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**FREQUENTLY ASKED QUESTIONS  
REGARDING  
OFFSHORE WEALTH PRESERVATION TRUSTS**

**MARIO A. MATA  
CANTEY & HANGER, LLP  
1999 Bryan Street, Suite 3330  
Dallas, Texas 75201  
Telephone: 512-474-4200  
Facsimile: 512-469-0474  
Website: [www.CanteyHanger.com](http://www.CanteyHanger.com)  
E-mail: [mmata@canteyhanger.com](mailto:mmata@canteyhanger.com)**

## **MARIO A. MATA**

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Mario A. Mata, a business and estate planning partner, joined Cantey & Hanger, LLP in 2001 after having established himself as a nationally recognized authority on international trusts and related wealth preservation planning. Mr. Mata is a graduate of the University of Texas School of Law in Austin where he received his law degree in 1978. Prior to that, Mr. Mata graduated from the University of Texas School of Business where he received his BBA in Accounting with Honors in 1976.

Mr. Mata has experience in all aspects of business, estate and tax planning for high net worth individuals and families. However, Mr. Mata is best known for his use of offshore wealth preservation structures for high net worth individuals. The offshore structures designed by Mr. Mata are commonly used by high net worth individuals and families for wealth preservation planning purposes. However, when combined with other international planning opportunities, the structures can also be used as part of a comprehensive offshore tax planning strategy. All structures are specifically designed to be fully compliant with U.S. tax laws. Mr. Mata's areas of practice include:

- Domestic and International Trusts and related Wealth Preservation Planning for Professionals, Executives and High Net Worth Individuals.
- Business and Estate Planning including formation of domestic trusts, family limited partnerships, limited liability companies and related business and investment holding companies.
- International Business Tax Planning including foreign entity formation
- Pre-Marital Wealth Preservation Planning

Mr. Mata is a member of the International Tax Planning Association and is Vice-Chair of the Asset Protection Planning Committee of the American Bar Association. Mr. Mata was licensed as a Certified Public Accountant (1981-1985) and was board certified in Commercial Real Estate by the Texas Board of Legal Specialization (1991-1999).

Mr. Mata is a frequent speaker on international trust and related wealth preservation topics having made presentations at over 200 legal and tax seminars throughout the United States and Canada including the American Bar Association's Estate Planning Symposium, the Advanced Estate Planning Conference of the Texas Society of CPA's and numerous other business and tax planning conferences sponsored by the American Bar Association, the State Bar of Texas, the University of Houston Law Foundation, the University of Texas School of Law, ALI-ABA and numerous other business and estate planning forums. Mr. Mata is also a contributing author to the American Bar Association's book "*Asset Protection Strategies: Planning with Domestic and Offshore Entities*" and has also contributed articles published in *Texas Lawyer* and *The Practical Tax Lawyer*.

**FREQUENTLY ASKED QUESTIONS  
REGARDING  
OFFSHORE WEALTH PRESERVATION TRUSTS<sup>1</sup>**

**Mario A. Mata  
Cantey & Hanger, LLP  
Dallas, Texas**

**INTRODUCTION**

Few areas of the law are as complex or misunderstood as the law applicable to offshore trusts and international wealth preservation planning. This paper is intended to address common questions and issues associated with an international wealth preservation structure for the high net worth individual or family with assets at risk in today's litigious society. Of course, the issues discussed in this paper are not intended to be an exclusive list of relevant issues. Instead, it is intended to provide a very basic discussion of the issues and planning opportunities available with an international trust as part of a comprehensive wealth preservation strategy for the high net worth client.

**THE INTERNATIONAL TRUST**

**What exactly is an international or "offshore" trust?"**

An international trust, commonly referred to as an "offshore trust", is a trust that has been formed outside the resident jurisdiction of the person establishing the trust (the "settlor"). While a trust formed outside the settlor's home country is technically an international trust, most "offshore" jurisdictions are typically considered to be those jurisdictions that are very independent of the major G7 nations and impose little to no taxes on income earned in the jurisdiction (hence the term "tax haven").

**Are international or "offshore" trusts legal?**

As with any other structure, an international trust is lawful if organized and used for a lawful purpose. There are many lawful reasons for establishing a trust in a foreign jurisdiction. An international trust formed

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<sup>1</sup> A comprehensive discussion of the topics discussed in this FAQ is available in the author's paper entitled "Offshore Trusts and Related Wealth Preservation Strategies" presented at the Advanced Estate Planning Conference sponsored by the State of Texas in June, 2003. Copies of the paper may be requested via e-mail from the author at [mmata@canteyhanger.com](mailto:mmata@canteyhanger.com)

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

to perpetuate a fraud or evade tax can result in severe civil and criminal penalties for the settlor of the trust and potentially his or her advisors. However, if the settlor is not clearly rendered insolvent by transfers to the trust, a lawful international wealth preservation trust can be used to protect assets from potential creditor claims or to incorporate complex international tax planning strategies.

