

The New Frontier in Asset Protection

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TO protect wealth from the claims of creditors, litigious spouses, and the rulings of courts, Americans in recent years have moved billions of dollars in assets offshore. Some 17 jurisdictions, from Belize in Central America to the Channel Islands off the Normandy coast to the tiny island of Vanuatu in the South Pacific, have passed laws making it difficult for creditors to seize assets held in trusts set up on their territory. Proponents of offshore asset-protection trusts argue that they have legitimate uses and that many business owners and high net-worth individuals benefit from them. Doubters, however, argue that the trusts carry serious political risks and are used largely by those who, for one reason or another, seek to evade the U.S. legal system.

Now business owners who don't want to expose themselves to the risks of going offshore have an alternative. A recent law in Alaska permits you to set up a trust in which you remain a possible beneficiary while keeping the trust assets beyond the reach of creditors and out of your estate. Only one caution: Your life should be in order when you create an Alaskan trust, because if it's set up for the specific purpose of avoiding an imminent threat to your assets, the act will be considered a "fraudulent conveyance."

Under legislation passed in April 1997, Alaska became the first state to prevent creditors from seizing assets in a trust from which the grantor may benefit. The statute was written by a New York attorney, Jonathan G. Blattmachr, who says the new trusts pose a challenge to the whole offshore asset-protection-trust industry.

Individuals and businesses, he argues, can now seek the same protection within the safest and most stable legal system on earth—that of the United States—by setting up an Alaskan trust.

Under a well-developed body of law, assets transferred to a lifetime trust will not be considered part of your estate when you die as long as you retain no right to benefit from or to control those assets. If the trust is legally subject to the claims of creditors, however, the assets will be included in your estate.

In most and perhaps all states, you can name yourself as one of the beneficiaries of a trust along with, say, your spouse, your children, and grandchildren. This doesn't mean you're automatically entitled to receive income from the trust or to get back the trust assets upon request. It means the trustee is authorized to make payouts to you, if, in his discretion, your request is reasonable. Since corporate trustees tend to do what the beneficiaries want, they are likely to make such payouts—for example, if you suddenly fall on hard times and need money.

Assets in such trusts are still allowed to accumulate estate-tax free. But in every state save Alaska (and possibly Delaware, which is weighing a similar statute), the assets would be liable to the claims of creditors because you are a possible beneficiary. Therefore, the trust contents will be subject to estate tax when you die.

As indicated, an Alaska trust will not protect your assets from creditors if it can be demonstrated that it was set up in the first place to avoid a court judgment or some other immediate threat such as the claims of a divorcing

spouse. Blattmachr, who is with Milbank, Tweed, Hadley & McCloy, the largest estate planning firm in New York, says clients who come to him seeking offshore asset protection usually have just such evasions in mind. They're breaking up with a spouse and want to put their assets beyond the spouse's reach; or they're on the brink of declaring bankruptcy and want to minimize what their creditors can hope to grab; or there is a court judgment pending against them for a car accident in which several people were seriously injured.

Many offshore jurisdictions that do a big business in trusts do not have rules against fraudulent transfers. Others have rules with convenient exemptions, according to Blattmachr. For example, they may specifically exclude spouses from seizing the assets. Some favorite offshore jurisdictions require people trying to seize assets to prove beyond a reasonable doubt that the fraudulent transfer was directed specifically against them and not against any claimants.

"Some of these places don't just say, 'You can create an asset protection trust here,'" notes Blattmachr. "They have passed laws prohibiting their courts from enforcing an American judgment against assets in the trusts." The lawyer who has won his case in a U.S. court may thus face insuperable difficulties in collecting on the judgment. "You'll have to retry the case in another jurisdiction," according to Blattmachr. "You'll have to bring your witnesses and documentary evidence 12,500 miles to a place you can't find on a map. You'll have to prove your case beyond a reasonable doubt and not just by a preponderance of evidence."

Judges in the U.S. bankruptcy courts tend to take a dim view of offshore transfers that appear to have been set up under pressure from creditor claims and threats of lawsuits. In one recent case (*In re Portnoy*, 1996), a New York businessman seeking a discharge in bankruptcy argued that the judge had no jurisdiction over a trust he had set up in the Channel Islands. The Marine Midland Bank was seeking to collect on a \$1 million business loan for which Portnoy had given a personal guarantee. Denying his motion for a summary judgment, the judge ruled that he had created the trust soon

after learning the bank would call the loan, and had concealed it from the bank. Portnoy was, moreover, a beneficiary of the trust; he retained the right to use of the assets.

While the judge may not have had jurisdiction over the trust, she made it very clear that the court did have power to determine whether Portnoy was entitled to bankruptcy protection. "If you want a discharge in bankruptcy but have done something to evade the American legal system," says Blattmachr, "don't expect a judge to come out in your favor."

The Alaska Trust Act is still fairly new and untested, and lawyers who specialize in setting up offshore asset trusts suggest it may not work as advertised. They argue that claimants will be able to seize assets in an Alaskan trust simply by getting a court judgment in another state. Under the "full faith and credit" clause of the U.S. Constitution, courts in one state honor the judgments of courts in every other state.

Blattmachr disagrees. He contends that Alaskan courts would honor another state's judgment against an individual, but would permit access only to the individual's assets and not assets held in a trust created under the new statute.

It should be pointed out that there are other ways to tuck away assets so that they are immune from creditor claims. In some states, cash inside an annuity contract is exempt from such claims—again, unless put there for the specific purpose of defrauding someone. Blattmachr calls such annuities "a phenomenal deal" in the various states that permit the exemption, but points out that Alaskan trusts have unique advantages as well.

Asset protection wasn't the main reason Blattmachr wanted the state of Alaska to adopt the new trust law. He believes the statute opens up a new dimension to estate planning. The biggest benefit of an Alaskan trust, he says, is that it enables the grantor to be an eligible beneficiary and still have such protection.

Yet very few of his clients have so far come forward to set up such a trust. Why? It's human nature. People just have a mental block to kissing assets goodbye forever by putting them in a lifetime trust—even if it will ultimately redound to the heirs' benefit. Blattmachr's point is that people don't have to do that when they

create an Alaska trust.

Under the Alaska statute, the trust is perpetual. You can gift \$1 million to it now, and it can grow forever. You and your heirs will never have to pay tax on it. If you live another 30 years and trust assets are invested wisely, they could be worth \$30 million when you die.

"The problem is, people say, 'Well, what happens if I need that \$1 million someday?' The Alaska statute breaks down that psychological barrier. If the trust creator falls on hard times, he can go to the trustee and say, 'How about giving me some of that money back?' And the trustee does it. Of course, you've wasted the [gift tax] exemption. But that should make the IRS happy." ■

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