

**CURRENT ISSUES AND TRENDS
AFFECTING OFFSHORE ASSET PROTECTION TRUSTS**

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by Elizabeth M. Schurig*

I. Background: Trusts as Asset Protection Vehicles

Although there are those who decry asset protection structures, limited liability has always been permissible (and even encouraged) by our legal system. The fundamental nature of asset protection in our legal framework can be seen most clearly in each state's set of statutory opportunities for segregating and sheltering assets from the claims of creditors (*i.e.*, corporations, limited liability companies ("llcs"), limited liability partnerships ("llps"), retirement plans, life insurance, annuities, homestead, etc. are all statutorily prescribed asset protective vehicles).¹ Each of these was borne out of a perceived need to protect assets.

The last hundred years of our history has produced additional risks to economic viability. The United States judicial system has developed in a way that causes many wealthy individuals to feel exposed to legal judgments that are wholly disproportionate to any actual liability. This fear, along with a general distrust of governmental regulatory agencies and the potential liability arising from future United States legislation, has led many United States persons to look for additional ways to protect themselves from these risks. The "spendthrift trust" (which protects a beneficiary's assets by not allowing the beneficiary to alienate their interest in the trust and by disallowing the beneficiary's creditors from reaching the trust assets) was created at the end of the nineteenth century in response to the general social fear and unease arising out of the unstable business environment during those times.² Though creditors and many scholars disliked these arrangements,³ the courts approved of them, and by the first part of the twentieth century, the states all adopted by statute the spendthrift trust concept.⁴

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¹ See DUNCAN E. OSBORNE AND ELIZABETH M. SCHURIG, ASSET PROTECTION: DOMESTIC AND INTERNATIONAL LAW AND TACTICS chs. 5-12 (West, 1995) for an exhaustive list and discussion of these statutory exemptions.

² See JESSE DUKEMINIER AND STANLEY M. JOHANSON, WILLS, TRUST, AND ESTATES ch. 7 at 464 (Little, Brown & company, 3d ed. 1984); See Restatement (Second) of Trusts § 2 (1979).

³ See J. Gray, Restraints on the Alienation of Property iii (2d ed. 1947).

⁴ See *Nichols v. Eaton*, 91 U.S. 716 (1875); *Broadway National Bank v. Adams*, 133 Mass. 170 (1882) discussed in JOHANSON at 540.

Historically, the perceived threats were business creditors that threatened to compromise a business or a family's financial well-being. The underlying policy concerns dictated that business and entrepreneurship be encouraged. The protective vehicles, both business (corporations, llcs, llps, etc.) and personal (retirement plan, life insurance, annuities, homestead, etc.), were necessary to the fulfillment of this policy because, if an entrepreneur felt that his assets were too vulnerable, he would not be willing to take the business risks that we perceived as necessary to our economic viability.

Spendthrift trust legislation, in an effort to compromise the interests of creditors and debtors, specifically disallowed individuals from transferring assets to trusts for their *own* benefit to protect them from creditors. This was not a codification of existing law *per se*; it was a compromise of interests. Similar to the emergence of spendthrift trusts in the early twentieth century, foreign trusts have evolved as a way to protect individuals against perceived risks. Just as a corporation may choose to organize under the laws of Delaware rather than the laws of another state because Delaware's corporate law is better developed and more protective of shareholders, some settlors may choose to settle a trust in a foreign jurisdiction because that country's laws are more protective of the trust assets. Indeed, the estate planning and asset protection advantages of foreign trusts have become so well and widely accepted that five states (Alaska, Delaware, Nevada, Rhode Island, and Utah) have enacted legislation permitting the creation of asset protection trusts in the United States which approximate the asset protection advantages provided by offshore trusts.⁵ However, these domestic asset protection trusts have their own problems, and a foreign trust is still preferable if the goal is asset protection.⁶

Unlike a corporation, which is an entity, a trust is a relationship in which one person (the "settlor") entrusts another person (the "trustee") with the legal title to an asset (the "trust property") with the understanding that the trustee will manage, administer, and distribute the trust property solely for the benefit of the individual or individuals that the settlor wants to benefit from the trust property (the "beneficiary" or "beneficiaries").⁷ As opposed to entities, which must be created and maintained according to a very strict set of statutory rules, the manner of trust creation is not specifically prescribed by law. "The sole question is whether the settlor manifested an intention to create a trust relationship."⁸

⁵ More fully discussed in Part II. A, *infra*.