### **What are the primary benefits of forming an international trust?**

Although there are many advantages of forming a wealth preservation trust in an overseas jurisdiction, there are two primary benefits for doing so. First, by selecting the law of a foreign jurisdiction to form the trust, the client is able to utilize the best law available to fulfill the client's goal of effective but lawful wealth preservation. Many offshore jurisdictions have adopted legislation which are specifically designed to offer the maximum amount of protection to the settlor and the assets transferred to the trust by a solvent settlor. This is true even when the settlor is the primary beneficiary of the trust, an option that is generally not available in the United States. Secondly, Americans seek the benefits of an international trust to protect assets from the risk associated with having such assets within the United States and thus easy targets for potential future creditors.

### **Can persons who are not citizens or residents of the United States benefit from forming an international trust?**

Persons who are not citizens or residents of the U.S. arguably have a more compelling reason to consider the use and benefits of an international trust. While there is no need for secrecy to insure the success of an international trust, wealthy clients, particularly Latin American clients, are extremely desirous of maintaining the strictest of confidence with respect to their financial affairs. Information regarding the high net worth of a foreign citizen could result in that person being targeted for kidnapping and extortion. Therefore, use of an international trust, which helps maintain assets outside their home country, is a great benefit to international citizens.

Similarly, the use of an international trust can insure the smooth transition of family wealth in the event of the death of a family matriarch or patriarch. Use of an international trust can virtually eliminate the need for a testamentary will. In most countries, probate is an extremely costly, time consuming, and public process. Even in the United States, trusts are often used to avoid the need to probate an estate, a process which is open for public review and scrutiny. Use of an international trust eliminates the need for probate of all liquid assets. In fact, with the proper and careful use of local entities, it is usually possible to totally avoid the need for

## **O & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

probate by having local assets, such as real estate, owned by entities which in turn are owned by the international trust.

In short, use of an international trust by a non-U.S. citizen is an ideal means by which high net worth individuals can hold, maintain, and preserve wealth for their own benefit and for the ultimate benefit of their family and heirs.

### **How important are offshore banking secrecy laws to the success of an international trust?**

Contrary to popular belief, offshore secrecy laws do not play a vital role in the success of an international trust. Lawful international wealth preservation planning should be conducted on the assumption that full disclosure will eventually be required. Moreover, all activity of the international trust is typically required to be reported to the Internal Revenue Service. An international trust succeeds because of (a) the jurisdiction and law selected to govern the trust, and (b) the legal structure established by the trust agreement. Offshore secrecy laws are therefore not a necessary element to the success of the international trust. However, offshore secrecy laws do provide a client, particularly a very wealthy family, the ability to protect the confidentiality of their financial affairs, a goal which is important to many wealthy families, particularly those in Latin America.

### **If offshore secrecy is not a major factor in planning an international structure, why is there a need to go offshore in the first place?**

As a general rule, all but 5 states have legislation prohibiting a settlor from establishing a valid spendthrift trust for his or her benefit. A typical state law provision provides that *“if the settlor is also a beneficiary of the trust, a provision restraining the voluntary or involuntary transfer of his beneficial interest does not prevent his creditors from satisfying claims from his interest in the trust estate.”* Hence, a typical client who desires to establish a “trust fund” for a “rainy day” has historically been unable to protect those assets as a result of the general prohibition against “self settled” trusts which, until 1997, was the law in all 50 states. It is true that 5 states have recently enacted legislation which purport to allow self settled trusts for a solvent settlor. However, the Supremacy clause of the U.S. Constitution clearly makes such laws subject and inferior to conflicting federal law. Moreover, many practitioners feel that the Full, Faith and Credit clause of the U.S. Constitution may require states with domestic asset protection trust legislation to recognize a judgment rendered in a sister state. By contract, a typical offshore jurisdiction will provide that, either through statute or by common law, a settlor can also be a beneficiary of a self settled trust without subjecting such interest to the claims of creditors.

**How is an international trust formed?**

Formation of a typical international trust is not too different from the formation of a domestic trust. A trust agreement (commonly referred to as a “deed of settlement” in offshore jurisdictions) is drafted to incorporate the wealth preservation goals of the client. While the trust agreement for an international trust will be drafted to comply with the laws of the governing jurisdiction, a typical trust agreement will also include extensive language to address various complex income and estate planning issues associated with the formation of an international trust by a U.S. citizen or resident. In some, but not all jurisdictions, the trust is registered by the trustee once organized. However, in those jurisdictions that provide for trust registration, the only information that is disclosed as part of the registration process is the name of the trust, the formation date of the trust, and the identity of the trustee.

