SELF-SETTLED TRUSTS & BANKRUPTCY

I. BACKGROUND.

A. A self-settled trust is a trust in which the settlor, i.e., the donor, remains eligible to receive distributions of income and/or principal from the trust. The Restatement (Second) of Trusts Section 156(2) (1959) provides in relevant part “[w]here a person creates for his own benefit, a trust for support or a discretionary trust, his transferee or creditors can reach the maximum amount which the trustee under the terms of the trust could pay to him or apply for his benefit.” See also Restatement (Third) of Trusts Section 25. Restatement (Third) of Trusts Section 58(2) provides “A restraint on the voluntary and involuntary alienation of a beneficial interest retained by the settlor of a trust is invalid.” See also Comment e to Restatement (Third) of Trusts Section 58(2). This black letter rule is commonly referred to as the “Self-Settled Trust Doctrine.” It is adopted from old English law. See e.g., Stat. 3 Hen. VII, c.4. (1487), providing, “[a]ll deeds of gift of goods and chattels, made or to be made in trust to the use of that person or persons that made the same deed or gift, be void and of none effect.” The Self-Settled Trust Doctrine is currently the majority rule in the United States, however, the current legislative trend is to reverse this rule. Thus, the Self-Settled Trust Doctrine may soon become the minority rule.

B. Subsection (a)(2) of Section 505 of Article of 5 of the Uniform Trust Code provides:

Whether or not the terms of a trust contain a spendthrift provision, the following rules apply: (2) With respect to an irrevocable trust, a creditor or assignee of the settlor may reach the maximum amount that can be distributed to or for the settlor’s benefit. If a trust has more than one settlor, the amount the creditor or assignee of a particular settlor may reach may not exceed the settlor’s interest in the portion of the trust attributable to that settlor’s contribution.

C. A number of states have reversed the Self-Settled Trust Doctrine by statute. Alaska Laws, SLA 1997, Ch. 6 (H.B. 101), A.S. §§13.12.205(2), 13.27.050(a), 13.36.035, 13.36.310, 13.36.390, 34.40.010, 34.40.110(a), 34.40.110 (Alaska); 12 Del. Code Ann. §§ 3570-3576 (1997) (The Qualified Dispositions in Trust Act) (Delaware); M.R.S. §§428.005-428.059, 456.020, and 456.080 (Missouri); N.R.S. §166.040 (Nevada); Title 18, Chapter 9.2 of the General Laws of Rhode Island (The Qualified Dispositions in Trust Act) (Rhode Island); 2003 Utah Laws Ch. 301 (H.B. 299), Utah Code §25-6-14(1)(a) (Utah); SDCL § 55-16-1, et seq. (South Dakota); 35-15-505(a)(2) (Tennessee); W.S. 4-1-510 (Wyoming); N.H.R.S. § 56-D:1, et seq. (New Hampshire); Permitted Transfers in Trust Act § 554G-1, et seq. (Hawaii); Virginia Code §§ 64.2-745.1 and 64.2-745.2 (Virginia); Ohio Legacy Trust Act, § 5816.01, et seq. (Ohio); Mississippi Qualified Disposition in Trust Act, Title 91, Chapter 9, Article 15, Miss. Code Ann. §§ 91-9-701–91-9-723 (Mississippi); Okla. Stat. tit. 31, § 10, et seq. (Oklahoma); see also §38-10-111 of the Colorado Revised Statutes (Colorado). Additionally, the Self-Settled Trust Doctrine is no longer applicable in most common law jurisdictions outside the United States. For a brief discussion of the laws in some of these jurisdictions see Rothschild & Rubin, 810 T.M., Asset Protection Planning, at p. A-31 and Working Papers. Thus, contrary to popular belief, the trend in most foreign common law jurisdictions, including the United Kingdom,
Australia (See Bankruptcy Act (Commonwealth) 1966), Canada and New Zealand (See Insolvency Act 1967), is towards a public policy of permitting self-settled trusts that protect the settlor’s assets from the claims of his or her creditors. In 1997, Alaska and Delaware each revised its trust laws causing the use of domestic self-settled trusts to become a popular planning technique. In such states, a settlor, regardless of his or her state of residence, can establish a self-settled trust and remain eligible to receive discretionary distributions of income or principal from the trust. If the statutory guidelines of such states are followed and the formalities of the trust relationship adhered to, it should be possible (in theory) for a settlor to protect the wealth held in such trust. The efficacy of using such a trust for asset protection purposes has not fared well in the domestic court system. See e.g., Battley v. Mortensen, et al., (In re Mortensen), 2011 WL 5025249 (Bankr. D. Alaska); Parrott v. Sasaki, Del. Ch., C.A. No. 7227-VCL (Filed Feb. 7, 2012); and In re Huber, 493 B.R. 798 (Bankr. W.D. Wash 2013); but see Dahl v. Dahl, Utah County Civil No. 090402989 (Utah.Distr.4th, Nov. 11, 2011). It is without argument, however, that a properly implemented foreign asset protection trust is a superior vehicle to use to protect assets transferred to a self-settled trust.

D. Section 548(a) of the Bankruptcy Code contains the general fraudulent transfer rule that is applicable in a bankruptcy case. Except as modified by Section 544(b)(1) under this rule a bankruptcy trustee is given the power to avoid particular transfers effectuated by a debtor that are made within two (2) years prior to the date that a bankruptcy case is filed; and obligations that are entered into by a debtor within two (2) years prior to the date that a bankruptcy case is filed. Notwithstanding the foregoing rule set forth in Section 548, Section 544(b)(1) of the Bankruptcy Code provides in relevant part:

the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

The fraudulent transfer rule under § 548(a) and (b) of the Bankruptcy Code is modified by §548(e)(1) in the case of a “self-settled trust.” Nevertheless, the Bankruptcy Code does not provide an express definition of the term self-settled trust. The provision addresses the use of a classic wealth protection trust, both foreign and domestic. Section 548(e)(1) provides:

In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if-(A) such transfer was made to a self-settled trust or similar device; (B) such transfer was by the debtor; (C) the debtor is a beneficiary of such trust or similar device; and (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted. (Emphasis supplied.)

Section 548(e)(2) of the Bankruptcy Code expounds upon the meaning of the term “transfer” in §548(e)(1), providing:
a transfer includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would be incurred by-(A) any violation of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws; or (B) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 781 and 78o(d) or under Section 6 of the Securities Act of 1933 (15 U.S.C. 77f).

Section 101(15) of the Bankruptcy Code provides “The term ‘entity’ includes person, estate, trust, governmental unit, and United States trustee.

The terminology used in the statute is confusing and repetitive. It refers to a self-settled trust in three (3) separate ways. As mentioned, a self-settled trust is a trust in which the donor-settlor (in this case, the debtor) remains eligible to receive distributions of income and/or principal from the trust. The statute, however, refers to a transfer made to “a self-settled trust” “by the debtor” in which “the debtor is a beneficiary.” What type of interest in the trust is required to make it a “self-settled trust” or “similar device”? Can a transfer only be avoided under this provision to the extent the trust is self-settled? Suppose the debtor transfers property to a trust and retains only the right to receive income (such as a common law grantor retained income trust) or annuity payments (such as a grantor retained annuity trust) from the trust for a term of years or for life or suppose the debtor can only receive such payments in the discretion of an independent trustee. Query whether a qualified personal residence trust is self-settled and to what extent. Suppose the settlor and the residence are located in Florida and the settlor’s interest in the trust would otherwise qualify for protection under the Florida homestead exemption. (See Fla. Const. Article X, §4.) Consider the case of a transfer of wealth to a charitable lead trust established in a jurisdiction such as Delaware with asset protection legislation where the remainder interest is directed to be distributed to a trust in which the debtor is a discretionary beneficiary of the income and/or principal. Suppose the term of the lead trust extends over ten (10) years. Query whether this is a self-settled trust under the statute. Would the asset protection trust’s vested remainder interest in the charitable lead trust be considered an attachable property interest under this rule? This would seem to be the correct result. See In re Yerushalmi, 487 B.R. 98 (Bankr. E.D. N.Y. 2012).

Although the provision was clearly not drafted by a trusts and estates lawyer, it does seem to be a step in the right direction. It appears to condone the use of a self-settled trust established under appropriate circumstances. The self-settled trust has been misunderstood by bankruptcy judges and lawyers alike (and some practicing and non-practicing trust and estate lawyers too) and this has caused serious concern (sometimes too much) among practitioners who assist clients in establishing such trusts under appropriate circumstances. Cases such as In re Portnoy, 201 B.R. 685 (S.D. N.Y. 1996) and In re Lawrence, 279 F.3d 1294 (11th Cir. 2002) are good examples of this problem where although the holding of each court was correct, the legal analysis was severely flawed. Section 548(e) forces bankruptcy judges and creditors’ counsel to consider the validity of the trust and analyze conflicts of law principles - which was lacking with no apparent justification in the bankruptcy decisions involving self-settled trusts prior to the date
of this statute. This is the product of judges reviewing cases with egregious facts. (Note that this problem is not limited to self-settled trust cases in the bankruptcy court system. In many cases it is apparent that bankruptcy judges and bankruptcy lawyers simply lack a sufficient knowledge of local trust, estate and property law principles. Too often this has led to inequitable results which sometimes (but not always) do not get overturned on appeal. See e.g., In re Planas, 199 B.R. 211, 217 (Bankr. S.D. Fla. 1996), aff’d. in part, rev’d. in part, 1988 WL 757988 (Bankr. S.D. Fla. 1988) and In re Bosonetto, 271 B.R. 403 (2001).)

Another twist that may cause interpretation problems is the inclusion of §548(e)(2). Does this provision limit the scope of §548(e)(1) to transfers made in anticipation of the potential matters addressed in this provision or is §548(e)(1) or does it have far broader reach applying to any potential transfer made to a self-settled trust?

