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ESTATE PLANNING COUNCIL OF SOUTHEAST DENVER

INTEGRATING ASSET PROTECTION PLANNING WITH ESTATE PLANNING

November 8, 2011

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Barry S. Engel is the founding principal (1984) of Engel & Reiman pc, a Denver, Colorado-based law firm having an international client base and an international reputation for excellence in asset protection planning and integrated estate planning.

Mr. Engel is one of three co-authors of the 1989 amendments to the Cook Islands International Trust Act (1984), as enacted by the Parliament of the Cook Islands. The first asset protection specific statutory trust law of its kind, this enactment has served as the model for similar trust law as subsequently adopted in more than 20 offshore financial centers and by approximately 20% of our state legislatures.

Mr. Engel is the author of Asset Protection Planning Guide, now in it second edition, as published by CCH Incorporated, Chicago, Illinois. He has written extensively on all aspects of asset protection and on its relationship with estate planning. His writings have contributed in large part to the widespread acceptance of asset protection planning and to how it is undertaken today by the planning community on behalf of clients. Mr. Engel has also chaired or otherwise participated in hundreds of continuing education programs for lawyers, CPAs, financial planners and other professionals, both domestically and abroad.

Barry Engel has been written about or quoted by some of the business and professional world's publications of highest regard, including *The Economist*, *Business Week*, *American Bar Journal*, *National Bar Journal*, *Wall Street Journal*, *New York Times*, and *Forbes*. He was recently designated as a 2011 Colorado Super Lawyer, a peer-review distinction bestowed upon only 5% of the lawyers in his home state. His past appointments include Presidency of the Isle of Man-based Offshore Institute (1992 – 1997), the Executive Committee of the Offshore Institute (1992 – 2003), the Editorial Board of UK-based *Trusts & Trustees*, Consulting Editor of the International Offshore and Financial Centres Handbook and of the Offshore Institute Membership Directory and Analysis (1996 – 2000). Mr. Engel founded and served as the Consulting Editor of *Shore to Shore*, an offshore industry magazine published calendar-quarterly by Highbury House Communications PLC, London.

He is a member of the International, the American and the Colorado Bar Associations, and is admitted to practice before the Colorado State and District Courts and the U.S. Tax Court.

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Outline and Presentation by:

Barry S. Engel, Esq., Engel & Reiman pc

I. Introductory Remarks

II. What is Integrated Estate Planning and what is its Asset Protection Component?

A. Integrated Estate Planning refers to the marrying of conventional estate planning (which focuses heavily on what happens upon a client's death) with the lifetime side of the overall estate plan (which focuses heavily on the asset protection component of the overall estate plan). As used herein, "IEP" refers to "integrated estate plan" and "integrated estate planning," as the context may indicate.

B. Definition of the Asset Protection Component of the Integrated Estate Plan - the process of organizing one's assets and affairs in advance so as to safeguard them against risks to which they otherwise would be subject.

C. Emphasis on the advance nature of the asset protection component of the IEP - a vaccine, not a cure.

D. "Nest egg" approach vs. "in toto" approach

E. Design variables

F. Flexibility vs. protection trade-off

III. The Engel Ladder of Integrated Estate Planning Asset Protection Tools

IV. Practical Applications of IEP and Integrated Estate Planning Trusts ("IEPTs")

A. When coordinated with the estate plans of other family members, an IEP can be very useful in protecting an inheritance that otherwise may be at risk when distributed to the beneficiary. For example, it would make little sense for an IEP client to have an inheritance just received from a deceased parent exposed to the various risks against which the client was planning.

B. A number of jurisdictions have "forced heirship" laws that dictate the percentage of an estate certain heirs must receive, as well as perhaps the timing of the distributions to those heirs. IEPs have proven quite useful for clients desiring to achieve "testamentary freedom" and carrying out their dispositive desires as to the ultimate disposition of their property, irrespective of local law requirements.

C. It is not uncommon for a person who sells his or her business or professional practice to be concerned with protecting the proceeds of the sale. One concern often voiced is that the buyer may not be as successful with the business or practice as was the seller, and as such the buyer may reappear several years later only to claim, on whatever basis, that too much was paid in the transaction. Protecting sales proceeds that result from transactions of this nature is thus another application of and IEPT.

D. IEPs have been used to provide a replacement or supplement to liability insurance, whether professional malpractice insurance, tail coverage, errors and omissions insurance, or directors and officers liability coverage.

For example, a number of physician clients who for various reasons are not required to carry coverage have opted to go bare once the IEP was in place. Other physicians as well as other high-profile professionals have found it advisable to reduce the amount of coverage otherwise in place, with the IEP in essence providing self-insurance.

E. Many people are of the opinion that a large insurance policy serves as a magnet for litigation. IEPs have allowed individuals who are of this thinking to either go bare or to reduce their coverage to a lower level.

F. IEPs have been used for covering periods of time during which there is, for whatever reason, a lapse in insurance coverage.

G. Recognizing that many insurance policies are quite porous with exclusions and exceptions from coverage, and recognizing that the insurance carrier could itself suffer economic reversals, the IEP is useful in providing a means of backup insurance coverage.

H. Many business people and professionals are often involved in business or investment activities that are outside the scope of their main area of work. An IEP affords protection against risks that can arise from these other activities. For example, an architect or surgeon who is a general partner in a real estate investment may be unpleasantly surprised to learn that she is 100% liable for all partnership debts, of whatever nature. This sort of a risk may pose a greater problem for this investor than her professional activities may pose.

I. Many people with wealth believe that their financial profile may encourage litigation against them. Statistics support this belief. IEPs have accordingly been used as a means to reduce one's financial profile so as to discourage lawsuits.

