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ADVISOR'S GUIDE TO ASSET PROTECTION PLANNING

NORFOLK/PLYMOUTH ESTATE PLANNING COUNCIL

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I. Asset Protection: Is It The Sole Objective Or Just Part Of The Big Picture? And Is It A Global Picture?

It wasn't that long ago that a "typical" family estate plan consisted of two wills, occasionally including a testamentary trust for minor children. Only a very few plans went beyond this. In today's estate plan a significant percentage of clients not only direct us to the objectives noted above, but actually have estates and circumstances which may warrant such demanding objectives.

As can be readily seen, these objectives encompass many different considerations and areas of law. To single out "asset protection" as a sole objective is like building only part of a vehicle in the hopes that it will get us where we want to go. Nonetheless, it is often a driving force in many plans and places new demands on attorneys, accountants, insurance advisors, financial advisors, and others who play a role on the estate and financial planning team. That is, not only must we be familiar with estate and gift taxation, trust law, property law, partnerships, limited liability companies, corporations, family law, conflicts of laws, and ERISA, but we must now be conversant in debtor-creditor law, and, if we go "offshore", the tax laws relating to offshore trusts and other entities and the laws of foreign jurisdictions, among other things.

While these materials will not assume knowledge of every one of these areas, they will assume an advisor's general familiarity with estate and gift taxes, property law, and trust law, for the purpose of presenting the available options using trusts and other entities in satisfying a significant portion of the typical client's objectives. But NOTE that this outline is only offered as a basic guide to introduce the advisor to the important issues, the fundamental principles, and the first stage of options that apply to planning for the protection of assets.

II. The Basic Rules of Creditor's Rights

Based on the rules of "fair play", the cases and development of statutes around the never-ending battle between creditors and debtors have engendered certain fundamental principals, codified by the Uniform Fraudulent Conveyance Act ("UFCA"), the Uniform Fraudulent Transfer Act (UFTA");[1] and more recently the Uniform Voidable Transactions Act, and to an extent the 1995 Bankruptcy Act, discussed below. They are:

- Creditors can reach benefits that the debtor can reach
- Creditors can receive what the debtor can receive
- Creditors can reverse an "unfair" (fraudulent) transfer of assets
- Creditors can have a debtor's assets placed in the hands of a receiver
- Creditors can attach, freeze, and/or force a sale of a debtor's assets
- Creditors can force a debtor into bankruptcy

III. The Basics of Fraudulent Transfers

A. Uses of the UFTA or UFCA Where Assets Are Otherwise Unreachable

Generally, a creditor will only resort to use of the fraudulent transfer rules when the transferred assets of the debtor are not legally reachable by a direct attack. For instance, if a debtor makes a

transfer to a revocable trust of which he is a beneficiary, or even (in most jurisdictions) to an irrevocable trust of which he is a discretionary principal beneficiary, generally, the trust assets in both cases are directly reachable by creditors without the need to argue that a fraudulent transfer has been made. Where the assets are not directly reachable, as in the case of an outright transfer to a third party, then the creditor must seek to show that the transfer was fraudulent. Furthermore, the issue arises as to whether the transfer was fraudulent only as to existing creditors, but as to future creditors as well.

B. Criteria for a Fraudulent Transfer

Determining whether a transfer was fraudulent is seldom easy or clear. What follows are the five basic criteria and related examples of typical fraudulent transfers:

1. Transfer made with the actual intent to hinder, delay, or defraud a creditor. Wendell transfers all of his assets to his wife following a car accident, contemporaneously exclaiming to his creditors, “Take your best shot!” Here, “intent” may be easy to establish, assuming there are witnesses to Wendell’s outcry. But more often “intent” can be difficult to prove, such as where Wendell suddenly decides to liquidate all his investments and place the cash in a life insurance policy to “protect his family.” With such behavior in mind, the UFTA contains a number of indicia of actions (so-called “badges of fraud”) which may be considered by the court, such as concealment of the transfer, a transfer to close relatives or “insiders,” transfers for less than full consideration, transfers of substantially all of a debtor’s assets, transfers to “protected” arrangements, such as life insurance or retirement plans, transfers just after threat or service of a law suit, and others.[2]

2. Incurrence of a debt beyond the debtor’s ability to pay. Wendell sells his $1 million home to his daughter for $260,000 leaving him with assets valued at $490,000. He thereafter executes a personal guarantee of a $600,000 debt.

3. Transfer which renders the debtor insolvent. Wendell has assets of $2 million and debts of $1.2 million. He transfers his $1 million mortgage-free home to his wife. Note that this category of transfers includes transfers made while the debtor was insolvent, as well as those rendering him insolvent.

4. Transfer for inadequate consideration by person engaging or about to engage in business (the "under-capitalization" rule). Wendell has personal assets of $200,000. He forms a business that would reasonably require $200,000 to operate, placing $50,000 capital in the business and transferring $150,000 to his spouse. The business runs up an operating debt of $200,000 and defaults on the debt. Based on the undercapitalization rule, the creditors of the business could reach the funds transferred to Wendell's spouse

5. Transfer to an insider by an insolvent debtor to pay an antecedent debt, where the insider had reasonable cause to believe the debtor was insolvent. Wendell has accumulated debts of $380,000 but has assets of only $150,000. Part of the debt is a note of $125,000 due to his brother-in-law, who is aware of Wendell's financial straits. Realizing he cannot pay all of his creditors, Wendell pays off the note to his brother-in-law and subsequently files for bankruptcy. In such a case, the brother-in-law is clearly an "insider" and the payment of the note would probably be recovered as an asset of Wendell's estate in bankruptcy.

Note that most fraudulent transfers may be attacked by both present and future creditors. There are also the provisions of the U.S. Bankruptcy Code, which contains similar provisions applying to estates of individuals in bankruptcy. [3]

C. Trouble and Expense for Creditors

Efforts made by creditors to rescind or reach transfers based on the fraudulent transfer rules are "actions within actions." That is, a creditor, after bringing the initial litigation to establish the debt or claim, finds the debtor without assets to satisfy the judgment. The creditor must then undertake a separate proceeding during which the court conducts a separate hearing to determine

whether a transfer was fraudulent. Such proceedings themselves can be drawn out and expensive.

D. Periods of Limitations

In general, the statutes of limitation on fraudulent transfers in the several states range from three years to eight years, and in some states, one year on transfers to an insider. [4] In Tennessee, for example, the open period is two years for future creditors and for existing creditors, the greater of two years or six months after discovery of the transfer [5]. (Note, there are special limitations periods that apply where the debtor has filed for bankruptcy):

> 1. If the transfer was made with intent to hinder, defraud, and delay, the creditor has the later of (i) four years from the date of the transfer, or (ii) one year from the time the creditor should have reasonably discovered the transfer.[6]
>
> 2. If the transfer was constructively fraudulent, four years from the date of the transfer;[7] and
>
> 3. If the transfer was a preferential transfer to an insider, one year from the date of the transfer.[8]

E. The "Balance Sheet" Insolvency Analysis

To determine whether a client is "insolvent" the following calculation is made: First, add together all assets that are reachable by a creditor with all such reasonably anticipated assets. Do not consider protected assets, such as, for example, a qualified retirement plan account (IRA accounts not exempt in all states) or, in some jurisdictions, property with a secured creditor. Then add together all known liabilities with all reasonably anticipated liabilities. Subtract the second from the first. If the result is a positive number, say, $1 million, then the client has $1

million of assets that may be transferred without the transfer being deemed a fraudulent transfer. If the result is a negative number, you have an insolvent client. Some states, such as Tennessee, require the transfer/settlor of an asset protection trust to sign and file a “Qualified Affidavit” as to solvency on creating the trust.[9]

F. Fraudulent Conversion

Distinct from a fraudulent transfer is a fraudulent conversion. Generally speaking, this occurs when action is taken which transforms an asset that may be reachable by a creditor into one that is not reachable by a creditor, or becomes harder to reach.[10] For example, Phil has $500,000 of assets in his name, and he seeks to protect those assets from a recent judgment issued against him. He and his brother form a limited liability company to which they each contribute $500,000 in assets for a 50% interest. While the transfer appears to be one for fair consideration (and thus a defense to a fraudulent transfer attack), it is clearly a fraudulent “conversion,” which may be subject to attack on that basis.

G. Advisor Liability

Increasingly, commentators admonish advisors that a failure to consider asset protection planning may rise to the level of malpractice. Conversely, overly aggressive asset protection planning can sometimes land the advisor in hot water. In one Massachusetts fraudulent transfer case, a District Court judge referred the debtor’s planning attorney to the Board of Bar Overseers for conduct the judge found to be “too slick by half”.[11] And down in New Jersey, a creditor was allowed to pursue a claim against the debtor’s attorney for assisting in actions which hindered, delayed, and defrauded the creditor.[12] So, do your “due diligence!”

Viewing all of these concepts from the debtor’s perspective, they actually offer some guidance in applying principles that operate to protect assets. These principles may be illustrated through four basic entities and one type of product typically used in asset protection and discussed in this guide: the trust, the corporation, the limited partnership, the limited liability company, and insurance products.

IV. The 2005 Bankruptcy Act

It is interesting to note that most asset protection plans, from the simplest to the more complex, can go a very long way to frustrate and even defeat creditors, often leaving the debtor in a favorable negotiating position to settle the debt. This all changes when the debtor files or is forced into bankruptcy. Here the tables dramatically turn and new rules come into play. So, although early planning is usually the key, the future is unpredictable, and our client may unexpectedly find himself in bankruptcy. Therefore, in order to best advise our clients, we need to understand the implication for asset protection planning in light of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act"), which amended the Bankruptcy Code (the "Code," for the purposes of this Section IV) . What follows is a thumbnail summary of the important provisions of the Act, which is available on the Library of Congress website at http://thomas.loc.gov (Pub. L. 109-9). It is important to remember that this Section IV is focused on bankruptcy; as noted above, the rules are often different outside of the bankruptcy court.

