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Noteworthy Legal Developments
Affecting Asset Protection Planning

by

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INTRODUCTION

Whenever a lawyer holds herself out as an expert in a particular area of the law (e.g., asset protection planning), the applicable state Code of Professional Conduct typically subjects that lawyer to a higher standard of competence. See, for example, ABA Model Rule 7.4. In some jurisdictions (such as Massachusetts), a lawyer may avoid the higher standard by stating that she “welcomes” asset protection cases or “handles” such cases, rather than holding herself out as an expert in the field. Massachusetts Rules of Professional Conduct Rule 7.4(c).

In any event, whether one “specializes” in or merely “welcomes” asset protection planning clients, most lawyers feel duty bound to provide the best professional service possible to his or her client. In a field such as asset protection planning, in a day and age where transactions, in a blink of the computer screen, cross not only state but international boundaries, the pressure upon a practitioner to be aware of the latest developments worldwide is paramount.

The following review includes highlights from previously published “Legal Developments” columns from the Asset Protection Journal from the Winter 1999 issue through the Winter 2001 issue with a two-fold purpose: First, to provide a concise up-date on selected asset protection developments, which, in the authors’ opinion, are the most noteworthy and useful to the asset

protection practitioner. Second, to give the practitioner-researcher a flavor for the type of issues that present themselves in asset protection planning.

CASE LAW

COOK ISLANDS TRUST ASSETS ARE SUBJECT TO EQUITABLE DISTRIBUTION IN DIVORCE LITIGATION: Dr. Riechers established and funded an irrevocable trust in the Cook Islands in December of 1992 in a legitimate effort to protect the assets from potential medical malpractice claims, thereby preserving the assets for members of the Riechers' family. Sometime thereafter marital disharmony ensued, and divorce proceedings commenced. A New York court, while admitting that it did not have jurisdiction over the corpus of the offshore trust, nonetheless stated that the physical location of marital property is irrelevant to the determination of equitable division and awarded the wife \$ 2 million, which was one-half of the value of the trust's assets as of December 1994 (the approximate date that Dr. and Mrs. Riechers separated).

The Supreme Court of New York, Appellate Division, Riechers v. Riechers, 1999 N.Y. App. Div. LEXIS 13303 (1999), affirmed the lower court holding that the assets used to establish the offshore trust two years prior to the commencement of the divorce proceedings were subject to equitable distribution, and that the December 1994 date controlled for valuation purposes. However, the Court noted a computation error and increased the award to Mrs. Riechers to \$2,178,865.

Since the New York Court could not order the Cook Islands trustee to distribute trust assets to either Dr. Riechers or his wife, it dealt with the problem by ordering Dr. Riechers to transfer to her the assets he retained in the United States, demonstrating a second way to "skin the cat." Fortunately for Mrs. Riechers, her husband apparently had sufficient reachable assets to satisfy the order.

The case also illustrates that a determined creditor or potential creditor can, with at least apparent cause, freeze if not reach assets in even the most respected offshore jurisdiction under the right circumstances. While it is clear that the High Court of the Cook Islands will not recognize a

Unites States court order or judgment, it is also clear that the court will allow a “mareva injunction” to issue in certain cases, even though a trust was established well beyond the two year limitations period. Apparently, the injunction in this case was issued based on Mrs. Riechers’ assertion that the assets used to fund the trust (and related limited partnership) were marital assets and thus a portion belonged to her. If this were so, Dr. Riechers funded the trust with assets that were not his and the period of limitations would not protect him. A similar argument was successfully made and a mareva injunction was issued in the highly visible case of Grupo Torras, SA v. Sheikh Fahad Mohammed Al Sabah, Chemical Bank & Trust (Bahamas) and Private Trust Corp. (Supreme Court of the Bahamas, September 1, 1995).

Contrast Riechers with Hess v. Line Trust Corporation Limited & Hess (No. 17 of 1997 in the Court of Appeal for Gibraltar), based on a fraudulent transfer argument, where the Gibraltar Court would not even hear the spouse’s argument that her husband intended to defraud her, since protection in that jurisdiction is immediate, regardless of intent, so long as the transfer to the trust did not render the grantor insolvent. Nevertheless, as seen in the Riechers case, if Hess retained sufficient assets in the United States, a court could compensate simply by increasing the spouse’s share of the United States assets.

U.S. TRUSTEES OF OFFSHORE ASSET PROTECTION TRUST JAILED FOR CONTEMPT: Michael and Denyse Anderson of San Diego California established and funded a Cook Islands asset protection trust, naming themselves as trustees and apparently as trust protectors as well. In Federal Trade Commission v. Affordable Media, CV-S-98-669-LDG(RLH) (D. Nev. 1998)(often referred to as the “Anderson” case), the Andersons were named as civil defendants by the FTC, claiming the Andersons were connected with an alleged \$50 million fraudulent investment scheme. In the course of the proceedings the existence of the trust surfaced and the judge ordered the Andersons to repatriate \$1.3 million of trust funds to the U.S. The Andersons, still acting as trustees, sent a request for the funds to the Cook Islands, noting in their request that it was pursuant to a court order.

As is quite typical, their trust contained an “anti-duress” provision, and not only was the request for funds denied in accordance with the terms of the trust, but the Andersons were automatically

removed as trustees. When the judge was advised that the funds would not be forthcoming, he scheduled a contempt hearing, reportedly advising the Andersons to “bring a toothbrush.” At the contempt hearing on June 17, 1998, the judge ordered the Andersons jailed, providing they could purge the contempt by repatriating the funds as ordered.

After spending the last six months in jail, the Andersons were released by Judge George on December 22, 1998 on the condition, among others, that they release their passports, remain in San Diego, and cooperate with the government’s attempt to repatriate funds from the Cook Islands trust.

Another condition for their release from jail was that the Andersons would appoint a new trustee and trust protector of their Cook Islands trust, one that was associated with the FTC. When the trust documents were presented to the Cook Islands court, however, they were rejected in favor of preservation of the trust assets, as dictated by the terms of the trust. It has been reported that the court based its decision in part on the fact that the attempt to amend the trust to benefit the FTC was an impermissible exercise of the Anderson’s powers as protectors because the FTC was an “excluded person” under the trust document. This decision has been appealed to the High Court of the Cook Islands.

In light of this Cook Islands court decision, the FTC moved to have the preliminary injunction against the Anderson’s modified to permit the funds to remain outside of the United States as long as the funds were held under the control of a foreign court. In response to the motion, Judge George issued an “Order Modifying Preliminary Injunction” on September 23, 1999 so modifying the preliminary injunction under the conditions that (1) the trust funds remain intact (except for payments of less than \$50,000 to the trustee for administrative and legal expenses); (2) that the Registrar of the High Court of the Cook Islands be made a signatory to the trust account; and (3) that no decision had been rendered in the case pending appeal in the High Court of the Cook Islands.

The original contempt citation against the Andersons was eventually upheld by the Ninth Circuit in Federal Trade Commission v. Affordable Media, LLC., 179 F.3d 1228 (9th Cir. 1999). In its

decision the Ninth Circuit affirmed the District Court's order directing the repatriation of Cook Island trust assets and the Anderson's eventual jailing for contempt when the funds were not forthcoming. The Court's opinion is notable for the utter disdain Judge Wiggins exhibits for the Andersons in general and the particular offshore plan utilized in this case.

The outcome of this situation should be no surprise to any experienced asset protection planner. The real surprise, or rather puzzling aspect of this situation, is (1) why anyone would advise the Andersons to be their own trustees of their offshore asset protection trust, and (2) why would the Andersons be foolish enough to remain as trustees throughout the litigation proceedings, and have the gall to appear at the contempt hearing while still acting as trustees of the trust.

The laws relating to contempt, although extensive and somewhat complicated, can nevertheless be boiled down to two basic principals: first, a person cannot be held in contempt of court for failing to do something that is impossible for him or her to do; and second, if the impossibility of performance was itself created by the person at a point in time proximate enough to the action to be reasonably interpreted as being connected with it, then the first rule will not apply and the person may be held in contempt.

In this case, the creation and funding of a trust which by its terms would prohibit the repatriation of funds may not have been an act of contempt if it was done long enough before the proceedings to be considered a separate act. It is not clear by the available facts when the Andersons established and funded their trust. What is clear, however, is that for some reason they remained as trustees up until the fatal moment. By sending the notice to the Cook Islands they themselves effectively and (presumably) knowingly created an impossibility of performance. Furthermore, even after they were "automatically" removed as trustees, they continued to hold the powers, as protectors, to appoint successor trustees. By appointing foreign successor trustees (instead of domestic trustees who could have complied with the court order) in the very face of the contempt order, they angered the judge even further, effectively leaving him no choice but to jail the Andersons for their blatant disregard of the judicial process.

If nothing else, this case illustrates the hard way how critical it is to have expert advice when employing asset protection trusts and related entities. Perhaps the answer in this instance is that the Andersons had no advice but instead were do-it-yourselfers. In either case there is no excuse, and we can all learn a good lesson, at the Andersons' expense.

MAURITIUS ASSET PROTECTION TRUST IGNORED BY BANKRUPTCY COURT: In one of the more caustic opinions of recent years, In re Lawrence, 227 B.R. 907 (Bankr. S.D. FL 1998), the bankruptcy court castigated the debtor for his egregious “ ... hide the ball ‘catch me if you can’ conduct” and held that despite declarations and trust provisions to the contrary, the debtor's rights and interests in an offshore trust with a situs in the Republic of Mauritius were governed by the laws of Florida and federal bankruptcy laws.

As reported by the court, Stephan Jay Lawrence is an MIT graduate and former high-stakes options trader who found himself and his companies on the wrong side of a \$20 million margin deficit with Bear Sterns as a result of 1987's Black Monday in the stock market. A forty-four month long arbitration proceeding resulted in a NASD panel award favoring Bear Sterns, but just two months shy of the panel's decision Lawrence settled the Lawrence Family 1991 Intervivos Trust in the Jersey Channel Islands, funding the trust with \$7 million. One month later (and before the arbitration award), the governing law of the trust was changed to the Republic of Mauritius, supposedly to take advantage of its greater creditor protection laws. Days after the governing law change, the NASD panel award was confirmed by the United States District Court for the Southern District of New York, and a few months later a final judgment in favor of Bear Sterns was entered for \$20.4 million. Lawrence filed a petition for bankruptcy.

The present case came before the court on a Trustee's motion to compel Lawrence to respond to discovery interrogatories in a non-evasive manner regarding the location of his assets and, if the information was not forthcoming, for the imposition of the sanction of a default judgment. The court ordered an evidentiary hearing during which the court stated that it had a unique opportunity to observe the Debtor and “endured eleven hours of what can candidly only be described as disingenuous and untruthful testimony from the Debtor.”