J. IEPs have been used as an alternative to a prenuptial agreement. They can be particularly attractive to a client who is facing a second (or so) marriage and does not wish to broach the issue of a marital agreement with his or her spouse-to-be.

K. IEPs have been using as a back-up to a prenuptial agreement, for those clients who wish to take a "belt-and-suspenders" approach to their premarital planning.

L. When an individual or a business signs for a loan or otherwise takes on a financial obligation, the individual or the business is, generally speaking, subjecting all owned assets to the loan or obligation. To avoid this result, an IEP has been used to segregate wealth into various pockets so that not all is at risk for one particular transaction.

M. Certain applications of principles borrowed from IEPs have been applied to protect interest in retirement plans and other retirement benefits.

N. A person who is suffering creditor problems may be able to use an IEP as part of an overall strategy to increase his or her strategic position with respect to creditor negotiations. This application must, however, be applied cautiously, for it is fraught with traps for the unwary.

O. IEPs have been used as a means to rebuild wealth that is free from the client's past or current financial problems. This is often referred to as a "business opportunities approach," and involves a planning structure designed in part to exploit business opportunities of which the client might otherwise take advantage.

V. What the Asset Protection Component is Not

A. In the author's view, asset protection planning should not be based on hiding assets or on secrecy, although many clients do appreciate the confidentiality that can be obtained in their financial affairs.

B. In the author's view, asset protection planning should not be a means or excuse to evade or avoid taxation in the U.S. or other jurisdictions.

C. In the author's view, asset protection planning should not be a means or excuse for making fraudulent conveyances.

1. Under American law, fraudulent conveyance laws protect present and subsequent (also known as future) creditors against transfers made with the intent to hinder, delay or defraud them.

2. While fraudulent conveyance law protects present and subsequent creditors, under American law it generally does not protect future potential creditors (i.e., those persons who may in the normal course of events become creditors of the transferor, when they are neither "present" nor "subsequent" creditors within the meaning of fraudulent conveyance law). If, following a transfer, the transferor embarks on a path of

fraudulent conduct or then proceeds with his affairs with reckless disregard for the rights of others, an injured or aggrieved party would not be classified as a future potential creditor, but as a subsequent creditor.[1, 2]

VI. Trusts as Planning Techniques

A. General Comments

B. Foreign v. Domestic Trusts; Settlor's Ability to Choose Applicable Law

C. Foreign Situs Trusts

1. In the IEP context, almost always designed to be tax neutral for U.S. income, gift and estate purposes.

2. Major advantages of foreign trusts domiciled in a protective jurisdiction when compared to domestic trusts:

a. Increased ability of settlor to retain benefit and control.

b. Foreign trust less likely to be an automatic target in litigation against settlor.

c. Foreign element will impact a creditor's decision concerning how far to go in pursuing assets; a much greater daunting effect.

i. Burden of proof

ii. Standard of proof

iii. Statute of limitations

iv. Costs and fees

v. Foreign court may not award punitive or treble damages.

vi. Discovery and interim remedies may not be as broad.

d. Foreign element ultimately more protective as a matter of statutory specificity.

e. No "full faith and credit" issues.

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1 This topic is covered extensively in Engel, "When is a Subsequent Creditor not a Subsequent Creditor," *Journal of International Trust and Corporate Planning*, Vol. 3, No. 2 (1994).

2 This topic is covered extensively in Engel, "Big Nets Catch Small Fish," *Trusts & Trustees and International Asset Management*, Vol. 1, No. 3 (1995).

f. No "supremacy clause" issues.

i. Bankruptcy court

ii. Federal agencies

(a) Internal Revenue Service

(b) Securities Exchange Commission

(c) Federal Trade Commission

3. Five bodies of law are necessarily involved:

a. Law of the selected jurisdiction.

b. Local/domestic law relating to creditors' rights and like issues.

c. Tax law of the settlor's home jurisdiction.

d. Law of jurisdiction where assets may ultimately be positioned.

e. "Applicable Law" selected for tax purposes (for U.S. Settlors, often the U.S.).

4. Choice of Law analysis.

a. E.g., a New York business incorporating in Delaware or Nevada.

b. In re Renard, 437 N.Y.S.2d 860 (N.Y. Sur. Ct., 1981) - Decedent was born a French citizen in 1899. From 1941 to 1971 she was domiciled in New York. She became a U.S. citizen in 1965. In 1971, she returned to live in France, where she died seven years later. While in France she executed a will wherein she left the bulk of her estate in equal shares to a French friend and a French charity. She selected New York law as the law governing her will, for New York law did not provide her surviving son with a forced share, as did French law. Upon her death, her son challenged the proposed distribution of property, claiming that French law should govern and that he was therefore entitled to one-half of his mother's estate. The court upheld the decedent's choice of New York law, and, accordingly, the son did not prevail.

c. For an excellent analysis of choice of law principles as applied by U.S. courts considering offshore trusts, see "Self-Settled Spendthrift Trusts: Should a Few Bad Apples Spoil the Bunch?" *Vanderbilt Journal of Transnational Law*, Volume 32, Number 3,

authored by Jonathan G. Blattmachr, Gideon Rothschild, and Daniel S. Rubin.

d. Why should one limit his or her choice of law to the law of his home jurisdiction when other governing law is available?

5. Foreign trusts are not a new concept. Uses have historically included protecting against political strife, exchange controls, forced repatriation of assets, and confiscatory tax rates. New uses include protection of assets from creditors as herein discussed, and quite importantly, the avoidance of forced heirship provisions where applicable.

