

**Asset Protection in the New Millenium**

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# ASSET PROTECTION TRUSTS©

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## I. INTRODUCTION

Although the use of the so-called “offshore” trust as a vehicle to protect assets from creditors has been oft cited as a relatively recent phenomenon, in actuality offshore jurisdictions have long been favoured for various asset protection purposes. Most notably, offshore trusts have been used to escape domestic political strife, exchange controls, forced heirship provisions, confiscatory government action or to obtain favorable tax benefits; all of which can, to some extent, be considered to be “asset protection” purposes. Today’s offshore asset protection trusts, however, are at least as likely to be created for the purpose of obtaining leverage against future private creditors as for these other purposes since such trusts can provide significant procedural, substantive and psychological barriers which impact upon a private creditor’s ability to attach a debtor’s assets. For individuals resident in stable political and economic jurisdictions, such as the United States, leverage against private creditors is probably the most common use of the offshore asset protection trust today.

The “offshore” trust is unique to asset protection planning since, if established in one of a number of jurisdictions which have repealed the common law prohibition against self-settled spendthrift trusts, the settlor can name himself as a discretionary beneficiary of the trust while at the same time protecting the trust corpus from the claims of future creditors. Thus the settlor is relieved from the traditional dilemma inherent in having to divest himself of property in order to protect it from potential future creditors. Although a handful of domestic jurisdictions have recently followed suit in repealing the self-settled spendthrift trust rule, application of the Full Faith and Credit Clause of the United States Constitution makes it questionable whether trusts established under the law of such domestic jurisdictions will actually provide any asset protection.

Of course, as an asset protection device, the traditional domestic trust (as well as an outright transfer of property) remains viable where the settlor, for whatever reason, desires to irrevocably transfer his property for the benefit of another. Where the named beneficiaries include the settlor's spouse, the transferred property can potentially be used for the indirect benefit of the settlor; provided, of course, that neither a divorce nor the spouse's untimely death intervene. In the past, however, such asset protection planning techniques were used because no viable alternative existed. Today those who are at substantial risk (such as real estate developers, corporate directors, doctors, lawyers, and others who are viewed as "deep pockets"), and who are willing to incur the greater costs associated with the trust settlement, have the viable alternative of protecting their assets in an offshore self-settled spendthrift trust.

As the use of offshore trusts for asset protection purposes has become more and more prevalent in recent years, a basic understanding of the law governing such entities has become *de rigueur* for professionals practicing and providing advice across a broad spectrum of disciplines. This chapter will provide the reader with such a grounding in the law relating to offshore asset protection trusts.

## II. BENEFITS OF OFFSHORE ASSET PROTECTION TRUSTS

### 1. Creditor Protection

A trust, foreign or domestic, is uniquely geared to providing asset protection to its beneficiaries since the very concept of the trust involves a division between the legal (i.e., administrative or managerial), and the beneficial ownership of property. Specifically, a trust imposes a fiduciary relationship with respect to property, subjecting the title holder (the "trustee") to equitable duties to deal with the property for the benefit of another (the "beneficiary"). Pursuant to this important distinction, and in accord with the legal maxim of

*cujus est dare, ejus est disponere* or “whose it is to give, his it is to dispose”, most courts will recognise, as effective, a trust provision purporting to restrain the alienation of the beneficial trust interest, either voluntarily by the trust beneficiary or involuntarily by his or her creditors. Such a provision is called a “spendthrift provision” and such a trust is called a “spendthrift trust” although it is important to note that whether the beneficiary is actually a “spendthrift” is, in fact, immaterial to the protection afforded.

Notwithstanding the wide recognition of spendthrift trust protections where one individual establishes a trust for the benefit of another, however, an exception is often made on public policy grounds for the so-called “self-settled” spendthrift trust, which is a trust in which the settlor retains for himself an interest as a beneficiary, even if it is only a potential to receive distributions from the trust within the discretion of an independent, third-party trustee. The principal underlying such limitation (where it exists) is that it is against public policy to allow an individual to tie up his property in such a way that he can still enjoy it but can prevent his creditors from reaching it. Significantly, this is the case whether the settlor’s creditors are present or future, reasonably anticipated or impossible to foresee, as an intent in the settlor to defraud creditors is not required to invalidate a self-settled spendthrift trust in such jurisdictions.

The settlor of a trust, however, may designate the law of any jurisdiction as governing the administration of his trust, and hence may designate a jurisdiction which recognises self-settled spendthrift trusts as valid even if the settlor’s domicile does not. Moreover, under established rules relating to conflict of laws, including the Hague Convention on the Law Applicable to Trusts and on their Recognition, and The American Law Institute’s Restatement (Second) of the law of Conflict of Laws, the settlor’s designation of governing law should be respected, both domestically and internationally, regardless of venue. Notwithstanding the foregoing, however,

case law indicates that particularly egregious cases (generally those which implicate fraudulent conveyance or sham trust arguments) are unlikely to withstand a spirited attack on public policy grounds in the settlor's domicile.

Beyond having repealed the self-settled spendthrift trust rule, however, an offshore trust geared towards asset protection should be sited in a jurisdiction which has also statutorily modified the Statute of Elizabeth. The Statute of Elizabeth, which was enacted in England in 1571 and which now forms the basis of fraudulent transfer law throughout most of the common law system, renders void any transfer made with an intent to defeat, delay, or hinder any creditor. Since the Statute of Elizabeth sets a very low threshold relating to the imputation of fraudulent intent and since the Statute of Elizabeth contains no set period of limitations within which a creditor must bring a fraudulent conveyance claim, no real asset protection can be obtained in a jurisdiction in which the Statute of Elizabeth is in force. In contrast, a jurisdiction which has statutorily repealed the Statute of Elizabeth will typically provide for a short limitations period and will limit the potential to impute, from the circumstances surrounding the transfer, the intent required for finding that the settlor has made a fraudulent conveyance.

It is also important that an offshore asset protection trust be sited in a jurisdiction which denies judicial comity to foreign judgments that conflict with the substantive law of the jurisdiction. Absent this facet of asset protection law, a judgment rendered in the trust settlor's domicile on fraudulent conveyance grounds could potentially be filed and then enforced in the offshore jurisdiction without ever implicating the otherwise protective asset protection laws of that offshore jurisdiction.

Finally, aside from the United States, most common law jurisdictions (i) do not allow attorneys to take matters based on a contingency fee, and (ii) provide that the losing party to a

lawsuit must pay all of the victor's expenses, including attorneys' fees. Combined with an evidentiary standard in some asset protection jurisdictions which requires proof beyond a reasonable doubt on fraudulent conveyance claims, assets held in trust may in the end be unreachable. At a minimum, the process of litigating such a claim in an offshore jurisdiction may prove prohibitively expensive for a creditor when the potential reward is so uncertain. The aggregate of these factors will likely provide the settlor of an offshore asset protection trust significant leverage against his creditors.

## 2. Estate Planning

Since the settlor of an *offshore* asset protection trust will almost always be named as a discretionary beneficiary of the trust (since preservation of the trust estate would generally be as well served *onshore* if the trust were not, in fact, self-settled), the trust will normally be structured so that its funding is an "incomplete gift" for transfer tax purposes. As an incomplete gift, no transfer tax is imposed upon the funding of the trust.

A gift to the trust will be deemed complete for transfer tax purposes if the settlor has so parted with dominion and control over the gifted property so as to leave in the settlor no power to change the disposition of property. Conversely, United States Treasury regulations provide that a gift will be deemed incomplete if and to the extent that a reserved power gives the settlor the power to name new beneficiaries or to change the interest of the beneficiaries as between themselves (provided, however, that the power is not a fiduciary power limited by a fixed or ascertainable standard). Pursuant to this guidance, a self-settled, spendthrift trust structured so that its funding constitutes an incomplete gift will typically reserve a power of appointment to the settlor. The retained power should, however, be carefully circumscribed so that its existence does not have the inadvertent effect of opening up the trust to claims of the settlor's creditors.

