the term of a trust so that it cannot continue to exist beyond 21 years after the death of the last individual in a designated class living at the inception of the trust.

The Alaska Law, effective April 2, 1997, is found in Alaska Statutes ''13.12.205(2)(A); 13.36.035(a)(c); 13.36.045(a)(2); 13.36.310; 13.36.390; 34.27.050(a)(3); 34.40.010.

The Delaware law, effective July 1, 1997, is found in Del. Code, Title 12, ''3570-3576, amended to repeal '3573(b) retroactively, and Title 25, '503(a). The current State of Delaware=s asset protection trust statute is summarized and analyzed in detail in Part II hereof. Delaware=s legislative history states that the aim of the statute is to Amaintain Delaware=s role as the most favored jurisdiction for the establishment of trusts.@ Delaware=s law has been amended (and improved) almost annually to address areas of concern which have arisen based on experience with the statute.

A very helpful recent article appeared in 30 ACTEC Journal 10 (2004) by David G. Shaftel, an Alaska practitioner, entitled ADomestic Asset Protection Trusts: Key Issues and Answers.@ According to Mr. Shaftel=s article a recent informal poll of the five jurisdictions disclosed that same 1,250 domestic asset protection trusts (DAPTs) have been established since 1997, 681 in Alaska, 400 in Delaware, 150 in Nevada. About 2/3 of the Alaska DAPTs were designed for both asset protection planning and transfer tax minimization purposes, whereas in Delaware apparently 5/6 were designed for asset protection only. The full results of this survey and much more interesting and relevant information is found in the outline AEverything You Always Wanted to Know About Domestic Asset Protection Trusts But Could Never Find Out@ at the 38th University of Miami Institute on Estate Planning (January 2004). The Shaftel article

deals very helpfully with such issues as the following:

1. How can a creditor attack a DAPT?
2. Will full faith and credit be given to a judgment entered by a non-DAPT court?
3. Does either Section 2036 or 2038 apply to include a DAPT in the Settlor=s gross estate?
4. Why don=t we have more legal authority on domestic asset protection trust tax and asset protection issues?

One purpose of these 11 relatively new domestic statutes is to provide creditor protection for certain self-settled spendthrift trusts that permit purely discretionary income and principal distributions to the settlor.

Characteristics of the laws of all 11 U.S. jurisdictions are summarized in detail in Exhibit B to this outline, which was prepared by Duncan E. Osborne and Mark E. Osborne and published as part of their handout for the program for ALI-ABA of April 26, 2010 in New York City, "Asset Protection: Trust Planning" and is published with consent. The full outline is available from ALI-ABA. The author of this outline gratefully expresses his appreciation to them for permitting him to use these materials.

Wilmington Trust publishes an annually updated book, the latest Delaware Trust 2010 by Richard Nenno which is subtitled "Asset Protection: Domestic and International Law and Tactics," which also appears as a chapter in Duncan Osborne's and Elizabeth Schurig's treatise Asset Protection: Domestic and International Law and Tactics published by West, probably the best treatise in the asset protection area.

A. Irrevocable Trusts.

Both statutes apply only to irrevocable trusts.

B. Retained Powers.

Both statutes provide that certain powers retained by the settlor will not cause the trust to be deemed revocable, including:

(1) a settlor=s power to veto a distribution from the trust

(2) a testamentary special power of appointment or similar power

(3) a settlor=s potential or actual receipt of a distribution of income, principal or both in the sole discretion of a trustee who is neither the settlor nor a related or subordinate party within the meaning of I.R.C. ' 672(a) (in the case of the Delaware statute) or in the discretion of a trustee who is someone other than the settlor (in the case of the Alaska statute).

(4) Alaska permits the Settlor to retain the rights (a) to income distributions of charitable remainder trusts in the DAPT, (b) to receive distributions from a GRAT or GRUT in the DAPT, (c) the right to use real estate held in a QPRT, (d) an interest in an IRA.

C. Specific Incorporation of State Law.

Both statutes require a trust instrument to expressly incorporate the relevant state law to govern the trust=s validity, construction and administration.

D. Spendthrift/Anti-Alienation Provision.

Both statutes require a trust instrument to contain a spendthrift or anti-alienation provision.

E. Resident Trustee.

Both statutes require a resident trustee, either a natural person resident in the state or a bank or trust company authorized to act as a trustee in the state.

F. Administrative Activities in State.

Both statutes require that certain administrative activities be performed in the relevant state including:

(1) custody of some or all trust assets

(2) maintenance of trust records on an exclusive basis

(3) preparation or arrangement for preparation of fiduciary income tax returns; and

(4) other material participation in the administration of the trust.

G. Exceptions to Creditor Protection.

Both statutes generally prohibit legal actions against trust property that is subject to the statutes, with several exceptions.

(1) Fraudulent Conveyances. The asset protection trust statutes do not override the state=s fraudulent

conveyance statutes. Alaska=s law has recently been amended to provide that a transfer may be set aside if the transfer has been proven to have been motivated by the intent to defraud a current or contemplated creditor, but it will NOT be sufficient to prove intent to hinder or delay, which are considered equivalent in general fraudulent conveyance statutes. Delaware law provides that the burden of proving fraudulent conveyance in connection with a Delaware asset protection trust is clear and convincing evidence.

As to pre-transfer creditors, actions must be brought within the <u>later</u> of (a) 4 years after the transfer was made, or (b) one year after the transfer is or <u>reasonably</u> <u>could</u> <u>have</u> <u>been</u> <u>discovered</u> by the creditor.

As to post-transfer creditors, actions must be brought within 4 years after the transfer in trust is made.

(Nevada has the shortest statute of limitations -- two years after the transfer or, if later, 6 months after transfer reasonably should have been discovered. If the claim arose after the transfer, the two-year limit is absolute. As in Delaware, in Wyoming the creditor must prove fraud by clear and convincing evidence.)

(2) <u>Child Support Claims</u>. The Alaska (and Utah) statute provides that trust assets will not be protected from child support claims if, at the time of the transfer, the settlor was in default by 30 days or more in making child support payments, but otherwise such a trust can avoid child support claims that arise in the future, a surprising public policy for a “family values” state such as Utah?

The Delaware (and Rhode Island) statute also provides that trust assets will not be protected against child support claims, with
no express requirement comparable to the Alaska/Utah requirement that the transferor be delinquent in payments at the time of the
transfer. (Nevada has no spendthrift trust
exception for child support.)

(3) <u>Spousal Claims</u>. The Delaware (and Rhode Island and Utah) statute excepts marital property divisions or

distributions from protection, again with no express limitation to outstanding divisions or distributions at the time of the transfer to the trust. Alaska (and Nevada) has no exception for spousal claims, but the surviving spouse's statutory right to elect against Settlor's Will might apply in Alaska to DAPT assets.

(4) Tort claims from Injuries Occurring On or Before the Date of Transfer to the Trust.
The Delaware statute does not insulate trust property from a person who suffers tort injuries (death, personal injury, or property damage) on or before the date of the transfer to the trust, in cases where the injury or damage is caused in whole or in part by an act or omission of the transferor or by someone for whom transferor is or was vicariously liable.

The Alaska statute does not have a comparable provision.

(5) Claims Arising from Reliance Upon the Settlor=s Written Representation that Trust Assets Were Available to Satisfy Claims.
In original form, the Delaware statute provided that its creditor protection should not apply to any creditor who became a creditor of the settlor in reliance upon an express written statement that the trust property remained the settlor=s property following the transfer and was available to satisfy any debt of the settlor to the creditor. As discussed below, this provision raised potential transfer tax problems. It has been repealed in a bill signed by Delaware Governor Carper on March 30, 1998.

The Alaska statute does not have a comparable provision.

NOTE: As with an offshore asset protection trust, pick your state in which to establish a DAPT based on the type of creditor and claim you are worried about.

H. Jurisdictional Issues.

The Alaska statute provides that for trusts qualifying for the statute=s protections, Alaska courts will have exclusive jurisdiction over and will apply Alaska law in proceedings regarding the internal affairs of trusts.

The Delaware statute provides that for trusts qualifying for the statute=s

protections, no action can be brought to attach or otherwise reach trust property, and that Delaware will not enforce other state=s judgments on such actions.

I. Transfer Tax Issues.

(1) Completed Gift: Whether a settlor makes a completed gift in funding a trust of which the settlor is a beneficiary depends upon: (i) the extent of the settlor=s retained interest in the trust; and (ii) the extent to which the settlor=s creditors can reach the trust property.

Purely discretionary interest in trust. If the settlor=s only interest or power under a trust is to receive purely discretionary distributions of income or principal from a third party trustee, then the settlor=s gift to the trust will be complete. Treas. Reg. '25.2511-2(b).

Creditor access to trust. To the extent the settlor=s creditors can reach the trust assets because of the settlor=s retained interest, then the gift will be incomplete.

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

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

Because under the common law rule of many states, as restated in the Restatement (Second) of Trusts '156(2), a settlor=s creditors can reach trust property to the maximum extent that the trustees may distribute the property to the settlor, a settlor in those states will be deemed to have rights to the property within the meaning of I.R.C. '2511. See Outwin v. Commissioner, 76 T.C. 153(1981) and Paolozzi v. Commissioner, 23 T.C. 182(1954). This would be the result in Virginia by virtue of the law cited above.

(2) Removal of Assets from Estate.

(a) Avenues for Estate Inclusion.

1. I.R.C. '2036. I.R.C. '2036(a)(1) provides that a transferor=s gross estate includes the value of any transferred property over which the transferor retained the right to possession, enjoyment or income for life or for a period not ascertainable without reference to the transferor=s death. Does the discretionary power of a trustee to distribute income to the grantor create a potential rationale for the IRS to argue for including the assets of a Delaware or Alaska Trust in the grantor=s taxable estate? Professor Jeffrey Pennell argues maybe yes. (Pennell, 2 Estate Planning, ''7.3.4.2 and 7.345 (Aspen 2003)) Mal Moore, on the other hand, argues that Athe proponents of non-inclusion have the better part of the argument.@ (AComments on Alaska/Delaware Trusts,@ Malcolm A. Moore, ALI-ABA Video Law Program, May 20, 1998.) Dick Covey is reported to agree with Mal Moore=s position.

2. I.R.C.'2038. I.R.C. '2038(a)(1) provides that a transferor=s gross estate includes the value of any transferred property over which the transferor, at the time of his death, had a power (in any capacity) to change the enjoyment, through a power to alter, amend, revoke or terminate.

(b) Cases and Rulings. A number of cases and rulings have been cited for the proposition that the transferred assets may be removed from the estate for estate tax purposes. See, e.g., Estate of German v. United States, 85-1 U.S.T.C. (CCH) &13,610 (Ct.Cl. 1985); Estate of Paxton v. Commissioner, 86 T.C. 785 (1986); Estate of Wells v. Commissioner, 42 T.C.M. (CCH) 1305 (1981); Estate of Skinner v. United States, 316 F.2d 517 (3d Cir. 1963); Estate of Uhl v. Commissioner, 241 F.2d 867 (7th Cir. 1957);

Private Letter Ruling 9332006; Private Letter Ruling 8829030; Technical Advice Memorandum 8213004; Private Letter Ruling 8037116; Private Letter Ruling 7833062.

(c) Facts and Circumstances. Many of the above cited cases are clear in outcome if not always in reasoning. The courts looked at all facts and circumstances surrounding the creation and administration of the trusts. Facts and circumstances helpful to the desired estate tax result (exclusion of the trust assets from the estate) include: the absence of any pre-arrangement that all trust income be paid to the settlor; the absence in fact of payment of all trust income to settlor; the failure of the settlor to place all of his or her assets in the trust; and the reporting of the creation of the trust as a gift for gift tax purposes.

(d) Delaware Statute. The Delaware statute in its original form had a fatal transfer tax defect. Because Section 3572(b) originally allowed the transferor to make the transferred property subject to the claims of the transferor=s creditors by means of an express written statement to that effect, this would appear to have prevented a completed gift and triggered includability under I.R.C. '2038(a)(1), as it would amount to a retained right to indirectly terminate the trust by giving creditors recourse to it for payment of claims. This problematic section has been repealed retroactive to the effective date of the Act.

David Shaftel in the article cited above in the ACTEC Journal has a helpful analysis of the transfer tax issues.

J. The Enforceability of Foreign Judgments.

(1) Jurisdiction of Out-of-State Courts.

(a) The Issue. Despite Alaska=s statutory announcement of exclusive jurisdiction over self-settled spendthrift trusts created under its statute, and despite Delaware=s statutory prohibition against actions attaching assets in self-settled spendthrift trusts created under its statute, can a non-Alaska or non-Delaware court obtain jurisdiction over the trust and decide the validity of the spendthrift provisions? For a thorough analysis of this and related jurisdictional issues, see Cannon, *The New Self-Settled Trust Statutes*, California Trusts and Estates Quarterly, Vol. 3, Number 4

(Winter 1997) and Giordani and Osborne, *Will the Alaska Trusts Work?* Journal of Asset Protection (September/October 1997).

(b) The Authorities.

1. Statutory extra-territorial impact. A state statute that purports to have extra-territorial impact outside of that state may not be effective to prevent another state from deciding a matter in which that state has an interest. See generally Thomas v. Washington Gas Light Co., 448 U.S. 261 (1980); Alaska Packers Association v. Industrial Accident Commissioner of California, 294 U.S. 532 (1935); Tennessee Coal, Iron & Railroad Co. v. George, 233 U.S. 354 (1914). Hence, it is unclear that either the Alaska statute, which purports to give Alaska exclusive jurisdiction over trusts created under its statute, or the Delaware statute, which prohibits actions to attach or otherwise reach the property of a trust created under its statute, is effective to prevent another state from ruling on the validity of the trust spendthrift provisions when that other state has an interest in the trust and a basis for jurisdiction over the trust.

2. Jurisdictional bases for non-Alaska or non-Delaware forum courts over Alaska or Delaware trusts.

   (i) The due process clause of the 14th Amendment to the U.S. Constitution in general requires a forum court to have either personal jurisdiction over the trustee of the trust or in rem jurisdiction over the trust assets. See Hanson v. Denkla, 357 U.S. 235 (1958).

   (ii) Presumably, so long as a trust has exclusively Alaska or Delaware trustees, those trustees have no contacts in the forum state, and all of the trust assets are held in Alaska or Delaware, a non-Alaska or non-Delaware forum state would fail to have jurisdiction over the trust. A national corporate trustee with offices in many states may effectively be subject to the jurisdiction of the courts of each of those states.

   (iii) Note that a forum court that could legitimately exercise jurisdiction may decline to do so, either because the forum is not convenient or because the court does not want to interfere with the courts of

another state.

(2) Conflicts of Laws.

(a) The issue: can a non-Alaska or non-Delaware forum court which has jurisdiction over the settlor of an Alaska or Delaware self-settled spendthrift trust created under one of these statutes, apply the law of the forum state rather than that of Delaware or Alaska? Consider In re Brooks, 1998 Bkrptcy, LEXIS 60, 1998 WL 30018 (B. Conn. 1998) discussed infra at XV under Conflict of Laws Issues.

(b) The Authorities.

1. As a general rule, a settlor of an inter vivos trust may create a spendthrift trust in another state and take advantage of that state=s spendthrift trust laws. See Fratcher, Scott on Trusts '626 (1989) and Restatement (Second) of Conflict of Laws '273(b) (1971).

2. Note that the common law underlying the Scott and Restatement authority likely dealt with non-self-settled spendthrift trusts, as most states traditionally did not permit self-settled spendthrift trusts.

3. In at least one case, In re Portnoy, 201 B.R. 685(S.D.N.Y. 1996), a U.S. court has ignored the foreign law (Jersey) incorporated into an offshore self-settled asset protection trust and instead applied New York law.

NOTE: There are dark clouds over DAPTS – There is no case law on critical Constitutional issues. However, with 11 states having such statutes and more on the way, full faith and credit and conflict of laws challenges are less likely in the future.

(3) Full Faith and Credit.

(a) The issue: if a non-Alaska or non-Delaware forum court which has jurisdiction over an Alaska or Delaware trust created under one of the statutes applies the forum state=s own law and finds the spendthrift provisions invalid, must Alaska or Delaware recognize that judgment?

(b) The Authority.

1. The full faith and credit clause of Article IV of the U.S. Constitution requires that each state give full faith and credit to the judicial proceedings of every other state.

2. However, whether assets are exempt from the claims of creditors is determined by the law of the state where the assets are located. See Restatement (Second) of conflict of Laws '132 (1971). Therefore, when a creditor asks an Alaska or Delaware court to enforce a sister state judgment against the trust assets, the Alaska or Delaware court would use Alaska=s or Delaware=s exemption laws.

3. Note that in theory an Alaska or Delaware court could, under general conflicts of laws principles, decide that a sister state has a greater interest in the trust and apply that state=s law, but query how likely this is given the clear legislative purposes of these statutes.

(4) ”Supremacy Clause” Concerns.

Under the U.S. Constitution’s Supremacy Clause, in Article VI, Section 2, federal courts are not bound by state laws. Accordingly there is a risk that if a judgment creditor is able to obtain jurisdiction over a judgment debtor or the debtor’s assets in a DAPT by virtue of federal question jurisdiction or diversity jurisdiction, the creditor will have the opportunity to avoid the debtor-friendly provisions of the DAPT laws. The harsh provisions of the new federal bankruptcy laws discussed in K.(1)(a)(2) below are a particular threat to DAPTs.

(5) ”Contract Clause” Concerns.

The Constitution prohibits states from enacting any law that impairs the obligation of contracts (in Article I, Section 10), and this clause was particularly intended to prevent states from enacting extensive debtor relief laws.

(6) Sham or Alter Ego.

A court outside the DAPT venue could invalidate the DAPT on the grounds that it is a “sham” or the “alter ego” of the Settlor, under legal precedents for such attacks.

K. Advantages and Disadvantages of Offshore Trusts Versus Alaska or Delaware Trusts.

(1) Advantages of Offshore Trusts.

(a) Legal.

1. Absence of full faith and credit. Some foreign jurisdictions will not honor judgments of United States courts, thereby forcing a creditor to relitigate its claims in the offshore jurisdiction. In contrast, Alaska and Delaware are required by the full faith and credit clause of Article IV of the U.S. Constitution to honor valid judgments of other states.

2. Shorter statutes of limitations for fraudulent conveyances. Some foreign jurisdictions have statutes of limitations for fraudulent conveyances of two years or less. In contrast, the Alaska and Delaware (and Utah and Rhode Island) statutes do not disturb the four year statutes of limitations for fraudulent conveyances generally applicable in those states. The Nevada statute of limitations is two years. And generally these states have a Adiscovery exception@ which allows a creditor to assert a fraudulent transfer attack after the expiration of the general statute of limitations for attacks Awithin one year (six months in Nevada) after the transfer was or could reasonably have been discovered by the claimant.@ But Alaska in 2003 adopted a statute that should curtail this exception and more certainly cut off claims four years after the transfer.

NOTE: As noted supra in VI. J., the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (P.L. 109-8) ("BAPCPA") substantially amended the Bankruptcy Code. Relevant to state asset protection trust statutes, the new Bankruptcy Act gives the bankruptcy trustees a 10 year look-back period in connection with alleged fraudulent transfers to self-settled trusts and Aother similar devices.@ Accordingly, whatever statute of limitation period Delaware, Alaska and other U.S. asset protection trusts jurisdictions adopt to limit challenges to the trust, the federal government has preempted state law with a federal 10-year statute of limitations. This development certainly damages U.S. APTs in a comparative analysis vis a vis offshore APTs, because U.S. courts would have to enforce the federal

limit, while offshore courts might not.

Again, as noted supra at VI. J., Senator Schumer proposed an amendment to this Bankruptcy Act which would have imposed a limit of $125,000 on transfers to offshore or domestic asset protection trusts, but Senator Hatch of Utah, whose state has a new asset protection statute, opposed the amendment and it was defeated. This was a positive development for APTs, but especially for OAPTs.

3. Child support claims may not be avoided under certain circumstances in Delaware or Alaska, and spousal claims and certain tort claims may not be avoided in Delaware.

(b) Practical. A creditor=s practical difficulties in both discovering the existence of a trust and its underlying assets and instituting legal proceedings against it are far greater with offshore trusts than with Alaska or Delaware trusts.

(2) Disadvantages of Offshore Trusts.

(a) Concerns about economic stability of the selected jurisdiction.

(b) Concerns about political security of the selected jurisdiction.

(c) Substantial IRS-mandated reporting requirements for foreign trusts with U.S. beneficiaries.

(d) Cost vs. Benefit – It is probably not worth establishing an OAPT to hold less than $1-$2 million. The set-up and maintenance fees will be too expensive.

L. Potential Uses for Alaska or Delaware Self-Settled Spendthrift Trusts.

(1) Encourage Lifetime Gifting Programs. Although the transfer tax benefits of lifetime gifting programs are well documented, even very wealthy individuals may be reluctant to part with assets in the face of uncertain future needs. If it is possible for a donor to create an irrevocable trust, make a completed gift to the trust for gift and estate tax purposes, and nevertheless retain the possibility of receiving distributions from an independent trustee at the trustee=s discretion in the event of financial need -- and this tax issue is not free from doubt -- this may help motivate the donor to make additional gifts in a more traditional fashion. If the donor becomes comfortable with the idea that this trust could be a safety

net in the event of financial need, the donor may be less reluctant to make additional gifts for traditional estate planning purposes. If such a result becomes confirmed in tax law, Delaware and Alaska would have a very powerful attraction in offering the possibility of (a) transferring property out of the grantor=s taxable estate, (b) while retaining the grantor as a discretionary beneficiary, (c) while protecting the assets from the grantor=s creditors.

(2) Possible Coupling with Traditional Irrevocable Trusts. The statutes may prove useful not only with perpetual dynasty trusts but also with, for example, Crummey trusts, grantor retained annuity trusts after the annuity interest expires or charitable lead trusts after the charitable interest ends.

(3) Possible Legitimate Protection from Certain Future Creditors. Because the statutes permit a trust to be irrevocable but not necessarily a completed gift for gift tax purposes (when, for example, the settlor retains a limited testamentary power of appointment), these trusts could be used as asset protection vehicles apart from estate planning vehicles, subject to the general U.S. asset protection limitations discussed above. An individual seeking professional investment management may see a benefit to hiring a Delaware or Alaska corporate fiduciary to manage assets as trustee of an irrevocable trust, and obtaining possible protection from future creditors that would be unavailable were the individual=s account managed outside of those states which have adopted DAPT statutes.

(4) Perpetual Duration. The fact that trusts may be established in Delaware and Alaska for perpetual duration offers an opportunity that even most offshore jurisdictions do not afford.

(5) For Foreigners. See page 11 and the article by Mark Holden cited there.

(6) If in Trouble, Move to Host State of OAPT. If a debtor in trouble has used a U.S. asset protection trust, he might consider moving to the state of trust situs in hopes of receiving a more sympathetic hearing from local judges.

M. Continuing Evolution of U.S. Asset Protection Statutes. It must be said that with the continuing evolution of DAPTs, each year new states adopting DAPT statutes more aggressively pro-debtor than those which have gone before and with older statutes constantly evolving to be more pro-debtor, more serious consideration should be given to DAPTs, particularly where offshore trusts are for whatever reason not to be considered. But the almost total lack of case law on the efficacy of DAPTs continues to discourage reliance on them where OAPTs may be used.

XIV. IS IT WISE FOR THE FOREIGN ASSET PROTECTION TRUST TO HAVE U.S. CONTACTS?

See Exhibit 4 attached, the author=s article from the Journal of Asset Protection, May/June 1996, ANo U.S. Connections Allowed With an Offshore Trust? Wrong! Use Onshore Contacts.@

XV. HOW CREDITORS ATTACK FOREIGN ASSET PROTECTION TRUSTS AND THOSE WHO ESTABLISH THEM: HOW TO PROTECT AGAINST SUCH ATTACKS

As a preliminary matter keep in mind Gideon Rothschild=s reassuring words in the June 16, 2005 ALI-ABA Program: AThere never has been a successful seizure of assets held in an offshore asset protection trust.@ So far as the author is aware, that statement continues to be accurate.

U.S. creditors and U.S. courts are not without recourse when it comes to attacking offshore trusts and those who create, or seek to create, them. Interestingly, Ron Rudman, who with his partner in the law firm of Engel and Rudman invented the U.S. law practice of offshore asset protection trusts when they were involved with the drafting of the first such statute for the Cook Islands in 1989, later separated his practice from Engel and concentrated his practice on the representation of creditors seeking to recover assets offshore. He admitted that his livelihood depends on clients and lawyers who try to do effective offshore asset protection trust planning but either do not know how to or fail to attend to all details.

The following are some instructive case citations with brief comments. Notice that almost every celebrated case in this area reflects a combination of bad facts and terrible lawyering.

U.S. v. Matthewson, 93-1 U.S.T.C., CCH & 50, 152, wherein the court injunctively restrained the defendant from leaving the U.S., in effect holding him under Ahouse arrest@ in the U.S. to keep him from moving himself and his assets to the Caymans. He owed $5 million in back taxes to the I.R.S. The Court upheld a writ of Ne Exeat Republica, which Latin scholars will recognize as a writ to detain a resident from leaving the U.S. to enable the Government to have discovery, both on issues of liability and with respect to the location, value and legal status of taxpayer property.

Securities and Exchange Commission v. Giuseppe B. Tone, et al. and Certain Purchasers of the Common Stock of St. Joe Minerals, 638 F. Supp. 596 (S.D.N.Y. 1986), aff=d 638 F. Supp. 629 (2d Cir. 1987), and S.E.C. v. Certain Unknown Purchasers of Common Stock of Santa Fe Resources, Fed. Sec. L. Rep. (CCH) p. 99, 424 (1983), and S.E.C. v. French, et al., 817 F.2d 1018 (2d Cir. 1987). These are

related cases wherein a federal judge ordered that all accounts held by a Swiss bank in the U.S. be frozen pending disclosure of information from the Swiss bank. The judge also ordered substantial daily fines pending disclosure of the information.

S.E.C. v. Levine, 1986 U.S. Dist. LEXIS 24576; Hercules Incorporated v. Leu Trust and Banking Limited, a Bahamian Corporation, and Bank Leu, a Swiss Corporation, 611 A.2d 476 (Del. 1992); and Litton Industries, Inc. V. Dennis Levine, et al., 767 F. Supp. 1220 (S.D.N.Y. 1991). American authorities were able to persuade the American branch of a Swiss bank parent corporation to provide information on Mr. Levine=s large bank account with a Bahamian subsidiary of the Swiss bank, notwithstanding Bahamian bank secrecy law.

U.S. v. Bank of Nova Scotia, 740 F.2d 817 (11th Cir. 1984). The Miami branch of the Bank of Nova Scotia suffered daily fines of $25,000 pending receipt of information from the Bahamian branch of the same bank. The Miami branch cooperated.

Orange Grove, in the High Court of the Cook Islands. In this case in which Barry Engel characterized the decision as an example of Abad facts make bad law,@ creditors obtained a California judgment against a debtor and made an application in the Cook Islands for a Mareva Injunction (which is like a Temporary Restraining Order in the U.S.) to restrain parties from removing the administration of the trust and any property from the jurisdiction of the Cook Islands. The Court granted a temporary Mareva Injunction. The initial Mareva Injunction was set aside as not having been brought timely. On appeal the Mareva Injunction was reinstated and the creditors were permitted to proceed against the international trust. The Court made a controversial ruling on when the creditors= cause of action accrued for purposes of determining the statute of limitation, after which, a Cook Islands trust cannot be assailed.

The creditors were still left with the burden of proving beyond a reasonable doubt that the trust was created with intent to defraud them.

The funding of the trust left the settlors insolvent.

Barry Engel pledged to amend Cook Islands law to clarify the issue which he believed the Court misconstrued, but I am not sure whether that has ever happened.

Brown v. Higashi, U.S. Bankr. Court for the District of Alaska, No. 95-3072 (1996). The bankrupt had set up an offshore trust in Belize. The case considered whether the assets in the offshore trust were included in the debtor=s bankruptcy estate. The Court concluded that the trust was a sham, and the assets of the trust were found to be part of the bankrupt=s estate. This was another case with very bad facts for the bankrupt.

In re Portnoy, 201 Bankr. 685, 1996 Bankr. LEXIS 1392. The debtor Portnoy

transferred virtually all of his assets into an irrevocable offshore trust in Jersey at a time when he knew his personal guaranty was about to be called. The party to whom the guaranty was given brought a New York lawsuit against Portnoy. Portnoy was the Aprincipal beneficiary@ of the trust. The Court cited numerous occasions on which Portnoy and his wife were not truthful or credible in their dealings with creditors and the Court. These facts were viewed by the Court as being indicia that Portnoy was intentionally attempting to hinder and delay his creditors. The Court denied his discharge in bankruptcy. There is no indication that the creditors ever pursued the assets in Jersey.

Grupo Torras, S.A. v. S.F.M. Al-Sabh, Chemical Bank & Trust (Bahamas) and Private Trust Corp., (Sawyer, J.) (Sup. Ct. of the Bahamas, Sept. 1, 1995). Kuwaiti Sheikh Fahad obtained assets through illegal means and then transferred those assets to Bahamian trusts. Creditors sought to set aside the transfers to these trusts. The Court emphasized that the protections to a settlor made available through the use of Bahamian trusts would not apply to assets that the settlor did not legitimately own at the time of the transfer to trust.

In a recent outline on Ainternational asset recovery@ Ronald L. Rudman makes the following observation:

AIn cases involving claims brought against American settlors or debtors, there may be no necessity to resort to foreign courts in the event the planner and settlor have selected a major international bank as the trustee of the trust or the depository for trust assets. This is due to the increasingly extraterritorial reach of the U.S. courts. A growing body of law in the United States now clearly provides that a foreign parent or affiliate of a bank or other entity operating within the U.S. must disclose any information in its possession outside of the United States, pursuant to a U.S. court proceeding, even if such disclosure would constitute a criminal violation of the confidentiality or other laws of the foreign parent or affiliate=s domicile. This is true even though the domestic U.S. entity is not even a party to the subject litigation. This trend creates the potential for extension to the compulsion of further acts, beyond the mere disclosures of information.@

He cites Societe Nationale Industrielle Aerospatiale v. U.S. District Court, 482 U.S. 522, 107 S. Ct. 2542 (1987), United States v. First National City Bank, 379 U.S. 378 (1965), United States v. Vetco, 691 F.[2d] 1281 (9th Cir. 1981), and Richmark v. Timber Falling Consultants, 959 F.[2d] 1476, in addition to United States v. Bank of Nova Scotia, cited above.

Conflict of Laws Issues.

Offshore trusts denominate the law of the trust=s domicile as governing the interpretation and administration of the trust. Such a provision may not be given effect

by courts of other jurisdictions, or even courts of the trust=s domicile, with respect to issues relating to the funding of the trust, particularly where fraudulent conveyance is alleged. The Hague Convention dealing with the recognition of foreign trusts treats the funding of the trust as a preliminary matter outside the scope of the Convention and therefore a matter of local law.

In the U.S., courts hearing a creditor claim will apply public policy tests to apply the law least offensive to U.S. public policy, which will invariably be U.S. law. In Dearing v. McKinnon Dash & Hardware Co., 165 N.Y. 78, 58 N.E. 773 (1900), the New York court stated:

AJudicial comity does not require us to enforce any clause of the [trust] instrument, which even if valid under the lex domicili, conflicts with the policy of our state relating to property within its borders, or impairs the rights or remedies of domestic creditors ...@

In a very recent case, In re Brooks, 1998 Bkrptcy., LEXIS 60, 1998 WL 35018 (C. Conn. 1998), the Connecticut bankruptcy court held that certain assets transferred by the debtor to his wife, which she in turn transferred to offshore trusts, naming the debtor as the beneficiary, were property of the debtor=s bankruptcy estate. In 1990, in an alleged estate planning exercise, debtor transferred corporate stock certificates to his wife who, within days, transferred them to offshore trusts in Jersey (Channel Islands) and Bermuda. The trusts designated Jersey and Bermuda law as controlling, contained spendthrift clauses and named the debtor sole beneficiary. In 1991 an involuntary Chapter 7 bankruptcy petition was filed against debtor, which was converted to a Chapter 11.

The court concluded that the trusts were self-settled by the debtor. The court dismissed the ideas that the wife settled the trusts and that they were motivated by estate planning considerations, not asset protection. The wife was viewed as debtor=s agent in a scheme to protect the assets from creditors but leave the debtor with the income.