Finally, maintaining a record of the reasons a client establishes and funds an asset protection trust is critical under this provision because the settlor may be forced to prove that his or her transfer of wealth to the trust was not made with the “actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.” For instance, was the foreign self-settled trust established to enable the settlor to gain access to certain investments not available to investors in the United States or was the trust established for certain estate planning reasons.


II. CASES

A. Battley v. Mortensen. Only a few cases have now percolated through the Bankruptcy Court system since the enactment of Section 548(e) in 2005. Battley v. Mortensen, et al., (In re Mortensen), 2011 WL 5025249 (Bankr. D. Alaska), was a case of first impression involving an Alaska Bankruptcy Court’s interpretation of Section 548(e). In Mortensen, Thomas Mortensen (“D”) was a resident of Alaska and a self-employed project manager who held a master’s degree in geology. He did not work in geology, however, instead managing the environmental aspects of construction projects. D purportedly contracted with major oil companies for work.

In 1994, D and his spouse (now his former spouse) acquired 1.25 acres of real property located in a remote area near Seldovia, Alaska (the “Seldovia Property”) for $50,000. When D and his former spouse divorced D received his former spouse’s interest in the Seldovia Property. Following the divorce D added some improvements to the Seldovia Property. On February 1, 2005, D deeded his interest in the Seldovia Property to a “self-settled trust,” which became the “focal point” of this case.

D’s divorce was apparently a bitterly contested matter. Additionally, D’s income “fluctuated substantially” following his divorce. Both the divorce and the economy adversely affected D’s financial situation.
Through “casual conversation” D learned about Alaska’s laws providing an individual with asset protection over property transferred to a self-settled trust. (The court inappropriately referred to such laws using the derogatory term “scheme.”) D investigated the subject further and using a form he uncovered in his research (one he located searching the internet and found on the website for the Alaska Trust Company) drafted a trust document he called the Mortensen Seldovia Trust (the “Trust”). D intended the Trust to qualify as an asset protection under Alaska’s asset protection trust law. D purportedly asked an attorney to review the Trust and represented that the attorney only suggested “minor changes” be made to the document following the attorney’s review.

The court noted:

The express purpose of the trust was “to maximize the protection of the trust estate or estates from creditors’ claims of the Grantor or any beneficiary and to minimize all wealth transfer taxes.” The trust beneficiaries were Mortensen and his descendants. Mortensen had three children at the time the trust was created.

Mortensen appointed his brother and a friend as trustees and designated his mother as the protector. The protector was given the power to remove trustees and appoint successor trustees and could designate a successor protector. The protector could not designate herself as a trustee.

As required by Alaska law, the Trust was registered with the state on February 1, 2005 and Mortensen provided an affidavit that stated:

1) he was the owner of the property being placed into the trust, 2) he was financially solvent, 3) he had no intent to defraud creditors by creating the trust, 4) no court actions or administrative proceedings were pending or threatened against him, 5) he was not required to pay child support and was not in default on any child support obligation, 6) he was not contemplating filing for bankruptcy relief, and 7) the trust property was not derived from unlawful activities.

D transferred the Seldovia Property to the Trust by executing a quite claim deed on the same date the Trust was registered with the state. According to the terms of the Trust the Seldovia Property was “a special family place that should not be sold and should remain in the family.”

The Seldovia property was worth approximately “$60,000” when it was deeded into the Trust by D. Interestingly, D’s mother sent him checks totaling $100,000 following the transfer of the Seldovia Property into the Trust. D argued that he and his mother had entered into an agreement for him to transfer the Seldovia Property to the Trust to preserve it for his children and that the payment was made in consideration for the transfer. The foregoing testimony was corroborated by certain notes that D’s mother sent to him with two checks. D’s mother sent him two checks for $50,000 each on February 22, 2005 and April 8, 2005.

D claimed he used some of the funds his mother paid him to pay existing debts and transferred approximately $80,000 to a brokerage account in the name of the Trust as “seed money” for operating expenses related to the property. According to D he lent the $80,000 to the Trust, however, no promissory note was ever entered into evidence.
According to D, the Seldovia Property was recreational property used by him and his children and sometimes by other family members. Prior to creating and funding the Trust, D lived on the property full time and argued that he could have claimed the property was exempt from seizure to satisfy his creditors at that time by claiming the state’s homestead exemption.

Following the creation and funding of the Trust, D’s financial condition deteriorated and his income was “sporadic.” According to the court:

[D] used the cash he received from his mother and his credit cards to make speculative investments in the stock market and to pay living expenses. His credit card debt ballooned after the trust was created. In 2005, total credit card debt ranged from $50,000 to $85,000. When he filed his petition in August of 2009, Mortensen had over $250,000 in credit card debt. The $100,000 he received from his mother has been lost.

D claimed that he always had the ability to make the minimum payments required on his credit card debt until he became sick in April of 2009. At that time he required surgery and hospitalization for two weeks followed by a prolonged period of convalescence. Following his illness D stated that he attempted to return to work, however, he was on medication that inhibited his cognitive abilities which in turn caused him to lose several contracts.

D filed for bankruptcy on August 18, 2009. He did not list the Seldovia Property as part of his assets and he listed $251,309.16 in debt from twelve separate credit cards. He also listed $8,140.84 in medical debt.

The bankruptcy trustee alleged that D failed to create a valid asset protection trust because he was not solvent when the Trust was established and funded. After some analysis regarding this issue the court concluded that D was solvent when he established and funded the Trust and therefore recognized the validity of the Trust.

The court held that D’s transfer to the Trust violated the extended ten (10) year fraudulent transfer rule under Section 548(e). Some practitioners have been quick to reach the conclusion that Mortensen should be read broadly as enabling a bankruptcy trustee to reach any assets transferred to a self-settled trust during the ensuing ten year period. Caution is warranted, however, for anyone quick to reach this conclusion for the following reasons:

1. The court’s holding in Mortensen can be read narrowly. The court appeared to reach the proper conclusion (assuming D was actually the settlor of the portion of the Trust relating to the Seldovia Property).

2. D’s counsel appears to have missed an important argument in this case. D’s counsel could have argued with credibility that D’s mother was the grantor of the portion of the trust attributable to the Seldovia Property. This argument is consistent with the record. Of course, had D and his mother sought the advice of competent counsel to assist in originally structuring this transaction such counsel would have certainly advised D’s mother to purchase the land from D and then contribute it to the Trust herself or some variation of this structure. On motion for rehearing in the case D did in fact argue that his mother was the settlor of the Trust, however, the court declined to accept this argument.
3. The debtor could have argued Section 548(e) is unconstitutional because it violates the 10th Amendment of the Constitution of the United States which provides “The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” Until the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) was enacted the fraudulent transfer rule in the Bankruptcy Code was only two (2) years and in certain cases the trustee could use the longer period provided by applicable state law. The two (2) year period did not exceed the shortest period provided to question fraudulent transfers under the laws of any state at that time. Defining property rights and how such rights are governed (including rules related to avoiding the transfer of assets) is traditionally considered reserved to the states. Of course, prevailing on any Constitutional challenge to validity of such a statute would be a monumental task and has an unlikely chance of success.

4. The judge’s ruling is too broad. Except for a small portion of D’s debt, the creditors in question, that is, under D’s twelve credit cards, existed and were contemplated when the Trust was created and funded, regardless of whether D was solvent when the Trust was created. This appears to be the most important fact and supports the court’s decision under Section 548(e). D gave away a substantial portion of his net worth in this case. Such action was certainly odd for someone in his financial situation who was not contemplating placing such assets beyond the reach of a foreseeable creditor. D does not represent the typical client most estate planning attorneys who specialize in asset protection assist in their practice. In fact, D did not even retain counsel to assist in structuring this transaction, rather only to review a trust he drafted himself. Section 548(e) should not reach future creditors who are not contemplated when a trust is created and funded. No existing fraudulent transfer statute is that broad nor should it be interpreted that broadly. Accepting such a broad interpretation would bring into question the finality of too many transactions and is not good policy. One would also have to question why congress would choose to enact a fraudulent transfer rule as opposed to simply enacting a blanket limitation that captures all transfers to a self-settled trust for the ten (10) year period.

The law regarding fraudulent transfers generally characterizes a creditor as either a present creditor or a future creditor.

Present creditors are those creditors whose claims arose before the transfer. They are also referred to as “existing creditors.” A debtor is aware of a present creditor when the debtor effectuates a transfer. A creditor does not have to possess a judgment to constitute a present creditor. In Mortensen, D was clearly aware that he was indebted to certain credit card companies.

Future creditors are those creditors whose claims arose after the transfer. They are also referred to as “subsequent creditors.” For clarification, possible future creditors should be further divided into two distinct categories, only one of which is protected under the fraudulent transfer rules:

Foreseeable future creditors. Foreseeable future creditors are those creditors whose specific claims did not exist prior to the transfer, but were anticipated or should have been anticipated. Such creditors include a creditor whose rights originated following a transfer where a debtor intended to conduct the debtor’s activities or business in a fraudulent way or with
reckless disregard for the rights of a potential creditor. In Mortensen, D was clearly contemplating that he would continue to be indebted to certain credit card companies and it can be inferred from the facts that he intended to increase such debt following the creation and funding of the Trust. In fact, the court noted that his annual expenses exceeded his annual income.

**Unforeseeable future creditors.** An unforeseeable future creditor is an unidentifiable person or entity who a debtor was not aware existed at the time the debtor effectuated a transfer. An unforeseeable future creditor cannot possess a "claim" against a debtor for purposes of the fraudulent transfer rules. Thus, a transfer made by a debtor should not be avoidable by an unforeseeable future creditor under any existing fraudulent transfer rule including Section 548(e).