**Is it advisable to use the trust agreement proposed by the offshore trustee?**

The typical trust agreement prepared and offered by an offshore trust company is drafted to conform to local law while providing the asset protection benefits sought. However, with few notable exceptions, a typical trust agreement offered by an offshore trustee will *not* take into account the tax consequences to the settlor of forming an international trust. Thus, while a proposed trust agreement offered by an offshore trustee might be ideal to provide the asset protection benefits sought, it might also result in catastrophic tax consequences to the settlor in the U.S. In fact, many large institutional trustees will typically not become involved in establishing an international trust for a U.S. citizen unless the prospective client is represented by U.S. legal counsel. Therefore, any individual, particularly a U.S. citizen, seeking the multiple benefits of an international trust should enlist the assistance of experienced tax counsel to insure that the execution and funding of the international trust does not result in unintended adverse tax consequences back home.

Some trust companies, particularly large institutional trust departments of foreign banks, have retained U.S. legal counsel to assist them in drafting trust agreements which should prevent potential adverse tax consequences to a U.S. settlor. Nevertheless, it is crucial that the settlor and the settlor’s family retain their own tax counsel to assist them with the complex international tax planning issues involved in establishing an international trust.

**THE TRUSTEE**

**Who is the trustee of an international trust?**

A typical trustee is either (a) a private trust company specializing in international trusts, or (b) a major financial institution or trust company such as a large international bank or institutional trust company.

Offshore private trust companies are organized and licensed much the same way as they are domestically. They are typically small in size with less than 100 employees, and typically do not have a U.S. office. Larger offshore financial institutions are typically well known and well capitalized. Both private trust companies and institutional trustees have advantages and disadvantages similar to that of domestic trustees. For example, private trust companies, because of their smaller size, are typically easier to deal with and somewhat flexible in their policies whereas institutional trustees can, but not always, have the disadvantages associated with dealing with a large financial institution. Private trust companies will typically accommodate smaller accounts whereas institutional trustees usually cater to larger accounts. A private trust company will typically delegate investment management authority to a professional investment manager, whereas a typical institutional trustee has billions under management and is very capable of handling the investment management of trust assets.

**How is the offshore trustee compensated?**

A significant difference between a private trust company and an institutional trustee is the method of compensation. A typical private trust company will charge an annual flat fee, averaging \$2,000 per year, and will also bill the trust on an hourly basis for any services rendered by the trustee. On the other hand, an offshore institutional trustee will typically receive compensation equal to a percentage of the assets held under management. Typical fees for offshore institutional trustees average from 1% to 2.5% per annum. Some well established private trustee companies will also bill on a percentage basis similar to institutional trustees. If a client decides to form a trust using a private trustee company, the trustee will typically incorporate the services of an institutional asset manager, typically a bank, to manage liquid trust assets.

**Can a trustee be removed?**

Yes. The typical trust agreement provides that the trustee may be removed, with or without cause, by the trust protector (discussed below).

## **O & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

### **THE PROTECTOR**

#### **What is an offshore trust protector?**

The concept of a trust protector is new to the United States but common in offshore jurisdictions. In simple terms, the offshore trust protector is a person that acts as the “guardian angel” or “overseer” of the trust. The powers of the trust protector are typically outlined in the trust agreement but include the power to:

- Remove or replace a trustee.
- Relocate the situs of the trust.
- Approve or decline any proposed distribution to a beneficiary.
- Provide for the amendment of the trust agreement to address unforeseen circumstances.
- Consent to the proposed appointment of a new investment manager different than the original investment manager initially appointed when the trust was formed.

#### **Who serves as protector?**

Anyone, other than the trustee, can serve as the trust protector. However, the ideal trust protector is an offshore person that is familiar with the responsibilities of an offshore trust protector. While there are many professional groups that are willing to serve as trust protector, our law firm prefers to use the services of an offshore protector that is affiliated with an experienced law firm.

#### **How is the protector compensated?**

Typically, a trust protector will charge \$500 to \$1,000 annually. In addition, like a private trust company, a typical protector will charge a small fee for attending to requests made by the settlor or trustee, such as approval of proposed distributions. Fortunately, such fees are typically very small.

### **BENEFICIARIES OF AN INTERNATIONAL TRUST**

#### **Who are the beneficiaries of an international trust?**

There are no restrictions on who can be the beneficiary of an international wealth preservation trust. In a typical international trust structure, the settlor and the settlor’s spouse are the initial beneficiaries. If the settlor is single, or is married but funding the trust with separate property assets, the settlor is typically the sole beneficiary of the trust. Contingent beneficiaries are typically the settlor’s children and their heirs.

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

### **How does a beneficiary get money out of an international trust?**

The beneficiary of an international trust may request a distribution from the trust at any time. Such a request is typically made in writing and is subject to approval by the trustee and trust protector. If approved, the distribution is typically made directly to the requesting beneficiary via wire transfer. The process usually takes no more than 2 weeks and substantially less if the trust has the funds to be distributed on deposit in a money market account.