Therefore, the power should be limited (i) to a select class of beneficiaries (i.e., the settlor's descendants), and (ii) to a testamentary exercise so as to avoid the potential argument that the settlor retained an excessive amount of control over the trust during life.

In the alternative, if it is unlikely (though not impossible) that the settlor will ever need a distribution from the trust, the offshore asset protection trust would be better structured if its funding were a completed gift (albeit at a current gift tax cost for transfers exceeding the tax exempt amount which is currently USD 650,000 and which is increasing to USD 1 million by the year 2006). As a completed gift, the trust corpus, as well as any post-transfer appreciation thereon, will not be included in the settlor's estate when the settlor dies notwithstanding that the settlor can, in the interim, receive distributions from the trust within the discretion of the trustees. Aside from the estate planning benefit, however, a trust structured in this manner gains an additional asset protection benefit since the settlor can then defend against a creditor's fraudulent conveyance attack by demonstrating that the trust was funded for an estate tax benefit rather than to hinder, delay or defraud the settlor's creditors.

Most domestic trusts, however, cannot confer this estate planning benefit because the estate tax regime US will deem a trust includable in the settlor's estate to the extent that the settlor's creditors can access the trust. This is because the settlor is considered to have retained to himself, at least indirectly, the "use and enjoyment" of the transferred assets since his creditors can look to the trust corpus in satisfaction of their claims against the settlor. In the same vein, however, if the trust is sited in a jurisdiction where the settlor's creditors cannot reach the trust assets (i.e., a jurisdiction which has repealed the self-settled spendthrift trust rule), then the gift will be complete for United States federal transfer tax purposes notwithstanding the fact that the trustees have discretion to make distributions to the settlor.

Since many offshore trust jurisdictions have also repealed the common law rule against perpetuities, an additional estate planning benefit can be obtained by creating a perpetual offshore asset protection trust and then allocating a sufficient amount of the settlor's unused generation-skipping transfer tax exemption (currently USD 1,010,000) to the trust. Properly structured, such a "dynasty" trust will preserve the transferred assets, as well as any accumulations thereto, free from creditors of both the settlor and the settlor's descendants, including all tax authorities. Generally, such a trust would provide that to the extent possible, the trust corpus would be preserved for the benefit of the beneficiaries rather than being distributed to the beneficiaries; for example, the trust could purchase a home for a beneficiary to live in rent-free rather than distribute corpus to that beneficiary and thus enabling the beneficiary to purchase a home in his own name. In this manner, the home will never be subject to the beneficiary's creditors (including an ex-spouse of the beneficiary), and will not be taxed as a part of the beneficiary's estate when the beneficiary ultimately dies.

### 3. Foreign Investment

As noted in the previous section regarding estate planning, the question of whether an offshore asset protection trust will be able to withstand creditor attack will depend, in part, upon the strength of the creditor's fraudulent conveyance claim, which in turn will depend, in part, upon the settlor's intent in creating the trust. In this regard, any evidence the settlor can proffer that demonstrates an intent other than to avoid creditors may prove critical to preserving the trust.

To the extent that the settlor cannot afford (or otherwise does not wish) to structure the offshore asset protection trust as a completed gift, the estate tax benefits of the trust may be insignificant. Therefore, the settlor may have to look to the unique opportunities which an

offshore trust provides for foreign investment (which are not available to US residents) in order to provide the “good” intent necessary to defend against a fraudulent conveyance claim.

The vast majority of offshore investment opportunities are unavailable to onshore entities because such investments choose not to meet the relatively strict US regulatory requirements relating to public investments. In consequence, certain offshore investments are arguably more attractive than domestic investments, in part because they have the potential to earn higher returns than similar onshore investments that must bear the substantial costs of complying with domestic regulation of public investments.

#### 4. Confidentiality

A legitimate offshore asset protection trust need not operate by means of secreting assets. In fact, it is questionable whether any asset protection benefit is obtained by secreting assets, since concealment of assets from creditors one of the badges of fraud that may be used to impute intent of fraudulent conveyance. Notwithstanding the foregoing, however, *confidentiality* is often an important consideration in choosing to create an offshore asset protection trust or in choosing the particular jurisdiction in which to settle the trust. To the extent that a settlor’s legitimate desire for confidentiality can be distinguished from an impermissible effort to secrete assets from creditors, this beneficent aspect of the offshore asset protection trust should not be deemed a badge of fraud.

An offshore asset protection trust provides confidentiality to its beneficiaries primarily by reason of the natural division between the beneficial and legal ownership of the trust structure; since assets are held in the name of the trustees, in a fiduciary capacity, rather than in the name of any one or more of the beneficiaries, the beneficial ownership of the assets is hidden from casual observance. In order for the beneficial ownership of the assets to be discovered,

generally, a copy of the trust document must be reviewed – and the trust document is not a public document. Onshore, the use of revocable living trusts as a substitute for a will is a common example of how a trust provides confidentiality to the settlor. Additional confidentiality can be obtained if the trust assets are held by a nominee on behalf of the trustees or in the name of a corporation or other business entity which, in turn, is wholly owned by the trust.

In fact, the trust instrument could legitimately provide that the trustees have no obligation to furnish even the trust beneficiaries with any information relating to the trust's holdings (although it may be deemed to violate public policy to limit the trustees' obligation to provide such information to the settlor at the same time). Certainly, however, the trustees are under no obligation to reveal information concerning the trust to any non-governmental third party (such as the settlor's creditors). In addition, offshore asset protection trusts will likely provide greater confidentiality than will onshore trusts since most offshore centers that wish to attract significant trust business have made it a criminal offence to divulge information relating to the establishment, constitution or business affairs of an offshore trust.

#### 5. Avoidance of Forced Heirship

Forced heirship (including a right of election in a surviving spouse) is the legal right of a family member to claim an interest in the estate of a decedent despite the fact that the decedent desired to exclude the family member under his dispositive testamentary documents. Although property held in trust is, for most purposes, not considered to be part of the decedent's probate estate, many domestic jurisdictions will deem the trust a "testamentary substitute" subject to the jurisdiction's forced heirship provisions as though the trust corpus were, in fact, a part of the decedent's probate estate. Although an offshore asset protection trust will also likely be deemed a testamentary substitute in the decedent's domicile, assets held in an offshore trust may avoid a

forced heirship if neither the trust nor the property held therein can be claimed subject to the jurisdiction of the domestic court. In addition, the law of the offshore jurisdiction will likely override the forced heirship claim in the deceased settlor's domicile.

### III. JURISDICTIONAL ISSUES

#### 1. Common Law vs Civil Law

The trust concept, rooted in equity, is a product of the common law legal system and is distinct from the civil law system, which does not generally recognize the trust concept. For this reason, the vast majority of asset protection trusts are created within a jurisdiction governed by common law principles. Notwithstanding the fact that the trust is not native to the civil law, several civil law jurisdictions have enacted legislation which attempt to append the trust concept onto their legal system. Although these civil law jurisdictions will, ostensibly, recognize the offshore asset protection trust, complications which are likely to arise by reason of a general unfamiliarity with the trust concept inherent in a civil law jurisdiction will likely warrant the use of a similarly protective jurisdiction with a common law tradition.