Importantly, the court determined the enforceability of the spendthrift provision under Connecticut law and found that Connecticut law did not acknowledge the validity of self-settled spendthrift trusts. Should the court have applied Jersey and Bermuda law, which recognize self-settled spendthrift trusts? Would a Connecticut court take a similar view of Delaware or Alaska self-settled spendthrift trusts? Were the facts just too bad?

One may not even assume the law of the situs of real estate will govern where fraudulent conveyance is alleged. In James v. Powell, 19 N.Y. 2d 249, 225 N.E. 2d 741 (1967) a New York court warned that

Aif, in exploring the law of Puerto Rico [regarding the transfer of land

> situated in Puerto Rico], it were to be found that it was specifically designed to thwart public policy of other states ... by denying a remedy to all judgment creditors ... in order to attract foreign investment in real estate, the courts of this State would be privileged to apply the law of New York rather than that of Puerto Rico.@

As noted above in citing In re Portnoy, the bankruptcy courts will apply a similar standard. In Hong Kong and Shanghai Banking Corp., Ltd. v. HFH USA Corp., 805 F. Supp 133 at 140 (W.D.N.Y. 1992), a Federal District Court applied the law most favorable to the creditor, remarking that a choice of law provision Awill not be regarded where it would operate to the detriment of strangers to the agreement, such as creditors or lienholders.@ See also Broadcasting Rights Int=l Corp. V. Societe du Tour de France, 675 F. Supp. 1439 (S.D.N.Y. 1987), Carlson v. Tandy Computer Leasing, 803 F.[2d] 391 (8th Cir. 1986) and Ferrari v. Barclays Business Credit (In re Morse Tool, Inc.), 108 B.R. 384 (Bankr. D. Mass. 1989).

The Anderson Case and Its Progeny.

Federal Trade Commission v. Affordable Media, LLC, and Denyse and Michael Anderson, 179 Fd 1228 (9th Cir., 1999) (commonly referred to as the AAnderson@ case), is a very important case for the lawyer practicing in the area of asset protection planning and the client considering implementing an asset protection strategy.

In 1995 Mr. and Mrs. Anderson established an irrevocable Cook Islands trust, with Asiaciti Trust Limited as the foreign situs trustee. The original beneficiaries of the trust were their children, but some six months after establishing the trust the Andersons were added as beneficiaries. This was their first major mistake. The Andersons initially served as co-trustee and as trust protector. This was their second major mistake. The trust contained Aevent of duress provisions.@ According to the General Manager of Asiaciti Trust, it conducted Aits usual due diligence procedures to ensure that the property being settled on the trust was neither the result of a fraudulent conveyance nor derived from any illegal activity.@ (See Anderson Case - The Offshore Trustee=s Perspective, by Adrian L. Taylor, Esq., in the May/June 2000 issue of the Journal of Asset Protection, hereinafter cited as AMr. Taylor=s article.@

The property settled in the trust included a nominal amount of cash and a 98% interest in a U.S. corporation, The Anderson Family LLC (Anderson LLC). Anderson LLC carried on business in the U.S. as a telemarketer. From 1995 through May 1997 Anderson LLC made regular distributions to the trust in accordance with the operating agreement.

Sometime after April 1997, two years after the Cook Islands trust was created, Mr. and Mrs. Anderson became involved in a telemarketing venture that offered

investors the Aopportunity@ to invest in $5,000 Amedia units,@ each of which consisted of 201 commercials to be aired on late night television. Investors were to receive a share of each product sold as a consequence of the commercials composing their media units, and extraordinary returns were described. In fact, the investments were simply a Ponzi scheme. According to the FTC, in its enforcement action brought in April of 1998, investors lost some $13 million and the Andersons pocketed $6.3 million in commissions. Further distributions to the Cook Islands Trust were made by Anderson LLC from June 1997 to February 1998 and it is these later distributions that the FCC challenged, for in April 1998 the FTC obtained an ex parte temporary restraining order (TRO) against the Andersons. The TRO had the effect of freezing all assets owned by the Andersons and required the Andersons to repatriate to the U.S. all assets held by them outside of the U.S. A federal district court incorporated the terms of the TRO into a preliminary injunction in May 1998, prior to any judgment in regard to the alleged wrongdoing against the Andersons, and through the end of 1999, according to Mr. Taylor=s article, no judgment had been entered against the Andersons.

The Andersons faxed the TRO/Preliminary Injunction to Asiaciti Trust demanding repatriation as required. In May 1998 Asiaciti Trust, on advice of counsel, refused because --

X the TRO constituted AduressA under the terms of the trust;

X under the trust duress automatically triggered removal of the Andersons as trustees, leaving Asiaciti Trust the sole trust;

X because the Andersons= children were also beneficiaries, Asiaciti refused to disburse, viewing its responsibilities as running impartially to all beneficiaries. The District Court ordered the incarceration of the Andersons for civil contempt in June, 1998, rejecting their defense of impossibility of performance. The Andersons appealed, and their appeal from the finding of civil contempt was the issue before the 9th Circuit. The Court of Appeals affirmed the District Court.

The Court of Appeals described three issues for its review of the contempt finding: 1) it reviewed the civil contempt order for abuse of discretion; 2) it reviewed the trial court=s findings of fact for clear error; and 3) it reviewed the trial court=s rejection of an impossibility defense proffered by the Andersons for clear error. The third issue was pivotal and the Court of Appeals held that the defendants had not satisfied their burden of proving the affirmative defense.

The court cited precedent that stated that the party claiming impossibility as a defense to civil contempt must show Acategorically and in detail@ the nature of the alleged impossibility. The appellate court cited the fact that the Andersons were

protectors of their own trust, standing alone, as an appropriate basis for a finding that they had not satisfied their burden of proof, and the West Publishing key number system cites the case under ATrusts key number 153" for the proposition that AA protector of an offshore trust can be compelled to exercise control over the trust to repatriate assets if the protector=s powers are not drafted solely as the negative powers to veto trustee decisions or if the protector=s powers are not subject to the anti-duress provisions of the trust.@ But the court=s holding extends beyond that relatively narrow issue of drafting.

The court held that in the asset protection context, the burden of proof for the party asserting the impossibility defense is Aparticularly high,@ at least in part because of what the court characterized as a Alikelihood@ that any attempted compliance with court orders will be a mere charade. Together, the requirement that impossibility be proved Acategorically and in detail@ and the Aparticularly high@ burden of proof give a trial court considerable latitude in which to reject the impossibility defense. Because of the limited ability of parties to appeal a trial court=s finding of fact, assuming the trial court applied the correct standard, beneficiaries of offshore protection trusts may have considerable difficulty in avoiding contempt, at least in the 9th Circuit, even if the trust avoids the particular drafting pitfalls present in the Anderson case.

Although arguably *dicta*, the Court of Appeals expressed Askepticism@ that a rational person would send millions of dollars overseas and retain absolutely no control over the assets, and it cited the fact that the Andersons were able to obtain approximately $1 million to pay taxes as evidence that they retained some measure of control.

In *dicta*, the court went considerably further and speculated that a Aself-induced@ impossibility might not be a defense at all. Although it left that Amore difficult question@ for another day, because it was able to dispose of the appeal on the grounds that the defendants had not met their burden of proof, the court suggested that it would not regard such self-induced impossibility to be a defense. Obviously, such a finding would vitiate one of the key defense strategies touted for offshore asset protection planning.

Three points should be noted. First, the fact that the Andersons established their offshore asset protection trust approximately two years before the conduct that gave rise to the claim against them and the fact that the court does not mention any evidence suggesting that the creation of the trust otherwise made them insolvent indicates that conventional fraudulent conveyance theory played <u>no</u> part, explicit or implicit, in the outcome. Second, building on the court=s analysis regarding payment by the trust of the Andersons= tax liability, so long as the judgment creditor could show evidence of payments for the benefit of the judgment debtor after the event of duress, it would seem that a trial court could always find evidence tending to refute the affirmative defense of impossibility that would justify a finding that the proponent of the defense failed to meet

his burden of proof. Thirdly, it was a mistake for the Andersons (or anyone under their control) to serve as Trustee or Protector, and it gave a bad flavor to the facts that the Andersons themselves were added as beneficiaries after the trust was executed.

Subsequently the Andersons were released from jail on the condition that they would appoint a new trustee and new protector of the Cook Islands trust. They attempted to do so. However, the Cook Islands High Court refused to recognize the Anderson=s appointed -- and FTC-controlled -- trustee and protector. (See Butterworths International Trust and Estate Law Reports at 2 ITELR 482.) The Court=s rejection of the new trustee was mandatory under the terms of the trust documents. The High Court determined that the FTC was an Aexcluded person@ and therefore its nominee was also. Undoubtedly at least in part because of the High Court decision in the Cook Islands, and upon motion of the FTC, the preliminary injunction was amended to keep funds under the control of the foreign court except for the payment of legal fees and administrative costs. Additionally, the registrar of the High Court of the Cook Islands was made a signatory on the trust account.

The FTC also initiated proceedings in the Cook Islands, but ruling that the statute of limitations under Cook Islands law had expired, the FTC was denied recourse and assessed costs. The FTC appealed again, and High Court in the Cook Islands in December of 2001, following English common law, refused to enforce what it considered a Apenal@ law of the U.S., which was the basis of a monetary judgment against Settlors for false representations and deceptive practices under the FTC Act. Interestingly, the Court cited two U.S. cases in support. It is understood that a settlement has recently been reached in the Anderson case for $4 million.

Summary

Although the procedural posture of the Anderson case somewhat limits the actual holding, both the District Court and the Court of Appeals demonstrated considerable antipathy to offshore asset protection planning. In its holding, the court stated that the burden of proof to assert impossibility as a defense to civil contempt is Aparticularly high@ in asset protection cases and found that the defendants failed to meet it. In dicta, the court challenges the fundamental premises of asset protection planning by suggesting that an impossibility defense to a charge of civil contempt (for failure to repatriate assets held overseas) may be unavailable when the alleged impossibility is Aself-induced,@ and the court=s opinion expresses skepticism generally about allegations of impossibility.

Cases Subsequent to Anderson.

Two cases in 2000 purportedly follow Anderson--one in the 8th Circuit and one in the 11th. Chicago Truck Drivers Union Pension Fund v. Brotherhood Labor Leasing, 207 F.3d 500 (8th Cir. 2000) cites Anderson for the proposition that a party asserting an

inability to comply with a court order as a defense to civil contempt must show (1) Acategorically and in detail@ the nature of the inability and (2) the inability must not be self-induced. The court cited a line of cases from 1991 and earlier for the second proposition, e.g., In Re Power Recovery Systems, Inc., 950 F.2d 768 (1st Cir. 1991), at 803. Chicago Truck Drivers Union is not an asset protection planning case; rather the judgment debtor was basically arguing that he could not pay because he spent all the money.

The second case in 2000 citing Anderson is an asset protection planning case. In In Re Lawrence, 238 B.R. 498 (U.S. Bankruptcy Ct., S.D. Florida 1999) the debtor failed to comply with a ATurnover Order@ entered by the court and the Trustee sought civil contempt. Much like the Anderson case, the trust -- in this case a Mauritian Trust -- appears to have been inartfully drafted, and the debtor was apparently as bad a witness as it is possible to imagine, so the case is not one that the asset protection planning bar would choose to showcase. The court characterized Mr. Lawrence=s sworn testimony as Ashockingly less than candid.@ That said, the court found that the debtor failed to carry his burden of proof regarding impossibility and it expressly based its finding on the entire record, including the court=s refusal to believe that the debtor would give up control over 90% of his liquid assets to a stranger on the far side of the earth. The court cites Anderson for the Aparticularly high@ burden of proof in such cases and Pesaplastic, C.A. v. Cincinnati Milacron Co., 799 F.2d 1510 (11th Cir. 1986) for the proposition that impossibility is not recognized when the impossibility is self created. ***The court appears to hold as a matter of law that impossibility is unavailable because the trust was the debtor=s own, voluntary creation. Lawrence, at 501.*** In this case the court hammered the debtor--$10,000/day fine (beginning immediately) and incarceration in approximately two weeks if he did not turn the money over. Unlike Anderson, the bankruptcy context does not appear to leave any question as to the substantive merits of the underlying Aturnover order.@ Mr. Lawrence=s most obvious problem with the Court was that the Court concluded that he systematically and shamelessly lied throughout the proceedings. So far as the author has been able to determine, there has been no recovery of assets by creditors from Mr. Lawrence=s Trust in Mauritius. However, Mr. Lawrence apparently spent at least 27 months in jail for contempt, and may still be there. See Lawrence v. Goldberg, 279 F.3rd 1294 (11th Cir. 2002).

The July 2004 issue of Trusts & Estates contained a very interesting article by Wendy Davis on AAsset Protection=s Bad Boy,@ who is this Stephen Jay Lawrence. He has been in jail for contempt of court in a bankruptcy case because of planning he did involving a Mauritius asset protection trust he created and funded with $7 million in 1991, Bear Sterns obtaining a $20 million judgment against him in 1991. Lawrence battled against the judgment until 1997 when he filed for bankruptcy. In 1993 he had amended the trust to add a Aduress@ clause, directing the Trustee to ignore all instruction from him made under coercion, including Afrom a process of law for the

benefit of his creditors.@ In 2002 the Eleventh Circuit Court of Appeal ruled Lawrence=s Aimpossibility of performance@ defense to contempt of court findings for not repatriating the trust was invalid, because he created the impossibility when he amended the trust. All courts involved in his case also expressed the belief that he could repatriate the funds if he wished to.

He apparently is relying on the Elizabeth Morgan precedent that he will eventually be released. Elizabeth Morgan went to jail for years for hiding her daughter (in New Zealand it turned out) in a child custody dispute case.

The article=s author quotes a critic of offshore trusts, Jay Adkisson, as reporting that about six contempt cases in OAPTs have gotten to court in the U.S. and Ano court has ever denied to hold a debtor in contempt for [ignoring] a repatriation order. Creditors are batting 1,000.@ Contrast this with Gideon Rothschild's quote on page 41. This is a classic example of the adage that the glass is either half full or half empty depending on your perspective. This is frankly an anomaly: there are many harsh US judicial decisions attacking offshore asset protection trusts, but in no case has there been a recovery from the offshore trust by the US creditor except by voluntary settlement with the debtor. Consequently it may be said that even fraudulent transfers to offshore asset protection trusts "work."

MOST RECENT CASES

The Brennan Case

Robert Brennan, who frequently appeared in TV ads for his brokerage firm, First Jersey Securities, in the 1980's, has had ongoing legal battles with the SEC and other federal and state regulators for more than a decade. The SEC has charged him with fraud civilly and criminally and has attempted to have him held in contempt. The U.S. Government has admitted to spending over $1 million in costs in its effort to trace any attempt to recover $45 million Brennan allegedly transferred to offshore trusts and Avarious tax havens.@

The first SEC action for fraud was filed in 1985, and after trial in 1994 it obtained a judgment against Brennan in the amount of $75 million. In 1993-1995 Brennan established three offshore trusts in Gibraltar with a total value of some $25 million. Brennan=s sons and his charitable foundation were beneficiaries of the trusts. Brennan himself has a reversion after 10 years, or later if the Trustee determines. Under the flight clause the trust was subsequently moved first to Mauritius, then to Nevis.

Brennan=s bankruptcy trustee has filed suit in Nevis, so far without success.

In 2000 state and federal prosecutors brought criminal fraud charges against Brennan, for which he went to trial in 2001. The charges were bankruptcy fraud and

theft, money laundering and obstruction of justice. He was convicted and was given a five-year sentence without parole and the obligation to make $4.6 million in restitution payments.

Brennan=s lawyers have denied fraud in the establishment of the trusts, defending them as legitimate estate planning devices in light of Brennan=s family circumstances.

An interesting feature of the Brennan case was the cooperation received by the U.S. attorney prosecuting the case from Isle of Man authorities, who were described by the prosecutor as Aquite helpful.@ A Manx court ordered Peter Bond, who managed Brennan=s offshore companies through Valmet in the Isle of Man, to give evidence. His testimony in a New Jersey courtroom helped convict Brennan. The Bank of Scotland, which claimed it was an Aunwilling conduit@ for the sale of $4 million in hidden bearer bonds by Brennan, also cooperated with prosecutors.

On the other hand, in 2000 a U.S. federal appeals court held that one of Brennan=s overseas asset protection trusts could not be invaded by creditors, and a jury failed to convict him on another count of bankruptcy fraud relating to his failure to disclose over $500,000 of Mirage casino chips. Brennan has apparently agreed to repatriate another $20 million in a Gibraltar asset protection trust, but that agreement may or may not be approved by a Gibraltar court. The author understands that this case has recently settled under confidential terms and that most of Brennan=s secreted assets remain protected offshore.

At least three important points should be gleaned from Brennan and Anderson: (1) all bets are off if the creditor sought to be avoided is the U.S. government, and most bets are off if the creditor is a powerful and motivated corporate entity, like a U.S. bank, as in the Weese case cited below. These have resources, tenacity and influence other creditors do not; and (2) even in those cases, the government=s vast efforts apparently did not yield complete recovery, so the Trusts Aworked,@ at least to some extent, as the debtors hoped; and (3) bad facts made “bad law” in all of these cases.

Other Cases.

In Re Coker, 251 B.R. 902 (Bankr. M.D. Fla. 2000). Prior to filing bankruptcy Cokers established an OAPT. The Court ruled that OAPT funds should be turned over to trustee. Cokers cite impossibility. Citing Lawrence and Affordable Media (Anderson) the court held the Cokers could not use the defense of impossibility when the impossibility was self-created. Debtors held in contempt. (The creation of the OAPT was done at the A11th Hour.@)

SEC v. Bilzerian, 112 F. Supp. 2d.12 (DC 2000). Mr. Bilzerian was convicted of

securities fraud and conspiracy to defraud the U.S. SEC filed civil suit, obtained judgment and an order in 1993 forcing Bilzerian to disgorge $33 million. Two years after disgorgement order he established a Cook Islands Trust and transferred $15 million to it. He was a beneficiary but removed as beneficiary by trust protector in 1998. He argued Afinancial inability@ to meet the disgorgement order. The court held Mr. Bilzerian to an Aespecially high@ standard in his impossibility defense. When he failed to provide the court with a copy of the trust, the court questioned whether he held an indirect beneficial interest. The District Court found him in contempt and incarcerated him. The trust was not repatriated.

Eulich v. U.S. (N.D. Tax Case No. 99-CV-01843, August 18, 2004) In the early 1990s Mr. Eulich established an OAPT in The Bahamas with $100 million (possibly to avoid U.S. taxes). IRS asked for information, he said he could not obtain information. Court refused to accept impossibility as a defense because it was self created and required the Settlor to sue for the information in Bahamian Courts. Eventually fine of $10,000/day imposed for failure to produce documents.

Federal Trade Commission v. Ameridebt, 373 F. Supp. 2d 558 (D. Md. 2005) There was an FTC investigation of Ameridebt and Mr. Pukke, its controlling shareholder, for allegedly defrauding consumers. After learning of the FTC investigation in 2002, Pukke made transfers to friends and relatives and established trusts in Delaware, Nevis and Cook Islands. Court required defendants to turn over assets to a receiver during pendency of investigation to avoid prejudicing FTC=s ability to recover. A federal district court stated that plaintiff FTC could move for contempt if the defendant failed to comply with a repatriation order, allowing that the defendant would be free to argue an impossibility defense.

U.S. v. Grant, Case No. 00-8-986, 2005 U.S. Dist. Lexis 22440 (S.D. Fla. Sept. 2, 2005) Mr. and Mrs. Grant set up reciprocal OAPTs in Bermuda and Jersey, one each as Settlor and beneficiary, in 1988 and 1984. In 1991 and 1993 IRS assessed huge taxes. Because of their power to remove and replace trustees retained, a federal magistrate recommended that the court order repatriation to satisfy a federal tax lien. The magistrate arguably made several erroneous statements regarding trust law and fiduciary duties, but the recommendation nevertheless indicates the current U.S. legal atmosphere, at least to apparent attempts to thwart the IRS. Apparently it did not matter to the magistrate=s view that the trust was funded 10 years before the tax liability arose.

Morris v. Wroble, Case No. CIV-06-80479 (S.D. Fla.) aff=d. Appeal No. 06-80452-CV-DTKH (11th Cir. Nov. 16, 2006) Mrs. Morris executed a post-nuptial agreement with her husband which provided for a $1.5 million payment and contained an non-contestability clause providing that she would forfeit the payment if she ever contested the agreement. In 2001 they divorced, and she received a $1.5 million payment. In 2003 she brought an action which she claimed was not a contest, but the

court determined it was a contest and ordered her to repay $1.5 million plus costs and attorneys= fees. While appealing she transferred most of her assets to a Cook Islands Trust. Court found the transfer fraudulent and ordered her to repatriate. When she refused to appear and fled the jurisdiction, she was found in criminal contempt and her appeal was dismissed.

The Weese/Bibelot vs. Allfirst Bank and Bank of America Case in Baltimore

In the spring of 2001 Allfirst Bank and Bank of America, claiming they were owed millions of dollars by the owners of the bankrupt Bibelot Bookstores in Baltimore, the Weeses (heirs to the Rite-Aid fortune), filed suit to recover the debts and an injunction seeking to force the Weeses to give creditors access to an estimated $25 million in assets in offshore trusts. The claim by the banks was that the Weeses, in transferring assets to a Cook Islands asset protection trust, had committed a fraudulant conveyance with intent to hinder, delay or defraud their creditors. The banks= claim was that the Weeses had assets to pay their debts when they fell due.

In 2000 a $17 million promissory note by Bibelot personally guaranteed by the Weeses fell due. Subsequently a judgment was entered against the Weeses for repayment of the loan. Months later Bibelot filed for bankruptcy. After the Bank of America note was due the Weeses borrowed another $1.6 million from Allfirst. Within a month thereafter, in July of 2000, Bank of America initiated arbitration proceedings. On the day they entered into arbitration proceedings with the Bank the Weeses created a Cook Islands trust with Cook Islands Trust Ltd. and Mrs. Weese=s father as Co-Trustees and transferred $25 million of assets to it. Among the assets transferred to the trust were a Baltimore house appraised at $3 million, which was transferred in consideration of a $10 payment. At the time the house was security for a $1.7 million loan from Wachovia. The Weeses subsequently consented to the entry of an arbitration award for $17.6 million.

The Weeses were apparently represented in the creation of the trust by Allan Gibber, a well-known, respected practitioner and author of the definitive treatise on Maryland probate law. Mr. Gibber, in turn, apparently engaged the services of Barry Engel as special counsel to assist in the creation and funding of the Cook Islands trust.

The bank creditors pursued litigation in both Maryland and overseas. In fact, trial was scheduled in New Zealand for February 2003 in the Cook Islands case. The debtors defended the establishment and funding of the Cook Islands trust by general and vague allusions to Aestate planning@ and Aproviding for the children.@ The trusts are grantor trusts includible in the Grantor=s estate. Settlor Elizabeth Weese=s father was initial Co-Trustee with Cook Islands Trust Company, and as between the two, his authority was governing. Elizabeth Weese was initial protector with authority to veto any decision of the Trustee.

In the past year there were two important decisions in the Weese case, both going against the Settlors. First, the High Court in the Cook Islands rejected the Trustees= and Settlors= claim that the privacy provisions of the International Trust Act prevented a plaintiff from obtaining discovery of documents. Second the Court of Appeals upheld the High Court=s denial of a claim of attorney-client privilege attaching to certain specified documents because it ruled a prima facie case of fraud had been established. Apparently a Mareva injunction was obtained freezing the trust assets.

A settlement was ultimately reached in this case in which substantial funds were paid to the creditor bank by Settlor=s father, who apparently purchased his daughter=s note at a discount. Again, at least to some extent, the trust Aworked.@

Interestingly, the Settlor of the Weese Trust is the daughter of former Rite-Aid CEO Martin Grass, who recently plead guilty to what the Wall Street Journal characterized a Amassive accounting fraud.@ Reportedly Martin Grass bought the bank note due from his daughter for a very substantial payment to settle this matter.

Also very interesting is the fact that the Plaintiff U.S. bank creditors who brought suit in the Cook Islands applied for discovery of certain documents in the drafting attorney=s file which the defendant and counsel tried to protect as privileged. The Court refused to uphold the attorney-client privilege of the documents because it found that the client=s interest in seeking legal advice was to further a crime or fraud. The Court found that it was not relevant to its ruling on the privilege issue whether or not the attorney was cognizant of the client=s nefarious purposes. In effect, the Court invoked the crime/fraud exception to the attorney-client privilege, taking in fact an expansive view that there is no privilege not only where there is fraud, but even Awhere there are commercial practices or business dealings that would readily be described as dishonest to the point of fraud by a reasonable businessman.@ The Court did require a Astrong prima facie case of fraud or dishonest purpose or a strong probability there was fraud@ and found that test met in this case. The Court found that the asset protection trust statute did not modify this privilege rule and quoted with approval another Cook Island case: AIt should not be lightly assumed that Parliament intended to defeat the claims of creditors by allowing international trusts to be used to perpetuate a fraud against a creditor.@

Actions in Foreign Courts.

The general rule of international law is that countries will grant comity to the courts of other countries such that one country will enforce the judgments and find orders of the courts of other countries provided that certain minimal Adue process@ standards are met, e.g., notice, jurisdiction, fundamental fairness, etc. Therefore, it may be a mistake to assume that a foreign trust will not be bound by a domestic judgment in favor of creditors.

Certain jurisdictions have by statute provided that foreign judgments against trusts domiciled in such jurisdiction will not be recognized or enforced, but these jurisdictions are relatively few and obscure: Belize, the Cook Islands, Labuan, Nevis, Niue and St. Vincent and the Grenades. Other jurisdictions may have court decisions in which comity was refused, as the Isle of Man is reported to have, but it may be perilous to rely on local common law in the absence of an express statute.

In the courts of English common law jurisdictions a U.S. or other foreign judgment for a liquidated claim may be recognized pursuant to summary proceedings provided that certain standards are met:

- X foreign court must have been a court of competent jurisdiction
- X foreign judgment must be final and conclusive
- X the judgment must be for a fixed and definite sum of money
- X judgment must not have been obtained by fraud
- X judgment must not be contrary to public policy of the host court

In order to keep the assets from disappearing once proceedings are commenced in an English common law jurisdiction, a remedy similar to a temporary restraining order may be obtained. Following the name of a 1975 English case, Mareva Compania Naviera S.A. v. International Bulkcarriers S.A., 2 Lloyd=s Rep. 509, this remedy is commonly referred to as a Mareva injunction. Such an injunction allows the freezing of assets on an ex parte basis pending the outcome of other ancillary proceedings either in the courts of the jurisdiction in which relief is sought or in another jurisdiction. The injunction may be sought and granted either before or after a judgment on the merits has been obtained.

Bankruptcy Law Considerations.

Where a debtor is foolish enough to settle an offshore asset protection trust and then file for bankruptcy or immediately before being involuntarily forced into bankruptcy, a bankruptcy trustee steps into the debtor=s shoes and may exercise all of his rights, including any over the administration of the offshore trust. In some jurisdictions however, such as the Cook Islands, there is no recognition of bankruptcy decrees of foreign courts.

Contempt of Court.

While impossibility of performance is a defense to a contempt of court citation,

where an obviously fraudulent conveyance has very recently been made the defense will not serve. A typical offshore trust will instruct a trustee to ignore instructions given under the compulsion of court order. But where the settlor=s defense of impossibility of performance was caused by the settlor/debtor=s actions shortly before the court order, impossibility of performance is no defense.

Flight Clause Issues.

A typical offshore asset protection trust contains a provision granting the trustee or others the power to take action to defeat the impact of adverse court orders in the trust=s domicile by various evasive maneuvers such as changing the trust=s domicile or governing law or the appointment of new trustees in a new jurisdiction.

A Mareva order, as noted above, may render such a flight clause nugatory. Upon a prima facie showing of a fraudulent conveyance or similar claim against a trustee, the judgment creditor or claimant may be able to obtain a court order barring the trustees from moving assets any further anywhere in the world, resigning or appointing new trustees, surrendering or distributing trust assets, or changing the governing law of the trust.

No case comes to mind with sympathetic facts for the debtor which received harsh judicial treatment in the U.S. Like family LLP/LLC tax cases, bad facts for the debtor (taxpayer) lead to adverse decisions against the debtor (taxpayer). By and large offshore asset protection trusts cases, like FLP/FLLC cases, have been handled by US courts as they should have been handled.

Conclusion.

Not surprisingly, careful lawyers and well-advised clients will be rewarded, careless lawyers and foolish and unscrupulous clients will be punished. A properly chosen strategy carefully and thoughtfully implemented will effectively shield assets from claims of future creditors. The wrong choice of trust domicile, bad timing in making transfers to the trust, the wrong choice of a third country in which to hold trust assets, the wrong choice of trustees, trust protectors, investments or depositary institutions can leave offshore trust assets vulnerable to attack by creditors of beneficiaries.

As general guidelines, move only liquid assets to an OAPT and less than 50% of net worth, use independent trustees and protectors, make adequate provision from U.S. assets or from OAPT assets to pay successful claims by the U.S. government, maybe by large corporate creditors.

XVI. HOW TO USE AN OFFSHORE ASSET PROTECTION TRUST TO HOLD

U.S. REAL ESTATE OR OTHER U.S. ASSETS WHICH ARE NOT LIQUID[3]

A U.S. citizen concerned about potential future creditors and wishing to protect a valuable real estate holding or other U.S. assets faces an obvious dilemma if he wants to maintain some kind of control over the property. If he retains an interest in or control over the property, any domestic conveyance is unlikely to be effective. On the other hand, he obviously cannot physically transfer real estate overseas and outside of the jurisdiction of the local courts, and he may simply be unwilling to transfer more liquid assets out of his control.

One approach is for the U.S. domiciliary to establish a U.S. family limited partnership to hold such U.S. assets, real or personal, retaining one percent (1%) general partnership interest which has all management rights, and conveying the ninety-nine percent (99%) limited partnership interest to a foreign asset protection trust. The trust may create a Asubsidiary@ controlled foreign corporation of which the grantor and those beholding to him are directors.

In the event of a suit against the grantor, he will disclose on his balance sheet the existence of the trust and his one percent (1%) interest. He will explain to his creditor that the other ninety-nine percent (99%) interest is owned by the offshore Asset Protection Trust, under which the trustees have complete discretion to distribute income or principal or neither to him or his spouse or his descendants. He will explain the trust is irrevocable so he cannot dissolve it or get at the assets; that the jurisdiction does not recognize foreign judgments, that the creditors must prove fraudulent conveyance beyond a reasonable doubt and that the suit must be brought within two years of the creation of the trust; that the jurisdiction is 9,000 miles away; and that the partnership has been liquidated and the limited partner=s interest as 99% tenant in common has been distributed to the foreign corporation.

The local court will have no jurisdiction over the foreign trustee who owns ninety-nine percent (99%) of the real estate. For this purpose one only uses foreign trustees with no U.S. nexus which might support jurisdiction in the U.S. of a law suit. That portion of the real estate or other assets owned overseas should therefore remain immune to creditor claims.

XVII. CLIENTS WANT ASSET PROTECTION PLANNING

Two recent surveys, one reported in the Fall of 2003 in The Wall Street Journal, ALitigation Boom Spurs Efforts To Shield Assets,@ by Rachel Emma Silverman, and another reported in the September 2003 issue of Trusts & Estates in an article entitled

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[3]See *Asset Protection Aspects of Art*, Peter Spero, Journal of Asset Protection, January/February 1998, Vol. 3, No. 3.

AShelter From the Storm,@ by Russ Alan Prince and Richard L. Harris, document the rapidly increasing interest in and demand for asset protection expertise in their professional advisors by HNWI. With the phase-out of the importance of estate tax planning with the dramatic recent and scheduled increases in the estate tax exemption, trust and estate planning lawyers and other financial service providers -- accountants, financial planners, investment advisors, trust bankers -- have a strong motivation to increase their expertise in the asset protection area as the opportunity presents itself to find other profit centers in their practices. According to a survey, 69% of investors holding $5 - $25 million are fearful of being targeted by an unfounded lawsuit. 1.8 million Americans were sued in 2004, the most recent year for which figures are available.

These two articles are attached as Exhibits 7 and 8.