5. The judge’s references to Senator Charles Schumer’s statement in the legislative history of Section 548(e) is misplaced because it is not relevant to the provision that was ultimately passed by the Senate. Senator Schumer lobbied for the BAPCPA to include a significant dollar limitation on the amount that a settlor could protect by transferring assets to an asset protection trust. Senator Schumer’s proposed amendment was defeated and his commentary on the issue was thus rendered completely irrelevant.

6. Section 522(o) of the Bankruptcy Code contains a substantially similar ten (10) year fraudulent conversion rule applicable to debtors who convert non-exempt wealth to homestead. This rule provides that if within the ten (10) years prior to filing a petition a debtor converts non-exempt property to homestead with the actual intent to hinder, delay, or defraud a creditor, the value of the homestead is reduced by the value of such converted property. The existing cases involving this rule have not applied it as broadly as some commentators suggest Section 548(e) should be applied. See e.g., In re Addison, 8th Cir., Nos. 07-2064, 07-2727, 8/7/08 and In re Osejo, U.S. Bankruptcy Court, S.Dist. Florida, Case No. 10-31218-BKC-JKO, Chapter 7, 22 Fla. L. Weekly Fed. B727a (2011). It would seem highly unlikely that Congress intended to pass two substantially similar statutes involving fraudulent transfers and conversions with each statute to be applied in a completely different manner. Arguably, use of a homestead exemption to shelter wealth in this context is significantly more “abusive” than the use of a self-settled trust. The ten (10) year fraudulent transfer rule applicable to the homestead exemption is not interpreted so broadly and neither should the substantially similar rule for self-settled trusts.

One has to question the necessity of a legislative body enacting a fraudulent transfer rule rather than a rule with a blanket limitation if it is to be interpreted so broadly. No other existing fraudulent transfer rule in the United States has been applied in such a broad manner. The result in Mortensen can certainly be reconciled with a more appropriate and narrow interpretation of Section 548(e). While the authors are not proponents of using domestic asset protection structures, they do not believe that Section 548(e) will be applied in a manner that will vitiate the use of domestic asset trusts if such trusts are created and funded under appropriate circumstances.

*Mortensen* does, however, strengthen the argument that practitioners should advise clients to implement and use properly structured foreign trust structures. This is because of the uncertainty of the immediate application of Section 548(e). Where such uncertainty is
immediately removed by using a foreign trust structure it can only be removed through case law or legislative mandate with domestic trusts. Such is unacceptable in asset protection planning where certainty is a necessity. Nevertheless, planners who assist clients in implementing foreign asset protection trusts should never assist those clients in making transfers that violate any fraudulent transfer rules. A significantly broader interpretation of Section 548(e) would seem to be problematic for ethical planners who desire to avoid knowingly contravening this rule. It is doubtful, however, that Section 548(e) will be interpreted in such a manner. Offshore trust structures are superior because such structures remove significant legal uncertainty that may exist for the next several decades when using a domestic trust and because there is such a significant difference in the economics of using a foreign asset protection structure versus a domestic structure. Defending a domestic structure will almost certainly prove much more costly.


B. In re Huber. In In re Huber, 493 B.R. 798 (Bankr. W.D. Wash 2013), the Bankruptcy Court for the Western District of Washington held that a debtor’s prepetition transfer of assets to a self-settled Alaska trust for the benefit of himself and his children was void under Washington law.

The debtor, Donald G. Huber (“D”), was involved in real estate development and management in Washington for over forty (40) years. In 1968, D founded United Western Development, Inc. (“UWD”) in Washington. D invested in and developed real estate through UWD. D served as the president of UWD, however, beginning in 2001, D’s oldest son, Kevin ("Kevin"), served as a vice president of UWD and had become primarily responsible for the operations of UWD prior to the time that D petitioned for bankruptcy.

Generally, D would own real estate through a corporation or limited liability company separate and apart from UWD, with D owning all, or a portion, of such entity. D was required to sign as guarantor on loans in favor of third party lenders on many projects. Many of the lenders were local banks. All of the real estate held in D’s various entities was located in Washington.

D established the Donald Huber Family Trust on September 23, 2008 (the “Trust”). The record before the Court demonstrated that the Trust was established to “protect a portion of [D’s] assets from [D’s] creditors.” The beneficiaries of the Trust were D, D’s eight children and stepchildren, and D’s grandchildren. The Trustees of the Trust were Kevin, D’s stepdaughter, Amber Haines, and the Alaska USA Trust Company (“AUSA”). The Trust was created in Alaska and designated Alaska law to govern the Trust.
At the time D established the Trust, UWD was in default on numerous loans of which D was a guarantor. The Court gave four examples of loans that were described by the Court as “fragile at best” which were in existence when D established the Trust. Those loans all came due prior to February 10, 2011, when D petitioned for bankruptcy. At the time of the Court’s decision, those loans remained outstanding in the amounts of $1,659,245.46, $1,706,000, $588,250, and $1,101,750, respectively.

D transferred $10,000 in cash and his ownership interests in over twenty-five (25) entities to DGH, LLC (“DGH”), an Alaska limited liability company, established on September 4, 2008. D transferred ninety-nine percent (99%) of DGH to the Trust and Kevin, who also served as its manager, owned the remaining one percent (1%). D also transferred his shares of UWD to the Trust. D’s residence in Washington was conveyed to an Alaska corporation, the shares of which were then transferred by D to DGH. D then leased the residence back from the corporation, and the Trust made the mortgage payments for the residence. In sum, most of D’s valuable assets were transferred to the Trust.

The Court noted that there was only one asset held in the Trust in Alaska, which was a certificate of deposit of $10,000 transferred by D to a bank account in Alaska held in the name of the Trust. The Court stated that all other assets were located in Washington. The Court may be wrong on this point. D transferred real estate located in Washington to an Alaska corporation and a limited liability company. Generally, the situs of intangible assets, such as stock or a membership interest in a limited liability company, is deemed to be located where its owner is domiciled. Therefore, the stock or membership interest that was transferred to the trustee of the Trust should have been deemed to have a situs in Alaska under basic conflicts of law rules. The Court ignored any discussion of this question.

The Trust generated $345,248 in net income in 2010, and $360,000 in 2009. The total amount distributed from the Trust to the beneficiaries of the Trust between October 1, 2010, and July 30, 2012, was $571,332.81. From the date of the filing of the petition on February 10, 2011, through July 30, 2012, the amount of the distributions to the beneficiaries of the Trust totaled $406,837.27.

The Bankruptcy Trustee (“T”) contended that D made requests for disbursements from Kevin, who then prepared a request for a payment, and AUSA approved the disbursement, without any inquiry. D asserted, however, that Kevin at times refused D’s requests for disbursements. The Court stated that the record indicated that AUSA did nothing to become involved with the preservation or protection of the assets of the Trust and acted merely as a “straw man,” approving all distributions of assets.

D filed a voluntary petition for bankruptcy on February 10, 2011. The Court examined two principal issues related to whether the assets of the Trust were part of the estate and should be distributable to D’s creditors. First, whether the Trust should be invalidated under Washington law, and second, whether D’s transfer of assets to the Trust should be avoided under 11 U.S.C. § 548(e)(1) and/or under 11 U.S.C § 544(b)(1). Clearly, the Court could have based its decision solely on a fraudulent transfer analysis.
T contended that D’s transfers to the Trust should be invalidated under Washington State law. Although the Trust was established under Alaska law, Washington did not recognize the efficacy of a self-settled trust for asset protection purposes. See RCW 19.36.020. Under RCW 19.36.020 all transfers made by a person in trust for the use of the transferor are void as to “the existing or subsequent creditors of such person.” The Court (inappropriately) examined choice of law rules to determine which state law applied.

The Court examined Section 270 of the Restatement (Second) of Trusts ("Restatement 270") to address the validity of the Trust. Restatement 270 states:

> [a]n inter vivos trust of interests in movables is valid if valid . . . under the local law of the state designated by the settlor to govern the validity of the trust, provided that this state has a substantial relation to the trust and that the application of its law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship under the principles stated in § 6.

Furthermore, comment b of Restatement 270 provides certain criteria for determining if a state has a substantial relation to the trust. According to comment b:

A state has a substantial relation to a trust when it is the state, if any, which the settlor designated as that in which the trust is to be administered, or that of the place of business or domicil of the trustee at the time of the creation of the trust, or that of the location of the trust assets at that time, or that of the domicil of the settlor, at that time, or that of the domicil of the beneficiaries.

The Court stated that, under Restatement 270, D’s choice of Alaska law designated in the Trust should be upheld if Alaska had a substantial relation to the Trust. The Court noted that D and the Trust beneficiaries were not domiciled in Alaska. The Trust was to be administered in Alaska and the location of one of the trustees, AUSA, was in Alaska, however, the Court noted that, except for a $10,000 certificate of deposit, all of the assets of the Trust were located in Washington (although this contention was questionable.) Therefore, the Court held that Alaska did not have a substantial relation to the Trust, applying the standards set forth in Comment b.

The Court also held that, pursuant to RCW 19.36.020, Washington had a “strong public policy” against self-settled asset protection trusts.

As a result of the foregoing, the Court disregarded D’s choice of Alaska law, and applied Washington law to determine the validity of the transfers to the Trust. Under RCW 19.36.020, the assets of the Trust could be reached by D’s creditors.

The Court also held that D’s transfers were fraudulent under 11 U.S.C. § 548(e)(1). Under the facts of this case, it seems far more appropriate for the Court to have based its decision under §548(e)(1) rather than under its alternative choice of law analysis (that rests on rather dubious grounds).

