



# Offshore Asset Protection For United States Clients\*

*By Leslie C. Giordani and Elizabeth M. Schurig\*\**

*Compliments of Giordani Fitte Grossman & Ripp LLP*

## Background

The explosive litigation industry in the United States, capricious legislative bodies, and the volatility of financial markets and economies have evoked a powerful response. The buzz word among lawyers representing clients at risk is “asset protection.” More than at any time in our legal history, attorneys are scrambling to find ways to protect and preserve the wealth of their clients. High net worth individuals perceive new and potentially devastating threats to their wealth, and creative lawyers must conceive and render more protective solutions. Traditional asset protection ranges from simplistic homestead and retirement account planning to family limited partnerships. Cutting edge approaches dictate the use of more sophisticated vehicles such as offshore trusts.

## Legal Threats

Threats to individual wealth from litigation arise across the spectrum of contract and tort law. The plaintiff's bar in the United States has been marvelously creative in its practice over the past decade. It has contrived new theories of liability in the malpractice, products liability, contract, securities, ultra vires, and employment areas and judges have accepted many such theories. The measures of damages (compensatory, punitive, and exemplary) for psychological, emotional, and other highly subjective injuries have also expanded tremendously.

Some causes of action stem from legitimate and expected contract creditors, such as those occasioned by consumer and bank debt or the breach of an obligation to perform. Less easily anticipated claims arise from guaranties, contingent liabilities, and joint and several partnership obligations. Debtors often can be surprised by the extent of this exposure and the reaches of creditors. For example, unexpected risks can derive from the financial failure of a partner or business associate, the judicial interpretation of a guaranty beyond its intended scope, or simply from the size and amount of damages awarded in business litigation judgments.

The extension of corporate liability to officers and directors also results in unpleasant surprises and economic losses. Shareholders, governmental entities, and business associates have successfully sued under theories of liability that render the corporate veil of limited usefulness. While perhaps justified, the government's success in achieving personal liability judgments against former officers and directors of failed financial institutions dramatically exemplifies this trend.

Beyond the contract creditor and business claimant is the tort creditor. Numerous publications describe the unrestrained growth in tort litigation. Media headlines continuously report new theories of liability and astronomical damage awards. The United States enjoys the dubious reputation as the world's most litigious society, and the prospects of meaningful tort reform appear bleak. Even with the Republican majority in Congress, tort reform legislation is currently limited in scope and halting in progress.

While liability insurance once provided the trusted shield from potential economic devastation resulting from a civil judgment, individuals with “deep pockets” are increasingly susceptible, irrespective of their insurance coverage. The escalating cost of premiums, the unavailability of coverage for some risks, and the routine denial of coverage by some insurance companies detract from the utility of traditional insurance.

In addition to the potentially disastrous effect of tort, contract, and business liability, there is increasing concern about what might be called regulatory (or legislative) liability, evidenced in recent years primarily in the form of the United States environmental statutes. Landowners, whether individuals or businesses, may be liable under federal law (e.g., CERCLA, the Comprehensive Environmental Response, Compensation and Liability Act<sup>1</sup>) or state law for environmental hazards on land that they own. This liability can apply regardless of whether present owners created the hazard or whether they acquired the land with knowledge of the hazard. Furthermore, liability can be imposed under such laws on former landowners or, in the instance of corporate landowners, on directors or shareholders if they had substantial “control” over the land<sup>2</sup>.

Business owners perceive other legislative liabilities in the form of the Americans with Disabilities Act<sup>3</sup> and the Family Medical Leave Act<sup>4</sup>. While motivated by praiseworthy aspirations, these acts have an economic impact on business and create additional causes of action.

Another contemporary concern in the area of claims on wealth comes from the divorce court, not because divorce claims are new, but because they are so prevalent. Judges and legislators are understandably anxious to protect a nonworking spouse, but even carefully planned premarital arrangements (with both spouses represented by counsel) often fail to withstand judicial scrutiny. Moreover, the evolution of interspousal tort liability claims (e.g., intentional infliction of emotional distress) in some cases effectively renders premarital agreements meaningless<sup>5</sup>. Lawyers find planning in this area very challenging, and concern is not necessarily limited to the client or even the actions of the

client's spouse, but often includes concern for children whose inheritance the client wishes to protect from loss upon divorce.

Compulsory dispositions, whether inter vivos or testamentary, present a more familiar asset protection problem. However, our highly mobile society and the related fact that clients increasingly have assets in more than one jurisdiction have generated a new awareness of this issue. Most civil and common law jurisdictions have statutory provisions for forced dispositions at death or upon the termination of marriage. Common law legal systems recognize dower and curtesy rights, and civil law systems usually incorporate forced heirship concepts. In community property states, these battle lines are drawn along the character of the property, that is, the determination of whether it is separate or community property. Movement by a married couple from one jurisdiction to another complicates the nature of property and marital rights as well as rights of heirs and legatees. Today, clients seek to insure that property passes to the intended beneficiary rather than to a claimant under these various theories.

