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Domestic Asset Protection Trusts: The “Estate Planning Tool of the Decade”¹ or a Charlatan?

I. INTRODUCTION

The current American liability system can best be described with the following analogy:

Think of the liability system as a poker game. Each person, corporation, or other entity in the economy is a player. Players risk their chips, that is their wealth, by tossing them into the pot, that is, investing them in liability-generating economic activity. Chips contributed to the pot are at risk of loss; the system can take them to satisfy liability. Chips withheld are not at risk.

This poker game has an odd twist to it. Withholding chips does not reduce significantly the amounts players can win or players' likelihood of winning. Even players who don't put any chips in the pot—that is, players who are judgment proof—can keep playing the game and are eligible to win. Why do players put chips in the pot? No rules require them to do so.²

As Professor Lopucki aptly explains in the above analogy, no player is required to ante up any assets to continue to play the high stakes game of liability poker.³ The ability of people to remove their chips from the

* Copyright © 1998 by Ritchie W. Taylor. The author would like to thank R. Christopher Hunter, principal of the Hunter Law Firm in Chapel Hill, NC, for introducing the author to and tutoring him in the topic of asset protection. This article is dedicated to Robert W. and Mary R. Taylor, the author's parents, without whose support the author would never have made it through law school.

1. Lynn Asinof, *Protection of Offshore Trusts Comes Onshore in Two States*, WALL ST. J., July 23, 1997, at C1 (statement made by Gideon Rothschild, a New York Attorney).

2. Lynn M. Lopucki, *The Death of Liability*, 106 YALE L. J. 1, 3 (1996). Professor Lopucki's article on judgment proofing strategies provides a detailed discussion of domestic liability limiting strategies available to corporations, which is beyond the scope of this article, but the poker analogy aptly applies to personal asset protection as well.

3. The stakes have risen over the past 20 years. Between 1976-1986, the number of personal injury cases in federal court rose by 600% and the size of the average jury verdict tripled over that time period to \$1 million. See generally Marc Galanter, *The Day After the Litigation Explosion*, 46 MD. L. REV. 3 (Fall 1986).

table and continue to play, through use of asset protection, has helped fuel the phenomenal growth of offshore financial centers over the past 30 years. Today, an estimated one-half of the world's money supply passes yearly through offshore financial centers.⁴ This accounts for more than \$5 trillion annually.⁵

The multi-faceted growth of these centers has been fueled by a desire to obtain regulatory relief from burdensome United States governmental regulation, protect financial privacy, provide international investment opportunities, and, most recently, by a desire to achieve asset protection. People have resorted to anticipatory measures to protect their possessory property interests through use of asset protection techniques. Asset protection allows clients to locate their assets in jurisdictions where the rules of litigation are more friendly to property owners. These jurisdictions are quite different from the plaintiff friendly court structure present in the United States. Many attorneys and clients consider asset protection to be leveling the judicial playing field, allowing both defendants and plaintiffs to enjoy "fair play"⁶ in litigation.

Currently, asset protection trusts are the most popular method of using offshore financial centers to achieve asset protection. It is estimated that over \$1 trillion of foreign trust funds are in asset protection trusts.⁷ Offshore asset protection trusts are self-settled trusts established in foreign jurisdictions that recognize these trusts as entities separate from the grantor. Asset protection trusts arrived to fill the void left in the wake of judges allowing juries to pierce traditional liability limiting entities, such as corporations, limited liability partnerships, and limited liability companies, to satisfy judgments.⁸

In addition to statutory protections afforded offshore asset protection trusts, offshore financial centers provide a beneficial choice of law situs for such trusts. Traditionally, asset protection trusts have been viewed as tax neutral, although this has been somewhat debated.⁹

4. See David D. Beazer, *The Mystique of "Going Offshore,"* 9 UTAH BAR J. 19 (Dec. 1996).

5. See *id.*

6. Jonathan L. Mezrich, *It's Better in the Bahamas: Asset Protection Trusts for the Pennsylvania Lawyer*, 98 DICK. L. REV. 657, 675 (1994); Gideon Rothschild, *Establishing and Drafting Offshore Asset Protection Trusts*, 23 EST. PLAN. 65, 65-66 (Feb. 1996).

7. See Elena Marty-Nelson, *Offshore Asset Protection Trusts: Having Your Cake and Eating It Too*, 47 RUTGERS L. REV. 11, 14 (1994).

8. See Rothschild, *supra* note 7, at 65.

9. See Elena Marty-Nelson, *Offshore Asset Protection Trusts: Are they Tax Neutral?* 7 J. INT'L TAX'N 107 (March 1996); Marty-Nelson, *Taxing Offshore Asset Protection Trusts: Icing on the Cake?* 15 VA. TAX REV. 399 (1996) (discussing why offshore asset protection trusts may not be tax neutral). See also Howard D. Rosen & Patricia A. Donlevy-Rosen, *Internal Revenue Service Targets Abusive Trust Arrangements*, 2 J. OF ASSET PROTECT. 6 (July/Aug. 1997) (discussing the various attempts to achieve favorable tax treatment of offshore trusts in ways not grounded in law).

Despite the favorable advantages of asset protection trusts, until April, 1997, domestic asset protection trusts were not a viable option for Americans. However, in April, 1997, Alaska became the first state to statutorily permit asset protection trusts.¹⁰ In July, Delaware followed suit.¹¹ Now asset protection practitioners must consider how, if at all, domestic asset protection trusts can play a part in a client's asset protection system.

This comment weighs the benefits unique to both domestic and offshore asset protection trusts. Part III compares the choice of procedural and statutory law—including fraudulent conveyance law—available in both Delaware and Alaska, with such law in offshore financial centers. Part IV discusses the considerations in selecting a trust situs and the likelihood of attachment of trust assets to fulfill a judgment granted to a potential future creditor of the grantor. Part V discusses the possible federal income, estate, and gift tax consequences under both domestic and offshore asset protection trusts. Part VI contains an evaluation and conclusion, based on the foregoing analysis, of when domestic asset protection trusts may be a viable option for a client and when such trusts may fail to serve a client's interest. The conclusion will highlight when a domestic asset protection trust may provide the best answer for a client and when it acts as a charlatan. In other words, once you scratch off the gold covering, do domestic asset protection trusts provide equal protection to clients or are they simply cheap imitations or charlatans of offshore trusts?