A. Domicile

Certain property is exempt from the reach of creditors in bankruptcy. The Code permits a debtor to choose between the exemptions in the Code, other federal law, and the exemptions of the state of a debtor's domicile, provided the state permits such election, as Massachusetts does. This choice is often referred to as "forum shopping" – a time honored bankruptcy tradition which has become more difficult under the Act. Prior law looked to the debtor's domicile during the 180 days immediately prior to the filing of the bankruptcy petition. The Act has increased the domicile look-back period to 730 days (about two years). But what if the debtor has moved around and has not been a domiciliary of any one state for the prior 720 days? In this case, the Act looks back 730 days, and then looks back an additional 180 days to see where the debtor was domiciled during that time. If the debtor was not domiciled in one state during the entire 180 day period, domicile is determined by where the debtor spent the majority of time.

Example: Debtor lives in FL for 100 days, then lives in MA for 90 days, then lives in NH for a year, then back to FL for a year, then to MA for 30 days. A petition is then filed. Looking back 730 days, no continuous domicile is established. Looking back the next previous 180 days, the debtor lived 40 days in NH, 90 days in MA, and 50 days in FL. The longest period of domicile during this time is the 90 days in MA, and thus MA should be the domicile of the debtor under the Act.

Note that if the there is a "tie" between states, then the debtor defaults to the federal exemptions.

B. Homestead Protection

Generally speaking, the homestead exemption is a creature of state law which protects a debtor's primary residence from creditors who arise after the homestead is declared, but the protection varies widely from state to state. In Massachusetts, for example, the homestead protection is $500,000 (with special rules that apply to those 62 or older), contrasted with Tennessee, where the exemption varies from a mere $5,000 to a high of $25,000 for a married couple, where both are over 62 years of age,[13] and Pennsylvania, which has none at all. Often, the primary focus of pre-petition forum shopping was to establish domicile in a state that has very liberal homestead protection, such as Texas or Florida, which have unlimited exemptions, and choose that state's exemption to apply in bankruptcy. For example, a debtor that saw bankruptcy on the horizon could hot-foot it down to Florida, purchase a $5 million principal residence, establish domicile in 180 days, and thereafter file for bankruptcy and choose to utilize the unlimited Florida homestead exemption. If successful, the homestead protection of the principal residence in bankruptcy would be $5 million, with certain acreage limitations (one-half acre within a municipality, 160 contiguous acres outside a municipality). A good debtor deal.

But Congress has closed this loophole for last minute planners. To take advantage of the state homestead exemption, the debtor must jump through three hoops. First, the debtor must establish

domicile under the new 730 day rule. Second, even if domicile is established, the homestead in bankruptcy will be limited to $125,000 unless the debtor can establish that the interest was acquired 1,215 days prior to filing of the bankruptcy petition. (About three years and four months.) However, there are liberal “same state rollover rules” that permit a debtor to tack on the holding period from one principal residence to another within the same state to achieve the 1,215 day period, and family farmers are entirely exempt from the 1,215 day rule. Third, even if the 180 day domicile test and the 1,215 day acquisition test are met, a debtor may still be held to the $125,000 limit if the debtor was convicted of a felony, or convicted within the past five years of securities fraud or other intentional tort, or if can be shown that the debtor converted non-exempt assets into the exempt homestead asset with the actual intent to hinder, delay, or defraud the creditor.

Finally, note that a bankruptcy court in Arizona narrowly construed the homestead provisions of the Act to hold that the $125,000 limitation does not apply to debtors domiciled in a state such as Arizona which has opted out of the federal exemptions.[14] However, in a state which permits an election as to whether state or federal exemptions apply, the $125,000 limitation has been upheld.[15]

C. Retirement Benefits

The Act substantially increased the protection of retirement benefits in bankruptcy. A debtor/participant’s tax-exempt retirement plans, such as a 401(k) plan, rollover IRA, SEP IRA, and SIMPLE IRA now have unlimited protection, whether or not the debtor chooses federal or state exemptions. The protection for a traditional IRA and a Roth IRA is $1 million in the aggregate. The best practice would be to advise a client not to combine a rollover IRA with a traditional or Roth IRA, and to deplete first the traditional and Roth IRA when taking required minimum distributions. Note that inherited IRA accounts will not be protected from the beneficiary creditors.[16]

D. Education Accounts

A new provision of the Code grants limited protection to certain educational IRAs and §529 Plans. The protection is limited to accounts for the benefit of a child, stepchild, grandchild, or step-grandchild. The protection for these accounts cannot exceed the applicable Internal Revenue Code funding limitations, and contributions are protected only if made not later than a year before the filing of the bankruptcy petition. There is also a two-year pre-filing cap of $5,000 in the aggregate for all accounts of the same type having the same designated beneficiary.

E. Fraudulent Transfers

Prior law permitted a trustee in bankruptcy to avoid any transfer made within one year of the filing of the bankruptcy petition. The Act has increased the avoidance period to two years. A special ten year avoidance period applies to self-settled trusts or "similar devices", which are discussed next.

F. Self-Settled Trusts and Similar Devices

As commonly understood, a self-settled trust is typically a fully discretionary irrevocable trust settled and funded by the client for the client's own benefit, but often including the client's family within the class of permissible discretionary beneficiaries. The general rule in Massachusetts, and 43 other states, is that a creditor of the settlor can reach the assets within a self-settled trust to the maximum extent a trustee could distribute those assets to the settlor, even if the trust contains spendthrift provisions. For example, if client settles and funds a self-settled spendthrift irrevocable trust in Massachusetts and retains only a discretionary income interest, absent the application of fraudulent transfer rules, a creditor of the settlor can only reach the income of the trust. Fifteen U.S. jurisdictions (AK, DE, HI, MO, MI, NH, NV, OH, OK, RI, UT, SD, TN, VI, WY) and many offshore jurisdictions hold the opposite. That is, a client can settle and fund an irrevocable trust, retain the right to discretionary payments of income and principal,

and the trust will be outside the reach of the client's creditors under the law of that jurisdiction.[*] Again, fraudulent transfer rules apply to varying degrees, and certain "super creditors" are given preferential rights against the trust.

During Congressional deliberations, a New York Times editorial decried the protections afforded by these domestic and offshore asset protection jurisdictions, and asserted that corporate executives involved in Enron-like transgressions would avoid the reach of the bankruptcy court by transferring funds to an offshore trust or to a trust within a protected domestic jurisdiction. In response, Senator Schumer proposed a $125,000 limit on self-settled spendthrift trusts (similar to the homestead limit). This was rejected in favor of a proposal by Senator Talent which added a new Code section that imposes a special ten year reach-back provision in bankruptcy matters for self-settled trusts or "similar devices".

The Code had always contained a protection for spendthrift trusts enforceable under applicable state law, but a question persisted as to whether this protection included self-settled spendthrift trusts. The addition of the ten year reach-back in the new section seems to indicate that the Code does protect self-settled spendthrift trusts as long as the applicable state law protects them. Why else include a limitation on that protection? This good news aside, the reach-back provision will bring many asset protection trusts within the reach of the bankruptcy trustee if five conditions are met. The conditions are: (1) there is a transfer within ten years of the filing of the bankruptcy petition; (2) the transfer is to a self-settled trust or similar device; (3) the transfer is by the debtor; (4) the debtor is a beneficiary of the self-settled trust or similar device; and (5) the debtor made the transfer with the actual intent to hinder, delay, or defraud any entity to which the debtor was or became indebted.

Where an offshore asset protection trust is concerned, however, inclusion within the bankruptcy estate may be a pyrrhic victory. This is because the assets in the offshore trust typically would

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[*] Oklahoma allows a settlor to retain the power to revoke the trust but not to be named as a beneficiary; Colorado recognizes self-settled asset protection trusts but does not have a specific statute to that effect.

not be reachable by the trustee nor by the debtor/settlor. This is not to say that the trustee or the court would have no other recourse. For one, the court could refuse to grant a discharge.[17] For another, if the court believed the debtor/settlor could find a way to recover the funds but did not, the debtor/settlor could be held in contempt of court. In two well publicized cases on similar facts, the debtor/settlor was imprisoned for contempt.[18]

There are many issues raised by this relatively new section. For example, what is a "similar device"? Are the estate planner's tools under Chapter 14 of the Internal Revenue Code (QPRTs, GRITs, and GRATs) implicated as a similar device?[19] And what about retirement plans? Clearly a self-created and funded plan is similar to a self-settled trust. Does this mean that the unlimited protection discussed above for some retirement benefits are limited to the funding which occurred more than ten years prior to the filing of the bankruptcy petition? (This is unlikely, since the new law would then contradict itself, but transfers to such a plan would be subject to the same fraudulent transfer rules as any other transfer.) Can we plan around the application of the reach-back section if the debtor is not a beneficiary of the trust, but his wife and children are? And what if there is a trust protector that can add the debtor (among others) as a discretionary beneficiary at a later date? Can a debtor fund a ten year charitable lead trust that pours over into a self-settled trust in, say, Delaware, and circumvent the Act? These are just a few of the unanswered questions being discussed within the asset protection bar, and which will probably be resolved in the courts.

V. Asset Protection Options: From the Sledge Hammer to the Scalpel

The client's goal is to legally move, place, or arrange one's assets in a manner that is beyond the reach of creditors, without, of course, violating the fraudulent transfer rules. The advisor's goal is to assist the client in a legal and ethical manner. Unfortunately, some of the options that may accomplish this goal also place the assets beyond the reach and enjoyment of the client himself. Thus, while the assets may be protected in such cases, they are also lost, and in most cases they are exposed to creditors of the transferee. For instance, a transfer to the client's spouse or child (the sledge-hammer approach) will not only leave the transferred assets beyond the control and enjoyment of the client, but they will be reachable by the creditors of the spouse or child as well.