#### 2. Effect of Retained Interests and Powers

Retained interests and powers are, for various reasons, including an innate distrust of an unknown, offshore trustee, often made a prerequisite to the settlor's agreement to settle the trust. Unfortunately, the retention of control has a direct, inverse relationship to asset protection. For example, the most control (i.e., the settlor retaining the assets in his own name) provides the least of asset protection. At the other extreme, were the settlor to transfer his assets to a non-self settled trust, with an independent corporate fiduciary overseen by an independent corporate protector, he would obtain the most asset protection. Between these two extremes, the settlor's

creditors are afforded various arguments with which to attack either (i) the validity of the trust, or (ii) the settlor himself. In this regard, to the extent that the settlor remains within the jurisdiction of the domestic court rather than expatriating at the first sign of a creditor attack, the settlor must rely upon the trust's anti-duress clause and his own impossibility of performance to protect him from the spectre of being held in contempt for failing to repatriate the trust's assets. Since the burden of proving impossibility of performance is upon the settlor, case law has demonstrated that to the extent the settlor has exercised control over the trust up until entry of the court's order, the settlor will be hard pressed to prove a current inability to the court in an effort to avoid punishment for contempt.

### 3. Effect of Statute of Elizabeth

As noted above, the Statute of Elizabeth was enacted in England in 1571 as a compilation of prior English common law on fraudulent conveyance. More than four centuries later, the Statute of Elizabeth still provides the basis for the prohibition on fraudulent conveyances throughout the entire common law system, including the United States.

The Statute of Elizabeth provides that transfers made with the intent to hinder, delay, or defraud creditors of the transferor are voidable. Although the Statute requires that the debtor's actual intent be proved, it was recognized early on that very few debtors would admit to such an intent. The courts have, therefore, deemed a number of facts as so-called "badges of fraud" which, when aggregated in sufficient number, will be deemed to provide proof of the debtor's intent. Some "badges of fraud" heretofore recognized by the courts are:

- (i) that the transfer was to an insider;
- (ii) that the debtor retained possession or control of the property transferred;
- (iii) that the transfer was concealed;
- (iv) that the debtor had been sued or threatened with suit prior to the transfer;
- (v) that the transfer consisted of all or substantially all of the debtor's assets;
- (vi) that the debtor absconded;
- (vii) that the debtor removed or concealed assets;
- (viii) that the value of the consideration received by the debtor was not reasonably equivalent to the assets transferred;
- (ix) that the debtor was insolvent at the time of the transfer or that the debtor was thereby rendered insolvent; and
- (x) that the transfer occurred at the same time that a substantial debt was incurred.

It is important to note that the Statute of Elizabeth does not distinguish between existing creditors and future creditors; provided, of course, that the requisite fraudulent intent exists and can be sufficiently proved. Similarly, each of the Uniform Fraudulent Conveyance Act and the Uniform Fraudulent Transfer Act (which in the aggregate form the law of fraudulent conveyance in thirty-three of the fifty United States), allow a fraudulent conveyance claim by a future creditor (again, provided that the transfer was made with the actual intent to hinder, delay or defraud, which is likely a more difficult proposition for future creditors to prove). A major difference between pure Statute of Elizabeth jurisdictions and Uniform Fraudulent Conveyance/Transfer Act jurisdictions exists, however, with regard to the limitations period within which a creditor must bring his or her claim; to wit, no limitations period exists under the Statute of Elizabeth, while Uniform Fraudulent Conveyance/Transfer Act jurisdictions generally provide for a limitations period of four years, or one year from discovery, whichever is greater.

#### 4. Comity Issues

Under principals of judicial comity, the courts of one jurisdiction will often give effect to the judicial decisions of another jurisdiction as a matter of deference and mutual respect. The Full Faith and Credit clause of the United States Constitution which provides, in pertinent part, that “Full Faith and Credit shall be given in each State to the public Acts, Records and judicial Proceedings of every other State”, is a clear example of a codification of the principal of judicial comity.

Since the principal of judicial comity is effective both domestically and internationally, its potential application by an offshore asset protection jurisdiction in favor of the jurisdiction of the settlor’s domicile would vitiate any certainty that asset protection can be achieved through the creation of an asset protection trust in such jurisdiction. Therefore, it is important that the

trust be settled in a jurisdiction which has negated the potential application of judicial comity through a statute providing that foreign judgments are unenforceable to the extent that the foreign judgment conflicts with the substantive law of such jurisdiction. For example, the *International Trusts Act 1984* of the Cook Islands provides that no proceedings for or in relation to the enforcement of a foreign judgment against a trust may be brought in a Cook Islands court if the judgment is based upon the application of law inconsistent with that Act.

#### 5. Tax Laws and Exchange Controls

In the increasingly competitive market for offshore asset protection business, most (but not all) offshore asset protection jurisdictions exempt trusts settled by non-residents from taxation; those jurisdictions recognize that the local services which such trusts necessarily use provide a much more lucrative benefit to the local economy than does a direct tax on the trusts themselves. Therefore, the offshore asset protection trust should be settled in a no-tax jurisdiction. Similarly, the trust should be settled in a jurisdiction that does not impose exchange controls.

#### 6. Selected Jurisdictions With Favorable Asset Protection Law

Many offshore jurisdictions have adopted legislation to obtain a piece of the asset protection trust pie but considerable differences exist among jurisdictions. The first jurisdiction to enact such legislation was the Cook Islands (in the South Pacific) when it passed the *International Trusts Act 1984*. With subsequent amendments to the Act made in 1985, 1989, 1991, 1995-96 and 1999, the Cook Islands is generally considered to remain the foremost offshore asset protection jurisdiction, notwithstanding that its notoriety in this regard may, in the eyes of some planners, be considered to detract from the asset protection which a Cook Islands asset protection trust can provide.

At least 15 jurisdictions have enacted legislation which encourages the use of trusts to protect assets from creditors; those jurisdictions being:

- (i) the Bahamas
- (ii) Belize
- (iii) Bermuda,
- (iv) the Cayman Islands
- (v) the Cook Islands
- (vi) Cyprus
- (vii) Gibraltar
- (viii) Guernsey, Channel Islands
- (ix) Jersey, Channel Islands
- (x) Liechtenstein
- (xi) Mauritius
- (xii) Niue
- (xiii) Nevis
- (xiv) St. Vincent and the Grenadines, and
- (xv) the Turks and Caicos Islands.

The planner must select the jurisdiction in which to establish the trust by analyzing numerous factors, including the jurisdiction's legal system and specific trust law, political and economic stability, tax laws, the existence of exchange controls, the availability of professional services, the presence of modern telecommunications facilities, and the existence or lack of language barriers.

#### IV. FUNDING THE TRUST

##### 1. Revocable and Irrevocable Trusts

Although a revocable trust with a spendthrift trust provision can provide asset protection to non-settlor beneficiaries, the settlor's retention of such direct control over the trust will vitiate any asset protection vis à vis the settlor's own creditors even if the settlor is not named as a beneficiary of the trust. This is because the right to revoke the trust is tantamount to the retention of a general power of appointment over the trust's assets. In fact, an irrevocable self-settled trust (in the appropriate jurisdiction) provides a greater degree of asset protection since the settlor cannot, by his will alone, receive back the trust assets.

##### 2. Control Issues

Even though it is almost universally recognized that a settlor should not retain control of assets transferred to an offshore asset protection trust by naming himself a co-trustee of the trust, there are a number of other ways in which a settlor can retain control over his or her trust. In the first instance, the named trustee need not be adverse to the settlor's wishes in order to be deemed "independent". Most commonly, a friend or relative of the settlor is named as a domestic co-trustee of the trust (perhaps with the power to administer the trust on a day-to-day basis without being required to consult with the offshore trustee). In addition, the settlor can also retain overall supervision of the trust by naming himself or a third party as "protector" of the trust with the power to add or replace trustees and, perhaps, with a veto power over certain significant trustee discretions.

Above and beyond such direct means of control over the trust, by combining the trust with a family limited partnership or limited liability company the settlor can retain control over the trust's assets without infringing upon the trust's sovereignty. Specifically, the assets can be

wrapped within a limited partnership or limited liability company structure, with the trust then funded with the settlor's interest in the partnership or limited liability company. In order to retain control over the assets, the settlor retains either a one percent general partner's interest or is designated as the manager (non-member) of the limited liability company. This structure has the additional benefit of administrative convenience since the settlor can continue to manage the transferred assets as though his own (albeit in a fiduciary capacity). If a lawsuit is commenced against a settlor, the trustee can have the settlor discharged as a manager or general partner.