II. BRIEF INTRODUCTION TO ASSET PROTECTION

Traditional methods of asset protection include the use of corporations, limited liability partnerships, and, most recently, limited liability companies. These traditional models have been remolded in recent years to include family limited partnerships. Such traditional business structures have suffered several setbacks as more ends-minded judges and sympathetic juries have looked beyond legal details and have pierced through these entities in their search for funds to satisfy judgments against businesses. Traditional methods for shielding personal assets have included transferring the personal assets into family limited partnerships or to the lower liability spouse. Transfers to spouses no longer remain a viable option for most Americans due to America's extraordinary divorce rate¹² and to the unwillingness of most spouses to relinquish all legal control and ownership of assets to their spouses or children.

10. See ALASKA STAT. § 34.40.110 (Michie 1997).

11. See DEL. CODE ANN. tit. 12, § 3572-73 (1997).

12. See Mezrich, *supra* note 7, at 658.

The current asset protection industry is the response to the failure of these traditional methods.¹³ The asset protection industry is a natural appendage of the estate and tax planning industry. Asset protection attorneys assist clients in completing an asset protection plan. The plan includes three parts: estate planning, tax minimization strategies, and judgment creditor planning.¹⁴ Indeed, with today's continuing litigation explosion, asset protection may not only be a necessity for high net worth clients, but the estate planner may have an ethical duty to assist clients in either developing asset protection plans or referring them to those who specialize in the field.¹⁵

Clients who make the voyage offshore may realize numerous advantages in addition to asset protection. These advantages may include tax planning, international estate planning, global investing and banking, protection of privacy, facilitation of international business transactions, relief from regulatory burdens, reinsurance, shipping, and expatriation planning.¹⁶

One popular asset protection device, the offshore asset protection trust, is an irrevocable trust, typically established for a term of years with a reversionary interest in the grantor.¹⁷ The trustee typically has unfettered discretion over how, if at all, trust income will be distributed.¹⁸ However, trustees are typically governed by either a letter of intent prepared by the grantor or by a protector. A protector can be either one individual or a committee of advisors. Having a protector allows the grantor to retain some control over the trustee by making the trustee serve at the pleasure of the grantor's trusted ally who is either the protector or chairperson of the committee.¹⁹

Asset protection trusts offer several advantages unavailable to clients through traditional domestic means. Offshore clients have enhanced ability to retain both beneficial use of and effective control of their assets. Also, many of these offshore jurisdictions have incorporated other statu-

13. See Richard S. Amari, *Asset Protection Trusts: Nuclear Bomb Shelter*, 66 FLA. B. J. 17 (July/Aug. 1992); *supra* note 4.

14. See generally Barry S. Engel, *Using Foreign Situs Trusts for Asset Protection Planning*, 20 EST. PLAN. 212 (July/Aug. 1993).

15. See R. Christopher Hunter, *An Impassioned Argument for Offshore Advocacy as an Ethical Duty*, 3 J. ASSET PROTECT. No. 2 pg. 48 (Nov./Dec. 1997) (Mr. Hunter is the leading proponent of the belief that an attorney must consider a limiting a client's lawsuit exposure in order to be a zealous advocate); Peter Spero, *How to Arrange a Client's Property for Asset Protection*, 22 EST. PLAN. 226 (1995) (maintaining that attorneys may now have a duty to raise the issue of asset protection with clients). See also MODEL RULE OF PROFESSIONAL CONDUCT Rule 1.1 cmt. 2 (1995).

16. See Beazer, *supra* note 5, at 19.

17. See Nelson, *supra* note 8, at 12-13.

18. See Nelson, *supra* note 8, at 12-13.

19. See Nelson, *supra* note 8, at 12-13.

tory changes in traditional trust law, such as revoking the rule against perpetuities.²⁰ Furthermore, by locating their assets offshore, their assets are not automatic targets for plaintiffs' attorneys hungry for a favorable judgment.²¹ Another advantage is that foreign trusts create practical barriers to potential creditors. Lastly, offshore jurisdictions often provide greater protection to traditional liability limiting entities.²²

All of these protections do not come without significant potential risks and expenses that clients must consider when deciding whether to take assets offshore. The first consideration is possible political instability in the nation where the assets are deposited.²³ This risk may in reality be minimal, but for Americans accustomed to federally insured banks and brokerages, the political and economic instability they may encounter offshore may be a significant enough risk that they would prefer to leave their assets in the United States. There are two important safeguards in most offshore trusts that minimize these risks. First, most trust documents contain a flight clause, which enables the trustee to remove the trust to another country if he feels the home situs is a risky location for the trust.²⁴ The second safeguard is that once the assets are moved into the trust, they are usually and immediately reinvested in the United States.²⁵

The major reason these trusts were unavailable in the United States until 1997 was the fundamental American rule against recognizing self-settled trusts with spendthrift protection. Allowing a person to use spendthrift trusts to inhibit a creditor from attaching assets formally owned by the grantor, who is now a beneficiary, was traditionally deemed to be against public policy. The reporter for the Restatement on Trusts supported that belief when he wrote, "it is well settled that where a person creates for his own benefit a trust with a provision restraining the voluntary or involuntary transfer of his interest, his transferee or creditor can reach his interest."²⁶ The black letter law has been that state and federal courts refuse to enforce spendthrift provisions in self-settled trusts.²⁷ This

20. Five other American states have done likewise: Alaska, Delaware, Idaho, South Dakota, and Wisconsin. See *infra* note 114, at 357.

21. See MODEL RULE OF PROFESSIONAL CONDUCT Rule 1.6(a) (1995) (stating that the duty of confidentiality helps protect client's transfer from being discovered).

22. See Engel, *supra* note 15, at 214.

23. See, e.g., Serge F. Kovaleski, *Organized Crime Exercises Clout in Island Nations*, WASH. POST, Feb. 17, 1998, at A1 (pointing out the increasing power of drug dealers to influence and corrupt Caribbean Island governments).

24. See Nelson, *supra* note 8, at 66.

25. See Nelson, *supra* note 8, at 67.

26. RESTATEMENT (SECOND) OF TRUSTS § 156 reporter's notes (1957).

27. See Nelson, *supra* note 8, at 29-30. Some states have statutory prohibitions against self-settled spendthrift trusts. See generally CA. PRO. CODE. § 15304 (West 1991); GA. CODE ANN. § 53-12-28(c) (Supp. 1994); IND. CODE ANN. § 30-4-3-2 (West 1994); KAN. STAT. ANN. § 33-101 (1986); LA. REV. STAT. ANN. § 2004(2) (West Supp. 1994); N.Y. CIV. PRAC. L. & R. § 5205(c)

policy only applies to self-settled spendthrift trusts because courts have long recognized the right of a grantor, as absolute owner of his assets, to vest them in whomever he wishes and have that right protected from potential creditors of the beneficiary.²⁸

Courts have traditionally considered trusts self-settled if one of several factors is present.²⁹ These factors consider whether the settlor is a beneficiary of the trust, retains dominion or control over the trust corpus, retains and reserves a general power of appointment in himself, or the trust was created for the settlor's own support.³⁰ If any of these factors are present, courts will usually find such trusts to be self-settled. Courts have rejected the form over substance arguments to impute the assets to the grantor-beneficiary when the trust corpus comes from the beneficiary, even though, on paper, the trust was created by a third person.³¹

Despite the common law rule against self-settled spendthrift trusts, some courts have upheld them. In *Herzog v. Commissioner*, the discretionary features of Herzog's trust were allowed to block creditors because Herzog was not the only income beneficiary of the trust.³² Likewise, all but two states currently preclude tort victim creditors from satisfying judgments from support payments or assets contained in a traditional spendthrift trust.³³ This extension of spendthrift protection has already occurred in other self-settled trusts, such as ERISA plans,³⁴ custodial accounts, annuities, and insurance contracts.³⁵ Alaska and Delaware are attempting to continue this movement towards extending spendthrift protection to all properly established self-settled trusts.