⁶ See Leslie C. Giordani and Duncan E. Osborne, *Will the Alaska Trusts Work?*, 3 J. Asset Prot. 1, at 7.

⁷ See RESTATEMENT (THIRD) OF TRUSTS, Tentative Draft No. 1, § 3 (1996).

⁸ JOHANSON at 541.

II. Reactions to Asset Protection: the State Legislatures, the Federal Government, and the Courts

One of the main goals of asset protection planning is to protect individuals from litigation that many times allows plaintiffs to recover damages that far exceed the amount that would compensate for the actual injury. Such planning is essentially the same as other widely accepted limitations on liability such as limited partnerships, corporations, or homesteads.

There are those who view asset protection trusts with skepticism and animosity despite their legitimate purposes.⁹ Such enmity is misdirected; it is more properly aimed at those with dishonest objectives in creating offshore trusts (such as money laundering or tax evasion) and at the foreign laws that make those objectives easier to fulfill.¹⁰

Each level of our government views asset protection differently. The state legislatures would like to allow asset protection trusts domestically in order to keep wealth in local financial institutions. The federal government disregards financial privacy in the name of catching a few criminals or hedging bankruptcy abuse. And the state and federal courts generally approve of asset protection planning, but allow access to trust assets in egregious situations.

A. *The State Legislatures: Embracing Asset Protection*

Alaska, Delaware, Nevada, Rhode Island, and Utah (the “domestic venues”) have enacted legislation¹¹ with a view toward becoming viable venues for establishing asset protection trusts, and asset protection trust legislation is pending in some form in many other states. In fact, the Texas legislature almost passed a protective trust statute, but it was tabled for further drafting. I believe that Texas will eventually join Alaska, Delaware, Nevada, Rhode Island, and Utah as a domestic venue for asset protection. Additionally, in an attempt to allow assets to stay in trust longer, many states have either repealed the Rule Against Perpetuities, have exempted certain trusts from it, or have allowed a trust instrument to expressly state that the Rule Against Perpetuities shall not apply.

Domestic asset protection planning has its drawbacks—although all five statutes in the domestic venues appear to offer substantial 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 a part of the United

⁹ See, for example, Randall J. Gingiss, *Putting a Stop to “Asset Protection” Trusts*, 51 Baylor L. Rev. 987.

¹⁰ See for example, Andrew Keltie, *Asset Protection Trusts—If the Game Is Not Up, It Should Be*, 2 Asset Prot. J. 2.

¹¹ AK ST § 13.36.070 *et seq.*; Del. Code Ann. tit.12, § 3570 *et seq.*; Nev. Rev. Stat. § 166.001 *et seq.*; RI ST § 18-9.2-1 *et seq.*

States and are, therefore, bound by the United States Constitution. By virtue of the “full faith and credit” mandate in the Constitution,¹² a state’s courts must recognize judgments rendered under the laws of less debtor-friendly states. Additionally, a state law enabling asset protection trusts may itself violate the Constitution’s contracts clause,¹³ which prohibits states from enacting any law that substantially impairs the obligations of parties to existing contracts or makes them unreasonably difficult to enforce.¹⁴ Finally, due to the supremacy clause¹⁵ of the Constitution, no state can protect debtors from conflicting federal law (such as bankruptcy law).

Even if state asset protection trust legislation passes constitutional muster, it will not necessarily defend an asset protection trust from some of the arguments available to creditors through other existing state laws; sympathetic courts can find ways to penetrate the trust structure in favor of creditors. However, the fact that states are beginning to adopt such legislation signifies an acceptance of, and a positive attitude towards, asset protection in the United States, which, if the trend continues, may result in nationwide legislative acceptance in much the same way that spendthrift trust legislation was nationally adopted. In fact, given the domestic financial institutions’ desire to encourage investors to keep their money in the U.S., there may even develop additional protective statutory concepts similar to the recently passed Montana Foreign Capital Depository Act.