As noted above, however, there exists the potential that a US court will deem such indicia of control as excessive and hence harmful to the protectiveness of the trust structure. Therefore, to the extent that the trust settlor is comfortable with having the trust assets under the direct control of an offshore corporate fiduciary, and to the extent that the trust settlor is comfortable with an independent offshore protector, the trust settlor should be counseled to forego these aspects of control.

### 3. Asset Situs and Related Issues

Since most offshore asset protection jurisdictions do not require any local investment by the trust, an offshore asset protection trust need not invest its assets in the jurisdiction of the governing law of the trust. Moreover, although an offshore investment might strengthen the settlor's defense to allegations that the trust was funded to avoid creditors, many settlors wish to have the trust retain their original, domestic, investments following settlement of the trust. However, since conflicts of law rules are generally considered too esoteric to engender a consistent favorable application by the domestic courts, it is highly advisable to have the trustees position assets outside of the jurisdiction of the domestic courts prior to any creditor problem. Provided that the trust's assets are located offshore (whether in the jurisdiction of the trust's

governing law or an established financial center such as Switzerland or Luxembourg), a creditor with a domestic judgment will still be faced with significant hurdles before actually being able to levy on any of the trust's assets. In fact, since most offshore asset protection jurisdictions will not recognize foreign judgments, the creditor may be forced to re-litigate its entire case against the trust if the trust's assets are appropriately sited in a timely manner.

#### D. PROTECTIVE TRUST CLAUSES

##### 1. Discretionary Distributions

A provision in the trust agreement giving the trustees the sole discretion to distribute any amount, or all or none of the trust corpus, to one of a number of beneficiaries is deemed protective of the trust corpus since no one beneficiary (nor his or her potential creditors) has any vested interest in the trust corpus. In the alternative, were the settlor entitled to a set amount of the trust corpus, a court could potentially order the distribution of such vested amount to the settlor's creditors. Moreover, if the settlor is not necessarily entitled to a set amount of the trust corpus, but is the sole trust beneficiary entitled to trust corpus within the discretion of the trustees, a court might mistakenly deem the entire trust corpus as vested in the settlor and command its distribution to the settlor. Therefore, a trust provision allowing the trustees to distribute trust corpus, within their discretion, to one or more of (i) the settlor, and (ii) one or more other persons, is most protective. Such a discretionary distribution provision can provide unfettered discretion in the trustees, for example, as follows:

The Trustees may pay to, appropriate or apply for the benefit of one, more or all of the Beneficiaries so much of the net income and/or capital of the Trust Fund as the Trustees in the Trustees' sole and absolute discretion may think fit for any purpose.

Alternatively, such a discretionary distribution provision can limit the trustees' discretion to distribute trust corpus. A provision limiting the trustees' discretion to make distributions might be desirable if the interest of a particular beneficiary (such as the settlor) is particularly likely to be the subject of a creditor attack, since a distribution in satisfaction of a creditor's claim might be outside of the trustees' discretion and hence less likely to be compelled by a court with jurisdiction over the trustees. An example of a discretionary distribution provision which limits the trustees' discretion might read as follows:

The Trustees may pay to, appropriate or apply for the benefit of the Settlor the net income or capital of the Trust Fund only to the extent reasonably necessary or appropriate, as determined in the sole and absolute discretion of the Trustees, for the Settlor's needs for health, support or maintenance in the Settlor's accustomed standard of living, after considering the Settlor's other income or resources.

## **II. Spendthrift Provision**

Asset protection is not exclusively within the domain of foreign trusts. One of the more common uses of trusts in the United States is for protection from creditors. Consider, for example, the spendthrift trust provision included in most trust agreements. Such provisions have been upheld in most jurisdictions except where the settlor retains excessive control over the trust or benefits from the trust. A sample spendthrift clause might be:

Subject to the Applicable Law, no Beneficiary shall have any right, power, or authority to sell, assign, pledge, mortgage or in any other manner to encumber, alienate or impair all or any part of his interest in the Trust Fund or otherwise under this Settlement. The beneficial and legal interest in, and the capital and income of, the Trust Fund and every part of it shall be free from interference or control of any creditor of any Beneficiary, and shall not be subject to the claims of

any such creditor, including claims for the payment of alimony, nor liable to attachment, execution, bankruptcy, or any other legal or equitable process. No creditor of any Beneficiary shall be entitled to obtain an order for attachment of the Trust Fund or any part thereof either by way of execution, in bankruptcy proceedings or otherwise. No benefit devolving on any Beneficiary under this Settlement shall be subject to seizure, attachment or lien by any creditor.

### **III. Anti-Duress Provision**

If an offshore asset protection is drafted so that the settlor retains certain powers (*i.e.*, to remove and replace trustees), a creditor may attack the trust by moving to compel the settlor to exercise such retained power so as to discharge the foreign trustee and repatriate trust assets held offshore into the hands of a domestic receiver appointed as “trustee”. Accordingly, an anti-duress clause should be included in the trust so as to direct the foreign trustee to ignore any order or instructions given by the settlor if made under duress. The purpose of such a clause is to protect the settlor against acts of coercion by a domestic court since impossibility of performance, if proven, should be an absolute defense to coercive civil contempt. The following is a sample anti-duress clause:

The Settlor directs that this Settlement be administered consistent with its terms, free of judicial intervention and without order, approval, or other action of any court. To the extent any person is granted the power hereunder to compel any act on the part of the Trustee, or has the authority to render advice to the Trustee, or to otherwise approve or compel any action or exercise any power which affects or will affect this Settlement, the Trustee is directed, to the extent the Trustee would not be subject to personal liability or personal exposure (for example, by being held in contempt of court or other such sanction by a court having jurisdiction over the Trustee): (i) to accept or recognize only instructions or advice, or the effects of any approval or compelled action or the exercise of any power, which are given by or are the result of persons acting of their own free will and not under compulsion of any legal process or like authority; and (ii) to ignore any advice or any directive, order, or like decree, or the results or effects thereof, of any court, administrative body or any tribunal whatsoever, or of past or present Trustees, or of any Protector hereunder, or of any other person, where (a) such has been instigated by directive, order, or like decree of any court, administrative

body or other tribunal, or where (b) the person attempting to compel the act, or attempting to exercise the authority to render advice, or otherwise attempting to compel any action or exercise any power which affects or will affect this Settlement, is not a person either appointed or so authorized or the like pursuant to the terms and conditions of this Settlement.

#### **IV. Change of Situs Provision**

There may come a time when a change of situs may be desired to protect assets from the claims of creditors, the threat of political instability, or a change in the law. The trust agreement can include various provisions to permit a change of (1) trustees, (2) the situs of the trust, or (3) the situs of the trust's assets. These provisions (often referred to as flee clauses) can give the trustee or a trust protector a discretionary power to change the situs by appointing new trustees, removing trust assets to another jurisdiction, or amending the trust to comply with the laws of a new jurisdiction. A sample flee clause follows:

The Trustees may by a signed declaration in writing, at any time or times and from time to time, during the Trust Period, as the Trustees shall deem advisable in the Trustees' discretion for the benefit or security of this Trust Fund or any portion hereof, remove (or decline to remove) all or part of the assets and/or the situs of administration thereof from one jurisdiction to another jurisdiction and/or declare that this Settlement shall from the date of such declaration take effect in accordance with the law of some other state or territory in any part of the world and thereupon the courts of such other jurisdiction shall have the power to effectuate the purposes of this Settlement to such extent. In no event, however, shall the law of some other state or territory be any place under the law of which: (i) substantially all of the powers and provisions herein declared and contained would not be enforceable or capable of being exercised and so taking effect; or (ii) this Settlement would not be irrevocable. From the date of such declaration the law of the state or territory named therein shall be the Applicable Law, but subject always to the power conferred by this paragraph and until any further declaration be made hereunder. So often as any such declaration as aforesaid shall be made, the Trustees shall be at liberty to make such consequential alterations or additions in or to the powers, discretions and provisions of this Settlement as the Trustees may consider necessary or desirable

to ensure that the provisions of this Settlement shall (*mutatis mutandis*) be so valid and effective as they are under the Applicable Law governing this Settlement at the time the power contained herein is exercised. The determination of the Trustees as to any such removal or change in Applicable Law shall be conclusive and binding on all persons interested or claiming to be interested in this Settlement.