According to the Trusts & Estates article, while less than 28% of lawyers agreed strongly with the assertion that AAsset protection is legal and should be discussed with most wealthy clients,@ 55% of high net worth clients were reported as Avery@ or Aextremely@ interested in asset protection planning. Interesting, more successful lawyers were more in tune with their clients= sensitivity to asset protection. Fewer than 13% of wealthy investors have any type of asset protection planning. Clients need asset protection planning. Clients want asset protection planning. Yet many estate planning lawyers are not providing this service to their clients. With the opportunities for tax-oriented estate planning shrinking, estate planning lawyers have an opportunity to grow their practices into asset protection planning.

AFFIDAVIT OF SOLVENCY

RE: THE [ ] TRUST ("the Trust")

The undersigned,_____, being first duly sworn upon oath, deposes and states as follows:

1. That to the best of my knowledge and belief the information provided, and any attachments hereto, are true and correct.

2. I am a Settlor of the Trust and I contemplate making transfers of property thereto in addition to my initial nominal contribution thereto.

3. That there are no pending or threatened claims or proceedings that I reasonably anticipate may result in a judgement against me, and I am not a named defendant in any lawsuit or involved in any administrative proceedings as of this date, or a judgement debtor [other than as disclosed in any attached schedule].

4. That I do not anticipate filing for relief under the provisions of the applicable bankruptcy or insolvency laws, nor am I involved in any situation that I reasonably anticipate would cause me to file for relief under the applicable bankruptcy or insolvency laws in the future.

5. That following any transfer of my property to the Trust structure, I will be solvent and able to pay my reasonably anticipated debts (including any claims or lawsuits against me) as they come due from the balance of my property after such transfer.

6. That I have full right, title and authority to transfer the assets to the Trust.

7. That I have read and understood the annexed description of unlawful activities, and confirm and represent that none of the assets which I may transfer to the Trust was derived from any of the activities described therein.

8. That I am not to my knowledge, nor do I reasonably expect to be, under investigation by any federal or state agency, or in violation of any statutes administered by, or empowering, the Internal Revenue Service, the Federal Trade Commission, the Securities Exchange Commission, the United States Postal Service, the Drug Enforcement Agency, or the Federal Bureau of Investigation.

9. That I am not engaged in or about to become engaged in a business or transaction for which remaining assets will be unreasonable in relation to the business or transaction.

10. That I do not intend to incur or reasonably believe that I will incur debts beyond my ability to pay as they become due and I do not have the actual intent to hinder, delay, or defraud any creditor.

SUBSCRIBED AND SWORN before me, a Notary Public in and for the State of

_____ by _____ this _____ day

of (month) _____ [1999] / [200__].

Witness my hand and official seal

Notary Public:_____ Stamp

My commission expires:_____

My address is: _____

ANNEXURE TO AFFIDAVIT OF SOLVENCY CONCERNING UNLAWFUL ACTIVITIES

The law of a jurisdiction may contain legislation (the "legislation") making it criminal for anyone to conduct or attempt to conduct certain financial activities which involve the proceeds of unlawful activities. The transfer of assets into a limited partnership, Trust, or other entity may constitute a criminal activity within the scope of such legislation if the assets transferred to such entities were derived from any of the unlawful activities specified in the legislation.

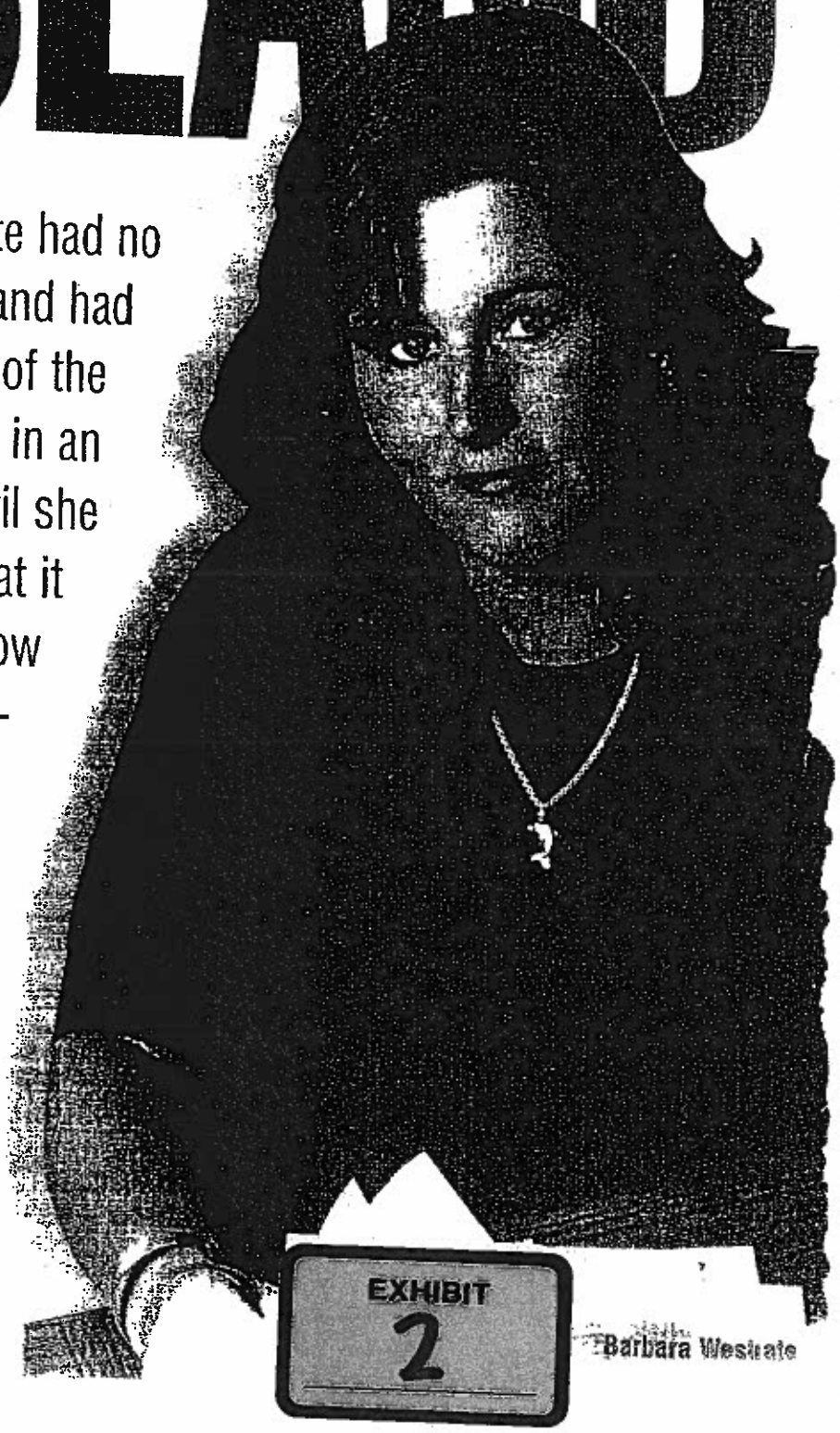
The unlawful activities under the legislation commonly consist primarily of drug-trafficking offences, financial misconduct and environmental crimes. Drug-trafficking offenses include the manufacture, importation, sale, or distribution of controlled substances; the commission of acts constituting a continuing criminal enterprise; and transportation of drug paraphernalia.

Financial misconduct includes the concealment of assets from a receiver, custodian, Trustee, marshall, or other officer of the court, from creditors in a bankruptcy proceeding, or from a statutory corporation or similar agency or person; the making of a fraudulent conveyance in contemplation of a bankruptcy proceeding or with intent to defeat the bankruptcy law; the giving of false oaths or claims in relation to a bankruptcy proceeding; bribery; the giving of commissions or gifts for the procurement of loans; theft, embezzlement, or misapplication of bank funds or funds of other lending, credit, or insurance institutions; the making of fraudulent bank or credit institution entries or loan or credit applications; and mail, wire, or bank fraud or bank or postal robbery or theft.

Environmental crimes include violations of statutory or regulatory laws. Other specified unlawful activities in such legislation could include counterfeiting, espionage, kidnapping or hostage-taking, copyright infringement, entry of goods by means of false statements, smuggling, removing goods from the custody of customs, illegally exporting arms, and trading with a country's enemies.

ISLAND

Barbara Westrate had no idea her husband had hidden most of the family's wealth in an offshore trust. Until she discovered that it excluded her. Now lawyers with high-asset clients are discovering that a fine line can separate financial advice from ethics sanctions.



Barbara Westrate

EXHIBIT 2

CASTAWAY

BY DEBRA BAKER

David Westrate claims his only reason for setting up a family trust in 1994 was to preserve his family's fortune for the benefit of himself, his wife and his four children.

As the owner and operator of National Business Institute, a multi-million-dollar company that sponsored legal education seminars for lawyers, Westrate says he wanted to guard against the threat of frivolous lawsuits and claims by unforeseen creditors.

But Barbara Westrate, his wife of 11 years, says she had no idea her husband had shipped 90 percent of their assets—an estimated $11 million—to the Cook Islands, located 1,900 miles off the coast of New Zealand.

And, she says, he never mentioned that the trust did not specifically name her as a beneficiary, referring instead to "spouse of the settlor."

In fact, Barbara Westrate maintains, it wasn't until she filed for divorce in January 1996 that she learned about the trust at all, not to mention that her husband had set it up just four months after meeting with a domestic relations lawyer.

It was only through the course of Florida divorce proceedings that she began to understand the implications of what he had done. Because her name is not mentioned in the document, she will have no claim as a beneficiary once the divorce is final.

Moreover, because the trust—the bulk of which contains marital property—is subject to the laws of a country that does not recognize U.S. judgments, including divorce decrees, its trustee doesn't have to acknowledge a U.S. court order that grants her access to its assets.

The bottom line: Regardless of what a U.S. judge rules, Barbara Westrate might never get her share of the trust holdings.

"Offshore trusts, when you use them to try to defraud a spouse, are rotten things," Westrate says. "If the courts care about family, this shouldn't be allowed. They should be concerned when one parent can burn another like this—legally."

Estate Planning or Money Hiding?

Over the last decade, the offshore trust industry has emerged as a popular estate-planning mechanism for wealthy entrepreneurs, executives, doctors and lawyers seeking to safeguard their funds.

But as the Westrate case suggests, there are growing concerns that these trusts are being used to hide money from spouses and other legitimate creditors. Significant questions also are being asked about the role lawyers play in designing trusts for use by clients with fraudulent intentions.

David Westrate's lawyers came under scrutiny in June when a central Florida judge found a prima facie case existed to apply the crime-fraud exception to the attorney-client privilege between him and his lawyers. Judge Vivian C. Maye of Hillsborough County (Tampa) Circuit Court ordered the attorneys to respond to interrogatories so she could determine whether their testimony would be admissible at trial.

A settlement of the case left unresolved the inquiry into the actions of David Westrate's attorneys, as well as the wider reaching question of where the line is drawn between assisting a client and perpetrating a fraud.

"These are cutting-edge questions being raised," says Barbara Westrate's attorney, Arnold D. Levine of Levine, Hirsch & Segall in Tampa. "Very seldom do you get to this level in these types of proceedings."

So-called asset protection trusts are designed to shield wealth by moving it to a foreign jurisdiction that does not recognize U.S. judgments or other legal processes, such as asset freezes and forfeitures.

Typically trusts are set up to replace or supplement professional liability insurance, reduce assets and discourage lawsuits, enhance a strategic position when dealing with creditors, and avoid or supplement prenuptial agreements. Experts estimate that $1 trillion to $5 trillion is currently being held offshore.

Barry S. Engel, who co-authored the trust laws in the Cook Islands in 1989 and set up the trust in the Westrate case, says these trusts help wealthy individuals who believe the legal system can't protect them.

"What we're doing is a response. We're leveling the playing field," says Engel, a lawyer with the Englewood, Colo., firm of Engel, Reiman & Lockwood.

Moving money to locales such as the Cook, Channel and Cayman

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ABAJ/STEVE WOIT

CHRISTOPHER REDMOND and ALAN GOUGH ***focus their practices on offshore trusts and tracking assets. 'The real issue is intent,' Redmond says.***

islands provides a layer of insulation for the settlor of the trust because creditors or others who win a judgment from a U.S. court must then go to the foreign jurisdiction where the trust sits if they want to collect.

The laws of these debtor-friendly jurisdictions make it difficult and costly to prevail. Discovery is limited, and fraud must be proved beyond a reasonable doubt. Those seeking to challenge a trust must pay up front to retain local counsel; lawyers in these countries generally don't work on a contingency basis. And the statutes of limitations—as short as one or two years from the time the money was transferred—often have expired by the time a claim is brought.

A well-drafted offshore trust provides other benefits, as well For example, if the trust is threatened, a "flight clause" enables the foreign trustee to physically move the assets or the trust itself to another location.

Further, an offshore trust, unlike a U.S. trust, may allow settlors to maintain significant control over their assets Trusts can include co-trustees in the United States to watch over the actions of the foreign trustees, and settlors can name anyone, including themselves, as "protectors" to oversee the trustees and veto their actions if necessary.

If litigation is threatened, the protector and the co-trustee can resign so that no one within the personal jurisdiction of a federal or state court has control over the assets of the trust.

Ambiguous Legal Rules

Complex legal principles relating to the offshore industry make it difficult to discern when Americans can lawfully move their assets out of the reach of the law.

"Even the courts don't understand this," Engel says "It varies state by state It varies within states It's difficult for us without a crystal ball to predict what's going to happen."

Asset protection devices are legitimate so long as they are designed to protect against future, unanticipated litigation and are not intended to hide funds from present or threatened disputes.

While there is little question that clients who intentionally conceal or fail to disclose material facts to creditors with the intent to deceive can face charges of fraud, the issues relating to fraudulent conveyance are more complex

A fraudulent conveyance is a transfer made with the intent to hinder, delay or defraud creditors. Unlike fraud, which voids an entire transaction, a fraudulent conveyance is still a valid transfer, even though the intent is fraudulent. Laws prohibiting such transfers are remedy statutes that allow creditors to recover their losses

Transferring funds offshore when litigation is pending or when known creditors exist generally will violate state and federal fraudulent conveyance statutes.

But if litigation isn't pending, it is more difficult to determine when transfers will be deemed fraudulent. Some say a probability of future litigation violates the law, while others believe a mere possibility is enough.

The answer is often a question of semantics. "It's what the game is," Engel says "You try to find common threads that run through fraudulent transfer laws, and you can't."

Christopher J. Redmond, a Kansas City, Mo., lawyer who specializes in tracking down funds that have been fraudulently transferred outside the country, says each case ends up being considered on its own facts.

"The real issue is intent," says Redmond, who is the chair of the International Bankruptcy Committee of the ABA Business Law Section and a lawyer with Husch & Ep-

ABAJ/ISLAND PHOTOGRAPHICS ISLE OF MAN

penberger. "No one is going to say, 'I did this because of a divorce or because of creditors.' The only way you can establish it is from the totality of evidence."

The risk of making an offshore fraudulent transfer is unclear. While the laws of the foreign jurisdiction may still keep the money out of the hands of the creditor, the client may face contempt of court proceedings for concealing information about the whereabouts or the extent of control he or she has over the money.

The matter of attorney liability is equally vague. Legal and ethics rules, as well as interpretations of those rules, vary by state. Many suggest, however, that lawyers may expose themselves to discipline, disbarment or even jail time for assisting in conduct that violates rules prohibiting fraud, deceit or misrepresentation.

Aside from fraud and fraudulent transfer issues, other ethical questions come into play when dealing with trusts.

A conflict of interest clearly exists in cases where an attorney represents both a husband and wife but sets up a trust that works to the benefit of only one of the parties, Redmond says. Similarly, if a trust is set up for the director of a corporation and the shareholders' interests are put at risk, a corporate attorney may be breaching his or her duties.

Fraudulent transfers carry unclear risks. Foreign laws may keep the cash away from a creditor, but the client may be found in contempt of court.

But some attorneys say they are not violating ethical rules, no matter what the intent of their clients. They argue that because fraudulent transfer laws are merely remedial statutes, lawyers who assist clients in making such transfers are doing nothing illegal.

The Right to Move Money

Denis Kleinfeld, an asset protection attorney in Miami, says the legal nuances relating to client intent are not relevant because the attorney's only involvement is in making the transfer, which is a legal transaction. If the client has a fraudulent intent, the creditor has a means, through the statute, to go after the money, he says.

Attorneys have a right, even a duty, to set up a workable estate plan for clients regardless of intent, Kleinfeld says. And clients have a right to do what they wish with freely alienable property, he says.

"You can be right in the middle of a [court] proceeding," Kleinfeld says. "The question is: Do you have a lawful right to draft a will and a trust? Of course you do. There is no law that says you can't. If property is freely alienable, [you] can move it anywhere in the world."

Kleinfeld says that representing trust clients with suspect motives is no different from a criminal defense attorney representing child molesters or murderers.

But Levine, the lawyer for Barbara Westrate, sees a clear distinction. "There is a difference between a client who says, 'I committed a crime; represent me,' and one who says, 'Help me commit a crime,'" he says. "If an attorney had knowledge of marital discord and set up a trust, unquestionably

Anatomy of an Offshore Trust

Barbara Westrate claims in a Florida divorce case that her husband, David, has hidden at least $11 million in marital assets in a trust in the Cook Islands. Here is how it was set up:

Settlor: David Westrate
Formed: December 1994
Beneficiaries: Settlor
Spouse of the Settlor
Settlor's children (listed by name)
Protector: David Westrate
Trustees: Richard Admundson
SouthPac Trust International

Trust features:
- Irrevocable
- Subject to the laws of the Cook Islands
- An "anti-duress" clause
- A "flight" clause

Contents: National Business Institute, real estate, cash, other assets

Since Barbara Westrate is not listed by name, she does not collect in the event of a divorce

Laws in the Cook Islands don't recognize U.S. divorce decrees

This clause prohibits the trustee from altering the trust to comply with court orders and allows one trustee to discharge a co-trustee who is subject to U.S. personal jurisdiction

This clause allows the trustee to move the trust or its assets anywhere in the world if creditors overcome jurisdictional hurdles to bring a claim

The trust is formed by David Westrate 13 months before his wife, Barbara, files for divorce

Westrate retains indirect control of the trust by naming himself to this position, which advises the trustees. He and trustee Admundson, a business partner, later resign, leaving U.S. courts with no personal jurisdiction over anyone who controls the trust's assets

Barbara Westrate alleges the trust contains 90 percent of marital assets, estimated to be in excess of $11 million. NBI, originally owned by Westrate alone, was transferred to the trust when it was valued at $36 million, but it was later sold for $7.1 million to Westrate and three business partners.

Source: Hillsborough County (Fla.) Court record. Definitions from "The Offshore Trust: A Contemporary Asset Protection Scheme" by James Lorenzetti, 1997 *Commercial Law Journal*

GRAPHIC BY JEFF DIONISE

he is involved in the perpetration of fraud."

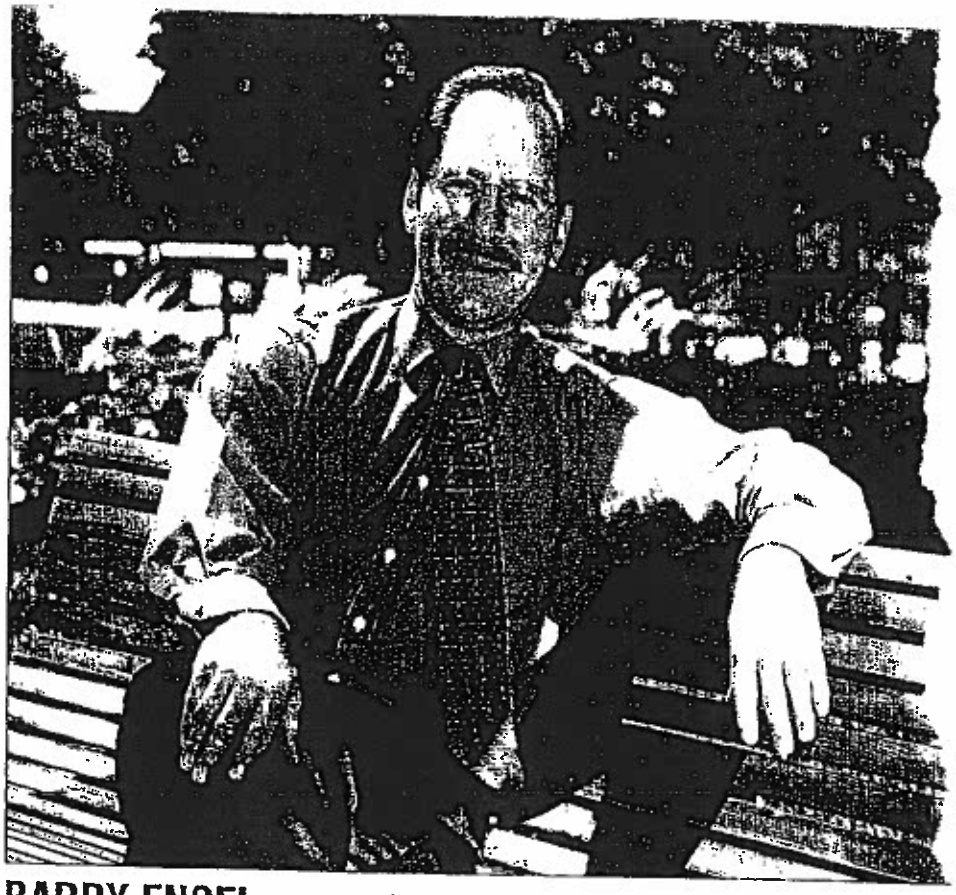
Even among staunch advocates of asset protection trusts, few are willing to read the law as broadly as Kleinfeld. They note it is unlikely that a disciplinary board would accept the subtle distinction between fraud and fraudulent transfers

The Embittered Spouse

While fraudulent transfer issues are common in bankruptcy and other creditors' rights scenarios, it is divorce cases that present some of the most flagrant examples of abuse

Domestic relations lawyers say bitter spouses who hold the purse strings are willing to go to great lengths, sometimes planning long in advance of a divorce action, to keep money out of the hands of their partners

"'Hide the income' is the biggest game being played," says Sandra Little, vice chair of the ABA Family Law Section. "It makes the nonmonied spouses spend money they don't have to try to crack the trust It's a hardball tactic: If they run out of money, they lose."



BARRY ENGEL, ***co-author of the Cook Islands trust laws, says 'even the courts don't understand' offshore assets.***

In divorce, it is difficult to prove an asset protection trust was actually intended to defraud a spouse, particularly when it was set up a year or two before the divorce filing. Further, the law is unclear about whether a spouse will fall into the same category as a creditor in a fraudulent transfer situation.

"It comes down to the question of intent If someone sees divorce on the horizon and starts making transfers, the intent is probably there," says Engel "It's a very muddy, murky and confused area of the law."

A case in point is that of a wealthy Westchester County, N.Y., couple whose divorce became final in July. Dr Roger Riechers, a board-certified urologist, had set up an asset protection trust in the Cook Islands in 1992 without the knowledge of his wife, Mary Riechers. The trust was established two years before the divorce was filed, but two years after marital problems had developed and while the couple was undergoing marriage counseling.

Dr. Riechers maintained that he set up the trust after defending three malpractice lawsuits filed against him between 1984 and 1988. He did not tell his wife what he had done, let alone include her in the decisions about the future control of their assets. As in the Westrate case, Mary Riechers was never mentioned by name in the trust and would only receive benefits if she were to maintain her status as "spouse of settlor."

Despite the circumstantial evidence, the trial judge said in his written opinion that there was no evidence to prove the trust was for anything other than the purpose Dr. Riechers asserted

Although the judge, Kenneth W. Rudolph of the New York Supreme Court, ruled that half the assets in the estimated $4 million trust belonged to Mary Riechers, she has no access to the money because the foreign trust doesn't recognize U.S judgments

"She got half a loaf," says Marilyn S. Faust, Mary Riechers' attorney. "The judge was correct in ruling how he did, but he didn't give her a means to get at the money."

Mary Riechers was expected to appeal the New York ruling and has initiated an action in the Cook Islands to try to break the trust.

Levine says evidence of fraud should be apparent when a spouse is not involved in planning the trust, is not given draft copies of the documents, and is identified only as "wife" or "spouse" in the trust document.

Attorneys should not be able to close their eyes to a client's true intent merely because he or she says the trust is for a legitimate purpose, he adds.

"When someone hides behind the fact that their client did not specifically ask them to perpetrate a fraud, I say that's bull," Levine says. "It at least runs up to the line, and I'm satisfied an ethical practi-

ABAJ·RICHARD HARRIS

tioner would say it is going over the line. It's certainly sleazy."

In the case of David Westrate, Levine argues, there was no reason to go offshore to protect himself, or even his company, from the risk of lawsuits when standard business insurance would have provided all the protection he needed.

"Why did he need an offshore trust? Did he think an attorney was going to get a paper cut and sue him?" Levine says.

William B. Barnett, David Westrate's divorce lawyer, says his client had no idea the trust would keep money out of the hands of his wife in the event of a divorce. Westrate never realized the impact of using the "spouse" designation instead of his wife's full name and had no ulterior motive in moving his assets offshore, says Barnett of the Orlando firm of Barnett, Barclay & Springmann.

"A lot of people consult lawyers years before a divorce is ever filed," he says. "This is an unfortunate set of facts, but it was not intended."

A Lawyer Protection Device

For his part in the Westrate case, Engel says he was merely a special counsel retained by another Westrate attorney and not by David Westrate himself. As a result, he is one step removed from Westrate.

Because 90 percent of Engel's work is in creating the structures for clients of other lawyers, he is able to shift the burden to those lawyers to ensure their clients are not harboring fraudulent intent.

For his own clients, Engel insists they fully disclose to him all relevant information, and he has them sign a written statement to that effect.

"Lawyers tend to get nicked when they are supposed to be aggressive on behalf of the clients. But it's one thing to be aggressive and another to be plain stupid," Engel says. "We don't put blinders on. There's too much good business out there."

Offshore trusts are a lucrative business for lawyers like Engel. Typically they charge at least $18,500 to set up such a trust and then continue to receive income from every subsequent transfer.

The lure of those fees may spur inexperienced lawyers wanting to create a niche to put on blinders when dealing with clients. By doing so, attorneys not only place themselves at risk, but they also may unintentionally expose their clients to legal liability.

"People have no idea the complexity involved in setting up these trusts, so they put their reliance on the attorney setting it up," Redmond says. "It puts a greater duty on the attorney to look out for the client."

One aspect of this complexity is that an offshore trust can only secure funds if the money remains outside the reach of U.S. courts.

Barbara Westrate's property settlement, finalized Sept. 8, included $3.4 million in trust assets traced to investments the foreign trustee made inside the United States.

Levine says he would have been able to assert federal jurisdiction over the trustee had it been necessary to secure the funds for his client. "I essentially busted the trust."

Westrate says she is fortunate. She ended up with $4.3 million, including the trust assets, from her husband. She also secured $2.5 million from National Business Institute, which the foreign trustee had sold, allegedly for less than fair market value. As part of the divorce proceedings she had sued NBI, claiming its owners were part of her husband's scheme to defraud her.

Even though the fraud issues raised by the case were left unresolved, Levine says the settlement was in his client's best interest.

"For women generally, it would have been nice to have the trust established as a fraud, but I was trying the case for Barbara," Levine says. "With the money on the table, she was getting more than half and is going to have more than enough money to live comfortably. That's what my job was."

With cases such as the Westrates' often ending in settlement, it likely will be some time before the boundaries for using offshore asset-protection trusts will be more clearly defined.

Until then, advocates of the asset protection devices will continue to defend the aggressive tactics they use to protect their clients. After all, they say, isn't that what their job is?

"Let's face it, it is not a perfect society and it never will be," Engel says. "I'm not a moralist. I'm not a social engineer. I'm a lawyer." ■

What ACTEC Fellows Should Know About Asset Protection

*by Duncan E. Osborne and Elizabeth M. Schurig**
Austin, Texas

ACTEC lawyers probably have a duty to engage in asset protection planning for their clients, but if they do not, then to protect themselves from potential malpractice liability, they should clearly communicate to their clients that their representation does not involve any advice regarding asset protection. While this hypothesis may seem outrageous, in a recent article of the *ABA Journal*, Peter Spero argues that, at least under California law, a lawyer engaged in estate planning may well have a duty beyond traditional trust, estate, and tax planning which would, in fact, extend to asset protection planning.[1] Whether or not one agrees with Mr. Spero, the mere fact that he has taken that position and has identified a possible "duty" should send a warning signal. The reality of our litigious society is that once a lawyer argues that a "duty" exists, judges often allow a plaintiff to pursue an argument based on that "duty." If this plaintiff is successful, juries are often quick to award generous damages to the injured party. Indeed, this constant identification of new theories of liability is the very aspect of our legal system which in large measure drives the asset protection industry.

There are certainly ACTEC Fellows who resist the notion that asset protection planning is a part of the service owed to clients. Some argue that the potential for unwittingly assisting a client in defrauding his creditors is enough of a risk that this representation should not be undertaken. Indeed, some argue that this risk may itself serve as the basis for a defense to a malpractice claim founded on a duty to provide asset protection advice. Some would go further and say that under the fraudulent conveyance and fraudulent transfer laws,[2] all potential creditors are protected, no matter how removed in time and events from a transfer, so it is wrong under all circumstances to engage in asset protection planning. In support of such a position, those Fellows might refer to the language of the fraudulent transfer laws dealing with the rights of present and future creditors. They might also cite the recent cases which have held against the debtor and have struck down foreign asset protection trusts and that have, in some cases, subjected the settlors to imprisonment in civil contempt proceedings.[3] Finally, they might argue the long-standing policies of Anglo-Saxon jurisprudence which generally tend to support creditors' rights to access self-settled spendthrift trusts.[4]

The problem with these arguments is that they are superficial and they do not withstand serious analysis

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[1] Peter Spero, *Search and Rescue Missions*, A.B.A. J. Oct. 1999 at 70; *See also* Samuel I. Braunstein and Carol F. Burger, *Protecting the Wealth*, A.B.A. J., Nov. 1999 at 58.

[2] All states have laws to protect creditors from fraudulent transfers. Thirty-five have some version of the Uniform Fraudulent Transfer Act, six have a version of the Uniform Fraudulent Conveyance Act, and nine have some other statutory or common law derived from the Statute of Elizabeth. *See Duncan E. Osborne, Asset Protection: Domestic and International Law and Tactics* §§2:01-2:06 (1999). In this article, fraudulent transfer and fraudulent conveyance are used interchangeably.

[3] *In re B.V. Brooks*, 217 B.R. 98 (Bankr. E.D. Conn. 1998); *In re Larry Portnoy*, 201 B.R. 685 (Bankr. S.D. N.Y. 1996); *Federal Trade Commission v. Affordable Media, Inc.*, 179 F.3d 1228, 1999 WL 387259 (9th Cir. 1999) (This case is usually referred to as "the *Anderson* case" in asset protection circles); *In re Stephan Jay Lawrence, Debtor, Bankruptcy No. 97-14687-BRC-AJC* (Bankr. S.D. FL. Miami D.V. Sept. 8, 1999). *See also* Duncan E. Osborne and Elizabeth M. Schurig, *Asset Protection Trusts: Impact of Recent Case Law*, 5 J. Asset Prot. No. 2 at 24 (Nov./Dec. 1999).

[4] *See e.g. In re B.V. Brooks*, *supra* note 3; *see also In re Larry Portnoy*, *supra* note 3.

EXHIBIT 3

of the statutes and of the case law Fraudulent transfer law is extraordinarily complex [5] While it is absolutely true that the fraudulent transfer law of any given state may, on its face, appear to be susceptible to the interpretation that future creditors, remote in time and circumstances from the "transfer" are protected, that is not, and never has been, the way in which the courts have interpreted those laws.[6] Courts have always fixed on the relative proximity of the various creditors to the events that led to the insolvency or to the financial injury to the creditors. Indeed, for those who take the time to study the bankruptcy cases, the creditors' rights cases, and the articles written by the creditors' rights bar, it is almost alarming what the courts do permit in relation to the federal fraudulent transfer law applied in a bankruptcy context. There is even an area of the law called pre-bankruptcy planning which allows asset transfers far beyond what these authors have ever advocated [7] In short, a serious legal analysis of what can and cannot be done to protect assets from creditors under both state and federal law reveals wide latitude for asset protection planning.