A. Tenants by the Entirety

A somewhat better option but far from the best is a tenancy by the entirety* between the client and spouse, but this is not available in all states, nor is it always available for different types of property. For example, in Massachusetts only a principal residence may receive the protection of tenancy by the entirety,[20] while in New York, all real estate held that way enjoys protection, and in Florida, any property held that way is protected, as a general rule. Tennessee recognizes and protects tenancy by the entirety, including the opportunity to maintain such title in a trust.[21]

B. Partnerships

Next up the protection ladder are partnerships, which protect the assets of the partnership itself from the debts of the individual partners (referred to as "outside liability"). The partners, however, other than limited partners, are fully exposed to the debts of the partnership (referred to as "inside liability"). For instance, say that Mickey and Mike are general partners, and Morrie is a limited partner in a furniture company. In a separate business deal <u>outside</u> the partnership Mickey runs up a personal debt (Mickey's outside liability). Generally, Mickey's creditor cannot reach the assets of the furniture company. On the other hand, if a deal within the furniture company goes sour (inside liability), the company's creditors can reach not only its assets but also the <u>individual</u> assets of Mickey and Mike as general partners. Morrie would have no personal liability for the partnership debts.

C. Corporations

The corporate structure may be the oldest and most familiar of asset protection structures. It is commonly known that a shareholder's (personal) liability for corporate debt is limited to the

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* A tenancy by the entirety is a special form of joint tenancy that may only be held by a husband and wife, and neither may transfer his/her share without consent of the other. A number of states (e.g. New York, Florida) prevent creditors of a spouse from reaching property held this way.

shareholder's investment in the company. Thus, if Bill would like to start a software company and does not want his personal assets at risk, the venture may be organized as a corporation. If Bill adequately capitalizes the corporation with $1 million, typically the $1 million is at risk for corporate debt and no more. This assumes, of course, that the corporation is a true entity and operated as such.

What is not as commonly known is that the corporation is not safe from the personal debt of a majority shareholder. Assume in the above example that Bill is the sole or super-majority shareholder, and his new company is very successful. If Bill has a personal creditor (e.g., Bill is a losing defendant in a personal injury suit), Bill's judgment creditor could reach Bill's stock in the corporation in satisfaction of the judgment. The creditor is then free to operate, sell, or liquidate the company and apply property or proceeds to satisfy the judgment. (Note that Nevada law provides an exception to this rule by applying the charging order law (discussed in part VIII) to its small corporations. However, there is no guarantee that this Nevada law would apply to a shareholder who lived outside of Nevada).[22]

D. Limited Liability Companies

Improving on both the partnership and the corporation concept is a statutory creation called a limited liability company (LLC). This is a hybrid between a partnership and a corporation, since the members of the LLC (analogous to partners of a partnership) are by law protected both from inside liability of the LLC and outside liability of the individual members. It must be noted, however, that such protection may not be regarded as absolute, and that the LLC assets, assuming they are in the U.S., are always under the jurisdiction of U.S. courts.

> NOTE: Protection for both the partnership and the LLC generally depend on the actual running of a business or investment enterprise. Placing a principal residence in an LLC is unlikely to offer protection unless the property is rented, and use of the LLC assets for personal expenses can similarly cause protection to be lost. (See further comments on LLC's at part VIII below.)

E. Trusts

Moving up to trusts may in some states offer the best domestic protection without giving up the benefits of the assets in question. As stated earlier, fifteen states have adopted laws which allow a person to establish a domestic asset protection trust (DAPT) for his own benefit while removing the assets in that trust beyond the reach of his creditors. It does not matter that the settlor (the person creating the trust) does not live in the particular state offering the protective trust law. (See discussion later in Part VI.)

F. Insurance and Annuities

Still other states offer protection where the debtor owns a life insurance or annuity contract (discussed in detail later). Where protection is offered, creditors may not reach either the cash value or the proceeds of the insurance or annuity contracts. Unfortunately, the degrees of protection vary almost as much as the weather in the various states, and just because a state offers protection of a life insurance policy in no way suggests that the same state also offers protection of an annuity contract, and vice versa. Furthermore, it is well-settled that protection may be lost if or to the extent that premiums paid into the policy were the subject of a fraudulent transfer.

G. Retirement Benefits

As discussed above in IV.C, the Bankruptcy Act provides extensive protection for most retirement benefits to a debtor who has either declared bankruptcy or has been brought to the bankruptcy court kicking and screaming by his creditors. But what about the non-bankrupt debtor? In that instance, state law (which varies) must be consulted. As a general rule, however, retirement benefits are a protected class of assets while those assets remain inside the plan. The

government does not want the debtor on the public dole.

H. Pre-Nuptial and Post-Nuptial Agreements

Marital agreements can provide a significant degree of asset protection in some cases.

1. Pre-Nuptial Agreements. A pre-nuptial agreement is a contract between two parties who intend to marry. In the typical contract, the parties agree to a division of property in two instances: the death of a party and the divorce of the parties. All other legal rights – such as alimony at divorce and a spousal elective share at death – are waived. Generally speaking, to be enforceable there must be full disclosure of current assets and expected inheritances, no duress (the pre-nuptial should not be signed at the rehearsal dinner), and both parties must be represented by separate counsel.

2. Post-Nuptial Agreements. A post-nuptial agreement is a contract between two parties who are already married to each other and do not contemplate a divorce. While not as universally recognized as pre-nuptial agreements, most commentators believe a post-nuptial agreement will be enforceable if there is disclosure, free will, and adequate representation.

> NOTE: If only one spouse is in financial trouble, a post-nuptial should be considered to set the parameters of the innocent spouse's property rights and in some cases, even make transfers. It is also important that the agreement be reasonable and recorded in a public registry. The debtor spouse should not simply release all his rights to all marital property.[23]

I. Offshore Trusts

The scalpel of asset protection is clearly the offshore trust. When established at the right time and in a proper jurisdiction it is virtually impossible for a creditor to reach the assets in such a trust. (See more on this later.)

VI. Trusts and Asset Protection

Typical estate-planning trusts for a married couple generally take the form of revocable, reciprocal inter vivos trusts designed to take advantage of the state and federal estate tax marital deduction and the credit-shelter by-pass trust. Single clients will also often have an inter vivos trust for asset management and privacy reasons. Lifetime asset protection offered by an inter vivos revocable trust: generally none, except in certain states and where certain offshore jurisdictions are employed (see discussions below).

A. General Asset Protection Issues

1. Spendthrift Trust Rules. A spendthrift trust is one containing a provision stating that the assets of the trust shall not be reachable by the creditors of any beneficiary. As a general rule in the great majority of jurisdictions, a spendthrift provision in a trust established and funded by a party other than the beneficiary will protect the trust assets from the creditors of the beneficiary, with only certain exceptions in the case of necessaries provided to a beneficiary in good faith by a creditor. [24] However, if the beneficiary is also the settlor of the trust (a self-settled trust), the general rule is that a creditor of the settlor can reach whatever the settlor/beneficiary can reach, as well as whatever benefits the settlor/beneficiary could enjoy, assuming the trustee exercised its maximum discretion under the terms of the trust,[25]but note the discussion below on self-settled asset protection trusts in certain states.

Note that Georgia and Louisiana make exceptions to the spendthrift protection rule in the case of tort creditors of a trust beneficiary, while the ten "domestic asset protection jurisdictions" allow spendthrift protection even for self-settled spendthrift trusts, as discussed below.

2. Classes of Creditors. Not all creditors are alike. There are creditors, and then there are "supercreditors." Supercreditors are sometimes able to leap tall asset protection trusts

in a single bound, even where fraudulent transfer is not an issue. Supercreditors are the federal government, spouses, and sometimes, dependents.

a. The Federal Government. It is generally accepted that an enforceable interest in a spendthrift trust constitutes the taxpayer's property for purposes of a federal tax lien.[26] The question is not quite as clear where the beneficiary's interest is discretionary and there are other beneficiaries. On the other hand, it was only the beneficiary's income interest that could be reached in such cases, the corpus of the trust was protected. Even this exposure can be protected in non-self-settled trusts by including a forfeiture provision, terminating the beneficiary's interest under the trust in the event of an attack by any creditor.[27]

b. Spouses and Dependents. In many cases, it has been made clear that spouses and dependents, but particularly spouses, are even more preferred creditors than the federal government. State courts have been known to readily step over proven and basic principles of trust and property law in order to grant a spouse his or her rights to "marital property" or to enforce a grantor's obligation to support a dependent.[28]

B. Domestic Asset Protection Trusts - North to Alaska? . . . or What?

In 1997 people began to be told that taking a cruise would no longer be the only reason they should come to Alaska.[*] We were (and are still) told that as a result of 1997 Alaskan legislation we could create and transfer our assets to a trust that could provide us benefits for life, offer protection against creditors, and be tax free in our estates.[29] Delaware was quick to follow, and since then, thirteen other states have enacted similar laws.

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[*] The comments on this section relating to Alaskan trusts will generally apply as well to DAPTs in the other domestic asset protection trust jurisdictions, except, in part, to Wyoming, Tennessee, and Oklahoma.

The Alaskan legislation[30] (and for the most part, the other relevant states as well, and in this outline such trusts are collectively referred to as "DAPT's," for Domestic Asset Protection Trusts) provides that a creditor of a settlor/beneficiary will not be able to reach assets of the self-settled trust so long as:

- The trust is not revocable by the settlor;
- The settlor was not in default of a child support payment by 30 days or more;
- Distributions to the settlor are discretionary; and
- The transfers to the trust were not fraudulent.
- The trust contains a spendthrift provision.
- Some states (e.g., Tennessee) require the settlor to execute a "Qualified Affidavit."