1. *The Montana Foreign Capital Depository Act*

U.S. citizens expect privacy as a fundamental right and further seek financial anonymity for many legitimate reasons. For example, wealthy individuals can be targets of crimes or frivolous lawsuits when their fiscal information is readily available; a successful business person may not want her competitors to know what types of business strategies or acquisitions she’s engaged in; or a rich grandfather might not want a jealous grandchild to know about his gift to another grandchild.

Many offshore jurisdictions offer banking privacy to U.S. citizens. Unfortunately, this heightened privacy might attract individuals wishing to hide their illegal activities from the U.S. government, thus prompting action at the federal level.¹⁶ As a result, federal initiatives tend to lose sight of the important legitimate aspects of asset protection planning and privacy, thereby punishing the innocent for the wayward conduct of others.

¹² *U.S. Const.*, Art. IV, Sec. 1.

¹³ *U.S. Const.*, Art I, Sec. 10.

¹⁴ Wright, *The Contract Clause of the Constitution* (1938); Nowak and Rotunda, *Constitutional Law*, at 11.8 (5th Ed. 1995).

¹⁵ *U.S. Const.*, Art. VI, Sec. 2.

¹⁶ More fully discussed in Part II. B., *infra*.

The Montana Foreign Capital Depository Act¹⁷ is a good example of a state government addressing at the local level the reality of financial crimes, while allowing privacy for bank customers. The Act prohibits disclosure of financial records unless illicit activity is suspected. To protect against money laundering, it requires depository institutions to implement “know your customer” policies and security measures “to deter and prevent theft, fraud, and corruption.”¹⁸ More importantly, however, the Act reflects the desire of U.S. jurisdictions to attract foreign investors by offering “a prudent blend of financial privacy, asset protection, and profitability.”¹⁹

At the time of Montana’s passage of the Act, Montana senator, Michael Sprague, predicted that the depositories could bring in up to \$1 billion in annual revenues to the state of Montana. This may not be a difficult goal to reach, with plenty of foreign investors eager to deposit the minimum \$200,000 to the depositories. Each depository must pay a \$50,000 license fee to the Montana Commerce Department, a \$10,000 annual charge, and a tax equal to 1.5% of deposits (derived from fees charged depositors.)²⁰

The Montana Foreign Capital Depository Act is additional evidence that financial privacy should not be reserved to Swiss banks and offshore trusts.

B. The Federal Government: Going Too Far

Money laundering and bankruptcy abuse in the United States are increasing stresses on our economy, and our representatives in Washington have good intentions when attempting to combat these problems. But, blinded by their crusade, they have forgotten our fundamental rights. In attempting to curb money laundering, they have passed laws that clearly violate our Constitutional right to privacy and our guarantee against illegal search and seizure.

¹⁷ MT ST 32-8-101 *et seq.*

¹⁸ MT ST 32-8-301.

¹⁹ MT ST 32-8-102.

²⁰ McMenamin, Brigid, “Rocky Mountain High,” *Forbes*, November 3, 1997.

1. *Disregarding Financial Privacy*²¹

Money laundering, estimated at about \$600 billion a year, is one of the U.S. government's main concerns regarding offshore financial transactions. The United States is a member of the Organization for Economic Cooperation and Development (OECD) along with 29 other countries²² and the Financial Action Task Force on Money Laundering (FATF) with 28 others.²³

The FATF attempts to set international financial standards with "forty recommendations" to FATF member countries. Examples of some of these recommendations are as follows:

- financial institutions should maintain records on all transactions in order to "comply swiftly with information requests from the competent authorities";
- financial institutions should be protected from liability for breach of any restriction on information disclosure imposed by contract or by any legislative, regulatory, or administrative provision "regardless of whether illegal activity actually occurred"; and
- financial institutions "should not be allowed to warn their customers when information relating to them is being reported to the competent authorities."

While the FATF stresses that financial institutions should know their customers and practice due diligence in order to prevent illicit activity, these recommendations also reveal that the FATF will invade customer privacy to control money laundering.

The Secretary of the Treasury and the Attorney General recently recommended legislation allowing the opening of mail outbound from the United States

²¹ The facts in this section are taken from the OECD website, <http://www.oecd.org>, and Debra B. Treyz and Anthony E. Woods, "Ethical Issues in Offshore Planning: Money Laundering and Harmful Tax Competition," speech given at the ALI-ABA International Trust and Estate Planning Conference, August 3-4, 2000.

²² Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxemborg, Mexico, The Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Spain, Sweden, Switzerland, Turkey, United Kingdom.

²³ Argentina, Australia, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, China, Iceland, Ireland, Italy, Japan, Luxemborg, Mexico, The Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, Turkey, United Kingdom.

to foreign locales in an effort to “deal comprehensively with the smuggling of currency out of the United States” and to create consistency in certain laws. For instance, the Customs Service has the authority to “conduct border searches without warrants in virtually every situation in which merchandise crosses the U.S. border. This authority extends to the searching of: (i) individuals entering and exiting the country; (ii) luggage entering and exiting the country; (iii) international mail entering and exiting the country that is sent through private carriers; and (iv) international mail entering the country that is sent through the U.S. mail.”²⁴ Apparently, the Constitution’s mandate against illegal search and seizure²⁵ does not apply when the government is rooting out criminals.

While these efforts can be justified by simply saying that “if you don’t have anything to hide, it shouldn’t matter,” Americans should be alarmed at the fact that they are being gradually stripped of freedom in the name of catching a few crooks. Rather than publicizing private activities, the federal government can effectively deal with money laundering by encouraging financial institutions to perform due diligence and to know their customers, as many offshore jurisdictions have successfully done.

C. *The Courts: Legal Theories Used to Gain Access to Trust Assets*

Our laws simply do not require individuals to put all of their assets at risk.²⁶ While courts approve of legitimate asset protection and foreign trust planning, these structures are not inviolable. Estate planners should be aware of some of the creative ways that sympathetic courts have found to gain access to trust assets.

1. *Corporate “Alter Ego” and “Sham” Concepts*

Despite the inherent difference between an entity and a trust, and because of the litigation environment favoring plaintiffs in the United States, courts are applying legal principles to trust cases that, in my view, are inappropriate. For example, courts have used the corporate “alter ego” theory to grant access to trust assets by a settlor’s creditor.²⁷ Courts have also used “sham” theories to attack trusts,²⁸ and

²⁴ *Id.*

²⁵ *U.S. Const.*, Amend. IV.

²⁶ See *Geron v. Schulman*, 2000 U.S. Dist LEXIS 12576 (S.D.N.Y. 2000); *Reichers v. Reichers*, 679 N.Y.S.2d 233 (N.Y. Sup. Ct. 1998) in which the court recognized this fact and blessed properly structured foreign trust planning; and *U.S. v. Evseroff*, Slip Copy, 2006 WL 2792750 (E.D.N.Y.), 98 A.F.T.R.2d 2006-7034, 2007-1 USTC P 50,222, in which the court disallowed the IRS’s claim that the transfer of assets to a trust immediately before a judgment was entered in Tax Court against the taxpayer-transferor was not a fraudulent transfer because the taxpayer remained solvent after the transfer.

²⁷ See *Cohen v. United States*, 1998 U.S. Dist. LEXIS 15302 (D. Cal. 1998); *Castleberry v. Branscum*, 721 S.W.2d 270, 271-273 (Tex. 1986); *Tigrett v. Pointer*, 580 S.W.2d 375, 388 (Tex. Civ. App. Dallas

sometimes have discussed both the alter ego and sham theories simultaneously.²⁹ While it may be convenient to apply these concepts to trust law because of the wealth of well-developed law and cases in that area, to do so ignores the fact that in a trust situation, if a valid trust relationship is formed between the settlor, trustee, and beneficiary, but the trustee then allows the settlor to control the trust assets, the trustee has breached its fiduciary duty to the beneficiary and is therefore liable for that breach. This breach of fiduciary duty will not cause the trust itself to fail. And while a particular settlor may have less than virtuous reasons for creating a trust, this will not affect whether a valid trust relationship was actually formed. Despite the inappropriateness of using these theories to reach trust assets, courts are doing so, and prudent estate planners should be aware of that fact.

2. *A New Front of Attack: Civil Contempt*³⁰

A recent case, *Federal Trade Commission v. Affordable Media*³¹ (known as “the Anderson case”), which found for the party seeking to penetrate the asset protection structure, has received extensive attention in the financial press. This attention lies largely in the fact that the settlors were jailed for six months for civil contempt. The Andersons, a Nevada couple, were operating a telemarketing venture that the Federal Trade Commission (“FTC”) attacked as a fraudulent investment scheme. The Andersons had previously established a Cook Islands trust and were putting their ill-gotten gains into it. The FTC argued that the Andersons were running a classic Ponzi scam and that the Andersons should repatriate the proceeds. Further, the FTC moved—and the court agreed—that the Andersons be found in civil contempt and jailed for failing to repatriate the assets.