6. One of the primary benefits of a foreign situs asset protection trust includes giving greater effect to favorable spendthrift provisions as to the settlor, and as to others with respect to future potential liability. Other benefits also exist, which include

a. Probate avoidance

b. Confidentiality

c. Vehicle for global investing

d. Ease in transferring assets

e. Avoidance of monetary exchange controls

f. Will substitute/avoidance of multiple wills

g. Privacy

h. Facilitating the handling of affairs in the event of disability or unavailability

i. Flexibility

j. Concept of the "protector" may be better established under the foreign law

7. Many factors to consider in selecting the applicable law, which include:

a. Favorable and protective trust law

b. Favorable and stable economic, political and social environment

c. Favorable/non-burdensome tax laws

d. No/minimal language barriers

e. Availability and quality of professional services

f. Procedural and other barriers (e.g., lack of comity) which may impact a creditor's decision as to whether or not trust assets are worth pursuing

g. Modern telecommunications facilities

h. Reputation of the jurisdiction in the global financial community

i. Accessibility (or inaccessibility, depending on one's goals)

j. No or minimal exchange controls or currency restrictions

8. Several approaches to the use of foreign situs asset protection trusts

a. Secrecy (not recommended by the author)

b. Placing assets outside the practical reach of creditors

c. Best approach - one that affords confidentiality, provides practical barriers, but ultimately works in carrying out the asset protection goals of the overall IEP given the use of favorable, protective and carefully selected trust law - an approach that affords a much greater degree of certainty in the process of advance planning for protection of assets from claims of potential future creditors

9. A foreign situs asset protection trust is often coupled with one or more domestic family limited partnerships or other underlying entities.

10. Selection of Foreign Trustee - Under U.S. law and the concept of extraterritorial jurisdiction, trust assets are most secure if the foreign trustee does not have a presence in the U.S.

a. See, e.g., Securities Exchange Commission v. Levine, 1986 U.S. Dist. Lexis 24576 (S.D.N.Y. June 5, 1986); Hercules Inc. v. Leu Trust Banking Ltd., 611 A.2d 476 (Del. 1992); and Litton Industries, Inc. v. Dennis Levine, et al., 767 F. Supp. 1220 (S.D.N.Y. 1991) involving Mr. Levine's large account with the Nassau subsidiary of a Swiss bank. Bahamian bank secrecy law notwithstanding, American authorities were able to "prevail upon" the American branch of the Swiss affiliate to provide information.

b. Consider also S.E.C. v. Tome (St. Joe Minerals), 638 F. Supp. 596 (S.D.N.Y. 1986), aff'd 638 F. Supp. 629 (2nd Cir. 1986), amended on reconsideration by 638 F. Supp. 638 (S.D.N.Y. 1986), aff'd by

833 F.2d 1086 (2d Cir. N.Y. 1987), writ of cert. denied 486 U.S. 1014 (1988); Securities and Exchange Commission v. Certain Unknown Purchasers of Common Stock of Santa Fe Resources, Fed. Sec. L Rep. (CCH) P99, 424 (1983); Securities Exchange Commission v. French, et al., 817 F.2d 1018 (2nd Cir 1987), cert. denied 484 U.S. 1060 (1988). These are related cases wherein a federal judge ordered that all accounts held by a Swiss bank in the U.S. be frozen pending disclosure of information from the Swiss bank. The judge also ordered substantial daily fines pending disclosure of the information.

c. In U.S. v. Bank of Nova Scotia, 740 F.2d 817 (11th Cir. 1984), cert. denied, 469 U.S. 1106 (1985), the Miami branch of the Bank of Nova Scotia suffered daily fines of $25,000 pending receipt of information from the Bahamian branch. The Miami branch cooperated.

11. Select United States tax issues of a foreign situs asset protection trust.

a. Income, gain and excise tax issues.

i. Asset protection trusts settled by U.S. citizens or residents are typically "grantor trusts."

ii. Careful design of the trust can result in the trust being a foreign situs trust for asset protection planning purposes, yet a domestic trust for tax purposes. This has always been the case, and continues to be the case under the definition of "foreign trust" as brought about by the Small Business Job Protection Act of 1996.

(a) The definition of a foreign trust changed under this Act to any trust, unless "(i) a court within the United States is able to exercise primary supervision over the administration of the trust, and one or more United States fiduciaries have the authority to control all substantial decisions of the trust."

(b) This change was effective for tax years beginning after December 31, 1996.

iii. The trust's status may change from a domestic trust to a foreign trust, depending on actions the trustees may take subsequently pursuant to their duty to protect assets of the trust. The tax implications which follow from such a change include the following:

(a) Increased reporting requirements, including written notice to the I.R.S. of the trust becoming a foreign trust and of subsequent transfers of property to the trust, an annual accounting of the trust's financial activities, and a report by any trust beneficiary who receives a distribution from the trust during the year.

(b) Penalties, some quite burdensome, for failure to comply in a timely fashion with the various reporting requirements.

(c) Designation of a domestic "agent" for the Trust is required. The agent must be available to accept service of process, give testimony concerning the trust, and allow for the examination of Trust records for the purpose of determining the amount of tax due and owing.

(d) Prior to the Taxpayer Relief Act of 1997, a 35% excise tax on the gain inherent in any property transferred to a foreign trust was imposed by Code Section 1491. However, under prior law, Revenue Ruling 87-61 and I.R.S. Notice 96-65 made it clear that as long as a foreign trust was also a "grantor trust" under U.S. tax law, the Section 1491 excise tax would not apply.

(e) The Taxpayer Relief Act of 1997 replaced the Section 1491 excise tax with a gain recognition provision effective August 5, 1997. Now, under Section 684, the gain element of any property transferred to a foreign trust is taxed for income tax purposes. The conversion of a domestic trust to a foreign trust for tax purposes is considered a transfer to a foreign trust. This change under the Relief Act has the following three effects: (i) any gain recognized on the transfer to a foreign trust is now added to the basis of the assets transferred (under prior law, the excise tax did not increase the basis of the assets transferred); (ii) the amount of income tax paid on a transfer to a foreign trust will generally be less than the 35% excise tax under old Section 1491; and (iii) the grantor trust exception to the excise tax (previously allowed by Revenue Ruling 87-61) is now applicable to the gain recognition provision, pursuant to Section 684(b) of the 1986 Internal Revenue Code, as amended.