Existing creditors (at the time of the transfer to the trust or the creation of the trust, or both) may attack the transfer up to the later of four years from the transfer or one year from the time the transfer was or could reasonably have been discovered by the creditor. (In Nevada, South Dakota, Utah, Tennessee, and Ohio, the periods are less, ranging from two years and six months, respectively to eighteen months and six months.) Future creditors must make a claim under the "creditor protection theory" put forth by promoters of DAPT's, i.e. if creditors of the settlor cannot reach the settlor's interest under the trust, then the transfer constitutes a completed gift for gift tax purposes. Accordingly, the proponents suggest that, assuming there are no other retained interests which would cause the assets to be included in the grantor's estate, the assets in the DAPT will be excluded from the grantor's estate, even though the grantor is a permissible discretionary beneficiary of the trust. As authority for this conclusion they cite two PLR's (not precedent to anyone other than the taxpayer who applied for the ruling). In PLR 9332006, the IRS ruled that a transfer by a U.S. settlor to an offshore creditor protection trust was a completed gift (no testamentary power of appointment was retained) and would not be in the settlor's estate for federal estate tax purposes. More recently, however, they cite PLR 200944002, which deals specifically with a domestic asset protection trust. Unfortunately, the ruling of that PLR is inconsistent with their claim, as in it, while the IRS does rule (once again) that a transfer to a

trust constitutes a completed gift if the transferor's creditors are unable to reach the transferred assets, the IRS also specifically declines to rule on whether the transferred assets will be excluded from the transferor's estate for estate tax purposes.

To qualify as a DAPT, at least some of the trust assets must be deposited and administered in the DAPT state, either in a checking, brokerage, or similar account and at least one trustee must be a "qualified person". A qualified person is a resident of the DAPT state or a bank or trust company with a principal place of business in that state. (Surprise!)

One potential problem with the creditor protection of a domestic asset protection trust is the constitutional law and conflict of law questions. Many commentators have expressed concern over proponents' suggestions, if not assertions, that a creditor's judgment from another state will not be enforceable against a DAPT holding assets of the defendant settlor/ beneficiary, but this remains a serious question.[31] Proponents of domestic asset protection trusts cite, among other sources, Hanson v. Denckla, 357 U.S. 235 (1958), where the U.S. Supreme Court upheld the Delaware Supreme Court's refusal to recognize the Florida Supreme Court's judgment over a Delaware trust.

One point is very clear, however, and that is that until these issues are resolved by case law (likely by the U.S. Supreme Court), and the IRS rules on the estate tax issue, it is not only risky but it may not be necessary to go to any of the DAPT states to create Asset Protection Trusts. Instead, there are proven techniques that in certain circumstances allow a similar vehicle in virtually every state, as discussed in part VII below.

C. The Attraction (and Reporting) of Offshore Trusts

A number of offshore jurisdictions have adopted trust legislation specifically providing that the assets of a self-settled discretionary trust will not be reachable by creditors of the settlor/beneficiary in the absence of a fraudulent transfer.[32] The trust is typically structured to provide benefits, at the discretion of the trustee, for the settlor and the settlor's family. A protector is often appointed with powers overriding those of the trustee, including the power to

remove and replace trustees, giving the settlor some comfort that the trust may be adjusted to accommodate changing family circumstances. As a general rule, the protector of an offshore trust should not be a U.S. person.[33]

1. Fraudulent Transfers. In the case of a claimed fraudulent transfer, the burden of proof is on the creditor, who must prove <u>beyond a reasonable doubt</u> that the transfer was fraudulent (a much harsher standard than that employed in the U.S.).[34] Furthermore, the claim, or suit against the trust, must be made <u>in</u> the foreign jurisdiction (the Cook Islands, for example), as judgments rendered by the United States (or other "foreign" jurisdictions) are not recognized, and the action must be commenced rather quickly (in the Cook Islands within the first to occur of two years of the establishment of the trust or one year from accrual of the cause of action).[35]

Some jurisdictions, e.g., Gibraltar, Liechtenstein, and the Isle of Man, offer <u>immediate</u> protection (i.e. a <u>zero</u> open period of limitations) if the transfer to the trust did not render the transferor insolvent, and virtually all of the commonly used offshore jurisdictions offer immediate protection against creditors whose claim arises after the settlement of the trust. Finally, in <u>most</u> of the offshore jurisdictions, attorneys do not work on a contingent fee basis in such matters, so the creditor must finance the full cost of the litigation on a "pay as you go" basis, and some offshore jurisdictions require the creditor to post a cash bond before suit may commence.

2. Tax Issues. Virtually all asset protection trusts established by a US person especially, including offshore trusts,[36] are established as "grantor" trusts under the U.S. tax code.[37] A grantor trust is one which is treated as a pure conduit or pass-through for federal income tax purposes, so that no income tax consequences result from transfers to such trusts, and all trust income or losses are passed through to the grantor. In addition, the trusts, although irrevocable, usually contain a reserved special testamentary power of appointment held by the settlor (who is likely to be the grantor for income tax purposes,) so there is no completed gift for gift tax purposes.[38]

***3. Reporting Requirements*.** On the belief that interest on accounts held in many offshore trusts was not being reported, in 1995 Congress passed the Small Jobs Protection Act, which included strict reporting requirements for any U.S. person who establishes or receives distributions from foreign trusts.[39] A foreign trust is one where substantial decisions are made by a non-U.S. person (the "control test") or where no U.S. court is able to exercise primary jurisdiction over the trust administration (the "court test").[40] If either one of these conditions applies, the trust will be considered a foreign trust for U.S. tax purposes. These requirements do not result in any extra tax but are designed to report the existence of, transfers to, and assets in the foreign trust. Briefly, the four most important forms to be filed are IRS form 3520 (by the taxpayer) and form 3520A (by the offshore trustee), Treasury Form FinCEN 114 and form 8938.[41] Failure to file form 3520 when due can result in a penalty of thirty-five percent (35%) of the amount transferred to the trust. Failure to file the 3520A will result in a penalty of 5% of the amount in the trust. Both penalties apply on an annual basis. Of course, all income earned on the accounts held in the foreign trust must be reported, in this case, on the U.S. settlor's individual income tax return, regardless of who may receive distributions.[42]

VII. Asset Protection with Domestic Trusts in the Other Thirty Five States

A. Income-Only Trusts Offering Protection of Principal

If a settlor/beneficiary of an irrevocable trust reserves the right to receive only income and no principal, then the settlor's creditors could only reach the income. The principal would be protected[43] [absent a fraudulent transfer].

B. Using Powers of Appointment

***1. Some General Observations – The Power of Special Powers*.** A special - sometimes referred to as a "limited" or "non-general" - power of appointment is one that cannot be exercised in favor of the holder of the power, his creditors, his estate, or the creditors of his estate.[44] A typical special power, for instance, might provide that the holder of the

power can appoint the subject property to any one or more of his lineal descendants. But the power may be much broader than that and still be a special power. That is, the holder may have the power to appoint to anyone in the world, on such terms and conditions as he may dictate, except to or for the benefit of himself, his creditors, his estate, or the creditors of his estate. Also note that "anyone" in this sense may include an entity, such as a corporation, partnership, or LLC, so long as the terms of the power are not breached, and so long as any applicable rule against perpetuities is satisfied.

Despite the extent of this power, it is still considered a special power, and, absent a fraudulent transfer, the transferred property is unreachable by creditors of the holder, who may be a beneficiary of a trust which includes the power, even though the powerholder may be the settlor of the trust.[45] Furthermore, a court cannot compel a powerholder to exercise the special power.[46]

> NOTE: A very notable exception to the rule regarding retained special powers may be the DAPT. For instance, virtually all DAPT statutes provide that if the settlor reserves a special lifetime power of appointment exercisable without the consent of an adverse party, he will be deemed to have the power to revoke the trust and creditors may be able to reach trust assets (Wyoming is an exception).

The power can be exercisable during the holder's lifetime (by a deed), or at the holder's death (through his last will), or both. Note that, although the power can be irrevocably exercised only once, it can also be exercised on any terms and conditions conceived by the holder, even on a revocable basis. For instance, say that Maxwell establishes an irrevocable trust naming himself as income beneficiary (no principal distributions may be made to him) and granting his wife, Minwell, a lifetime special power of appointment over the principal. Concern over a lawsuit against Maxwell, Minwell exercises her power and appoints the entire trust principal to a new trust for the benefit of their children, but reserves the right to revoke the appointment and reappoint the property under the terms of the original grant of the power.

2. Taxes. Federal gift tax laws provide that a transfer of property where the transferor retains a special power of appointment is not a completed transfer.[47] A transfer with retained lifetime and testamentary special powers effectively allows the transferor to have legally given the property away, but to have "kept" the property for tax purposes, because he has retained virtual complete control over the disposition of the property. Therefore, even though the transferor has legally disposed of the property, because he has retained virtually unlimited dominion and control over the property, the transferred property will be treated in every respect as if it still belonged to the transferor (the holder of the retained power) for income, gift, and estate tax purposes. In addition to the clear confirmation of this concept in basic principles of taxation, it has been repeatedly confirmed by the courts in a respectable list of cases.[48] This opens the door to asset protection planning using powers of appointment without adverse tax consequences.

Interestingly, in most of these reported cases the taxpayer/transferor sought to shift the tax burden to the transferee while retaining certain powers or retaining enjoyment over the transferred property. In the asset protection context, however, we often seek to do just the opposite where income-producing property is concerned. The two reasons for seeking to retain the tax ownership are retention of actual benefits over the income and realization of the step-up in basis at death. That is, we seek an arrangement where we can have the best of all worlds: We want a completed transfer for asset protection purposes that starts the fraudulent transfer period running, but an incomplete transfer for income, gift, and estate tax purposes. Remember, a transfer by a donor with a retained special power, or one where the special power is granted to another constitutes a conveyance (for property law purposes) at the time the original transfer is made by the donor and not when the power is subsequently exercised by the holder. The exercise of the power is considered to be a completion of the terms of a disposition previously made by the donor at the time of the original transfer that contained the grant of the power.[49]

3. General Power of Appointment. As seen above, property subject to a special power of appointment is not reachable by the powerholder's creditors, regardless of whether the

power was created by the powerholder himself or by a third party. What about a general power?