A U.S. District Court in Florida, in *In Re Stephan Jay Lawrence*,³² recently upheld the Bankruptcy Court’s 1998 contempt and incarceration orders of a

1979, writ ref’d n.r.e.) in which the alter ego theory is applied. *But see Wilshire Credit Corp. v. Karlin*, 988 F.Supp. 570 (D. Mass. 1997) in which alter ego theory is rightly rejected by the court as applying to trusts.

²⁸ See *SEC v. Bilzerian*, 112 F.2d 12 (D.C. Cir. 2000); see also *Johnston v. Commissioner*, T.C. Memo 2000-72. Cf. *Alsop v. Commissioner*, T.C. Memo 1999-172 (finding no *intention* to create a valid trust, but labeling it as a “sham trust.”)

²⁹ See *United States v. Scherping*, 187 F.3d 796 (8th Cir. 1999); *In Re Richards*, 231 B.R. 571 (D. Pa. 1999).

³⁰ Civil contempt is imposed solely to force the contemnor to do a particular act—such as turn over assets. The contemnor must be released when he complies. This is in contrast to criminal contempt, which is punitive; the contemnor is sentenced and must serve the term, much as in a criminal proceeding.

³¹ 179 F.3d 1228 (9th Cir. 1999).

³² 251 B.R. 630 (Dist. Ct. Fla. 2000).

debtor who refused to turn over the corpus of a trust he created during an arbitration which led to a multi-million dollar settlement against him.

Most recently, in *Securities and Exchange Commission v. Bilzerian*,³³ a debtor transferred substantial assets into a complex structure of offshore trusts and family-owned companies and partnerships after a disgorgement order of over \$62 million. The district court held the debtor in contempt, and adopted the *Anderson* rationale that, “[w]here assets are held in an offshore trust, the ‘burden of proving impossibility as a defense to a contempt charge will be especially high.’”

3. *Lessons from Recent Case Law*

The question then arises: what impact do the alter ego, sham, and contempt cases have on asset protection trusts? While these cases seem to pose a new threat to asset protection, the specific facts of each case reveal that, as always, courts just won’t tolerate crooked debtors or idle lawyers. It is essential that the estate planner learn from the judicial guidelines posed in these cases when advising their client on asset protection planning.

a. *Bad Intentions*

Generally, asset protection structures are more at risk when the Court feels that the debtor is of poor character or is not forthright with the court.³⁴ Courts are also impatient with individuals who try to enjoy their property while at the same time claiming that they don’t own it.³⁵

Due diligence, which includes professional inquiry as to the client’s reputation for business and financial dealings, is paramount. Attorneys cannot expect every client to have snow-white scruples, but attorneys should avoid assisting their clients in shady schemes that may tempt the Court to apply such theories as “alter ego” or “sham.” Due diligence can protect the estate planner from professional liability as well.

³³ 258 B.R. 850 (Bankr. M.D. Fla. 2001).

³⁴ See *SEC v. Brennan*, 230 F.3d 65 (2nd Cir. 2000); *Geron v. Schulman*, 2000 U.S. Dist. LEXIS 12576 (S.D.N.Y. 2000); *SEC v. Brennan*, 112 F.2d 12 (D.C. 2000); *American Insurance Company v. Coker*, 251 B.R. 902 (Bankr. Ct. Fla. 2000); *In Re Stephan Jay Lawrence*, 1998 WL 880645 (Bankr. S.D. Fla. 1998); *FTC v. Affordable Media*, 1999 WL 387259 (9th Cir. 1999); *In Re B.V. Brooks*, 217 B.R. 98 (Ct. 1998).

³⁵ See *Brennan*, 230 F.3d 65; *Brooks*, 217 B.R. 98; *Richards*, 231 B.R. 571.

b. Duress Clauses and Impossibility

In the area of asset protection planning, concerns about imprisonment were often answered by the principle that the defense to civil contempt is impossibility. That is, an individual cannot be jailed for failing to perform an act that is impossible to perform. *Anderson* and *Bilzerian* weaken this defense.