At the hearing, Lawrence repeatedly testified that the offshore trust was set up solely for retirement and estate plan purposes, peppering his testimony with the conflicting statements that he was no longer a beneficiary of the trust and did not have any idea what the trustee was doing with the trust property or who were the present beneficiaries and whether they ever received trust distributions. Lawrence time and again denied any creditor protection motivation in settling the Mauritian trust.

The court's opinion stressed that while pre-bankruptcy planning was permissible under the federal law, it remained axiomatic that a bankruptcy discharge was a privilege, one to benefit the honest debtor, and thus once a petition is filed it becomes the duty of the debtor to come forth with a complete and accurate financial disclosure. As for Lawrence, the court found his conduct so outside the bounds of honesty that the judge stated his intent to refer the matter to the United States Attorney for further investigation.

In its conclusion, the court not only held that public policy demanded that Florida and federal law control the disposition of the assets within Lawrence's self-settled trust but expansively stated that this would be true even if a " ... settlor did not intend to defraud her creditors or was solvent at the time of the creation of the trust." (emphasis supplied). The court's ordered Lawrence not to contact the trust or its representatives without the bankruptcy trustee's or the court's permission.

In September of 1999, Mr. Lawrence was incarcerated following an order adjudicating Lawrence in contempt of court for his failure to repatriate the funds, In re Lawrence, 238 B.R. 498 (Bankr. S.D. FL 1999), although he was released two days later because of procedural defects with the adjudication of contempt.

The Lawrence case is yet another unfortunate example of a brash debtor blatantly challenging the court with a reckless asset protection plan, virtually daring the court to try and do something about it. The sad result is to enhance the negative image of asset protection planning, causing many, otherwise legitimate plans, to start out with at least one strike against them. To get the flavor of the court's attitude towards Mr. Lawrence's flimsy argument and aggravating

performance in court, one only needs to consider a few of the judge's comments: "This court endured eleven hours of what can candidly only be described as disingenuous and untruthful testimony from the Debtor." "The Debtor's efforts to disqualify the (Bankruptcy) Trustee and his counsel were vicious, outrageous, baseless, and unsupported by credible evidence." And as to the selection of Mauritius as an understandable choice of jurisdiction, the court said, "candidly, it appears the Debtor would have set the trust up on Mars if he could have." Citing In Re Portnoy, 201 B.R. 685 (S.D. N.Y. 1996), the court stated, "There is a growing body of law surrounding debtors who have secreted their assets in distant jurisdictions with laws which would make the stereotypical Swiss banker proud." And finally, "A bankruptcy discharge for a debtor who engages in this type of conduct should be as rare as the dodo bird which once graced the shores of Mauritius."

Subsequently, Stephen Jay Lawrence was hauled back into court, In re Lawrence, 238 B.R. 498 (Bankr. S.D. Fla. 1999), and charged with civil contempt for his failure to turnover the Mauritian trust assets to the Chapter 7 bankruptcy trustee. The court stated that it "tortures reason" to believe Mr. Lawrence's statements that he transferred over \$7 million to a trust "in a far away place administered by a stranger" over which he has no control. The court found that Mr. Lawrence's retention of the power to change trustees sufficient to infer that he also had the power to repatriate the trust assets to the United States. Citing with approval the Ninth Circuit's decision (and scathing language) in Federal Trade Commission v. Affordable Media, LLC et al., 179 F.3d 1228 (9th Cir. 1999), the court in Lawrence agreed with the Ninth Circuit that although impossibility of performance is often a defense for civil contempt, in cases involving offshore asset protection trusts ". . . the burden of asserting an impossibility defense will be particularly high . . ." (quoting the Ninth Circuit). In declining to give ". . . sympathy [to] an orphan who has killed his own parents", the court held Mr. Lawrence in civil contempt, ordered him to pay \$10,000 a day until the contempt was purged, ordered him to appear back in court in one week so the court could determine compliance, ordered him to be ready to pay \$130,000 at that time if compliance was not forthcoming. It has been reported that Mr. Lawrence's ultimate failure to comply with the Court order resulted in his being jailed, although he was released after serving only two days due to procedural defects which may be the subject of an appeal.

A subsequent decision in Lawrence was issued on July 31, 2000 in which U.S. District Court Judge Gold affirmed the Bankruptcy's turn over order, contempt order, and incarceration order. 251 B.R. 630 (S.D. Fl. Bkrpt. 2000).

In affirming the turn over order, the court noted that the offshore trust was settled in 1991, and thereafter in 1994 was amended to provided that Lawrence was an "Excluded Person", that is, he could not be a beneficiary under the trust. However, the court noted that the trust documents did not state whether this exclusion was revocable or irrevocable, and since the trustees had broad power to add or exclude a beneficiary, and since Lawrence retained the power to remove and appoint trustees, that (read together) Lawrence in effect retained the power to have himself reappointed as a beneficiary and to have the entire trust property assigned to himself.

In response to Lawrence's argument that the Trustee of the Trust was a necessary part to the proceedings and must be joined as such, the court stated ". . . the Debtor/Settlor . . . remains the sole indispensable party. What we are left with is a foreign alleged trust with 'at will' trustees, and 'at will' beneficiaries, who serve or benefit at the power of the Settlor/Debtor, who created the foreign trust to hide assets and protect himself from creditors. In these proceedings, the Debtor's 'indispensable party' argument represents a guise to further shield himself from complying with the Turn Over Order, when, in reality, the so called 'rights of third parties' are no more than smoke."

AUTOMATIC STAY PROVISIONS OF BANKRUPTCY CODE PROTECTS AGAINST REPATRIATION ORDER: In Securities and Exchange Commission v. Brennan, 230 F.3d 65 (2nd Cir. 2000), the S.E.C. had procured a \$75 million dollar judgment against Robert E. Brennan and his company, First Jersey Securities, Inc. (a discount broker-dealer), for defrauding its customers in the purchase of securities. During the trial but before the judgment ordering Brennan to "disgorge" the \$75 million (and before Brennan filed for bankruptcy), Brennan established an offshore asset protection trust in Gibraltar (the Cardinal Trust, which subsequently moved to Mauritius, then to Nevis pursuant to a "flight clause"), and funded the trust with \$5 million. Brennan's three adult sons and the Robert E. Brennan Foundation were the beneficiaries of the trust, although the trustees had complete discretion whether or not to make payments to a

beneficiary. Further, the trust provided that the principal and undistributed income would revert to Brennan in ten years (or at a later time established by the trustees). Brennan initially omitted the offshore trust from his bankruptcy schedule but, upon discovery by enforcement authorities, the trust was added to the bankruptcy petition and valued at zero. [Two other offshore trusts were established by Brennan but were frozen by agreement and not the subject of this court opinion.]

The bankruptcy court denied the application by the bankruptcy trustee for an order requiring Brennan to repatriate the trust's assets, but did enter an order enjoining Brennan from taking any action which would cause the transfer of the trust's assets. Thereafter, the bankruptcy trustee brought an action in the High Court of St. Kitts and Nevis to recover the trust's assets but this action was dismissed by the High Court for failure to state a claim under Nevis law.

Following the failure of the bankruptcy trustee to reach the trust's assets, the S.E.C. filed a motion to have Brennan held in contempt for failure to comply with the disgorgement order while maintaining a "lavish lifestyle." The court in that action issued an order requiring Brennan, among other things, to repatriate the trust's assets and to deposit them in the court's registry. Brennan appealed this order as in violation of the "automatic stay" provisions of the Bankruptcy code, 11 U.S.C. 362(a).

In a case of first impression, a divided Court of Appeals found that the exception in the automatic stay provisions for an action or proceeding by a governmental unit to enforce the governmental unit's police or regulatory power was inapplicable because the "governmental unit" exception contained its own exception, that is, an exception for the government's effort to enforce a money judgment. Finding that "the question is a close one", the majority held that the governmental unit exception permits the entry of a money judgment against a debtor but not any proceeding after such entry, such as the entry of the repatriation order.

As a final note, in April of 2001 Mr. Brennan was convicted by a jury in the United States District Court in New Jersey for bankruptcy fraud and money laundering, with the possible sentence of six to ten years in prison.

DEFENDANT WHO TRANSFERRED MILLIONS INTO OFFSHORE ENTITIES FOUND IN CONTEMPT OF DISGORGEMENT ORDER BECAUSE OF INDIRECT BENEFICIAL INTERESTS: In Securities and Exchange Commission v. Bilzerian, 112 F. Supp 2d 12 (D.C. 2000), Mr. Bilzerian had been found in violation of the securities laws and had been order to disgorge approximately \$33 million in illegal profits. Bilzerian argued “financial inability” despite over \$15 million in funds offshore, primarily funneled through a Cook Islands trust established two years after the disgorgment order. Bilzerian was the Settlor of the trust, and was at one time a beneficiary but he had been removed as such by the trust protector, his sister-in-law. It was alleged that Bilzerian did not participate in his removal, and the evidence suggested that if the trust was to terminate Bilzerian would not receive any of the trust property.

The court stated that “assets in which Bilzerian may have an indirect beneficial interest are at the heart of the contempt application”, and stated that the burden on Bilzerian to establish the impossibility of repatriating the funds was “especially high” (citing FTC v. Affordable Media, 179 F3d 1228 (9th Cir. 1999 --- the “Anderson Case”) Further, the court found Bilzerian’s failure to provide the court with a copy of the Cook Islands trust to be a grave omission which “deeply concerns” the court. The court noted that Cook Islands law favored “asset protection trusts” and it may be that the trust document would disclose that Bilzerian retained significant powers over the trust and the trust property, such as retaining the right to remove the trustee or the trust protector.

In a footnote, the court noted the following as “indicia of a sham trust erected as a shell to defraud creditors”: (1) the trust was revocable; (2) until recently both Settlers of the Trust were the only beneficiaries; (3) until recently, the Settlor of the Trust was also the trustee; and (4) the current trustees and trust protector were family members.

Finally, the court noted that Bilzerian and his wife were the owners of the largest home in Tampa, estimated at \$3.5 million. The opinion traced the ownership of the home (at various times held as tenants by the entirety, or solely by Mrs. Bilzerian, or jointly, and finally one-half by the offshore trust) and noted that it was subject to a Florida homestead declaration. In a one line footnote, the court appears to state that it may consider Bilzerian’s interest in the home

despite the homestead, citing SEC. V. AMX, International Inc., 7 F3d 71 (5th Cir. 1993). In that case, Mr. Clark was the focus of an SEC disgorgement order, his only asset being his Texas home, subject to a Texas homestead. Mr. Clark had successfully argued in the lower court that the disgorgement order was a “debt” under the Federal Debt Collection Procedures Act of 1990 (28 U.S.C. Section 3001 et. seq.), and that under the Act he could elect to apply the available Texas exemptions, which included a generous homestead protection. In reversing the lower court, the Fifth Circuit held that an SEC disgorgement order was not a “debt” under the Act, but more akin to “an injunction in the public interest”: its purpose is not to compensate a victim of fraud, but rather to deny the wrongdoer of “his ill-gotten gain.” Query whether the same reasoning is applicable in Bilzerian where Fair Debt Collection Act is not in play, but rather the bankruptcy laws had been raised by the defendant.