## V. Trust Protector Provision

The use of a trust protector (alternatively called a “trust advisor” or a “trust enforcer”) is common among foreign trusts, although it is only recently becoming commonplace among domestic trusts. This person (or a committee of such persons) generally has the power to replace trustees and, perhaps, to veto certain discretionary actions by the trustees. With the exception of the power to remove and replace trustees, the protector’s powers should generally be drafted as negative powers subject to the trust’s anti-duress provisions so as to protect against an order compelling the protector to exercise his control over the trust in a manner adverse to the beneficiaries’ interests. A sample trust protector provision might provide:

Notwithstanding anything to the contrary herein contained, and in particular anything conferring an absolute or uncontrolled discretion on the Trustees hereof, all and every power and discretion vested in the Trustees by this Settlement and incorporated herein by this reference shall only be exercisable by the Trustees subject always to the power of the Protector to veto any exercise by the Trustees of such power or discretion, and accordingly the Trustees shall be required to provide the Protector with reasonable prior notice before any such powers or discretions may be exercised so as to allow the Protector reasonable advance opportunity within which to veto or refrain from vetoing the exercise of the power or discretion. The Protector's exercise or non-exercise of this veto power shall be communicated in writing to the Trustees and failure to so communicate in a timely fashion provided notice is actually received by the Protector shall be treated by the Trustees as a veto by the Protector of the proposed exercise of the power or discretion; however, if one or more of the Trustees reasonably believe that failure by the Protector to so communicate is due to the Protector being restrained or enjoined from doing so, then such failure to

communicate shall be treated by the Trustees and deemed for all purposes hereof as acquiescence by the Protector to the proposed exercise of the power or discretion. It is further provided that, notwithstanding anything to the contrary otherwise herein expressed or implied, no discretion or power conferred upon the Protector, or upon any other person by this Settlement, or by any rule of law, or arising in consequence of the exercise of any power conferred upon the Protector, or any other person by this Settlement, shall be exercised, and nothing contained herein shall operate, so as to cause the Protector to be successful in ordering any action or causing any result which is not of the Protector's own free will, or which is otherwise the result of the Protector acting under the duress or influence of an outside force.

## **E. SELECTIVE JURISDICTIONAL REVIEW**

### **I. The Bahamas**

The Bahamas is a group of islands located in the western Atlantic Ocean just off the east coast of Florida. Although the Bahamas has been completely independent of Great Britain since 1973, it is still a member of the British Commonwealth.

The Bahamas has strict bank secrecy laws. Under Bahamian secrecy laws, it is a crime for a banker (or other 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 unless the customer consents to the disclosure. Moreover, although the Bahamas requires the reporting of large currency transactions in certain situations, it excepts customers who have an existing relationship with a Bahamian bank, as well as transactions by customers who have the recommendation of a "reputable" party.

Fraudulent dispositions are addressed in the Bahamas under the Fraudulent Disposition Act of 1991. Under that statute, dispositions are voidable by the creditor prejudiced by the disposition if the transferor made the disposition with "an intent to defraud". Under the statute an "intent to defraud" means an intention to defeat willfully an obligation owed to a creditor. The burden of proof for establishing such intent is on the creditor and the statute of limitations is two years from the date of the applicable disposition.

e. Trusts and Other Entities. The Trusts (Choice of Governing Law) Act of 1989 provides, in pertinent part, that if Bahamian law is designated as the trust's governing law, such designation will be binding and effective regardless of any other circumstances. The Perpetuities Act of 1995 fixes the life of a trust at eighty years. Pursuant to general principles of trust law, a settlor may name himself as a discretionary beneficiary of his trust and the settlement will be protected against the settlor's creditors provided that the settlement does not violate the provisions of the Fraudulent Disposition Act of 1991.

Finally, 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 and does not tax offshore trusts in any manner.

## II. Bermuda

Bermuda is a group of islands located in the Atlantic Ocean approximately 650 miles east of the coast of North Carolina. Bermuda is an English speaking dependent territory of the United Kingdom and has a common law legal system.

Strict privacy laws prevail with regard to Bermuda trusts. Significantly, Bermuda trusts do not have to be registered or filed with any public agency.

The Statute of Elizabeth does not apply in Bermuda. However, certain types of transfers are likely to be recognized as fraudulent in Bermuda and, therefore, may defeat a transfer of assets to a trust. These transfers generally equate to recognized badges of fraud; for instance, the transfer of most of the settlor's assets, the settlor's continued possession of the assets, or continuation of enjoyment of their use or income, the settlor's secrecy or haste in disposing of the assets, the settlor's disposition of assets while litigation is pending, or the settlor retaining an advantage under the trust are all recognized badges of fraud under Bermuda law. In addition, there must be a two-year period of time after the trust's creation, or after any transfers are made to the trust, during which the settlor has no knowledge or reasonable notice of any creditor or action. If there is a problem during that two-year period, the creditor has six years to bring an action to declare a transfer to a trust void or fraudulent.

Bermuda law recognizes the settlor's choice of governing law expressed in a trust as well as the trust's ability to change its governing law to or from that of Bermuda. Questions of

capacity and the validity of the trust are, therefore, determined under the law of Bermuda. Bermuda law allows full delegation of powers of investment and management of the trust fund. A Bermuda trust may accumulate income, and the trust term can be for as long as one hundred years. The trust laws in Bermuda protect a trust from the laws of another jurisdiction on forced heirship claims. Similarly, subject to the Judgments (Reciprocal Enforcement) Act of 1958 whereby judgments rendered in the United Kingdom and certain other Commonwealth nations may be enforced in Bermuda, Bermuda courts generally do not recognize foreign court awards. A Bermuda trust may be validly self-settled.

### **III. Cayman Islands**

The Cayman Islands are located in the western Caribbean Sea, approximately four hundred and sixty miles south of Miami, Florida. The Cayman Islands are an English speaking dependent territory of the United Kingdom and have a legal system based on the English common law system strongly influenced by English case law.

The b. Confidentiality. Cayman Islands have strict secrecy laws which provide for substantial penalties for revealing confidential information. In general, a foreign government cannot obtain assistance from the Cayman Islands in pursuing criminal matters unless the offense is also an offense under Cayman Islands law. For instance, tax crimes are not an offense under Cayman Islands law (since the Cayman Islands is a no-tax jurisdiction). Notwithstanding the foregoing, however, the United States and the Cayman Islands entered into a Mutual Legal Assistance Treaty in 1988 under which the Cayman Islands promised to provide

United States authorities information in investigations involving either drugs or certain white-collar crimes, including bank fraud. However, the person who is required to give evidence or make a disclosure must still receive permission for such action from the Cayman Islands' Grand Court.

As it relates to fraudulent transfers, Cayman Islands law provides that a disposition is voidable by a creditor prejudiced by the disposition only if the disposition was made with "an intent to defraud". An intent to defraud is defined as an intention of the transferor to willfully defeat an existing obligation owed to a creditor. The burden of proof for establishing an intent to defraud is on the creditor. If a fraudulent disposition is proved, it will only set the disposition aside to the extent necessary to satisfy the claim of the creditor bringing the action. Finally, the statute of limitations on proving a fraudulent disposition is six years from the date of the disposition.