### **What happens to the trust assets when the primary beneficiary dies?**

The typical solution is to allow the settlor to retain a special power of appointment authorizing the settlor to designate the recipient of trust assets upon the settlor's death. Thus, upon the death of the settlor, the trustee distributes assets as directed in the settlor's last will and testament. If the assets at the time of death are community property, only the interest of the deceased settlor will be distributed. The assets of the surviving settlor will remain in trust until his or her death.

Allowing the settlor to retain a special power of appointment to dispose of assets upon his or her death has the advantage of allowing the settlor the flexibility of making adjustments to the settlor's testamentary intentions up to the time of the settlor's death or mental incompetence.

## **INVESTMENT MANAGEMENT ISSUES**

### **Once an offshore trust jurisdiction is selected as the "situs" of the trust, is that where funds are deposited?**

No. The use of a jurisdiction with favorable trust legislation does not automatically mean that the jurisdiction is an ideal financial center. For example, the Cook Islands have excellent international trust legislation but are not known as a financial center. Instead, a trustee, particularly a private trustee company, will typically establish an investment account for the trust in a well-known offshore financial center such as Switzerland or the Cayman Islands. The account is typically established with a well-capitalized institutional investment manager such as a large bank, investment company or private bank.

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

### **Does the offshore trustee also manage funds transferred to the international trust?**

As implied above, the typical offshore trustee will delegate investment management responsibilities to a large financial institution such as a Swiss or Cayman bank. In doing so, the selected investment manager is typically given full investment authority and management responsibility subject only to investment parameters and restrictions established by the trustee. Those investment parameters are typically solicited from the settlors at the time that the trust is first established. If the trustee is a large financial institution in its own right, such as a large international bank, the investment branch of the institutional trustee will typically assume responsibility for management of trust assets.

### **How is the investment manager selected?**

The investment manager is selected by the trustee. However, prior to formation of the trust, the settlor can and typically does provide input to the trustee regarding the preferred investment manager. After all, if the settlor is not satisfied with the proposed investment manager, the funds will not be transferred to the trust. Thus, in a typical situation, one of the issues to be addressed by the settlor is the settlor's preference of a third party investment manager for the trust. In other words, selection of the initial investment manager is typically a decision made by the settlor similar to the decision involving the selection of a trustee and a trust protector. Once the trust is formed, only the trustee, with the protector's consent, can replace and name an investment manager.

### **What kind of investments can be made by an offshore investment manager? Is the international trust limited to offshore investment products?**

This is an area of much misconception. A typical offshore financial institution, acting as an investment manager, can access virtually any investment product available in the world including U.S. securities. Thus, if the settlor prefers U.S. securities, the trustee can so instruct the investment manager when establishing an account for the trust. In such case, the investment manager will acquire only U.S. securities, mutual funds, and other U.S. based products. However, one of the advantages of using a foreign based investment manager is the opportunity to invest in non-U.S. products available in the international financial markets. This helps to diversify the investment risks associated with the trust investment portfolio.

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

### **Can funds transferred to an international trust remain in the United States?**

Yes. However, great care should be undertaken when pursuing such a strategy. In this scenario, the international trust establishes an account in the United States with an investment manager domiciled in the U.S. However, in the event of litigation against the settlor, the U.S. based assets of the international trust are potentially at risk. Thus, while such a strategy is acceptable when the settlor is not involved in serious litigation, the trustee will undoubtedly relocate assets outside the United States should the settlor and/or beneficiaries of the trust find themselves subject to serious litigation in the United States.

### **What is a “U.S. advised” offshore account?**

A U.S. advised offshore account is an investment account established by the trustee with an offshore financial institution that is nevertheless managed by a U.S. investment advisor. In a typical situation, the liquid assets under management are deposited in a “custodial account” with an offshore financial institution. However, the offshore financial institution merely acts as the “custodian” of the deposited assets and is given no investment authority. Instead, the investment authority is delegated by the trustee to a U.S. based advisor. As such, the U.S. advisor has full investment and management authority over the assets that are deposited in the offshore financial institution. However, the U.S. advisor’s authority is *strictly* limited to investment management and, thus, will have no authority to disburse funds from the account. That authority is retained by the offshore trustee.

The advantages of a U.S. advised offshore account are obvious. It allows the assets under management to be held in a protected offshore account while being managed by a U.S. based advisor. Such an arrangement allows the settlor easier access to the investment managers of the trust account. While the settlor retains no control over trust assets, having a U.S. based advisor allows the beneficiaries of the trust to remain better informed about trust investment strategies. Some settlors and beneficiaries also take comfort from the use of a U.S. based investment advisor that may be more familiar to them.

### **How is the investment manager compensated?**

A typical investment manager is paid a fee equal to a percentage of assets under management. Typical fees range from 1% to 2.5%. Some investment managers have sliding fee schedules that establish the fee based upon assets under management. Obviously, the larger the assets under management, the lower the fee. Some offshore financial institutions will also negotiate their fees for very large accounts (in excess of \$10 million).