After the failure of Mr. Bilzerian to comply with the disgorgement orders, the District Court in January of 2001 found him in civil contempt, and ordered him imprisoned. 131 F. Supp. 2d 10 (D.C. 2001).

FEDERAL COURTS MAY NOT ISSUE MAREVA-LIKE INJUNCTION ON BEHALF OF AN UNSECURED GENERAL CREDITOR: In Grupo Mexican De Desarrollo v. Alliance Bond Fund, 527 U.S. 308, 119 S. Ct. 1961, 144 L. Ed. 2d 319 (1999) Justice Scalia, writing for a divided 5-4 United States Supreme Court, and rejecting the amicus curiae position of the United States Department of Justice, held that the well established principal that a debt must be fixed by a judgment prior to a court’s interference with a debtor’s use of his property, prohibited a court of equity from issuing a Mareva-like injunction, because the equitable powers conferred on the federal courts by the Judiciary Act of 1789 did not include the power to create new equitable remedies.

The facts of the case are as follows: the defendant, a Mexican holding company engaged in the construction of Mexican roadways and toll roads, sold to the plaintiffs (11 United States investment funds) \$75 million of promissory notes. Three years later the defendant found itself mired in debt totaling over \$450 million, the majority of it owed to Mexican investors. The total debt far exceeded its available assets, such assets including “Toll Road Notes” that the Mexican

Government had issued to the defendant to reimburse them for unpaid construction receivables and expenses. The plaintiffs alleged that the defendant had instituted a program of assigning its assets to its Mexican creditors at the expense of the American investors and this they sought to stop under Fed.R.Civ.P. 65 (preliminary injunction) in the federal court. The Second Circuit Court of Appeals upheld the issuance of the injunction and the defendant appealed to the Supreme Court.

The Supreme Court's opinion preliminarily addressed, and rejected, respondent's claim that the appeal of the preliminary injunction was moot because a permanent injunction had subsequently been entered. All Justices joined in this part of the opinion.

Turning to the merits of the case, the Court first acknowledged that the equity jurisdiction of the federal courts derived from the system of law established by the English Court of Chancery and, thus, the question was one of whether the relief sought was one traditionally authorized by courts of equity. The Court examined the equitable "creditor's bill" -- raised by the United States -- and found that historically the remedy was only available to a creditor who had already reduced the debt to a judgment and found that neither the respondent nor the United States had raised any valid exceptions to the general rule, such rule being based in the sound public policy that interference with the alleged debtor's property may prove fruitless if in fact the creditor's claim failed at court.

Next the Court considered whether broad principles of equity required pre-judgment injunctive relief due to the alleged inadequacy of legal remedies in modern times of international business and lightening quick financial transactions. Refusing to elevate the court of equity beyond flexibility to what it perceived as "omnipotence", the Court left to Congress the fashioning of remedies for creditors and debtors stating that bankruptcy and fraudulent conveyance laws were better suited to regulate abuses rather than " .. an equitable power to restrict a debtor's use of his unencumbered property before judgment ..."

[As an aside, the Court noted that the Uniform Fraudulent Conveyance Act and Federal Rule of Civil Procedure 18(b) appear to provide a non-judgment creditor with rights against a debtor's

property. However, the Court noted that the Rule does not mention preliminary relief and, in any event, since neither issue was briefed by the parties it would not consider it.]

After an analysis of why the so-called “merger of law and equity” within the Federal Rules of Civil Procedure did not merit the result reached by the Second Circuit wherein the equitable arsenal was put in service for a legal claim, the Court turned to a discussion of Mareva Compania Navieras S.A. v. International Bulkcarriers S.A. 2 Lloyd’s Rep. 509 (1975) which it found to be characterized as a “dramatic departure” from prior English practice quoting commentators who called it the “nuclear weapon of the law” which “revolutionized English practice” for general creditors. The Court noted that the power to issue a Mareva injunction had subsequently been codified in England. Then, quite simply, the Court refused to take the same leap as was taken by the English court stating: “We think it incompatible with our traditionally cautious approach to equitable powers, which leaves any substantial expansion of past practice to Congress, to decree the elimination of ..a.. significant protection for debtors.”

Writing for the dissent, Justice Ginsburg stated that the majority’s opinion disarmed the district courts unnecessarily because the issuance of the “well-supported” preliminary injunction was consistent with general equity principals conferred by Congress on the federal courts in 1789. The dissent emphasized that equity was not “static” but rather adaptable to the needs and conditions of the times finding that “ ...[a] dynamic equity jurisprudence is of special importance in the commercial law context.” It found this especially so because of the “... increasingly sophisticated foreign-haven judgment proofing strategies coupled with technology that permits the nearly instantaneous transfer of assets abroad ...” which may provide debtors with a method of avoiding valid creditor claims. The dissent concluded that the Mareva court had properly exercised its equitable powers to fashion a remedy which would defeat a debtor’s attempt to make himself judgment proof.

Post-Grupo decisions have uniformly limited its holding to cases where a plaintiff neither has a lien nor an equitable interest in the defendant’s assets. See United States ex rel. Rahman v. Oncology Associates P.C., 198 F3d 489 (4th Cir. 1999); Steadfast Insurance Co. v. Auto Marketing Network Inc., 1999 U.S. App. LEXIS 19605 (7th Cir. 1999)(unpublished opinion). In

Walczak et al. v. EPL Prolong, Inc. et. al., 198 F3d 725 (9th Cir. 1999), the Ninth Circuit was faced with a purely legal claim for damages but also found Grupo distinguishable.

In the Ninth Circuit case, the minority shareholders in a class action shareholder's derivative suit alleging RICO violations, fraudulent conveyance, and breach of fiduciary duty, sought and received from a district court a preliminary injunction enjoining the consummation of a corporate plan to dissolve EPL Prolong. The corporation appealed, citing Grupo Mexicano for the proposition that the district court did not have the power to prevent the defendant from utilizing its assets simply in order to preserve those assets as a source of funds for a legal damage remedy that may result from a future judgment.

In distinguishing Grupo Mexicano, the Ninth Circuit admitted that the lower court was concerned about the dissipation of assets, a concern the United States Supreme Court had addressed and rejected as a reason to issue a preliminary injunction where no lien or equitable interest is claimed in the defendant's assets but nonetheless upheld the preliminary injunction in this case because the district court had simply restrained the corporation from proceeding with its liquidation agreement, rather than broadly freezing all the corporation's assets.

As an aside, the Ninth Circuit was presented with the interesting question of whether or not a shareholder is a "creditor" for purposes of the Uniform Fraudulent Transfer Act. While seemingly intrigued with the question, the court could find no decisions on point and did not need to reach the issue to decide the case.

UNITED STATES SUPREME COURT HOLDS THAT PRE-EXISTING FEDERAL TAX LIEN ATTACHES TO DISCLAIMED INHERITANCE BECAUSE OF THE DOMINION AND CONTROL EXERCISED BY THE DISCLAIMER OVER THE INTESTATE PROPERTY: In Drye v. United States, 528 U.S. 49, 145 L.Ed.2d 466, 120 S. Ct. 474 (1999), an unanimous Supreme Court affirmed the Eighth Circuit's holding that an intestate heir's inheritance was subject to a pre-existing Internal Revenue Service (IRS) tax lien under Internal Revenue Code (IRC) Section 6321 despite the heir's valid disclaimer of the property.

Mrs. Irma Drye died intestate, with an estate of approximately \$230,000, survived by her son, Rohn Drye, and Rohn's daughter, Theresa. At that time, Mr. Drye owed the government over \$300,000 in taxes, interest, and penalties, such liability far exceeding his assets. At the time of Mrs. Drye's death, the IRS had valid tax liens under IRC Section 6321 against all of her son's "property" or "rights to property". Rohn was appointed administrator of his mother's estate but thereafter resigned and simultaneously executed a valid disclaimer under Arkansas law, thereby surrendering all rights to his mother's estate, which then, under state law, passed to Theresa. Concurrent with the disclaimer, daughter Theresa established The Drye Family 1995 Trust which she ultimately funded with the disclaimed property. This spendthrift trust had as its beneficiaries Theresa and, during their lifetimes, Rohn and his wife. An unrelated trustee (Rohn's attorney) had the discretion to make distributions for a beneficiary's health maintenance and support.

In affirming the decision of the Eighth Circuit, the Supreme Court (Ginsburg, J.) agreed with the lower court's holding that state law controlled the determination as to whether a set of circumstances creates a "right or interest" while federal tax law controlled the determination as to whether the right or interest is "property" or the "right to property" under IRC Section 6321.

Here, the Supreme Court stated that Drye's right to his mother's intestate property was, under state law, a "valuable, transferable, legally protected right to the property at issue." If this right was devoid of value, merely a personal right of Mr. Drye's, then the Court's opinion stated that it would not rise to the level of "property" or the "right to property" under IRC Section 6321 because it would not have an "exchangeable value". In so holding the Court appeared to agree with Drye's contention that a taxpayer could decline an inter vivos (lifetime) gift without Section 6321 consequences because such declination merely maintained the status quo, that is, the property remained with the donor of the intended gift and under the donor's control.

However, the Supreme Court believed that Drye's disclaimer was tantamount to controlling the further disposition of the property. The Court state that he had the valuable "power to channel" the property to his daughter. It is this "breadth of control" which rendered the intestate inheritance "property" or the "right to property" within the reach of Section 6321.

Although there has been little, if any, initial disagreement from the Bar with the holding in Drye (who can argue that “dominion and control” are important concepts under the tax code) it can be argued that, once again, Drye represents a case of bad facts making bad law. Rohn Drye’s disclaimer of property which thereafter ends up in a trust for his (and others’) benefit, while defeating a substantial federal tax lien, is a slap in the face to a system that relies in large measure upon the taxpayer’s voluntary compliance with the tax laws.

However, the Court’s analysis of Drye’s “control” is inappropriate. While it is true that Drye could make the decision not to subject his inheritance to the tax lien, the subsequent disposition of the property was not in his control at all. It was under the control of the decedent. Contrary to the assertion of the Court that the decedent would have to be “revived” to exercise control, it may be that the decedent’s consciously chosen estate plan was to have the intestacy laws control the disposition of her estate. Further, if the decedent had died testate, the disclaimed property would have passed according to the terms of the decedent’s Will or trust, irrespective of the wishes of the disclaimant. It was not Rohn Drye’s act which channeled the property to his daughter, it was the act of the Arkansas legislature.