It is well-settled law that if the holder of a general power of appointment is also the grantor of that power, the property subject to the power will be reachable by the grantor/powerholder's creditors.[50] However, if the general power was granted by another, then the rule is quite different. As a general rule, except in bankruptcy cases, and states that have adopted the Uniform Trust Code,[51] creditors of the holder of a general power of appointment cannot reach property subject to the power unless and until the power is exercised.[52] A number of states, however, provide by statute that such property will be reachable if other assets of the powerholder are insufficient to pay his debts (New York, California, Michigan, Minnesota, Oklahoma and Wisconsin), and still other states provide that such property is reachable by creditors of the powerholder in any event (Alaska, District of Columbia, North Dakota, South Dakota and Tennessee).[53]

4. General Powers Subject to Consent. If the terms of the grant of a power require that the exercise of the power have the consent of another (disinterested) party, then such consent will be required before the exercise of the power can be valid. The requirement of consent can be an effective way of giving someone a general power of appointment for both legal and tax purposes without exposing the property to the creditors of the powerholder while the power remains unexercised. As with a special power, a court may not force a third party to consent to the exercise of a power absent fraud.

5. Anti-Duress Provision. Another creditor protective measure for powers, especially where the power is granted within a trust, is to provide that if the trustee has reason to believe that the exercise of the power is not of the free will of the powerholder and that the powerholder is acting under duress (such as pursuant to a court order), then the trustee is required to disregard the attempted exercise. It must be noted, however, that this provision may be ineffective in the event it is being exercised by the powerholder's U.S. trustee in bankruptcy, as that trustee would "stand in the shoes" of the powerholder and would certainly not be acting under duress.

6. Going Further. Taking the creative use of powers a step further, one might consider: the power to grant powers of appointment; cascading powers of appointment; assignable powers of appointment; and concurrent or joint powers of appointment. (But don't expect to sleep at night. . . .)

C. The Power to Amend

1. Equal to a Power of Appointment. A power to amend a trust held by the grantor or by someone other than the grantor of the trust is also a power of appointment.[54] Therefore, a person who is not a beneficiary of the trust may be given a "limited" power of amendment generally with no adverse tax consequences and with no exposure to creditors. That is, as with a special power of appointment, the holder of a limited power of amendment cannot be forced to exercise it.[55]

The terms governing the amendment will dictate the requirements and extent to which the trust may be amended. For instance, the trust may state:

> "*This trust may be amended by the powerholder (the "powerholder"), by a writing signed and acknowledged by the powerholder, provided that any such amendment shall in no way operate to make the powerholder, directly or indirectly, a beneficiary of the trust. The foregoing power may be exercised by the powerholder in his individual capacity and no fiduciary duty shall be implied or imposed in its exercise.*"

NOTE: If the power to amend is given to a trustee as opposed to a beneficiary or some outside party or parties (as with a protector), a broad exoneration clause should be included exculpating the trustee from liability to any beneficiary.[56] An advantage of the limited power of amendment over the limited power of appointment is that the trust provisions may be amended to suit the circumstances without transferring the assets out of the trust, as would be the case if a power of appointment were exercised.

If the settlor prefers not to grant someone the power to amend the trust, still another possibility exists by giving the trustee other than the settlor the power to grant the power to amend.

NOTE: As with the power of appointment, in those jurisdictions which still recognize the rule against perpetuities, care must be taken to prohibit the exercise of the power in a manner which would cause the rule to be violated. (unless you intend to trigger the "Delaware Tax Trap").

2. Authority Supporting the Power to Amend. The use of such a power for asset protection purposes as proposed here may be somewhat innovative, as the authors have found no cases directly on point. However, since it is clear that the power to amend is the legal equivalent of the power of appointment (authority cited above), there should be no question that the extensive legal precedents supporting the power of appointment will apply as well to the power of amendment.

3. Tax Consequences. There can be numerous and complex tax consequences to the granting of a power to amend the trust, and a thorough discussion of these is beyond the scope of this presentation. Accordingly, no power to amend as contemplated in this presentation should be added without a thorough consideration of all attendant income, gift, and estate tax ramifications. Having this in mind, following are a few primary tax concerns worthy of note.

The granting of a power of amendment which is treated as a special power is usually more desirable than one constituting a general power. If the person holding the power to amend can amend in favor of himself, then the power will likely be treated as a general power of appointment under IRC section 2041(a)(2), and all of the property subject to the power to amend will be includable in the powerholder's estate. Further, under IRC section 678 (a)(1) all of the trust income will be taxed to the powerholder. Any amendment decreasing the powerholder's share will be deemed a taxable gift from the

powerholder, and the grantor (donor) will have made a completed gift when the section 678 power is granted, whether or not the power is exercised.

As stated earlier, to avoid a taxable gift by the donor (usually the settlor of the trust) when giving another a special power or the equivalent, the settlor would normally reserve for himself a special testamentary power of appointment to render the gift incomplete.[57] Of course, if the power given to another is exercised in a manner that removes the property beyond the settlor's control, the settlor will be deemed to have made a completed gift at the time of the exercise by the powerholder.

D. Protectors

A protector is (typically) an independent individual named in a trust who has certain overriding authority or power granted him under the terms of the trust, but who is not a trustee. The modern concept of the protector originated in Europe with family trusts and foundations and was conceived to give a person, trusted by the family, the authority to oversee the administration and distributions of the trust but without conferring any fiduciary duty or ongoing administrative responsibility on the protector. Modern professional opinion and a growing number of cases, however, unequivocally and consistently hold that the office of protector is almost always a fiduciary office, and the duty of the protector to act sensibly and in a manner consistent with the purpose of the position is not dispensable.[58]

The protector may be given any or all of a variety of powers, including an absolute veto power over trust distributions, the power to remove and appoint trustees, and the power to delete or add beneficiaries other than himself or his interested parties. As with the granting of a power to amend, very careful consideration must be given to any tax consequences that may result if the protector is an interested party or a potential beneficiary, which is seldom a good idea. Where offshore asset protection trusts are involved, the protector of such trusts is typically a non-U.S. person.

VIII. Other Entities Used in Asset Protection Plans

A. Family Limited Partnerships and Limited Liability Companies [59]

Asset protection under the typical family limited partnership is achieved through the fact that, barring violation of the fraudulent transfer rules, a judgment creditor of a partner (for non-partnership matters) cannot force a liquidation of the partnership nor of the partner's share, regardless of whether the partner is a general or limited partner. Rather, the primary remedy (in some jurisdictions, the sole remedy) available to a judgment creditor is to obtain a "charging order", under which the creditor becomes an assignee of the debtor partner's share.[60]

1. Charging Order Protection. A charging order is a specific court order, issued pursuant to statute, allowing a court to charge or lien the proceeds of the debtor/partner's partnership interest for payment of the amount due to the judgment creditor. A court may or may not issue a charging order and may issue it against all or any portion of the debtor/partner's interest. To the extent it is issued, the judgment creditor has only the rights of an assignee of the partnership interest.[61]

As an assignee, the creditor has the right to receive all distributions the debtor partners would receive, if any, but otherwise his rights are extremely limited. The creditor/assignee has no voice in the management of the partnership, cannot inspect the partnership books, and cannot force distributions or sue for breach of fiduciary duty.[62] Further, although the IRS has ruled that the creditor/assignee may be treated as a "partner" for income tax purposes, meaning that the creditor/assignee will be subject to tax on his share of the partnership's undistributed taxable ("phantom") income,[63] there is strong argument against this treatment where a court-ordered charging order is imposed.[64] In fact, the consensus among commentators is that the debtor continues to be subject to tax on his share of income, despite the charging order.

Some jurisdictions, such as Delaware, have provided that a charging order is the exclusive remedy for a creditor, thus attempting to close the door on the ability of a

creditor to foreclose on the charging order, as is permissible in Massachusetts, for example.

There are, however, serious limits to charging order protection. For instance, a single member LLC may be order liquidated on the bankruptcy of the sole member,[65] and both LLCs and partnerships may be subject to the "ipso facto" law of bankruptcy, overruling agreements that require buyout on a partner/member's bankruptcy.[66]

2. Partnership vs. LLC. One potential problem with the family limited partnership is that the general partner of the partnership would be exposed to personal liability for partnership activities and debts. Although this was not a real threat in the typical asset protection case (since it is liability outside the partnership that we are attempting to shelter), the concern was (and is) present nevertheless. As a result, or in the case where the partnership carried on some sort of a business of its own, to avoid personal exposure to liability advisors would recommend a corporation as the general partner. Although legally effective, this arrangement in turn posed certain tax concerns, and along with that went the administrative details and expenses involved in operating the corporation. What was really needed was a partnership where even the general partners were protected from personal liability - thus was born the limited liability company (LLC).

Reportedly fashioned after the Sociedada Limitada of Mexico and other South American countries, the LLC was first adopted in this country by Wyoming in 1977. Since that time virtually every state has adopted an LLC statute. The LLC is a hybrid between a corporation and a partnership, in that it offers creditor protection of the members (partners) as if they were shareholders, while at the same time offering partnership tax treatment. And although there was at one time a concern over this tax treatment, the advent of the IRS "Check the Box" rules effective January 1, 1997, should allay any concern over whether the LLC will be taxed as a partnership.[67] The default rule is that a domestic LLC with more than one member is taxed as a partnership unless elected otherwise. A single member domestic LLC is disregarded for tax purposes.