Under its fraudulent transfer analysis, the Court found that five badges of fraud existed. First, at the time D transferred his assets into the Trust, there was threatened litigation against D.
The Court stated that it appeared that “foreclosure of several properties for which D had guaranteed the bank loans was becoming increasingly certain” and D was not making timely payments on those loans. Second, D transferred all or substantially all of his property into the Trust. Third, D was significantly in debt at the time of the transfers to the Trust. Fourth, the Court held that there was a special relationship between D and the Trust in that D was both the grantor and a beneficiary of the Trust. Fifth, the Court held that D effectively retained the property transferred into the Trust. Substantially all of D’s requests for distributions were granted. On average D received approximately $14,500 per month in distributions from the Trust. The only party to review D’s requests for distributions was his son Kevin. The Court stated that, based on the evidence, the only reasonable conclusion was that D continued to use and enjoy the assets of the Trust as he did before the transfers. Based on these badges of fraud, the Court held that D had the actual intent to hinder, delay, or defraud his current or future creditors, and therefore D’s transfers to the Trust should be avoided.

Additionally, under Section 544(b)(1) of the Bankruptcy Code, T could avoid fraudulent transfers under state law. Under Washington’s version of the Uniform Fraudulent Transfer Act ("UFTA"), a transfer is fraudulent if the debtor acts with actual intent to hinder, delay, or defraud a creditor, or transfers “[w]ithout receiving a reasonably equivalent value in exchange for the transfer or obligation.” RCW 19.40.041(a)(1)–(2). The Court held that D had actual fraudulent intent to hinder, delay, or defraud his current and future creditors under UFTA, and therefore D’s transfers to the Trust should be avoided based on UFTA.


C. In re Niroomand. In Goldberg v. Rosen (In re Niroomand), 11th Cir., No. 12-11231, Oct. 17, 2012, an overly aggressive, imprudent and perhaps poorly advised bankruptcy trustee pursued the legal fee charged by an attorney who specialized in asset protection. The trustee pursued the legal fee on a fraudulent transfer theory and argued that the attorney committed malpractice. As the facts of the case demonstrated, however, the attorney did his job in collecting sufficient due diligence prior to assisting the client with the planning. Collection of due diligence by the attorney included requiring his client to execute an affidavit of solvency. On the other hand and a bit refreshing from an asset protection planner’s standpoint, the bankruptcy trustee found himself in hot water along with his attorney who are each now defending a malicious prosecution action and the trustee’s attorney had to respond to a bar complaint. This time the good guy won!!!! Although the bar complaint was dismissed, the bankruptcy trustee and his attorney have been unable to bring the litigation to a close. “[Rosen’s attorney] and [Rosen], on the other hand, as can be gleaned from their desire to take pointless depositions, their filing of numerous, groundless motions, want to continue the litigation even after obtaining a final, appellate victory. It is therefore abundantly clear that their intent is to exacerbate the litigation and harass and malign Plaintiffs.” See In re Niroomand, Case No. 09-12141-AJC, Bankr. S.D. Fla., Pls.’ Opp’n to Defs.’ Emerg. Mot. to Compel (Dec. 4, 2012).
In *Goldberg*, Alan Goldberg ("T") was the bankruptcy trustee in the Chapter 7 bankruptcy of the debtor, Akram Niroomand ("D"). D was being pursued by Great American Insurance Company ("C"), which commenced a bond indemnity action on June 8, 2007 in the Southern District of Florida. Nearly a year later in May of 2008, C obtained a judgment against D in the amount of $2,930,899.97 (the "Judgment").

Approximately one (1) year prior to the Judgment and eighteen (18) months prior to filing for bankruptcy protection, D engaged the law firm Donlevy-Rosen & Rosen, P.A. ("Rosen") to create and fund an offshore asset protection trust structure. (Interestingly, Alan Goldberg was also the bankruptcy trustee in *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002), another famous “bad” fact case involving a foreign asset protection trust.) According to D, Rosen advised her to establish the Niroomand Family Trust, dated July 6, 2007 (the "Trust") in the Cook Islands to protect her assets. The pending claim was disclosed to Rosen.

After establishing the Trust, D transferred $500,000 to it, however, following this initial transfer D requested the trustee to return approximately $325,000. D used the funds that were distributed to her to pay down mortgages on her home in Florida. (Applying funds to pay down a mortgage on a primary residence is a common asset protection technique used in Florida when a debtor has an existing outstanding claim. Under Section 4 of Article X of the Florida Constitution a debtor can shelter such wealth even though such act represents a fraudulent conversion or transfer as to an existing creditor. See e.g., *Havoco of America, Ltd. v. Hill*, 790 So.2d 1018 (Fla. 2001); *Republic Credit Corporation, Inc. v. Upshaw*, 4th Dist. Case No. 4D08-1591 (March 25, 2009); *Palm Beach Savings & Loan Ass’n. v. Fishbein*, 619 So.2d 267 (Fla. 1993); *Jones v. Carpenter*, 106 So. 127 (Fla. 1925); *Craven v. Hartley*, 135 So. 899 (Fla. 1931); *LeMar v. Lechlider*, 185 So. 833 (Fla. 1939); *Sonneman v. Tuszynski*, 191 So. 18 (Fla. 1939); *In re: Gosman*, 382 B.R. 826 (S.D.Fla. 2007). Of course, following the enactment of the Bankruptcy Reform Act of 2005 the ability to shelter such wealth using this strategy was greatly reduced by the addition of several new statutes specifically designed to prevent the use of an unlimited homestead exemption to shelter such wealth immediately prior to filing for bankruptcy. See § 522(b)(3)(A) (730 day residency rule), § 522(p) (the value of the homestead of a debtor (other than farmers) in excess of $146,450 (as adjusted for inflation pursuant to § 104(b)(1) and (2) of the Bankruptcy Code) is no longer exempt until 1,215 days (that is, three (3) years and four (4) months) after the debtor acquired an interest in the home) and § 522(o) (if within the ten (10) years prior to filing a petition a debtor converts non-exempt property to homestead with the actual intent to hinder, delay, or defraud a creditor, the value of the homestead is reduced by the value of such converted property).) Following receipt of the first distribution D then requested the trustee in the Cook Islands to terminate the Trust and repatriate the funds to the United States and the trustee complied with D’s request. D made this request because presumably she was concerned that a court would eventually order her to repatriate such funds and then hold her in contempt if she failed to comply with such order. (In some cases involving egregious fact patterns where such orders have been issued to debtors courts have ordered such debtors incarcerated for failing to comply with such orders. See e.g., *In re Lawrence*, 279 F.3d 1294 (11th Cir. 2002) and *Federal Trade Commission v. Affordable Media*, 179 F. 2nd 1228 (9th Cir. 1999). The authors strongly urge readers to review such cases carefully to understand the reasons such debtors were incarcerated. In each such case no debtor was ever incarcerated for creating and funding such a trust. Incarceration was ordered to remedy what the court deemed to be serious problems in the design or timing of the funding of such trusts.)
Based on the foregoing, T, in furtherance of his statutory duties as bankruptcy trustee, alleged D’s payment of legal fees constituted a fraudulent transfer to Rosen (such transfers alleged to be both actually and constructively fraudulent). (According to T, the payment of legal fees for Rosen’s advice, which T claimed was negligent, was not justified and did not constitute reasonably equivalent value.) Under Section 548 of the Bankruptcy Code, such transfers would be avoidable by T. T also alleged Rosen committed malpractice in assisting D in establishing the Trust and was unjustly enriched from the payment of legal fees. According to T, D was insolvent when she paid for such legal services.

The only evidence T presented to the bankruptcy court to prove his case was D’s testimony. (However, according to T’s Initial Brief, “extensive documentary evidence was introduced, for the most part, by stipulation.”) T further stated, “the Bankruptcy Court made manifest error by not considering the documentary evidence that establishes that the Debtor made the transfers to the Appellees in exchange for less than reasonably equivalent value…” Notwithstanding T’s objections, the 11th Circuit did not find any support in the record for T’s claim that the bankruptcy court did not consider the documentary evidence in reaching its conclusions.) D testified she was insolvent when she transferred assets to the trust. T did not present any expert testimony regarding the alleged malpractice claim. Rosen, however, presented “voluminous documentary and testimonial evidence” that D was solvent when she transferred assets to the Trust. This evidence included D’s affidavit of solvency in which D testified she was solvent and could pay her anticipated debts, including any judgment that might be incurred in a lawsuit. The affidavit of solvency was used to impeach D’s testimony and the court found her testimony lacked credibility. As a result of D’s lack of credibility, the court found T’s case “woefully lacking” any evidence to support its allegations. The credible evidence supported finding D was solvent when she transferred assets to the Trust. The court found no fraudulent transfer and no evidence of malpractice or unjust enrichment.

According to the Bankruptcy Court:

The plaintiff’s case consisted of one witness, which in the first place the Court did not find credible, but, in addition, the evidence presented is rather clear.

While, I never found any evidence about legal malpractice, I’m looking for what could possibly be argued as unjust enrichment. As to the constructive fraud, fraudulent transfer, the Court thinks it’s abundantly clear that there’s been no establishment of insolvency.

In fact, the record is abundant with records of solvency. The witness signed a solvency affidavit, which she said she did not read, but the Court notes noted that the witness could remember some things in the way of financial numbers of a rather complicated structure down to the penny, and other things, she couldn’t remember at all. (Emphasis added.)