FOREIGN TRUSTEES AND PROTECTORS ARE DIFFICULT TO REACH FOR SETTLORS, AS WELL AS CREDITORS: In Smith v. Spillman et. al, 1999 Tex. App. LEXIS 7352 (TX Ct. App. 1999), Mr. Smith was the president and a director of a Texas corporation which was formed together with his wife, Connie, and father-in-law. The corporate stock was all owned by a Swiss trust of which Connie was the beneficiary. Two Swiss citizens, Mr. Spillman and Mr. Dunant, served as protector and trustee, respectively, and a Swiss private bank (Lombard, Odier & Cie) served as custodian of the trust’s assets. At a shareholder’s meeting in Switzerland, Spillman and Dunant, acting in their roles as protector and trustee of the Swiss trust, removed both Mr. and Mrs. Smith from the corporation’s board of directors, alleging that the Smiths were misappropriating corporate funds for their own private use.

Bad feelings ensued on all sides. The Smiths sued Spillman, Dunant, and Lombard for fraud and defamation (the case was settled), while the new corporate board referred the Smiths to the Federal Bureau of Investigation (FBI). After an indictment, trial, and acquittal, the Smiths once

again sued Spillman, Dunant, and Lombard for damages resulting from the referral to the FBI. The Swiss defendants all filed special appearances to contest personal jurisdiction in the Texas courts, such special appearances being sustained by the trial court. The Smiths' appealed.

In upholding the trial court, the Court of Appeals of Texas stated that the defendants' involvement with a Swiss trust that benefited a Texas resident was " simply not a sufficient basis upon which to assert personal jurisdiction over them."

Additionally, the Court of Appeals noted that Dunant was a director of a British Virgin Islands corporation (Heptagon BVI) which had a sister corporation (Heptagon Holland) which itself operated a subsidiary in Texas (Heptagon Capital Management) which had invested in the Smith's corporation. Heptagon BVI had also invested in the Smith's corporation. However, the Court noted that there was no evidence that Dunant had ever traveled to Texas or conducted any business on behalf of Heptagon BVI in Texas. Mere investment was not a sufficient contact to support personal jurisdiction.

Finally, it should be noted that the opinion repeatedly castigated the Smiths for failing to properly present their assertions of Texas contacts to the lower court, and for their failure to properly cite to the trial record on appeal. As a result, an interesting argument not addressed by the court was the Smiths' contention that the Swiss bank's web site constituted a solicitation of business in Texas sufficient to support jurisdiction.

A careful reader of this case would wonder why there was no power to remove? Was Dunant's investment enough to make him an adversary? Something seems to be missing?

INTERNAL REVENUE SERVICE GRANTED ACCESS TO MASTERCARD AND AMERICAN EXPRESS CREDIT CARD ACCOUNTS ISSUED BY BANKS IN THE BAHAMAS, THE CAYMAN ISLANDS, AND THE COUNTRY OF ANTIGUA AND BARBUDA: In In the Matter of the Tax Liabilities of John Does, Case No. 00-3919-CIV-JORDON (S.D. FL), a district court judge issued an order on October 30, 2000, permitting the United States to file "John Doe" summonses under 26 U.S.C. 7609(f) in order to investigate

individuals who may be using credit cards issued by offshore banks to avoid the payment of income tax. Under this tax avoidance scheme, individuals transfer otherwise taxable funds to offshore banks, and repatriate the funds to the United States tax-free by using credit cards issued by the offshore banks to make purchases, or for direct access to cash withdrawals.

DUAL FLORIDA HOMESTEAD EXEMPTIONS FOR MARRIED COUPLE WHO MAINTAIN SEPARATE RESIDENCES: In a case of first impression, the district court in Colwell and Colwell v. Royal International Trading Corporation, 226 B.R. 714 (S.D. FL 1998), held that a married couple, joint petitioners in a Chapter 7 bankruptcy could each claim a homestead exemption under the Florida Constitution where each spouse resided in a separate residence titled in his or her individual name. The court found persuasive the fact that petitioners had maintained the separate residences for an “extended period of time” (three and one-half years), that the Florida taxing authority granted each a homestead exemption for property taxes, and that the Corporation had advanced no evidence that the debtors, who are presumed honest, had maintained the separate residences for the purpose of defrauding creditors. The lower court’s decision was affirmed by the Eleventh Circuit. In re Colwell, 196 F.3d 1225 (11th Cir. 1999).

A BANKRUPTCY COURT MAY NOT ORDER TRUSTEE OF FULLY DISCRETIONARY SPENDTHRIFT TRUST TO GIVE A CREDITOR ADVANCE NOTICE OF DISTRIBUTIONS TO OF A BENEFICIARY. In In the Matter of Bass, 171 F.3d 1016 (5th Cir. 1999), grandparents of the debtor had established fully discretionary spendthrift trusts, one each for the benefit of each grandchild, including the debtor. Much later, the debtor fraudulently obtained loans from Mr. and Mrs. Denny, and when he was unable to repay this obligation, among others, the debtor fled a voluntary petition for bankruptcy. After obtaining a non-dischargeable judgment against the debtor, the Dennys learned that the discretionary trust had been providing the debtor with over \$300,000 a year. They sought and obtained an order from the Bankruptcy Court enjoining the spendthrift trust’s Trustee from making any distributions to the debtor without first providing the Dennys with at least 72 hour written and oral notice as to the date, time, source, and amount of the intended distribution. The district court affirmed based upon its reliance on the Circuit Court’s decision in In Re Moody, 837 F.2d 719 (5th Cir. 1988).

In reversing the District Court, the Circuit Court held that both the Bankruptcy Court and the District Court lacked jurisdiction. However, the Court continued to reach the “Merits” of the case even though its analysis would be admittedly “...persuasive authority at best...” in order to provide guidance on the correct interpretation of its holding in Moody. The Court went on to distinguish Moody on its facts eight ways. However, it found “...most significant from the standpoint of trust law ...” that in Moody the spendthrift trust required the Trustee to make mandatory quarterly income distributions. Therefore, the Moody Court’s order as to pre-distribution notice did not interfere with the Trustee’s discretion. In Bass, however, the Settlers of the spendthrift trust had given the Trustee “absolute discretion.” To interfere with that discretion was to “ ...ignor[e] centuries of trust law...” The Court’s opinion then provides a lengthy and instructive discussion of Anglo-American trust law regarding spendthrift trusts and discretionary trusts (of which the Bass trust was both), concluding that the courts “...can neither prohibit nor command the exercise of such discretion, or otherwise interfere -- directly or indirectly -- with the unfettered discretion of such Trustees.”

PROFESSIONAL ADVISORS MAY BE LIABLE TO THIRD PARTIES FOR AIDING AND ABETTING THE TORTS OF THEIR CLIENTS, ALTHOUGH THE COURT WILL NARROWLY AND STRICTLY INTERPRET THE ELEMENTS OF THE CRIME: In Witzman v. Lehrman, Lehrman & Flom, 601 N.W. 2nd 179 (MN 1999), the beneficiary of several trusts alleged that her brother, the trustee of the trusts, had breached his trust by failing to provide accounts, charging excessive fees, withdrawing trust assets for personal use, engaging in self-dealing by purchasing trust assets at less than fair market value, and making unwise investments. These claims were mediated and settled for approximately \$4 million. Thereafter, the beneficiary sued the accounting firm which had represented the trustee (both individually and in his fiduciary capacity) for aiding and abetting the alleged breach of trust. Specifically, the beneficiary alleged that the accountants had participated in the breach of trust by failing to disclose the trustee’s alleged tortuous actions, by preparing trust “draw accounts” used by the trustee, and by not acting to prevent the charge of excessive fees. At the trial level, the court held in favor of the accountants on all claims, holding that Minnesota did not recognize a common law cause of action against professionals for aiding and abetting tortuous conduct. The court of appeals reversed this holding and remanded the case to the lower court for trial on the issues. The

accountants appealed to the Supreme Court of Minnesota, which affirmed the court of appeal's decision.

The state Supreme Court cited Section 876 of the Restatement (Second) of Torts which provides that “. . .for harm resulting to a third person from the tortuous conduct of another, one is subject to liability if he . . . knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other so to conduct himself{.}” The Court explained that while it had long held persons liable for the tortuous conduct of another under the aiding and abetting theory of Section 876, it recognized that the Court had never applied that Section to a case involving the liability of a professional. To do so, the Court reasoned, could potentially undermine the professional-client relationship of trust, creating a conflict of interest for the professional who would be unable to perform “routine professional services” without concern for protecting their own backs. On the other hand, to grant professionals a blanket exclusion from the Section 876 tort would permit them “. . . to provide any assistance short of fraud . . .” in working with clients. Balancing these two competing interests, the Court held that in cases alleging aiding and abetting against professionals, the courts would “narrowly and strictly interpret the elements of the claim” and the plaintiff would be required to plead with particularity the facts to establish each claim.

The Court went on to examine each element of the claim in light of its holding and found that the beneficiary had failed to meet its burden because there was no factual pleading that the accountants had “actual knowledge” of the tortuous conduct (rather than knowledge inferred from 30 years of representation of the trustee), and there was no factual pleading that the accountants had substantially assisted the trustee (beyond the provision of routine professional services consisting of preparation of financial statements, provision of tax advice, and recording conveyances).

ERISA PENSION PLAN DOES NOT HAVE TO BE “TAX QUALIFIED” TO BE EXEMPT FROM BANKRUPTCY ESTATE: In In re Sewell, 180 F.3d 707 (5th Cir. 1999), the United States Court of Appeals for the Fifth Circuit followed the lead of the Seventh Circuit in In re Baker, 114 F.3d 636 (7th Cir. 1998) and held that a debtor's interest in her employer's pension

plan was excluded from her bankruptcy estate under Section 541(c)(2) of the Bankruptcy Code even though the plan was not tax qualified. Here, the plan had been administered in violation of Section 4975 and had lost its tax qualified status.

FACIALLY QUALIFIED PENSION PLAN USED BY DEBTOR AS HIS "PERSONAL PIGGY BANK" NOT EXEMPT FROM BANKRUPTCY ESTATE: In In re Goldschein, 244 B.R. 595 (D. MD. 2000) the debtor had approximately \$430,000 in a defined benefit pension plan that was admittedly "ERISA qualified" and also "tax qualified" under Internal Revenue Code Section 401(a), and which he sought to have excluded from his bankruptcy estate. However, the court noted that the debtor was the employer (he was the President of the corporation), the employee, and the plan trustee. Further, the debtor did not operate the plan according to its own terms or the requirements of the law: his wife was a plan participant even though she was not an employee, and the debtor took large unsecured loans from the plan at will. The court held that to exempt a qualified plan regardless of how it was operated would be to "elevate form over substance." Here, the abuse of the plan resulted from the debtor's own actions, and benefited the debtor himself, and therefore the plan lost the protection it might otherwise have been afforded.