Most domestic LLC statutes contain specific provisions closely fashioned after the limited partnership statutes providing for creditor protection in the form of a charging order. This made the choice of an LLC over a partnership somewhat clearer, but like the partnership, it generally required two or more members. Accordingly, until only recently if an individual wanted to shelter assets or shelter himself from business exposure, he was either forced to "create" a second partner or member, or to simply form a one-shareholder corporation. But now all states allow an LLC to be formed by a single member, possibly making the LLC even more attractive than a partnership and, in many cases, also more attractive than a sole-shareholder corporation, but with the same asset protection possibilities (to the extent domestic asset protection is possible), subject, however, to the inherent risk of running a "one-man show." That is to say, single member LLCs are vulnerable to a court's power to ignore the entity under certain circumstances, as noted below.

As a result of the single-member LLC movement, LLCs seemed to become the vehicle to use. A few advisors, however (these authors included), were leery of the arrangement, since it seemed to be walking a bit too close to the line. Sure enough, the fears of many of us were realized with the case of In re Albright.[68] In that case, the member of a single member LLC filed for bankruptcy. The LLC itself was not a debtor. The bankruptcy trustee asked the court to allow a dissolution of the single member LLC, since the trustee should be able to "stand in the shoes" of Albright, the debtor, and exercise the debtor's right, as sole member, to liquidate the LLC, thus allowing the trustee to access the assets of the LLC. The debtor argued that state law (Colorado) provided that the only remedy available to a creditor was the charging order, and so that should be all the trustee could get.

The court reviewed the law, the reason for the charging order, and the role (and standing) of a trustee in bankruptcy. The court observed that if there were another member, even to the extent of a "small" (e.g., 5 percent or more) ownership interest, the charging order would be respected. In the case of a sole member, however, there were no other

"partnership" interests to protect through the charging order, thus the trustee's request to liquidate and reach the LLC assets was granted.

This case illustrates a fact of which most of us are aware: the power of the judiciary to pierce or at least freeze virtually any domestic structure or arrangement within the Court's legal reach, depending upon the circumstances. Therefore, even though the LLC seems to offer attractive possibilities onshore, we may be even better off if we were to use an offshore LLC.

3. Foreign LLCs in General. For the most part, foreign LLC legislation is, in concept at least, fashioned primarily after the typical domestic LLC statute, providing, in effect, a partnership where no partner is exposed to personal liability. A cautionary note, however: Many of the foreign LLC statutes are too casually drafted and there are some serious oversights which may be troublesome or even fatal to the asset protection issue. For instance, the Cayman Islands LLC statute does not specifically prohibit a creditor from reaching a member's share. On the other hand, the Nevis LLC statute is one of the few which has specific charging order legislation, providing that a judgment creditor can only become an assignee.[69] Furthermore, privacy may be sacrificed in those jurisdictions which require the identity of the LLC members to be recorded with the articles of organization as a matter of public record.[70]

4. Why Use a Foreign LLC? As noted above, if we are concerned about leaving assets onshore, added protection can clearly be achieved by moving them beyond the reach of any domestic court. If the assets (other than U.S. real estate) are owned by a foreign LLC, they will not be subject to U.S. court jurisdiction. However, if the U.S. defendant is a member of the LLC, what then? Certainly if the court has jurisdiction over that individual, it can order the individual to take action with regard to any interests held by that individual, whether tangible or intangible, including an interest in a foreign LLC. The question then becomes what action could the individual take? If the operating agreement provides that the LLC share is not assignable or transferable it would offer no benefit to the court or the creditor since a court could not order a transfer which would be

in violation of the LLC operating agreement. But could the U.S. court issue a charging order that would bind the foreign LLC? Not likely, since the foreign LLC is not under the jurisdiction of the U.S. court, and therefore it need not recognize the U.S. court's order.

5. Reporting Requirements. The Small Business Job Protection Act of 1996 (P.L. 105-34) and the Taxpayer Relief Act of 1997 (P.L. 104-188) brought about a number of dramatic changes in the reporting requirements for foreign partnerships. (A foreign LLC would generally be treated as a foreign partnership). For partnership (and LLC) reporting, see generally IRC sections 6031 (e), 6038, 6038B, and 6046A. The reporting requirements for foreign partnerships and LLC's are only slightly less onerous than those for foreign trusts. NOTE that in the usual asset protection planning situation if a foreign LLC or partnership is utilized, the taxpayer must file IRS form 8832 to elect to disregard the entity for U.S. income tax purposes. Further, IRS form 8858 must also be filed for U.S. persons who own a foreign disregarded entity. Although form 8832 is only filed at the outset, form 8858 must be filed annually.[71]

NOTE: All information provided in this outline as to the filing of tax forms is for discussion purposes only. NO action should be taken or forms filed without specific advice from a tax advisor.

B. Non-Tax Planning Comparison of Foreign LLC with a Domestic Limited Partnership/Foreign Trust

The LLC, like a partnership or a corporation, is owned by its members. The articles of organization and the operating agreement of the LLC govern the activities of the LLC, and except for prohibitions on transfer of the member's share, they do not normally contain any dispositive provisions for the underlying shares. A trust on the other hand, typically contains extensive dispositive provisions for all assets held in the trust. Therefore, although the LLC may offer asset protection advantages, by itself it offers little or no opportunity for placing extended

and detailed control over the disposition of the membership shares (and therefore, the assets held by the LLC) for the family into the future.

In the typical "traditional" asset protection plan, a U.S. person or family will place their liquid assets into a domestic family limited partnership, where the individual (and/or his spouse) is the general partner with, say, a 1 or 2 percent interest, and an irrevocable family (grantor) trust with a foreign co-trustee is a 98 or 99 percent limited partner, poised for the possibility of a lawsuit against the individual or spouse. When the suit hits the fan, the partnership is immediately dissolved, the liquid assets distributed to the partners in proportion to their percentage interests, and, in the case of the irrevocable trust, the foreign trustee (who becomes the sole trustee as the domestic trustee resigns) takes the money "offshore", out of harm's way. One of the principal attractions for clients using this scenario is that it allows them to keep the assets local and under their control until a problem actually arises.

There is no reason (tax reporting issues aside) why the foreign LLC could not function in much the same way (if it is decided that a foreign LLC is advisable in the first place) and produce an even better result. The foreign LLC could act in the place of the domestic family limited partnership, except that instead of the individual and spouse being the general partners, they could simply be members of the foreign LLC, or even better, they could simply be designated local managers, with no direct membership interest. As with the partnership plan, the members could be one or more irrevocable family grantor trusts holding a 98 or 99 percent interest in the LLC, or in some cases (where only one member is required), the offshore trust could own 100 percent of the foreign LLC.

The important difference in this scenario (with the foreign LLC) would be that unlike a U.S. partnership, when the suit hits the fan, the LLC need not be dissolved. The local managers could simply resign or be removed by the offshore controlling member, and the assets would be immediately repatriated to the foreign jurisdiction. This could prove quite advantageous from a tax standpoint as well, in the event that the LLC holds appreciated investments and cash exceeding the member's basis. That is, the investments (and cash) would not have to be

liquidated and/or distributed to the members as they would with a domestic limited partnership where the distributions could be subject to a tax.

Accordingly, it seems the foreign LLC with local managers may appear to offer the best of all possible worlds but, of course, there could be a glitch. If the foreign LLC is deemed to be "doing business" in the state, it would have to qualify under the particular state's law as a foreign LLC. When this happens, it submits itself to the jurisdiction of the state court for legal matters – a situation potentially harmful or even fatal to the asset protection objective. If on the other hand, the mere management of liquid LLC assets (e.g., cash and securities) in a particular state does not constitute doing business in the state (the much more likely conclusion),[72] then the LLC will not be subject to local jurisdiction, and the arrangement could prove to be a very effective and perhaps even more desirable arrangement than that involving use of a domestic family limited partnership.

Use of a funded foreign LLC combined with an irrevocable foreign grantor trust can offer significantly better tax and asset protection results than the more popular (up to now) domestic limited partnership/foreign trust combination.

C. Life Insurance Policies and Annuity Contracts

The cash value of life insurance policies, the death proceeds of such policies, the proceeds of annuity contracts, and amounts held under annuity contracts can in whole or in part be exempt from the creditors of the insured or the owner or the beneficiaries, but the rules vary from state to state and there is little consistency among the states.[73]

> ***1. Life Insurance.*** Generally, the proceeds of a life insurance policy payable to a named beneficiary (as supposed to the estate of the deceased insured) are unreachable by the deceased/insured's creditors. Advisors, therefore, should be careful that the deceased/insured's estate is <u>not</u> a contingent or default beneficiary.

The cash surrender value of life insurance policies is protected in full in some states (e.g. Massachusetts, Florida, Michigan, Oklahoma, Texas), while protection is quite limited in others (e.g. Alaska, $10,000, Connecticut, $4,000, Wisconsin, $ 4,000). In Tennessee, the proceeds of a policy paid to a spouse, children, or dependent relatives are protected.[74] In those states which protect the full cash value, it would appear that the purchase of a large single premium policy could instantly protect large sums of money, but, it is not absolutely clear, and it is very likely that such a tactic could be attacked as a fraudulent transfer.

2. Annuities. As far as state protection goes, annuities appear to offer greater protection than life insurance policies, but one must remember that their usefulness for estate and tax planning purposes is considerably more limited. As with life insurance, protection for amounts held in annuities varies greatly from state to state, ranging from no protection at all (e.g., Massachusetts), to complete protection (e.g., Florida). Also, as with the purchase of large cash value life insurance, it is not at all certain that the purchase of an annuity in the face of a creditor's attack would not be vulnerable to a creditor's reach as a fraudulent transfer.