Many wealthy individuals view the United States legal system as facilitating the capricious redistribution of wealth. At a minimum, its judicial and legislative branches operate unpredictably and can have dramatic economic consequences to an individual's net worth.

## Economic Threats

The preceding section examined contemporary legal threats to wealth. In a different, but in a no less modern or serious vein, exist what might be classified as economic threats. Despite its current strength, concerns about the United States economy remain. Troubling issues include weaknesses in the social security and health care systems, the interest on the federal debt, and the United States government's propensity, albeit high-minded, for throwing money at a current crisis, whether national defense (e.g., the Gulf War) or internal calamity (e.g., the Mississippi River floods of 1993 and annual hurricane disaster relief). In addition, despite reform efforts, the foreign trade imbalance also continues to haunt the economy<sup>6</sup>.

The historical performance of certain foreign currencies, notably the Swiss franc, suggests that long-term investments denominated in such currencies are prudent. During the 1970's, for example, the Swiss franc appreciated against almost every major currency in the world<sup>7</sup>.

Prominent investment strategists believe that meeting the primary goal of investment, high return with acceptable risk, requires international investment. By mixing foreign and domestic investments, United States investors achieve superior diversification, thereby lowering risk. Consequently, reputable investment strategists are recommending that such investors place anywhere from 20 percent to 30 percent of their equity investments in foreign stocks.

A significant segment of the United States investment advisor community foresees economic threats to wealth and encourages foreign diversification. The existing risks would be exacerbated by potential foreign exchange controls or related legislation. Early planning potentially allows an investor to achieve diversification and minimize the consequences of possible currency devaluations.

## Political Threats

Citizens of countries in Latin America and the Middle East have a long history of using asset-protective planning to deal with revolution, governmental expropriation, and other attacks on private wealth occasioned by unstable governments or civil unrest. While such political extremes are certainly less likely to occur in the United States, concern about the domestic economy and its tax structure has caused individuals to consider expatriation (or perhaps repatriation, for foreigners living in this country).

There has been a sharp increase in clients seeking expatriation advice. Anecdotal reports among lawyers in this field suggest that citizens increasingly are discouraged about the United States' inability to solve its domestic problems, the readiness with which Congress adopts a "tax-the-rich" approach, and the confiscatory nature of the wealth transfer tax system. Business owners express frustration at the cost of operating in a litigation-prone society with a government that is antagonistic to their needs. Congress, concerned about the economic impact of this trend, has tightened the tax rules governing tax motivated expatriates and has recently passed an immigration law prohibiting re-entry by such expatriates into the United States.

While forfeiture of citizenship carries a profound emotional price for some citizens, others view it as just another business decision. Political threats, whether real or perceived, drive personal and economic decisions. Reconsideration of citizenship is becoming a reality in the United States<sup>8</sup>.

## The Multiple-Entity Theory of Asset Protection Planning

Lawyers who counsel high net worth individuals should be attuned to the potential consequences of these legal, economic, and political threats. To help clients protect their wealth from depletion by virtue of these threats, for example, at the hands of future judgment creditors, sophisticated attorneys engage in "asset protection planning." This planning optimally involves aggressive, "multiple-entity" structures that include the use of limited partnerships, corporations, trust arrangements, foundations, retirement plans, life insurance, and the like. While multiple entity structures enable both tax planning and orderly wealth transfer, they also facilitate the additional benefit of asset protection.

"Multiple-entity" planning dictates that wealth should be segregated and placed in isolated, sheltered compartments, with each compartment legally and physically unconnected to the other, thus preventing claims against one entity from affecting the others. Opportunities for this planning abound in domestic legal vehicles such as corporations, limited partnerships, limited liability companies, limited liability partnerships, trusts for the benefit of third parties, retirement plans, life insurance, annuities, homesteads, spousal arrangements, inheritances, and foundations.

Permutations and combinations of entities and venues offer even more asset protection. For example, one should segregate passive assets from those with greater intrinsic liability exposure (e.g., compartmentalize listed securities in an entity that is

separate from a general business entity) and segregate the categories of the latter from themselves (e.g., create separate limited partnerships for parcels of real estate, each of which has its own inherent risk or liability). Clients who have asset protection concerns should also consider having limited partnership interests held by trusts. It is also prudent to incorporate or form limited partnerships in hospitable jurisdictions such as Alaska, Delaware, and Nevada. When added to this form of domestic planning, the foreign solution of an offshore trust represents yet another protective compartment.