SPENDTHRIFT TRUST PROTECTION UPHOLD WHERE DEBTOR IS CO-TRUSTEE AND DISCRETIONARY BENEFICIARY: In In re Schwen, 240 B.R. 754 (D. Minn 1999), a spendthrift trust was established by the debtor's mother two years prior to the debtor's filing of Chapter 7 bankruptcy, at which time the mother was deceased and the trust irrevocable. The debtor and her brother were co-trustees who had to act jointly, and the beneficiaries of the trust were the debtor, her brother, and her father. The trustees had the power, in their sole discretion, to pay income or principal for a beneficiary's "accustomed manner of living, education, and maintenance in health and reasonable comfort." Except for a pre-petition distribution to the debtor of \$13,800 and a \$5,000 post-petition distribution to her, all other distributions were made for the benefit of the father. The bankruptcy trustee brought suit to declare the spendthrift provision invalid because the debtor exercised too much control over the trust property. In holding for the debtor, the court stated that the debtor's control was sufficiently limited by her co-trustee to preserve the spendthrift protection. Additionally, the court stated that the fiduciary

duties owed to her father as well as to her brother sufficiently limited the amount of control the debtor exercised as trustee.

“ABUSIVE TRUST” CASES MAKING THEIR WAY TO COURT: The IRS in Notice 97-24, 1997-1 C.B. 409 (1997) alerted taxpayers to its position that promoters of “certain trust arrangements” considered abusive by the IRS, and the taxpayers who establish such trusts, were to be the subject of active examination by the IRS as part of the National Compliance Strategy, Fiduciary and Special Projects. Two years later, disputes prompted by this effort has begun to reach the courts. In two companion cases, Zachman v. Commissioner, T.C. Memo 1999-391 (1999) and Zachman v. Commissioner, T.C. Memo 1999-392 (1999) the Tax Court assessed deficiencies, additions to tax, and penalties on taxpayers who had set up “business trusts” for the sole purpose of avoiding income tax liability. In Ramseyer v. United States, ____ F. Supp. ____, 99-2 U.S. Tax Cas. (CCH) P50,931 (N.D. OH 1999), the taxpayers sought to quash an IRS Section 7602 summons issued as part of the National Compliance program. In upholding the summons, the District Court stated that the IRS met its prima facia burden of establishing that the summons was issued in “good faith”, in part by relying on the existence of Notice 97-24 to establish the “legitimate purpose” of the summons.

DOMESTIC LEGISLATION

RHODE ISLAND: With Senate Bill 867, adding a new Chapter 18-9.2 to Title 18 “Fiduciaries”, Rhode Island entered the competition for individuals who want to settle irrevocable trusts to protect themselves from the claims of certain creditors. Effective immediately, the law in large measure tracks the ground-breaking Delaware law. However, the Rhode Island law incorporates none the refinements made by Delaware in 1998 and onward.

As a companion bill, S.B. 869, amending Section 34-11-38 of the General Laws, abolishes the Rule Against Perpetuities for interests in property created after the effective date of the Act. The law bluntly states that “The common law Rule Against Perpetuities shall no longer be deemed in force and/or of any effect in this state.”

NEVADA: In a major revision of its laws relating to spendthrift trusts and fraudulent transfers, Nevada has thrown its hat into the ring to become a player as a creditor protection jurisdiction. The provisions of A.B. 469 include:

- Settlor may execute spendthrift trust for his or her own benefit: Previously, a Nevada spendthrift trust could only be executed for the benefit of someone other than the Settlor. Amended NRS 166.040 extends the protection of a spendthrift trust to the Settlor as long as the trust is irrevocable, income or principal distributions to the Settlor are in the discretion of a third party, and the trust was not intended to hinder, delay or defraud known creditors. For the purposes of this section, “irrevocable” includes a trust wherein the Settlor may prevent a distribution from the trust and/or the Settlor holds a testamentary special power of appointment or “similar power.”
- Two Year Statute of Limitations: A new section to Chapter 166 provides that if a person is a creditor at the time a Settlor makes a transfer to a spendthrift trust, an action with respect to that transfer must be brought within the later of 2 years from the transfer or 6 months after the creditor discovers (or reasonably should have discovered) the transfer. The law also amends Nevada’s fraudulent transfer law (NRS 112.230), which provides 4 years to challenge a fraudulent transfer, to conform to the new 2 year limit for transfers to spendthrift trust.
- Nexus to Nevada: Amended NRS 166.060 provides that for a spendthrift trust to benefit from the Nevada law, it may be created in a state other than Nevada as long as some of the trust property is located in Nevada or at least one Nevada Trustee has the power to maintain the trust records and prepare income tax returns and at least part of the administration of the trust is performed within Nevada. Additionally, if the spendthrift trust is self-settled, at least one trustee must be a person who is a resident domiciliary or is a trust company or bank doing business in Nevada.
- Rule Against Perpetuities: Amended NRS 166.140 applies the Uniform Rule Against Perpetuities (NRS Section 111.103 to 111.1039) to spendthrift trusts.

Nevada, which has been a domestic “tax haven” for many years, apparently has sought to become a domestic asset protection jurisdiction, along with Alaska, Delaware, and Rhode Island. In fact, it appears that Nevada has gone “one better” in this regard by virtue of its shorter statute of limitations: two years from the transfer to the APT or six months after an existing creditor could reasonably have discovered the transfer, versus four years and one year, respectively, for the other three states. Whether this, along with its weather and popular entertainment attractions, will cause Nevada to be the jurisdiction of choice remains to be seen, as does the more essential underlying question of whether domestic asset protection trusts really work at all.

ALASKA: Several changes in the Alaska asset protection law have occurred since its enactment in 1997. They include:

(1). In 1998, S.B. 354 was signed into law which amended several provisions of the Alaska Code, including AS 13.36.105 - AS 13.36.295 (The “Alaska Trusts Act”). Note that Section 25 of the law states that most of the changes regarding trusts apply only to testamentary trusts created by persons dying after the effective date of the Act, nontestamentary trusts created on or after the effective date, and testamentary and nontestamentary trusts that are registered or re-registered after the effective date of the Act if the registration specifically states that the trust will be governed by the Act. Highlights include:

- Change of Situs: New section AS 13.36.043 sets forth the mechanism for changing the situs of an existing trust to Alaska.
- Flexibility: Unless otherwise provided in the trust instrument, new section AS 13.36.157 permits a trustee of a testamentary instrument or an irrevocable inter vivos agreement, whether or not originally created in Alaska, who has the absolute discretion to invade the principal of the trust for the benefit of a present income beneficiary to exercise that discretion by appointing part or all of the principal of the trust to a trustee of a different trust as long as no income interest is thereby diminished.

- Challenges to a Trust: New subsection AS 13.36.310(b) preserves a trust by stating that where a successful creditor asserts rights under AS 34.40.110 (restricting transfers of trust interests), the trust (or property transfer) will only be voided to the extent necessary to satisfy the creditor's claim and costs and attorney's fees otherwise permitted under the rules of the Alaska courts. The successful creditor may still fail to reach satisfaction, however, as new subsection AS 13.36.310(c) establishes a superior trustee lien as against a successful creditor for the fees, including attorney's fees (regardless of court rules), incurred by a good faith trustee in defending against the court action
- Nonqualified trustees: New section AS 13.36.320 states that individuals who reside outside of Alaska, trust companies that have their principal place of business outside of Alaska and are not organized under Alaska laws, and banks that have their principal place of business outside of Alaska or are not organized under Alaska law may all be trustees as long as there is at least one qualified (Alaskan) trustee. Further, such nonqualified trustee will not be considered as engaging in business within Alaska solely based upon its status as a nonqualified trustee.
- Fraudulent Transfers: Section AS 34.40.110(d) relating to a cause of action for relief with respect to a fraudulent transfer was expanded to include not only a creditor's cause of action under Alaska law [AS 34.40.110(b)(1)] but also other laws as well, presumably the laws of other states where the transfer into trust may have originated prior to the transfer of the trust to Alaska. It does not appear to expand the period of limitations under existing Alaskan law. Additionally, new Section AS 34.40.110(f) does not permit a creditor or any other person from asserting a cause of action against a trustee or others involved in the preparation or funding of the trust for conspiracy to commit fraudulent conveyance, aiding and abetting a fraudulent conveyance, or participation in the trust transaction.

(2) In 2000, Alaska amended AS 34.27 to add new Sec. 34.27.051 which provides relief from the so-called "Delaware Tax Trap." While not identical to Delaware's law, which provides similar relief, look to Delaware below for a detailed summary of this issue.

(3) Also in 2000, Alaska House Bill 222 amended several sections of the Alaska code to make clear that a charging order is the exclusive remedy of a judgment creditor whether the judgment debtor be a member of a limited liability company (new AS 10.50.380) or a general or limited partner of a limited partnership (amended AS 32.11.170(b) and new AS 32.11.340). The act makes clear that foreclosure on the debtor's interest and a court order for directions, accounts, or inquires are not permitted.

DELAWARE: Several changes in the Delaware asset protection law have occurred since its original enactment. They include:

(1) Delaware enacted several laws in 1998 to fine-tune its trust and business entity laws. In H.B. 747, signed into law on June 29, 1998, amends Title 12 of the Delaware code (the 1997 "Qualified Dispositions in Trust Act"). Highlights include:

- Release or Relinquishment not a Disposition: The definition of "disposition" in 12 Del. C. 3570(4) was amended to exclude the release or relinquishment of an interest in property by the transferor as long as such property theretofore was the subject of a qualified disposition. The intent of this provision is to permit a transferor to release a special power of appointment without causing the limitations period to start again. This is consistent with fraudulent conveyance laws in general.
- Statute of Limitations: The fraudulent transfer provisions of 12 Del. C. 3572 were amended to add a new subsection 3572(c) which provides that where a qualified disposition is made by a transferor who is a trustee, the original transfer to the trustee marks the beginning of the running of the limitations period.
- Note that Section 3573 of the Delaware Code provides that the protections afforded a transferor by the state's Qualified Dispositions In Trust Act do not apply to debts a transferor may have to a spouse or former spouse. With enacted Senate Bill 67, the legislature made clear that the exemptions do not apply to a spouse or former spouse who becomes married to the transferor after the qualified disposition has occurred.