Due to an ambiguity in the Code, an issue existed whether the death of an individual who is the grantor of a foreign trust under Code Section 671, et seq., triggered the Section 684 tax. For a discussion, see "The Impact of New Code Section 684 On Foreign Situs Asset Protection Trusts Settled by U.S. Persons," Shore to Shore, summer 1998.

Fortunately, on August 7, 2000, long-awaited guidance regarding the applicability of Section 684 at the time of the death of a grantor of a trust came in the form of proposed regulations promulgated by the Treasury Department. Although it had long been argued that Congress did not intend for Section 684 (or its predecessor Section 1491) to apply at the time of a grantor's death (and even if Section 684 did apply at the time of a grantor's death, that the step-up in basis under Section 1014 should operate to eliminate the amount of gain that otherwise would be recognized), the proposed regulations provide that Section 684 will not apply to recognize gain to the grantor upon the grantor's death if both: (i) the trust property is included within the grantor's gross estate for U.S. federal estate tax purposes; and (ii) the property receives a step-up in basis in the hands of the trust upon Section 1014.

(f) S corporation stock cannot be owned by a trust that is a foreign trust for U.S. tax purposes, whether or not the trust is a grantor trust. If the trust does not, before it becomes a foreign trust for U.S. tax purposes, properly divest itself of all S corporation stock it may own, each such corporation's status as an S corporation would be terminated.

(g) Income taxation after death: As mentioned above, if the settlor of an asset protection trust dies while the trust is a foreign trust for U.S. tax purposes, the trust will no longer qualify as a grantor trust. It would then be considered a non-grantor foreign trust. Under certain circumstances, all or a portion of a non-grantor foreign trust's income is not directly subject to U.S. federal income tax, with taxation instead deferred until the income is distributed to one or more U.S. beneficiaries. While the deferral aspect is attractive, there are two

drawbacks: (i) if income and gains are accumulated, then long term capital gain treatment is not allowed; and (ii) when the accumulated income is distributed, the recipient beneficiary will have to pay, in addition to the income tax payable on the distributed amount, a non-deductible, compounding floating-rate interest charge on the accumulated distributions.

b. Gift Tax Issues.

i. Incomplete gifts - Treasury Regulations Section 25.2511-2(b) provides, in pertinent part, that "if upon transfer of property (whether in trust or otherwise) the donor reserves any power over its disposition, the gift may be wholly incomplete, or may be partially complete and partially incomplete, depending upon all of the facts in the particular case." See Private Letter Ruling 9535008.

ii. Annual exclusion availability (so long as completed gifts are of a "present" interest and not of a "future" interest).

iii. Gift tax unified credit availability.

iv. Trustees of a fully discretionary trust who have an interest in the remainder may face gift tax treatment if they exercise their power to pay principal to income beneficiaries. Treas. Reg. Sec. 25.2511-1(g)(2).

c. Estate Tax Issues.

i. Incomplete gifts will be included in the settlor's estate upon death.

ii. If the trust is to be funded with gifts that are complete for gift tax purposes, then the design of the Trust will necessarily be different from the more flexible, control-oriented design which is typical of asset protection trusts, so as to prevent inclusion of the corpus of the Trust in the estate of the settlor upon the death of the settlor. Along these lines, in Private Letter Ruling 9332006, the Internal Revenue Service ruled that no portion of an irrevocable trust established in a foreign country by two siblings was to be included in the estate of either sibling upon death, even though each was one of the discretionary beneficiaries of the trust. The ruling turned on the fact that neither settlor/beneficiary could compel distributions from the

trust; that the protector was not under the control of the settlor/beneficiaries; and that "the Trustee's discretion to make distributions to a Settlor is not a retained interest or power for purposes of [Code Sections 2036, 2037, or 2038]."

iii. Trust can be designed as the main estate planning instrument (with typical "A-B Trust" language) or as an instrument supplementing or complementing other estate planning instruments.

iv. If the settlors reside in a community property state, consider ability to preserve double step-up in basis.

v. If that trust is a discretionary trust, care should be exercised in the selection of trustees and protectors, in light of Code Section 2041. This Code Section could result in trust assets being taxed in the estate of a beneficiary if the beneficiary is also a trustee or protector, for such beneficiary may be regarded as having a general power of appointment over trust assets.

vi. Private Letter Ruling 8916032 concludes that trust property should be included in the estate of a trust beneficiary who has the power to remove and replace a trustee having the authority to distribute income and principal for the benefit of the beneficiary.

12. No income, gift, estate, excise, capital gain or other form of tax whatsoever will be imposed on the trust or its assets by certain foreign jurisdictions if the trust is properly structured.

VII. Do Foreign Situs Asset Protection Trusts work?

A. The following excerpt is from the author's text, Asset Protection Planning Guide, 2d Edition, published by CCH, Chicago, Illinois.

> **¶185 Does Asset Protection Planning Work?**
> In a 1993 article, the author predicted that over the course of time, claimants would attack a certain number of offshore asset protection plans and that a certain percentage of these attacks would produce less than favorable results for the planning structures involved. These results would come about because of the way in which the asset protection plan was designed and implemented. This prediction (which was an easy one to make) has proven to be accurate. Because

of these attacks, some wealth planners and their clients have become concerned about the effectiveness of asset protection planning. Should they be concerned? At the risk of sounding too vague, the answer is that "it depends" on a number of factors, including (1) the standard applied in determining whether a plan worked, (2) the many variables that existed under a given plan, and (3) the planning vehicle or vehicles used within the asset protection plan.