On appeal, the district court upheld the bankruptcy court’s findings. The 11th Circuit affirmed these decisions on Oct. 17, 2012. The court found no error in the bankruptcy court’s findings. The bankruptcy court heard D’s testimony and discredited it, which left T without any credible evidence to support his case. The bankruptcy court was entitled to find D was solvent at
the time of the transfers because the credible evidence supported that finding. There was no indication that the Bankruptcy Court looked beyond the solvency badge to other indicia that established fraudulent intent. T’s unwillingness to stop litigating after the Bankruptcy Court’s dismissal apparently fueled a significant amount of animosity between Rosen and T. (Rosen and his attorney filed suit against T and T’s attorney for malicious prosecution. See Case No. 12-10693CA23 filed in the Circuit Court of the Eleventh Judicial Circuit, Miami-Dade County. See paragraph 7 of T’s Motion to Dismiss and for Sanctions, which amounts to three words, that is, “Shame on them” (referring to Rosen and his attorney). T accused Rosen and his attorney of engaging in a “vexatious, frivolous attempt to intimidate” T and his attorney in T’s Motion to Dismiss.) Rosen moved for sanctions against T, and in doing so, noted T’s “evident personal disdain (and/or that of his counsel) for [Rosen’s] area of practice—‘asset protection’—cannot form a principled basis for an otherwise meritless appeal.” (See Appellees’ Reply in Support of Their Motion for Sanctions under Rule 38, and Appellees’ Response to Appellant’s “Cross-Motion” for Sanctions, filed June 8, 2012.) T’s rationale for his appeals is set forth below by cause of action.

**Negligence & Unjust Enrichment.** Rosen cited Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999) to justify its willingness to assist D with this planning. (A discussion of Grupo Mexicano is beyond the scope of this outline.) T disagreed with Rosen’s reliance on this case. T’s Civil Appeal Statement indicated that the determination of the appeal would turn on the interpretation of Grupo. Indeed, Rosen engaged in planning based on his interpretation of Grupo, which was articulated in the pleadings that stated:

I have sort of a general feeling about it, that once there’s a judgment, there probably are restrictions on how you can transfer property, okay, that don’t exist pre-judgment, at least according to the U.S. Supreme Court in Grupo [sic] Mexicano, so that’s sort of been like the guideline for us…

However, T correctly countered that Grupo’s holding did not evaporate remedies available to creditors prior to obtaining a judgment providing:

Although Grupo held there was no common law authority entitling a plaintiff the right to a pre-judgment injunction preventing a debtor from transferring their property as they see fit, it specifically noted there may be one or more statutory basis that may nevertheless preclude a debtor from doing so, but that was not before the Court.

Indeed, the Supreme Court acknowledged pre-judgment remedies available to creditors under UFCA and UFTA. “Several States have adopted the Uniform Fraudulent Conveyance Act (or its successor the Uniform Fraudulent Transfers Act), which has been interpreted as conferring on a nonjudgment creditor the right to bring a fraudulent conveyance claim. See generally P. Alces, Law of Fraudulent Transactions & ¶ 5.04[3], p. 5–116 (1989). Insofar as Rule 18(b) applies to such an action, the state statute eliminating the need for a judgment may have altered the common-law rule that a general contract creditor has no interest in his debtor’s property. Because this case does not involve a claim of fraudulent conveyance, we express no opinion on the point.” See also, American Surety Co. v. Conner, 251 N.Y. 1, 166 N.E. 783, 65 A.L.R. 244 (1929), “We think the effect of these provisions is to abrogate the ancient rule whereby a
judgment and a lien were essential preliminaries to equitable relief against a fraudulent conveyance. The Uniform Act has been so read in other states.”

T argued that Rosen’s advice, which grossly misinterpreted Grupo, was negligent, resulted in a fraudulent transfer of fees paid to Rosen, and allowed Rosen to be unjustly enriched. D’s planning amounted to legal fees of $41,000 that accomplished nothing (and according to T, could have subjected D to civil contempt) and such fees should have been part of the bankruptcy estate. T felt Rosen should have known a creditor has remedies that involve reversing transfers pre-judgment and refusal to comply with a court order could result in D being held in civil contempt.

Rosen also argued that their inclusion of a “loophole” (commonly referred to as a “Jones Clause”) negated liability on his part for alleged negligence in providing advice to create the Trust. (For a discussion of Jones Clauses see LISI Asset Protection Planning Newsletter #212 (October 30, 2012) at [http://www.leimbergservices.com](http://www.leimbergservices.com).) It should be noted, however, that the Jones Clause included in the Trust would have required T to file a law suit in a court in the Cook Islands and obtain a determination that T was entitled to a remedy. Nonetheless, the Cook Islands does not give full faith and credit to judgments entered by a court in the United States. Thus, any ruling issued by a court in the United States would not be respected under the law of the Cook Islands. As a result, it would seem strained to argue that the Jones Clause in the Trust assuaged a fraudulent transfer concern. To the contrary, it seems clear that it had the effect of hindering or delaying T from collecting on its debt.

T also disagreed with Rosen’s view on the application the “impossibility defense” if D became subject to a court order involving the Rosen’s planning. T cited Rosen’s memorandum to file which included the note, “I told her that the law in the US is such that one can not be incarcerated for failing to do that which is [im]possible to do, even if one has created the impossibility, no matter how reprehensible the conduct…” (See page 27 of T’s Notice of Appeal to the United States Court of Appeals for the Eleventh Circuit, citing Defendants’ Exhibit Register, Bankruptcy Court, ECF 99, Exhibit “L.”)

**Fraudulent Transfer:** The court’s ruling on the fraudulent transfer issue rendered the negligence argument asserted by T nugatory. As previously mentioned, T argued that the Supreme Court did not intend to eviscerate creditor remedies under the Uniform Fraudulent Transfer Act (“UFTA”) in its holding in Grupo Mexicano. While the authors firmly believe this position is correct, the 11th Circuit accepted the Bankruptcy Court’s findings that a fraudulent transfer simply did not exist in this case. Thus, the issue of whether Grupo Mexicano applied to UFTA became immaterial.

T also cited Martinez v. Hutton (In re Harwell), 628 F.3d 1312, (11th Cir. 2010) in his Initial Brief for his 11th Circuit appeal and asserted a similar course of conduct between Rosen and the attorney in Harwell. (For a discussion of Harwell, see LISI Asset Protection Planning Newsletter #168 (January 13, 2011) at [http://www.leimbergservices.com](http://www.leimbergservices.com). See also, Gassman, “In re Harwell: Years of Bankruptcy Court Litigation End Badly for Lawyer Who Allowed His Trust Account to be Used for Transfers to Avoid Creditors,” LISI Asset Protection Planning Newsletter #243 (April 24, 2014 at [http://www.leimbergservices.com](http://www.leimbergservices.com).) However, in Harwell, the issue before the 11th Circuit was whether the attorney (who the court determined was an
initial transferee) was entitled to use the conduit defense while failing to meet a good faith
standard. (The attorney in Harwell faces strict liability for various fraudulent transfers amounting
to nearly $400,000.) In Niroomand, Rosen avoided transferee status due to D’s solvency.
Furthermore, D did not use the Rosen’s trust account as a vehicle to orchestrate fraudulent
transfers. Instead, D paid Rosen for services rendered which normally would constitute
“reasonably equivalent value” in a fraudulent transfer analysis. T’s argument was essentially that
the fees could not be reasonably equivalent value because the advice was negligent. According to
T in his pleadings, “It is inconceivable that the Debtor received any value from Appellees when
the facts are that Debtor could have been held in contempt for hiding behind the Trust in an
attempt to avoid payment of her debts. Obviously, the Debtor realized such and repatriated the
balance of the funds, after incurring substantial losses related to the creation and termination of
the Trust.” (See page 22 of T’s Notice of Appeal to the United States Court of Appeals for the
Eleventh Circuit, filed March 7, 2012.) As noted, however, the Bankruptcy Court dismissed the
fraudulent transfer argument based on D’s solvency.

Niroomand illustrates several important points that should be considered as part of the
asset protection planning process. The following are also tips to live by when counseling clients
on asset protection strategies.

First, timing is a critical aspect of effective asset protection planning. Given the existence
of a claim, the creation and funding of an offshore trust was not appropriate. Clients should plan
only at appropriate times and under appropriate circumstances and attorneys should only assist
clients under such conditions. Many people seek advice about wealth protection strategies
because they are involved or concerned that they are about to become involved in serious
litigation. This may be the wrong time to plan or valuable opportunities may be foreclosed
without raising serious fraudulent transfer issues.

As a general rule, if assisting a client with a particular strategy raises an issue as to a
fraudulent transfer do not proceed or proceed with a great caution. Bad things can happen to
good people if planning is done under inappropriate circumstances. This does not mean that we
cannot ethically assist clients who are involved in litigation (or concerned that litigation is
imminent). However, it does mean exercise discretion. Contrary to Rosen’s stated practice,
Grupo Mexicano should not be interpreted as providing an attorney and his or her client the
ability to engage in aggressive planning so long as its completed before judgment.

Second, as a result of the jurisdiction where a client resides or may want to reside, the
manner in which a client owns certain property interests (for example, homestead or tenancy by
the entirety), it may be possible to achieve significant wealth protection for a client involved in
litigation or concerned that litigation is imminent. In Niroomand, it was only after tens of
thousands of dollars were wasted on an offshore trust structure that D eventually followed advice
to pay down her mortgage – which ultimately may have been a much safer strategy for D and a
far less expansive. Nonetheless, D would have also most likely found it necessary to avoid
finding herself in a bankruptcy proceeding for many years following the payment of the
mortgages on her primary residence.

Third, carefully consider the consequences of using a “Jones Clause” in an asset
protection trust. If the clause is substantially similar to the one used in the Trust, that is, it
creates substantial hurdles for a creditor, it probably will not work to protect the client (or the attorney).