(2) Next, the 140th Delaware General Assembly continued the refinement. Highlights include:

- Superlaw Protection for Professionals Utilizing the Qualified Dispositions In Trust Act: In order to “. . . maintain preeminent position in the field of trust law . . . “ H.B. 369 amends Delaware’s Qualified Dispositions In Trust Act. First, 12 Del. Code Section 3572 is amended by deleting subsection (d) in its entirety and adding new subsections (d) and (e). New subsection (d) provides that creditors (whether or not the claim arose before or after the qualified disposition) or “any other person”, may only assert those rights given in 12 Del. Code Sections 3573 and 3574, and may not proceed against a trustee or advisor or any other person involved in “counseling, drafting, preparation, execution, or funding” a trust that is a subject of a qualified disposition. Subsection (e) further provides that no action of any kind, whether in law or equity, may be brought against the same above-noted persons to enforce a judgment of a court (or other body with adjudicative authority) if, as of the date such action is brought, an action by a creditor with respect to the qualified disposition would be barred. Second, Section 3574(b)(2) was amended to afford a beneficiary (including a beneficiary/transferor) the presumption that she or he acted in good faith in creating the trust or by accepting a distribution from the trust according to its terms.
- Companion Protection For Advisors Under The Fraudulent Transfer Law: 6 Del. Code Section 1307 of the Delaware Code (Fraudulent Transfers), was amended by H.B. 370 to provide that “notwithstanding any other provision of law or equity”, a creditor may not petition Delaware Courts for relief against a “trustee, attorney, or other advisor” who did not act in bad faith “merely by counseling or effecting a transfer.”

(3) In June of 2000, Senate Bill 318, was enacted which sets forth ten additional changes to Delaware’s Qualified Dispositions in Trust Act. They are:

- Section 3570(4) definition of “disposition” is expanded to include “a change in the legal ownership of property occurring upon the substitution of one trustee for another or the addition of one or more new trustees”

- Section 3570(9)'s definition of "qualified trustee" is amended by deleting subsection 9(e) and adding new subsections (e) and (f). The amendment clarifies that in the case of co-trustees, only one such co-trustee must be a Delaware individual or a Delaware bank or a Delaware trust company
- Section 3570(10)'s definition of "trust instrument" is expanded by deleting Subsection 10(b) and adding new Subsections 10(b)(4) and (5) which provide that a charitable remainder trust may be the subject of a qualified disposition as so may a so-called "total return trust" as long as the transferor retains a yearly interest which does not exceed 5% of the trust property
- A new Subsection (d) of Section 3570(10)'s definition of "trust instrument" to state that the trust instrument does not have to state that Delaware law controls in order for a qualified disposition to occur as long as there is a disposition by a non-qualified trustee to a qualified trustee and all other requirements are met
- Section 3571 (Retained Interests of Transferor) is amended in its entirety to make clear that a transferor has no powers other than those specifically provided in the trust instrument and no rights to property other than those permitted by the Delaware statute
- Section 3572 (Avoidance of Qualified Dispositions) is amended to provide in Subsection 3572(a) that the Court of Chancery shall have exclusive jurisdiction over any action with respect to a qualified disposition
- Section 3572 is further amended to make clear that the extinguishment of a creditor's claim is governed by Delaware's fraudulent transfer law (6 Delaware Code Section 1309) and that in any action brought by a creditor, the burden of proof lies with the creditor and the standard of proof is one of clear and convincing evidence
- Section 3572 is further amended to amend Subsection 3572(c) in its entirety to permit the "tacking" of the existence of a trust even if the tacking period includes a time prior to July 1, 1997, the date of enactment of the Qualified Dispositions in Trust Act
- Section 3573 (Persons Not Subject to Qualified Disposition) is amended to state that Subsection 3573(1), which exempts certain alimony and support payments from the Act, does not apply to any claim for forced heirship or legitimate
- The new law provides for a severability clause and also states that items (i), (ii), (iv), (v), (viii) above, and the severability provision, are effective as of July 1, 1997 while all other provisions are effective as of the date of enactment of Senate Bill 318.

(4) In 2000, relief was provided for the so-called “Delaware Tax Trap.” Under the “Trap” [IRC Section 2041(a)(3)] federal estate tax inclusion results for a donee of a limited (special) power of appointment when such power is exercised at death to create a second power, but only if applicable local law permits the second power to be exercised in a manner which postpones the absolute ownership of the property for a time period ascertainable without regard to the date of the creation of the first power, and the effect of which would be to postpone vesting beyond the applicable perpetuities period. The same estate tax would apply with regard to the gift tax rules and lifetime exercise of limited powers of appointment. Delaware law permits such postponement of ownership, and due to the popularity of Delaware dynasty trusts with practitioners that may not be familiar with this aspect of the federal tax code and Delaware law, there has arisen a concern that donees of limited powers of appointments may inadvertently find the property subject to that power included in their estates. Enacted Senate Bill 313 amends Section 503(c) and adds a new Section 504 to Chapter 5 “Rule Against Perpetuities; Powers of Appointment” to insure that the tax trap does not apply to dynasty trusts which are exempt from the federal generation-skipping transfer tax. In the case of these exempt trusts, every interest created by the exercise of a limited power of appointment which grants another (“second”) limited power of appointment, then that second power and any interests created by the second power’s exercise (including additional powers of appointment) shall be deemed to have been created at the time of the creation of the first power. The new law applies to wills, deeds, and other instrument exercising powers of appointment that are exercised after the date of the law without regard to when such power of appointment was granted.

(5) Also in 2000, Senate Bill 359 amended Delaware’s Chapter 5 “Rule Against Perpetuities; Powers of Appointment” by enacting a new subsection 503(f) to make clear that a Delaware trust is permitted to own intangible personal property in perpetuity even though the trust may also own real estate. Delaware law presently applies a 110 year Rule Against Perpetuities for real property held in trust. Intangible personal property would include interests in a corporation limited liability company, or any other business entity regardless of whether or not such business entity itself owned real estate.

SOUTH DAKOTA: Note should be taken of South Dakota's enactment of legislation establishing disinterested third-party "trust protectors", S.D. Section 55-1B, a relatively new phenomenon in domestic trusts. The powers of a trust protector may include the power to modify the trust instrument to obtain favorable tax status, to increase or decrease the interests of any beneficiary, and to modify a power of appointment. The trust protector may not, however, grant a beneficial interest to one or more persons not specifically provided for within the trust instrument. By becoming a trust protector, that individual is thereby subject to the jurisdiction of the courts of South Dakota.

IDAHO: Under Idaho's new law (S.B. 1078 enacted March 24, 1999), a trust protector is defined as any disinterested third party whose appointment is provided for within the trust document. The trust protector's powers track the powers provided under the South Dakota law and may include the power to modify or amend the trust to achieve favorable tax status; to increase or decrease the interests of any named beneficiary of the trust; and to modify the terms of any power of appointment granted within the trust. However, the trust protector may not grant a beneficial interest to any individual(s) not specifically provided for within the trust itself. The law also provides for a trust advisor who is nominated for the sole purpose of making investment decisions for the trust to the exclusion of all others. The settlor may be a trust advisor.

It is encouraging (and perhaps a direct credit to the Asset Protection Bar) to see our states gradually recognizing the role of protector. Those of us who use them are well aware of the value and flexibility they can add to family trusts, asset protection and otherwise. The more we learn about and understand the role of protector the greater the puzzle as to why we have not been using the office long before this.

The Idaho protector law goes somewhat further than the laws of the only two other states that allow for protectors, in that it enumerates some specific powers the protector may hold. The potential risk or shortcoming to this approach, however, is that it can be exclusionary. For instance, while it is clear that an Idaho protector can increase or decrease interests of beneficiaries (which presumably means she could delete a beneficiary by decreasing his interest to zero), it is equally clear the protector can't add a new beneficiary (unless, perhaps, she did so

by modifying the terms of a power of appointment, as allowed by the statute). These and other questions will hopefully be answered as the law is put into use.

MISSISSIPPI: In response to the Supreme Court of Mississippi's disregard of a trust's spendthrift provision where the settlor's son, a lifetime income beneficiary, was the defendant in a successful personal injury action, see Sligh v. First National Bank of Holmes County, 704 So. 2d 1020, rehearing denied, 706 So. 2d 251 (1997), the Mississippi legislature has enacted "The Family Trust Preservation Act of 1998." The Act is codified as Article 11 in Chapter 9, Title 91. The Act provides that that except in the cases of a self-settled trust, a beneficiary's interest which is the subject of a spendthrift provision may not be transferred nor subjected to the enforcement of a money judgment until paid to the beneficiary.

Note that Georgia, O.C.G.A. Sec. 53-12-28(c)(1) (1998), and Louisiana, La. R.S. 9:2005(3) (1998) by statute continue to permit a beneficiary's interest in a spendthrift trust to be seized or transferred to satisfy a tort judgment in certain cases.

COLORADO: Wealthy foreigners who seek to shelter their assets in a stable political and economic environment can now add Colorado to the available list of offshore jurisdictions, that is if anyone with a \$200,000 minimum investment takes up the legislature's invitation to establish a foreign capital depository ("FCD") pursuant to the recently enacted S.B. 83. The state hopes to profit from the FCDs by charging initial charter fees, annual charter fees, and a yearly charge of 1.5% of the value of the deposits. Montana, which enacted similar legislation two years ago, has yet to have charter a FCD. The only other state to consider FCD legislation, Hawaii, decided in 1998 to forgo the idea, primarily due to concerns that Hawaii would become a haven for money-laundering activities.

MAINE: With House Bill 371, Maine exempts from the rule against perpetuities trusts wherein the trust instrument itself states that the rule does not apply and the trustee has the power to sell, mortgage, or lease property for a period of time which exceeds the perpetuities period.

INTERNAL REVENUE SERVICE AND THE TREASURY DEPARTMENT

TRANSFER TO IRREVOCABLE DOMESTIC (ALASKAN) ASSET PROTECTION SPENDTHRIFT TRUST FOR THE BENEFIT OF SETTLOR AND OTHERS A COMPLETED GIFT FOR GIFT TAX PURPOSES. In PLR 9837007, issued on June 10, 1998, almost one year following the initial ruling request, the Internal Revenue Service issued its first ruling regarding transfers to an Alaskan Trust: Under the facts of that ruling, the donor, a resident of Alaska, proposed to create an irrevocable spendthrift trust for the benefit of herself and her descendants. Neither the donor, her descendants, or any related party within the meaning of section 672(c) of the Internal Revenue Code could serve as trustee. The Trustee would have sole and absolute unfettered discretion to pay income and/or principal to any beneficiary. Under Alaskan trust law a creditor of the donor would be unable to reach the trust assets.

Based on the representation that there is no implied or express agreement between the Donor and the Trustee as to how the discretion will be exercised, the IRS ruled that the transfer would be a completed gift for gift tax purposes but specifically refrained from ruling as to whether the transferred property will be out of the donor's estate for estate tax purposes.