**TAX ISSUES**

**Is it true that income earned in an offshore tax haven (i.e., Cayman Islands, Bahamas, etc.) is not taxable?**

Offshore taxation is another area that is subject to much misconception. The subject of international taxation is incredibly complex. However, as a general rule, persons or entities that are citizens or residents of the United States are subject to taxation in the United States on their worldwide income. This outcome is not affected by the fact that income may have been earned in an offshore tax haven. A typical offshore tax haven, such as the Cayman Islands or the Bahamas, will not subject income earned in those jurisdictions to taxation *there*, hence the term “tax haven.” However, the mere fact that income is not taxable in a tax haven does not mean that it is not taxable in the United States if earned by a U.S. person. Generally, it is.

**What are the tax consequences of forming an international trust?**

A typical international trust is formed as a “grantor” trust, and is therefore “tax neutral.” In other words, a typical international trust has no tax advantages or disadvantages associated with its formation. An international trust can be formed as a “non-grantor” trust if certain complex tax strategies are desired. However, a transfer to a non-grantor trust constitutes a taxable gift and a sale or exchange of the asset transferred. The tax consequences of a non-grantor trust are very significant. Thus, a typical international trust is formed as a grantor trust.

**What are the IRS reporting obligations associated with an international trust?**

An international trust is required to file an “information return” similar to a partnership return. In other words, the international trust is not a taxpaying entity. However, it is required to file Form 3520-A with the Internal Revenue Service. That tax return provides a basic summary of the income and expenses of the trust and information regarding any distributions to and from the trust.

**Does forming an international trust increase the risk of an IRS audit?**

In this author’s opinion, no. The IRS obviously develops a heightened interest if it learns that a U.S. taxpayer has an offshore account. However, the offshore accounts that are of interest to the IRS are those that have been established by U.S. persons without reporting the existence or income from the account to the Internal Revenue Service. The IRS

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

estimates that 85% of all offshore accounts held by U.S. taxpayers are established for the purpose of tax evasion. Any taxpayer that is suspected of having an undisclosed offshore account is definitely going to attract IRS interest. On the other hand, the Internal Revenue Service is not otherwise going to develop an interest in a taxpayer that has established an international structure and reported the existence of the structure and its activities to the Internal Revenue Service as required by law. As with any business decision, a decision by the IRS to investigate a taxpayer is, in part, a cost benefit analysis. The Internal Revenue Service is definitely interested in investigating a taxpayer who may have an undisclosed offshore account. The IRS is not necessarily concerned with the U.S. taxpayer that has disclosed the existence of the structure to the IRS and reports activities of the trust to the IRS as required by law.

### **Do I need an international trust if I already have a family limited partnership (“FLP”)?**

A FLP can provide valuable estate and asset protection benefits. However, from an asset protection standpoint, the benefits available with a FLP do not compare with the benefits available with an international trust. If the assets to be protected are real estate or other assets that cannot be readily relocated offshore, the FLP serves a good purpose but should probably be combined with an international trust to maximize protection. If the assets in the FLP are liquid assets, the entire FLP, including the general partnership interest, should probably be transferred to the international trust to maximize protection. In an ideal situation, assuming the amount held by the FLP justifies the additional cost, a domestic FLP should be redomiciled as a foreign limited partnership to maximize protection.

### **Do I even need a FLP if I have an international trust?**

If the client’s sole interest is to protect liquid assets and investments from potential creditor claims, there is no need for a FLP. However, a FLP may nevertheless be suggested if the trust is structured as a grantor trust, as is typically the case. In those situations, the assets of the international trust are fully taxable in the estate of the settlor upon his or her death. Therefore, normal estate planning strategies otherwise suggested for the taxpayer should be considered and, where appropriate, pursued. By having the assets of the international trust held by a “dropdown FLP,” the settlor is able to protect assets in the trust while at the same time maximizing estate tax discounts that might be available by having that ownership interest held through a FLP.

## **O & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

### **How does the combination of an offshore FLP and an international trust provide enhanced wealth preservation protection for the client?**

Recent court cases, such as Estate of Strangi v. Commissioner, T.C. Memo 2003145 (2003), have continued to underscore attempts by the Internal Revenue Service to challenge the use of FLPs for estate planning purposes. Some of the recent successes of the IRS are based upon cases with bad facts. Nevertheless, other successes are based upon the implicit, if not express control, which the taxpayer is deemed to have retained in a FLP, thus causing inclusion issues under Internal Revenue Code Section 2036 and related provisions. However, all of these issues, including the issues in the Strangi case, can be adequately and successfully addressed by incorporating the FLP into the client's international trust. In a typical scenario, the client's interest in the FLP is transferred to the client's international trust. Thereafter, the client's entire interest in the FLP, including the general partner interest, is owned and controlled by an international trust which is managed by an independent third party offshore trustee. Enhanced wealth preservation can be further achieved by utilizing the benefits of modern offshore limited partnership legislation such as that found in the Bahamas or Cayman Islands. Thus, in addition to achieving ideal asset protection for the client's interest in the FLP, the client is able to defend or avoid allegations by the IRS that the client's continued control of the FLP prevents the taxpayer from realizing the estate planning benefits typically associated with the use of a FLP. Thus, while such planning is quite complex and must be done on an arms-lengths basis to be successful, it nevertheless underscores the significant estate planning opportunities associated when integrating a properly structured offshore FLP into the client's international trust.