Fourth, following the creation and funding of a foreign trust or any other wealth protection strategy, filing bankruptcy should be viewed as an option of last resort notwithstanding that the planning may have been completed under appropriate circumstances. This is not to say that a properly implemented foreign trust structure or other wealth protection strategy cannot survive a challenge in a bankruptcy proceeding. Nonetheless, it is clear from a few bad fact cases that the present environment in the Bankruptcy Court system is hostile toward certain wealth protection strategies. Unfortunately, bankruptcy judges typically have the pleasure of reviewing bad fact cases involving foreign trusts. Experience demonstrates that judges in bad fact cases usually reach the proper result; however, the legal analysis is faulty. This faulty analysis has significantly damaged public perception regarding legitimate wealth protection planning. It is clear, however, that §548(e)(1) of the Bankruptcy Code (that is, the ten (10) year fraudulent transfer rule that applies to self-settled or classic asset protection trusts) mandates that bankruptcy courts respect the validity of such trust structures. Gone are the days when bankruptcy judges could wrongfully dismiss such trust structures as shams. Instead, the court must now engage in an analysis of whether a debtor’s transfer of assets to such a trust constituted a fraudulent transfer. (See e.g., Battley v. Mortensen, et al., (In re Mortensen), 2011 WL 5025249 (Bankr. D. Alaska). For an excellent discussion of Mortensen see Shaftel, “Court Finds Fraudulent Transfer to Alaska Asset Protection Trust,” 39 EP 15 (April 2012); Sullivan, Merric, Gillen, Bove & Nenno, “Fraudulent Transfer Claims,” 150 Trusts & Estates 43 (Dec. 2011); and “Gopman & Rubin: Further Analysis on In re Mortensen,” LSI Asset Protection Planning Newsletter #187 (November 7, 2011) at http://www.leimbergservices.com. See also, “Oshins & Keebler on Mortensen: No, the Sky Isn’t Falling for DAPTs!,” LSI Asset Protection Planning Newsletter #186 (October 31, 2011) at http://www.leimbergservices.com and “Adkisson & Riser on Mortensen: Alaska Asset Protection Trust Fails To Protect Future Assets in Bankruptcy under New Section 548(e) Against Future Creditors,” LSI Asset Protection Planning Newsletter #185 (October 20, 2011) at http://www.leimbergservices.com.) The importance of obtaining an affidavit of solvency should not be ignored in this context. If a debtor’s financial situation and affidavit is such that a transfer would not render the debtor insolvent, it would seem difficult for a creditor to argue that a debtor possesses the actual intent to hinder, delay or defraud such creditor from collecting on its judgment.

Fifth, reliance on Grupo Mexicano for the proposition that a creditor has no pre-judgment remedies seems misplaced. Clearly, a creditor does have pre-judgment rights and can exercise such rights to a client’s detriment. These rights should be disclosed to a client prior to assisting a client with making any transfers. Additionally, the issue of civil contempt should be discussed in these situations emphasizing that a judge may order incarceration in certain circumstances. It is important to advise a client in the context of using a foreign trust that it is likely that the client will remain in the United States within the jurisdiction of a court here.

It is just as important, however, to recognize that honest people seek legitimate wealth protection by using foreign trusts that are created and funded under appropriate circumstances. When properly structured and established under appropriate circumstances, foreign trusts are one of the most (if not the most) effective wealth protection strategies available. It is also important to recognize that the law permits individuals, businesses and other organizations to plan to
protect assets and income from the claims of future unforeseen creditors. It is equally important to recognize that lawyers have a duty to zealously represent their clients, including lawyers who practice in the estate planning area. Zealous representation mandates that practitioners discuss all available planning wealth protection strategies and convey sufficient accurate information regarding such strategies so clients can make informed decisions.

Finally, collection of due diligence should never be viewed primarily as a method of impeaching a client’s testimony as addressed by the court. Properly collecting due diligence to ensure that an attorney is not assisting a client with a fraudulent transfer should not only protect the attorney by proving the planning was done under appropriate circumstances, it should also protect the client by enabling the attorney, as the client’s advocate, to prove to the court that such planning should be respected and accepted by the court.

In assisting a client with the implementation of an effective wealth protection plan a firm should have due diligence-client intake procedures (know your client (“KYC”) procedures) in force that are used as a matter of common business practice in all cases.

An individual should be prepared to answer questions candidly and produce any documentation related to a wealth protection plan that may be required in a court proceeding. This does not mean that it is necessary to disclose such information if it is not required in a legal proceeding, however, a quality wealth protection plan will withstand scrutiny and should not require or be based upon any concealment.

Know your client and document the reasons your client is establishing an offshore structure. Reputable banks, trust companies and other financial institutions in quality foreign jurisdictions are required to conduct extensive due diligence before accepting a new client relationship. This process is generally far more extensive and impressive than the due diligence required by domestic institutions. A client may be required to prove source of wealth and substantiate that funding the structure will not result in a fraudulent transfer issue. Collect extensive financial information on a client who is engaging you to provide wealth protection advice, including a financial statement prepared by a reputable accounting firm that has extensive knowledge of the client’s financial condition, individual and corporate tax returns for at least the three past tax years and extensive information regarding the source of the client’s wealth and employment or business history. Demand reference letters from professionals who have worked with the client such as attorneys, accountants, bankers and financial advisors. Finally, conduct an extensive background check on the client using Lexis-Nexis, WorldCheck, Google and any one or more of the deep web search engines available. Properly using these data bases should enable a planner to uncover civil and criminal cases involving the client as well as any tax liens, administrative proceedings and civil penalties that may have been imposed against the client.

Goldberg v. Rosen does represent an important victory for attorneys who assist clients with asset protection planning. It also teaches planners a valuable lesson, that is, engage in an appropriate level of due diligence in relation to your clients to help ensure that you are advising clients to engage in appropriate planning. Notwithstanding the foregoing, despite Mr. Rosen’s testimony regarding the application of the holding in Grupo Mexicano, we believe it would be unwise to view this case (or Grupo Mexicano for that matter) as permitting free transferability of
assets in disregard of existing or foreseeable claims that have not been reduced to judgment. Such reliance could place an attorney in a difficult position. This case also fires a warning shot at aggressive creditors counsel and bankruptcy trustees to proceed with caution and ensure that they have a strong basis for asserting claims against other professionals. In this case T and his attorney found themselves on the wrong end of a nasty malicious prosecution law suit and T’s attorney on the wrong end of a complaint that was filed with The Florida Bar.

Good practitioners understand full well that we do not collect due diligence on the theory that it will later be used to impeach a client’s credibility. Quite the contrary, such due diligence is collected to protect a client’s interest and prove why a structure and sound planning should be respected. What transpired in Niroomand regarding the use of the affidavit of solvency to discredit D is no different than a tax lawyer providing a letter that explained the risks of a transaction that is later being questioned by a client. Asset protection planning, when done properly, helps the client and the attorney. In this case, it only helped the attorney.

D. **In re Porco.** In re Porco, 447 B.R. 590 (S.D. IL 2011) was the first case where the court addressed the meaning of term “similar device.” In Porco, the court held that a constructive trust and a resulting trust did not constitute a similar device under Section 548(e) noting “the ‘similar device’ language in Section 548(e) also requires an express trust.” For a discussion of Porco see “Bove & Langa on In re Porco: Case of First Impression Interprets Similar Device for Purposes of Section 548(e) of Bankruptcy Code,” LSI Asset Protection Planning Newsletter #184 (October 12, 2011) at http://www.leimbergservices.com.

E. **In re Cowin.** Mortensen and Huber provide little guidance that will assist a practitioner in determining whether a transfer to a self-settled trust constitutes a fraudulent transfer. Nonetheless, a review of case law under § 522(o) of the Bankruptcy Code may prove helpful. Section 522(o) contains a similar ten year extended fraudulent conversion rule in regards to non-exempt wealth that is converted into homestead by a debtor.

In In re Cowin, a real estate developer (“D”) filed a Chapter 7 petition in the Bankruptcy Court for the Southern District of Texas. In D’s petition, D claimed a homestead exemption for a condo (the “Condo”) he had acquired approximately three years earlier as part of a real estate development project with Midtown Edge, L.P. (“MELP”). The Chapter 7 Trustee (the “T”) filed an objection to D’s claimed homestead exemption under 11 U.S.C. Sec. 522(o) (“§ 522(o)”).

D had acquired the contractual right to purchase 22 condo units, however, subsequently agreed to cancel this right in exchange for a promissory note (“Note #1”). When MELP failed to pay D the amount due on Note #1, D agreed to cancel Note #1 in exchange for a subsequent promissory note (“Note #2”) and the contractual right to purchase the Condo. D subsequently exercised his right to purchase the Condo by cancelling Note #2 (by marking it “Pd in full”), representing approximately eighty percent of the purchase price, and paying the remaining balance by giving MELP a promissory note.

The court, citing In re Sissom, 366 B.R. 677 (Bankr. S.D. Tex. 2007), indicated that to prevail under § 522(o), a trustee must prove four elements, that is:

1. the debtor disposed of property within ten years preceding the bankruptcy filing;
(2) the disposed property was non-exempt;
(3) some or all of the proceeds from the disposition of this non-exempt property were used to buy a new homestead, to improve an existing homestead or reduce debt with an existing homestead; and
(4) the debtor disposed of the non-exempt property with the intent to hinder, delay or defraud a creditor.

The court stated that T had satisfied the first element by establishing that D filed bankruptcy on February 21, 2013 and disposed of Note #2 on March 11, 2011 by cancelling the note. The court found that T had satisfied the second element by establishing that promissory notes are clearly non-exempt property under the Texas Property Code. Furthermore, the court found that T had satisfied the third element by establishing that D used the proceeds from the disposition of Note #2 to satisfy some or all of the purchase price for the Condo for which D had claimed a homestead exemption.