(West Supp. 1993); TEX. PROP. CODE ANN. § 112.035(d) (West 1984); VA. CODE ANN. § 55-19(c) (Michie Supp. 1994).

28. See *Broadway Nat'l Bank v. Adams*, 133 Mass. 170, 173 (1882); Nelson, *supra* note 8, at 20.

29. See RESTATEMENT (SECOND) OF TRUSTS § 156(2) (1959); RESTATEMENT (SECOND) OF PROPERTY § 13.3 and cmt. a (1986).

30. See Nelson, *supra* note 8, at 31-33.

31. See Nelson, *supra* note 8, at 31-33.

32. See *Herzog v. Comm'r*, 116 F.2d 591, 594 (2nd Cir. 1941).

33. The two states not allowing for this protection are Georgia and Louisiana. See LA. REV. STAT. ANN. § 9:2005(3) (West 1991); GA. CODE ANN. § 53-12-28(c) (Michie 1997).

34. See *Patterson v. Shumate*, 504 U.S. 753 (1992) (upholding the anti-alienation clause in ERISA plans).

35. See Eli R. Mattioli et al., *Creditor's Rights Regarding Trusts*, 202 PRACTICING LAW INSTITUTE/ESTATE PLANNING HANDBOOK 273, 276 (1991).

III. PROCEDURAL AND STATUTORY CONSIDERATIONS IN DOMESTIC AND OFFSHORE ASSET PROTECTION TRUSTS

In determining whether an offshore or domestic asset protection trust is the most beneficial option for a client, an attorney must evaluate both the procedural and statutory protections available to clients in both domestic and offshore jurisdictions.

A. *Procedural Law Considerations*

Several procedural advantages are available to clients who locate their assets in offshore jurisdictions. Often these procedural safeguards provide the primary incentive to locating assets offshore. This section will consider each of the primary procedural motivations and its weight in a client's asset protection calculus.

1. *No Statute of Elizabeth*

One of the primary procedural reasons assets are able to be seized in the United States is the Statute of Elizabeth. The Statute of Elizabeth, requiring fraudulent conveyances to be set aside, entered the English legal tradition in 1571.³⁶ All states in the United States have either retained the common law codified in the Statute of Elizabeth or have enacted a counterpart in either the Uniform Fraudulent Conveyance or Fraudulent Transfer Acts.³⁷ Most offshore financial centers have repealed the Statute of Elizabeth and replaced it with weaker fraudulent conveyance standards, making these centers more attractive for offshore asset protection trusts.³⁸ This comment later reviews in more detail Alaska's and Delaware's fraudulent conveyance laws and how they apply to asset protection trusts sited in those states.

2. *Short Statute of Limitations*

One way fraudulent conveyance standards are weakened in offshore jurisdictions is through implementing shorter statutes of limitations for determining if a conveyance is fraudulent. Most common law jurisdictions have a statutory time period in which any conveyance can be undone in order to satisfy a judgment. The range for statutes of limitations for offshore jurisdictions varies from presuming no assets in the trust are

36. 13 Elizabeth I Ch. 5 (1571).

37. See Sandra E. Mayerson et al., *Four Centuries of Fraudulent Conveyance Law in Forty Minutes: Its Continuing Development and Application*, 652 PLI/COMM 31, 33-34 (1993). These acts will be discussed in more detail in Part III B.

38. Engle, *supra* note 15, at 215-16.

fraudulently placed there³⁹ to a statute of limitation of two years.⁴⁰ Without exception, offshore jurisdictions will not allow, as a matter of law, an action to set aside a conveyance as fraudulent if the transaction between the creditor and debtor occurred after the funds were transferred into the trust.⁴¹

Alaska amended its fraudulent conveyance law to require that the creditor prove both that the creditor was a pre-existing creditor and either that the "transfer was intended in whole or in part to hinder, delay, or defraud creditors or other persons" or that the trust is revocable by the settlor.⁴² Pre-existing creditors of the settlor are given four years from the transfer to make a claim on the assets or one year after the "transfer is or reasonably could have been discoverable by the person."⁴³ It appears that the discovery rule would take precedent over the four year rule. Although Alaska's asset protection trust protections are less generous than many offshore jurisdictions, these protections are fair to both creditors and debtors and allow for a reasonable time for discovery of the trust and to file a writ of attachment against any assets.

Delaware's statute of limitations is substantially more liberal. Section 3572 of the Delaware code is substantially the same legislation as Alaska's, but section 3573 of the same code makes several key exceptions. These exceptions allow for the trust to be pierced to pay child support, alimony, and any creditor who relied on a written statement of the transferor that the property was available to satisfy the debt.⁴⁴ These groups are already pre-existing creditors; therefore, this section was an unnecessary addition to section 3572, which may act as a door to allow judges to use their "equity" powers to pierce any trust they feel is unjust. Delaware severely limited the protection offered in its statute and hopefully will reconsider section 3573.

3. *No Contingency Fees*

Another procedural barrier to protecting assets in the United States has been the availability of contingency fees. Despite the traditional com-

39. See Bankruptcy (Amendment) Ordinance 1990 42A (Gibraltar). This act provides that if a settlor is an individual and is not insolvent on the day of a registered transfer, then no settlor—existing or subsequent—can set aside the transfer. The exception to this rule is for contingent liabilities of which the settlor had actual knowledge.

40. See Bahamas Fraudulent Dispositions Act, 1991 4; International Trust Act 1984 13B (Cook Islands); Nevis International Exempt Trust Ordinance 1994 24(3).

41. See *Patterson v. Shumate*, 504 U.S. 753 (1992); Mattioli, *supra* note 36.

42. ALASKA STAT. § 34.40.110(a)(1) (Michie 1997).

43. *Id.* at § 34.40.110(d)(1).