3. Is There an Alternative to U.S. Products? As seen in the first part of this discussion, the cash value of life insurance policies, the death proceeds of such policies, the proceeds of annuity contracts, and amounts held under annuity contracts can, in whole or in part, be exempt from the creditors of the insured, or the policy owner, or the beneficiaries, or all of the above, but the rules vary dramatically from state to state, and there is no consistency among the states. Furthermore, even where protection appears to be afforded, it must be kept in mind that the contracts and the companies issuing the contracts are here in the United States and always subject to the jurisdiction of a U.S. judge who may feel inclined to carve out an exception to the law in a particular case. But what about the case where no state's laws are involved? Where the annuity or insurance contract is governed by the laws of a foreign jurisdiction? Will there be added protection or just added complication?

4. Offshore Insurance and Annuities. In various parts of the world, the laws of a number of jurisdictions provide that the cash value and proceeds of life insurance and annuity contracts issued in such jurisdictions are protected from the reach of the owner's and the beneficiary's creditors. Some of the European jurisdictions, e.g., France and Austria, provide protection only where the spouse or dependent child is named beneficiary. Liechtenstein offers particularly strong protection of insurance and annuity contracts issued by a Liechtenstein issuer, as noted below. Certain Caribbean jurisdictions are also noted for their protective laws, e.g., the Bahamas, but each jurisdiction's laws must be considered in light of a particular client's needs, circumstances, and objectives. Following is a brief overview of the relevant features of selected jurisdictions commonly considered by advisors.[75]

a. **Bermuda.** This jurisdiction is unique in that it allows qualified insurance companies qualified to business in Bermuda to propose the terms of the contract(s) they plan to issue (including the contract's asset protection features) and the Bermuda authority votes to approve (or not) the terms of the proposal. As a result, a number of Bermuda insurance companies offer policies that provide protection from creditors of the owner. There are a number of concerns, however, in counting on such protection. For one, creditors existing at the time of the purchase may be able to reach the policy value; for another, bankruptcy proceedings within six months of the acquisition of the policy will overcome the protection; next, there is the possibility of Bermuda's recognition of a US judgment; and lastly the open period of limitations for a fraudulent transfer attack is six years, as opposed to one, two, or none in other jurisdictions. In addition, while protection extends to owners it does not seem to extend to the beneficiaries, unless they are also the owners. On the death of the owner, however, the surviving beneficiary would receive the proceeds free of creditors, subject to the foregoing exceptions (e.g., a creditor's attack before the owner's death).[76]

b. **Bahamas.** The Bahamas has made a special effort to ensure protection of life insurance and annuity contracts issued by its insurance companies. First, the Bahamas does not recognize U.S. judgments. Second, although its normal limitations period for fraudulent transfers is two years, it reportedly (though does not formally) takes the position that the acquisition of an insurance or annuity contract is per se a transfer for valid consideration and therefore may be subject to immediate protection by Bahamian law. There are no special beneficiary requirements.

c. **Isle of Man.** The Isle of Man is a highly respected insurance jurisdiction with strong protective laws governing the funds held by Manx Insurance Companies. And although the Isle of Man it has an indefinite open period of limitations on fraudulent transfers, it will only apply to claims that existed prior to or at the time of the policy acquisition. Accordingly, for any creditors whose claim arises after the acquisition of the contract, the contract proceeds and its cash value would be immediately protected.

d. **Liechtenstein.** This jurisdiction offers some of the strongest and well established protective laws of all the jurisdictions, fashioned in almost all respects after the corresponding Swiss law. By specific statutes, life insurance and annuity contracts are strictly protected against debt collection proceedings brought against the policy owner (whether the insured or a beneficiary) and will not be considered a part of the owner's bankruptcy estate, even when a foreign judgment or court order expressly directs the seizure of such policy. For instance, if a U.S. bankruptcy court found that a Liechtenstein annuity contract owned by the debtor was a part of the debtor's estate (for bankruptcy purposes) and issued a finding to that effect, Liechtenstein law, with very limited exception, would nevertheless prohibit a Liechtenstein court from issuing an order for the transfer or liquidation of the contract in recognition of the foreign (US) bankruptcy court order. Furthermore, creditors seeking to attack a Liechtenstein contract must sue in a Liechtenstein court and must post a local cash bond in the amount of 10 percent of the amount they seek in the lawsuit. Liechtenstein also recognizes an anti-duress concept

where a Liechtenstein issuer of an annuity or insurance contract is only authorized to comply with a contract owner's instructions if the issuer believes such instructions reflect the owner's true intent and free will. If the issuer has reason to believe that the instructions are being given pursuant to court order (i.e., under duress) and do not reflect the unfettered wish of the owner, then the issuer will not honor such instructions. Creditors arising after the contract is acquired will have no right to attack the acquisition. Creditors existing at the time of the acquisition may only attack the contract if they can show that the debtor was insolvent (or became so) at the time of the acquisition and must do so within five years of the acquisition. Outright claims against a transfer that did not result in insolvency of the debtor must be made within one year of the acquisition.

e. **Canada.** Much to the surprise of many, Canada's insurance laws offer protection to the owners and beneficiaries of a contract, provided the named beneficiary is a spouse, child, grandchild, or parent of the insured person.[77] If any other beneficiary is named, the protection is lost, except that on the insured's death, the proceeds are protected regardless of the identity of the beneficiary (provided, of course, it is not the insured's estate). If the acquisition of the policy is determined to be a fraudulent transfer, however, protection may be lost, and unfortunately, Canada (Ontario) law has no limitations period on fraudulent transfers.[78]

f. **Switzerland.** Until recently, Switzerland was, in the authors' opinion, the jurisdiction of choice for offshore life insurance and annuities.[79] Their protective laws, reputation, and the strength of their insurance companies is without equal. Unfortunately, beginning sometime in 2008, Swiss insurance companies have discouraged, and even refused outright, the purchase of contracts by US persons, moving virtually all of that business to newly formed companies, branches, and subsidiaries in Liechtenstein.

5. <u>Relevant U.S. Tax Issues for Foreign Insurance Contracts</u>. If the offshore insurance or annuity contract is tax compliant under U.S. tax law,[80] the inside build-up of

the contract is generally deferred from U.S. income taxation until withdrawn, at which time it is taxed under the provisions of Internal Revenue Code section 72, including possible penalties for "early" withdrawal (prior to age 59 ½ or permanent disability).[81] Note that where a foreign annuity is involved, this deferral rule will only apply to foreign annuities that are variable annuity contracts, meaning that the funds held under the contract are invested in various types of investment vehicles that may appreciate or depreciate with the applicable investment markets. Foreign fixed (not variable) annuities do not enjoy tax deferral.

In order to qualify for the U.S. tax deferral, the owner of the foreign variable annuity or insurance contract must not be able to direct or control the investments held under the contract, and such investments must be adequately diversified.[82] Selection from categories of investments (such as selection among a group of mutual funds not available to the general public) will not violate the rule against "self-directed" investments. As to diversification, specific requirements that are set forth in the tax regulations indicate what would satisfy the adequate diversification rule, and there is a special "look through" rule when qualifying mutual funds are purchased in a variable annuity.[83]

Life insurance contracts (both domestic and foreign) are subject to special rules for withdrawals. Briefly, if the policy is fully funded within 7 years (maybe a year or two less in some cases), then any withdrawals from the policy will be deemed to carry out any excess of the owner's basis in the policy and will be subject to income tax. Such a policy would be considered a "Modified Endowment Contract" (MEC).[84] Typically, efforts are made to avoid having a MEC, in order to allow "tax-free" loans to be made to the owner. Whether a MEC or not, however, if there are no withdrawals, there will be no tax on the inside build-up of the cash value either during the owner's lifetime or at the insured's death.

For U.S. estate tax purposes, the value of the foreign contract will be included in the owner's estate unless she has made a completed gift of the contract during her life and retained no benefit or control over the contract or the designation of beneficiaries.[85] In

the typical case, where the contract is purchased for asset protection purposes, such control or benefit will, in fact, be retained, so usually there will be no estate tax savings. Note that if the beneficiary designation is irrevocable, say to an irrevocable trust, and the owner has not retained any control over the trust there could possibly be a completed gift depending upon the rights retained by the owner in the contract during her lifetime.
As in the case with U.S. annuities, the tax deferred build-up received after the death of the owner will be subject to U.S. income taxes as income in respect of a decedent.[86] And like U.S. annuities, any withdrawal before age 59 ½ or disability from a foreign annuity is subject to the last in-first out rule, as well as a 10% penalty.[87]

There is a one-time excise tax of one percent (of the premium) that a U.S. purchaser of a foreign insurance or annuity contract must pay.[88] On acquisition of the contract, IRS form 720 is filed to report and pay the tax.

It is also important to note that if the cash value of the contract, together with any other offshore financial accounts held by or controlled by the owner, exceeds $10,000 at any time during the year, the owner must file Treasury Form FinCEN 114 by June 30th of the following year.[89] (That form must be filed electronically.) Substantial penalties may result for failure to file this form.

6. U.S. Courts' Attitude. Perhaps there is one more significant benefit to foreign insurance and annuity contracts worth mentioning. In the recent past, U.S. courts have demonstrated a greater and greater cynicism, if not a prejudice, against debtors who place their assets beyond their own control in a foreign asset protection trust. It may well be that the purchase of an offshore life insurance or annuity contract, which are not nearly as "foreign" to our courts as offshore trusts, may be regarded as more acceptable by them, but this does not necessarily mean that the IRS will be equally accepting.

IX. Conclusion

As noted in the introductory comments of these materials, the sub-specialty of asset protection requires a sound working knowledge of many different areas of expertise. The foregoing discussion is in no way intended as a thorough review of all of the related areas, for such would be a Herculean task, filling volumes. Rather, the intention is to provide the practitioner with a quick resource covering the basic issues as well as the more commonly used concepts so as to enable him or her to knowledgeably advise a client.

Authors

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[1] In Tennessee the UFTA is codified Tenn. Code. Ann. § 66-3-301 et seq.