## Asset Protection as a Goal

“Asset protection” has always been implicitly embodied in estate planning. That is the very essence of the estate planning exercise: to preserve and transmit wealth. Prior to 1980, United States clients primarily focused on minimizing taxes, but since the early days of trust law, originating in England, the overriding goal has been the security and protection of wealth. Elementary to trust law is the notion of management of wealth for the beneficiary whose enjoyment might otherwise be compromised by disability, inability, other compelling commitments, personal factors, or external threats. In short, a dominant theme of trust law is asset protection.

During the 1980s, estate planning lawyers in the United States developed greater sensitivity to the issue of asset protection. The economic failures of that decade saw many entrepreneurs pushed to the brink of, and into, bankruptcy. As clients plunged into financial turmoil and tapped dwindling financial reserves, some clients and their counselors were gratified that prior estate planning arrangements prevented total disaster. Perhaps these measures were initially motivated by tax considerations, but nevertheless they provided a shield from creditors.

Arrangements such as minority trusts, “Crummey” trusts, life insurance trusts, life insurance planning, retirement plans, family limited partnerships, small business corporations, professional corporations, spousal gifts and trusts, and foundations, while born out of tax creativity, preserved some portion of the family wealth from creditors and bankruptcy trustees. The lessons from the eighties were not lost on practitioners. Estate planners now integrate these tools into their planning, having a sharp focus on both the tax collector and the potential creditor.

## U.S. Domestic Strategies

The laws of the fifty United States vary markedly in what they offer by way of protection from the claims of creditors. Texas and Florida have debtor-friendly legal climates and, therefore, offer the most sanctity. Similarly, the beneficial aspects of Alaska, Nevada, and Delaware corporate and partnership law invite the use of those jurisdictions when appropriate. Domestic solutions, if properly implemented, can provide extensive asset protection opportunities.

Domestic asset protection planning vehicles exist in every state, but the asset that is shielded in one state may be exposed in another. The nature of the client’s wealth and sources of income dictate the nature and extent of the coverage. Whether the

means are modest or substantial, the variety stemming from the laws of the fifty states produces widely differing results. It is important to know not only what is available in one’s own state, but it is also important to understand the protections available in other jurisdictions as well.

## Foreign Strategies: The Offshore Trust

When domestic strategies fail to meet all of the client’s needs for asset protection, the offshore trust, when properly structured, can serve as a highly successful asset protection vehicle. Because an offshore trust is jurisdictionally severed from the United States, it is a less accessible target than a domestic vehicle from which to satisfy a future judgment or claim. The legal difficulty in penetrating the trust might deter a potential future claimant from pursuing action, or at least influence a more favorable settlement for the defendant. With varying limitations and risks in different foreign jurisdictions, an individual can create a protective trust or trust-like entity and yet remain a beneficiary eligible to receive distributions.

Economic goals also are attainable through the use of a foreign trust. For example, engaging a foreign money manager to oversee the investment of a portion of one’s assets is likely to enhance economic wealth preservation because it enables international diversification. Such an advisor, with ready access to local information and to facts or insights about the business personnel, and performance of the stock or bond issuer, has a decided advantage over United States money managers who are trying to make investment decisions from abroad. In addition, foreign portfolio managers have different antecedents, training, and philosophies than their United States counterparts. With such backgrounds, these professionals structure investments with a local focus and the client achieves correspondingly greater economic diversification.

A United States investor may not necessarily need a foreign legal vehicle, such as a trust, to take advantage of foreign money management; on the other hand, it might be required. Due to the Securities and Exchange Commission’s regulations, foreign investment managers, whether fund managers or individual portfolio managers, may not be able to make their products and/or services available to a United States investor, but can make them available to foreign trusts and foreign corporations, even if owned or controlled by a United States person. Furthermore, in civil law countries, achieving liability protection or dealing with a legal system that does not readily recognize trusts strongly suggests using a foreign corporation. For example, investing in Switzerland frequently is accomplished by a foreign trust through a subsidiary or ancillary foreign corporation. In addition, using an offshore legal vehicle can serve to avoid or ameliorate the effect of exchange control laws and local foreign taxes. Finally, if the corpus represents a substantial block of wealth, estate planning concerns will likely require the use of a trust as a necessary component of a coordinated estate plan to reduce taxes, plan for tax payments, and facilitate the orderly disposition of assets at death.

Because an offshore trust substantially facilitates a United States person’s ability to expatriate, it also “keeps options open” for progressive clients. That is, a properly structured offshore trust establishes a new set of financial and legal relationships and

expedites further movement of a client's wealth to a new base in the event the client makes the final decision to expatriate.