One lesson from these cases concerns the use of a duress provision in a trust instrument. A duress clause directs the trustee to refuse to make distributions to a beneficiary if the beneficiary is under a court order to repatriate the trust assets. Conservative planners have maintained that putting this clause into the trust document will result in enraging a judge and in gaining immediate judicial sympathy for the claimants.³⁶ *Anderson* certainly bears out the merits of those concerns. Duress clauses are a form of lawyer trickery, and judges are not going to be patient with them. Courts are becoming increasingly intolerant of debtors who claim impossibility in a contempt proceeding when the impossibility was “self-created.”³⁷

c. Fraudulent Conveyance is Still the Courts’ Main Concern

Because a settlor’s intent, rather than motive, determines whether a valid trust has been created, the fraudulent conveyance doctrine has always been available to protect creditors. While American law recognizes legitimate asset protection structures, if a debtor transfers property into a trust with the intent to “hinder, delay, or defraud” his creditors, that transfer can be held invalid. The timing of the transfer, the degree of the settlor’s control over the trust assets, and the amount of the transfer can prompt a court to find that the debtor has made a fraudulent conveyance.

i. Timing of the Transfer

In *In Re Larry Portnoy*,³⁸ the debtor transferred his assets into an offshore trust when he knew that his guarantee of his corporation’s indebtedness would be called. The New York court found that, because the settlor was clearly trying to avoid liability for the debt, upholding such an arrangement would be repugnant to New York’s public policy. Thus, that state’s laws would apply, rather than the foreign jurisdiction’s, and the trust assets were available to the trustee in bankruptcy. And the *Bilzerian* court held the debtor in contempt because

³⁶ OSBORNE AND SCHURIG, at § 26:06.

³⁷ *SEC v. Bilzerian*, 112 F.2d 12 (“If [the debtor] cannot convince the trustees or Trust Protector to return his assets to him, it is a problem of his own making.”); *American Insurance Company v. Coker*, 251 B.R. 902 (“Debtors’ proposed defense of impossibility is invalid in that the law does not recognize the defense of impossibility when the impossibility is self created.”)

³⁸ 201 B.R. 685 (S.D.N.Y. 1996).

he “purposefully sought to insulate his assets”³⁹ from a disgorgement order of over \$62 million dollars.

As always, the timing of the transfer, such as during litigation, is essential in finding a fraudulent conveyance.⁴⁰ Even fervent critics of asset protection admit that the timing of the transfer and the intent to defraud is important in defeating a valid trust.⁴¹ Lawyers who do not engage in due diligence and who ignore pending claims, threats, and creditors not only jeopardize their client’s plans, but also play professional Russian roulette.

ii. Degree of Control over Trust Assets

A close reading of the *Anderson* case will demonstrate that the Court was not only persuaded, but moved, by the control issue. The Andersons were co-trustees and protectors—this determined the court’s conclusion that the Andersons *could* comply with the repatriation order and that the impossibility defense was not available to them. In *Bilzerian*, the debtor was a trustee of the trust that held nearly all of his assets; and the debtor in *Portnoy* was accused of maintaining “unlimited control”⁴² over the trust assets.

It is axiomatic that the more control a settlor has, the less asset protection he or she enjoys. Indeed, the only solid structure is one in which the settlor cedes total control. The settlor obviously should not be a trustee, co-trustee, protector, co-protector, or retain the power to appoint a trustee or protector. All trustees and protectors should be independent and should not be subordinate to the will or control of the settlor. From an asset protection planner’s perspective, understanding the Court’s analysis of control is as important as understanding that a settlor can be jailed for contempt.

³⁹ *Bilzerian*, 112 F.2d at 23.

⁴⁰ See *SEC v. Bilzerian*, 112 F.2d 12 (D.C. 2000); *SEC v. Brennan*, 230 F.3d 65 (2nd Cir. 2000); *In Re Lawrence*, 251 B.R. 630 (Dist. Ct. Fla. 2000); *Geron v. Schulman*, 2000 U.S. Dist LEXIS 12576 (S.D.N.Y. 2000); *In Re Heginbotham* (Isle of Man 1999); *FTC v. Affordable Media*, 179 F.3d 1228 (9th Cir. 1999); *In Re Larry Portnoy*, 201 B.R. 685 (S.D.N.Y. 1996).