### **What are the tax advantages of including offshore life insurance strategies with the client's wealth preservation structure?**

The use of offshore life insurance products for both asset protection *and* income tax planning has gained popularity in recent years. The subject matter is extremely complex and not capable of being easily summarized. Nevertheless, in a typical situation, the client's international trust will purchase an offshore private placement variable life insurance policy from a licensed offshore insurance company. Although similar products are available domestically, the products offered by offshore carriers are usually available at a substantial cost savings. Some of these policies are issued by insurance companies in Bermuda, arguably the life insurance capital of the world. If properly structured and compliant with U.S. tax law, the policy allows the accumulated investments within the policy to grow tax-free. If necessary, funds can be accessed from the policy by the trust through a "policy loan" similar to that found in domestic policies. However, in a typical situation, the goal of such offshore life insurance

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

strategies is to allow the investments within the policy to grow tax-free until such time as the settlor of the trust reaches retirement age.

A recent IRS private letter ruling has complicated the issue involving the extent of investment control that is available to the owner of the policy while still being able to maintain the tax-free status of income and assets within the policy. Nevertheless, a properly structured offshore private placement variable life insurance policy can provide significant advantageous tax and wealth preservation benefits, particularly when combined with an international trust.

### **MARRIAGE AND DIVORCE**

#### **Are there any benefits associated with forming an international trust prior to marriage?**

Yes. It is usually possible to structure an international trust, combined with domestic or foreign entities, to fully insulate the assets of an individual prior to marriage. The structure basically acts as a substitute for a premarital agreement. In community property states, it is likely that distributions made by the trust to the settlor will be classified as community property if no premarital agreement exists which otherwise changes the status of such distribution. However, the assets of the trusts themselves will be protected from potential claims of the future spouse.

#### **What happens to the assets of the international trust upon a divorce of the settlor-beneficiary who was married at the time the trust was established?**

Again, the answer depends upon (a) the state of residence of the settlor, and (b) the marital classification of property transferred to the trust. In a community property state, such as Texas, or a state that recognizes the rights of both spouses in the “marital property” of the spouses, it is important that the marital property rights of either spouse not be adversely affected by the formation or existence of the trust. In a typical situation, the ideal strategy is to have the settlor and the settlor’s spouse act as co-settlors of the trust. Should a divorce occur, the trust agreement will typically provide that the assets of the trust will be divided into two separate trusts pursuant to (a) whatever is agreed to by the divorcing parties, or (b) whatever is ordered by the divorce court having jurisdiction over the divorce. Again, the foregoing resolution is necessitated by the fact that, in a community property state such as Texas, or a state that recognizes “marital property”, such as New York, *both* spouses have an actual or, at least, an equitable interest in the marital property assets transferred to the trust.

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

Of course, if the assets contributed to the trust are the separate property of the contributing spouse, the subsequent divorce by that spouse will not affect the assets in the trust, particularly if the contributing spouse is the sole settlor of the trust. Even if both spouses are settlors of the trust, the trust agreement can, in many jurisdictions, provide that property contributed by the settlors shall retain the marital status of the property when contributed into the trust. Careful planning and coordination with the trustee will be necessary to insure this result. In any event, regardless of the state of the settlor's residence, it is absolutely critical that the marital property status of assets to be transferred to the trust be determined before such transfer occurs.

### **JURISDICTION ISSUES**

#### **Which are the “best” jurisdictions to use for establishing an offshore trust?**

As with any legal issue, the ideal jurisdiction for any one particular individual or family will be affected by multiple issues too numerous to discuss in detail here. There is a wide range of jurisdictions from which to select a situs for the client's trust. The trust law in these jurisdictions can vary significantly.

In recent years, some jurisdictions have adopted very “specific” asset protection trust legislation which is expressly drafted to aggressively protect the assets transferred to a trust by a solvent debtor. On the other hand, some, more “traditional” jurisdictions, have intentionally decided to avoid such a strategy and instead rely upon the common law that has developed over many years within those jurisdictions. Other jurisdictions, sometimes described as “middle of the road” jurisdictions, have elected to adopt moderately debtor friendly legislation to compliment their existing common law that has been extensively developed over many years.