## Indications for Use

Offshore trusts are appropriate in a variety of situations, but the two reasons expressed by United States clients most often are (1) asset protection, and (2) meaningful economic diversification. When the first reason is present, legal advice begins with the issue of present and existing or known potential creditors and corresponding fraudulent transfer exposure. If that obstacle is successfully hurdled, the attorney should ensure that there are not sufficient domestic asset protection solutions before embarking on the offshore exercise.

Having focused on the two most prominent indications for using an offshore trust, companion factors for creating such a vehicle also exist. Neither the client nor the advisor should manufacture any of these reasons, but it is not improper to take advantage of legal opportunities to protect assets, and if the trust is later challenged, the existence of non-asset protection motivations will help counter charges of fraudulent intent.

### Non-asset protection motivations might include:

1. economic diversification;
2. achieving financial privacy or anonymity with respect to wealth;
3. avoiding forced dispositions;
4. premarital planning;
5. preserving entitlements (e.g., Medicare and Medicaid);
6. marital property planning (e.g., establishing a vehicle for partitioning community property, spousal gifts, and marital trusts);
7. tax planning, (e.g., qualified personal residence trusts, marital trusts, life insurance trusts, exemption equivalent trusts, and generation-skipping transfer tax exemption trusts);
8. planning for the contingency of changing one's domicile or citizenship;
9. participation in investments not otherwise available to U.S. investors;
10. pre-planning in anticipation of currency controls or restrictions on the ownership of bullion; and
11. liability protection, tax planning, or strategic advantage in the context of an active trade or business abroad.

## Conceptual Issues in Offshore Trust Planning

The basic difference between foreign trusts and domestic trusts in the context of asset protection derives from the common law United States rule (adopted by the Restatement of Laws) that a person may not create a valid spendthrift trust for his own benefit<sup>9</sup>. In large measure, this rule has prompted exploration of offshore options. In some foreign jurisdictions, there is simply no equivalent law. Although many jurisdictions had once adopted such measures, they have been abrogated or compromised by statute.

Going offshore to accomplish what cannot be achieved

domestically explains the principal reason why foreign "asset protection" trusts elicit a more indignant response from the plaintiffs' and creditors' rights bar than do the traditional methods of asset protection. Many among that group would claim that a transfer to an offshore trust has no other purpose than to impede creditors' claims, and, therefore, should be deemed a fraudulent transfer.

Observers advocating the rights of individuals to protect assets view the situation differently. That is, in today's business setting, a transfer to an offshore trust should not be characterized as a fraudulent transfer as to any creditor unless the creditor is known or reasonably knowable. In fact, in light of the following observations, one might validly challenge the arguably expansive scope of fraudulent transfer law.

## Fraudulent Transfer Issues

The Statute of Elizabeth is a sixteenth century, seven paragraph act that is the antecedent of modern fraudulent conveyance law. Conveyances, alienations, etc., designed to "delay, hinder, or defraud creditors" are declared "utterly void."<sup>10</sup> The Act includes criminal and civil penalties. With almost four and three-fourths centuries of tradition, is it any wonder that sole purpose asset protection trusts (discussed below) stir the emotions of creditors and their lawyers? Yet those who righteously criticize "asset protection trusts" should consider the environment of the late twentieth century juxtaposed against the environment that produced the Statute of Elizabeth and its modern equivalents, the Uniform Fraudulent Conveyance Act and the Uniform Fraudulent Transfer Act.

In 1570, it was extremely difficult to secure detailed information about a prospective business associate. Lacking were the Dunn & Bradstreet and TRW services with computer database power that can furnish extensive business, personal, and financial information, not to mention the modern practice (or requirement, in some cases) of due diligence. Also lacking were laws which provide penalties for supplying false financial data<sup>11</sup>.

A strong argument can be made that the modern variants of the Statute of Elizabeth should be interpreted in the current setting. Without question, known and reasonably knowable creditors should be protected from fraudulent transfers. But is a creditor remote in time and events from the moment of a transfer also entitled to such unlimited, broad-based protection?

Lawyers facing the constraints of the rule against self settled spendthrift trusts and broad reaching fraudulent transfer laws wonder how they can possibly justify transfers offshore. Is it not clear that the only purpose is to defraud creditors? There is tension in the areas of fraudulent transfer and bankruptcy law because it would appear that these laws are susceptible to the interpretation that they protect unknown, future, potential creditors, no matter how remote in time from the date of the transfer. Historically, courts have not so interpreted the statutes; rather, they have focused on the relative proximity to known, or at least reasonably knowable, creditors. Unknown, future creditors removed in years and in events from the transfer have not been protected by the courts and, indeed, should not be. Nothing states that one must preserve one's assets for unknown future claimants. If this were not the case, inter vivos dispositions of all



sorts would be prohibited, whether gifts to children or friends, charitable contributions, or the settlement of trusts for the benefit of others.