44. DEL. CODE ANN. tit. 12 § 3572-73 (1997).

mon law preclusion of contingency fees,⁴⁵ the United States is one of three countries that has accepted contingency fee arrangements as valid.⁴⁶ Even if the plaintiff's bar is correct that these arrangements open the doors of justice to those who would otherwise be barred from bringing "meritorious" actions, contingency fees also encourage attorneys to take cases the attorney believes can extract a settlement, regardless of the merits of the case. Offshore jurisdictions prohibit contingency fee arrangements, making marginal or nuisance claims more risky and assisting the debtor in leveling the playing field. Alaska and Delaware continue to allow contingency fee arrangements, thereby reducing the attractiveness for asset protection trusts in those jurisdictions.

4. *Statutory Bank Secrecy*

Another key procedural protection many individuals seek offshore is bank secrecy. In this information age, a person's personal financial affairs can be pierced by credit bureaus and telemarketing agencies, all using a personal skeleton key—the person's social security number.⁴⁷ Americans typically think of bank secrecy as originating in Switzerland,⁴⁸ but this is not completely accurate. Under the English common law, all bankers had a duty not to divulge bank clients' financial records.⁴⁹

In order to track financial transactions involving illegal activity, Americans sacrificed this traditional confidentiality right with the passage of the Bank Secrecy Act⁵⁰ and subsequent court decisions have upheld this act.⁵¹ This act requires banks to microfilm all checks written against its accounts, retain those records for five years, and to report all transactions involving \$10,000 or more to the Treasury Department.⁵²

45. Contingent fees system was prohibited under the medieval doctrine of Champerty, which prohibited a "suit in exchange for the promise of a share of the recovery." F.B. MACKINNON, *CONTINGENT FEES FOR LEGAL SERVICES* 36-38 (1964).

46. The other countries that permit contingency fees are Spain and certain provinces of Canada. See Philip H. Corboy, *Contingency Fees: The Individual's Key to the Courthouse Door*, 1976 LITIG. 27, 30 (1975-76).

47. For a discussion of the erosion of financial privacy, see *How to Keep your Personal Information Personal: Tips from the Privacy Rights Clearinghouse*, 14 CAL. REG. L. REP. 1 (Winter 1994); Alexander C. Papandreou, *KREBS v. Rutgers: The Potential for Disclosure of Highly Confidential Personal Information Renders Questionable the use of Social Security Numbers as Student Identification Numbers*, 20 J. COLL. & UNIV. L. 79 (Summer 1993).

48. Eleven years before the Swiss enacted Article 47, which codified the Germanic custom of bank secrecy, the English courts recognized that right. See *Tourmier v. National Provincial and Union Bank of England*, 1 K.B. 461 (C.A. 1924).

49. See *id.*

50. See 12 U.S.C. §§ 1951-59 (1970).

51. See *Cal. Bankers Assoc. v. Shultz*, 416 U.S. 21 (1974).

52. See 12 U.S.C. §§ 1951-59 (1970).

Most offshore jurisdictions have strong statutory provisions protecting bank secrecy.⁵³ Since bank secrecy no longer exists in the United States, a domestic asset protection trust is not a viable option for clients who feel they need the extra asset protection that financial privacy can provide.

5. *Fee Shifting*

Possibly the greatest disincentive for judgment creditors to pursue offshore assets is the rule that the loser must pay all court costs.⁵⁴ As will be discussed later, offshore jurisdictions do not recognize foreign judgments; therefore, if a plaintiff wishes to pursue assets offshore in order to satisfy the judgement obtained in the United States, the whole matter must be relitigated. Furthermore, in addition to bearing his own cost in the relitigation, if the judgment creditor fails to prove actual intent to defraud, then the challenge to the validity of the trust will fail and the creditor will be responsible for all litigation costs incurred by the trust. This provision is not in effect in Delaware, but is, to a lesser degree, in Alaska.⁵⁵ Fee shifting acts as a powerful mace in the hands of a debtor to beat his potential creditor into a more favorable settlement.

6. *Sovereignty, Jurisdiction, and Recognition of Foreign Judgments*

Perhaps the greatest advantage offshore asset protection trusts have over their domestic cousins is that they are located in a separate sovereign nation. Because of this fact, the United States must respect the decisions of those other countries and cannot hold its laws to be above those of another nation.⁵⁶ A client using an offshore jurisdiction as his trust situs will be able to place the assets outside the reach of any court in the United States. Furthermore, when selecting an offshore trust situs, an attorney should advise a client that the greatest level of asset protection is

53. Bundesetz über die Banken und Sparkassen, Des of Nov. 8, 1934, as amended by Federal Law March 11, 1971 (Swiss codification of bank secrecy); Cayman Confidential Relationships Law (Law 16 of 1976) as amended (Law 26 of 1979) (reprinted in U.S. v. Davis, 767 F.2d 1025, 1032 n.14 (2nd Cir. 1985)).

54. Many have suggested that America adopt the English rule of fee shifting, which is the rule in all common law offshore havens. See generally Susanne Di Pietro & Teresa W. Carns, *Alaska's English Rule: Attorney's Fee Shifting in Civil Cases*, 13 ALASKA L. REV. 33 (1996) (explaining the effect of fee shifting in Alaska courts).

55. See ALASKA R. CIV. P. 82 (West 1998). In cases awarding money damages, 20% of the first \$25,000 and 10% of any additional amount are shifted to the losing party. In contingency fee cases 30% of the fee is shifted for cases that go to trial and 20% for those that settle.

56. See Ellen C. Auwarter, Note, *Compelled Waiver of Bank Secrecy in the Cayman Islands: Solution to International Tax Evasion or Threat to Sovereignty of Nations?* 9 FORDHAM INT'L L. J. 680 (1985-86) (discussing the sovereignty and conflict of law issues facing offshore centers).

achieved when the assets are placed in a jurisdiction that does not recognize foreign judgments, such as Nevis or the Cook Islands.⁵⁷

Unfortunately, a false sense of security may be promoted when people locate their assets in a domestic asset protection trust. The Constitution requires that "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State."⁵⁸ The Full Faith and Credit Clause of the Constitution requires all states to forego their sovereignty and to have full comity between the states as to their laws and judgments. The requirement of comity could produce an adverse result for a domestic asset protection trust, as demonstrated in the following example.

