

Points of Law

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THANKS TO READERS

Your responses to my last newsletter were appreciated. This issue discusses a subject of interest to high-income/high-risk clients, Domestic Asset Protection Trusts. The discussion's talking points may prove useful to you. Please feel free to call me for more information.

ASSET PROTECTION IN THE USA?

Clients who invested in the offshore accounts, trusts and IBOs that have been promoted heavily for the last decade have good reason to be concerned. Belize, the Cook Islands, and other nations are being pressured for names, amounts and dates in the widening war on terrorism. They are not likely to distinguish between the accounts of regular folks and those of terrorists. Fear that IRS auditors will not be far behind the CIA investigators has led to new interest in Domestic Asset Protection Trusts such as are allowed by the states of Alaska, Delaware, Nevada, and Rhode Island.

Domestic Asset Protection Trusts have a short history. The first of them resulted from Missouri laws enacted in 1986. The current asset protection trusts drawing interest were created by Delaware and Alaska in 1997 and Nevada and Rhode Island in 1999. They provide a short period for creditors to enforce claims that existed at the date the trust is funded. That short period is followed by statutory protection against all claims that arise after the assets are placed in trust or that fall outside the limitation period.

Because the trusts are so new, no one yet knows how well they will serve. The consensus is that they will work as intended. That consensus seems to be based on the lack of a substantial number of cases challenging such trusts and the belief that although courts generally disfavor laws

that limit their reach, they are bound by the enabling legislation within their own states and by the full faith and credit clause with respect to the laws of sister states. The most critical requirement is that the trust jurisdiction provides the same rules for the enforcement of its judgments as it imposes on judgments of the courts of other states.

Domestic trusts will not provide the tax savings that some clients achieved with foreign trusts, but most of those tax savings were the result of violations of US law that are now too likely to be prosecuted.

Domestic trusts will not provide the same cushion of remoteness that made litigation against foreign trusts unattractive. However, US courts are unlikely to disregard properly formed and administered trusts as they have disregarded some foreign trusts. See *FTC v Affordable Media* (179 F.3d 1228, Ninth Circuit) where the Court simply refused to believe that the Anderson family had sent millions of dollars beyond their control and decided that it could order them to reside in jail until they had brought the money back.

Strict compliance with the legislation that allows each trust is necessary. Complicated rules affect retained rights of trustors. The trustee and the trust assets need to be kept within the jurisdiction whose law is relied on to create the trust. The Trustor should not be the Trustee. Side deals or practices contrary to the terms of the trust document may be used by the IRS and creditors to set the trust aside.

The trusts, properly integrated with other concepts, can be useful for estate planning purposes. Exemption equivalents or any amount of funds may be placed in such trusts beyond the reach of creditors.

Domestic Asset Protection Trusts will not be for everyone, but for those in high risk and high income professions, who have a serious need to protect their assets from liability, they may be the only remaining rational choice.