The idea of preserving one's wealth for unknown, future creditors also is contrary to fundamental concepts in the common law. Limited liability is a concept that always has been allowed and even encouraged by limited partnership and corporate law. Spendthrift trusts are time honored, wealth-protective vehicles. Homestead law provides a further example. The law simply does not require one to put all of one's assets at risk. Furthermore, if a client passes the balance sheet test (i.e., the transfer does not render the transferor insolvent) and there is no claimant on the horizon and no misrepresentation to creditors or claimants, the client is merely prudently positioning assets.

As previously noted, the issue of whether the purpose of the transfer was to impede creditors' rights can be diffused to a certain extent, if not eliminated, if there are motivations for the creation of a foreign trust that are not directly related to asset protection. However, other attributes of sole purpose asset protection planning bear examination.

### The "Sole Purpose" Asset Protection Trust

Sole purpose asset protection trusts are offshore trusts created with the sole purpose of defeating the claims of future creditors. Thousands of such trusts currently exist and new trusts are created daily. Driven by professionals and business owners who fear the United States litigation and legislative environment because they perceive it as plaintiff-oriented, unlimited in damage awards, and creditor-friendly, sole purpose asset protection trusts are a growing industry.

The legal community has responded to this pent-up demand. Foreign trust specialists have evolved within law firms, and, indeed some firms practice nothing but sole purpose asset protection planning. Traditional offshore jurisdictions have, in many cases, enacted legislation expressly designed to attract offshore trust business, and trust companies and banks have positioned themselves to market, accept, and serve this business.

Foreign trust law has changed rapidly in the last few years and will grow even more briskly for the balance of the decade. As a result, more court cases involving a United States creditor seeking to reach assets held in an offshore asset protection trust will be filed, tried, and appealed<sup>12</sup>. On the domestic legislative front, rhetoric abounds for tort reform designed to reduce the need for asset protection trusts. On the foreign front, jurisdictions will witness a continued honing of statutes in the near term and the adjudication of litigation locally brought and tried. This area of the law is destined for rapid evolution.

Response from attorneys in the United States to these changes varies dramatically. Some express gratitude that at last hard working, community-serving, business and professional people have a weapon like an offshore trust with which to defend themselves. Others, citing the more than 400-year history of the Statute of Elizabeth, profess moral indignation at the idea that any honest citizen subject to the Anglo-Saxon legal framework should attempt to place wealth beyond the reach of creditors, even unknown, potential future creditors. The legal debate

resonates with more than usual emotion.

Due to the attorney's potential exposure as a co-conspirator defendant in a scheme to defraud creditors, most attorneys working in the offshore trust area proceed cautiously. Participation in a fraudulent transfer arrangement can result in civil and criminal consequences and disbarment. Arguably, that is the greatest risk associated with counseling clients in connection with sole purpose asset protection trusts.

### Importing the Law v. Exporting the Assets

There are two fundamental, and at times conflicting, methods of achieving asset protection through a foreign trust. The first method is to place the assets in a trust governed by the laws of a foreign jurisdiction that names a foreign trustee and to arrange the entire configuration so as to sever all jurisdictional ties with the United States federal and state judicial systems. This method requires a claimant seeking to satisfy a United States judgment to travel to the trustee's jurisdiction in an effort to enforce the claim, an environment in which chances of success are bleak and costly. Using this method one "exports the assets" to a foreign trust.

The second alternative is to select a foreign jurisdiction with a favorable body of trust and fraudulent conveyance law (i.e., specific and aggressive with regard to creditor's claims, fraudulent transfers, and the like) enacted to be protective of the settlor and the beneficiaries. The settlor implements the foreign trust in conjunction with a United States family limited partnership or other domestic legal entity that holds some or all of the settlor's assets. The settlor conveys all or a portion of the domestic limited partnership interests or the domestic corporation's shares to the foreign trustee.

Under this arrangement the hard assets remain in the domestic partnership or corporation and, therefore, physically situated in the United States. Of course, being situated in the United States, the assets are theoretically susceptible to local in rem proceedings. The goal, however, is that the impediments of the specific and aggressive foreign law will have been brought "onshore" to the United States; that is, the local court will apply the foreign law that is the governing law of the trust to matters involving trust assets. In theory, even the prospect that a court would apply the aggressive foreign laws should severely discourage the claimant. Using this method, one "imports the foreign law."