The client's individual needs and realities may also affect the choice of jurisdiction. For example, individuals who are on the board of directors of an SEC reporting publicly held company may prefer to use a more traditional or contemporary jurisdiction rather than to use a jurisdiction with more aggressive legislation. On the other hand, most professionals and other individuals involved in high-risk endeavors usually prefer to utilize a jurisdiction that has very favorable asset protection legislation. In the end, it is the client's advisor who must carefully evaluate the goals and needs of the client when recommending an appropriate jurisdiction for the client.

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

### **What are some of the issues that should be considered in selecting an offshore jurisdiction?**

There are multiple legal and non-legal issues that should be considered when selecting the appropriate jurisdiction for a client. Additionally, when drafting a trust agreement for an international trust, it is important that the jurisdiction selected have statutory authority or common law precedent to legally support the wealth preservation strategies drafted into the trust agreement. Among the factors that should be used in evaluating a particular jurisdiction are:

- recognition and protection of self-settled trusts;
- confidentiality;
- unambiguous fraudulent conveyance laws and favorable statute of limitation periods;
- recognition of trust provisions which override the forced heirship laws or marital property laws of the debtor's home jurisdiction;
- non-recognition of foreign judgments;
- favorable tax law (almost all offshore jurisdictions exempt foreign trust from taxation in their jurisdiction);
- the availability of competent and financially strong trustees;
- the availability of local professional services, including legal counsel;
- the proximity of the jurisdiction to the United States;
- the availability of modern telecommunications, including reliable telephone and communication facilities;
- the compatibility of the offshore jurisdiction to the settlor's language and culture (not all offshore "tax havens" are English speaking); and
- the existence of a modern and stable government.

### **Which are the jurisdictions that have "specific" asset protection legislation?**

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

A handful of jurisdictions have adopted legislation specifically designed to provide statutory clarity in the area of asset protection trusts. Typically, strict statute of limitations exist governing the ability of a creditor to challenge a transfer to an asset protection trust. While such jurisdictions typically do have fraudulent transfer statutes, a creditor must typically prove, beyond a reasonable doubt, that a transfer to the trust was done with fraudulent intent. Jurisdictions with specific asset protection legislation include the Cook Islands in the South Pacific, Nevis in the Caribbean, and St. Vincent and the Grenadines in the South Caribbean,

### **Which jurisdictions can be considered “Middle of the Road” jurisdictions?**

Several jurisdictions which have historically relied on traditional notions of trust law have, in recent years, “modernized” their trust law to incorporate the realities of self-settled wealth preservation trusts. However, these “middle of the road” jurisdictions have adopted legislation which, while debtor friendly, is not necessarily as aggressive as that found in jurisdictions such as the Cook Islands. Thus, while these jurisdictions can be considered to have very good asset protection legislation, they have nevertheless retained, for the most part, fundamental common law trust concepts which are considered to be indispensable in many Commonwealth jurisdictions, notwithstanding the modification of the common law by modern trust legislation. Jurisdictions that can be considered to fall into this category include Bermuda, the Bahamas, and the Cayman Islands.

### **What about the Channel Islands? Are they still viable options?**

The Channel Islands has historically been a favorite of individuals in Europe, particularly the United Kingdom. The Channel Islands include the Isle of Man, Jersey, and Guernsey. The trust law in the Channel Islands relies, to a large extent, on the common law adopted by those jurisdictions from the United Kingdom. Nevertheless, some of these jurisdictions have recently adopted legislation to modernize their existing trust law.

### **Why is New Zealand popular with some planners?**

New Zealand is not typically considered an “offshore” jurisdiction by practitioners. It has neither asset protection legislation nor is it a tax haven. In fact, it is typically considered a “high tax” jurisdiction like Britain or France. However, New Zealand’s close association with the Cook Islands, a progressive trust jurisdiction and former New Zealand protectorate, combined with favorable tax legislation for non-resident trust income, provides some very unique planning opportunities for New Zealand trusts. Some of the principal benefits of a New Zealand trust include the following:

## ***Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS***

- New Zealand is a well known and well respected member of the British Commonwealth. While its roots are based in England, it has a modern economy, a democratically elected government, and all of the benefits usually associated with an English speaking democracy. The legal system is based on the English model which also forms the basis of the United States legal system.
- Although New Zealand does not tax trust income earned outside of New Zealand, it is nevertheless not known as a “tax haven.” As a result, it has avoided the scrutiny usually reserved for offshore financial centers, some of which have not had the best of reputations. New Zealand has also avoided the money laundering issues that have plagued many offshore jurisdictions. New Zealand has not been “blacklisted” by any of the major countries that have adopted “anti-money laundering” or “tax haven” legislation. As a result, New Zealand has become very popular with many wealthy Latin American and European families.
- New Zealand has a modern infrastructure. It is accessible by most major airlines and has a communications network as modern as any in the world. Its major metropolitan centers have abundant professional talent available, much of which is educated in the United States, England and Australia. Most of the major international banks of the world are represented in New Zealand.
- New Zealand has a close economic and political association with the Cook Islands, a jurisdiction that arguably has the best asset protection legislation in the world. Should it become necessary, a New Zealand trust can easily be transferred to the Cook Islands, thus benefiting from the strong asset protection safeguards available in the Cook Islands.