One reason that there is such wide latitude for protecting assets is that the law (either common law or federal or state statutory law) has never required an individual to preserve his or her assets for the benefit of future creditors Fraudulent transfer statutes focus on "intent" and one cannot "intend" to defraud a creditor who does not exist If the law did require individuals to preserve assets for the benefit of future creditors, then gratuitous transfers of all kinds (to family members, to charities, etc) would be prohibited and the ability to use limited liability entities, e.g., corporations, limited liability partnerships, and limited liability corporations, would not be allowed [8] However, from the earliest times in our history, persons have had the ability to limit their liability, and creditors have had fraudulent transfer laws and bankruptcy laws to protect them.

What has changed, and what has consequently fueled the debate about asset protection planning, is the legislative evolution in jurisdictions in which individuals may legally protect assets from their creditors by establishing and funding trusts for their own benefit, the assets of which are statutorily protected from the settlor's creditors. At least since 1989, when the Cook Islands enacted its asset protection legislation, individuals settling trusts in the Cook Islands or other jurisdictions with similar asset protective legislation have been able to settle assets in trust and benefit from those assets even though such assets were not available to their creditors.[9] Some lawyers and legal scholars argue that this result is a wrenching departure from Anglo-Saxon jurisprudence and simply should not be allowed These authors disagree with those lawyers and scholars Anglo-Saxon jurisprudence simply does not dictate that individuals should not be permitted to settle assets in trust for their own benefit and thereby protect those assets from their creditors

Anglo-Saxon jurisprudence has evolved in much the same way that the use of trusts has evolved into a legal institution.[10] However, the law governing trusts has historically been governed by the courts of equity rather than the courts of law.[11] This is because a trust is not really a legal entity, it is a "trust" relationship and therefore defining the relationship and its legal components historically required the application of conscience rather than strict legal principles that was better accomplished by ecclesiastics than lawyers [12] Though courts of equity do not exist in our country, it is important to remember that a trust is a relationship rather than an entity and that in the absence of a compelling reason to

[5] Confusion results, in part, from the difficulty in understanding the distinction between a fraudulent transfer, which may be grounds for a civil law remedy, and a fraud, which may be a tort or grounds for a criminal proceeding In a way it is unfortunate that the word "fraud" is included in both See also Ronald L Rudman and David L Lockwood, *Asset Protection Planning: Why it Works* and *Ethical/Liability Considerations for the Practitioner*, Financial and Estate Planning, §31,501 at 25 709 (Commerce Clearing House 1994)

[6] Osborne *supra* note 2, at §20:02 *See also* materials cited at note 7, *infra*

[7] *See* Peter Spero, *Prebankruptcy Planning*, 5 J Asset Prot No 2 at 73 (Nov./Dec 1999) The following articles and speeches by Neal L Wolf, a leading bankruptcy and creditors' rights attorney, are also very helpful in this regard: Neal L Wolf, *Understanding the Uniform Fraudulent Conveyance Act and Its Application in Creditor Attacks*, 1 J. Asset Prot No 4 at 34 (March/April 1996); Neal L Wolf, *Fraudulent Conveyance Law as Contained in the U.S. Bankruptcy Code*, 1 J. Asset Prot No 6 at 25 (July/Aug 1996); Neal L Wolf, *The Right of 'Future Creditors' Successfully to Maintain Actions Under the Fraudulent Conveyance Statutes*, 2 J. Asset Prot No 5 (May/June 1997); Neal L Wolf, *Fraudulent Conveyance Law: The Tool By Which The Aggrieved Creditor Attacks the Asset Protection Plan* Address before the American Bar Association 9th Annual Spring CLE and Committee Meeting (May 14, 1998)

[8] Osborne, *supra* note 2, at §20:02

[9] *See*, The International Trusts Act (1984), as amended by the International Trusts Amendment Act (1985) the International Trusts Amendment Act (1989), the International Trusts Amendment (No 2) Act (1989) and the International Trusts Amendment Act (1991) (Cook Is)

[10] Austin Wakeman Scott and William Franklin Fratcher, The Law of Trusts, § 1 at 12 (4th ed 1987)

[11] *Id* at 9-11

[12] *Id* at 8-11

disturb this relationship, the relationship should be honored Indeed, trusts (or "uses" as they were originally termed) have been used historically to avoid the application of laws that had become outdated (for example, in the fifteenth century uses were employed to defeat feudal doctrines).[13] While "[t]he use of the trust to evade the claims of creditors has been resorted to for some six hundred years [and such] purpose is to be condemned," the trust has also been an historical "instrument of law reform" when the laws required modernization.[14] While "[t]he trust has often served as a means of evading the law [t]he evasion that in the long run proves successful is usually a reform."[15] The evolution of the asset protection trust and its statutory framework is in answer to a shifting legal and economic environment that is demanding change If the planning is done with due and careful regard for creditors' rights, there is nothing inherent in Anglo-Saxon jurisprudence that necessarily condemns asset protection trusts Planning must be done within the bounds that protect creditors but if those creditors worthy of protection are protected then the asset protection trust should be able to comfortably take its place among the other vehicles available to protect one's assets and limit liability For example, at the core, there is really no distinction between an asset protection trust and an ERISA qualified plan, and no one has seriously condemned ERISA's anti-alienation provisions.

In addition to the fact that there is planning flexibility under creditors' rights law, there are some powerful forces working in favor of asset protection First and foremost is client demand; the interest in protecting assets is not universal, but it is both widespread and incessant, and it is driven in large measure by a serious lack of faith in our legal system to render fair results Many persons of wealth perceive themselves to be at risk no matter what sort of professional, business, or personal activities they undertake They genuinely believe that the plaintiff's bar can make a case and generate liability under the most absurd and unlikely set of facts. This concern reaches across the spectrum of those who have wealth: doctors, lawyers, accountants, architects, entrepreneurs, entertainers, professional athletes, heirs to fortunes, etc Whether the perceptions are well-grounded or not, they are real, and they drive the decisions of these individuals As a result, most wealthy clients are interested in asset protection advice.

Second is legislative reaction In response to these concerns regarding the inability of the legal system to render fair results, beginning in 1989 in the Cook Islands and proceeding apace on a global basis, jurisdictions have enacted laws to compete for and service the asset protection work[16] In addition to the so-called offshore jurisdictions, no less than four states, Alaska, Delaware, Nevada, and Rhode Island, have now made it possible to settle asset protection trusts in their respective jurisdictions.[17] And finally, while the anti-asset protection advocates have cited with delight the imprisonment of the settlors in the *Anderson* case and the *Lawrence* case, no less an authority than the Supreme Court of the United States has, at a minimum, expressed understanding for and acceptance of, if not actually sanctioned, asset protection planning.[18] All that is to say that while the legal debate about the appropriateness of asset protection planning may rage, neither side has a clear winner, and there is substantial statutory and case law facilitating asset protection planning

It may well be true that some of the client's concern is paranoia. It may also be that the paranoia is fed by marketers of asset protection structures, both foreign and domestic Indeed, clients may come to an ACTEC Fellow with an asset protection plan that someone has sold or is trying to sell Lawyers may not be competent to understand, much less evaluate, all the subjective factors that motivate clients, but if an attorney is engaged to provide counsel regarding asset protection planning, that attorney must be prepared to respond to the vagaries of the client's agenda, including the client's perceived asset risk Because so many clients have asset protection high among their priorities, this issue will be even more important in the ACTEC Fellow's practice in the ensuing years

As a practical matter, what does all this mean for the ACTEC Fellow? It is submitted that asset protection advice and asset protection trusts do not inherently violate the foundational principles of Anglo-Saxon jurisprudence and that they will eventually find their place and their boundaries in our current legal system either by virtue of legislative change or judicial recognition Therefore, the "duty" identified by Mr Spero at the outset of this article is a concern to be taken very seriously The estate planning bar is particularly at risk in terms of a potential duty, because various aspects of the estate planning representation inherently involve asset protection activities, i e , tax planning, creation of

[13] *Id* at 16.
[14] *Id* at 7.
[15] *Id*
[16] Osborne, *supra* note 2, at §§27:01-47:93.
[17] Alaska Trust Act, Alaska Stat §§ 13 36 105 220 (1997); Qualified Dispositions in Trust Act, Del Code Ann tit 12, §§3570-3575 (1998); Spendthrift Trust Act, 1999 Nev Stat 299; Qualified Dispositions in Trust Act, 1999 R I Pub Laws 402.
[18] *See Grupo Mexicano de Desarrolo S V. v. Alliance Bond Fund, Inc* 119 S Ct 1961 (1999).

trusts for spendthrift children (or spouses) or other beneficiaries who may need assistance with asset management, retirement plan work (ERISA qualified plans under federal law enjoy the best of all asset protection, but some states also protect non-qualified plans) and the inevitable involvement with client's assets and solutions to their problems which produce, for example, limited liability structures such as family limited partnerships What is all this work, if not, at least in part, the exercise of limiting exposure to liability, *i e*, asset protection planning? It would be easy for a creative plaintiff's lawyer to argue that an estate planner has a duty to engage in asset protection planning.[19]

Of course, an ACTEC Fellow may well decide that he or she does not want to do asset protection work. Prudence suggests that in such a case the lawyer should raise the issue with the client and make it clear that this legal service is not being rendered and should articulate that position in conferences and confirm it in writing, preferably in an engagement letter that is acknowledged by the client. If estate planning representation is underway, the ACTEC Fellow should consider modifying the engagement letter to reflect the understanding that asset protection advice is not being rendered

If the ACTEC Fellow does decide to engage in asset protection planning, he or she must be educated about the fraudulent transfer laws applicable in the jurisdictions in which that person practices At a minimum, the lawyer should have a working knowledge of the statutes and the cases decided under them Knowledge of the federal bankruptcy statutes that protect creditors is also necessary, although as a practical matter, state statutes are usually *more* protective of creditors' rights than the bankruptcy laws If a lawyer plans under the guidance of the state laws, the resulting plan is *generally* more conservative than would be the case under the federal laws. Finally, a lawyer must know the so-called shield laws of his or her state, i e, those laws that exempt certain assets from the claims of creditors.

With respect to any given case, the lawyer should do a serious in depth analysis of the client's solvency[20] This project begins with a listing of all assets, a subtraction of all debts, liabilities, claims, and contingent liabilities *and* a subtraction of assets which are already protected from creditors' claims under applicable state and federal law, *e g*, homestead, ERISA qualified plans, etc Be aggressive about identifying liabilities and contingent liabilities, *i e*, list not only debts, but guarantees, contingent claims, pending lawsuits, and even potential claims In some cases, it may be appropriate to engage a CPA to produce an audited financial statement Also, inquire about the client's business and professional reputation For example, does the physician client have a history of malpractice claims? Does the business client have a history of disputes with creditors, associates, etc ?[21] (The information on the Internet can be tremendously helpful here.) If anything untoward arises in the course of the solvency analysis, the lawyer should secure the relevant facts and evaluate them. If a serious problem appears, the attorney might either withdraw from the representation or retain as co-counsel an attorney with expertise in creditors' rights[22]

Finally, at the end of the solvency analysis, devise a methodology which is sure to protect creditors These authors typically implement a plan with a limited percentage of the solvency figure For example, assume a client with the following:

$ 10,000,000	total assets
- 2,000,000	debts, claims, guarantees, contingent liabilities, threats, etc
- 3,000,000	protected assets, e g., ERISA plan, homestead, annuities, life insurance[23]
$ 5,000,000	SOLVENCY
x 30%	
$ 1,500,000	available for further asset protection planning

There is no magic to the 30% figure shown in the example; it is a matter of subjective judgment However, only in very rare cases do these authors exceed 50%, and the figure is usually less The influencing factors are the size of the assets (*i e*, the absolute dollars involved), the nature of the client's business and professional activities, the potential source of any claims and the additional tools that might be available But the primary point here is: leave something signif-

[19] Braunstein and Burger, *supra* note 1

[20] Duncan E Osborne, *Asset Protection and Jurisdiction Selection* 33 Univ of Miami Philip E Heckerling Institute on Estate Planning 14-1, 14-4 (1999)

[21] As a practical matter, uncovering a serious problem generally occurs within the first client conference and does not take serious digging

[22] These authors have on occasion proceeded with creditors rights co-counsel and completed planning that permitted the implementation of some asset protection tools and rejected others.

[23] States vary in the protection from creditors that is afforded annuities and life insurance, but in many states, the cash surrender value is protected Osborne *supra* note 2 at 8:01- 8:53

icant on the table Such an approach minimizes, if it does not eliminate, the possibility of a fraudulent transfer argument because there are necessarily adequate reserves for all possible claimants

Not all asset protection planners are as conservative as the foregoing example suggests, and many attorneys will go much further and employ *"in toto"* arrangements where virtually all of a client's wealth is placed in one or more asset protection structures. Such plans bring clients to the very brink of solvency and pose risks for the client and his or her attorney The nature and extent of asset protection planning calls for a serious exercise of professional judgment

In summary, what should an ACTEC Fellow know about asset protection planning?

- You may well have a duty to deal with it either by undertaking it or expressly confirming that you are not undertaking it
- Clients want it More and more clients are interested in asset protection counsel There is a demand, and it is being encouraged by marketers of asset protection plans Do not be surprised by clients asking for it
- If you undertake asset protection planning on behalf of a client, educate yourself on the applicable state and federal laws that protect creditors and identify and establish a relationship with a leading creditors' rights attorney in your locale.
- Undertake an in depth solvency analysis of the client's assets, liabilities, and creditor protected assets Make sure you know the extent of your client's real and likely risks
- Educate yourself about the asset protection options in your state Domestic solutions frequently work in debtor friendly states like Texas and Florida, but even in *creditor* friendly states, you may be able to achieve all that is necessary, for example, with a life insurance plan, a retirement plan, and a family limited partnership Offshore trusts and out-of-state trusts can be complex and expensive and may not really be necessary
- Always be aware that you may be at risk for potentially engaging in a conspiracy to commit a fraudulent transfer and plan conservatively
- Remember, in the context of asset protection planning, you are damned if you do (under a potential conspiracy theory) and damned if you don't (under a theory that you have a duty to your client to render asset protection advice). No one ever said the practice of law was not challenging!

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EXHIBIT
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No U.S. Connections Allowed With an Offshore Trust? Wrong! Use Onshore Contacts

Frederick J. Tansill

Offshore asset protection trusts can be an excellent device for sheltering assets, but many clients worry about not having onshore connections to the trust assets. Various onshore contacts can help alleviate these fears.

It is widely believed and frequently stated that if protection is to be had for a citizen or resident of the United States using an offshore asset preservation trust (OAPT), there must be no connections between that trust and the United States. The concern with onshore connections is that, in the event claims are asserted by U.S. creditors, a U.S. nexus of the trust could provide a basis on which jurisdiction against the trust or its assets could be obtained by U.S. plaintiffs in U.S. courts.

The purpose of this article is to suggest that in many—perhaps even most—circumstances, it is perfectly appropriate and consistent with asset preservation goals for an OAPT to have certain U.S. connections, including any or all of the following:

- Location or custody of assets in the United States;
- Investment management in the U.S.;
- Trust protector domiciled in the U.S.; and
- A corporate affiliate of the offshore trustee may have a permanent establishment in the United States.

To evaluate and understand these issues in context, it is worthwhile to review the basics of asset preservation planning in general and of OAPTs specifically.

Asset Preservation in General

It is legal, moral, and prudent to protect oneself from possible claims by prospective future creditors. Persons with certain profiles and persons in certain lines of business may reasonably anticipate in our litigious society the reasonable possibility of future suits and claims. Under American law, including the U.S. Bankruptcy Code, transfers made with intent to hinder, delay, or defraud present creditors or reasonably anticipated future creditors may be set aside by such creditors as fraudulent transfers. Gratuitous transfers that render a debtor insolvent are typically deemed fraudulent as to creditors regardless of intent. Virtually all states follow the Uniform Fraudulent Conveyance Law or the Uniform Fraudulent Transfer Act or the principles of the Statute of Elizabeth, passed in 1571, all of which disregard either sort of transfer as fraudulent.

On the other hand, American law permits and sanctions transfers intended to protect the transferor's assets from *possible future* creditors.[1] Spendthrift trusts in which the settlor is among the class of potential beneficiaries are generally against public policy, void and ineffective against the settlor's creditors under U.S. law.[2]

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"Other British Common Law jurisdictions generally recognize a spendthrift trust of which the settlor is a beneficiary as perfectly valid."

The following techniques and numerous others are used in the panoply of domestic asset preservation strategies: gratuitous transfers, outright or in trust; estate freezing techniques using partnerships, charitable trusts, and/or personal residence trusts; and titling property in tenancy by the entirety. But OAPTs offer certain advantages that domestic strategies do not.

Offshore Asset Preservation Trusts (OAPTs). OAPTs are usually established in jurisdictions whose laws have one or more of the following characteristics:

- Refusal or reluctance to recognize U.S. judgments as automatically enforceable. Examples of such jurisdictions include the Isle of Man, the Cook Islands, Nevis, Belize, and Liechtenstein.
- Recognition of spendthrift trusts for the benefit of settlor as valid. Examples of these jurisdictions include the Channel Islands (Guernsey and Jersey), Gibraltar, Bahamas, Bermuda, Mauritius, Turks and Caicos Islands, the Cook Islands, Belize, and Cyprus.
- Less stringent fraudulent conveyance law than the United States. All jurisdictions that have adopted asset protection trust legislation (some fourteen at present) have this feature.

If U.S. juries tend to be receptive to plaintiffs with grievances against deep-pocket defendants, courts of many foreign jurisdictions will not give the "full faith and credit" to their verdicts and awards, which other U.S. courts must. It will be difficult to enforce a U.S. judgment in many foreign jurisdictions against assets of the settlor in such jurisdictions, and virtually impossible to enforce a U.S. judgement against assets irrevocably conveyed before a creditor problem arose by settlor into a discretionary spendthrift trust administered by an independent institutional trustee domiciled in such jurisdiction.

Unlike the United States, other British Common Law jurisdictions—for example, Belize, the Cayman Islands, the Cook Islands, Cyprus, Gibraltar, Turks and Caicos Islands—generally recognize a spendthrift trust of which the settlor is a beneficiary as perfectly valid.[3] To reduce the obvious opportunities for fraud under such a generous regime, other British Common Law jurisdictions generally permit creditors to challenge transfers to such a trust even if such creditors can show that they were potential, albeit unknown, creditors at the time of the transfer to trust.[4]

Ideal asset preservation jurisdictions (those that since 1989 have adopted specific Asset Preservation Trust legislation) have reversed this general Common Law rule permitting potential unknown and unanticipated future creditors to challenge transfers as fraudulent, and no longer sanction such claims. Such laws take various forms in various jurisdictions, but all have the effect of making it more difficult for plaintiffs to bring the cause of action and to prove fraudulent conveyance and attack trust assets.[5] Some jurisdictions impose a heavy burden of proof on the plaintiff (for example, Cook Islands law requires proof "beyond a reasonable doubt") and some have brief statutes of limitations after the creation of the trust within which any challenge must be brought or permanently barred.[6]

Psychological and Chauvinistic Hurdles for U.S. Domicilaries Setting Up OAPTs

To put it bluntly, U.S. citizens rarely trust offshore banks, offshore asset managers, or offshore lawyers. This lack of trust is typically based on lack of familiarity with offshore institutions and professionals. When U.S. citizens are told

that OAPTs are effective only if their assets are held and managed offshore, and that the offshore bank trustee they barely know may only be discharged by an offshore trust protector, presumably an offshore lawyer who is totally unknown to them, they are nonplussed and discouraged from using OAPTs. In that context, OAPTs are too "foreign" in every sense of the word.

At one time, about a decade ago, most Americans believed the United States had the only safe banks in the world. Then, in the recent recession, many U.S. banks struggled mightily, and some failed. That was a blow to the chauvinistic thinking of many Americans. Two other factors in the past decade have opened the minds of U.S. citizens who are candidates to be settlors of OAPTs to possible offshore financial arrangements: (1) more and more of the businesses they own or work for have overseas business dealings with suppliers or customers and (2) most U.S. citizens with substantial investment capital have mutual fund investments in offshore stock.

These developments have raised the comfort level of wealthier, more sophisticated U.S. residents in foreign arrangements of all types and have helped break down psychological and chauvinistic barriers to the establishment of foreign trusts. In the present environment a great deal of interest has been generated in OAPTs, and there is great demand for information on them. Nevertheless, lingering concerns will still discourage most potential U.S. candidates from OAPTs unless some amelioration of the "foreignness" of the OAPT may be offered.

Getting Comfortable With U.S. Connections

To accommodate our clients, we need to offer them options for security and comfort and show them areas of the OAPT we can tailor to provide one or more U.S. connections for their peace of mind.

U.S. Trust Protector: The classic OAPT is an irrevocable discretionary spendthrift trust of which the U.S. settlor and his family members are the beneficiaries. Typically two mechanisms provide the U.S. settlor with a sense of "control" over such a trust: (1) providing the trustee with a non-binding "Letter of Wishes," describing the manner in which he or she "hopes" the trust will be administered, typically and (2) naming in the trust a "Protector." A trust protector has the following authority:

- To discharge the trustee and name a successor trustee at any time and for any reason;
- To change the situs of the trust and its governing law in the event of unexpected developments; and
- To add and delete beneficiaries of the trust or authorized distributions to them.[7]

The role of protector is of critical importance in the settlor's overall comfort with the offshore arrangement. Why should not the protector be the settlor's lawyer, accountant, or trusted friend in the United States? Two prominent commentators—Larry W. Gibbs and Mark A. Schwartzman—serve as protectors of OAPTs they draft and recommend that the U.S. lawyer drafting the OAPT serve as protector to monitor tax planning, tax compliance, and administration at least for the trust's first few years while another suitable protector (for example, the settlor's U.S. accountant) is trained.[8]

The fear of using a U.S. protector arises from the perceived risk that a U.S. court will obtain jurisdiction over the protector and attempt to compel the protector to exercise his or her authority to relo-

"The role of protector is of critical importance in the settlor's overall comfort with the offshore arrangements."

cate the trust assets to the United States, where the creditors may seize them.

However, if we assume that an OAPT will not be used to evade existing creditors, but only to protect from potential future creditors, then we can assume that in the great majority of cases, no creditor problems threatening the OAPT assets will ever, in fact, arise. In that light, the clear priority of the settlor is to be certain that the trust is a sensible estate planning and financial planning vehicle with the flexibility to provide asset protection should the need arise. The settlor will, therefore, want to be certain that the trust will be administered in a professional, capable manner consistent with his or her expectations. A trusted protector will assure that. If a creditor problem ever looms on the horizon, it will probably be desirable for the U.S. protector to resign. The trust may provide for the succession of a protector domiciled offshore in that event. An offshore protector will not be subject to the threat of court order, mandamus, and contempt proceedings by a rogue U.S. judge determined to circumvent the perfectly legal offshore structure and get control of the offshore assets.

"Confidentiality should appertain even though the assets are held and/or managed in the United States."

U.S. Custody/Investment Management. Typically, candidates for OAPTs have substantial liquid assets and U.S. investment managers whom they have come to trust and rely on over time. Moreover, it is those very advisors who are frequently sophisticated enough and in the best position to recommend OAPTs. The use of those advisors to manage OAPT assets would both motivate the advisors to recommend OAPTs to their clients where they are otherwise appropriate, and accommodate the clients' desire to use familiar and trusted advisors to manage the assets held by the OAPTs.

Unlike U.S. banks, offshore bank trustees are accustomed to bifurcated fiduciary responsibilities, and are frequently asked to engage the investment advisor of the settlor's choice rather than manage the assets themselves. U.S. settlors often direct or "request" that their offshore trustees to engage their long-standing U.S. investment managers. Offshore trustees will often be willing to negotiate reduced trustee fees if they are not obligated to assume day-to-day investment management responsibilities. If the investment advisor is in the United States, the investment assets themselves could remain in the custody of the U.S. investment advisor or the custody of the assets could be offshore. If custody is in the United States, the investment account will not be in the name of the settlor. It will be an investment management account bearing only the name of the offshore trustee, and it may be pooled indistinguishably with other funds of such trustee. Therefore, confidentiality should appertain even though the assets are held and/or managed in the United States.

As we assume that the OAPT has been established as a failsafe for an unlikely future threat, it makes sense for the settlor to put a priority on the use of a familiar and trusted investment advisor. If, as, and when the first hint of a creditor problem suggests itself, the assets can be liquidated or wire-transferred overseas, and the investment management shifted offshore with the assets almost instantaneously.

Offshore Trustee With U.S. Affiliates. There are few, if any, very substantial, very sophisticated offshore banks or trust companies that do not have affiliates with a situs in the U.S. The offshore company might be a parent of the U.S. bank, or a sister corporation or a distant relative sharing a common corporate greatgrandparent. The power and wealth of the U.S. economy is such that virtually all of the important financial institutions in the world want to have a physical presence here. It is perilous to choose as trustee of an OAPT

an entity that has a corporate "relative" in the United States because of the concern that the U.S. affiliate could be served in a U.S. court proceeding brought by a creditor of a customer of its offshore trust affiliate.

Anxiety in this regard is reasonably founded. In *In re Grand Jury Proceedings (Bank of Nova Scotia)*,[9] the U.S. government, pursuing a criminal investigation against a U.S. citizen involving illicit drugs, obtained a grand jury subpoena duces tecum upon a U.S. branch of the Toronto-based Canadian banking corporation. The subpoena required production of financial documents pertaining to two individuals and three companies from the parent bank's branches in the Bahamas, the Cayman Islands, and Antigua. The Southern District of Florida imposed a $25,000/day fine, which eventually amounted to $1,825,000, on the bank for civil contempt of its order to comply with the subpoena and successfully compelled production in the United States of sought-after Bahamian and Cayman assets and information. The case is potentially a nightmare precedent, and one every knowledgeable attorney in this area should be familiar with.

However, a state court might not be as anxious as this federal court was to assist a nongovernmental creditor in a civil case, and that fair consideration of this case does not necessarily lead to the conclusion that OAPTs should only be established with banks and trust companies with no U.S. nexus.

To counter the *Bank of Nova Scotia* case risk, all OAPTs should have a trust protector with power to discharge the serving trustee and engage a new one. (The issues involved with the question of whether such a protector may be a U.S. resident have been discussed previously.) If a creditor problem flickers on the horizon, the protector should immediately discharge a trustee with U.S. nexus and substitute one with no possible grounds for U.S. jurisdiction.

The desirability of using a substantial offshore bank or trust company, which will inevitably have a U.S. presence, derives from the desire of U.S. settlors to avail themselves of well-established, respected institutions with sophisticated trust officers, systems and investment management, and security of custody. In those cases where the asset protection motivation is combined with a motivation to diversify the settlor's investment portfolio to include offshore equities with which such large offshore institutions are more familiar than U.S. investment managers, then the desirability of using a large offshore institution as fiduciary is emphasized.

"Is this foolproof? No."

On the other hand, because any U.S. creditor's first line of attack is likely to be against any affiliate of the trustee in the U.S., the settlor may want to choose a purely foreign trustee. In that case, the risk of dealing with such an entity, which is less "established," may be ameliorated by arranging for onshore custody and investment management of the trust assets. As noted previously, such U.S. assets will be difficult to trace and may be expeditiously removed from the U.S. if U.S. creditor threat looms.

U.S. Real Estate in an Offshore Trust. Trust protectors of OAPTs may be domiciled offshore, the custody and management of OAPT assets may be offshore, a trustee with no U.S. connection may be nominated, but if the assets sought to be protected consist of real estate located in the U.S., the realty cannot be shipped offshore. Or can it?

U.S. real estate can be contributed by the settlor of an OAPT to a limited partnership in exchange for a one percent general partnership interest and a 99% limited partnership interest. The limited partnership interest may, in turn, be contributed to the OAPT by the settlor, who may retain the general partner's interest and thereby retain control. Alternatively, the settlor may arrange for an unrelated party he trusts

to own the one percent general partnership interest and control the partnership. In the event of creditor problems, the limited partnership interests and the underlying real estate should be insulated from seizure and sale.[10]

Is this foolproof? No. American judges have extraordinary authority and discretion, and the underlying property and the settlor, who may also be the general partner, will be within a U.S. court's jurisdiction. If a U.S. state court judge decides to exercise his authority under equitable or legal principles to issue a court order, injunction, mandamus, or contempt citation, he may be able to bully those within his jurisdiction to do what he deems appropriate without regard to what they may view as their legitimate legal rights.

Notwithstanding the risks of this approach, it may be the only strategy available to protect substantial equity in U.S. realty from creditor claims, and, without doubt, putting U.S. real estate into a limited partnership and assigning the 99% limited partnership interest to an offshore trust will "uglify" the realty from a creditor's point of view and set up material hurdles that will improve the debtor's bargaining leverage with the creditor.

U.S. Settlor's Retained Rights. To secure the efficacy of an OAPT, the U.S. resident settlor should not have power to revoke the OAPT. The settlor should not serve as protector of his own trust, even though the laws of Belize and the Cook Islands expressly permit it. Neither should the U.S. settlor or any other U.S. resident party (other than a protector, subject to the cautions outlined previously) have any right to discharge and appoint trustees, to discharge or appoint protectors, to designate custodians or investment advisors, or to change the situs of the trust or its governing law. If the U.S. settlor has no absolute legal rights with respect to the trust, he may not be intimidated in the U.S. legal system.

"The settlor should not serve as protector of his own trust."

Tax Issues

The types of onshore connections discussed herein have no impact on the U.S. tax treatment of OAPT assets. OAPTs are normally structured to be tax neutral. Any offshore trust with U.S. beneficiaries created by a U.S. resident will, by virtue of IRC § 679, be treated for U.S. income tax purposes as a "grantor" trust, and its income will be taxed to the U.S. settlor. This is true regardless of the existence or absence of any other U.S. nexus.

Regarding the estate and gift tax consequences of an OAPT, typically the transfer of assets to such a trust will be structured as an incomplete gift.[11] As a consequence, there would be no current gift or gift tax obligation, but the full value of the trust would be included in the settlor's taxable estate at death.[12]

Conclusion

Offshore asset preservation trusts are friendlier, more useful financial planning vehicles for our U.S. clients if we open our minds to possibilities for onshore contacts for them, such as involving U.S. professionals, using offshore trustees with onshore affiliates, and transferring for protection in OAPTs title to assets located in the United States. ■

[1]See e.g., Wantulok v. Wantulok, 214 P2d 477 (Wyo. 1950); Hurlbert v. Shackelton, 560 So. 2d 1276 (Fla. Dist. Ct. App. 1990).
[2]See Scott and Fratcher, The Law of Trusts, Vol 2A, note 3, § 156 at 167–168; Restatement (Second) of Trusts, § 156.

[3]See Estate of German v. United States, 7 C. Ct 641 (1985).
[4]MacKay v. Douglas (1872) LR 14 Equity 106 (UK); Ex Parte Russell in Re Butterworth (1882) 19 Ch. Div. 588 (UK); Re Cadogan v. Cadogan (1977) 1. All ER 200 (UK).
[5]Such jurisdictions include Bahamas, Belize, the Cayman Islands, the Cook Islands, Cyprus, Gibraltar, Liechtenstein, Turks & Caicos Islands.
[6]Two years from the date of transfer in Cyprus and the Bahamas, one year under certain circumstances in the Cook Islands.
[7]E. Marty-Nelson, "Offshore Asset Protection Trusts: Having Your Cake and Eating It Too," 47 Rutgers L. Rev. 11, 64.
[8]L.W. Gibbs and M.A. Schwartzman, "Tips on International Planning for the U.S. Citizen," July 1995 Trusts & Estates 37, at 39 - 40
[9]In re Grand Jury Proceedings (Bank of NS), 740 F2d 817 (11th Cir. 1984), cert. denied, 469 US 1106 (1985); In re Grand Jury Proceedings (Bank of NS), 691 F2d 1384 (11th Cir. 1982), cert. denied, 462 US 1119 (1983). See also United States v. Levine, 951 F2d 1466 (6th Cir. 1991), in which Mr. Levine had an account at a branch of a Swiss bank in the Bahamas, and despite Bahamian bank secrecy laws, U.S. authorities gained access to information about the account by exerting pressure on the U.S. branch of the Swiss bank. In re Marc Rich & Co., AG, 707 F2d 663, 668 (2d Cir. 1983), cert. denied, 463 US 1215 (1983)
[10]B.S. Engel, "Using Foreign Situs Trusts for Asset Protection Planning," Estate Planning July/Aug. 1993, 212
[11]Treas. Reg. § 25.2511-2.
[12]Note, however, PLR 9332006, which describes circumstances in which a transfer to an OAPT was characterized by the IRS as a *completed* gift by the settlor subject to gift tax and excluded from the settlor taxable estate. This may be a trap for the unwary.