When one imports the foreign law, it may still be possible to export the assets at a later time. That is to say, if the structure initially involves retaining the hard assets physically in the United States, but a problem subsequently arises, the assets can at that later date be moved offshore. The risk, of course, is that the assets will be frozen by a court order before they can be moved. Some assets are difficult or impossible to move, for example, real estate or a professional practice. Hypothecation of such assets and removal of any cash may provide some flexibility. When one uses this method, the timing of when to trigger the removal becomes very critical.

Under either method, the practitioner and client should not take great comfort in the fact that the assets that are potentially subject to collection are offshore (either physically or technically)

or that the arrangement was made in great secrecy. While secrecy should be the rule, it is prudent to assume that all facts surrounding the foreign trust will be discovered. A competent, aggressive attorney for a judgment creditor will not be daunted by foreign law or an exotic structure. One should assume full disclosure; if the structure's legal foundation is solid, the trust should work nevertheless. Indeed, in some cases, early disclosure may facilitate a prompt and economical settlement.

If the assets are physically offshore, a claimant or creditor pursuing the assets typically will have to do so in the jurisdiction that is the situs of the trust. Most jurisdictions will not enforce foreign judgments or will only do so after the case is retried under local law. In some countries, contingent fee contracts are not permitted, and plaintiffs are required to make substantial down-payments (e.g., ten to fifteen percent of amount claimed) as a condition precedent to filing a lawsuit.

### Aggressive v. Non-Aggressive Legislation

Previously discussed were the two alternative theories of "exporting the assets" and "importing the law." In importing the law one seeks the protection of those jurisdictions with aggressive asset protection legislation (such as the Cook Islands, Gibraltar, and the Bahamas). Alternatively, if "exporting the assets" is selected, the client will take comfort in the fact that jurisdictional ties will be severed and that there is greater security for one's assets in the established financial centers (such as The Isle of Man, one of The Channel Islands, Bermuda, or Liechtenstein).

A client should consider the argument that even if the sole objective is asset protection, selecting a jurisdiction that has aggressive legislation is not necessarily the most appropriate action. A potential claimant could assert that the presence of aggressive asset protection legislation is the only reason one selected such a jurisdiction, thereby possibly supporting a fraudulent transfer claim.

### Nest Egg v. In Toto Planning

What percentage of a client's assets should be offshore or in an offshore structure? Some attorneys argue that placing virtually all of one's assets in a United States family limited partnership and then transferring nearly all of the limited partnership interests into a foreign trust provides substantial protection, even if the underlying assets are located within the physical jurisdiction of United States courts. While this approach may ultimately be successful, it has not been judicially tested. Indeed, the very possibility of judicial attachment of assets on the basis of in rem jurisdiction arguably places the "in toto" approach at or near the "less creditor protective" end of the offshore planning spectrum.

At the other, "more creditor protective," end of the offshore planning spectrum, representing perhaps the most conservative philosophy, is the "nest-egg" approach. This strategy contemplates that the client place a limited percentage of his assets in an offshore trust, severing all jurisdictional ties, and locating the cash, stocks, or other wealth physically offshore. Moreover, the arrangement would have well-documented purposes other than, or at least complimenting, asset protection.

The "nest-egg" approach will be less likely to cause fraudulent conveyance claims because the client, by definition, would remain solvent after funding the offshore trust. Furthermore, a well-developed body of conflicts of law cases, relatively speaking, in the area of offshore trusts does not exist. With respect to in toto-type arrangements, all or a large portion of a client's wealth is ostensibly subject to the law of the foreign trust's situs. However, the assets would remain physically within the United States, and a potential conflicts of law analysis by a court that favored application of the law of the jurisdiction in which the assets are physically located would arguably pose too great a risk. This uncertainty must be considered in determining how much of one's wealth should be subject to the risk of an unfavorable outcome of a conflicts of law analysis.

### Control

Maintaining control, an overriding pre-occupation in offshore planning, has an inverse relationship to achieving asset protection. Most clients resist surrendering control of their assets to a foreign trustee; however, that sacrifice must be made to achieve the protection afforded under the approach of "exporting the assets." Accordingly, clients seek ways to retain (or to cede to some family member) the power to influence or control the foreign trustee. Axiomatically, the more the client relinquishes control, the more effective the asset protection of the structure becomes. Conversely, when the client retains more control, the level of asset protection falls. A spectrum of intermediate arrangements exists between the client being trustee and having complete control and the naming of a foreign trustee who has complete control. There are a number of specific methods of addressing the control issue (protectorships, letters of wishes, advisory committees, co-trusteeships, and the like), but ultimately the attorney determines where to draw the line of control in order to avoid rendering the trust a sham that is not defensible in court.