First, the standard applied in determining whether the asset protection component of the IEP "worked" must be defined by reference to where a client would have ended up financially, had he or she not engaged in the planning. The ultimate goal of integrated estate planning is realized if the client weathers a legal storm at least moderately better than he or she otherwise would have in the absence of any planning.

Comment: In the experience of the author as well as in the experiences of most if not all of the many attorneys and other professionals with whom the author has co-counseled planning cases, this modest and realistic standard can almost always be surpassed provided the planning is undertaken at an appropriate time and provided the plan is designed, implemented, and administered competently. Further, even in those cases where the plan did not completely stop a creditor, in almost all cases the defendant fared better than he or she would have in the absence of any planning.

Second, the many variables that exist under any given IEP prevent, in all fairness, the use of blanket statements such as a particular asset plan "works" or it "does not work." The following variables are generally of key importance in determining how a particular IEP will fare if challenged:

1. The client's net worth.
2. The client's goals.
3. The nature of assets transferred under the plan.
4. The skill with which the plan was crafted.
5. The skill with which the plan is attacked.
6. The skill with which the plan is defended.
7. The thoroughness and protectiveness of the applicable law.
8. Who is the claimant?
9. The biases or the bent of the presiding judge.

Third, the asset protection component of an IEP involves implementing one or more asset protection vehicles, such as state or federal exemptions, a family limited partnership, a limited liability company, a domestic trust, or a foreign asset protection trust. Some of these tools, such as exemptions, protect only certain types of assets (e.g., retirement benefits). Other tools, such as a domestic trust, generally are more effective for asset protection purposes (e.g., when a parent transfers assets in an irrevocable trust to a child). Many plans combine one or more asset protection vehicles—(such as the family limited partnership combined with a foreign IEPT). The asset protection planner's knowledge of whether and when to implement the various asset protection vehicles will strongly affect the degree to which a given asset protection plan will "work."

Comment: To date, the author's firm has designed and implemented well over 1,000 foreign IEPTs and has thereby protected billions of dollars in assets. Approximately 10 percent of these plans have come under attack by an adverse party. This is not considered to be a high percentage considering the wealth profile of the typical client. Further, in all cases but one, the clients weathered the storm in substantially better shape than he or she would have in the absence of any planning, thus far surpassing the "moderately better" standard for determining whether a particular plan "worked." The following examples are summaries of a few of the planning cases designed and implemented by the author's firm that were subsequently challenged. The names used are of course fictitious.

Example 1: Robert and Judy Albert sold the family business for $12 million. Promptly following the sale, they settled their net after-tax proceeds in a foreign IEPT. A few years later, the business that was sold filed for bankruptcy. The bankruptcy trustee filed an action against the Alberts as sellers based upon a reverse fraudulent transfer theory under which the bankruptcy trustee sought to recover the gross sales proceeds received by the Alberts ($12 million). In other words, the bankruptcy trustee was seeking to recover more from the Alberts than they had received after taxes. Generally, a bankruptcy trustee is a particularly problematic creditor due to all of the powers granted to the bankruptcy trustee under the Bankruptcy Code. In this case, however, the bankruptcy trustee learned of the asset protection planning structure that was undertaken several years earlier, and the bankruptcy trustee settled his claim for $175,000 (i.e., about 1.5 cents on the dollar).

Example 2: Bart Bernard was a real estate investor. Knowing the many perils of the real estate market and given his various liquidated and contingent liabilities, he protected as much of his estate as was appropriate at the time by transferring as much of his asset base to a foreign IEPT as he could and still avoid a claim under a fraudulent conveyance theory. Several years later, Bernard suffered a judgment as a co-guarantor. Unfortunately for Bernard, the other guarantors had already been forced into bankruptcy due to other real estate deals with which they were involved. Therefore, Bernard became the sole focus of a collection effort by a very large bank and its Wall Street law firm. This combination would represent a formidable opponent for most asset protection plans. Fortunately, Bernard had utilized a foreign IEPT, and even though the foreign IEPT held one-half of the assets in Bernard's home state, a fact of which his creditor was fully aware, the judgment against Bernard was settled for less than five cents on the dollar.

Example 3: Dr. Joe Calvin was an uninsured practicing physician. Within months of Calvin's foreign IEPT being funded, Calvin was unexpectedly named as one of several defendants in a malpractice nuisance suit. The plaintiff's legal counsel was advised that Calvin's assets had been protected with a foreign IEPT, and a token settlement offer was extended. After confirming that Calvin's assets were indeed protected and that Calvin was uninsured, the plaintiff accepted Calvin's settlement offer. Unfortunately for the remaining defendants, the plaintiff continued to pursue the claim against them.

Example 4: Robert Donahue, the owner of vast real estate holdings, was concerned about the potential of a toxic waste problem with one of his holdings. At the time of funding his foreign IEPT, Donahue had no reason to believe that this general concern was a reality and otherwise did not know whether any of his property was in fact contaminated. Several years went by, and, as is the case with many asset protection planning clients, the motivating factor (i.e., toxic waste) for his concern did not materialize. Instead, a different asset protection concern developed as Donahue's wife filed for divorce. As a result of Donahue's asset protection planning, a property settlement was reached as part of the divorce negotiations. As assessed by Donahue's divorce counsel, the settlement was substantially more favorable than would have resulted had Donahue not implemented his planning.