With regard to the fourth and final element of § 522(o), the court engaged in a thorough analysis of how it can be established that a debtor disposed of property with the actual intent to hinder, delay or defraud his or her creditors (or with “Fraudulent Intent”). The court conceded that direct evidence of such Fraudulent Intent will be unusual, noting that not surprisingly in the case before it D had denied disposing of the 2010 Note with Fraudulent Intent. The court, however, stated that a debtor’s Fraudulent Intent can alternatively be established by analyzing ten separate “badges of fraud” set forth in the Texas Uniform Fraudulent Transfer Act and three additional badges that have been previously adopted by the 5th Circuit, that is:

1. Was the transfer to an insider?
2. Did the debtor retain possession or control of the property after the transfer?
3. Was the transfer concealed?
4. Before the transfer was made, had the debtor been sued?
5. Was the transfer one of substantially all of the debtor’s assets?
6. Has the debtor absconded?
7. Has the debtor concealed the asset?
8. Was the value of the consideration received by the debtor reasonably equivalent to the value of the assets transferred?
9. Was the debtor insolvent or did he become insolvent, shortly after the transfer?
10. Did the transfer occur shortly before or after a substantial debt was incurred?
11. Was the transfer completed immediately before the debtor filed his bankruptcy petition?
12. Is the debtor unable to explain the disappearance of assets?
13. Has the debtor engaged in a pattern of “sharp dealing” prior to the bankruptcy?

The court pointed out that “not all, or even a majority, of the ‘badges of fraud’ must exist to find actual fraud” and that a court can properly infer a debtor’s fraudulent intent when several of such badges are present.

In its analysis, the court emphasized D’s long history of dishonest behavior. This included prior litigation in which D was found to have wrongfully deprived perfected lienholders
of thousands of dollars from foreclosure sales as well a protracted series of misstatements, false statements, omissions, and insufficient disclosures designed to cover up D’s use of a non-exempt asset to acquire the residence for which he claimed a homestead exemption.

The court held that T established nine out of the thirteen badges of fraud, “more than adequately” meeting his burden of proof of establishing D’s Fraudulent Intent. The court added that even if T had only established a few badges, singling out the third, the seventh and the tenth badges, it would have still concluded that D acted with Fraudulent Intent. In re Cowin provides an excellent analysis of the factors a court may use to determine whether a debtor has acquired a homestead with the intent to hinder, delay or defraud his or her creditors.

Additionally, the case may be helpful in analyzing whether a debtor has transferred assets to a self-settled asset protection trust with the intent to hinder, delay or defraud his or her creditors under 11 U.S.C. Sec. 548(e)(1). The elements of § 522(o) and § 548(e) are substantially similar. Both statutes require an examination of whether a debtor has engaged in a transaction or course of action with “intent to hinder, delay, or defraud” the debtor's creditors and both statutes contain a ten year look back period. In re Cowin analyzes a number of the badges of fraud that can be used to prove a debtor’s transfer of property to a self-settled asset protection trust was made with the intent to hinder, delay or defraud his or her creditors.

F. In re Castellano. In In re: Castellano, 2014 WL 3881338 (Bk.N.D.Ill.), the United States Bankruptcy Court for the Northern District of Illinois found that a trustee’s transfer of a remainder beneficiary’s interest to a spendthrift trust created by the trustee should be avoided as a fraudulent transfer under 11 U.S.C. Sec. 548(e). The court attributed the trustee’s transfer to the spendthrift trust to the debtor, found that the spendthrift trust established by the trustee was the equivalent of a self-settled trust and held that the transfer should be avoided under 11 U.S.C. Sec. 548(e).

Faith F. Campbell (“Faith”) created a living trust (the “Living Trust”) governed by South Carolina law on February 18, 1997. The Living Trust provided that the trust would terminate upon Faith’s death and upon settlement of her estate, at which time the remaining assets would be distributed in equal shares to Faith’s surviving children. Additionally, a spendthrift clause (the “Spendthrift Clause”) in the Living Trust provided as follows:

If any beneficiary should attempt to alienate, encumber, or dispose of all or any part of the income or principal of this Trust before it has been delivered by the Trustee, or if by reason of bankruptcy or insolvency or any attempted execution, levy, attachment, or seizure of any assets remaining in the hands of the Trustee under claims of creditors or otherwise, all or any part of the income or principal might fail to be enjoyed by any beneficiary or might vest in or be enjoyed by some other person, then the interest of that beneficiary shall immediately terminate. Thereafter, the Trustee shall pay to or for the benefit of that beneficiary only those amounts that the Trustee, in its sole and absolute discretion, deems advisable for the education and support of that beneficiary until the death of the beneficiary or the maximum period permissible under the South Carolina rule against perpetuities, whichever first occurs.
Faith died on February 11, 2011 survived by four children, including Linda K. Castellano (the “Debtor”). Under the Living Trust, Bank of America was appointed trustee upon Faith’s death. Bank of America declined its appointment and the Debtor and her siblings appointed J.T. Del Alcazare (the “Trustee”), the Debtor’s nephew by marriage, as successor trustee.

In a letter to the Trustee’s attorney dated October 5, 2011 (the “Letter”), the Debtor’s attorney indicated that the Debtor was insolvent, intended to file for bankruptcy protection and asked the Trustee to “exercise his authority consistent with the provisions of the [Spendthrift Clause].” Castellano at 2. Upon receiving the letter, the Trustee opened a Merrill Lynch account titled the “Faith F. Campbell Spendthrift Trust f/b/o Linda Castellano” and deposited the Debtor’s ¼ share into this account (the “Spendthrift Trust”).

On November 18, 2011, the Debtor filed a Chapter 7 petition (the “Petition”) in the United States Bankruptcy Court for the Northern District of Illinois. In Schedule B of her Petition, the Debtor listed herself as the “[b]eneficiary of deceased mother’s trust protected by spendthrift provision” in the amount of $400,000. Castellano at 3. Roy Safrada was appointed as the Chapter 7 trustee (the “Chapter 7 Trustee”).

On November 21, 2011, the Debtor executed a Receipt and Release instrument (the “R&R”). In the R&R, the Debtor was referred to as “a life-time, limited beneficiary at the sole discretion of the trustee of the Faith F. Campbell Spendthrift Trust created under the Campbell Living Trust.” Castellano at 3. Additionally, the R&R provided that the Debtor’s status as a named beneficiary under the Living Trust had terminated, and that the Debtor was a limited beneficiary whose rights were subject to the Trustee’s sole discretion.

The Chapter 7 Trustee filed a complaint (the “Complaint”) against the Debtor and the Trustee on two grounds. The Complaint sought to avoid the alleged fraudulent transfer to the Spendthrift Trust under 11 U.S.C. § 548(e)(1) (“Section 548(e)(1)”). Additionally the Complaint sought turnover of the assets under 11. U.S.C. §§ 543 and 550.

Section 548(e)(1) provides:

(e)(1) [T]he trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if—

(A) such transfer was made to a self-settled trust or similar device;

(B) such transfer was by the debtor;

(C) the debtor is a beneficiary of such trust or similar device; and

(D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that the transfer was made, indebted.
The court, citing *In re Porco*, 447 B.R. 590 (Bankr. S.D. Ill. 2011) (“*In re Porco*”), noted that Section 548(e) was enacted to avoid the deleterious results of certain state laws that permitted debtors to shelter their assets into self-settled spendthrift trusts (or similar devices) shortly before filing for bankruptcy. *Castellano* at 3. The court then proceeded to analyze whether the transaction satisfied the four prongs of Section 548(e)(1).

First, the Court found that the Debtor transferred an interest in property. 11 U.S.C. Section 101(54)(D) defines a transfer as “each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with – (i) property; or (ii) an interest in property.” The court, noting that the Debtor could have received her outright interest in the Trust and subsequently conveyed such interest to a self-settled spendthrift trust, found that the Debtor accomplished an equivalent result by rejecting her outright interest and “recruit[ing] the . . . Trustee” to establish the Spendthrift Trust. Thus, the court equated the Debtor’s request contained in the Letter with an actual transfer. Additionally, the court interpreted the R&R as the Debtor’s admission that the effect of the Letter was the establishment of the Spendthrift Trust.

Second, the court determined that the Spendthrift Trust was self-settled by the Debtor. Citing *In re Porco*, the court noted that Congress intended the term “similar device” contained in Section 548(e) to be interpreted broadly so that “crafty lawyers” could not avoid the application of the statute by drafting devices that are not technically self-settled trusts. *Castellano* at 5. The Court based its finding that the Spendthrift Trust was a device similar to a self-settled spendthrift trust based on three considerations. The court pointed to the Letter and the language of the R&R as evidence that the Debtor caused the creation of the Spendthrift Trust by “coaching” the Trustee to so act. *Castellano* at 5. Additionally, the Court noted that the familiar relationship between the Debtor and the Trustee as well as the total absence of court supervision resulted in (A) the Trustee not actually having independent discretion and (B) the Debtor being able “to exercise a significant degree of control” over the assets. *Castellano* at 5. Finally, the court noted that that Section 548(e)(1)(A) does not require proof of a self-settled trust, but rather only proof of a similar device. The court found that the Chapter 7 Trustee adequately proved the existence of a similar device based on the fact that: (A) similar to a self-settled spendthrift trust, the Spendthrift Trust was created in part to shield the Debtor’s assets from her creditors and to preserve the right of the Debtor to receive future distributions, (B) the Debtor indirectly caused the creation of the Spendthrift Trust via her instructions to the Trustee in the Letter and (C) it is irrelevant under Section 548(e) whether the formal requirements for establishing a trust under South Carolina law were established.

Third, the court found that the Debtor was a beneficiary of the Spendthrift Trust. The court noted that the Trustee, in his sole discretion, could make distributions from the Spendthrift Trust to the Debtor. Additionally, the court concluded that the lack of judicial oversight and the close familiar relationship of the Debtor and the Trustee resulted in the Trustee having unfettered discretion to make distributions.