SUNDAY, NOVEMBER 5, 1995

The Washington Post

OUTLOOK

Commentary and Opinion

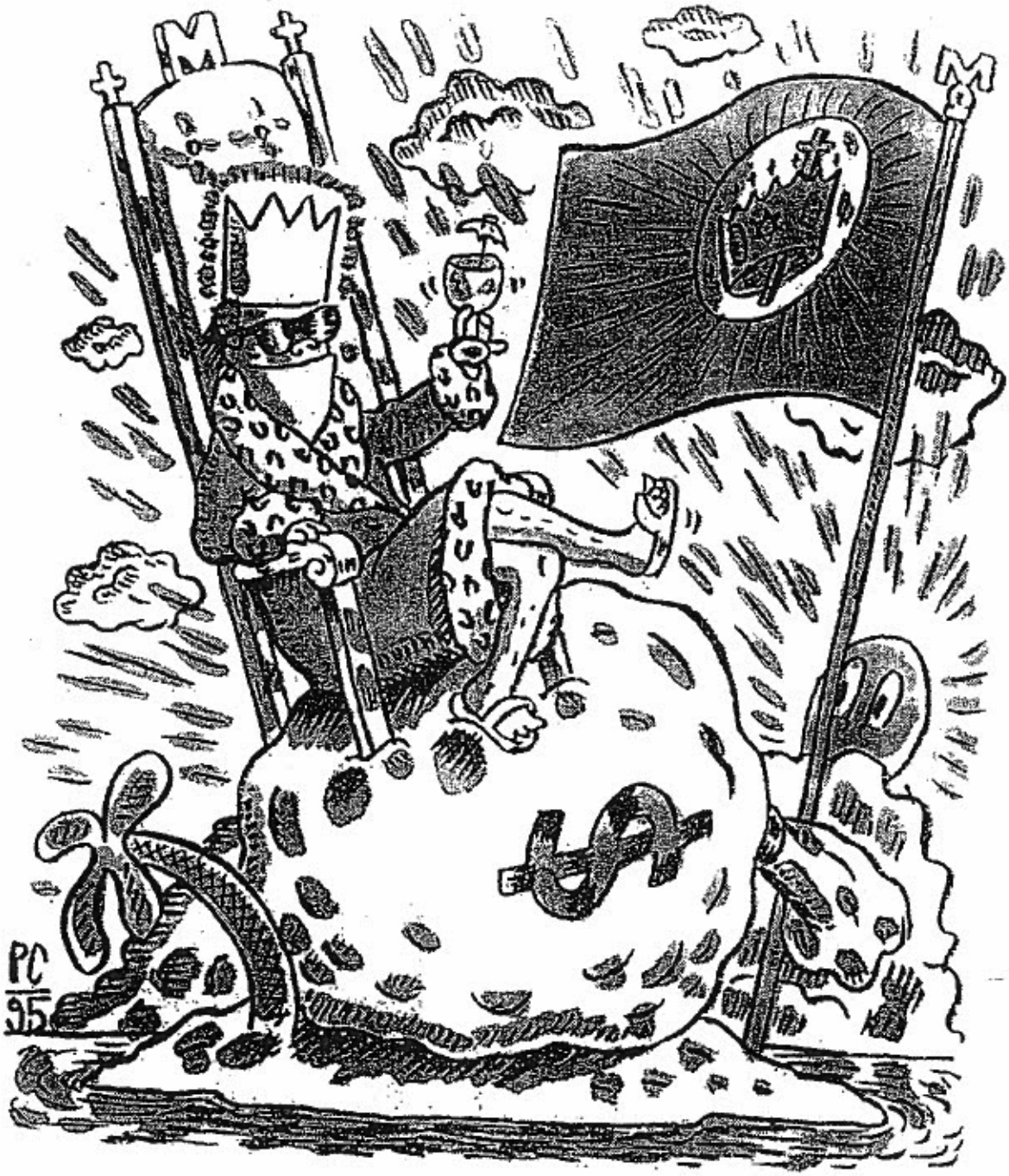
THE RUSE THAT ROARED

It's War! Island Nation Targets France in Ruthenian Missile Crisis

"We have declared war; we have declared war in an honorable cause. And we must, with honor, bring that war home to the enemy."

—From "The Mouse That Roared"

EXHIBIT 5



PAUL CORIO FOR THE WASHINGTON POST

By Richard Leiby and James Lileks

IT IS A SAD fact of modern life that anyone with a fax machine and a few spare nuclear devices can declare war nowadays. France, for example, lately has been threatened with atomic hellfire by the Dominion of Melchizedek—a mysterious island nation whose leadership consists of such colorfully named personages as Branch Vinedresser (the minister plenipotentiary) and G.M.R. Wijbers (minister of European affairs).

You might suspect that Vinedresser and his cabinet are sprung from the same sort of puckish imagination that gave us the pugnacious Duchy of Grand Fenwick in the classic 1955 novel "The Mouse That Roared." Though it lists diplomatic offices in Washington, Rome and Jerusalem, the Dominion of Melchizedek can't be found on any map. Its only apparent land holding is an uncharted, Gilliganesque isle, 14 miles square, in the conveniently remote South Pacific—which it supposedly purchased for $5 million last year.

Melchizedek (pronounced mil-KIZ-uh-dek) also claims an alliance with the dispossessed peoples of Ruthenia, who dwell in the Carpathian mountains of Eastern Europe and have no country as such. Ruled over the years by the Austro-Hungarian Empire, Poland, Czechoslovakia, the Soviet Union and Ukraine, the Ruthenians may or may not have access to nuclear weapons left behind in the former U.S.S.R.

Does this mean the rulers of Melchizedek, like the wine-makers of Grand Fenwick, now have control of The Bomb?

Probably not. Melchizedek may be merely a ruse, but getting to the truth requires a walk down a bizarre labyrinth that includes a home-brew religion, officials' names that change with kaleidoscopic ease and a history of more legal proceedings than "Melchizedek" has syllables. Based more on tax laws than territory, Melchizedek may be the ultimate post-modern state. It appears to exist mainly so that money can be whisked through shell banks. It calls to mind the prophesy issued in the movie "Network" that in the future corporations would replace nations. It even has elements of performance art: Invent your own country for fun and profit. Let a thousand Branch Vinedressers bloom.

Melchizedek calls itself "an ecclesiastical and constitutional sovereignty based on the principles of the Melchizedek Bible" (in the Old Testament, Melchizedek is the "king of righteousness" who blessed Abraham). "Our ultimate spiritual goal is to usher in the millennium of peace and righteousness," says Tzemach Ben David Netzer Korem, who serves in Washington as ambassador plenipotentiary and vice president of Melchizedek.

Such pacifism would seem at odds with declaring war on France (in retaliation, by the way, for France's recent nuclear tests in the Pacific) but then, very little about Melchizedek makes sense. It has no actual diplomatic headquarters: Don't go running for asylum to its "embassy" at 601 Pennsylvania Avenue unless you can squeeze yourself into a mailbox. Its founder, a Californian named Mark Logan Pedley, has two swindling convictions. Its president, a woman who goes by the names Mz. Pearlasia and Elvira G. Gamboa, was successfully sued by the California State Banking Department to prevent her from representing herself as a banker there.

Melchizedek says its several hundred banks hold a "net asset value" of $25 billion, yet President Pearlasia remains in arrears to the state of California, having failed to pay a court-imposed sanction of $1,431.90 for her "bad-faith actions" related to the lawsuit. On the whole, secular authorities tend to take a dim view of the Dominion.

"It's a con artists' operation through and through," declares John Shockey, head of the fraud unit in the office of the U.S. Comptroller of the Currency. "It's a phony bank, a phony country, a phony dominion—the whole thing's a phony."

From Canada to Mexico, London to Hong Kong, financial entities and individuals connected to Melchizedek have drawn the attention of banking and investment regulators. Officials say the Dominion was concocted to issue bogus banking charters; Shockey routinely issues warnings that U.S. banks should not process any checks or drafts drawn on Melchizedek banks.

In Hong Kong this summer, a judge sentenced a young

See MOUSE, C2, Col 1

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The Ruse That Roared

MOUSE, From C1

Austrian baker to six months in jail for attempting to cash checks totaling $500,000, drawn on the Asia Pacific Bank of Melchizedek. The baker called himself Crown Prince Gerald-Dennis Sayn-Wittgenstein-Hohenstein and held a diplomatic passport as Melchizedek's "ambassador at large." According to an account in the South China Morning Post, the judge dismissed the idea that the whole thing was a joke, saying, "A fraud on the banking system of Hong Kong is a very serious business."

Beyond being an annoyance to bankers and bureaucrats, the Dominion of Melchizedek enjoys toying with journalists. A few weeks ago, the Dominion grew testy with France when President Jacques Chirac insisted on detonating nuclear devices near desolate atolls in French Polynesia. Fax machines at news-radio stations spit out a press release, datelined Jerusalem and headlined "NATION DECLARES WAR ON FRANCE." It explained:

Under the Constitution of the Dominion of Melchizedek, WAR has been declared on France. On November of 1994, Melchizedek acquired sovereignty over one of the three Karitane islands in the South Pacific from the obscure Kingdom of Polynesia. The declaration of war became a necessity to protect Karitane from damage that has occurred . . . from the nuclear testing in the South Pacific. The declaration is made on behalf of all mankind.

It is with reluctance that the Polynesian Melchizedek Dominion declares war on France, since up till recently France was considered a silent ally. The Ruthenian Melchizedek Dominion is considering aiming at France the nuclear weapons left behind in the Carpatho mountains by the Soviet Union as leverage in the war.

No doubt confused and sidetracked by the Comoran Island crisis in the Indian Ocean (which also involved those trigger-happy French), most journalists ignored the provocative fax. Gravely concerned, we called the Melchizedek Embassy in Washington for more information and were sent follow-up communiques that attempted to clear up everything.

"There has been a leak concerning our pending Declaration of War which we have not yet released to France," one fax read.

A leaked threat of war? How could this possibly happen?

"We're not entirely sure," Vice President Korem elaborated by telephone. "We were working on a possible official declaration of war to send to France, but before we could do that, we started getting calls from radio stations asking if we'd declared war on France. We were only discussing it and somehow it turned into a press release."

In any event, he denied that the Dominion was serious about using its nukes to protest nuclear testing: "The indication is that our people in Ruthenia are threatening to do that without our approval." The weapons, Korem warned, "are available to us if we want to use them. But we're caught in a dichotomy—our principles are peace, and to use nuclear weapons would run against our ideas. We want to establish the government on Earth that would be a model for other governments to follow."

The next day, Korem couldn't resist the temptation to insert The Washington Post into this diplomatic tango. "If you choose to write about [Melchizedek] you may use said article as a platform to announce our declaration of spiritual war on France, not to harm, but only to bless our enemies," he faxed. "This is our way of registering our protest against further nuclear testing."

We informed the French Embassy of the situation. The French, being French, were snootily amused.

"I have nothing to say," remarked embassy spokesman Jean-Christopher Belliard. "Of course, I feel a great deal of emotion now; we are probably at war, I may be called at any minute to fight." Then he started laughing. "I follow matters quite closely and haven't been informed of this."

The Ruthenians, being Ruthenian, were a bit difficult to locate. Several hundred thousand of them—now usually called Carpatho-Rusyns—are dispersed throughout Ukraine, Slovakia, Poland, Yugoslavia and Hungary. Eventually we found an esteemed expert: Prof. Paul Robert Magocsi, head of the Carpatho-Rusyn Research Center in Vermont and representative to the World.

"In a word, it's silly," Magocsi said of the supposed alliance with Melchizedek. (He had two words for the notion of Ruthenian nukes: "completely unreal.")

"It's all news to me," said a spokesman for the State Department's Office of the Geographer and Global Issues. He proceeded to express considerable doubt about Melchizedek's claims to any territory—including Karitane island, which, Korem says, lies some 1,200 miles southeast of New Caledonia and was bought from the Kingdom of Polynesia.

Make that the *alleged* Kingdom of Polynesia—it does not appear on any list of nations, independent states or dependencies. "There's no such kingdom that would have any recognition by anybody," said the official.

Obviously, Melchizedek craves legitimacy. But so far, only one government has given it any diplomatic recognition: The Central African Republic.

Included in Melchizedek's eagerly-supplied kit of governmental bona fides is a copy of a 1993 letter from the president of the Central African Republic formally recognizing the Dominion and inviting it to open a diplomatic mission there. You get the feeling that the Central African Republic would recognize the State of Denial if it had a letterhead.

Another item in the kit is a copy of the Washington phone book page listing the embassy's number, right there with famous countries such as Malta, Mongolia and Myanmar. See? See? They wouldn't put it in the phone book if it wasn't true.

Korem also put us in touch with the Dominion's European emissary, G.M.R. Wijbers, who explained from Holland that he once met for "five minutes" with the previous president of the European Union and has exchanged letters with current officials. Wijbers had an impressive Dutch accent, chatted in German, and gave his full name as Gerrit Melvyn Rico Wijbers. Friends call him Rico.

So: Melchizidek has leaders, laws, religion, a flag, a disputed homeland and an unreasonable territorial claim—the textbook definition of your basic nation-state. Who's to say it's phony?

PHOTO BY DUDLEY M. BROOKS—THE WASHINGTON POST

There's even an April 1995 letter that the U.S. Immigration of Naturalization Service sent to the Dominion's embassy address. The letter requests "some item of uniform insignia from your country's law enforcement services," to be displayed in an exhibition of global law enforcement badges at the Atlanta airport in 1996. The INS is putting together the display for the Olympics and fired off a form letter to everyone on a list supplied by the post office. Janet Jackson probably got a request for the badges of the Rhythm Nation.

But Melchizedek treats this request as de facto recognition and even an invitation to ready its athletes for the Olympic games. Included in its listing of high officials is one Larry W. Axmaker, "Governor of the Dominion Olympic Team, co-founder of Dominion University." The university exists solely on the Internet, offering instruction by e-mail.

"We're not going to make it to Atlanta," Korem says with regret. "We're hoping that by the 2000 Olympics we'll be able to participate."

The nagging question: Why does Melchizedek want publicity? Having developed this bad reputation with bunko squads, why would it invite scrutiny by the press? Any reporter with the gumption to check Lexis-Nexis is bound to come across Melchizedek-related stories with such headlines as:

- "Action Taken on Pyramid Scheme" (The Financial Times, Aug 8, 1995)
- "Plot Thickens in Phony Bank Scheme" (Times of London, Aug. 8, 1993)
- "Insurer Chartered by Phony Country" (Orange County Register, Feb. 2, 1993)
- "District Probes Off-Shore Companies for Fraud" (Washington Business Journal Feb. 25, 1991)

William Barrett of Forbes magazine exposed Melchizedek in a January 1991 report titled "Father of His Country," which tracked the global dealings of the elusive Branch Vinedresser, also known as Mark Logan Pedley. Back then, "ambassador." Vinedresser claimed to own the island of Malpelo, 300 miles off the Pacific coast of Colombia—never mind that the island belongs to Colombia.

After the Forbes report, Pedley landed in the hoosegow in California for parole violations. He had been a codefendant with his father, David, in a Mexican peso conversion swindle. Pedley Sr. had a record of four convictions, including stock fraud.

David Pedley is reported to have died in Mexico in 1987—but the body was never identified upon arrival in

the United States. The Pedley famil refused to let FBI agents fingerprint the corpse at the closed-casket ceremony. Some officials suspect that body in the casket was not in fact David Pedley's—and that the elder man is still doing business somewhere.

"I learned it all from my father; I had years of lessons," Mark Pedley told Forbes. "He was the most Godly man I knew."

"I am the true vine, and my Father is the vine-dresser."

—John 1:15 (Confraternity Version)

Finally, we meet. Ambassador Korem is a striking figure, dressed in a loose tunic and sporting a cap worthy of an extra in a Cecil B. De Mille biblical epic. His beard flows to mid-chest, after the custom of "the Nazarites," he explains. Korem introduces his wife, Pearlasia, a Filipino resplendent in a red silk blouse and hand-woven skirt laced with thick golden threads.

The ambassador holds forth in a conference room seemingly made available to all the tenants of this particular floor, including those who, like Korem, only rent mailbox space. Korem has taped the flag of Melchizidek on one wall. He explains that he is shopping for a permanent location on Massachusetts Avenue's classy embassy row.

Larry G. Madrigal of Virginia Beach, another Melchizedekian "ambassador," offers evidence of the Dominion's wealth. He opens his briefcase and produces a royal purple velour bag. With the flourish of a jeweler, Madrigal invites a reporter to inspect the bag's contents. It's a gleaming, authenticated one-pound bar of platinum, worth about $6,500. There's 33½ *tons* more where that came from, says Madrigal—worth close to $440 million and available to back Melchizedek's currency.

The delegation also presents a copy of the Melchizedek Bible, price $24, which is the Word as "metaphorically translated" by David and Mark Pedley, who received their instructions from God while in prison. "Only God reveals noumenon and phenomenon," reads Genesis 1:1 of this bible.

Both David and Mark Pedley were persecuted men, says Korem. But for religious leaders, "being a political prisoner goes with the territory," he notes. "Martin Luther King. Ghandi. Moses. Joseph. Jeremiah. Joseph Smith, the founder of the Mormons, died in prison."

No need to mention what happened to Jesus Christ. Or, for that matter, David Koresh.

But Tzemach Ben David Netzer Korem denies that his ecclesiastical sovereignty is some low-grade cult; he says his nation has "millions" of spiritual citizens. A reporter asks for proof of various alliances and territorial claims and Korem supplies reams of paper decorated with gold seals. He hands over a "diplomatic passport" with the caveat that the reporter should not "abuse that power" by attempting to use it to beat D.C. traffic tickets.

The visitor wonders whatever became of the Pedleys, father and son. Is Pedley Sr. truly dead? "We don't know," Korem says. "In our hearts, he's alive."

And Mark Pedley—is he out of jail yet? Yes, and staying right here in Washington, Korem says. In fact, Pedley might even be willing to sit for an interview.

What of the past legal problems of Melchizedek? "That page has been turned," Korem vows. "We forgive the individuals in government who felt they had to persecute our leaders."

So, then, no more scamming. But just one more question. What is Korem's real name?

He produces his California driver license and translates his name from the Hebrew. Tzemach means "flower." Ben David means "son of David." Netzer means "stem." And Korem means—he pauses—"wine presser."

Stem Winepresser . . . Branch Vinedresser. A coincidence, no doubt. And it's just a coincidence that Korem's driver license photo uncannily resembles a police mug shot taken of Vinedresser, aka Mark Logan Pedley. And it's sheer happenstance that Mark Pedley and Korem were born on the exact same day, July 19, 1953.

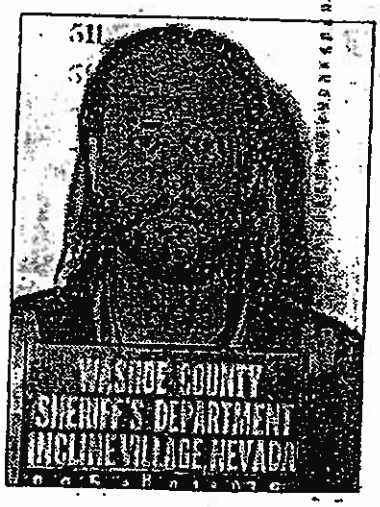
"God bless you," Korem-Vinedresser-Pedley calls out as the journalist takes his leave.

We can be sure of this much: The Dominion of Melchizedek is not a gag. Like the Duchy of Grand Fenwick, it is a work of art. Melchizedek's leaders may not own an island. But they do possess a pound of platinum. They can't launch nukes. But they can give creative bankers many interesting investment alternatives. Ultimately, the French need not worry. Melchizedek will not sweep the Olympics.

Above: Don't try beating a D.C. traffic ticket with one of these diplomatic passports.

At left: Tzemach Ben David Netzer Korem, the vice president and ambassador plenipotentiary of the Dominion of Melchizedek, on a visit to its Washington "embassy."

Below: The nation's "minister plenipotentiary," Branch Vinedresser, after his 1991 arrest in Nevada for a parole violation.



SAMPLE LETTER OF WISHES

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June 15, 2010

Trust Officer
_____ Bank & Trust (Bahamas) Limited
Nassau
The Bahamas

PERSONAL AND CONFIDENTIAL. SUBJECT TO ATTORNEY-CLIENT PRIVILEGE. NOT TO BE DISCLOSED TO ANY PARTY OUTSIDE OF BANK & TRUST

re: Letter of Wishes

Dear (Trust Officer):

The _____ Trust Settlement, between _____ and _____ Bank & Trust, an irrevocable trust, has been created. All terms used and not otherwise defined in this letter shall have the same meanings as in Trust Settlement.

The objectives of the said Settlement are minimization of death tax, particularly U.S. federal estate tax, avoidance of court supervised probate administration, investment management and diversification, including global investing, avoidance of court supervised guardianship, preservation of the confidentiality with respect to the nature of the assets and the dispositive plan, and the security and preservation of the capital contributed thereto. While the Settlor is alive this trust is to be held for the benefit of the Settlor, his spouse and children and more remote descendants (if any)

(the "Primary Beneficiaries"), and for the benefit of certain more distant relatives, and charitable organizations favored by the Settlor (the "Secondary Beneficiaries"). After the Settlor's death, after the payment of certain estate expenses, debts, devises, bequests, taxes and other charges, it is to be held in continuing trust for the benefit of his spouse for life, with all net income being distributed to her no less often than quarterly for life. Principal should be available to her if she needs it. At his spouse's death, or if she fails to survive, the Trust assets are to be held in lifetime discretionary trusts for his children in equal shares, subject to the exercise of testamentary powers of appointment. If at any time he has no immediate family, the Trust assets are held or are distributed to certain more distant relatives and possibly charitable organizations. The settlement allows _____ Bank & Trust considerable discretion with respect to distributions and administration, particularly while the Settlor is alive. The Settlor has asked me to write to inform the Trustees of his hopes and wishes with respect to the management, investment and distribution of the income and principal of the trust. The Settlor understands that he has no power to request the Trustees to follow his wishes, but he hopes the Trustees may find an expression of his wishes useful in discharging the responsibilities it has accepted as Trustee. This Letter of Wishes as originally drafted or as may be amended from time to time, by the persons authorized to do so, is not intended to be binding nor to grant any rights whatsoever to any persons named herein.

Consistent with that objective, the Settlor wants the Trustees to know that his wishes regarding distributions from the trust are as follows:

- Discretionary distributions of income and/or principal should be made only when such distributions may be enjoyed by the Beneficiaries free of significant legal constraints, such as bankruptcy, injunction, court order, mandamus, contempt of court or similar proceeding. If such distributions may not be so enjoyed, they should generally be deferred until they may be so enjoyed. The Settlor appreciates that the Trustees have full power to make distributions as they see fit and understands that the Trustees may decide that genuine need exists notwithstanding the presence of constraints.

- During his lifetime, while he is not under a disability, the Settlor would hope and expect the Trustees to consider himself as the principal beneficiary of the trust to the exclusion of all others. He would hope and expect the Trustees to consult with him in all matters relating to the investment of the trust funds, minimizing administrative expenses to the trust, and deal with all distributions of income and/or principal in accordance with his wishes. In particular, as the annual net income of the trust will be taxable to the Settlor in the United States, the Settlor would hope and expect that the Trustees would distribute to him annually sufficient funds to pay the U.S. federal and state income tax due on the trust's income, whether on ordinary income or capital gain, long- or short-term, if the Settlor so requests, or pay the tax due directly to U.S. federal and state taxing authorities. The Settlor does, however, express an overriding wish that the Trustees may act in their absolute discretion.

- While the Settlor is alive and not under a disability, if distributions to him are improvident because of unexpected constraints, the Settlor would hope the Trustees would look for opportunities to make distributions:

  - for his benefit, directly to vendors or service providers
  - indirectly for his benefit, to or for the benefit of the other Primary Beneficiaries, e.g., his spouse and his children
  - only if the Settlor suggests, if he is alive, or if his wife suggests, if he is not alive and competent but she is, or if his children unanimously suggest, if neither the Settlor nor his spouse are alive and competent, to the other beneficiaries named, the Secondary Beneficiaries

  as circumstances dictate.

The Settlor would like to see the Trustees handle the investment of the Trust Fund by managing certain assets itself, and with respect to other assets, by engaging, if the Trustees approves, an investment manager to be suggested by him with the advice and consent of you as Trustee. After discussing this matter with you, he will inform you of the assets he would like you to manage yourself, and how, and of his suggestion as investment manager, and your instructions to such manager. Please contact the Settlor with questions regarding any particular proposed investments or the selection of an investment manager.

The Settlor reserves the right to request that I or the Protector or he himself may send the Trustees another letter of wishes signed by him at any time during his life modifying the wishes expressed herein. Other than as stipulated above, while he is alive and not under a disability the Settlor does not wish for any person to have the authority to alter this letter of wishes. After his death or disability, the Settlor intends that his wife and his children who survive and have attained the age of eighteen, acting by majority, may jointly amend this letter, but only if the Protector then serving joins in the amendment of this letter. After the Settlor's death or disability, he wishes that the Protector shall direct the investment of the Trust Fund.

The Trustees should bear in mind at all times that the Settlor's first intention in establishing this trust is to provide for his own financial needs, secondly for the needs of the other Primary Beneficiaries, for his spouse and children and more remote descendants, and finally, only if no spouse and no descendants survive him, for the other Secondary Beneficiaries named in the Trust.

The Settlor asked me to write to the Trustees in this privileged communication to express his wishes. The Trustees may feel free to call the Settlor to confirm the authority of this letter. Because this letter should be free from discovery in any judicial proceeding because of the attorney-client privilege, the Settlor would not want to see the privileged status of this letter jeopardized by having the Trustees produce the letter to any other person for any reason. For the same reason, the Settlor does not wish to correspond with the Trustees directly with respect to these matters.

Respectfully,

FJT/slb

Frederick J. Tansill
Attorney for the Settlor

Enclosures

I have reviewed this letter of wishes and approve it.

_____
Date

Settlor

This will evidence receipt of the letter of wishes of the Settlor by the Trustee.

Bank & Trust Co.

By:

Name printed:

Title:

Date:

THE WALL STREET JOURNAL

TUESDAY, OCTOBER 14, 2003 D1

Litigation Boom Spurs Efforts To Shield Assets

Doctors, Executives Turn to Trusts That Are Off-Limits to Creditors; Opting to 'Go Bare' in Florida

By Rachel Emma Silverman

THE DRUMBEAT of litigation against doctors, accountants, business executive and other professionals is prompting a growing number of people to play defense: They're putting their money where creditors can't get to it.

A key technique is the so-called asset-protection trust. The idea is to put a big chunk of your money in an irrevocable trust. The trust is run by an independent trustee, who may opt to give you payments from time to time. If done correctly, the trust—which has to be located in a jurisdiction that has passed special laws—generally can't be touched by creditors if you're sued or file for bankruptcy protection.

Doctors have been setting up asset-protection trusts for years to protect themselves from malpractice litigation. But with the latest round of corporate scandals and the passage of the Sarbanes-Oxley Act, which makes top executives and directors accountable for their company's financial results, more executives are seeking asset-protection trusts.

"They don't want to lose everything they've worked hard for," says Gideon Rothschild, a partner at law firm Moses & Singer LLP, in New York.

Nobody tracks exactly how many asset-protection trusts are drafted each year, especially since many are located in exotic offshore jurisdictions. But lawyers and trust companies say interest in them seems to be increasing. National City Corp's Delaware-based trust company, which started only 10 months ago, expects to pull in $200 million in asset-protection trust business in its first two years. John Dadakis, a partner at Morrison & Foerster in New York, has seen his asset-protection work increase fourfold since the late 1990s.

Protection?

- [illegible]
- [illegible]
- [illegible]

Most asset protection trusts are located offshore, in locales like the Cook Islands, Nevis and Gibraltar, which have attracted sizable trust business by enacting laws that protect trusts from U.S. creditor claims.

But the number of U.S.-based trusts is now picking up as states change their laws, partly to lure people who are worried about putting their wealth abroad. Alaska, Delaware, Rhode Island, Nevada, and as of this year, Utah, now permit these trusts for both residents and nonresidents. About 1,500 domestic asset protection trusts holding more than $2 billion in assets have been created since 1997, estimates Richard Nenno, managing director and trust counsel, Wilmington Trust Co., Del.

Rising malpractice insurance rates are a key reason. In Florida, for example, climbing premiums have spurred many physicians to forgo coverage altogether, and instead use other asset-protection techniques. Marc Singer, a partner at Singer

Please Turn to Page D2, Column 4

EXHIBIT 7

Litigation Boom Spurs Efforts to Shield Assets

Continued From Page D1

Xenos Wealth Management, Coral Gables, Fla., says that about 60% of his physician clients "go bare" and drop malpractice insurance because of the high cost and limited coverage of policies. That's a big jump from 10 years ago, when only about 20% of his clients practiced without insurance.

A recent survey of individuals with more than $1 million in assets found that 35% had some form of asset-protection plan, compared with just 17% of respondents in 2000. And more than 61% of the respondents who didn't have an asset-protection plan were interested in creating one, up from only 43% in 2000, found the study by Prince & Associates, Redding, Conn., a market research and consulting firm.

Domestic asset-protection trusts are controversial, because they haven't yet been tested in court and it is still unclear how well they'll hold up. Article IV of the Constitution says that each state should have "full faith and credit" in the legal judgments made in other states. Lawyers, therefore, worry that a plaintiff who wins a judgment in a New York court might be able to enforce the ruling against an asset-protection trust created in Delaware.

"We are very careful to point out that this is not necessarily bulletproof, but that it is the best thing going," says Peter Valente of law firm Blank Rome.

People setting up asset-protect trusts have to pay attention to avoid running afoul of the law. While creating an offshore asset-protection trust may sound sketchy, they're legal as long as they're not used to evade income taxes; you have to disclose the assets and income in the trust to the Internal Revenue Service.

Another caveat: People shouldn't set up an asset-protection trust if you know you have a potential legal action looming on the horizon. Courts are likely to rule against such a trust, calling it a "fraudulent conveyance," if it is set up right before a lawsuit, bankruptcy or divorce.

Lawyers caution that you shouldn't put all of your assets into these trusts.

Brian D. and Elizabeth G. Weese, the owners of a now-defunct Baltimore bookstore chain, recently faced several lawsuits charging that they fraudulently moved nearly $20 million in assets to a Cook Islands trust called "Book Worm II" to avoid creditors ahead of bankruptcy. Several months ago, the Weeses settled the case for more than $12 million; the money was provided by Ms. Weese's father, Rite Aid Corp. founder Alexander Grass.

Domestic asset-protection trusts also can also be used to ease estate taxes. Because you give your assets to the trust, the funds are out of your estate for estate-tax purposes. However, the trust can't make payments to you on a regular basis, or that would invite the scrutiny of the IRS. "You can't use the trust as a checking account," says Mr. Nenno, of Wilmington Trust.

Asset-protection trusts don't come cheap. Offshore asset-protection trusts can cost anywhere from $20,000 to $50,000 to set up, plus annual administrative fees of $2,000 to $5,000 and asset-management fees of about 1% on the assets placed in the trust. Domestic asset-protection trusts cost less, running anywhere from $3,000 to $10,000 in attorney's fees, plus asset-management fees of roughly 1%.

Because of the high fees, asset-protection trusts generally don't make sense unless you're willing to put at least $1 million in them. Still, a few financial-services companies, like National City Corp., cater to smaller trust accounts of about $500,000, attractive to professionals at earlier stages in their careers.

Lawyers caution that you shouldn't put all of your assets into the trusts, because you're only a so-called discretionary beneficiary. That means you won't have regular access to the trust assets.

EXHIBIT 8

Shelter from the Storm

T&E exclusive: Survey charts the rising importance of asset-protection planning

By Russ Alan Prince, president, Prince & Associates, Shelton, Conn., and Richard L. Harris, managing member, BPN Montaigne LLC, Clifton, N.J.

Wealthy clients want asset-protection plans, and many lawyers, despite doubts about the savoriness of such strategies, are interested in considering them. But they don't because, they admit, they don't quite know how.

These are the findings of a 38-question telephone survey conducted in April by Prince & Associates of 227 private-client lawyers, all of whom derive at least 51 percent of their income from work with individuals (as opposed to institutions).

In asset protection, advisors essentially construct a legal fortress around wealth. This planning is particularly important for high-net-worth clients worried about litigation and divorce possibly endangering their estates. It is, however, sometimes unethical and maybe even illegal for advisors to help clients try to shelter assets from existing and probable creditors. (See "Asset-Protection Planning: Ethical? Legal? Obligatory?" page 42).