Example 5: Stuart Eckersly was an entrepreneur who had a proclivity for making deals happen and making money. Unfortunately, Eckersly incurred a substantial liability attributable to a general partnership in which he was one of the general partners. Not only did Eckersly lose most of his hard-earned wealth, but he lost his drive and ambition to continue making deals happen, since he felt that his future successes would serve only to satisfy his sole past failure. Although little integrated estate planning may be done to protect existing assets from a present claim, the same is not true for future business opportunities. Future business opportunities may be diverted to a foreign IEPT prior to their ripening into "property interests." Eckersly settled a foreign IEPT and the trustees of the foreign IEPT pursued any future business opportunities that Eckersly came across. The new wealth accumulated in the foreign IEPT was protected.When Eckersly later filed for bankruptcy, he was granted a discharge from his sole past failure, and the assets that developed from the business opportunities that were transferred to the foreign IEPT were not included in his bankruptcy estate.

Example 6: Dr. Juan Martine was besieged with a series of groundless and frivolous malpractice lawsuits immediately following a negative expos´e on local television. Prior to the television expos´e, Martine had an almost clean slate with regard to any malpractice actions. One of the plaintiff's lawyers thought, at a minimum, that they would be able to settle with Martine merely by subjecting him to the hazards of litigation and the high costs of defending himself. He was ultimately proven incorrect. Martine's malpractice premiums soared; he was constantly spending time gathering documents, meeting with defense attorneys, and being deposed or going to court; and he ultimately left his practice. After a few years of fighting the legal battles, Martine established a foreign IEPT. Martine's assets were protected to the extent permitted under applicable fraudulent conveyance law under the circumstances. Martine then fired his battery of defense counsel and proceeded to negotiate an end to each of his remaining malpractice suits. Each suit was settled by him for pennies on the dollar.

Example 7: Kevin Mesmer, Chuck Gallant, Gary Holland, and Mike Inez settled and funded foreign IEPTs with personal assets at a time when

their business was current on all its obligations and cash rich. At this time, there was no reason to believe that they would be called upon with respect to the personal guarantee on which each of them was personally liable. Therefore, there was not a fraudulent conveyance issue at the time that the trusts were funded. A few years later, the economy sputtered and their business started a slow downward spiral. At this time, the bank called the personal guarantees of Mesmer, Gallant, Holland, and Inez on the business loans. Since most of their personal assets had been transferred to foreign IEPTs, the bank attempted to pursue collection of the debt against the foreign asset protection trusts abroad. This pursuit proved unsuccessful, and the bank ultimately agreed to a global settlement on a substantially discounted basis. No settlement payment was required of or was made by any of the foreign asset protection trusts involved.

Example 8: Jerry and Susan Marconi were referred to the author's firm by their litigation counsel at a time when they were being sued on a promissory note secured by real estate. Since there was a pending claim, due to fraudulent conveyance issues the Marconis would be required to leave outside of any newly created integrated estate planning structure a sufficient amount of assets to satisfy the existing claim. Here, the Marconis wanted the creditor, a large bank, to proceed against the real estate rather than to proceed against the Marconis' substantial liquid assets. The liquid assets had a very low tax basis that would generate a substantial capital gain if they were used to satisfy the amount due on the promissory note. On the other hand, the real estate had a high tax basis that would actually generate a loss on sale. Unfortunately, the bank did not want to be bothered with the details of a foreclosure sale and was unwilling to allow the clients sufficient time to sell the property and remit the proceeds to the bank. The bank wished to proceed directly against the Marconis' liquid assets. In order to force the bank to proceed against the real property that secured the indebtedness, most of the liquid assets were transferred to a foreign asset protection trust. The result was that the bank could not reach these assets and was forced to look to the collateral that secured the loan for payment.

B. To date, there have been a number of reported cases involving foreign trusts utilized for asset protection goals. The results of these cases have been cited by a few to support the proposition that foreign trusts are not as effective as they once were in protecting assets. However, when the facts of each of these cases are considered, one can see why the results in each of these cases was not as hoped by those settlors (none of whom was a client of the author). Consider the following:

1. In Orange Grove Case, 515 S. Orange Grove Owners Ass'n. v. Orange Grove Partners, Plaint No. 208/94 (High Court Rarotonga, Civil Division, Nov. 6, 1995) the debtors were making property transfers to a Cook Islands trust up to a few weeks before their trial date.

2. In Brown v. Higashi (In Re Brown), 4 Ak. Br. Rpt. 279 (Bankr. D. Alaska 1995) the debtor's trustees in Belize had no idea who the settlor was, had

no record of the trust involved, and debtor apparently did not complete property transfers to the trust he settled.

3. In the opening words of the decision in Marine Midland Bank v. Portnoy (In Re Portnoy), 201 B.R. 685 (Bankr. S.D.N.Y. 1996), the court says the debtor Portnoy transferred virtually all of his assets into an irrevocable offshore trust in Jersey, Channel Islands "at a time when he knew his personal guarantee…was about to be called."

4. In the Bahamian case of Grupo Torras, S.A. v. S.F.M. Al-Sabah, Chemical Bank & Trust (Bahamas) and Private Trust Corp., (Sup. Ct. of the Bahamas Sept. 1, 1995) Kuwaiti Sheik Fahad obtained assets through fraud and then sought protection for these assets through offshore trusts.

5. In Re Colburn, 145 B.R. 851 (Bankr. E.D. Va. 1992), involved a debtor who lied on his bankruptcy schedules. He was denied his bankruptcy discharge. No decision was rendered as to the foreign trust in Bermuda the debtor had previously established.

6. In the case of In Re Brooks, 217 B.R. 98 (Bankr. Conn. 1998), the debtor had fraudulent intent, and settled two foreign trusts within 18 months of bankruptcy.

7. In FTC v. Affordable Media, LLC, 179 F.3d 1228 (9th Cir. 1999), commonly referred to as the Anderson case, the debtors controlled funds as and when the court ordered them to produce the funds. They were jailed for contempt of court for failing to repatriate that which they controlled.