The trust law of the Cayman Islands is comprised of The Trust Law of 1967, The Trusts (Foreign Element) Law of 1987 and The Fraudulent Dispositions Law of 1989 (noted above). As it relates to asset protection, Cayman Islands' trust law provides that the Cayman Islands will use the choice of governing law provision which the settlor sets forth in the trust instrument so that all questions regarding the trust will be determined by the laws of the Cayman Islands (unless and until amended under the trust instrument). Moreover, a Cayman Islands trust may not be set aside due to the fact that the laws of a foreign jurisdiction prohibit or do not recognize the trust concept or due to the fact that the trust defeats certain rights conferred by foreign law. In addition there is no limitation on the accumulation of income within the trust, and no

restriction on permissible investments by Trustees. A settlor may name himself as a discretionary beneficiary of his trust and the settlement will be protected against the settlor's creditors (except in the case of a bankruptcy), provided that the settlement does not violate the Fraudulent Dispositions Law of 1989.

The Cayman Islands impose no taxes whatsoever.

#### IV. Cook Islands

a. General Characteristics. The Cook Islands are located in the south Pacific Ocean east of Australia and south of Hawaii. The Cook Islands are a self-governing, democratic country, with a parliamentary system of government and a common law legal system. The Cook Islands closest link is with New Zealand, although the Cook Islands have been independent from New Zealand since 1965. English is the official language of the Cook Islands.

Fraudulent Disposition/trustsThe Cook Islands enacted the world's first comprehensive asset protection trust legislation with in the International Trusts Act 1984. The legislation addresses "International Trusts" and the effect thereon of fraudulent dispositions and bankruptcy. With respect to fraudulent dispositions, a creditor seeking to set aside a disposition must prove beyond a reasonable doubt that the disposition was made with an intent to defraud that particular creditor and that the transferor was rendered insolvent by the transfer. As a bright line rule, 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, an intent to defraud can necessarily not be found.

Even if the creditor meets the heavy burden necessary to prove a fraudulent disposition, 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. Furthermore, the statute expressly states that an international trust will not be deemed void by virtue of the settlor's bankruptcy. Another section of the legislation sets forth certain circumstances which will not be deemed badges of fraud; fraudulent intent cannot be imputed from a transfer to an international trust within two years of the accrual of a creditor's cause of action or the retention of powers or benefits by the settlor, or the designation of the settlor as a beneficiary, trustee, or protector.

With regard to fraudulent conveyance claims, if a creditor's cause of action accrues more than two years before a transfer to an international trust, the transfer will not be deemed to be fraudulent. If a creditor's cause of action accrues less than two years before a transfer to a trust, the creditor must bring an action within one year from the date the transfer to an international trust occurs, unless an action has been commenced in a court of competent jurisdiction before the expiration of one year from the date of transfer. Furthermore, if the transfer (whether initial or subsequent) to an international trust occurs before a creditor's cause of action accrues, such a disposition will not be fraudulent as to that creditor. A "cause of action" is defined as the first cause of action capable of assertion against a settlor. Finally, as regards redomiciled trusts, the limitations period commences at the time of original transfer, even though the transfer was to an offshore center other than the Cook Islands.

e. Trustsi. An international trust cannot be "declared void or be affected in any way" because the settlor has the power to revoke or amend the trust, to dispose of trust

property, or to remove or appoint a trustee or protector, or because the settlor retains, possesses or acquires any benefit, interest, or property from the trust, or because the settlor is a beneficiary, trustee, or protector. The rule against perpetuities has also been repealed in the Cook Islands. Other provisions of the trust legislation in the Cook Islands make selection of Cook Island law binding and conclusive, ensure that an international trust is not subject to forced heirship laws of other countries and mandates the non-recognition of a foreign judgment against an international trust, its settlor, trustee, and protector.

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

#### Confidentiality

### **V. Gibraltar**

Gibraltar is a British Territory located at the tip of the Iberian Peninsula. Gibraltar generally follows the English common law system.

The Trusts (Recognition) Ordinance of 1989 incorporates the 1984 Hague Convention on the Law Applicable to Trusts and on their Recognition, which expressly provides that a trust shall be governed by the law chosen by the settlor. In conjunction with its trust law, Gibraltar's Bankruptcy Ordinance provides that a creditor cannot reach the assets of a trust properly registered in Gibraltar (as an asset protection trust is required to do, in any event) by claiming that the settlement was a fraudulent conveyance if, at the date of settlement of the trust, the settlor (i) was solvent, (ii) did not render himself insolvent by reason of the transfer of property to the trust, and (iii) the settlor was not then subject to any outstanding litigation. It is important

to note, however, that Gibraltar does not provide for the non-recognition of foreign judgments, nor does Gibraltar provide for a statute of limitations on fraudulent conveyance claims. It should also be noted that the registration requirement of an asset protection trust in Gibraltar is required, upon criminal offence, to be kept confidential.

Offshore trusts which are established in Gibraltar are not subject to Gibraltar's income tax, notwithstanding the fact that the trustees are resident in Gibraltar, provided that the trust has no residents of Gibraltar as beneficiaries.

## **6. Jersey, Channel Islands**

Jersey is the largest of the Channel Islands which are a group of islands located in the English channel. Jersey, together with the rest of the Channel Islands, is a possession of the British Crown; it is, therefore, self-governing for all internal matters, including all tax matters. Jersey is a common law jurisdiction with a number of civil law aspects by dint of historical ties to France (in particular relating to inheritance and family rights).

As a partially civil law jurisdiction, Jersey had no trust law until 1984 when Jersey enacted the Trusts Law, codifying English common law principles relating to trusts. The Trusts Law specifically allows the settlor to be a beneficiary of the trust. Jersey does not, however, have any asset protection trust law but instead provides that the law of another jurisdiction (which does have asset protection trust law) may be validly designated as controlling.

Trust information is kept confidential by Jersey law which provides that absent court order, no person is entitled to information about the trust if he or she does not have an interest in the trust.

A trust established by a non-resident of Jersey for the benefit of a non-resident of Jersey is taxed only on local source income (excluding local bank deposits and excluding capital gains).

## **7. United States**

Of the fifty states which comprise the United States, only Alaska, Colorado, Delaware, Missouri, Nevada and Rhode Island have enacted legislation providing spendthrift protections to a settlor-beneficiary of a discretionary trust. Of these six jurisdictions, Alaska, Delaware, Nevada and Rhode Island have the most substantial statutory schemes regarding self-settled spendthrift trusts.

The Alaska Trust Act, effective April 2, 1997, modified Alaska's previously undistinguished body of trust law in an effort generally touted as making Alaska an onshore alternative to offshore asset protection trusts. In contrast to the general state of domestic spendthrift trust law at the time the Alaska statute was enacted (as exemplified by Restatement (Second) of Trust §156(2)), Alaska law permitted a settlor to create a trust for his own benefit which would be protected from the settlor's future creditors so long as: (i) the settlor did not retain the right to revoke or terminate the trust; (ii) the settlor was not in default by thirty (30) days or more in making a child support payment; (iii) the settlor's ability to receive distributions

from the trust was within the discretion of the trustees rather than mandatory; and (iv) the transfer of property to the trust was not intended to hinder, delay or defraud creditors (*i.e.*, a “fraudulent conveyance”). Moreover, under Alaska law, a creditor of the settlor existing at the time the trust is created must bring suit on a fraudulent conveyance claim within the later of four years from the transfer or one year after the transfer is, or reasonably could have been, discovered. A creditor arising after the transfer to the trust must bring suit within four years from the transfer.