Finally, the court determined that the Debtor made the transfer with the actual intent to hinder, delay or defraud her creditors. The court noted that the distributions of the remainder interests, which should have been made shortly after Faith’s death, were delayed for months. The court pointed out that the Debtor was insolvent at the time the Trustee made the distribution
to the Spendthrift Trust, and further that that Debtor admitted that the purpose of the Spendthrift Trust was to prevent creditors from reaching her interest in the trust. The court concluded that the facts suggested that the Debtor and the Trustee actively planned and timed the transaction to shield the assets from the Debtor’s creditors.

Having determined that the transfer to the Spendthrift Trust was avoidable by the Trustee, the court found that 11 U.S.C. § 550 entitled the Chapter 7 Trustee to recover the value of the Debtor’s interest. Additionally, because the Spendthrift Trustee was acting as custodian of the Spendthrift Trust, the court found that Spendthrift Trustee was required to turn over the Debtor’s property to the Chapter 7 Trustee and file an accounting under 11 U.S.C § 543.

III. SUGGESTED TIPS FOR COUNSELING CLIENTS WITH REGARD TO THE CREATION OF SELF-SETTLED ASSET PROTECTION TRUSTS

It is clear that we are in a different period in regards to asset protection trusts. No longer is a bankruptcy court permitted to dismiss such a trust as a sham when faced with questionable facts. As has been pointed out in prior commentaries, the bankruptcy court is now forced to consider the validity of the trust because of the addition of Section 548(e). This is true regardless of how this provision is ultimately interpreted. It also means we should counsel our clients to create and fund asset protection trusts. The earlier the better, because ten (10) years later that fund should be safe from the reach of a bankruptcy court.

Also important to the general estate planning community, a broad interpretation of Section 548(e) could have a devastating effect on many new and now commonly used estate planning techniques such as the use of a discretionary tax reimbursement provision that is included in a wholly owned grantor trust and a successor-backend (“SQIT”™) self-settled trust used in an inter vivos QTIP trust to benefit a donor-spouse who survives the donee-spouse. Many states have laws that specifically provide for a special exception to the self-settled trust doctrine related to these trusts. See e.g., F.S. § 736.0505(1)(c) and § 736.0505(3), N.C.G.S. § 36C-5-505(c), Texas Property Code § 112.035(g). Furthermore, many individuals are contemplating or have established self-settled completed gift dynasty trusts as a vehicle to take advantage of the increased gift tax exemption of $5,000,000 (as indexed). I.R.C. § 2505(a). The overwhelming majority of these trusts are taxed as wholly owned grantor trusts. In the same manner as a trust with a discretionary tax reimbursement provision, each payment by a grantor of the income tax liability attributable to the income generated by the assets held in such a trust is arguably an additional contribution and transfer of wealth to the trust. Each such contribution raises the possibility of the application of Section 548(e) to at least a portion of the trust for an additional ten (10) year period.

An attorney assisting a client with creating and funding a self-settled asset protection trust can help ensure that it will survive scrutiny under Section 548(e) by collection of the proper due diligence at the time the trust is established and/or funded. Such due diligence process can help ensure the attorney is not assisting a client with a fraudulent transfer. In exercising caution practitioners should implement some level of KYC procedures. Importantly, honest people seek legitimate wealth protection by using foreign trusts that are created and funded under appropriate circumstances. When properly structured and established under appropriate circumstances, foreign trusts can be one of the most effective wealth protection strategies. It is
important to recognize that the law permits individuals, businesses and other organizations to plan to protect assets and income from the claims of future unforeseen creditors. It is equally important to recognize that lawyers have a duty to zealously represent their clients, including lawyers who practice in the estate planning area. Zealous representation mandates that practitioners discuss all available planning wealth protection strategies and convey sufficient accurate information regarding such strategies so clients can make informed decisions. The following are tips to live by when counseling clients on asset protection strategies:

A. Counsel clients to establish wealth protection plans as part of the estate planning process. We live in a litigious society because of a justice system that permits the use (if not abuse) of the contingency fee. It is possible that any client who has amassed wealth will become involved in litigation. Will such a client return one day to the office of the client’s estate planning attorney inquiring why the client did not receive advice regarding wealth protection strategies. Wealth protection planning should be part of the general estate planning process in the same manner that estate planners counsel clients in legally reducing their estate and gift tax liabilities.

B. As a corollary to the foregoing, clients should plan only at appropriate times and under appropriate circumstances and attorneys should only assist clients under such conditions. Many people seek advice about wealth protection strategies because they are involved or concerned that they are about to become involved in serious litigation. This may be the wrong time to plan or valuable opportunities may be foreclosed without raising serious fraudulent transfer issues. As a general rule, if assisting a client with a particular strategy raises an issue as to a fraudulent transfer do not proceed or proceed with a great caution. Bad things can happen to good people if planning is done under inappropriate circumstances. This does not mean that we cannot ethically assist clients who are involved in litigation (or concerned that litigation is imminent). However, it does mean exercise discretion. As a result of the jurisdiction where a client resides or may want to reside, the manner in which a client owns certain property interests (for example, homestead or tenancy by the entirety) or expected inheritance or gifts, it may be possible to achieve significant wealth protection for a client involved in litigation or concerned that litigation is imminent.

C. Any client who implements a foreign trust should receive written advice regarding the preparation of and filing of all appropriate tax compliance with the IRS. It should be clear to a client implementing a foreign trust that it is not an income tax savings or tax avoidance device. A US taxpayer who creates and funds a foreign trust is responsible under the grantor trust rules for paying the income tax liability on all of the income generated by the foreign trust and will be required to file certain information returns with the IRS. Failure to comply with these filing requirements can result in significant penalties.

D. Following the creation and funding of a foreign trust or any other wealth protection strategy filing bankruptcy should be viewed as an option of last resort notwithstanding that the planning may have been completed under appropriate circumstances. This is not to say that a properly implemented foreign trust structure or other wealth protection strategy cannot survive a challenge in a bankruptcy proceeding. Nonetheless, it is clear from a few bad fact cases that the present environment in the Bankruptcy Court system is hostile toward certain wealth protection strategies. Unfortunately, bankruptcy judges typically have the pleasure of
reviewing bad fact cases involving foreign trusts. Additionally, bankruptcy counsel and judges typically possess insufficient knowledge of trust law, property law and conflicts of law rules to reach the proper technical result in most cases. Experience demonstrates that judges in bad fact cases usually reach the proper result; however, the legal analysis is faulty. This faulty analysis has significantly damaged public perception regarding legitimate wealth protection planning.

E. A foreign trust should not be used as a tool to violate any law. An individual who attempts to use a foreign trust to evade tax or violate any other law should be prepared to pay the ultimate price for such conduct. Reputable offshore service providers would never knowingly assist an individual in violating the law of any sovereign nation. The IRS or any other government agency is never a desired litigant. As important, however, bad people can violate the law using domestic as well as foreign planning vehicles. The foreign aspect may make reporting a bit more exciting though.

F. An individual should be prepared to answer questions candidly and produce any documentation related to a wealth protection plan that may be required in a court proceeding. This does not mean that it is necessary to disclose such information if it is not required in a legal proceeding, however, a quality wealth protection plan will withstand scrutiny and should not require or be based upon any concealment.

G. When implementing a foreign trust structure, a client should be strongly counseled not to serve as a co-trustee, protector, advisor or in any other fiduciary capacity. A client should be prepared to relinquish control of the client’s assets that will be transferred into the structure. Use only reputable trustees and reputable financial institutions located in an appropriate foreign jurisdiction that maintain nominal or no contact with the US. It may also be prudent not to retain any investment discretion and to custody the assets in such a structure in an appropriate foreign jurisdiction. Importantly, a provincial statement by an individual intimating that a logical person would not relinquish control of millions of dollars to an offshore service provider ignores reality and implies that quality wealth management only exists in the US. Sophisticated investors understand that there is no validity to such a position.

H. A client should always be prepared to use a wealth protection structure as a tool to forge a favorable settlement with a creditor. Most bad fact cases prove that even a foreign trust structure with a faulty design can provide significant protection for the assets held in the structure. Federal Trade Commission v. Affordable Media, 179 F.2nd 1228 (9th Cir. 1999) is a perfect example. The FTC spent years pursuing a nominal sum held in this foreign structure. It is believed that the corpus of this trust never exceeded $2,000,000 in value. Arguably, that structure had significant design faults. Furthermore, the trust had the world’s worst creditor pursuing its assets (that is, an agency of the US government). In the end, the FTC could not bust the trust. The agency settled with the trustee of the Cook Islands trust. It is believed that following this settlement a substantial portion of the original corpus remains under administration of the trust. While Affordable Media involved bad facts, it should serve as an excellent example of how well (and economical) a properly implemented offshore structure works to protect the assets held in the structure. Any creditor represented by qualified counsel should immediately recognize the insurmountable barrier that stands between the creditor satisfying its judgment.
I. Know your client and document the reasons your client is establishing an offshore structure. Reputable banks, trust companies and other financial institutions in quality foreign jurisdictions are required to conduct extensive due diligence before accepting a new client relationship. This process is generally far more extensive and impressive than the due diligence required by domestic institutions. A client may be required to prove source of wealth and substantiate that funding the structure will not result in a fraudulent transfer issue.

From a moral and legal perspective it is acceptable to protect wealth using a properly implemented foreign wealth protection structure. When properly structured and implemented under appropriate circumstances, an offshore trust is the most effective and versatile wealth protection strategy available. In a mobile world where professional and business opportunities require clients to move from one jurisdiction to another, such trusts enable a client to protect wealth without relying on arbitrary local law exemptions that differ from one jurisdiction to the next. Additionally, for the sophisticated investor an offshore trust will be far more attractive as a wealth protection vehicle in comparison to most other strategies such as investment in annuities and insurance contracts (investment vehicles that are potentially exempt in one form or another from the claims of creditors under laws of many states). The cost and limitations of using such vehicles will not be palatable to many sophisticated clients. Importantly, the bad fact cases must be viewed in proper perspective.