8. The court in In Re Lawrence, 235 B.R. 498 (Bankr.S.D.Fla. 1999), stated "[w]ithin a few days of [judgment entering for $20 million against the debtor] a transfer to a trust in a place called Mauritius [occurred]."

9. In Papson v. Papson, N.Y.L.J., Aug. 25, 1998, p. 29 (Queens County Supreme Court, N.Y., July 31, 1998), the settlor of a Cayman Islands *revocable* trust was making transfers to the revocable trust while he was under a restraining order requiring the he not make transfers, and while he was in arrears on child support, tuition, and other court-ordered payments.

10. In the Brennan case, 230 F3d 65 (2d Cir. 2000), Mr. Brennan established an offshore trust after trial had commenced.

11. In Morris v. Morris, Case No. 502005CA006191XXXMB (Circuit Court of the 15th Judicial Circuit, Palm Beach County, Florida 2006), Merry Morris committed regular and continued contemptuous acts and made transfer of property up to and after the point of litigation.

12. In SEC v. Solow, Case No. 06-81041, United States District Court for the Southern District of Florida, Mr. Solow made last minute transfers in the face of securities fraud allegations and litigation.

There are no surprises in these results. It would have been a surprise in these cases if the results desired by the settlors were obtained. These are not the circumstances under which offshore planning should be utilized with any realistic hope of it "working."

C. Recognizing that the vast majority of challenges never go so far as to become a reported (or unreported) decision and that they indeed settle before hitting the steps of the courthouse, to date, there have also been a number of judicial decisions that support the legitimacy of asset protection. Like happy news stories, these cases do not tend to make front page news:

1. Riechers v. Riechers, 679 N.Y.S.2d 233 (N.Y Sup. Ct. 1998) - As a result of three separate malpractice lawsuits filed between 1984 and 1988, Dr. Riechers began to consider asset protection planning to preserve his family's assets. Dr. Riechers settled a foreign integrated estate planning trust in 1992. In 1996, Dr. Riechers' spouse filed for divorce. The court held that "assuming arguendo, that this Court had jurisdiction over the corpus of the Riechers Family Trust, which it does not [i.e., because the trust was a foreign integrated estate planning trust], a cause of action would not lie to set aside the trust since the trust was established for the legitimate purpose of protecting family assets for the benefit of the Riechers family members."

2. Over the past several years a number of reported cases have dealt with contempt of court issues in the integrated estate planning context. The author's first experience with a settlor facing a charge of contempt of court dates back to 1995 and involved a client. The settlor in this particular case was not found to be in contempt of court (no client of the author's has been incarcerated, fined, or otherwise found to be in contempt of court). In these federal proceedings, the court stated:

> I've reviewed the law regarding contempt and the standards that are required for me to hold Mr. [X] in contempt. That standard is clear and convincing proof, which means something more than preponderance of the evidence but something less than absolute certainty.
>
> One thing I've learned a long time ago as a judge, you never order something you can't enforce. And if we order him to pay a million dollars, I have to be assured that's a reasonable order. As a matter of fact, contempt law says that one should not issue orders that cannot be complied with. It's a violation of due process to issue orders that the respondent cannot comply with.

> I'd look pretty silly if I entered orders that couldn't be enforced.
>
> There's case law to the effect that if we issue a compliance order that the respondent does not have the ability to comply with, that's punishment and violation of due process.
>
> By putting him in prison, that doesn't compel compliance, because he does not have the ability, apparently, to comply.

3. Chado v. Chado, Case Number 04 CV 3141 (District Court, City and County of Denver Colorado, August 2006) - Plaintiff obtained a default judgment against his brother, and Plaintiff was attempting to collect on the judgment. Defendant had few assets, but he was the 1% general partner of a Colorado limited partnership established in 1989. The 99% limited partner was an Isle of Man Trust settled and funded by Defendant's spouse in 1989 for the benefit of settlor, Defendant, and their respective issue. Shortly before he knew that his brother would be bringing a legal action against him, Defendant borrowed the equity out of his home and contributed the proceeds to the Colorado limited partnership. Plaintiff served the Colorado limited partnership with a Writ of Continuing Garnishment on April 18, 2006, praying "this Court enter an Order that [the partnership] pay the amount of the judgment, plus accumulated costs and fees. A hearing before the Court was held on August 4, 2006. At the hearing, the Court was presented with a copy of the Trust, the Partnership Agreement, and other documents necessary to show the relationship of Defendant to the overall planning structure and to the assets held therein. The Chado court was very quick to hold that the Trust was valid, the Partnership was valid, there was no fraudulent intent on the Defendant's part when he funded the loan proceeds into the planning structure, and that the Plaintiff's prayer for relief would be denied.

4. In re Matter of Joseph Heller Inter Vivos Trust, 613 N.Y.S.2d 809 (Sur. 1994).Case Number 04 CV 3141 - Joseph Heller settled an irrevocable inter vivos trust. The trust contained substantial cash, securities and a Manhattan apartment building. The trustee filed an application with the court to split the trust so that a Manhattan apartment building would be held in one trust and the cash/securities would be held in a separate trust. The purpose for the application was for the novel purpose of insulating the trust's substantial cash and securities from potential creditors' claims that could arise from the trust's real property. The trustee explained that he could not transfer the Manhattan apartment building into another entity, such as a corporation, to isolate it from the trust's other assets because of the substantial income and transfer taxes that would be incurred. The court allowed for the trust to be split. In making its decision, the court considered that (i) the dispositives of each of the two trusts would remain the same as those contained in the original trust; (ii) the trustee would not receive additional trustee fees as a result of administering two trusts; (iii)

there were no existing creditors or any threatened or reasonably anticipated creditors with respect to the assets held in the trust; and (iv) the Manhattan apartment building was adequately insured both as to liability and casualty; and insurance would continue to be maintained. The court further stated that the severance of the trust was consistent with the trustee's fiduciary duty to protect the trust from unnecessary exposure to risk of loss. Also, the court determined that there was no policy reason to resist splitting the trust because New York law recognizes the right of individuals to arrange their affairs so as to limit their liability to creditors. The court cited, as an example, the right that individuals have to renounce their interest in property that would otherwise be subject to creditors' claims, even where the creditor is the government. The court reasoned that if New York law allowed a person to defeat existing creditors by a renunciation, a trust can be severed for the purpose of limiting liability to non-existent, but possible, future creditors.