Suppose a North Carolina doctor establishes an Alaska asset protection trust. Two years later, a judgment is entered against him in North Carolina for malpractice that occurred one year after the asset protection trust was established. As part of that judgment, the North Carolina court determines, according to Alaska law, that the Alaska trust was a fraudulent conveyance, even though, under Alaska law, the conveyance would not be deemed fraudulent. This incorrect decision is later upheld by the North Carolina Supreme Court. Then the plaintiff files a motion in Alaska to have the North Carolina judgment enforced. The Alaska judiciary is left with no choice but to enforce the judgment, even though the judgment was based on a mistake of law. The United States Supreme Court makes it clear in *Fauntleroy v. Lum* that "[a] judgment is conclusive . . . and it needs no authority to show that it cannot be impeached either in or out of the State by showing that it was based on a mistake of law."⁵⁹ As was the case in *Fauntleroy*, the North Carolina court misinterpreted the desire of the Alaska legislature, thereby frustrating an important social policy of Alaska. Comity requires that the North Carolina judgment against the Alaska trust be given full faith and credit in Alaska.⁶⁰

Such adverse decisions would not be possible in an offshore jurisdiction, because most offshore jurisdictions do not recognize foreign judgments.⁶¹ The final judgment proffered in the United States would have to be relitigated in the offshore jurisdiction, with the offshore jurisdiction's own courts properly applying its own laws.

57. See Rothschild, *supra* note 7, at 67 n.8.

58. U.S. CONST. art. IV, § 1.

59. 210 U.S. 230, 237 (1908).

60. See William L. Reynolds, *The Iron Law of Full Faith and Credit*, 53 MD. L. REV. 412, 414 (1994) (providing excellent discussion of the harshness of this rule).

61. See generally INTERNATIONAL ESTATE PLANNING: PRINCIPLES AND STRATEGIES, 90-96 (Donald D. Kozusko & Jeffery A. Schoenblum eds. 1991) (discussing non-recognition of foreign judgments in several major offshore financial centers).

Besides comity among states, the Supremacy Clause⁶² of the Constitution poses additional obstacles to preventing domestic asset protection trusts from being pierced, mostly in bankruptcy court cases. The federal bankruptcy courts have nationwide jurisdiction enabling them to reverse any conveyance in any United States jurisdiction that is found to be fraudulent.⁶³ Fraudulent conveyances will be discussed in more detail later in this comment. Since the bankruptcy courts have nationwide jurisdiction, if a bankruptcy court determines that the trust was a fraudulent conveyance under Federal law, it can reverse, for example, an Alaskan conveyance, even if the conveyance would not be deemed fraudulent under Alaska law.⁶⁴ Again, this result would not happen if the trust were established in an offshore jurisdiction, because the Supremacy Clause would not apply.

7. *Flight Clauses*

The ultimate safeguard for an asset protection trust is a flight clause. A flight clause instructs the trustee to remove the trust and its assets to another jurisdiction in the event the trust may, in the trustee's sole discretion, be under attack.⁶⁵ This provision enables a trust to successfully hop around the world's scores of financial centers, avoiding detection, through bank secrecy, and further isolating the trust from attack.

At first blush, one might believe that a flight clause would make a domestic asset protection trust ideal because the assets could remain in the United States and, if the trust comes under attack, it could flee to another, more secure, jurisdiction. This assertion fails on two points. First, the assets could be impounded by judicial decree, even before a judgment is rendered. A judge may be more willing to order the assets frozen, because fleeing the United States at exactly the same time a lawsuit is filed against the grantor may reek of fraud. Second, even if the assets are initially removed, because the United States lacks bank secrecy, a removal of substantial assets in this manner would leave a paper trail, easily followed to the new jurisdiction. In the new offshore jurisdiction, the trust may not qualify for protection because the statute of limitations would not have run, and again the unwary client would be caught in the fraudulent conveyance net of both countries. Because the purpose of properly

62. U.S. CONST. art. VI, § 2.

63. See 11 U.S.C. § 548 (1990).

64. See generally *In re Oberst*, 91 B.R. 97 (Bankr. C.D. Cal. 1988) (denying the bankruptcy discharge because debtor engaged in bankruptcy planning by availing herself of state exempt property laws).

65. See also INTERNATIONAL ESTATE PLANNING: PRINCIPLES AND STRATEGIES, *supra* note 62, at 471-76.

performed asset protection is to shield assets without the appearance of impropriety, domestic flight clauses are often not a viable option and the lack of legitimate flight clauses severely handicaps domestic asset protection trusts.

B. Statutory Law Considerations: Bankruptcy and Fraudulent Conveyance Law

Having discussed the history and importance of asset protection as well as the various procedural considerations relevant to asset protection calculus, the next portion of the asset protection equation is statutory. In deciding whether domestic or offshore asset protection is best for an individual, an attorney must also consider several statutory law differences between United States and offshore jurisdictions. The major statutory considerations are bankruptcy and fraudulent conveyance laws.

Bankruptcy planning is one of the reasons people have turned to asset protection trusts. This is perhaps the most controversial area of asset protection, because traditionally, the primary public policy consideration against self-settled spendthrift trusts was the desire to prevent people from "exploiting" the bankruptcy laws to evade their debts.⁶⁶ American bankruptcy law has always allowed for some bankruptcy planning with homestead exemptions and other exempt property. This comment will not discuss the ethical or public policy considerations involved in bankruptcy planning, but instead will focus on available bankruptcy planning options through domestic and offshore asset protection trusts.⁶⁷

As previously noted, one of the primary motivations for people taking their assets offshore is to place assets in a jurisdiction that has revoked the Statute of Elizabeth and does not recognize foreign judgments. Some American courts have not accepted the fraudulent conveyance laws of other jurisdictions and have attempted to force the debtor to release the funds.⁶⁸ These assets were not kept in properly drafted trusts.

Since United States courts cannot make an offshore trustee release the funds to the American court, some courts may try to use contempt sanctions against the grantor in hopes the grantor, using whatever influ-

66. See RESTATEMENT (SECOND) OF TRUSTS § 156(1) (1957); *In re Oberst*, 91 B.R. 97, 99 (Bankr. C.D. Cal. 1988) (providing that the court must consider the gray area between "bankruptcy planning" and "intent to hinder, delay, or defraud a creditor.").

67. See generally *McElhanon v. Hing*, 728 P.2d 256 (Ariz. Ct. App. 1985) (holding that an attorney can be held liable for participating in a fraudulent conveyance scheme; therefore, it is important for attorneys to be extremely careful how they structure asset protection transactions).

68. See *In re Portnoy*, 201 B.R. 685 (Bankr. S.D.N.Y. 1996); Philip R. Rupprecht & Jonathan P. Friedland, *Is There Bankruptcy Protection in an Asset Protection Trust?* 14 *BANKR. STRATEGIST* 1 (July 1997).

ence he has over the trustee, will be able to get the assets repatriated.⁶⁹ A well-drafted asset protection trust should make it impossible for a client to ever repatriate the assets held in trust.⁷⁰ The Supreme Court has held that impossibility of performance is a complete defense to civil contempt,⁷¹ as long as the party claiming impossibility did not create the impossibility.⁷² The test applied to this exception is that there must be a "nexus in time between the order in question and the creation of the impossibility."⁷³ In other words, to impose contempt sanctions the court will have to find a willful attempt to evade the court's order, which should never occur with a properly drafted and funded asset protection trust.