The avowed purpose of the Delaware self-settled trust law is to allow settlors to reduce estate tax by excluding creditors' claims against self-settled trusts. Under the Delaware law, a trust must be irrevocable but can include one or more of the following provisions: (i) the settlor may retain power to veto distributions; (ii) the settlor may retain a special power of appointment; and (iii) the settlor may receive income, principal or both in the sole discretion of a trustee who is neither the settlor nor a related or subordinate party. Provided that the transfer of property to the trust was not intended to hinder, delay or defraud creditors no action to enforce a judgment can be brought for attachment against such transfer. Under the Delaware law a creditor existing at the time a transfer to a trust is made must commence an action to enforce a judgment within the later of four years or one year after the transfer was or could reasonably have been discovered by the creditor. If the creditor's claim arose after the transfer the action must be brought within 4 years of the transfer.

Similar to the Alaska and Delaware laws, Nevada law provides that a person may create a spendthrift trust for his own benefit (or for the benefit of the settlor and another), provided that

the writing establishing the trust (i) is irrevocable, (ii) does not mandate the distribution of income or principal to the settlor, and (iii) was not intended to hinder, delay or defraud known creditors. Moreover, the settlor may be given the power to prevent a distribution from the trust, and/or may hold a testamentary special power of appointment or similar power over the trust without effecting the validity of the self-settled trust under Nevada law. Unlike Alaska and Delaware, however, Nevada law provides for a substantially shorter period within which a creditor must commence a fraudulent transfer claim against the trust. If the creditor was existing at the time the transfer to the trust is made, the creditor must commence an action within two years after the transfer is made, or within six months after the creditor discovers or reasonably should have discovered the transfer; if, however, the creditor's claim arose after the transfer to trust, the action must be brought within 2 years of the transfer to the trust.

Finally, Rhode Island law provides that a person may create a spendthrift trust for his own benefit provided that (i) the trust is irrevocable, (ii) the trust does not require the distribution of income or principal to the settlor, and (iii) the trustee is neither the settlor nor a related or subordinate party. Moreover, a trust will not be deemed invalid simply because the settlor has retained the power to veto a distribution from the trust, or because the settlor holds a testamentary special power of appointment or similar power over the trust. Notwithstanding the foregoing, however, and unlike Alaska and Nevada law, a transfer to a self-settled Delaware or Rhode Island trust is ineffective in certain circumstances. Specifically, the trust will not protect against (i) the court ordered payment of support or alimony in favor of the transferor's spouse, former spouse or children, or for a division of distribution of property in favor of the transferor's spouse or former spouse (provided the transferor was married to the person at the time the

transfer is made, or (ii) any person who suffers death, personal injury or property damage on or before the date of the transfer, by reason of the transferor's act or omission, or the act or omission of another person for whom the transferor is or was vicariously liable.

With regard to the statutes of limitation applicable under Rhode Island law, if the creditor was existing at the time the transfer to trust is made, the creditor must commence an action within four years after the transfer or, if later, within one year after the creditor discovers or reasonably could have discovered the transfer; if, however, the creditor's claim arose after the transfer, the action must be brought within 4 years of the transfer.

#### **F. LEGAL CHALLENGES TO OFFSHORE ASSET PROTECTION TRUSTS**

Although, a self-settled spendthrift trust, valid under the law designated by the settlor as governing the trust, should be held similarly valid by all courts, wherever situate, a self-settled spendthrift trust may yet be tested against concepts of fairness and good faith if the settlor is ultimately forced to obtain judicial sanction of the trust in a jurisdiction which does not, under its own law, recognize self-settled spendthrift trust protections as valid. Although the heavy costs of litigation, when weighed against the likelihood of a successful recovery against assets held in an offshore asset protection trust, have severely limited the number of cases which have been decided in this area, a few reported decisions do exist which may provide insight into how the courts, both in the United States and internationally, are likely to view the offshore asset protection trust.

The first reported case involving an offshore asset protection trust, *In Re 515 South Orange Grove Owners Ass'n v. Orange Grove Partners*, was decided in 1994. The Orange Grove case (as it is commonly known), involved a California real estate developer sued by the purchasers of its condominiums under allegations of faulty construction and breach of warranty. Between the commencement of suit and the entry of a multi-million dollar judgment against them, the defendants transferred a substantial amount of their assets to a self-settled Cook Islands asset protection trust. The plaintiffs were, therefore, forced to bring suit in the Cook Islands in an attempt to enforce their California judgment.

The defendants argued to the Cook Islands court that the plaintiffs' claim was barred by the applicable statute of limitations since more than two years had elapsed since the condominiums were sold to the plaintiffs. The Cook Islands court, however, found for the plaintiffs under an argument that a cause of action to enforce a foreign judgment accrues upon the entry of the foreign judgment. Since less than two years had elapsed since the entry of the California judgment, the Cook Islands court allowed the plaintiffs' action to proceed. Notwithstanding the plaintiffs' success on this statute of limitations argument, the *Orange Grove* case was ultimately settled before any finding on the merits. Moreover, on November 21, 1996, the International Trusts Amendment Act was passed into law, in part to clarify that a cause of action on a foreign judgment accrues upon the earliest act or omission forming the basis for the underlying claim.

In *Brown v. Higashi*, a 1996 United States Bankruptcy Court case, the debtors, husband and wife, argued that certain assets sought by their tort judgment creditor were protected from attachment by reason of the debtors' self-settled spendthrift trust (which they had created under the laws of Belize). The Bankruptcy Court, however, found the potential application of the law of Belize to be "inappropriate" and the law of Alaska as controlling. The *Brown* Court, therefore, determined that the trust assets were includable in the debtors' bankruptcy estate. The *Brown* Court, however, was clearly indisposed to limit itself to the law cited by the debtors as governing under the trust instrument since, at all times, the trust was administered as a mere alter-ego of the debtors rather than as a legally distinct entity. Specifically, the trust was a common law business trust which incorporated features found in corporations and trusts and the debtors were the president and secretary of the trust. In such capacity the debtors exercised complete control over the trust's assets to the complete exclusion of their named trustee. For this reason, the Court called the trust a "sham" and cited the settlors' retention of direct control over the trust's assets as the "primary reason" for its finding that the settlors' transfers to the trust were fraudulent.

In the 1996 United States Bankruptcy Court case of *In re Portnoy*, the debtor placed virtually all of his assets into an offshore asset protection trust at a time when the debtor knew that his personal guarantee of the indebtedness of his corporation was about to be called. Against this backdrop, the creditor argued that the debtor should be denied a discharge in bankruptcy on the basis that the debtor had failed to disclose a retained interest in the trust as an asset of the bankruptcy estate. The debtor's position was that under Jersey, Channel Islands, law he had not "retained" a property interest in the trust. In its conflict of laws analysis, however, the

court concluded that the domestic jurisdiction had the weightier concern in determining whether or not the debtor's retained rights in the trust could be considered to constitute a property interest which should have been disclosed in his bankruptcy schedules. Moreover, the court held that application of the substantive law of Jersey would offend strong domestic bankruptcy policies if it were applied. The court, therefore, denied the debtor a discharge in bankruptcy.

In the 1998 United States Bankruptcy Court case of *In re B.V. Brooks*, the issue before the court was whether to apply domestic law or foreign law (here, the laws of Bermuda and of Jersey, Channel Islands) to an exemption for spendthrift trusts under the United States Bankruptcy Code. The creditor argued that the trusts are property of the bankruptcy estate because they were self-settled and invalid as a matter of domestic law. The debtors argued that the trusts were not property of the estate because they were enforceable spendthrift trusts under the laws of the offshore jurisdictions. Citing *Portnoy* as precedent, the court found the trusts' assets includable in the bankruptcy estate on the basis of domestic public policy considerations.