FINAL SECTION 7701 REGULATIONS ON GUIDANCE REGARDING THE DEFINITION OF A TRUST AS A DOMESTIC TRUST OR A FOREIGN TRUST: Final regulations (T.D. 8813) were released by the IRS on February 2, 1999. The final regulations contain more liberal definitions of the "court" and "control" tests. The control test will be met where one or more United States persons (including settlors and beneficiaries) have the authority to control all substantial decisions of the trust, rather than requiring, as did the proposed regulations, that all fiduciaries be United States persons. The court test will be met where the trust instrument does not direct that the trust be administered in a foreign jurisdiction and, in fact, the trust is administered in the United States.

The more liberal control test is what many asset protection attorneys have been arguing for, as it apparently allows the typical asset protection trust arrangement to be more conveniently carried

out. That is, the trust could have an offshore trustee and a U.S. trustee (perhaps the settlor and/or his spouse), providing that while the U.S. trustee continued to serve as trustee, he, she, or they would have effective control over substantial trust decisions. At such time as there was no U.S. trustee, all substantive trust decisions would be made by the offshore trustee. This event, along with the other necessary steps such as immediate expatriation of trust assets, would make the trust a foreign trust and remove it from the jurisdiction of the U.S. Courts.

GUIDANCE ON FOREIGN TRUSTS AND FOREIGN GRANTORS: IRS ISSUES FINAL, TEMPORARY AND PROPOSED REGULATIONS FOR SECTION 672, SECTION 643 AND SECTION 671 WHILE WITHDRAWING ITS PROPOSED REGULATIONS UNDER SECTION 7701: On August 5, 1999, the IRS issued its latest regulations concerning foreign trusts (T.D. 8831). An in-depth analysis of the 63 page document is beyond the scope of this summary. However, highlights include:

(1) Final regulations were adopted for Section 643(h)(Estate and Trust Definitions). The final regulations provide that property transferred from a foreign trust (FT) through an intermediary to a U.S. person where a principal purpose was U.S. tax avoidance will be deemed a direct transfer from the FT to the U.S. person if three conditions are met: (a) the U.S. person is related to the grantor of the foreign trust or has a relationship that supports the inference that the transfer could be gratuitous; (b) the U.S. person receives from the intermediary the property the intermediary received from the foreign trust (or its proceeds or substituted property) and such receipt is within the period beginning 24 months before and ending 24 months after the intermediary's receipt of the property; and (c) the U.S. person cannot demonstrate to the Commissioner that (among other things) intermediary acted independently of the grantor and trustee, the intermediary is not an agent of the U.S. person. This regulation is applicable to transfers made after August 10, 1999.

(2) Final regulations were adopted for Section 672(f)(Trust Definitions and Rules). The final regulations define when foreign persons are to be treated as owners (grantors) of a trust. Abandoning the complicated two-step analysis of the proposed regulations, the final regulations state that grantor trust rules other than Section 672(f) are first applied to determine whether any portion of the trust is to be considered owned by a person other than a U.S. citizen or resident, or

domestic corporation. The terms of the trust and the REGS. 1.671-1 et seq. will govern this determination. If it is so determined, such person will be treated as the owner of that portion only if such person is a Section 672(f) foreign corporation or qualifies for an exception set forth in Reg. 1.672(f)-3. This regulation is applicable to taxable years of a trust beginning after August 10, 1999.

(3) Temporary regulations under Section 671 [Reg. 1.671-2(e)] defining the grantor of the trust have been modified to make clear that an “accommodation grantor” (such as an attorney acting on behalf of a client) will not be treated as an owner of the trust if that person creates and/or funds a trust with an amount that is directly repaid to that person within a reasonable time, and makes no further gratuitous transfers to the trust.

INTERNAL IRS MEMORANDUM ARGUES THAT A SINGLE MEMBER LLC IS A DISREGARDED ENTITY FOR TAX PURPOSES, BUT NOT FOR TAX COLLECTION PURPOSES: The taxpayer, the sole member of a single member limited liability company (LLC) organized under West Virginia law, sought to avoid an IRA levy upon a business to which the taxpayer was performing services by directing the business to pay the LLC, rather than the taxpayer directly. The Revenue Officer inquired of the Branch 2 Chief (General Litigation) as to whether the IRS could file a lien against the LLC on the ground that it is a disregarded entity. The Branch Chief held that the mere fact that the LLC is a disregarded entity for federal income tax purposes is not in of itself sufficient to disregard it for tax collection purposes. In fact, one must look to state law to determine the taxpayer’s property interest in the LLC. Here, State law a member of a LLC is not an “owner” of the LLC, and does not possess a transferable interest in the property of the LLC. Therefore, the IRS would have to establish an independent basis for the collection of the tax such as collecting the taxpayer’s distributive interest in the LLC or collecting from the assets of the LLC on an “alter ego” basis, using a “piercing the veil” analysis borrowed from corporate law.

HUSBAND-BENEFICIARY’S STATUS AS TRUST PROTECTOR OF FOREIGN TRUSTS DO NOT CAUSE HIM OR HIS WIFE TO BE TREATED AS “GRANTORS” OF THE TRUSTS UNDER THE GRANTOR TRUST RULES OF SECTIONS 673-679: In a Field Service Advice dated September 23, 1999, foreign trusts were established by an individual

neither a citizen or resident of the United States and unrelated to the trusts' beneficiaries (a husband and wife). The husband was the protector of the trusts with the power to approve or veto all actions by the trustees. The trust specifically stated that the Protector did not have a general power of appointment over the corpus or any incident of ownership in the same. As a beneficiary, the husband was the entitled to the trust's income.

In holding that the Protector powers did not make the husband and wife "grantors" of the foreign trusts, the FSA assumed that the beneficiaries did not make any transfers to the trusts. It went on to state that if it turned out that the subsequent funding of the trusts was in large part undertaken by the husband and wife (or at their direction), then they may be considered "grantors" under Regulation 1.671-2T(e)(1). Additionally, if the individual who set up the trusts was simply a "straw man" (the husband and wife's agent), the grantor trust rules may render the husband and wife grantors.

In a separate discussion, the FSA discussed the application of Subpart F rules to the beneficiaries. Husband and wife were the beneficiaries of Foreign Trust 1, which was the 100% beneficiary of Foreign Trust 2. Foreign Trust 2 owned 100% of Foreign Corporation V and of Foreign Corporation W. Both of Foreign Corporation V and of Foreign Corporation W owned 10% of Foreign Corporation X and of Foreign Corporation Y. The husband's brother also owned 10% of Foreign Corporation X and of Foreign Corporation Y. The FSA (after a lengthy discussion) concluded that IRC Section 958(a)(2) and Regulation Section 1.958-1(c)(2) require the holding that the husband and wife are treated as owning 10% of the stock of Foreign Corporation X and of Foreign Corporation Y, and as such must take into account their 10% interest in the subpart F income of Foreign Corporations X and Y.

THE DEPARTMENT OF THE TREASURY'S FINANCIAL CRIMES ENFORCEMENT NETWORK ISSUES FINANCIAL ADVISORIES AGAINST 15 NATIONS: The federal Bank Secrecy Act (codified at 12 United States Code Sections 1829b and 1951-1959 and 31 United States Code Sections 5311-5330) authorizes the Secretary of the Department of the Treasury to issue regulations which require financial institutions to keep records and file reports that would be useful as tools against money-laundering and that would be useful for other criminal, tax, and

regulatory matters. This authority has been delegated to the Director of the Financial Crimes Enforcement Network (FinCEN).

In March of 1996 FinCEN began publication of the “FinCEN Advisory.” This publication is designed to inform domestic and international financial, regulatory, and law enforcement communities of money-laundering and financial crimes trends and developments. These Advisories may be found on the web at www.ustreas.gov/fincen. In July of 2000, FinCEN issued 15 FinCEN Advisories directing financial institutions to give “enhanced scrutiny to all financial transactions originating into or routed to or through” any one of the 15 named nations or which involved “entities organized or domiciled, or persons maintaining accounts” in any of the countries. Each Advisory made clear that United States financial institutions could still maintain legitimate business relations with each county, stated the United States’ readiness to assist each nation in an effort to eliminate the named deficiencies.

The nations cited in the Advisories are the Commonwealth of The Bahamas, the Cayman Islands, the Cook Islands, the Commonwealth of Dominica, the State of Israel, Lebanon, the Principality of Liechtenstein, the Republic of the Marshall Islands, the Republic of Nauru, Niue, the Republic of Panama, the Republic of the Philippines, the Russian Federation, the Federation of St. Kitts and Nevis, and St. Vincent and the Grenedines. Note that the Financial Action Task Force on Money Laundering (FATF), an group international of 29 member states created in 1989 and affiliated with the Organization for Economic Cooperation and Development (OECD), on June 22, 2000 issued its annual report which cited these same 15 nations as “non-cooperative” in the fight against money-laundering.

A full discussion of each FinCEN Advisory is beyond the scope of this summary but the following are the major issues raised by FinCEN: (1) Failure to institute a requirement that financial institutions report suspicious transactions; (2) Failure to institute adequate “know your customer” safeguards or to even identify the customer at all; (3) Requirement of court order to cooperate with supervisory officials of host country; (4) Cumbersome judicial process to cooperate with officials of other jurisdictions; (5) Strict bank secrecy, including anonymous and numbered accounts; (6) International business companies or “exempted companies” which issue

bearer shares; (7) Failure to maintain bank records; (8) Failure to make money laundering a criminal offense, or criminalizing it in only limited instances; (9) Ownership records of offshore entity may be kept in nominee form; (10) Offshore entities not required to disclose names of officers, directors, beneficial owners; (11) Ineffective supervision of offshore entities; (12) Delegation of supervisory responsibilities to foreign private sector interests; and (13) Persons with criminal records may hold management positions in banks.

INTERNATIONAL LAW

BAHAMAS SCRAPS TRUSTEE LAWS GROUNDED IN THE 19TH CENTURY AND LEAPS INTO THE 21ST: The new Trustee Act of 1998 is a complete revision of the Bahamas' existing trustee laws, such law originating in the English Trustee Act of 1893. The 1998 Act incorporates the use of trust protectors, modernizes the types of investments a trustee may utilize, provides for the declaration of protective trusts, and delineates trust accounting requirements.

SAMOA STRENGTHENS ITS OFFSHORE LEGISLATION: The Government of Samoa passed legislation amending existing laws and enacting new ones in an attempt to make it more attractive as an offshore destination. According to John Ashwood of the Asiatic Trust Group, the highlights include:

- An amendment to the “International Companies Act” allowing for the formation of international companies limited by guarantee, and by both shares and guarantee, the latter termed “hybrid companies.” The amendments were based on legislation from the Cook Islands and Alderney in the Channel Islands. These type of companies are popular in civil law jurisdictions.
- Enactment of the “International Partnership and Limited Partnership Act.” The Act, premised upon English common law with some modifications, requires that either type of partnership have one partner who is either an international company, a foreign company, or a trustee company registered in Samoa and all other partners must be non-residents. The partnership

must maintain a registered office in Samoa and operate under a registered name. Limited partners take no part in the management of an International Limited Partnership.