Another technique judges have used to punish persons who fail to include offshore assets in their bankruptcy declaration is to deny them discharge in bankruptcy.⁷⁴ These courts feel that bankruptcy discharge is a privilege and failure to approach the proceedings with what the court perceives as "candor" warrants denial of discharge.

When using a domestic asset protection trust, perhaps the largest potential pitfall lies in the area of fraudulent conveyances.⁷⁵ When one files for bankruptcy, the bankruptcy trustee may have the option to apply either the federal or state fraudulent conveyance laws and statute of limitations to the bankruptcy estate.⁷⁶ The trustee will be allowed this choice provided that one of the unsecured creditors would have standing to bring a state claim,⁷⁷ which is almost always the case. The trustee will probably choose to apply the state law if it is more stringent than the federal law.

Most states have adopted either the Uniform Fraudulent Conveyance Act or the Fraudulent Transfer Act.⁷⁸ Both acts focus on whether the transfer was made for "fair consideration"⁷⁹ or "reasonably equivalent

69. Besides contempt sanctions, the court could choose to apply 18 U.S.C. § 157 (1997), which allows the bankruptcy court to punish debtors who make false or fraudulent representations under Title 11 proceedings with fines and or five years in prison.

70. See Engel, *supra* note 15, at 218; David D. Beazer, *The Mystique of "Going Offshore,"* 9 UTAH B. J. 19, 21 (Dec. 1996).

71. See, e.g., *U.S. v. Bryan*, 339 U.S. 323 (1950); *Healy v. U.S.*, 186 F.2d 164 (9th Cir. 1950).

72. See, e.g., *American Fletcher Mortgage Co. v. Bass*, 688 F.2d 513, n.8 (7th Cir. 1982).

73. Engel, *supra* note 15, at 218. See *FTC v. Blaine*, 308 F.Supp 932 (N.D. Ga. 1970); James O. Ehinger, *Pre-litigation Planning in Multinational Cases*, 33 ARIZ. ATTY. 21 (April 1997).

74. See *In re Colburn*, 145 B.R. 851 (Bankr. E.D. Va. 1992) (denying discharge because client understated his assets in the bankruptcy process; client had established a trust and sent its assets to the Bank of Bermuda).

75. This is also the case with offshore trusts. See generally William D. Lipkind & Elizabeth Gasser, *On the Road Offshore: The Struggle between Protection of Assets and Fraudulent Conveyances*, 147 N.J. LAWYER 40 (July/Aug. 1992).

76. See 11 U.S.C. § 544(b) (1984).

77. See *id.*

78. See Mayerson et al., *supra* note 38.

79. See UNIFORM FRAUDULENT CONVEYANCE ACT § 3 (1918).

value.”⁸⁰ Since asset protection trusts are typically created with no legally defined “consideration,” such a trust would fail the test. As a result, the trust assets would be deemed to be owned by the grantor, not by the trust, and thereby subject to forfeiture in the bankruptcy proceeding.

Federal law tends to focus more on the traditional “badges of fraud,” which allow the judges or trustees to set aside conveyances that they subjectively believe have fraudulent intent. If the trustee believes the transfer took place with the actual intent to defraud, then the trustee can set aside any such conveyance that occurred within the past three years.⁸¹ Otherwise, the trustee is limited only to setting aside conveyances that occurred within one year of filing for bankruptcy.⁸² As discussed, the court may be able to borrow the state’s statute of limitations if it increases the length of the state’s statute of limitations.

The reason fraudulent conveyances pose more problems for domestic asset protection trusts than offshore asset protection trusts is the reach of the bankruptcy court. Since bankruptcy courts have national jurisdiction,⁸³ they generally find it easier to reach the assets and may be more inclined to do so. On the other hand, the court may take into account several mitigating factors, including the fact that the trust is located within the United States, provides no protection against pre-existing creditors,⁸⁴ and that the trust is governed by a four year statute of limitations.⁸⁵ When compared to the short statute of limitations in most offshore jurisdictions, these provisions in domestic trusts may seem sufficiently reasonable to an American judge. These factors, as well as the court’s possible prejudice against offshore trusts, may cause the court to view the trust as a legitimate planning tool and not an attempt by the debtor to evade his obligations.

IV. CONSIDERATIONS IN SELECTING THE SITUS OF AN ASSET PROTECTION TRUST

A. *Availability of Protector*

American courts, as a matter of public policy, require that the trustee be able to exercise independent discretion over the trust assets and not be influenced by the beneficiary.⁸⁶ The rationale for such a policy is to pre-

80. See UNIFORM FRAUDULENT TRANSFER ACT § 4(a)(2) (1918) (ignoring good faith as a determination of value).

81. See 11 U.S.C. § 548(a)(1) (1990).

82. See *id.*

83. See 11 U.S.C. § 548 (1990).

84. See ALASKA STAT. § 34.40.110 (Michie 1997).

85. See *id.*

86. See RESTATEMENT (THIRD) OF TRUSTS § 5 cmt. g (draft April 1996).

vent beneficiary self-dealing through the trustee. In contrast, most off-shore jurisdictions, while maintaining the trustee's authority to exercise discretion, do not require the grantor-beneficiary to relinquish all supervision over the trustee.⁸⁷

The grantor may employ several methods to control the trustee's actions. The first is a letter stating the grantor's wishes. While the trustee has a fiduciary duty to the trust and its assets, he also has a moral obligation to manage the trust according to the objectives for which the grantor established the trust.

Another method commonly used in offshore trusts to retain some grantor control is the establishment of a protector or a committee of protectors. Protectors are typically non-beneficiaries whose duty it is to insure that the trustee adheres to the grantor's wishes. If the trustee fails to perform his duty, then the protectors have the ability to remove the trustee and appoint a new one. If a single protector is used, it is common for grantors to appoint a relative to this post. Sometimes when a committee approach is used, the grantor-beneficiary will serve as chairman of the committee.⁸⁸ Both of these approaches give the appearance of self-dealing to an American court.

There is nothing in the Alaska or Delaware trust statutes prohibiting a disinterested party from serving as a protector. Unfortunately, the grantor probably cannot serve in the protector capacity for a domestic trust. Even if the grantor does not serve in this capacity, domestic trusts may face the problem of the trust protector being the agent of the grantor-beneficiary. Thus, through agency theory, the grantor-beneficiary may have retained a general power of appointment over the trust corpus, making the trust revocable and available for attachment by judgment creditors and, as Part V will point out, making the trust an uncompleted gift for tax purposes.