### Sham Arrangements

When a trust is designed to allow the settlor some measure of control, regardless of how elaborately structured or formally observed, the possibility that the trust can be attacked as a sham either under United States law or applicable foreign law arises. Generally, the trust becomes vulnerable if the settlor is aggressive about retaining control. If the arrangement is ultimately controlled by the settlor and if the settlor has in effect complete beneficial enjoyment, a court could easily render the entire structure a sham and order turnover of the assets upon a judgment creditor's demand<sup>13</sup>. In effect, when significant control is maintained, overcoming a sham argument presents a serious challenge.

### Beneficial Enjoyment

In addition to wishing to maintain control, clients generally want to retain, either currently or prospectively, the right to beneficial enjoyment of the trust assets. The concept of shifting, expanding, and contracting beneficial enjoyment may be new to the United

States trust practitioner; however, it is commonly used in foreign trust planning.

A common device for obtaining asset protection while maintaining benefits is a provision that creates a term during which the beneficiaries are individuals other than the settlor. During this term, the settlor has no rights to income or principal. In addition, upon the occurrence of certain events, this term can be extended. Under this arrangement, the settlor has no interest that claimants can reach. The term could coincide with, or at least be sensitive to, the foreign jurisdiction's statute of limitations period.

An easy and related solution is to have the settlor be one of a permissible class of beneficiaries. The trustee would have complete discretion regarding distributions of income. In addition, the trustee would be given the authority to remove at its discretion a beneficiary from the permissible class and to substitute new beneficiaries, including charitable beneficiaries.

Another option would allow the settlor to be a beneficiary until an event that triggers a new class of current beneficiaries occurs. For example, if a claimant secures a judgment against the settlor, the settlor's beneficial interest in the trust automatically becomes either eliminated or the last to be recognized under the terms of the trust, and a new class of beneficiaries is established.

## Selection of Jurisdiction

### Overview

Many nonlegal issues affect the selection of the situs of an offshore trust. The following are issues that might affect the choice of a trust situs: political stability, economic stability, taxes, costs, and fees, prospects for future taxation, tax treaties, exchange controls, business environment, legal framework, transportation facilities, and language. Some of these issues are subjective, dictated primarily by the motivation of the client. The attorney should consider all facets in the selection of the trust's venue.

### Political Stability

Political and civil stability of the prospective jurisdiction should also be a serious consideration. For example, practitioners frequently select Panama as an offshore or tax haven country. Indeed, the "tax haven business" is a large part of Panama's economy, but its historical instability is troubling in the offshore trust context. Unlike an offshore corporation which may be able to transact business without any contact with the host jurisdiction, an offshore trust typically will have a trustee and perhaps other professionals resident and active in the host country. A political crisis may cause irreparable delay for urgent trust business.

### Economic Stability

Economic stability in a small jurisdiction is typically integrated with political stability, but not always. In some of the island nations, one exists without the other. Both are a prerequisite for an offshore trust situs.

Ideally, the locale should have a certain economic substance measured by the status of its population, domestic output, infrastructure, and professional community. For example, Cyprus, irrespective of its other advantages and disadvantages,

has developed a diverse economy, separate and apart from its business as an offshore financial center. Liechtenstein has as well. In addition, both nations possess legal independence and participate as members of the United Nations. Many other jurisdictions possess stable economic and political environments, and such issues merit serious consideration before establishing a foreign trust.

### Influences of Other Countries

Most offshore jurisdictions are small countries or dependencies that are subject to the economic influence of larger nations. The United States, for example, has the potential to force policies, such as the Caribbean Basin Initiative, on Caribbean island countries because of their dependence on United States tourism. Also, many jurisdictions have some legal and economic ties to the United Kingdom.

The impact of these relationships should be reviewed and evaluated. For example, if a United States agency (e.g., the Environmental Protection Agency or the Resolution Trust Company) is a claimant, its enforcement power may have more sway in the Caribbean than in Europe. Similarly, given that the United States and the United Kingdom have signed an enforcement of foreign judgments agreement, an attorney should consider under what circumstances the protocol might apply to British Dependent Territories.

Perhaps deserving special attention is the fact that for many of the countries with ties to the United Kingdom, the court of last resort is the Judicial Committee of the Privy Council, which sits in London. There is no clear indication as to the policy of the Judicial Committee in relation to the legislation of dependent territories and independent members of the Commonwealth. In some instances the Privy Council has been willing to overrule colonial courts and in others, it has exercised great deference to them<sup>14</sup>.

### Choosing a Jurisdiction

Selection of a jurisdiction is a significant challenge. Due to the logistical difficulties of having reliable contacts in every possible country and due to the burden of trying to follow the laws and the political and economic climates of many jurisdictions, it is very tempting to select one country and then do "cookie-cutter" structures for all clients. This temptation should be resisted, however, and research regarding the legal and nonlegal issues relevant to various jurisdictions and specific client needs is essential.