VIII. Tax and Other Filings to Consider for Foreign Trusts (all not always required)

A. Department of the Treasury, Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts

B. Form 56, Notice Concerning Fiduciary Relationship

C. Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return

D. Form 720, Quarterly Federal Excise Tax Return

E. Form 926, Return By a U.S. Transferor of Property to a Foreign Corporation

F. Form 1040 NR, U.S. Nonresident Alien Income Tax Return

G. Form 1041, U.S. Income Tax Return for Estates and Trusts

H. Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons

I. Form 1065, U.S. Partnership Return of Income

J. Form 1120-F, U.S. Income Tax Return of a Foreign Corporation

K. Form 3520, Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts

L. Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner

M. FINCEN Form 104, Currency Transaction Report (formerly Form 4789)

N. Treasury Department Form 4790, Report of International Transportation of Currency or Monetary Instruments

O. Form 5471, Information Return of U.S. Person With Respect to Certain Foreign Corporations

P. Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business

Q. Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business

R. Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships

S. Form FSA-153, U.S. Dept. of Agriculture Agricultural Foreign Investment Disclosure Act Report

T. Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities

U. Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund

Integrated Estate Planning Trust Law
Comparative Grid - Select Jurisdictions
(As of July 1, 2011)

Provisions (6 most important integrated estate planning trust law provisions appear first) Jurisdiction	(1) Statutory certainty regarding non-recognition of foreign judgments	(2) "Beyond Reasonable Doubt" standard of proof required in establishing fraudulent intent	(3) Statute of limitations on challenging an APT	(4) Statutory certainty that Settlor can be a beneficiary	(5) Statutory certainty that Settlor can retain some degree of control	(6) Burden of proving fraudulent intent is always on creditor	(7) Statutory recognition of different classes of creditors	(8) Specific Statute of Elizabeth override provisions	(9) Posting of Bond Required Before Litigation Can Commence
Antigua/Barbuda	X	X	X	X	X	X		X	X
Bahamas			X	X	X	X	X		
Belize	X			X	X				
Bermuda			X			X	X	X	
Cayman Islands			X		X	X	X	X	
Cook Islands	X	X	X	X	X	X	X	X	
Cyprus			X	X		X	X		
Gibraltar			*				X	X	
Jersey	X				X				
Labuan	X	X	X	X	X	X	X		
Mauritius	X		X	X		X	X		
Nevis	X	X	X	X	X	X	X	X	X
Saint Vincent and the Grenadines	X	X	X	X	X	X	X	X	
Seychelles		X	X	X		X			
Turks and Caicos			X			X	X		
Alaska			X	X	X		X	N/A	
Colorado			X	X			X	N/A	
Delaware			X	X	X		X	N/A	
Hawaii[1]			X	X	X	X		N/A	
Missouri			X	X	X		X	N/A	
Nevada			X	X	X	X	X	N/A	
New Hampshire			X	X	X		X	N/A	
Oklahoma			X	X			X	N/A	
Rhode Island			X	X	X		X	N/A	
South Dakota			X	X	X	X	X	N/A	
Tennessee			X	X	X		X	N/A	
Utah			X	X	X	X	X	N/A	
Wyoming			X	X	X	X	X	N/A	

[1] On July 1, 2010, Hawaii Act 182, entitled "Permitted Transfers in Trust Act" became effective making Hawaii the most recent domestic jurisdiction to enact self-settled spendthrift trust law.

Integrated Estate Planning Trust Law
Comparative Grid - Select Jurisdictions
(As of July 1, 2011)

Provisions Jurisdiction	(10) Statutory certainty that trust remains valid if fraudulent transfers determined to have taken place	(11) Retroactive protection afforded immigrant trusts	(12) Statutory certainty regarding requirements for freezing assets for an APT	(13) Presumption against fraudulent intent if transferor remains solvent following transfers	(14) Binding effect of choice of law	(15) Forced heirship override provisions	(16) Community property provisions
Antigua/Barbuda	X				X	X	X
Bahamas	X				X	X	
Belize					X	X	
Bermuda	X					X	
Cayman Islands	X				X	X	
Cook Islands	X	X	X	X	X	X	X
Cyprus					X	X	
Gibraltar	X			X	X		
Jersey					X		
Labuan	X	X		X	X	X	
Mauritius					X	X	X
Nevis	X	X		X	X	X	X
Saint Vincent and the Grenadines	X	**		X	X	X	X
Seychelles					X	X	
Turks and Caicos				X	X	X	
Alaska	X				X	X	
Colorado							
Hawaii							
Delaware	X						
Missouri							
Nevada							
New Hampshire	X						
Oklahoma							
Rhode Island	X				X		
South Dakota							
Tennessee							
Utah	X				X		
Wyoming					X		

* While some believe Gibraltar law provides "instant" protection if transferor is solvent following transfers, post-transfer solvency of transferor and hence validity of transfers can be challenged.
** Non-specific treatment in the law.
NOTE: Local bank secrecy and other non-disclosure provisions do not appear because of the author's view that such provisions are not material considerations in asset protection planning.

Comparative Grid July 2011