⁴¹ Randall J. Gingiss, *Putting a Stop to “Asset Protection” Trusts*, 51 Baylor L. Rev. 987. Referring to dicta in the *Anderson* case, Professor Gingiss says that “the restrictive provisions of offshore trusts *designed* to frustrate the rights of the settlor’s creditors should not be recognized when the defense of impossibility to comply with the court order is raised in a civil contempt proceeding” (emphasis added).

⁴² *Portnoy*, 201 B.R. at 695.

iii. *Amount of the Transfer*

The *Anderson* Court repeatedly mentions, and indeed seems preoccupied with, the fact that the Andersons put *all* of their wealth into an offshore trust. The *Lawrence* Court found it hard to believe that the debtor “walked away from virtually all of his assets without any sort of a struggle”⁴³ when the trustee excluded him from the trust. And in *Portnoy*, the debtor transferred “substantially all of his assets”⁴⁴ into the trust.

Asset protection planners have long debated *in toto* planning versus nest egg planning.⁴⁵ *In toto* planning by definition brings a settlor to the very margin of solvency, a fact which supports a conclusion that the debtor retains control, and always helps bolster a fraudulent transfer claim. Nest egg planning, where only a limited percentage of the client’s wealth is sent offshore, will achieve a number of strategic goals. The nest egg approach will help defeat a fraudulent transfer claim because the client will remain solvent as to his or her U.S. assets. It will also be much easier for a court to believe that the client does not have control if the client is only giving up a portion of his or her net wealth as opposed to all of it.

iv. *Solvency*

A 2006 tax case, *U.S. v. Evseroff*,⁴⁶ illustrates very well the core principle of fraudulent transfer law that, if a debtor remains able to pay his existing debts after the transfer, then the transfer was not fraudulent and cannot be set aside. In the *Evseroff* case, the court held that despite evidence that Mr. Evseroff attempted to shield assets from the government by shifting money between accounts, giving money to his sons to hold rather than putting it in bank accounts, and establishing a trust after receiving a notice of tax deficiency only one month before a judgment was entered, the transfer to the trust was not fraudulent because he was solvent after the transfer was made. The opinion is well reasoned and provides substantial support for the viability of fundamental fraudulent transfer law.

⁴³ *In Re Stephan Jay Lawrence*, 1998 WL 880645, at 3 (Bankr. S.D. Fla. 1998).

⁴⁴ *Portnoy*, 201 B.R. at 695.

⁴⁵ OSBORNE AND SCHURIG, at § 20:07.

⁴⁶ Slip Copy, 2006 WL 2792750 (E.D.N.Y.), 98 A.F.T.R.2d 2006-7034, 2007-1 USTC P 50,222.

During the trial, three areas of facts relevant to the issues were developed: (1) Mr. Evseroff's intent in establishing the Trust; (2) Mr. Evseroff's assets at the time that the Trust was established; and (3) Mr. Evseroff's level of control over the Trust assets. These facts are more fully discussed below.

Mr. Evseroff's intent in establishing the Trust. Despite evidence that Mr. Evseroff attempted to shield assets from the government by shifting money between accounts, giving money to his sons to hold rather than putting it in a bank account, and purchasing the Florida residence, Mr. Evseroff claimed that his motivations in settling the Trust were for estate planning rather than avoiding the payment of his tax liability. Mr. Evseroff stated that he was concerned that his wife (from whom he was separated but not divorced) would take a share of his estate if he died and he wanted to provide for his two, unmarried sons who were living with him. He also admitted that he was concerned about the government's potential collection efforts but that despite that, his primary motivation was estate planning.

Mr. Evseroff's assets at the time that the Trust was established. At the time that the trust was established and funded, Mr. Evseroff was not rendered insolvent by the transfers. He had sufficient assets after the transfer to satisfy all of his debts, including the tax liability.

Mr. Evseroff's level of control over the Trust assets. Mr. Evseroff never used any of the money that he contributed to the Trust and, despite the fact that he lived in the house that the Trust owned, he did so pursuant to a valid rental agreement that required him to pay all expenses including taxes, water, sewer, utilities, fuel, insurance, mortgage, and repair costs.