> The wealthier a client is, the more interested he is in asset-protection planning.

Still, many lawyers have doubts about asset protection. Only 27.8 percent agreed strongly with the assertion, "Asset protection is legal and should be discussed with most wealthy clients." But asset-protection planning has its place.

Certainly clients think so. A majority of the private-client lawyers (55.1 percent) report that their clients are "very" or "extremely" interested in it.

And the more financially successful the survey respondents, the more likely they are to think asset-protection planning is important to clients. That's because the wealthier a client is,

tive It also would separate the financial and personal aspects of the relationship among the three children and allow for family harmony.

MONKEY WRENCH

Rodney is an unknown factor, as he may want to work for Famco after he graduates from college. If either of the Smiths is living at the time of his decision, they can handle the situation by creating an appropriate position for Rodney and transferring Famco stock to him either during their lifetime or in their wills, somewhat similar to what they decide to do for Sally. They will have to deal with the control of Famco between Sally and Rodney, or treat them equally with the voting stock that could create a deadlock or leave someone else, perhaps David or a trusted outsider, with a tie-breaking vote.

But what if one or more children has not decided whether to enter the family business by the time the last parent dies? One solution: The parents, company and undecided children can enter into an agreement that the children can elect to become an employee of Famco on terms to be subsequently established by the Smiths or by outside directors with or without the entrenched child. Similarly, the same group could allow the undecided children to acquire company stock at a formula or appraisal price payable on an installment method over a reasonable period of time to allow the undecided children to use their earnings for the payments. Thus, the parents would not have to rely on the entrenched child alone to make the decision and establish the terms of undecided children becoming employees and shareholders of the family business.

LOOSE ENDS

If Rodney becomes an employee of Famco or if other family or non-family member employees become Famco shareholders, one question that should be answered in advance is: Should the company have an option to acquire the shares of a departing employee?

If such an option is in place and is exercised, Famco probably will want to prevent the terminated employee from disclosing confidential information, calling on Famco's customers or otherwise competing with Famco for some reasonable period of time. All of these stipula-

continued on page 49

the more interested he is

About half the respondents earn $250,000 or more a year; their clients during the previous two years had an average net worth of $5.3 million. The other half of the lawyers surveyed earned less than $250,000 and, during the same period, had clients with an average net worth of $1.8 million.

A whopping 74.8 percent of the high-income lawyers saw considerable interest in asset-protection planning among their high-net-worth clients. Only 34.8 percent of the lower earning lawyers said asset protection was "very" or "extremely" important to their clients.

All the lawyers say that their wealthiest 20 clients tend to be more interested in asset-protection planning than the rest of their clientele. More than four out of five (84.6 percent) private client lawyers report that their top 20 clients are "very" or "extremely" interested in asset protection planning (90.4 percent of high-income lawyers and 78.6 percent of mid-income lawyers).

SIGN OF THE TIMES

Why has asset protection become such an issue? The respondents (63.4 percent) say it's because people "are just more afraid" (see "Why Asset Protection?" this page).

But a litigious society also makes asset protection planning seem essential to clients, according to 57.3 percent of lawyers. Higher-income lawyers are particularly likely to point to litigiousness (66.1 percent compared to 48.2 percent).

High divorce rates also make clients value asset protection, according to 52.4 percent of those surveyed. For high-income lawyers, this reason is more pressing (58.3 percent compared to 46.4 percent).

Private-client lawyers expect asset protection planning to become more critical in the future. Of those surveyed, 66.1 percent predict asset protection will play a greater role in their practices (See "Crystal Ball," page 40). This is especially true of the more financially successful lawyers (72.2 percent compared to 59.8 percent). A mere 10.1 percent of the total say they don't intend to make asset protection planning a major part of their practices.

LEARNING CURVE

But there is a gap between lawyers' current competency and their ideal skill levels (See "Confessions," page 40). Only 16.3 percent say they are authorities on asset-protection strategies and techniques. The more successful the lawyer, the more likely they are to rate their skills highly (22.6 percent compared to 9.8 percent).

The desire to learn is strong. Overall, 73.6 percent say they need to know more. A slightly higher proportion of the lower-income lawyers feel the need for such education (76.8 percent compared to 70.4 percent).

Where, precisely, are the deficits? A mere 13.2 percent of the total say they are very familiar with the Uniform Fraudulent Transfer Act (19.1 percent of the higher-earning lawyers versus 7.1 percent.)

In addition, many are unfamiliar with some of the strategies and techniques employed in this field (See "Toolbox," page 40). While most are comfortable with commonly used strategies such as corporate structures, outright gifts to family members, partnerships and limited liability companies,

The more financially successful lawyers are better versed in a greater number of asset-protection tactics.

WHY ASSET PROTECTION?

Respondents cite a number of reasons for clients' interest.

Percentage who agree with statement	[illegible]	[illegible]
People are more afraid now	[illegible]	[illegible]
Personal security is more important	[illegible]	[illegible]
The litigious atmosphere	[illegible]	[illegible]
Rising divorce rates	[illegible]	[illegible]

CRYSTAL BALL

Most say asset protection will play a greater role in their practices

PERCENTAGE WHO AGREE WITH STATEMENT	[illegible] LAWYERS	HIGHER EARNING LAWYERS	[illegible]
Asset protection planning will become increasingly important to my practice	[illegible]	72.2%	[illegible]
I do not intend to make asset protection planning a major part of my practice	[illegible]	5.3	[illegible]

CONFESSIONS

Respondents admit they need to know more

PERCENTAGE WHO AGREE WITH STATEMENT	[illegible] LAWYERS	HIGHER EARNING LAWYERS	[illegible]
I am an authority on asset protection strategies and techniques	[illegible]	22.6%	[illegible]
I am very familiar with the Uniform Fraudulent Transfer Act	[illegible]	19.1	[illegible]
I need to become more knowledgeable on asset protection strategies and techniques	[illegible]	70.4	[illegible]

TOOLBOX

How handy are they with these asset protection techniques?

PERCENTAGE WHO USE THE STRATEGY	[illegible] LAWYERS	HIGHER EARNING LAWYERS	[illegible]
Corporate structures	[illegible]	100.0%	[illegible]
Outright gifts to family members	[illegible]	100.0	[illegible]
Limited liability companies	[illegible]	99.1	[illegible]
Limited partnerships	[illegible]	100.0	[illegible]
Intra-family sales	[illegible]	97.4	[illegible]
Homestead	[illegible]	91.7	[illegible]
Retirement accounts as exempt assets	[illegible]	72.2	[illegible]
Domestic spendthrift trusts	[illegible]	73.0	[illegible]
Domestic self-settled trusts	[illegible]	67.0	[illegible]
Annuities	[illegible]	55.2	[illegible]
Life insurance policies	[illegible]	47.0	[illegible]
Offshore self-settled trusts	[illegible]	45.2	[illegible]
Life insurance	[illegible]	42.6	[illegible]
Equity stripping	[illegible]	11.3	[illegible]

few consider themselves experts in such areas as offshore self-settled trusts, life insurance and equity stripping. In general, the more financially successful lawyers are better versed in a greater number of asset-protection tactics.

One such strategy, equity stripping, is a way to protect domestic real estate from creditors. The technique involves the client making an investment in a mortgage company. The investment has little value to creditors. The client will receive a loan secured by a mortgage on the property to be protected. The secured interest passes to an asset-protection structure, such as a trust. The cash the client receives from the mortgage also goes to an asset-protection structure. The result is that the equity in the real estate is no longer directly available to creditors while the underlying assets that represent that equity are protected.

Although state bankruptcy and creditor laws are all different, most protect some of the cash value in a life insurance policy. Florida, for example, exempts all the value in both life insurance and annuities. A properly structured irrevocable life insurance trust also can afford some protection. The trustee could have the power to distribute the principal or income to any party (including the grantor) at the trustee's sole discretion. Additionally, properly drafted ILITs can protect assets for the beneficiaries as long as the assets are not distributed.

For lawyers interested in getting more involved in this area, there are a number of opportunities. The simplest is to work with a lawyer who practices this specialty. But there also are publications, meetings and conferences as well as an asset-protection committee of the American Bar Association. Contacting the ABA is probably a good place to start. ■

EXHIBIT A

Prepared by
Duncan E. Osborne
Mark E. Osborne
as part of their materials for an ALI-ABA Program
"ASSET PROTECTION: TRUST PLANNING"
Presented in New York City
April 26, 2010
(The entire outline is available from ALI-ABA)
These materials are republished here with
the consent of the authors.

VII. OVERVIEW OF SELECTED JURISDICTIONS

A. Introduction

Selection of a jurisdiction presents a challenge. Due to the logistical difficulties of having reliable contacts in every possible country and due to the burden of trying to follow the laws and the political and economic climates of many jurisdictions, it is very tempting to select one country and then do "cookie-cutter" structures for all clients. The attorney practicing in this arena should resist that inclination and become knowledgeable about the legal and nonlegal issues relevant to various jurisdictions. There are important differences among jurisdictions and the scene is not static. What works for one client may not be best for another; similarly, what works best this year may not work best next year. Trustees and lawyers in many jurisdictions are marketing their respective countries as being optimal for asset protection. Like marketing materials of any salesman, the information is helpful, but requires careful scrutiny. The following presents an overview of certain offshore jurisdictions. The jurisdictions presented are representative of various types previously discussed (aggressive vs. nonaggressive legislation) and of various geographical locations.

B. Bahamas

1. GENERAL CHARACTERISTICS. The Bahamas is located in the western Atlantic Ocean off the coast of Florida. The capital and financial center of the Bahamas is Nassau, which is on the main island of New Providence. There is excellent airline service from the U.S. and a modern communications system. The Bahamas is an English-speaking country with a common law legal system. Although completely independent of Great Britain, the Bahamas is still a member of the British Commonwealth. The official currency in the Bahamas is the Bahamian dollar, the value of which is equal to the U.S. dollar and is expected to remain so. The Bahamas enjoys a fair degree of political stability, but suffers from poverty and unemployment.

2. CONFIDENTIALITY. The Bahamas has strict bank secrecy laws which were modeled after the Cayman secrecy statute. The Bahamian secrecy laws are codified at

Section 10 of the Bank and Trust Company Regulation Act of 1965, as amended in 1980. However, the IRS, using suspect methods, has been successful in penetrating bank secrecy in certain covert investigations.[400] Under Bahamian secrecy laws, it is a crime for a banker or another person who, in a professional capacity, has acquired information about the identity, assets, liabilities, transactions, or accounts of a customer, to reveal such information to another person unless such disclosure is required by Bahamian law or the Bahamian courts or unless the customer consents to the disclosure.

The Bahamas requires reporting of large currency transactions in certain situations. However, exceptions to the reporting requirements exist. For example, the requirement does not apply to customers who have an existing relationship with a Bahamian Bank, and it also does not apply to transactions by customers who have the recommendation of a "reputable" party.[401]

3. TAXES. The Bahamas is essentially a no tax jurisdiction. It has no personal income tax, corporate income tax, value added tax, capital gains tax, withholding tax, gift tax, estate tax, or employment tax. Property taxes are imposed on both developed and undeveloped real estate. There are stamp duties on the sale of property and on most documents. Businesses and professionals operating in the Bahamas are subject to a business turnover tax on gross receipts from local sources.[402]

4. FRAUDULENT DISPOSITION. Fraudulent dispositions are addressed by statute in the Fraudulent Dispositions Act, 1991. Under the statute, dispositions are voidable by a creditor prejudiced by the disposition if the transferor made the disposition with an intent to defraud. The statute defines "intent to defraud" as an intention of the transferor to defeat willfully an obligation owed to a creditor, and the burden of proof for establishing such intent is on the creditor. The statute of limitations is two years from the date of the applicable disposition.[403]

5. TRUSTS AND OTHER ENTITIES.

a. Trusts Act. The Trusts (Choice of Governing Law) Act, 1989 affords trusts protection from forced heirship laws in the settlor's home country, and contains provisions addressing inbound and outbound redomiciliation. If Bahamian law is designated as the trust's governing law, such designation is binding and effective.

b. Trustee Act. The Trustee Act, 1998 liberalizes the rules applicable to Bahamian trustees. For instance, trustees are now held to an "ordinary person" standard of care.[404] Furthermore, a trustee may now delegate any power or discretion vested in him as trustee to another person.[405] Finally, the new law gives trustees discretion not to inform even vested beneficiaries of the existence of the trust.[406]

c. International Business Company. Bahamian legislation also provides for the formation of an International Business Company (an "IBC"). By combining an IBC with a trust, one achieves a double layer of confidentiality, and the structure provides a simple distribution mechanism at the death of the settlor because only shares in the IBC, and not trust assets, are distributed to the heirs.

6. OTHER CONSIDERATIONS.

a. U.S. Influence. Because the Bahamian economy is heavily dependent on U.S. tourism, there exists the potential for U.S. influence on the treatment of entities established there by U.S. citizens. While there does not appear to be any current movement in this direction, it should be considered in the selection of a jurisdiction.

b. Grupo Torras S.A. et al v. S.F.M. Al-Sabah et al.[407] In this case, a Bahamian lower court judge determined that the Fraudulent Dispositions Act of 1991 would not insulate the defendant-trustee from a claim against the assets of the trust even if the two-year statute of limitations for fraudulent conveyance claims had passed. The ruling, issued in 1995, gave way to considerable controversy about the continued validity of asset protection trusts in the Bahamas.

The case presented genuine issues concerning retention of control over the trust and/or its assets by the settlor that influenced the ruling. However, the non-application of the Fraudulent Dispositions Act (and, therefore, the inability of the defendant to protect itself with a statute of limitations defense) turned on the fact that the court found that the assets were not actually owned by the settlor at the time he transferred them to the trust because the assets were acquired by the settlor by fraud.

In 1997, the Bahamas Court of Appeal limited the *Grupo Torras* ruling to the specific facts of that case. Although the lower court's ruling therefore is not legally precedential, as a practical matter, its existence on the books should somewhat diminish the attractiveness of the Bahamas as an asset protection trust venue.

C. Bermuda

1. GENERAL CHARACTERISTICS. Bermuda is located in the Atlantic Ocean, approximately 600 miles due east from the North Carolina shoreline. It has regular air service with daily flights from New York, Boston, Atlanta, Philadelphia, Baltimore, and Toronto. Bermuda also has a state of the art communications system. Bermuda, an English-speaking country, is a common law jurisdiction. Bermuda is an old British "Overseas Territory" (former colony) and is part of the British Commonwealth. Bermuda may opt for independence from Britain, but in a 1995 referendum Bermudans rejected this direction. The United Kingdom is responsible for defense and foreign relations; however, economically, Bermuda is more closely linked to the United States. Bermuda has a long tradition of stability and conservative government. The island has a balanced budget, is well-administered, and has a highly educated populace. Strict regulations and a conservative approach to business and socio-economic problems have resulted in virtual absence of poverty, unemployment, and homelessness in Bermuda.

2. CONFIDENTIALITY. There are no banking secrecy laws in Bermuda, but information is not readily available to third parties under English common law protection. Bermuda and the U.S. have a tax treaty that serves to implement some exchange of tax

information provisions. However, the Attorney General must consult with an investigative committee before providing any information to foreign regulatory authorities.

3. TAXES. Bermuda is virtually tax-free. It does not have an income tax, gift tax, estate tax, business or value added tax, capital gains tax, sales tax, withholding tax, or accumulated profits tax. Approximately 32% of the government's revenue is earned from customs duties. Additional forms of taxation in Bermuda include a payroll tax, a departure tax, a motor vehicle fee, and a betting tax that is set at 20%.[408] Foreign ("exempted") companies incorporating in Bermuda can receive a guarantee exempting them from taxes until 2016.[409]

4. FRAUDULENT DISPOSITIONS. Fraudulent dispositions are addressed in several Bermuda statutes.[410] In particular, Sections 36A-36G of the Conveyancing Act of 1983 (as amended in 1994), must be considered in the context of trusts established for the purpose of protection from future creditors. Under Section 36C, a disposition with "requisite" intent is voidable by the affected creditor. However, under Bermuda law, "requisite intention" does not necessarily involve deceit or dishonesty; rather, the dominant purpose of the disposition must be to deprive present or potential creditors of assets which otherwise would have been available to them. Insolvency of the settlor at the time the trust is established is a badge of fraud. Furthermore, the provisions of Section 36C might apply to future creditors arising within two years after the relevant disposition if the requisite intent is present.[411] If it is clear that the primary purpose of establishing a Bermuda trust is something other than creditor protection (*e.g.*, estate, financial, or tax planning), Bermuda's fraudulent disposition law should not pose a problem, but caution is advised in this area.

5. TRUSTS. Bermuda is a good situs for the establishment of a trust, revocable or irrevocable, for the benefit of the settlor or his beneficiaries. Bermuda passed specific laws governing trusts in 1989, particularly the Trusts (Special Provisions) Act (the "Bermuda Act"). Among other provisions, the Bermuda Act contains language regarding a settlor's capacity to create a trust, provides for redomiciliation of a trust, addresses jurisdiction of the Supreme Court of Bermuda in trust matters, and provides for selection of the trust's governing law. Additionally, Section 11 of the Bermuda Act provides that in the absence of other Bermuda law or Bermuda public policy considerations to the contrary, a Bermuda trust cannot be varied or set aside by a Bermuda court pursuant to a law of another country regarding the effect of marriage, forced heirship, or insolvency of the settlor and creditor protection.

Part II of the Bermuda Act has recently been amended to streamline Bermuda trusts for non-charitable purposes ("purpose trusts"). The Bermuda Act now clarifies the conditions for the objectives of a purpose trust (sufficiently certain, lawful, and not contrary to public policy), and does away with the requirement for a "designated person trustee" (*i.e.*, a Bermuda lawyer, accountant, or licensed trust company).

Development of trust law in Bermuda continues to keep pace with modern trends and provides flexibility in private and commercial contexts. Notably, the Perpetuities and Accumulations Act, 2009 abolished the rule against perpetuities for trusts created on or after August 1, 2009 (with the exception of trusts holding Bermuda land).

6. ENFORCEMENT OF FOREIGN JUDGMENTS. A Bermuda court will generally only assume jurisdiction with respect to a foreign judgment if: (i) the judgment debtor is a resident of Bermuda; or (ii) the judgment debtor has agreed to or has voluntarily submitted to the jurisdiction of Bermuda courts (*e.g.*, by visiting Bermuda). It is unlikely that a Bermuda court would entertain an action to enforce a judgment against a U.S. settlor of a Bermuda trust. However, a judgment creditor or trustee in bankruptcy could attempt to bring an action against a Bermuda trustee on the grounds that the trustee holds property on "constructive trust" for the creditor (*i.e.*, the trust arrangement is a sham). To prove a constructive trust, the creditor would have to show either: (i) that the original trust fails either wholly or partially, or (ii) that the trustees hold the property as agents of the settlor.

7. PRIVATE TRUST COMPANIES. Bermuda also offers the incorporation and use of private trust companies to act as trustee of a group of trusts. Private trust companies are commonly employed in family contexts. This structure involves the incorporation of a Bermuda exempt company for the purpose of acting as trustee of family trusts, so long as the family members are related. A settlor can maintain control of the trust company by acting as director or shareholder. If the settlor does not want to (or should not) own shares in the company, the shares can be placed in a purpose trust (*i.e.* for the purpose of holding and voting shares in the private trust company). Alternatively, a private trust company can be established as a company limited by guarantee (*i.e.*, without share capital).

D. Cayman Islands

1. GENERAL CHARACTERISTICS. The Cayman Islands is located in the western Caribbean. There is regular air service to multiple U.S. cities and modern communication systems. The capital and main business center is George Town on the island of Grand Cayman. The Cayman Islands, an English-speaking British overseas territory, is a common law jurisdiction, is largely self-governing, and quite stable. Its economy is generally healthy despite feeling the effects of the global recession. The official currency is the Cayman Islands dollar.

2. CONFIDENTIALITY. The Cayman Islands has strict secrecy laws which impose substantial penalties for revealing confidential information. However, this legislation provides a mechanism for disclosure of information in limited circumstances; for example, in the course of a criminal investigation or when a bank must protect its own interests. If the person who is required to give evidence or make a disclosure resides in the Cayman Islands, that person must receive permission for such disclosure from the Cayman Grand Court.[412] By and large, a foreign government cannot obtain assistance in pursuing criminal matters unless the offense is an offense under Cayman law. However, in 1988 the U.S., the United Kingdom, and the Cayman Islands entered into a Mutual Legal Assistance Treaty under which the parties will give each other information in certain drug investigations and white-collar crimes, including bank fraud, and in 2001 these three nations agreed to the exchange of information regarding enforcement of U.S. income tax laws and the prosecution of criminal tax evasion. Additionally, the Cayman Islands have given effect to the EU Savings Tax Directive, meaning that relevant payments by

Cayman entities to EU citizens are reported to Cayman authorities, who in turn must share this information with EU countries.

3. TAXES. The Cayman Islands has no corporation, income, capital gains, profits, gift, estate or inheritance taxes. Certain guarantees against further taxes are available.

4. FRAUDULENT DISPOSITION. In 1989, the Cayman Islands passed the Fraudulent Disposition Law, 1989. Under this law (revised in 1996), a disposition is voidable by a creditor prejudiced by the disposition if the disposition was made at an undervalue and with an intent to defraud. "Intent to defraud" is defined as an intention of the transferor to willfully defeat an existing obligation owed to a creditor, and the burden of proof for establishing such intent is on the creditor. The statute of limitations is six years from the date of the applicable disposition.[413]

5. TRUSTS. There are three basic types of trusts available under Cayman law: ordinary, exempted, and Special Trusts (Alternative Regime) (a "STAR" trust). An ordinary trust parallels the general common law trust concept and may exist for up to 150 years. An exempted trust has the added benefits of a 50-year government guarantee against taxation and is also limited to a duration of 150 years. The STAR law establishes an alternative trust regime which applies to a trust if the trust instrument so provides. The Cayman Trusts Law refers to atrust to which STAR applies as a "special trust."[414] STAR trusts have several special features. For example, their objects may include non-charitable purposes, and it is up to the settlor to say who may have standing to enforce the trust. Additionally, the rule against perpetuities does not apply, which makes it possible to have a STAR trust with an unlimited life.[415]

Cayman Islands trust law recognizes the choice of governing law expressed in the trust instrument and the ability to change the governing law of a trust instrument. No Cayman Islands trust may be set aside by reason only that the laws of a foreign jurisdiction prohibit or do not recognize the concept of a trust, or that the trust defeats rights conferred by a foreign law. Accordingly, with respect to certain property owned by a trust, Cayman law may override the law of the settlor's jurisdiction, including forced heirship requirements.

6. OTHER CONSIDERATIONS. Cayman law is designed to attract business from individuals located outside its jurisdiction. In recent years, however, the Cayman Islands has come under pressure to address the issue of money laundering. In response, the Cayman Islands enacted counter-money laundering legislation and regulations in September, 2000 and is viewed as a leader in developing anti-money laundering programs in the Caribbean.

E. Cook Islands

1. GENERAL CHARACTERISTICS. The Cook Islands are located in the South Pacific Ocean, east of Australia and south of Hawaii. The capital is Rarotonga, with a modern international airport and regular air services to Los Angeles, Tahiti, and Auckland. The islands are remote from the world's major financial centers, but have modern communication systems. The Cook Islands are independent. Their closest link is with New Zealand, and they

use New Zealand currency. English is the official language, and there is a common law legal system.

2. CONFIDENTIALITY. The Cook Islands banking laws mandate secrecy about client information, with the penalty of one year imprisonment for a violation. In certain situations however, the Cook Islands' courts may have access to protected documents. Additionally, Cook Islands secrecy provisions are in some cases overridden by recent money laundering legislation.[416]

3. TAXES. So long as an international trust organized in the Cook Islands does not conduct business there, it is exempt from tax. The Cook Islands permits a trust's affairs to be administered by a Cook Islands trustee company, and this does not constitute "carrying on business" for tax purposes.

4. FRAUDULENT DISPOSITION/TRUSTS. The Cook Islands enacted comprehensive trust legislation in the International Trusts Amendment Act 1984 (the "International Trusts Act"). The legislation addresses international trusts ("ITs") and the effect thereon of fraudulent dispositions and bankruptcy. Section 13B of the International Trusts Act provides that a creditor seeking to set aside a disposition must prove beyond a reasonable doubt that (i) the disposition was made with an intent to defraud that particular creditor; and (ii) the transferor was rendered insolvent by the transfer. If the fair market value of the settlor's property after the transfer to the trust exceeds the value of the creditor's claim at the time of the transfer, there is no intent to defraud.

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

Section 13A of the International Trusts Act expressly states that an IT will not be void by virtue of the settlor's bankruptcy. The International Trusts Act also contains limitations provisions. If a creditor's cause of action accrues more than two years before a transfer to an IT, the transfer will be deemed not to be fraudulent, unless proceedings in respect of that cause of action had been commenced at the date of the relevant transfer. Also, if a creditor fails to bring an action within one year from the date the transfer to an IT occurs, the action is barred. Furthermore, a transfer to an IT will not be fraudulent as to a creditor if the transfer occurs before the creditor's cause of action accrues, where "cause of action" is defined as the first cause of action capable of assertion against a settlor.[417] Finally, an Amending Act provides that for redomiciled trusts, the limitations period commences at the time of the original transfer, even when the transfer was to an offshore center other than the Cook Islands.

Section 13B of the International Trusts Act also sets forth circumstances that will not be deemed badges of fraud. Fraudulent intent cannot be imputed from (i)transfer to an IT within two years of the accrual of a creditor's cause of action; (ii) retention of powers or benefits by the settlor; or (iii) designation of the settlor as a beneficiary, trustee, or protector.

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

a. has the power to revoke or amend the trust, to dispose of trust property, or to remove or appoint a trustee or protector;

b. retains, possesses or acquires any benefit, interest, or property from the trust; or

c. is a beneficiary, trustee, or protector.[418]

The rule against perpetuities has been repealed, but an IT may use a perpetuities period if the parties so desire. Other provisions of the International Trusts Act make selection of Cook Islands law binding and conclusive, ensure that an IT is not subject to forced heirship laws of other countries, and require non-recognition of a foreign judgment against an IT, its settlor, trustee, and protector. An Amending Act also provides that community property transferred to an IT retains its character as community property.

With respect to litigation, the International Trusts Act provides that a plaintiff may not obtain interlocutory relief—including discovery, interrogatories, and injunctions—without filing an affidavit that satisfies the court that the plaintiff will be able to meet various time limits and other presumptions.[419] As a consequence, this requirement may have the practical effect of deterring litigation.

6. OTHER CONSIDERATIONS.

a. Insularity. Unlike other offshore centers, the economies of which are tied closely to the U.S. or United Kingdom, the Cook Islands presumably would not be subject to economic or political pressure to relax secrecy provisions or reduce the benefits of entity formation for protective purposes.

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

c. 515 South Orange Grove Owners, et al. v. Orange Grove Partners.[420] In a 1995 decision appealing the issuance of a Mareva injunction against the trustees of an asset protection trust, the Court of Appeals in the Cook Islands found that a judgment creditor's action was not time-barred on the basis that the two-year statute of limitations on fraudulent conveyances in the International Trusts Act began to run on the date of the judgment against the settlor-transferor and did not commence when the cause of action accrued. Proponents of the International Trusts Act argued that the court misinterpreted the statute and rendered its judgment based on "bad facts."

The International Trusts Act was amended in 1996 to "cure" the possible ambiguity in the statute. Accordingly, while settlors can take comfort in knowing that the statute of limitations will begin when a potential judgment creditor's cause of action accrues, there remains at least some doubt as to which provision of the legislation might be susceptible the next time a court is presented with "bad facts" as it was in *Orange Grove*.

d. Federal Trade Commission v. Affordable Media, Inc. (also referred to as "the *Anderson* case").[421] (See discussion at Part VI.F.)

e. Bank of America v. Weese[422] (See discussion at Part VI.F.)

F. Gibraltar

1. GENERAL CHARACTERISTICS. Gibraltar is located off the southern coast of Spain. It has regular air service from London and modern communication systems. Gibraltar is a colony of the United Kingdom, and its constitution ensures that sovereignty will never be passed to another country against the will of the people of Gibraltar. The currency of Gibraltar is the Gibraltar pound, which is pegged to the British pound. English is the official language, but most inhabitants also speak Spanish. Gibraltar has a common law legal framework.

2. CONFIDENTIALITY. As more fully discussed below, trusts are subject to a limited disclosure requirement if protection under Gibraltar's fraudulent disposition statute, the Bankruptcy (Amendment) Ordinance, is sought; however, the disclosed information is confidential. The Banking Ordinance, 1992 imposes strict requirements of secrecy.

3. TAXES. Gibraltar allows the formation of "exempt companies," which can conduct business anywhere but Gibraltar. These companies pay no income tax and can transact business from Gibraltar, but in order to maintain exempt status, cannot do business with citizens or residents of Gibraltar. Similarly, income of a Gibraltar trust that is paid to a nonresident beneficiary is not subject to income tax.

4. FRAUDULENT DISPOSITION. Existing legislation addresses dispositions by nonresident settlors, under which disposition of assets by a settlor into a trust is not voidable by a creditor if:

a. the settlor is an individual;

b. the settlor is not insolvent at the time of the disposition;

c. the settlor did not become insolvent as a result of the disposition; and

d. the trust is registered in accordance with the Bankruptcy (Register of Dispositions) Regulations, 1990.[423]

Under the legislation, the registration process excludes those with actual knowledge of a contingent or prospective liability.

The Statute of Elizabeth governs non-registered trusts.

5. TRUSTS. The Bankruptcy (Amendment) Ordinance, 1990 and the Bankruptcy (Register of Dispositions) Regulations, 1990 expressly establish the concept of an asset protection trust. An asset protection trust must be registered as described above, and the trustee must affirm that: (i) the settlor has completed forms establishing his or her financial position and revealing contingent or prospective liability; (ii) the trustee has taken reasonable steps to substantiate the information received from the settlor; and (iii) the settlor has given the trustee an affidavit of solvency.[424] The registry is not open to public inspection and any information delivered to it is kept secret and confidential. The common law rule against perpetuities has been replaced by a 100-year limitation. Furthermore, Gibraltar law allows easy redomiciliation, and Gibraltar common law does not recognize forced dispositions from other jurisdictions.

6. TRUSTEESHIP. The Bankruptcy (Register of Dispositions) Regulations 1990 defines a trustee as "a company with a permanent place of business in Gibraltar and authorised by the Commissioner to act as a trustee."[425] The regulations provide that the Registrar shall register a disposition of assets only when the trustee making the application:

a. is the sole corporate trustee of the disposition;

b. is judged by the government (the Financial and Development Secretary) to have adequate financial and administrative resources to act as trustee in relation to the disposition;

c. has obtained the government's prior written approval of the inquiry forms administered to the settlor; and

d. has indemnity insurance in an amount exceeding 1 million pounds.[426]

Thus, it would appear that a corporate trustee with a Gibraltar situs is required with respect to Gibraltar trusts.

7. ENFORCEMENT OF FOREIGN JUDGMENTS. Judgments may be registered under specific reciprocal enforcement agreements with the U.K., other Commonwealth countries, and the European Union. Judgments from other jurisdictions are not enforceable in Gibraltar. Claimants must sue under Gibraltar law.

8. HESS V. LINE TRUST CORP., LTD. It this case, the court refused to hear the claim of a divorcing wife that a Gibraltar asset protection trust was established with intent to defraud her.[427]

G. Guernsey

1. GENERAL CHARACTERISTICS. Guernsey is one of the Channel Islands, located in the English Channel off the Normandy Coast of France. English and French are the official languages. Guernsey is reachable by air from London and other European cities. It is a dependent territory of the British Crown with considerable political stability due in part to the lack of political parties.

2. CONFIDENTIALITY. Guernsey does not have a statutory law of secrecy or confidentiality. However, the Royal Court has held that banks have a contractual duty of privacy to their customers.[428] Notable exceptions to the general rule of bankers' confidentiality include situations involving: serious or complex fraud; suspicion that funds are derived from or used in connection with drug trafficking, terrorism or money laundering; the need to protect depositors or the public interest; or potential insider dealing. Additionally, courts have the discretionary power to grant disclosure of otherwise confidential information in cases before any Guernsey court and in proceedings in other jurisdictions.

3. TAXES. Guernsey does not impose a tax on capital gains, capital transfers, inheritance, or estate duties, nor is there a wealth tax, a purchase tax, or a value added tax. With respect to income tax, as long as all of a trust's income is payable to beneficiaries outside of Guernsey, the only trust income subject to Guernsey income tax is Guernsey-source income other than bank interest.