### Size of Trust Corpus

Individuals should be prepared to put a minimum of \$1,000,000 into an offshore trust. Generally, costs, more than any other factor, dictate a minimum corpus in this range. However, individuals have funded foreign trusts with much more modest amounts (for example, \$100,000). If an individual desires to fund a trust at a modest level, other alternatives should also be explored. For example, foreign life insurance arrangements may provide asset protection and economic diversification without the commitment to the substantial costs of an offshore trust. In addition, a life insurance arrangement adds the additional element of income tax planning.

## Conclusion

Asset protection has always been at the heart of estate planning, and it deserves significant attention. Though estate planners have traditionally guarded family wealth from the tax collector, the spendthrift, the imprudent trustee, and intra-family predators, the current legal environment presents new and perhaps more dangerous threats to wealth. Fortunately, as long as the implementation of an asset protective structure precedes creditor problems, a full range of opportunities exists, including offshore trusts.

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\*\*Leslie C. Giordani and Elizabeth M. Schurig formerly led the International Estate Planning group at the Austin, Texas law firm of Giordani, Schurig, Beckett & Tackett, L.L.P. Their practices primarily involve the design and implementation of foreign trust and related business and investment structures, including the tax planning and compliance aspects of such structures. Ms. Giordani and Ms. Schurig are both board certified estate planning and probate lawyers (Texas Board of Legal Specialization) and are frequent authors and lecturers in the areas of asset protection and foreign trust planning.

<sup>1</sup>42 USC §9601.

<sup>2</sup>See *Michigan Natural Resources Comm'n v. ARCO Indust. Corp.*, 723 F. Supp. 1214, 1219 (WD Mich. 1989) (using "position in the corporate hierarchy and percentage of shares owned" as consideration in determining individuals' liability). See also *United States v. Northeastern Pharmaceutical & Chem. Co.*, 579 F. Supp. 823, 848 (WD Mo 1984), *aff'd*, 810 F.2d 726 (8th Cir.1986), *cert. denied*, 484 U.S. 848 (1987) ("An employee of a corporation can be personally liable for activities over which he had direct control and supervision.").

<sup>3</sup>42 USC §12101.

<sup>4</sup>5 USC § 6381.

<sup>5</sup>See, e.g., Geyelin, *Divorcing Couples Wage War with Domestic Torts*, Wall St. J., Feb. 2, 1994, at B1. See also *Moran v. Beyer*, 734 F.2d 1245 (7th Cir.1994).

<sup>6</sup>See, e.g., Greenberger, *U.S. Trade Gap Hits Eight Year High in 1996, Widened by Rise in Imports*, Wall St. J., Feb. 20, 1997 at A2.

<sup>7</sup>Lattman, *The Swiss franc - You Can Bank On It Still*, 27 *Offshore Investment* 19 (1992). However, in the past dozen years, the Swiss franc has stabilized against the U.S. dollar.

<sup>8</sup>8 USC §1182 (a)(10)(E).

<sup>9</sup>Restatement (Second) of Torts §156 (1959). Cf. 1997 Alaska Sess. Laws, Ch. 6. (H.B. 101); Del. Code Ann. tit. 12, §3570 et seq. For a general discussion of the issues facing domestic asset protection trust statutes see Giordani & Osborne, *Stateside Asset Protection Trusts: Will They Work?*, *Est & Pers Fin Plg* (West Group, Nov. Dec. 1997); Giordani & Osborne, *Will The Alaska Trusts Work?*, *J. of Asset Protection*, Sept.-Oct. 1997, at 7.

<sup>10</sup>13 Eliz c5 (1570).

<sup>11</sup>See, e.g., 18 USC §1014.

<sup>12</sup>See, e.g., *Duttie v. Bandler & Kass*, 999 F.2d 536 (2nd Cir.1993) (assets of Liechtenstein trust created by fraudulent conveyance reached by settlor's creditors). See also *In re B.V. Brooks*, 217 B.R.98 (1998) (stock certificates transferred by debtor to his wife which she then transferred to offshore trusts that named debtor as beneficiary were held to be bankruptcy estate property because (1) the trusts were self-settled, and (2) the trusts' spendthrift provisions were not enforceable under Connecticut law, which the court applied in lieu of the governing law of the trusts).

<sup>13</sup>See Hayton, *When is a Trust not a Trust? Strategic Uses of International Trusts*, IBC Conference, London, Dec. 1993.

<sup>14</sup>See generally W.S. Clarke, *The Privy Council, Politics and Precedent in the Asia-Pacific Region*, 39 *Int'l. & Comp. L. Q.* 741-56 (1990) (discussing at length the often dichotomous view taken by the Privy Council concerning the high courts of former colonies).