## **LITIGATION ISSUES**

### **Can someone form an international trust if they have already been sued or threatened with a civil lawsuit?**

Any type of wealth preservation planning is best undertaken when the client is clearly solvent and thus has the flexibility to successfully undertake whatever planning is best suited for the client and the client’s family. Use of a wealth preservation structure in an attempt to or as part of a scheme to commit fraud against existing creditors will, in most cases, fail outright, and in the worst case, result in potential civil, and, in some cases, criminal liability to the client and the client’s advisors. On the other hand, some clients, such as physicians, are constantly being named

## **Q & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

as defendants in lawsuits that, in many cases, are often frivolous lawsuits filed by those who seek a quick financial settlement against a known solvent defendant. So long as the client is not clearly insolvent, logic would suggest that the client should be allowed to continue to plan his or her financial affairs according to what is in the best interest of the client and the client's family, rather than to do nothing because of a lawsuit that may be groundless or capable of being settled within the limits of an existing liability insurance policy.

In fact, multiple court cases and a 1997 opinion of the U.S. Supreme Court have made clear that a debtor, generally speaking, has a right to undertake wealth preservation planning even if litigation is pending or threatened. Very important exceptions to this rule exist in multiple situations including (a) circumstances where asset transfers are prohibited by federal or state law, or (b) asset transfers that are prohibited by an agreement previously executed by the debtor. If a subsequent creditor is able to obtain a judgment on its claim, the creditor can attempt to set aside the transfer as a "fraudulent transfer" if it can be shown that the transfer rendered the debtor insolvent or was made with the intent to defraud, hinder or delay the creditor.

A handful of states do provide for sanctions or civil liability for fraudulent transfers regardless of the circumstances. The law of the individual states involved in a transfer must therefore be examined carefully before undertaking planning under the foregoing circumstances. Moreover, all of the foregoing issues can be avoided if the trust is formed when the client has no pending or threatened claims.

### **Must the existence of the international trust be disclosed in the event of litigation?**

Yes, if the appropriate and lawful inquiry is made, the existence of the international trust must and should be disclosed. More importantly, in most situations, assuming the trust has been lawfully organized and structured, there is no justification for not disclosing the existence of the trust. In fact, it is the author's policy to require *full* disclosure should the issue arise and appropriate request for information made. As indicated earlier, attempting to hide the existence of the trust serves no purpose and is not necessary for the protection of a lawful and properly organized trust. Of course, in making disclosure, one should do so only with the advice of competent legal counsel.

### **If the plaintiff is successful in the litigation, can they try to seize trust assets?**

Yes, however, the creditor will likely find that a new lawsuit will need to be filed against the trust in the jurisdiction where it was formed. The entire lawsuit may have to be re-tried under local rules. In most offshore

## **O & A: OFFSHORE WEALTH PRESERVATION TRUSTS**

jurisdictions, a judgment rendered in the United States is usually a worthless piece of paper. Witnesses must personally appear in the foreign court, as depositions are generally not admissible as evidence in the courts of most offshore jurisdictions. Moreover, in addition to having to retry the case in the foreign jurisdiction, the creditor will find that the law of most offshore jurisdictions does not allow the use of contingent fee agreements with attorneys.

### **SUMMARY**

The use of offshore wealth preservation planning to *legally* maximize the protection of a client's personal wealth has gained new recognition and acceptance in today's litigious society. Now, more than ever, any business or estate plan requires a careful review and analysis of the risks associated with the client's activities and business holdings. A client's advisor and other professionals should consider the benefits, goals, issues and risks involved in establishing an international trust as part of a comprehensive wealth preservation plan for the high net worth client, business owner or executive with significant business holdings or investments. The benefits of an international trust are all too obvious in those situations when a client without an international trust, but with substantial assets at risk, becomes a defendant in a serious lawsuit. If the client has not already protected his or her personal assets with a trust prior to the threat of litigation arising, the client could face financial ruin and is likely to ask why the client's advisors did not suggest that the client at least investigate the merits of using an international trust to protect the client's personal and family wealth.

While such structures can provide a multitude of benefits, they should only be used under specific circumstances. Both the client and the client's advisor must be fully knowledgeable of the issues and risks associated with the establishment of such an offshore wealth preservation structure and the consequences of establishing such a structure under the wrong circumstances. Nevertheless, with careful planning, an offshore wealth preservation structure can enhance the client's estate planning goals and provide the client with significant protection against ever increasing litigation risk in today's litigious society.

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