4. FRAUDULENT DISPOSITION. Under the 1929 Law Relating to Debtors and Renunciation, a transfer by an insolvent is considered fraudulent and void if made within three months before an application for a declaration of insolvency and with the intent of giving the transferee a preference over the insolvent's other creditors.

5. TRUSTS. Guernsey trusts are governed by the Trusts (Guernsey) Law, 2007 (the "Trust Law"). According to the Trust Law, a trust is invalid and unenforceable if it promotes action contrary to Guernsey law, lacks an identifiable beneficiary, or

> the Royal Court declares that –
>
> (i) it was established by duress, fraud, mistake, undue influence or misrepresentation or in breach of fiduciary duty,
>
> (ii) it is immoral or contrary to public policy,
>
> (iii) its terms are so uncertain that its performance is rendered impossible, or
>
> (iv) the settlor was, at the time of its creation, incapable of creating such a trust.[429]

The Trust Law does not specifically recognize asset protection trusts,

beyond permitting a beneficiary's interest in a trust to be "subject to a restriction on alienation . . . or subject to diminution or termination in the event of the beneficiary becoming bankrupt or any of his property becoming liable to arrest, saisie, or similar process of law."[430] Guernsey courts have not yet considered the issue of whether assets in a Guernsey trust are protected from present or future creditors of the settlor.

6. ENFORCEMENT OF FOREIGN JUDGMENTS. Guernsey recognizes registered judgments from reciprocating countries as carrying the authority of a judgment from the Royal Court of Guernsey. A judgment creditor may seek injunctive relief from a Guernsey court, and may also pursue postjudgment discovery in order to force the trustee to disclose information about the trust. If the judgment debtor has an enforceable interest in the trust, the trustee will be required to disclose whether the debtor's interest in the trust comprises sufficient assets to satisfy the judgment. If the judgment debtor is a discretionary beneficiary, the trustee could avoid making such a disclosure, but the judgment creditor would be entitled to seek an injunction requiring disclosure of the debtor's interest in the trust.

7. RULE AGAINST PERPETUITIES. The Trust Law abolished the rule against perpetuities for trusts created on or after March 17, 2008. Pre-existing trusts are subject to the old rule against perpetuities, which requires that noncharitable trusts terminate on the expiration of 100 years after creation.

H. Isle of Man

1. GENERAL CHARACTERISTICS. The Isle of Man is a British crown dependency situated in the Irish Sea and can be reached readily from London. English is the official language and the island has modern communication systems. It is a common law jurisdiction and considered to be very stable.

2. CONFIDENTIALITY. There is a strong tradition of confidentiality in the Isle of Man. Contractual agreements for the maintenance of a bank account generally prohibit the bank from divulging information regarding the client's affairs except by order of a Manx court or with the client's consent.

3. TAXES. There is no wealth tax, gift tax, estate tax, or capital gains tax in the Isle of Man. The Isle of Man does not tax nonresidents upon bank interest or income arising outside the island. This principle extends to companies which are beneficially owned abroad and trusts with nonresident settlors and beneficiaries.

4. FRAUDULENT DISPOSITION. The Manx government is reluctant to introduce specific statutes for the encouragement of asset protection trusts, believing that frivolous claims would be dismissed under existing law and fearing to disadvantage legitimate claimants. Currently, fraudulent dispositions are covered by the general law of the Isle of Man, for example by the Companies Act, 1931, the Bankruptcy Code, 1892, and the Theft Act, 1981.

5. TRUSTS. The law of trusts is governed by the Isle of Man Trustee Law of 1961. Provisions found in this legislation are similar to those contained in the English

statutory and case law regarding trusts. The Isle of Man Trustee Law of 1961 governs the powers and duties of trustees, provides for the distribution of capital and income to beneficiaries, and governs the appointment and retirement of trustees. Other pertinent Manx legislation includes the Variation of Trusts Act of 1961 and the Manx Perpetuities and Accumulations Act of 1968.

6. ENFORCEMENT OF FOREIGN JUDGMENTS. While U.S. judgments are not recognized, the Isle of Man recognizes judgments from the following countries: Guernsey, Israel, Italy, Jersey, the Netherlands, Sumatra, and the United Kingdom.

7. IN THE MATTER OF HEGINBOTHAM. In this case, the court held that a transfer into trust can only be voided if the transfer was made in an attempt to defraud present creditors. Present debts are defined as "known and associated debts which are to fall due in the future."[431] Debts which may be incurred in the future are not protected. In short, the Statute of Elizabeth is not part of Manx law.

8. RULE AGAINST PERPETUITIES. The Trustee Act, 2001 extended the maximum perpetuities period from 80 to 150 years.[432]

I. Jersey

1. GENERAL CHARACTERISTICS. Jersey is a British crown dependency located in the English Channel near the Normandy coast. In 933 the island became part of the area now known as Normandy, which today is a *département* of northern France. In 1204 the United Kingdom lost control of mainland Normandy, but Jersey remained loyal to the United Kingdom and has ever since. During the 20th century, a constitutional convention developed declaring that the United Kingdom will not interfere in matters of purely domestic concern or taxation. Nevertheless, the United Kingdom retains responsibility for Jersey's relations with foreign countries and its defense. Externally, Jersey's political stability benefits from its geographical location and its settled links with the United Kingdom and the European Union. Internally, political life is marked by the absence of political parties with candidates for the parliament almost invariably standing as independent candidates on the basis of local issues. The local economy is based mainly on finance, tourism, and agriculture. Although the official language of the Jersey court is French, the use of English is permitted and adopted in almost all proceedings. There is no exchange control in Jersey. Monies in any currency may flow into and out of the island.

2. CONFIDENTIALITY. The Jersey courts have indicated that the rule laid down by the English Court of Appeal in *Tournier v. National Provincial and Union Bank of England*—declaring that a banker owes his customer a contractual duty of confidentiality, subject to certain limited exceptions—is applied in relation to banking matters in Jersey. Any breach of this duty could give rise to a claim for damages.[433]

The duty of confidentiality is imposed with the opening of an account, whereupon information about the customer should not be released by the bank. This duty goes beyond the status of the account and beyond the time that the account is closed. It extends to all

transactions through the account and to information obtained from other sources resulting from the banking relations of the bank and the customer.

The circumstances in which disclosure can or must be made without the customer's consent pursuant to the *Tournier* decision have been modified and extended by statute.[434] For example, provisions in the Banking Business Law enable the Jersey Financial Services Commission to obtain information from Jersey banks for the purpose of their supervisory functions.

3. TAXES. The administration of income tax is in the hands of the Comptroller of Income Tax. Both the comptroller and the staff of the comptroller are required to take an oath of secrecy before the Royal Court and are bound by the oath not to disclose details of taxpayers to anyone except to the extent required in the event of a prosecution for an offense under the tax laws.[435]

The only Jersey tax that is significant for the purposes of tax planning is the income tax, with a standard rate of 20% that does not apply to most corporations. As a general rule, a nonresident of Jersey is only liable for income tax on income arising in Jersey and, by concession, this excludes Jersey bank interest.[436] In 2008, Jersey adopted a 0% corporate tax rate and initiated a phase-out of the exempt company regime.[437]

There are no capital taxes or inheritance taxes. Persons owning or occupying Jersey realty are liable to pay rates administered by the parishes of Jersey. Other sources of revenue include a stamp duty payable in respect of transfers involving Jersey realty. In Jersey, the mechanism of withholding tax on certain payments is used not only as a means of tax collection but also, in some cases, as a means of giving tax relief. Non-Jersey residents are not normally required to withhold tax on payments.

4. FRAUDULENT DISPOSITION. Because Jersey law has its roots in Norman customary law, the Statute of Elizabeth has never had effect on the island. Thus, the Jersey position with regard to fraudulent disposition is largely nonstatutory. With respect to dispositions which are governed by Jersey law, *Golder v. Sociétédes Magasins Concorde Limited* is the leading case.[438] The court in that case found that in order to set aside a disposition, the creditor has to prove the intention to defeat creditors and their actual defeat by showing that the debtor is insolvent and that his insolvency was a result of the act being challenged.

Dispositions by transferors resident or carrying on business in Jersey are also covered by the Bankruptcy (Désastre) (Jersey) Law 1990 under which certain dispositions (which might include a disposition to a trust) may be unwound by the Royal Court if they are made at an undervalue. Under this law, when a person enters into a transaction at an undervalue within five years prior to a declaration of bankruptcy (where the debtor is insolvent at the time of or becomes insolvent as a consequence of the transaction), the Viscount (the court officer charged with the administration of the bankruptcy proceedings) may apply to the Royal Court for such order as it thinks fit for restoring the parties' positions to what they would have been if the debtor had not entered into the transaction.[439]

5. TRUSTS AND OTHER ENTITIES. In 1984, the existence of trusts was governed on a statutory basis with the enactment of the Trusts (Jersey) Law of 1984 (the "Jersey Trust Law"), which was amended most recently in 2007. A central provision of the Jersey Trust Law is that a valid trust is created wherever a trustee-beneficiary relationship exists for a charitable or, subject to the requirements of the Trust Law, noncharitable purpose.[440] The Jersey Trust Law draws a fundamental distinction between Jersey trusts and foreign trusts.[441] The Jersey Trust Law has only a few provisions that relate specifically to foreign trusts, providing simply that they are governed by and interpreted in accordance with the relevant proper law subject only to certain exclusions as to legality and public policy.[442] Some provisions of the Trust Law relate to both foreign and Jersey trusts. These include the rule that the trust property is not available to the trustee's personal creditors,[443] some protection for third parties dealing with a trustee,[444] and the three-year period of limitation of actions.[445] With regard to Jersey trusts, the Jersey Trust Law generally restates traditional trust principles as known in English law, although there are some differences. Most importantly, Jersey trusts are generally valid and enforceable in accordance with whatever lawful terms the settlor chooses to establish.[446] As such, the provisions of a trust may be written in almost any way, and may provide any degree of flexibility between completely fixed trusts, where the interest of the beneficiaries is decided at the outset, and totally discretionary trusts.

No particular formality is required for the creation of a Jersey trust. The trust property must only be held by the trustee, and the terms of the trust must be lawful and clear. The beneficiaries of a trust must be identifiable by name or ascertainable by reference to a class or relationship with some person. An express power may be included in the trust for the addition or exclusion of persons to or from the class of beneficiaries.[447] Beneficiaries may disclaim their interests under the trust.[448] Any property except Jersey realty may be held in a Jersey trust.[449] Jersey realty may, however, be held indirectly in trust (*e.g.*, through a holding company). Subject to the terms of the trust, after provision of the initial assets, further assets may be added to the same trust. Indeed, the most common arrangement is to start with a purely nominal initial trust fund and to add the "real" assets later.

Amendments have given the settlor the ability to reserve certain powers, and have strengthened the protection against forced heirship claims and judgments of foreign courts.[450] A further amendment enables Jersey trusts for beneficiaries, Jersey purpose trusts, and Jersey hybrid trusts to exist for an unlimited period, replacing the previous rule against perpetuities, which imposed a 100 year limitation.[451]

6. ENFORCEMENT OF FOREIGN JUDGMENTS. No direct enforcement of a judgment of a foreign court can occur until it is registered in Jersey. Foreign judgments are capable of being registered in Jersey if they fall within the Judgments (Reciprocal Enforcement) (Jersey) Law, 1960. Jersey can direct to which country the 1960 Law applies; these include England, Wales, Scotland, Northern Ireland, the Isle of Man, and Guernsey. The judgment must be (i) from a superior court, (ii) final and conclusive, (iii) for the payment of a liquidated sum of money not with respect to taxes, fines, or penalties, and (iv) not entered prior to 1960.[452] The law provides that the registration of a foreign judgment may be set aside if the court considers, among other things, that the foreign court had no jurisdiction to hear the original action.

Registration will also be set aside (i) if the foreign judgment does not fall within the 1960 Law, (ii) if the defendant was not given due notice of the foreign proceedings, (iii) if the foreign judgment was obtained by fraud, (iv) if the enforcement of the foreign judgment would be contrary to Jersey public policy, or (v) if the rights under the foreign judgment are not vested in the applicant.

Once validly registered, a foreign judgment has the same force and effect for the purposes of execution as a judgment given by the Royal Court itself. If a foreign judgment cannot be registered, the judgment creditor will have to sue on the judgment debt, in a similar manner to any other creditor suing on an ordinary debt, in order to be able to enforce it in Jersey.

7. IN RE ESTEEM SETTLEMENT. In a 2003 ruling, the Royal Court upheld a trust against an attack by creditors of the settlor-beneficiary.[453] Plaintiff attempted to reach the assets of the trust on five separate theories. The court found that the trust was not a sham and further found that the settlor-beneficiary had not retained sufficient control over the trust to support a finding that the trust should be voided. The court also declined to apply corporate law's "piercing" doctrine to trusts and refused to adopt the concept of a remedial constructive trust, notions foreign to Jersey law. Finally, the court found that the trust did not violate public policy.

Plaintiff's case against the trust was thorough and aggressive, and the court dealt extensively with all of plaintiff's evidence and legal theories. Sheikh Fahad, a notorious fraudster, was an unsympathetic defendant. Despite these factors, the trust was upheld and its assets were not reached by the creditors. Assuming no fraud on creditors at the trust's inception, the case appears to be a ringing endorsement of Jersey as an asset protection jurisdiction.[454]

J. Liechtenstein

1. GENERAL CHARACTERISTICS. Liechtenstein is a small principality located between Switzerland and Austria. It is necessary to fly to Zurich, then drive or take a train to reach Liechtenstein. Liechtenstein is a very stable, civil law country, with strong ties to Switzerland. The Swiss franc is the legal tender of Liechtenstein. The official language is German, though English is often used. The capital of Liechtenstein is Vaduz.

2. CONFIDENTIALITY. Liechtenstein's enforcement of bank secrecy is even greater than that of Switzerland, providing heavy sanctions for breach of professional secrecy. Attorney/client and fiduciary/beneficiary privileges are very strong in Liechtenstein. Liechtenstein has recently concluded numerous tax information exchange agreements. While previously Liechtenstein had only a tax treaty with Austria and a customs union with Switzerland, Liechtenstein now has entered into tax information exchange agreements with the U.S., the United Kingdom, Luxembourg, Germany, Andorra, Monaco, France, San Marino, St. Vincent and the Grenadines, Ireland, Belgium, the Netherlands, Antigua and Barbuda, and St. Kitts and Nevis. These agreements will come into force during 2010.

3. TAXES. A nominal capital tax of 0.1% is levied upon entities if they are involved in investments and/or commercial activities outside Liechtenstein. Thus, the nominal capital tax is levied upon entities involved in investment (*i.e.*, non-commercial) activities, such as trusts.

Liechtenstein entities are also subject to value added tax ("VAT") of 7.6%. VAT is imposed on services provided in Leichtenstein and in Switzerland, including legal services, but does not affect assets held in trust.

4. FRAUDULENT DISPOSITION. A Liechtenstein statute regarding claims by creditors provides that creditors of a settlor can only bring a claim against trust property under fraudulent conveyance law or in accordance with the law of donations or succession. Liechtenstein law defines a fraudulent disposition as one made with the intention to harm the creditor in question.

A creditor with a foreign judgment must bring the action anew in a Liechtenstein court, which requires, among other things, a deposit of 10% to 15% of the judgment and/or a sum which will cover potential attorneys fees. Liechtenstein law expressly disallows contingent fee contracts and punitive or exemplary damage awards, and the losing party must pay all fees and costs of both sides.

Liechtenstein law provides that a creditor must bring a claim within five years of the establishment of a trust in order to contest the trust. If, however, a creditor serves a brief on the trustee via the Liechtenstein court system informing the trustee of its intention to set aside the transfer, and does so within the five-year statutory period, the limitations period begins to run from the time of service.

5. TRUSTS. Although it is a civil law jurisdiction, Liechtenstein law recognizes trusts. The Liechtenstein law of trusts is based on codification of an Anglo-American model. Contrary to common law, however, Liechtenstein trust law does not contain a rule against perpetuities; a Liechtenstein trust may therefore exist for an unlimited period of time. Redomiciliation is very easy in Liechtenstein. Purpose trusts may be created for any purpose that is not considered illegal, immoral, or impossible.

6. RECENT CASE STUDY. A United States settlor recently used a Liechtenstein trust to prevent the attachment of assets after a New Jersey court entered a judgment against her. The trust was settled after the prospect of litigation arose but before the New Jersey court entered a final judgment. The plaintiffs paid the requisite 10% of the judgment for securities for costs and fees, brought suit against the trustee as a third party debtor, and obtained an injuction from a Liechtenstein District Court. However, the trustee successfully appealed the injunction on the basis that Liechtenstein courts did not have jurisdiction. The Liechtenstein Court of Appeals and Supreme Court reasoned that an interest in a discretionary trust, with the settlor having no enforceable claim in respect of such interest, does not qualify as an asset and thus does not suffice for Liechtenstein jurisdiction.[455]

K. Nevis

1. GENERAL CHARACTERISTICS. The Island of Nevis is located in the eastern Caribbean, 225 miles southeast of Puerto Rico, and is in the Atlantic Time Zone, which is an hour ahead of the eastern United States. Nevis does not observe Daylight Savings Time. The Island was sighted by Christopher Columbus on his second voyage in 1493, but settled under British rule in 1793. Since 1983, Nevis and the nearby island of Saint Kitts achieved Independence from Britain and have comprised a single sovereign nation, known as the Federation of Saint Kitts-Nevis (the "Federation"). Under the Federation's Constitution, Nevis is allowed to have its own legislation, which has been used to establish an offshore financial services sector. Rated among the world's most stable countries, the Federation has exhibited a vibrant multi-party political system and deep-seated respect for human and property rights. The economy of the Federation, which is based on offshore financial services and tourism, enjoys low unemployment and one of the fastest growing per capita incomes in the Caribbean. The official language of the Federation is English. The currency of the Federation is the Eastern Caribbean Dollar, which is fixed at a rate of 2.7 to 1 to the United States Dollar, and there are no exchange controls applicable to offshore businesses.

2. CONFIDENTIALITY. The Confidential Relationship Act of 1985 applies to all those in the financial community, including, but not limited to, banks. Anyone disclosing banking, financial, and trust documents without court order is subject to criminal penalties, including fines or imprisonment.

3. TAXES. While Nevis collects several taxes from businesses engaged in business on the island, offshore trusts, offshore corporations, and offshore limited liability companies are tax exempt so long as they do not transact business on the island.[456] These entities only pay an annual Government fee of US $220. The legislation has a narrow definition of what constitutes "doing business" in Nevis. Maintaining bank accounts in Nevis, holding board meetings in Nevis, maintaining corporate or financial records in Nevis, maintaining an administrative or managerial office in Nevis with respect to assets and activities outside of Nevis, being a partner in a Nevis partnership, or acquiring real property in certain industrial or tourist facilities in Nevis approved by the government will not constitute doing business in Nevis.[457]

Nevis offshore trusts are not permitted to own property on the island. Both of the political parties in Nevis have expressed the intention of enacting no future taxation of offshore trusts and companies.

4. FRAUDULENT DISPOSITION. The Statute of Elizabeth was specifically repealed in Nevis for international trusts.[458] Instead, Nevis adopted the Nevis International Exempt Trust Ordinance (the "Ordinance") which provides that:

a. a creditor must prove beyond a reasonable doubt that the trust was settled or established, or property disposed to a trust with the principal intent to defraud creditors; and

b. a creditor must prove beyond a reasonable doubt that the settlement, establishment, or disposition rendered the settlor insolvent.

If both of these elements are established by the plaintiff, the trust shall only be liable to the extent that the settlor had an interest in the contributed property prior to the settlement, establishment or disposition.[459]

These remedies in the Ordinance are the exclusive remedies that a creditor, defined as any person who alleges a cause of action, has against the settlor, a trust, or any person who transfers property to a trust on behalf of a settlor.[460]

5. TRUSTS AND ENTITIES. The Ordinance, among other things, provides for spendthrift trusts, overrides the common law rule against perpetuities, overrides forced heirship, repeals the Statute of Elizabeth, and prohibits the enforcement of foreign judgments.

A company formed under the Nevis Limited Liability Company Ordinance, 1995, as amended (the "NLLCO") provides its members with full protection from company obligations, similar to a corporation, while simultaneously permitting them to contractually form a company that is best tailored to fit each situation, similar to a partnership.[461] Unique among offshore LLC statutes, the NLLCO provides asset protection through an exclusive charging order remedy[462] and estate planning opportunities through strict valuation provisions in compliance with IRS dictates.[463] Also unique to the NLLCO is the ability to form an NLLC with only one member.[464]

Known in the vernacular as NBCs, reflecting the name of the authorizing legislation—the Nevis Business Corporation Ordinance, 1984—Nevis's offshore corporations are tax exempt, provided that they do not carry on business with any person in the Federation. An NBC may be used, among other things, as a private trust company to be the trustee of a Nevis trust or as an open end investment company.

6. ENFORCEMENT OF FOREIGN JUDGMENTS. Foreign judgments are not recognized if the judgment is based upon law that is not consistent with Nevis law.

7. CONWAY V. QUEENSWAY. In response to a preliminary motion, the High Court of the Federation upheld the validity of a trust registered under the Ordinance in the face of an attack by a U.S. Trustee in Bankruptcy, refusing to grant the plaintiff-creditor an injunction to prevent the trustee from distributing, disposing or dissipating the assets.[465]

EXHIBIT B

Prepared by
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IV. DOMESTIC VENUES FOR ASSET PROTECTION TRUSTS[78]

A. Introduction

Alaska, Delaware, Nevada, Utah, Rhode Island, Oklahoma, South Dakota, Missouri, Tennessee, Wyoming, and New Hampshire (the "Domestic Venues")[79] have enacted legislation with a view toward becoming viable venues for establishing asset protection trusts. Although all Domestic Venue statutes appear to offer substantial (or at least some) asset protection (especially against the claims of future creditors), none of these states can be as protective a site for establishing trusts as an offshore jurisdiction because they are bound by the United States Constitution. By virtue of the "full faith and credit" mandate in the Constitution, the courts of one state must recognize judgments rendered under the laws of less debtor-friendly states.[80] In addition (and as more fully discussed below), the enactment of laws enabling asset protection trusts may itself violate the Constitution's contract clause.[81] Finally, due to the supremacy clause of the Constitution, no state statute can protect debtors from conflicting federal law (*i.e.*, bankruptcy law).[82] Even if state asset protection trust legislation passes constitutional muster, it does not necessarily defend an asset protection trust from some of the arguments available to a creditor through other existing state laws. The new statutes, existing statutory provisions, and common law provide various opportunities for a sympathetic court, whether in a Domestic Venue or elsewhere, to set aside or penetrate the trust structure in favor of creditors.[83]

B. Overview of Domestic Venue Asset Protection Trust Legislation

1. THE ALASKA TRUST ACT. Effective April 2, 1997, Alaska became the first state to offer a domestic alternative to offshore asset protection trusts with the passage of the Alaska Trust Act (the "Alaska Act").[84] Alaska's legislature has subsequently strengthened the Alaska Act with new legislation, which, *inter alia*, tightened the statute of limitations for creditor claims, narrowed the definition of fraudulent transfers, and introduced elements that were previously unique to foreign trusts.[85]

To come under the protection of the Alaska Act, the trust instrument must: (i) state that the trust is irrevocable;[86] (ii) state that Alaska law governs the validity, construction, and administration of the trust;[87] (iii) contain a spendthrift clause;[88] and (iv) appoint a "qualified trustee."[89] Only an Alaska resident, or a trust company or bank with trust powers headquartered in Alaska may serve as a qualified trustee.[90] Notably, the settlor may serve as the trustee adviser or even a non-qualified co-trustee, provided the settlor does not have control over discretionary distributions.[91] In addition, all qualified trustees must agree to be responsible for (i) maintaining trust records, (ii) preparing or arranging for the preparation of fiduciary income tax returns, and (iii) handling at least part of the administration, some of which must take place in Alaska.[92] Finally, at least some of the trust assets must be deposited in Alaska,[93] and the settlor must sign a solvency affidavit prior to any transfer.[94] If a trust satisfies these requirements, the trust assets are protected from creditors' claims, including a claim to enforce a judgment of a court in another jurisdiction.[95]

The Alaska Act permits the settlor to retain a variety of interests in the trust, including: (i) the right to receive distributions from a charitable remainder annuity trust or a charitable remainder unitrust; (ii) the right to receive distributions from a total-return trust, a GRAT, or a GRUT; (iii) the right to use real property held in a QPRT; (iv) an interest in an IRA; and (v) the right to receive distributions of income and/or principal made at the discretion of a person (including the trustee) other than the settlor.[96] The settlor may also retain seemingly broad powers over the trust, such as: the power to veto distributions; a special testamentary power of appointment; and the right to appoint a trust protector or trustee adviser.[97]

Alaska courts have exclusive jurisdiction over claims made against an Alaska asset protection trust.[98] Under the Alaska Act, claims that arose prior to the transfer in trust are extinguished by the later of four years after the date of the transfer or one year after the creditor discovers the transfer. To prevail on a claim against an Alaska asset protection trust that arose before the transfer in trust, the creditor must prove (by a preponderance of the evidence) that he or she asserted a specific claim before the transfer, or must file another suit against the settlor asserting a claim based on an act or omission of the settlor that occurred prior to the transfer. In addition, creditors' fraudulent transfer claims arising after the transfer in trust expire four years after the transfer.[99]

Importantly, claims may proceed against the trust if the settlor: (i) made the transfer with an intent to defraud creditors, (ii) was in default for 30 days or more in contravention of a child support judgment or order at the time of the transfer in trust, (iii) retained a right to mandatory distributions, or (iv) had a power to revoke or terminate the trust.[100] While an Alaska asset protection trust created before marriage is not subject to division in an Alaska divorce proceeding, a surviving spouse has the statutory right to elect against the settlor's will and might be able to pierce the trust and reach the trust assets.[101] Further, in such a case, the federal law providing for full faith and credit for child support orders might enable minor children to pierce an Alaska asset protection trust for support.[102] However, a creditor's access to trust assets is limited to the amount necessary to satisfy his or her claim and approved costs.[103]

In any event, the Alaska Act protects attorneys, trustees, and advisers from liability associated with the preparation or funding of Alaska asset protection trusts.[104] The Alaska Act also provides that certain assets of the trust, such as real property and tangible personal property, can be made available for the use of a beneficiary, without exposing such assets to a creditor as a "payment or delivery."[105] Such a "use" provision arguably permits the settlor to contribute a residence to an Alaska asset protection trust and continue to reside in that home. In addition, the Alaska legislature provided that a spendthrift trust restriction under Alaska law falls under the federal bankruptcy law exception for spendthrift trusts.[106] Further, a pre-existing non-Alaska trust may become an Alaska asset protection trust if it satisfies the requirements listed above. A trust that has its situs transferred to Alaska and has provisions that allow the trust to be perpetual or are not expressly prohibited by the laws of Alaska is effective and enforceable.[107]

For all practical purposes, the Alaska Act eliminates the rule against perpetuities, although some interests must vest within 1,000 years.[108]

2. THE DELAWARE TRUST ACT. The Delaware Qualified Dispositions in Trust Act[109] (the "Delaware Act") attempts to achieve a result similar to the Alaska statute in a somewhat parallel manner.

To provide protection for assets transferred by a settlor to a Delaware asset protection trust, such trust must expressly name Delaware law as the governing law of the trust, be irrevocable, name a qualified trustee, and contain Delaware's statutory spendthrift language.[110] A qualified trustee includes an individual resident of Delaware other than the settlor, or a corporate trustee authorized by Delaware law to act as a trustee and whose activities may be supervised by the Bank Commissioner of Delaware, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision. However, the settlor may appoint trust advisers who have the power to remove and appoint trustees and advisers or who have authority over trust distributions, and the settlor may even serve as an investment adviser.[111] Further, the trust may also have nonqualified co-trustees other than the settlor.[112] The Delaware Act also provides that the qualified trustee must ensure that some of the trust property is located in Delaware or otherwise materially participate in the trust administration.[113]

The Delaware Act allows a settlor to be a discretionary beneficiary of the trust, and a settlor's retention of the following rights is protected under the act: (i) a right to income; (ii) a right to receive a percentage (not exceeding 5%) of the trust assets annually; (iii) a right to receive distributions from a charitable remainder annuity trust, a charitable remainder unitrust, or a GRUT; (iv) a right to use real property held in a QPRT; (v) a right to receive distributions of trust principal, if made in the qualified trustee's discretion or pursuant to an ascertainable standard; and (vi) a right to distributions of income or principal to pay income taxes on trust income. The Delaware Act also permits a settlor to retain the right to veto distributions of trust property and the right to remove and replace a trustee or trust adviser, as well as a special testamentary power of appointment over the trust corpus.[114]

Delaware courts have exclusive jurisdiction over claims against Delaware asset protection trusts.[115] The statute of limitations for claims existing on the date of the transfer is the later of (i) four years after the transfer, or (ii) one year after the transfer was (or could reasonably have been) discovered by the creditor.[116] For claims arising after the date of the transfer, the statute of limitations is four years after the transfer.[117] In any action against a Delaware asset protection trust, the creditor has the burden of proving his or her claim by clear and convincing evidence.[118] As long as the settlor is not made a mandatory beneficiary, the assets in trust are free from the claims of the settlor's creditors, including claims based on a judgment of a court in another jurisdiction.[119] However, the protection from creditors does not extend to (i) claims for alimony or support of a spouse or former spouse who was married to the settlor on or before the date of the transfer, or children, (ii) a division of marital property, and (iii) existing tort claimants.[120] Furthermore, creditors' rights under the Delaware Fraudulent Transfer Act are expressly protected.[121] However, creditors are only allowed to reach trust assets to the extent of the debt and any costs the court allows.[122]

A trust created in another state may become a Delaware asset protection trust by transferring the trust to Delaware and meeting the requirements stated above.[123] Such a trust does not have to be governed by Delaware law.[124] If a trust is transferred to Delaware after June 30, 1997, the limitations period begins as of the date the trust was created, rather than as of the date of the transfer.[125]

In addition to the provisions noted above, the Delaware statute possesses some unique qualities. First, the statute permits a corporation or partnership (not solely individuals) to create an asset protection trust.[126] Second, the spendthrift clause contained in a Delaware asset protection trust is deemed to be a transfer restriction on the settlor's interest in the trust within the meaning of Section 541(c)(2) of the Bankruptcy Code.[127] Third, the Delaware Act provides that, in the event a non-Delaware state court declines to apply Delaware's law with respect to the validity, construction, or administration of a Delaware trust, the trustee's authority over the trust is immediately terminated and a successor trustee succeeds to the trusteeship. In the event the trust instrument fails to provide a successor trustee, the Court of Chancery appoints a successor.[128] Fourth, the statute provides that creditors may not bring claims against the trustee or trust adviser or any individual involved in the preparation or funding of such a trust.[129]

Finally, the Delaware rule against perpetuities is 110 years for real property and is nonexistent for personal property and with respect to certain types of trusts.[130]

3. THE SPENDTHRIFT TRUST ACT OF NEVADA. The Spendthrift Trust Act of Nevada (the "Nevada Act") is intended to effect asset protection results similar to those provided by the Alaska and Delaware statutes.[131]

A Nevada asset protection trust must be irrevocable.[132] In addition, all or part of the trust corpus must be located in Nevada, the settlor must be domiciled in Nevada, or the trust must have a qualified trustee. A qualified trustee is an individual domiciled in Nevada or a corporate trustee that is organized under federal or state law, maintains an office in Nevada,

and has and exercises trust powers. The Nevada Act also requires that at least some of the trust administration, including maintaining records and preparing trust income tax returns, must be performed in Nevada.[133]

The settlor may be a discretionary beneficiary of trust principal and income and continue to enjoy the protection of the trust assets from the settlor's creditors. In addition, as under the Alaska and Delaware legislation, the settlor may retain the right to veto distributions and may hold a special testamentary power of appointment over the trust.[134]

As to claims against the settlor existing on the date of the transfer to the trust, the statute of limitations is the later of (i) two years after the transfer, or (ii) six months after the transfer was (or reasonably could have been) discovered by the creditor. As to claims against the settlor arising after the date of the transfer to the trust, the statute of limitations is two years after the transfer.[135] However, certain questions concerning the time in which a creditor may bring claims against the trust based on a fraudulent transfer or a judgment from another state may reduce the asset protection capabilities of a Nevada asset protection trust.[136] In addition, the Nevada Act does not provide trust protection if the settlor is a mandatory beneficiary of the trust or if the trust was created to "hinder, delay, or defraud" known creditors.[137] Federal law might also enable minor children to access a Nevada asset protection trust for support.[138]

The Nevada Act does not address the possibility of moving existing trusts from other states to Nevada. Finally, Nevada has adopted a statutory rule against perpetuities of the later of twenty-one years after the death of a life in being or 365 years.[139]

4. THE UTAH TRUST ACT. In 2003, the Utah legislature amended the trust provisions of the Utah Uniform Probate Code (the "Utah Code") to provide additional protection for assets of trusts.[140]

To qualify for protection under the Utah Code, a trust must be irrevocable, and it must include a spendthrift clause.[141] In addition, at least one trustee must qualify as a Utah trust company and at least some of the trust administration must occur in Utah.[142] Individuals may serve as co-trustees with such trust company.[143] In addition, the settlor may appoint nonsubordinate trustee advisers or trust protectors who have the following powers: (i) to remove and appoint trustees; and (ii) to direct, consent to, or disapprove distributions. The settlor may also serve as an investment director or appoint investment directors.[144] Further, at least some of the trust assets must be held in a savings account, certificate of deposit, or other similar account in Utah.[145]

The settlor may retain the following rights and interests with respect to the trust while enjoying the protection of the trust assets from the settlor's creditors: (i) the right to receive discretionary distributions of income and principal from the trust or distributions of principal subject to an ascertainable standard, (ii) the right to veto a trust distribution, (iii) a testamentary special power of appointment over the trust, and (iv) the right to receive an interest in a charitable remainder annuity trust or a charitable remainder unitrust.[146]

The statute of limitations for claims under the Utah Code is the statute of limitations applicable to the underlying action.[147] The assets of the trust will not be subject to the claims of the settlor's creditors, including claims based on judgments from courts in other jurisdictions, except in eleven defined instances, some of which include: (i) a judgment from a legal proceeding that was commenced either before the transfer or within three years of the transfer, (ii) a transfer made with the intent to hinder, delay, or defraud a present creditor, (iii) the settlor's ability to revoke the trust without the consent of a person with a substantial adverse interest in the trust, (iv) the settlor's retention of a right to mandatory distributions, (v) claims for child support, (vi) a transfer made when the settlor is insolvent or a transfer that renders the settlor insolvent, (vii) claims for recovery of public assistance provided to the settlor, (viii) claims for municipal, county, state, or federal taxes, and (ix) claims by a spouse or former spouse for alimony or support or a division of property.[148] In any case, a creditor making a claim against a Utah asset protection trust has the burden to prove his or her claim by clear and convincing evidence.[149] If a creditor is allowed to access trust assets in satisfaction of a claim, such creditor may only reach the trust assets to the extent of his or her claim and any costs allowed by the court.[150]

A trust created in another state may become a Utah asset protection trust if it meets the requirements listed above and if its trustee transacts a major part of the trust business in Utah.[151] If a trust moves from another state to become a Utah asset protection trust, a transfer restriction similar to that provided for in the Utah Code is effective and enforceable.[152]

The Utah Code contains interesting provisions in addition to those addressed above. First, as in the Alaska and Delaware statutes, the Utah Code prevents the assertion of claims against anyone involved in the preparation and funding of a Utah asset protection trust.[153] Second, Utah courts have exclusive jurisdiction over any action brought against a Utah asset protection trust.[154] Third, the Utah Code provides that the statutory spendthrift clause is a transfer restriction on the settlor's interest in a Utah asset protection trust within the meaning of Section 541(c)(2) of the Bankruptcy Code.[155] Finally, Utah's rule against perpetuities permits transfers in trust that do not exceed 1,000 years in duration.[156]

5. THE RHODE ISLAND TRUST ACT. The Rhode Island Qualified Dispositions in Trust Act (the "Rhode Island statute") is virtually identical to the original 1997 Delaware Qualified Dispositions in Trust Act.[157] The Rhode Island statute does not, however, incorporate the 1998 and 1999 amendments to the Delaware Act.