The government brought forth two primary arguments: (1) Mr. Evseroff committed either intentional or constructive fraud by creating the Trust and (2) The Trust was Mr. Evseroff's alter ego or nominee and therefore the assets are available to satisfy the tax claim.

Mr. Evseroff committed either intentional or constructive fraud by creating the Trust. The government focused on the fact that Mr. Evseroff made the transfers to the Trust (as well as other transfers) and concluded that this was evidence of fraud. The court held that the issue was not whether transfers were made, but whether Mr. Evseroff was solvent after the transfers were made. This holding was based on New York law that "[I]t is hornbook law that '[a] conveyance cannot be fraudulent as to creditors if the debtor's solvency is not affected thereby, that is, if the conveyance does not deplete or otherwise diminish

the value of the assets of the debtor's estate remaining available to creditors.' " ⁴⁷

The Trust was Mr. Evseroff's alter ego or nominee and therefore the assets are available to satisfy the tax claim. The court applied the following six factors to determine whether the Trust was Mr. Evseroff's alter ego or nominee:

- (1) whether adequate consideration was paid by the Trust;
- (2) whether there was a close family relationship between the transferor and transferee;
- (3) whether the transferor continued to enjoy the property after the transfer;
- (4) whether the transferor retained possession after the transfer;
- (5) whether the transfer was accomplished in anticipation of a suit against the transferor; and
- (6) whether the transfer was recorded.

Despite the fact that the transfer was gratuitous and without consideration, that the Trust was for the benefit of his sons, that Mr. Evseroff continued to live in the house, and the transfer of the house was made after the notice of deficiency and only 4 weeks before the judgment was entered, the court held that since he had never touched the cash and had respected the rental agreement for the house, that the only factor indicating that the Trust should be set aside is the fact that Mr. Evseroff was partially motivated by his concerns about tax collection and that that factor alone is not sufficient reason to set aside the Trust.

III. Conclusion

Offshore trusts are still a viable option that can and should be used to achieve asset protection. Cases like *Portnoy*, *Anderson*, *Lawrence*, and *Bilzerian*, and government initiatives like the OECD and FATF don't prohibit, but guide attorneys in implementing solid estate plans for their clients.

⁴⁷ Lippe, 249 F.Supp.2d at 375 citing 30 N.Y. Jur.2d Creditors' Rights & Remedies Section 305 (2003).

The plan should, of course, begin with meticulous due diligence. A limited percentage of the client's wealth should fund the offshore asset protection trust; and attorneys must also be prepared to convince clients to forego control. The trust provisions should include distribution clauses that give total discretion to the fiduciaries. The trust should be irrevocable and contain comprehensive spendthrift language, but *no* duress clauses.

The trust should be part of an overall estate plan and should have purposes beyond asset protection. While asset protection planning as the sole goal of an offshore trust is proper, additional valid and appropriate reasons or purposes substantially support an argument against a fraudulent transfer claim. Fraudulent transfer claims mainly concern the *intent* of the transferor—if the intent is defensible, the settlor's actions are necessarily legitimate. Recurring motivations include: international diversification of wealth, anonymity with respect to wealth or certain assets, tax planning (for example, to secure offshore private placement life insurance, to establish a dynasty trust, or to establish a foreign non-grantor trust on the death of the settlor), investing in funds not otherwise available to U.S. investors, and pursuing foreign business opportunities. Lawyers should not manufacture purposes, but frequently, careful exploration of a client's goals and agenda will uncover companion purposes to asset protection.

Finally, the trust should be operated in a wholly professional manner. The trustee should behave with due regard for its duties and should always honor the integrity of the structure. A trustee should not act on the whim or instructions of a beneficiary regarding investments, distributions, or other aspects of the trust administration—the trustees, not the settlor or the beneficiaries, are the decision makers. These procedures will support lack of client control and avoid an argument that the trust is either a sham or is an alter ego of the client.

Lawyers can accomplish more for their clients if they plan within the guidelines of case and statutory law as opposed to ignoring or dismissing the result. The state statutes are still new, and their usefulness as asset protection options still remains to be seen. Currently, an awareness of the federal government's attitude towards offshore banking and a familiarity with the lessons from *Portnoy*, *Anderson*, *Lawrence*, and *Bilzerian* are most useful to estate planning attorneys when counseling their clients on asset protection planning.