In the matter of *In re Stephan Jay Lawrence*, a later 1998 Bankruptcy Court case, following a forty-two month arbitration and just sixty-six days before an award in excess of US \$20 million was entered against him, the settlor funded an offshore trust citing first the law of Jersey, Channel Islands, and about a month later, the law of Mauritius, as governing. Citing both *Portnoy* and *B.V. Brooks* as precedent the Bankruptcy Court found that the sole purpose of the trust was to shield the settlor's assets from a creditor which was about to obtain an arbitration award against him in the amount of twenty million dollars. Although the basis of the court's judgment against the settlor was seemingly well grounded in fraudulent conveyance law, the

Bankruptcy Court in *Lawrence* purported to base its holding upon an analysis of the conflict of laws issue. However, the *Lawrence* court's entire analysis as to the conflict of laws between the domestic forum and the trust's designated law of Mauritius is a statement that the court was persuaded by the decisions in *Portnoy* and *Brooks* and that the domestic jurisdiction had an overriding interest in the trust. Following the Bankruptcy Court's refusal to grant the settlor his discharge in bankruptcy, the creditors sought to collect their judgment by obtaining a court order compelling the settlor to repatriate the trust's assets. The settlor alleged that because the trustee would not accept the settlor's direction if made under duress, the settlor had no ability to repatriate the trust's assets. Based upon an extremely spare analysis of the settlor's alleged impossibility of performance defense, the court found the settlor in contempt and jailed him for non-compliance with the court's order.

*Grupo Torras, Grupo Torras, S.A. v. S.F.M. Al Sabah, Chemical Bank & Trust (Bahamas) and Private Trust Corp.*, a 1995 case adjudicated by the Bahamian Supreme Court, stands for the seemingly obvious proposition that the courts will not uphold a trust funded with *illegally* obtained assets. In *Grupo Torras*, creditors brought suit in the Bahamas to challenge a Bahamian trust on various grounds including the fact that the trust was funded with assets which the settlor had obtained by defrauding the plaintiffs. Citing long-standing principles of English common law, the Bahamian Supreme Court held that the spendthrift trust protections afforded by Bahamian law do not apply to illegally obtained assets.

*F.T.C. v. Affordable Media, LLC*, a 1999 case heard in the United States Court of Appeals for the Ninth Circuit, dealt with a tangential, yet important issue concerning the use of

offshore trusts; specifically the potential for the settlor to be deemed in contempt of court in the settlor's domicile by reason of being unable to convince the court that the settlor truly divested himself of control over the trust's assets. In *F.T.C. v. Affordable Media, LLC*, the settlors were determined to be in contempt of court for failing to comply with a court order to repatriate trust assets invested offshore. Specifically, the settlors, who were also co-trustees of their own trust as well as the trust protectors, were ordered to instruct their foreign co-trustee to repatriate more than six million dollars in profits collected under an alleged Ponzi-type investment scheme. In attempting to comply with the court order, however, the settlors either intentionally invoked (or at least intentionally failed to preclude the invocation of) an anti-duress clause in the trust agreement, thereby resulting in their removal as trustees and ensuring that the assets would not be repatriated pursuant to the order. When the assets were not timely repatriated, the settlors were held in civil contempt for failing to comply with the court order and were jailed pending repatriation of the assets. On appeal, the Ninth Circuit considered the settlors' claimed defense of impossibility of performance. Although the United States Supreme Court has repeatedly held that impossibility of performance constitutes an absolute defense to civil coercive contempt because the remedy is permissible only as a coercive measure presumed necessary to obtain compliance with the order, the Court of Appeals held the defense inapposite to the facts of the case since the settlors had retained actual control.

In *Riechers v. Riechers*, heard in the courts of New York State, the settlor was sued for divorce two years following his establishment of an asset protection trust sited in the Cook Islands. According to the settlor, the trust (which named the settlor's wife as a beneficiary only by designation as the "Spouse of the Settlor") was established following the resolution of several

medical malpractice suits against the settlor (a doctor) in order to guard against the likelihood of future medical malpractice claims. Although the parties were having marital difficulties at the time the trust was created, the settlor's wife was apparently aware that the trust was being established. In the divorce proceeding, the settlor's wife sought to have the trust included in computing an equitable distribution award since domestic law did not recognize the validity of a self-settled trust. The domestic court, however, noted that since the trust was established for a legitimate purpose of protecting family assets it did not have jurisdiction over the trust. The court, therefore, determined that issues such as whether the settlor's wife was entitled to any trust property should be left to a Cook Islands court to decide. The beneficent view of offshore asset protection trusts under the moderate facts of the *Riechers* case suggests that the predecessor cases, which flout established conflict of laws principles relating to the settlor's ability to effectively designate the controlling law of a trust, were decided pursuant to the axiom that "bad facts make bad law".

Ultimately, however, whether a domestic court gives credence to the application of offshore trust law is unlikely to effect the asset protection which such trust provides. Provided that the trust's assets are located offshore (whether that be in the jurisdiction of the trust's governing law or an established offshore financial center such as Switzerland), a creditor with a domestic judgment will still be faced with significant hurdles before actually being able to levy on any of the assets of an offshore asset protection trusts. For example, notwithstanding the bankruptcy court having denied the respective debtors their desired discharge in bankruptcy, reliable sources have reported that the creditors in *Brooks* settled for approximately fifty cents on the dollar and that the creditor in *Portnoy* settled for approximately twenty cents on the dollar.

Moreover, these reported cases obviously represent a tiny fraction of all offshore asset protection trust controversies; based upon the author's experience, most controversies are never reported because a favorable settlement is entered into prior to judgment.

The fact that the determination of the courts of the settlor's domicile may, in the end, not impinge upon the asset protection afforded by an offshore trust does not mean, however, that the trust should not be structured with an eye towards obtaining a favorable domestic judicial decision should the need arise. In this regard, the reported cases provide some important guidance. First, the trust should be as separate as possible from its settlor. This requires an independent, if friendly, trustee, who has control of the trust's assets exclusive of the settlor (even though the trust's sole asset may be a limited partnership of which the settlor is a one percent general partner and the trust is a ninety-nine percent limited partner so that the settlor can actually retain effective control of the assets without affecting the independent control of the trust). Additionally, as noted above, it would be advisable to give the trustee discretion to distribute trust assets to persons in addition to the settlor (called a "sprinkling power"), such as the settlor's spouse and descendants. Second, the circumstances surrounding the creation or funding of the trust must be as distant as possible from a potential creditor's claim. What this means is that the trust should be set up as early as possible for the purpose of guarding against *future*, rather than current, creditors.

## **G. Ethical Considerations with Asset Protection Planning**

There is little force behind the argument that asset protection planning, *per se*, is unethical. In this regard there are at least two state bar association advisory opinions which provide that asset protection planning, in the appropriate circumstances, is ethical. In fact, it can be argued with some merit that an attorney or other professional advisor who fails to counsel his clients as to opportunities to structure their planning in a manner which maximizes asset protection has committed malpractice. Most pointedly, imagine an attorney who counsels his client to operate a business as a sole proprietorship rather than as a corporation solely because the attorney regards the limitation of liability provided by the corporate form as unethical.

Notwithstanding the foregoing, asset protection planning as to any particular client may be deemed unethical depending upon that client's particular situation. Whether asset protection planning in any particular situation is an ethical pursuit depends primarily upon the application of local fraudulent conveyance law since, for example, the American Bar Association's model Rules of Professional Conduct provide that an attorney "shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows or reasonably should know is...fraudulent." Therefore, if an offshore asset protection trust is established during the pendency of litigation, it may result in disciplinary claims against the attorneys who assisted in the establishment of the trust since the trust's funding will likely be seen locally as a fraudulent conveyance.

The best way for an advisor to avoid violating applicable disciplinary rules and unethical behavior in the practice of asset protection planning is to perform a due diligence check on each

client who requests such planning. If an appropriate due diligence check is made prior to any planning, the advisor should be insulated from liability even if the client's transfer does, in fact, constitute a fraudulent conveyance since the scienter requirement necessarily cannot be met.