Similarly, if the grantor-beneficiary serves as the protector or as part of the committee of protectors, it may be more likely that the trust will be viewed as revocable by a court and will face possible attachment under a judgment against the grantor-beneficiary. Furthermore, as will be discussed later, a grantor-beneficiary retaining actual control through serving on the committee of protectors could block some possible tax benefits available to asset protection trusts.

87. See Howard Rosen, *The Protectors—the Role of this Little Known Breed with Particular Reference to the Operation of Off-shore Trusts*, 90 LAW SOCIETY'S GAZETTE 19 (July 14, 1993).

88. See Rothschild, *supra* note 7, at 64-65. Both Cook Islands and Belize allow a grantor-beneficiary to serve as protector. See International Trusts Act 1994 § 13(c) (amended 1989) (Cook Is.); Trusts Act, 1992, § 9(2) (1992) (Belize).

B. Privacy

Financial privacy has long been one of the reasons high-net worth persons have turned to trusts to settle their estates and control their financial affairs. Privacy is considered one of the premier protections available to asset protection trusts. Offshore jurisdictions provide comprehensive statutory bank secrecy laws, which serve to keep clients' financial laundry out of public view.⁸⁹

Unfortunately, offshore privacy has come under attack by the United States' desire to ensure it is collecting taxes properly due from foreign trust income. Changes to the Internal Revenue Code enacted in 1996 remove much of the privacy previously available to offshore trusts.⁹⁰ These provisions require taxpayers to report on their Form 1040 any foreign trust, account, or entity in which they have an ownership or controlling interest.⁹¹ The new amendments require that a taxpayer report to the Internal Revenue Service within ninety days of the occurrence of a reporting event with these foreign entities.⁹² Reporting events include the creation of a foreign trust, transfer of money to a foreign trust, direct or indirect lifetime or testamentary transfer of money to a United States person, and the death of the person who was taxed on the trust and the amount of tax owed on the offshore estate.⁹³ Only pension and charitable trusts are excluded from these requirements.⁹⁴ These foreign trust reporting requirements would not apply to domestic asset protection trusts.⁹⁵

Checking the box and complying with the reporting events makes it easier for a client's financial privacy to be pierced. A clever plaintiff's attorney will ask for a defendant's income tax return in discovery and through the return will discover the foreign trust. It is an unsettled area of the law whether an asset protection trust is under the "control or ownership" of a client, but the Internal Revenue Service intends for the law to include asset protection trusts. A client who chooses not to check the ap-

89. See Bundesgesetz über die Banken und Sparkassen, Des of Nov. 8, 1934, as amended by Federal Law March 11, 1971 (Swiss codification of bank secrecy); Cayman Confidential Relationships Law (Law 16 of 1976) as amended (Law 26 of 1979) (reprinted in *U.S. v. Davis*, 767 F.2d 1025, 1032 n.14 (2nd Cir. 1985)).

90. See Joseph G. Howe III & Kathleen M. Courtis, *The New Regulatory Frontier for Foreign Grantor Trusts*, 3 J. ASSET PROTECT. 20 (Nov./Dec. 1997); Robert B. Martin, Jr., *Small Business Act Requires U.S. Agent Appointment by Foreign Trusts*, 86 J. INT'L TAX 172 (March 1997); Leslie A. Share, *Planning Impact of New Expatriation and Foreign Trust Tax Rules*, 24 EST. PLAN. 51 (Feb. 1997).

91. See I.R.C. § 6048 (1997); I.R.S. Notice 96-60 (Nov. 11, 1996); I.R.S. Notice 96-65 (December 12, 1996); I.R.S. Notice 97-34 1997 I.R.B. 25.

92. See *id.*

93. See *id.*

94. See *id.* at § 6048(b)(ii).

95. See *id.*

propriate box may be relying on sound principles of international law and comity, but such principles will probably fall on deaf ears at the Internal Revenue Service. As the United States government continues to expand its ability to pry into offshore entities, over time offshore asset protection trusts may offer only a slight privacy advantage over their domestic counterparts.

C. Regulations

Another important consideration for some individuals in choosing a trust situs is regulatory relief. Regulatory relief is typically sought by corporations doing business offshore.⁹⁶ Highly regulated businesses, especially banks, were the first businesses to take advantage of the friendlier regulatory environment found offshore. Some individuals may find additional regulatory relief offshore, especially in investment opportunities. Domestic trusts provide no escape from the American regulatory state because of comity among the states and the Supremacy Clause. Clearly, if a client is using an asset protection trust with the objective of obtaining some sort of regulatory relief, such relief would be found only in an offshore, not a domestic, asset protection trust.

D. Investment Opportunities

Because of governmental regulation, an offshore trust may be ideal if a client wishes to take advantage of international investment opportunities not available in the United States. Moreover, domestic asset protection trusts offer no diversification or other investment opportunities not already available to clients. Therefore, if a client wishes to expand the value of the trust corpus through an international financial presence, the scale of choice would tilt toward an offshore asset protection trust.

V. TAX CONSEQUENCES OF DIFFERENT TRUST SITUS

Offshore asset protection trusts are widely considered to be tax neutral.⁹⁷ This is because, under the foreign grantor trust rules in the Internal Revenue Code, the assets contained in a foreign trust remain under the ownership of the grantor.⁹⁸ These foreign grantor trust rules reinforce the

96. As was explained in the introduction, the offshore industry was initially established to provide for financial institutions an environment where they could conduct necessary transactions that were prohibited in the countries in which they normally operate.

97. See Engel, *supra* note 15, at 216-17; Beazer, *supra* note 5, at 21. Many offshore jurisdictions have no income tax. However, these provisions have no effect on asset protection trusts, because of their tax neutral nature.

98. See I.R.C. §§ 673-77 (1997); Prv. Ltr. Rul. 93-32006 (Aug. 13, 1993). This is the only ruling on offshore asset protection trusts. The Service held that the trust constituted a completed

fact that the United States is the only country in the world that taxes its citizens on their worldwide income. The foreign grantor trust rules state that any trust created outside the United States continues to be owned by the grantor, as long as a United States citizen is a named beneficiary of any part of the trust income.⁹⁹ These rules are the foundation for the belief that offshore trusts are tax neutral.¹⁰⁰

If one is successful in treating the transfer of assets to an asset protection trust as a gift to the trust instead of a transfer to another part of the estate, the grantor would be subject to gift tax on the transfer, but then the trust income would be able to accumulate value free of gift and estate tax. This is possible because of the International Grantor Trust ("IGT") provisions of the Internal Revenue Code,¹⁰¹ as well as the fact that gift tax eligibility hinges on creditor access to the gift's corpus. The test commonly used by the Internal Revenue Service and the courts to determine whether a trust constitutes a completed gift and will be subject to gift tax is whether creditors can access the trust's corpus.¹⁰² If the court finds that creditors cannot access the assets, then the transfer constitutes a completed gift for tax purposes, and the settlor would be subject to gift tax. On the other hand, if the court deems the creation of the trust not to be a completed gift because creditors may still access the trust corpus, then no gift tax is due.