[2] The MA UFTA sets out a non-exclusive list of eleven of badges of fraud. MA UFTA §5(b).

[3] 11 U.S.C.A. §548, 28 USC §3304.

[4] Note that this is a dangerously brief overview of fraudulent transfer issues. For further reading, advisors are referred to the Acts themselves, and Chapter Three "Anatomy of a Fraudulent Transfer," by Jay D. Adkisson and Christopher Riser in *Asset Protection Strategies: Wealth Preservation Planning with Domestic and Offshore Entities Vol. II.* (Alexander A. Bove Jr. Ed. ABA Publishing 2005).

[5] Term Code Ann, § 66-3-310.

[6] MA UTFA §5(a)(1).

[7] MA UTFA §5(a)(2) and §6(a)

[8] MA UFTA §6(b).

[9] See, e.g., Tenn. Code Ann § 35 – 16-102 (10).

[10] See, e.g., Fla. Stat.ch. 222 § 30.

[11] *Fed. Refinance Co., Inc. v. Klock*, 352 F.3d 16 (1st Cir. 2003).

[12] *Morganroth & Morganroth v. Norris*, McLaughlin & Marcus, P.C., 331 F.3d 406 (3d Cir.2003).

[13] Tenn. Code Ann. § 26.2.301.

[14] *In re McNabb*, 326 B.R. 785 (Bankr. D. Ariz. 2005).

[15] *In re Kaplan* 331 B.R. 483 (Bankr. S.D. FL 2005).

[16] Clark v. Rameker, 134 S. Ct. 2242, 2244 (2014).

[17] *In re Portnoy*, 201 B.R. 685 (S.D.N.Y. 1996).

[18] *See In re Stephan Jay Lawrence*, 227 B.R. 907 (S.D. Fla. 1998); and *FTC v. Affordable Media,* LLC, 179 F.3d 1228 (9th Cir. 1999).

[19] In the case of *In Re Porco*, 447 B.R. 590 (S.D. IL 2011), the first case to date specifically interpreting the "similar device" language, the Bankruptcy Court held that term to mean and include only "an express trust." Accordingly, although GRITS, GRATS, etc. would be included, it appears, at least from this decision, LLC's, partnerships and corporations may not.

[20] M.G.L.ch.209 §1.

[21] Tenn. Code Ann. § 35-15-510.

[22] Nev. Rev. Stat. 78.746.

[23] "Using Spousal Agreements for Asset Protection* – A New Tool for the Advisor" (Alexander A. Bove, Jr. and Melissa Langa).

[24] George Bogert, *Trusts and Trustees* §221, at 405-406 (1992).

[25] *Outwin v. Comm'r of Internal Revenue,* 76 T.C. 153 (1981), for an excellent review of creditors' rights to self-settled trusts.

[26] *U.S. v. Rye*, 550 F.2d 682 (1st Cir. 1977). *But see also*, *First Northwest Trust Co. of S. Dakota v. Internal Revenue Service,* 622 F.2d 387 (8th Cir. 1980) holding just the opposite.

[27] *In re Fitzsimmons*, 896 F.2d 373 (9th Cir. 1990).

[28] Austin Scott & William Fratcher, *The Law of Trusts* §157.1 (4th ed. Little Brown 1987), and *e.g.*, *Gilbert v. Gilbert*, 447 So.2d 299 (Fla. Dist. Ct. App. 1984), *In re Chusid's Estate*, 301 N.Y.S.2d 766 (1969), Pfannenstiehl v. Pfannenstiehl, Mass. App. (2015) Slip No. 13 – P – 906.

[29] *See e.g*., Blattmachr, Zaritsky and Thwaites, *New Alaska Trust Act Provides Many Estate Planning Opportunities*, Estate Planning (October 1997).

[30] Alaska Stat. §34.40-110 (1997).

[31] See Leslie Giordani and Duncan Osborne, *Will Alaska Trusts Work?* Journal of Asset Protection, 7 (Sept/Oct 1997), raising both public policy and constitutional law questions on the issue.

[32] *See e.g*., Cook Islands International Trusts Act of 1984, as amended.

[33] *See* Alexander A. Bove Jr., *Trust Protectors - A Practice Manual With Forms*, Juris Publishing 2014 www.jurispub.com.

[34] *Id*. at §13 (B) (1).

[35] *Id*. at §13 (B) (3).

[36] Internal Revenue Code ("IRC") §679.

[37] IRC §§671-679.

[38] Treas. Reg. §35.2511-2 (c).

[39] IRC §6048; IRS Notice 97-37. Briefly, the primary forms required for foreign trusts include form 3520 and 3520A, with a penalty of 35% of the amount transferred for failure to file.

[40] IRC §§7701(a)(30)(E) and 7701(a)(31)(B).

[41] See IRS Notice 97-34, and IRS report of foreign bank and financial accounts, irs.gov.

[42] IRC §679.

[43] *Restatement Second Trusts 2d*, §156 (1987), and Scott, *Supra*, note 10, §156.

[44] *Restatement Second Property 2d*, §11.4. (1986).

[45] *Restatement Second Property 2d*, §13.1. (1986).

[46] *In Re Hicks,* 22 Bankr. 243 (N.D. Ga. 1982).

[47] Treas. Reg. §25.2511-2(c).

[48] *See e.g*. for income tax purposes, IRC §674, and *Corliss v. Bowers*, 50 S. Ct. 336 (1930), *Helvering v. Clifford*, 309 U.S. 331 (1940); for gift tax purposes, see Treas. Reg. §25.2511-2(c), and for estate tax purposes, IRC §§2036 and 2038.

[49] *Restatement Second Property 2d*, §11.1 Comment f (1986).

[50] *Restatement Second Property*, §13.3.

[51] Uniform Trust Code ("UTC"), §808.

[52] *Restatement Second Property*, at §13.2.

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[53] *Restatement Second Property 2d*, §13.2, statutory notes 1-3 (1986).

[54] *Restatement Second Property 2d*, §11.1, Comment C (1986).

[55] *In Re Hicks,* 22 Bankr. 243 (N.D. Ga. 1982).

[56] *See* McBryde and Keydel, *Building Flexibility in Estate Planning Documents,* Trusts and Estates (January 1996).

[57] Treas. Reg. §25.2511-2(c).

[58] *Von Knierem v. Bermuda Trust,* 1 BOCM 116 (Bermuda High Court, 1994), and *Steel v. Paz, Ltd.*, Manx Court of Appeal (October 10, 1995). See Alexander A. Bove, Jr., *Trust Protectors – A Practice Manual With Forms*, Juris Pub. 2014, ch. III.

[59] There are also International Business Companies, including hybrid and guarantee companies, but these are not as commonly used, involve complicated and often adverse tax consequences, and are outside the scope of this article.

[60] *See* Revised Uniform Limited Partnership Act, §§702 and 703, and *Evans v. Galardi,* 546 P. 2d 313 (Cal. 1976). A few decisions have suggested that in extreme cases, where the charging order is clearly a fruitless remedy or if the particular circumstances forced it, a sale of the partnership interest may be ordered. See e.g. *Hellman v. Anderson*, 233 Cal. App.3[d] 840, 852 (Cal. Ct. App. 1991), *Crocker National Bank v. Perroton*, 208 Cal. App.3d 1, 8-9 (Cal. Ct. App. 1989), and *Madison Hills Limited Partnership v. Madison Hills, Inc.*, 35 Conn. App. 81 (Conn. App. Ct. 1994).

[61] *Id*.

[62] *Griffin v. Box,* 910 F.2d 255, 261 n.6 (5th Cir. 1990).

[63] Rev. Rul. 77-137, 1977-1 CB 178.

[64] *See* Christopher Riser, *Tax Consequences of Charging Orders: Is the "K.O. By the K-1" K.O.'d By the Code?* Asset Protection Journal, 14 (Vol. 1 No. 4 Winter 2000).

[65] Albright.

[66] Elman.

[67] IRS Notice 95-14, 1995-14 IRB 7, Treas. Reg. §301.7701-3, and IRS form 8832 and instructions.

[68] *In re Ashley Albright*, 291 Bankr. 538 (D Colo. 2003).

[69] Nevis Limited Liability Company (Amended) Ordinance (2015), §43 (1) and (3) and § 43A.

[70] *See e.g*., Isle of Man Limited Liability Companies Act 1996, §7(1)(c).

[71] IRS form 8858: Information Return of U.S. Persons with Respect to Foreign Disregarded Entities; 2004-04 IRB 357 (December 29, 2003).

[72] IRC §864 (b) (2), and *Kaffenberg v. Kremer*, 63 F. Supp 924 (Dist. Ct. E.D. Pa. 1945).

[73] For an excellent review of the pertinent laws of all the states relating to insurance and annuities, See Chapter 10: "Creditor Protection for Life Insurance and Annuities" by Gideon Rothschild & Daniel S. Rubin in *Asset Protection Strategies: Planning with Domestic and Offshore Entities Vol I.* (Alexander A. Bove, Jr., Ed. ABA Publishing 2002) .

[74] Tenn. Code Ann §§ 26-2-110, 56-7-203.

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[77] Insurance Act (Ontario) R.S.O. 1990 c.1.8, §196 (2).

[78] The authors thank Martin Rochwerg, Esq. of Miller Thomson, Toronto, Canada for his expert assistance with this section.

[79] See Alexander A. Bove Jr., *The Swiss Annuity (*Trusts & Estates (March, 2007)).

[80] IRC §7701.

[81] IRC §72q.

[82] IRC §817.

[83] IRC §817(h)(4).

[84] IRC §7702A, §72(e)(10).

[85] IRC §2036, §2038, §2039.

[86] IRC §691.

[87] IRC §72(e)(5) and §72(g).

[88] IRC §4371.

[89] See Alexander A. Bove Jr. & Melissa Langa, *The Foreign Bank Account Bomb and How to Diffuse It*. Estate Planning (July 2008).