- Re-domiciliation made easier. It will be easier to bring an overseas company to Samoa because the consent of the home jurisdiction of the overseas company will no longer be required. Reduced fees have also been instituted.
- The Offshore Banking Act was amended to improve the quality of banking activities, especially in the areas of operational controls, record maintenance, reporting, and audit.
- Minor amendments to the International Insurance Act serve to tighten the supervision of offshore insurance companies although the operations of captive insurance companies licensed in Samoa are not expected to be materially affected.

COOK ISLANDS INCREASE CREDITOR PROTECTION: Sections 13B(14) and (15) of the International Trust Act of 1984 was amended early in 1999 to restrict the ability of creditors to enforce punitive damage awards within foreign judgments. The amendment defines “punitive damages” to include any amount awarded “which comprise any form of exemplary, vindictive, retributory, or punitive damages” including amounts arrived at by “doubling, trebling, or otherwise multiplying a sum assessed as compensation for the loss or damage” The creditor will have the burden of proving which part of the foreign judgment award does not constitute punitive damages. That is, all damages are considered punitive unless proven otherwise.

FROM JOHN MCFADZIEN, SPECIAL COUNSEL TO SOUTH PACIFIC TRUST LIMITED,
COMES THE FOLLOWING 2000 UP-DATE ON THE COOK ISLANDS AND NEVIS:

NEVIS: By an amendment to the Nevis International Exempt Trusts Ordinance 1994, the Nevis legislature recently updated its trust laws. The amendment became law on the 15th September, 2000. The amendments will strengthen the asset protection features of Nevis trusts and will allow advisors’ greater planning flexibility in that a trust may be registered in Nevis but retain

foreign law as its governing law until it is decided to amend the governing law to that of Nevis.

The amendments touch upon a number of areas, and in brief:

- Amend the definition of “person” so as to include a body corporate;
- Provide for “qualified foreign trusts”, being trusts which can be registered in Nevis but which are governed by other than Nevis law;
- Clarify, in relation to time limits set out in the Ordinance, when those time limits commence to run;
- Make a trust invalid and unenforceable when the trust assets or any part thereof are the proceeds of crime for which the settlor is convicted;
- Enable property settled on a trust with intent to defraud to be treated separately from other property of that trust;
- Define the date of a “cause of action” (from which date certain protective time limits run) as being the earliest possible cause of action capable of being asserted against a settlor, and providing further that the entry of judgment in any proceeding does not constitute a separate cause of action;
- Provide that a remedy under the Ordinance whereby a creditor of a settlor may allege fraud is the sole remedy available to the creditor;
- Prevent claims not alleged initially by a creditor, from being alleged in subsequent proceedings;
- Define “creditor” as including any person alleging a cause of action against a settlor;
- Re-write the registration provisions, enabling (as well as international exempt trusts governed by Nevis law) trusts governed by other than Nevis law, to be registered in Nevis as “qualified foreign trusts”. The asset protection provisions in section 44 of the Ordinance are extended to apply also to qualified foreign trusts upon their changing the governing law to that of Nevis. In such cases, section 44 is deemed to have applied as if, in relation to a disputed settlement of property on the trust, the trust was registered as an international exempt trust on the date on which that property was settled on the trust;
- Empower the Minister of Finance, without any stated cause, “to remove any trust from the register”.

COOK ISLANDS: Within two months of appearing on the FATF “blacklist” of countries alleged to have inadequate laws to prevent money laundering, the Cook Islands has enacted the Money Laundering Prevention Act. The Act became law on the 18th August, 2000. Until now, the Cook Islands has had the Offshore Industry (Criminal Provisions) Act which enabled trustee companies to report to a regulatory authority, suspicious transactions. The regulatory authority could then place the matter before the High Court, and seek directions, including as to the disposal of the funds involved in the transaction. In addition, the International Trusts (Due Diligence) Regulations required trustee companies to obtain certain assurances as to the origin and ownership of funds settled on international trusts, with assurances also as to the solvency of the person settling those funds. Neither of these laws however, both of which are retained on the statute books, made money laundering an actual offense. Nor did they establish a mutual assistance regime. The Money Laundering Prevention Act makes money laundering an offense.

- “Money Laundering” is defined as knowingly –
 - (a) engaging directly or indirectly, in a business transaction that involves property that is the proceeds of crime, knowing or having reasonable grounds for believing the same to be the proceeds of crime; or
 - (b) receiving, possessing, concealing, disguising, transferring, converting, disposing of, removing from or bringing into the Cook Islands any property that is the proceeds of crime, knowing or having reasonable grounds for believing the same to be the proceeds of crime.
- “Proceeds of crime” is defined as “the proceeds of unlawful activity (whether derived or obtained directly or indirectly through such activity), and includes any property that is mingled with property that is the proceeds of unlawful activity.”
- “unlawful activity” means “any activity which –
 - (a) is an offense under the Crimes Act 1969 [of the Cook Islands] and carries a maximum penalty of imprisonment of not less than 5 years imprisonment or the death penalty; or
 - (b) under the laws of the place where the activity occurs, constitutes drug trafficking; or
 - (c)

- (i) under the laws of any place where the activity occurs constitutes an offense which carries a maximum penalty of imprisonment of not less than 5 years or the death penalty, and
- (ii) would be an offense under the Crimes Act 1969 if such activity occurred within the Cook Islands and such offense carries a maximum penalty of imprisonment of not less than 5 years or the death penalty.

The Act establishes a Money Laundering Authority, made up of the Commissioner of Police, the Commissioner for Offshore Financial Services, and the Financial Secretary who is the senior Financial Adviser to Government. It is to this body that reports of suspicious activity are made. If reasonable grounds exist to suspect that money laundering is about to or has occurred, a copy of the report is sent to the Solicitor General, who is the principal legal adviser to the Crown and its agencies, and the person who would normally conduct prosecutions for serious offenses. The Authority may also issue operating guidelines to financial institutions. These may be enacted by Government in the form of regulations.

Obligations are placed on financial institutions to maintain records of all transactions exceeding NZD30,000 (Approximately USD12,300) in amount, every account opened and the beneficial owners of every account. Financial institutions are also required to develop and apply policies, procedures and controls to combat money laundering and develop audit functions to evaluate such controls. In the event that the Authority is required to take steps to investigate suspected money laundering by a financial institution, the Authority may obtain search warrants and property tracking orders from a judge of the High Court, upon satisfying the judge that there are reasonable grounds for doing so. Orders freezing property and, following conviction, forfeiting property, may also be obtained from the High Court.

The Act establishes a regime whereby the authority may consider and act upon requests from foreign States, provided certain information is supplied to the authority by that foreign State. This includes, confirmation that an investigation or prosecution is being conducted or that a conviction has been entered overseas, the basis for the investigation, identity of persons involved, and the information sought. Search warrants and property tracking orders can be

obtained by the Authority to obtain information from a financial institution if the Authority. Again, freezing and forfeiture orders can be made by the High Court if the Court is satisfied that proper grounds exist. Similarly, there is provision for the Authority to, make requests for information to foreign States. The Act does little more than impose as a legislative requirement, due diligence procedures which Southpac has had in place for some years. The Act was prepared in consultation with the Cook Islands Trustee Companies Association, and Southpac was engaged by the Government to prepare the final draft for presentation to Parliament.

CAYMAN ISLANDS ATTEMPT TO RESTRICT APPLICATION OF SHAM TRUST DOCTRINE: Ever since the infamous Rahman v. Chase Bank (CI) Trust Company Limited 1991 JLR 103, where a trust was considered a “sham” due to the powers retained by the Settlor, and therefore the trust’s assets were held to be in the estate of the Settlor and subject to the testamentary laws of the Settlor’s domicile, practitioners have been concerned about the amount of control a Settlor may retain without triggering Rahman. The Trusts (Amendment)(Immediate Effect and Reserve Powers) Law 1998 was enacted to create a presumption in favor of the establishment of a valid trust and sets forth a “safe harbor” for the powers that a Settlor may reserve without running afoul of Rahman. As long as the deed of trust does not specifically state that it is a testamentary instrument (Will or Codicil), the Amendment provides that such deed will establish a valid trust that will be given immediate effect. Further, the following powers may be reserved by the Settlor without rebutting the presumption of a valid trust given immediate effect: (a) a power to revoke, alter, or amend the trust instrument, in whole or in part; (b) a power to revoke, alter, or amend any power arising under the trust instrument, in whole or in part; (c) a power to act as an officer or director of a company even if the company is owned in whole or in part by the trust; (d) a power to direct the Trustee in decisions regarding the purchase or sale of property within the trust; (e) a power to add or remove a beneficiary; (f) a power to appoint or remove a Trustee or a Trust Protector; (g) a power to activate a flee clause; and (h) a power to limit the exercise of a Trustee’s discretion by requiring the Trustee solely to act with the consent of the Settlor or any other person identified within the trust instrument. The Amendment immediately applies to all trusts created after May 11, 1998. For pre-existing trusts, the Trustees by deed may apply the Amendment to the trust.

TRANSFERS TO THE ISLE OF MAN WILL NOT BE VOIDABLE BY FUTURE CREDITORS: In Re the Petition of Christopher Jollian Heginbotham, 2 International Trust and Estate Law Reports (ITELR) 95 (1999), the Isle of Man's High Court of Justice held that the Isle of Man's fraudulent transfer law applied only to transfers that had the intent to defraud known, existing (present) creditors, and creditors whose action/claim arose after the transfer could not use the law to reach the assets.

THE UNITED KINGDOM SEEKS TO MODERNIZE THE INLAND REVENUE'S ABILITY TO INVESTIGATE TAX FRAUD: On November 29, 1999, an Inland Revenue Technical Note set forth proposals to modernize the Inland Revenue's ability to investigate criminal tax fraud. Currently, the Inland Revenue's main criminal investigation power is Section 20C Taxes Management Act of 1970 which permits the Inland Revenue to obtain search warrants for the premises of third parties (typically lawyers, bankers, accountants, and other professionals who are not themselves suspected of criminal activity) in order to obtain knowledge of the targeted taxpayer's suspected fraud. If records are held off-site in a storage facility, a second warrant must be obtained for each premise. The Chancellor of the Exchequer proposes in Finance Bill 2000 to give the Inland Revenue the power to compel the production of original documents, rather than continuing the need for individual searches.

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