By casting the transfer as a gift to an IGT, the client will also be able to escape estate tax liability. Under the IGT rules, the grantor will remain the owner of the trust income for tax purposes and no additional gift tax will be owed on the accumulated income inside the offshore asset protection trust.¹⁰³ This allows accumulations of income to be taxed at a lower income tax rate rather than the gift tax rate. In order to achieve the IGT status, a trust must deliberately violate one of the grantor trust rules,¹⁰⁴ such as violating one or more of the prohibited controls contained in the grantor trust rules,¹⁰⁵ or simply making the trust a foreign trust.¹⁰⁶

gift, since dominion and control were relinquished and gift tax is due.

99. See I.R.C. § 679 (1997).

100. See *id.* at § 1491 (providing that a foreign grantor trust could be subject to a 35% excise tax on appreciated property transferred to the foreign trust if the capital gains tax is not paid on the property before it is placed in the offshore trust).

101. See Nelson, *supra* note 10, at 111; TREAS. REG. 25.2511-1(d) (1997).

102. See TREAS. REG. § 25.2518-2(c)(3) (1997); followed in *U.S. v. Irvine*, 511 U.S. 224 (1994).

103. See Nelson, *supra* note 10.

104. See Nelson, *supra* note 10, at 112.

105. See I.R.C. §§ 673-77 (1997).

106. See *id.* at § 679.

Both domestic and offshore asset protection trusts violate the grantor trust rules simply because the grantor is one of the beneficiaries.¹⁰⁷ Likewise, if the Internal Revenue Service determines, as it should, that the laws of Delaware and Alaska protect these trusts from creditors, then these trusts could qualify as completed gifts under the gift tax rules. The effective gift tax rate is lower in the United States than the effective estate tax rate. Therefore, if domestic asset protection trusts qualify, the assets inside a domestic asset protection trust will be able to appreciate inside the trust, without the donee—the trust—incurring additional gift tax liability.¹⁰⁸ Upon the death of the grantor-beneficiary, the remaining beneficiaries will enjoy the trust corpus free of estate tax. Because of this result, the domestic asset protection trust may provide a decisive advantage for those seeking to use asset protection trusts primarily as an estate planning device. Alaskan asset protection trusts have a decisive advantage over their Delaware cousins because Alaska has no income tax.¹⁰⁹

The Alaska and Delaware trust laws appear to offer sufficient protection against creditors to enable a client to reduce the estate tax burden while retaining a discretionary right to payments from assets one has already given to the trust.¹¹⁰ Professor Nelson has previously noted that for offshore asset protection trusts “it appears that if the settlor’s only continuing involvement with the trust assets is as a beneficiary of a discretionary trust, the transfer could be deemed a complete gift for gift tax purposes.”¹¹¹ Such beneficial tax treatment is now available to Alaska and Delaware trusts because creditors cannot access these trusts; therefore, the self-settled trust should be considered a completed gift by the Internal Revenue Service.¹¹² Unfortunately, at this point in time such determinations are purely conjecture, since the Internal Revenue Service has given practitioners little guidance as to how it will treat offshore asset protection trusts and no guidance for the tax treatment of domestic asset protection trusts. These trusts have not existed long enough for the Service to appropriately determine its response. Because of the courts’ tendency to

107. See *id.* at §§ 674, 677.

108. See Nelson, *supra* note 10, at 107.

109. See *infra* note 114, at 357.

110. See TREAS. REG. 25.2511-2(b) (1997). This regulation states the following:

For example, if the donor transfers property to another in trust to pay income to the donor or accumulate it in the discretion of the trustee, and the donor retains a testamentary power to appoint the remainder among his descendants, no portion of the transfer is a completed gift. On the other hand, if the donor has not retained a testamentary power of appointment, but instead provides that the remainder should go to X or his heirs, the entire transfer would be a completed gift.

111. Nelson, *supra* note 10, at 114.

112. See Nelson, *supra* note 10, at 114.

rely on local law to determine creditor access, domestic trusts should qualify for the favorable estate tax treatment formerly available only to offshore asset protection trusts.

VI. WHEN ARE DOMESTIC ASSET PROTECTION TRUSTS RIGHT FOR YOUR CLIENT

For over fifteen years, asset protection trusts have provided a form of anti-litigation insurance, making it costly and impractical for potential future creditors to attack a client's assets. Now, as a reaction to the litigation explosion, asset protection has gained more acceptance in the United States with Alaska and Delaware blazing the trail.

Domestic trusts lack some of the key procedural and statutory benefits that provide a strong anti-litigation foundation to the offshore trusts, as well as the benefit of being able to retain some indirect supervision over the disposition of the trust. What domestic trusts lack in procedural safeguards possibly may be recovered through greater investment security and through tax incentives formerly only available under the international grantor trust rule. Only time will tell if such incentives will sufficiently compensate for the lower levels of privacy and security domestic asset protection trusts enjoy.

Furthermore, domestic asset protection trusts may represent the best compromise for the hard public policy questions concerning use of self-settled spendthrift trusts. Because of this compromise, these trusts may be found to be more palatable to those judges who are prone to ignore legal entities in order to pursue what they consider to be justice.

The two key questions a practitioner must answer in evaluating whether a client should use a domestic asset protection trust are: first, whether the client's primary motivation is estate tax planning or asset protection,¹¹³ and, second, whether entity piercing judges will ignore domestic asset protection trusts as they have ignored other entities or choice of law provisions.¹¹⁴ The answer to the second question is "yes" and going offshore still remains the best option for most clients because, despite the alleged tax benefits of domestic asset protection trusts, as far as asset protection is concerned, domestic trusts are still charlatans.

Ritchie W. Taylor

113. If you are more interested in the estate planning aspects of Alaska trust, see Jonathan G. Blattmachr et al., *New Alaska Trust Act Provides Many Estate Planning Opportunities*, 24 EST. PLAN. 347 (Oct. 1997).

114. See *In re Portnoy*, 201 B.R. 685 (Bankr. S.D.N.Y. 1996) (court ignored choice-of-law provision contained in debtor's trust document).