A Rhode Island asset protection trust must be irrevocable and state that Rhode Island law governs the trust. The trust must also contain a spendthrift clause and have a qualified trustee.[158] A qualified trustee is an individual resident of Rhode Island or a corporate trustee that is authorized by law to act as a trustee and that is subject to supervision by the department of business regulation, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision.[159] The trustee must maintain trust property in Rhode Island or otherwise materially participate in the trust administration.[160]

The settlor may enjoy the protection offered by the Rhode Island statute and at the same time be a potential discretionary beneficiary of trust principal and income if the trustee is not the settlor or a related or subordinate party of the settlor.[161] In addition, the settlor may retain the right to veto a trust distribution and may hold a testamentary special power of appointment over the trust.[162]

As to claims against the settlor existing on the date of the transfer to the trust, the statute of limitations is the later of (i) four years after the transfer, or (ii) one year after the transfer was (or reasonably could have been) discovered by the creditor. As to claims against the settlor arising after the date of the transfer to the trust, the statute of limitations is four years after the transfer.[163] Unless the transfer into the trust was fraudulent, the trust assets of a Rhode Island asset protection trust will generally not be subject to creditors' claims. In addition to other claims, the Rhode Island statute bars enforcement of a judgment obtained in another jurisdiction against the trustee.[164] However, the trust assets will be subject to the following claims: (i) existing claims for alimony or support by the settlor's spouse, former spouse, or children, (ii) claims for a division of marital property, and (iii) existing tort claims.[165] Even if a creditor is allowed to access trust assets, such creditor may only reach the trust assets to the extent of his or her claim and any costs allowed by the court.[166]

The Rhode Island statute does not address the possibility of moving a trust from another state to Rhode Island. Finally, Rhode Island's rule against perpetuities has been repealed.[167]

6. THE OKLAHOMA FAMILY WEALTH PRESERVATION ACT. In 2004, the Oklahoma legislature passed the Family Wealth Preservation Act (the "Oklahoma Act"), creating a new breed of asset protection trusts with a rather extraordinary feature—revocability.[168] Under the Oklahoma Act, any individual, including non-residents of Oklahoma, can place up to $1,000,000 into an Oklahoma asset protection trust (a "Preservation Trust"). The first $1,000,000, and the growth thereon, held in the Preservation Trust is essentially exempt from creditors' claims.[169]

A Preservation Trust must be governed by Oklahoma law.[170] Unlike most asset protection trusts, the Preservation Trust is not created for the benefit of the settlor. The "qualified beneficiaries" of a Preservation Trust are the settlor's ancestors or descendants, the settlor's spouse or such spouse's ancestors or descendants, charities, and a trust of which any of the above-listed individuals or entities is the sole beneficiary.[171] The trust must at all times have an Oklahoma-based bank or Oklahoma-based trust company serving as the trustee.[172] The statute defines an Oklahoma-based bank or Oklahoma-based trust company as a bank or trust company chartered under the laws of Oklahoma, or a nationally chartered bank or trust company having a physical place of business in Oklahoma.[173] Individuals or entities other than an Oklahoma-based bank or an Oklahoma-based trust company may serve as co-trustees of the trust.[174] The statute requires that the trust be funded primarily (by value) with "Oklahoma assets," which include the following: (i) stock in an Oklahoma-based company; (ii) Oklahoma state, county, or municipal bonds or other obligations; (iii) accounts in Oklahoma-based banks or trust companies; (iv) certain mutual funds; (v) tangible personal property having a situs in

Oklahoma; and (vi) Oklahoma real property.[175] Additionally, the Preservation Trust must recite in its terms that it is subject to taxation under the income tax laws of the State of Oklahoma.[176] The statute does not appear to preclude funding the trust with the settlor's interest in an Oklahoma-based company (defined as corporations, limited liability companies, limited partnerships, and limited liability partnerships formed or domesticated in Oklahoma with a physical principal place of business in Oklahoma[177]) that hold assets located outside Oklahoma.

The most interesting feature of the Preservation Trust is its revocability.[178] While a settlor may revoke the Preservation Trust at any time, no settlor may be compelled to revoke such trust by a court or other judicial body.[179]

If the settlor made a transfer with actual intent to hinder, delay, or defraud a creditor, the statute of limitations for a claim arising before or after the transfer is the later of four years after the transfer or one year after the transfer was or reasonably could have been discovered by the creditor.[180] A claim arising before or after a transfer is extinguished four years after the transfer if the transfer rendered or was likely to render the settlor insolvent, and the settlor did not receive reasonably equivalent value.[181] Finally, a claim arising before a transfer for an antecedent debt to an insider who had reasonable cause to believe that the debtor was insolvent, at a time when the debtor actually was insolvent, is extinguished one year after the transfer.[182]

Transfers to a Preservation Trust are subject to the provisions of Oklahoma's Uniform Fraudulent Transfer Act, and any trust assets in excess of $1,000,000 or the growth thereon may be reached by the settlor's creditors.[183] In addition, a child support judgment is allowed as a lien against the Preservation Trust.[184] Once a Preservation Trust is revoked, the creditor protection features are lost as of the date of revocation.[185]

An interesting feature of a Preservation Trust is that a settlor may establish a new Preservation Trust upon revocation of a preceding one, but no more than one Preservation Trust created by the same settlor may be in existence at any time.[186] In addition, the Oklahoma Act states that its provisions constitute restrictions on the settlor's interest in the Preservation Trust within the meaning of Section 541(c)(2) of the Bankruptcy Code.[187] Further, Oklahoma retains a rule against perpetuities of twenty-one years plus a life or lives in being.[188]

The Oklahoma Act does not address the transfer of trusts created in other states to Oklahoma or the consequences of a creditor's successful attack against a Preservation Trust.

7. THE SOUTH DAKOTA QUALIFIED DISPOSITIONS IN TRUST ACT. South Dakota's legislation permitting self-settled spendthrift trusts applies to qualified dispositions made after June 30, 2005.[189]

To qualify for protection under the South Dakota Qualified Dispositions in Trust Act (the "South Dakota Act"), the trust instrument must be irrevocable, contain a spendthrift provision, and incorporate South Dakota law to govern its validity, construction, and

administration.[190] The trust must also have at least one qualified trustee, although it may also have other nonqualified trustees other than the settlor.[191] A qualified trustee is an individual resident of South Dakota other than the settlor or a corporate trustee subject to supervision by the Division of Banking, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, or the Office of Thrift Supervision.[192] Nonqualified trustees may also serve as co-trustees or as trust advisers or protectors.[193] The qualified trustee must "materially participate" in the trust administration or arrange for at least some of the trust property to be located in South Dakota.[194]

The South Dakota Act permits the settlor to retain beneficial interests in and powers over a spendthrift trust, including: (i) the right to receive distributions of principal determined in the discretion of a qualified trustee or pursuant to an ascertainable standard; (ii) the right to receive income from the trust or a percentage of the trust each year (and income and principal from a charitable remainder unitrust or a charitable remainder unitrust); (iii) a special *inter vivos* and/or a general testamentary power of appointment over the trust; (iv) the right to veto a trust distribution; (v) the right to appoint a nonqualified co-trustee, co-trustees, or trust protector who may have the authority to remove and replace qualified trustees or trust advisers and the power to direct, consent to, or disapprove trust distributions; (vi) the right to remove and replace a trustee or trust adviser with an individual or entity who is not related or subordinate to the settlor; and (vii) the right to use real property held in a QPRT.[195] Finally, the settlor may include in the trust a provision pouring all of the trust property into the settlor's probate estate or into a revocable trust at his or her death.[196]

According to the South Dakota Act, the trust may be penetrated only if the disposition was made with intent to defraud the creditor bringing the challenge.[197] Both present and future creditors may attack the trust on this basis, but they must establish their claims by clear and convincing evidence.[198] The statute of limitations for claims against the trust that arose before the transfer varies depending on the claim. Present creditors must bring a claim within three years after the transfer or one year after the transfer is discovered (or reasonably could have been discovered), whichever is later.[199] Claims arising after a transfer must be asserted within three years after the transfer.[200] The South Dakota Act provides that South Dakota courts have exclusive jurisdiction over claims against South Dakota trusts and bars judgments against such trusts entered in other jurisdictions.[201]

In the event a creditor's claim against a South Dakota asset protection trust is successful, the trust will only be liable for the amount necessary to satisfy the creditor's claim, together with associated costs.[202] Further, if the court determines that a trust beneficiary has not acted in bad faith, the creditor's ability to reach the trust assets is subject to the right of the beneficiary to retain any distributions from the trust made by a qualified trustee prior to the commencement of the action.[203] Notwithstanding these provisions, some creditors are afforded other protections under the South Dakota Act. For example, the act does not apply in any respect to (i) indebtedness owed by the settlor for child support or alimony under a domestic relations order to a person who was the settlor's spouse at or before the transfer, regardless of when the order is obtained, and (ii) tort claimants who were damaged on or before the date of the

transfer.[204] A surviving spouse may also be able to reach the trust assets by electing against the settlor's will.[205]

There are other interesting provisions of the South Dakota Act, in addition to those previously discussed. First, a trustee may move a trust created in another state to South Dakota if the trust meets the requirements provided above, with the exception that the trust does not have to state that it is governed by South Dakota law.[206] Second, the statute of limitations with respect to a transfer to such a trust is deemed to begin running as of the date the trust was originally created rather than as of the date the trust became a South Dakota trust.[207] Third, South Dakota's statutory spendthrift provision is a transfer restriction on the settlor's beneficial interests in the trust that is enforceable under applicable nonbankruptcy law within the meaning of section 541(c)(2) of the Bankruptcy Code.[208]

The South Dakota Act also purports to limit the liability of trustees, trust advisers, and persons involved in the counseling, drafting, preparation, execution, or funding of the trust.[209] Finally, South Dakota has abolished the common law rule against perpetuities but has replaced it with a statutory rule against perpetuities that is any life in being plus thirty years.[210]

8. THE MISSOURI UNIFORM TRUST CODE. Although Missouri amended its spendthrift statute as early as 1986 in an effort to provide trust settlors spendthrift protection for non-fraudulent transfers, several federal court decisions undermined the effectiveness of such amendments.[211] As part of the Missouri Uniform Trust Code (the "Missouri Code") enacted in 2004, the state's spendthrift statute was further amended.[212]

To enjoy the protection of the Missouri Code, a trust must be irrevocable and must contain a spendthrift clause.[213] A Missouri trustee is not required, and trust assets are not required to have their situs in Missouri. The settlor may be a discretionary beneficiary of a Missouri asset protection trust and still enjoy the protection provided by the Missouri Code.[214]

Under the Missouri Code, the statute of limitations for a claim that arose before or after the transfer if the settlor made the transfer with actual intent to hinder, delay, or defraud a creditor is the later of four years after the transfer or one year after the transfer was or reasonably could have been discovered by the creditor. A claim that arose before the transfer for which transfer the settlor did not receive reasonably equivalent value and which rendered, or was likely to render, the settlor insolvent, is extinguished four years after the transfer.[215] If a creditor's claim against a Missouri asset protection trust is successful, the creditor may choose his or her remedy. One such remedy is that the creditor may be able to reach trust assets in the amount necessary to satisfy his or her claim.[216] However, the range of remedies offered is broad. In fact, the statutory language provides that, subject to principles of equity and the rules of civil procedure, the creditor may obtain "[a]ny other relief the circumstances require."[217]

As amended, the Missouri Code clarifies that a spendthrift provision in an irrevocable trust will protect trust assets from creditors' claims, with the following exceptions: (i) a child, spouse, or former spouse of the settlor with a judgment for support or maintenance, or a

judgment creditor whose services provided protection of the settlor's interest in the trust, may obtain a court order attaching present or future trust income;[218] (ii) protection is not available for trust assets against a claim by Missouri or the United States to the extent specified by any Missouri or federal statute;[219] (iii) a fraudulent transfer of assets to the trust has no spendthrift protection;[220] and (iv) to the extent of the settlor's beneficial interest in the trust assets, there is no spendthrift protection if the settlor is the sole beneficiary of either the income or principal of the trust, or retained the power to revoke or amend the trust, or if the settlor is one of a class of beneficiaries and retained a right to receive a specific portion of the income or principal of the trust.[221] Thus, in a Missouri trust containing a spendthrift provision, if there is more than one beneficiary, the settlor is a discretionary beneficiary of income or principal, and there has been no fraudulent transfer, the trust settlor will have spendthrift protection.

The Missouri Code does not address moving a trust from another state to Missouri. Missouri retains a common law rule against perpetuities, which is a life in being plus twenty-one years and a period of gestation.[222]

9. THE TENNESSEE INVESTMENT SERVICES ACT. In 2007, the Tennessee legislature enacted legislation allowing the creation of self-settled spendthrift trusts.[223] This legislation, known as the Tennessee Investment Services Act (the "Tennessee Act"), was modeled after similar provisions in the Delaware and Rhode Island statutes. The Tennessee Act, unlike the previously established acts of sister states, refers to asset protection trusts as investment services trusts ("ISTs").

To create an IST, the trust instrument must: (i) state the trust is irrevocable; (ii) expressly incorporate Tennessee law to govern the trust's validity, construction, and administration; and (iii) contain a spendthrift clause. Further, establishing an IST requires the settlor to transfer assets to a qualified trustee.[224] A qualified trustee may be either a Tennessee resident individual or an institution supervised by the Tennessee Department of Financial Institutions or certain federal supervisory authorities. The qualified trustee must: (i) maintain or arrange for custody in Tennessee of some or all of the trust assets; (ii) maintain records; (iii) prepare or arrange for preparation of income tax returns; or (iv) materially participate in the IST's administration. The settlor may not serve as the qualified trustee.[225] However, the settlor may serve as an investment adviser, and non-qualified trustees are permitted to serve in addition to qualified trustees.[226] Finally, the settlor, prior to the transfer, must sign a sworn "qualified affidavit" that stipulates to certain facts regarding the assets transferred, the solvency of the settlor, and the legitimacy of the transfer.[227]

The settlor may retain the right to receive: (i) trust income; (ii) distributions from a charitable remainder annuity trust or a charitable remainder unitrust; (iii) annual distributions of up to five percent of the trust's initial value; and (iv) distributions of principal at the discretion of a qualified trustee or pursuant to an ascertainable standard, whether or not acting at the direction of a trust adviser.[228] In addition, the settlor may continue to enjoy certain powers over the trust, including (i) the power to veto distributions; (ii) a special testamentary power of appointment; (iii) the right to remove and replace a trustee or trust adviser

with an unrelated and non-subordinate party; (iv) the right to appoint trust advisers or protectors; and (v) the right to use real property held in a qualified personal residence trust.[229]

In Tennessee, claims arising prior to a transfer to an IST and those arising subsequently are subject to different statutes of limitations. Pre-transfer claims alleging an actual intent to hinder, delay, or defraud are not extinguished unless brought within the later of four years after the transfer or one year after the transfer was or could have been reasonably discovered.[230] Other pre-transfer claims expire four years after the debtor made the transfer or incurred the obligation.[231] Post-transfer claims are extinguished unless brought within four years of the date of the transfer.[232] Although the Tennessee Act offers protection to ISTs, such protection does not extend to claims under the Uniform Fraudulent Transfers Act.[233] Although Tennessee law appears to afford no special status to claims by spouses or dependent children, the federal law providing for full faith and credit for child support orders might enable minor children to pierce an IST for support.[234] In any event, the Tennessee Act only allows avoidance of an IST to the extent of the debt and any costs the court allows.[235]

In addition to those summarized above, the Tennessee Act contains other noteworthy provisions. First, an existing trust originally governed by the laws of another state may have title to its assets transferred to a qualified Tennessee trustee and become an IST if it meets all of the statutory requirements other than incorporating Tennessee law.[236] The statute of limitations begins to run on the date of the original transfer to the trust, rather than on the date the trust becomes a Tennessee IST.[237] Second, should a court in another jurisdiction decline to apply Tennessee law with respect to determining the effect of an IST's spendthrift protection, the trustee of that trust is automatically removed and a successor trustee is appointed.[238] Third, the Tennessee Act specifically provides that the spendthrift clause is a transfer restriction within the meaning of section 541(c)(2) of the Bankruptcy Code.[239] Fourth, the Tennessee Act prevents creditors and those seeking enforcement of certain judgments from proceeding against a trustee or any person involved in the preparation, execution, counseling, drafting, or funding of an IST.[240]

Finally, prior to the Tennessee Act, the Tennessee rule against perpetuities invalidated property interests after the later of 90 years after the interest was created or 21 years after a life in being.[241] The Tennessee Act extends the perpetuities period for all trusts that were created or become irrevocable after June 30, 2007. Specifically, the Tennessee Act requires that all interests vest or terminate, or the power of appointment be exercised within 360 years of the trust's creation or the date it became irrevocable. This extended period only applies, however, if at least one member of each generation of beneficiaries is granted a power of appointment at death. This power of appointment must include all descendants of that beneficiary, and may include other persons.[242]

10. THE WYOMING UNIFORM TRUST CODE. Alongside Tennessee's legislation, in 2007 the Wyoming legislature amended the Wyoming Uniform Trust Code (the "Wyoming Code") to allow for the creation of self-settled spendthrift trusts.[243]

To qualify for Wyoming spendthrift protection, the trust instrument must state that: (i) the trust is a qualified spendthrift trust under the Wyoming Code; (ii) Wyoming law governs the trust's validity, administration, and construction; (iii) the settlor's interest is subject to a spendthrift provision; and (iv) the trust is irrevocable.[244] When property is transferred into the trust, the Wyoming Code also requires a sworn affidavit from the settlor, which states that he or she is not attempting to defraud creditors, that the transfer will not render the settlor insolvent, that he or she is not contemplating filing for bankruptcy, and that he or she has personal liability insurance of $1,000,000 or an amount equal to the value of all property transferred to the spendthrift trusts thus far, whichever is less.[245]

In addition, only a Wyoming resident individual other than the settlor, a state-authorized trustee, or a regulated financial institution may serve as a qualified trustee.[246] All qualified trustees must either: (i) maintain or hold custody of at least some trust property in Wyoming; (ii) maintain trust records; (iii) prepare or arrange for preparation of the trust's tax return; or (iv) materially participate in the administration of the trust.[247] Provided that at least one qualified trustee serves, a nonqualified person (including the settlor) may serve as a co-trustee and have limited authority over the trust.[248]

Wyoming trusts may also have both trust protectors and trust advisers. A trust protector, as a disinterested third-party, may, *inter alia*, (i) veto distributions to beneficiaries; (ii) change the beneficiaries' interests in the trust; (iii) grant, amend, or modify powers of appointment; and (iv) elect qualified spendthrift status.[249] The settlor is the trust adviser by default, although another person may be designated instead.[250] The trust adviser may also be granted broad powers, including the power to: (i) direct acquisition or retention of investments, (ii) perform a specific duty or function normally carried out by the trustee or protector, and (iii) direct or veto distributions to a beneficiary.[251]

Without diminishing a trust's spendthrift protection, the Wyoming Code permits the settlor to receive: (i) trust income; (ii) distributions from a charitable remainder annuity trust or a charitable remainder unitrust; (iii) annual distributions of up to 5% of the initial value of the trust; and (iv) principal distributions at the trustee's sole discretion or based on an ascertainable standard. The settlor may also retain a number of powers without forfeiting spendthrift protection, including the power to veto distributions; a general or special *inter vivos* or testamentary power of appointment over the trust; the right to add, remove, or replace a trustee, trust adviser, or trust protector with an individual or entity other than the settlor; the right to act as an investment adviser to the trust; and the right to use real property held in a qualified personal residence trust.[252]

Under the Wyoming Code, the statute of limitations varies depending on the type of fraudulent transfer claim. The statute of limitations for a claim that arose before or after the transfer if the settlor made the transfer with actual intent to hinder, delay, or defraud a creditor is the later of four years after the transfer or one year after the transfer was or reasonably could have been discovered by the creditor.[253] A claim that arose before the transfer for which transfer the settlor did not receive reasonably equivalent value and which rendered, or was likely to render, the settlor insolvent is extinguished four years after the transfer.[254] Finally, a claim

arising before a transfer for an antecedent debt to an insider who had reasonable cause to believe that the debtor was insolvent, at a time when the debtor actually was insolvent, is extinguished one year after the transfer.[255]

Properly created and duly administered, a Wyoming qualified spendthrift trust prevents creditors from compelling or obtaining a lien on distributions to a beneficiary prior to the beneficiary's receipt of such distributions.[256] Even when the beneficiary serves as a co-trustee, Wyoming law protects future distributions from attachment if the terms of the trust limit the trustee's ability to make distributions to some standard. For example, distributions are protected where the trust instrument directs the trustee to make distributions to the beneficiary pursuant to an ascertainable standard.[257] However, a court is authorized to compel the trustee to make distributions to satisfy a child support judgment to the extent of the distributions authorized by the trust's distribution standard.[258] In addition, the Wyoming Code does not extend spendthrift protection to the settlor's child support creditors; to qualified trust property listed on a credit application, unless listed for the trust's benefit; or to property that was fraudulently transferred to the trust.[259] These exceptions aside, no creditor may initiate an action, including an action to enforce a judgment entered by the court of another jurisdiction, against qualified trust property unless the action is brought pursuant to the Uniform Fraudulent Transfers Act.[260] In the event a creditor is allowed to access trust assets, the Wyoming Code allows avoidance of a qualified transfer only to the extent of the debt and any fees allowed by the court.[261]

In addition to the provisions discussed above, the Wyoming Code contains a number of other provisions of interest. First, a pre-existing trust originally settled in another state may be moved to Wyoming and enjoy spendthrift protection, assuming the requirements under Wyoming law for such trusts, with the exception of the qualified transfer affidavit, are met.[262] For purposes of determining when the statute of limitations has run, the transfer is deemed to have occurred as of the date of the original transfer into the pre-existing trust.[263] Second, the Wyoming Code provides that the statutory spendthrift provision constitutes a transfer restriction for purposes of section 541(c)(2) of the Bankruptcy Code.[264] Third, creditors may not bring a cause of action against the trustee, trust protector, adviser, or other trust fiduciary, or any individual involved in the preparation or funding of the trust.[265] Fourth, the Wyoming Code permits, but does not automatically effect by operation of law, the trustee's resignation if a court in another state declines to apply the law of Wyoming to the trust.[266]

Finally, since 2003, Wyoming permits trusts to avoid the rule against perpetuities. To do so successfully, the trust instrument must: (i) state that the rule against perpetuities does not apply; (ii) terminate in 1,000 years or less from the date of its creation; (iii) be governed by Wyoming law and (iv) appoint a trustee that is a Wyoming resident or maintains a place of business or administers the trust in Wyoming.[267] This exception to the rule against perpetuities, however, does not apply to real property.[268]

11. THE NEW HAMPSHIRE QUALIFIED DISPOSITIONS IN TRUST ACT. In 2008, New Hampshire passed the Qualified Dispositions in Trust Act (the "New Hampshire Act") to provide protection for assets transferred to a trust through a qualified disposition.[269] This legislation is effective for transfers made after January 1, 2009.[270]

To qualify for protection under the New Hampshire Act, a trust must (i) appoint at least one qualified trustee, (ii) expressly incorporate the law of New Hampshire as the governing law of the trust, (iii) be irrevocable, and (iv) contain a spendthrift clause.[271] A qualified trustee may be an individual resident of New Hampshire other than the transferor, or a state or federally chartered bank or trust company having a place of business in New Hampshire.[272] A qualified trustee must have authorization to engage in trust business in New Hampshire. Further, some of the trust property must remain in New Hampshire, or the qualified trustee must maintain records in the state for the trust, ensure that fiduciary income tax returns are prepared in the state for the trust, or otherwise materially participate in the state in the administration of the trust.[273] In addition to the qualified trustee, the trust may also have one or more trust advisers, including the transferor, who are not required to meet the qualifications of a qualified trustee.[274] The trust advisers may have the authority to remove and appoint qualified trustees or trust advisers and to direct, consent to, or veto distributions.[275] However, if the transferor serves as a trust adviser, his powers must be limited to vetoing distributions and consenting to the trustee's actions relating to investment of trust assets.[276]

The transferor of a trust under the New Hampshire Act may retain the right to receive (i) income, (ii) distributions of income or principal from a charitable remainder unitrust or a charitable remainder annuity trust, (iii) yearly distributions of up to five percent of the trust's value annually, (iv) distributions of principal at the sole discretion of a qualified trustee or pursuant to an ascertainable standard, and (v) distributions of income or principal to pay income taxes on trust income at the discretion of the qualified trustee or a trust adviser.[277] The transferor also may retain an interest in a QPRT or a qualified annuity.[278] In addition, the transferor may continue to enjoy certain powers over the trust, including (i) the power to veto distributions, (ii) a special testamentary power of appointment, and (iii) the right to remove and replace a trustee or trust adviser with an unrelated and non-subordinate party.[279]

The only claims that may be brought against a trust that meets the requirements of the New Hampshire Act are (i) tort claims based on injury suffered on or before the date of a qualified disposition by a transferor; (ii) claims for support or alimony in favor of a transferor's spouse or former spouse who was married to the transferor at or before the time of the transfer or in favor of a transferor's children; (iii) claims by the transferor's surviving spouse for an elective share if the transferor made the qualified disposition for the purpose of defeating the surviving spouse's elective share rights; and (iv) claims brought under the Uniform Fraudulent Transfers Act.[280] In the event a creditor is allowed access to trust assets, the New Hampshire Act allows avoidance of a qualified disposition only to the extent necessary to satisfy the debt and any fees allowed by the court.[281]

Claims arising before the qualified disposition to the trust was made must be brought within the limitations period of the Uniform Fraudulent Transfer Act, which varies depending on the claim.[282] A claim based on a transfer made with actual intent to hinder, delay, or defraud must be brought within the later of (i) four years after the transfer was made, or (ii) one year after the transfer was or could reasonably have been discovered by the claimant.[283] A claim must be brought within four years of a transfer from which the transferor did not receive a reasonably equivalent value and at the time of which he was insolvent or as a result of which he

became insolvent.[284] A claim must be brought within one year of a transfer made for an antecedent debt to an insider who had reasonable cause to believe the transferor was insolvent at a time when the transferor was insolvent.[285] Claims arising after the qualified disposition to the trust was made must be brought within four years.[286]

A trust created in another state may be transferred to New Hampshire and become a trust subject to the New Hampshire Act even if the trust is not governed by New Hampshire law.[287] The limitations period begins as of the time of the original transfer into the trust.[288]

The New Hampshire Act contains several other noteworthy provisions. First, it specifically provides that the spendthrift clause is a transfer restriction within the meaning of section 541(c)(2) of the Bankruptcy Code.[289] Second, creditors and those seeking enforcement of certain judgments are prevented from proceeding against a trustee, trust adviser, or any person involved in the counseling, drafting, preparation, execution, or funding of a trust under the New Hampshire Act.[290] Third, after the transferor's death, a qualified trustee may pay the transferor's outstanding debts at the time of his death, estate administration expenses of the transferor's estate, or any estate inheritance tax imposed on the transferor's estate.[291] Finally, the New Hampshire Act provides that, in the case of an avoidance of a qualified disposition, a qualified trustee who has not acted in bad faith has a first and paramount lien against a qualified disposition for costs properly incurred in the defense of an action to avoid the qualified disposition, and a beneficiary who has not acted in bad faith is allowed to retain any distribution made by a qualified trustee of such trust.[292]

Finally, New Hampshire law provides that a trust is exempt from the common law rule against perpetuities if the trust instrument expressly exempts the trust and the trustee has the power to sell, mortgage, or lease property for some period of time beyond the perpetuities period.[293]

LOCAL COUNSEL AND REPRESENTATIVE BANKS AND TRUST COMPANIES

Advisors to clients considering establishing asset protection trusts need points of contact to get started in seriously evaluating each jurisdiction. Local trust lawyers, banks, and trust companies are the best place to start. So far as I am able to determine, all of these lawyers and institutions are reputable and knowledgeable, but I must disclaim any imprimatur. The attorneys whose names are followed by an asterisk (*) reviewed the outline or offered comments, but any inaccuracies are the responsibility of Mr. Tansill. Mr. Tansill gratefully acknowledges the generous assistance of these experts who assisted him.

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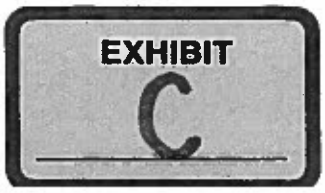

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e-mail: tom.2.hamilton@royalbank.com

Royal Bank of Scotland International, Ltd.
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Assets Under Administration: $65 billion plus

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