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IS THE USA TRYING TO WIN THE OFFSHORE TRUST RACE?

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It's no secret that the offshore trust business generates substantial profits for the banks that handle and manage the trust money—but these are not U.S. banks, and the U.S. banks have not been happy about that. The trend of sending money offshore began in seriousness around the 80's and 90's, when U.S. persons began sending more and more of their funds to offshore trusts they established for many reasons, including global diversivacation and asset protection. Going offshore was important for asset protection because a number of offshore jurisdictions passed laws that allowed a person to establish a trust for her own benefit while prohibiting the person's creditors from reaching the trust assets (called a self-settled trust). With minor exception, such an arrangement was simply not allowed in the United States.

Tiring of losing substantial profits and other business that was leaving the U.S. like a runaway train, U.S. banks and bar associations began to promote legislation that permitted the establishment of self-settled spendthrift trusts in their particular state, hoping this would reverse the trend. The first was Alaska in 1997, followed by Delaware only a few months later. Then other states began to do the same, the most recent being West Virginia only a few weeks ago. This brought the grand total to 17 of what are now called Domestic Asset Protection Trust (DAPT) states.

What does this mean? It means that a person (the settlor of the trust) can establish a trust in any of the 17 states and transfer assets to the trust, which may then pay benefits back to that settlor, while, the settlor's creditors cannot reach the trust assets. Of course, there are rules that must be followed and acknowledged. One important such rule is the statute of limitations. This is the period within which the settlor's creditors can challenge the transfer to the DAPT as a fraudulent transfer (one that unfairly prejudices the settlor's creditors). This varies among the 17 states from 18 months in Ohio to 5 years in Virginia. (In bankruptcy a 10 year statute of limitations may apply.) Then there is the very important question of whether it is the DAPT state's period of limitations that applies, or the period applicable in the settlor's domicile, as suggested by the new proposed Uniform Voidable Transactions Act (the UVTA). The UVTA also seems to suggest that a transfer of this sort could be regarded as per se fraudulent. The presence of those differences will bring about conflicts of laws issues to determine which state's laws will apply. And the conflict of laws question goes beyond the limitations issue, to include whether there is sufficient nexus to the DAPT state to brings its DAPT statute into play at all. And then there is the overriding issue of the full faith and credit clause of our federal Constitution. If a Massachusetts settlor established a South Dakota trust and a Massachusetts creditor obtains a judgment against him, the question may <u>not</u> be whether the creditor can enforce the judgement in South Dakota but rather, may the creditor enforce the judgment against the South Dakota <u>trust</u>?

Although "the jury is out" on this question, we must remember that one of the most important elements of an asset protection plan is to legally place obstacles before a creditor, encouraging a settlement or even a withdrawal of the lawsuit if the battle is to be a long one and the obstacles are disproportionally expensive to overcome. In the example above, for instance, it

may be that by the time the creditor gets his judgement in Massachusetts and seeks to enforce it in South Dakota, the South Dakota open period (2 years) has run, and that is one obstacle for the creditor to overcome. If the creditor is successful in establishing that the Massachusetts open period (4 years) will apply, then there is the issue of whether the full faith and credit clause should apply to the South Dakota Trust. It would be argued by the trustee that maybe it should not apply, because the judgment was against the settlor and not against the trust—still another obstacle, and this one in a federal court. And it may not end there!

Despite the obstacles presented in a case involving a DAPT, however, there remains the unsettling, underlying feeling that such trusts are still subject to U.S. courts' jurisdiction and to the unpredictable reaction by the judges in those courts. That is to say, it is not impossible for a court to interpret the "law" in a manner inconsistent with established principles to reach a result the court believes is fair, as we have seen in the recent Massachusetts decision in Pfannenstiehl. On the other hand, if it is the court in the DAPT jurisdiction that is deciding the case, one gets some encouragement by the fact that the court's inclination would be to support that state's law. In any event, it is generally agreed among practitioners knowledgeable in the field that on balance an offshore trust is substantially more protective than a DAPT, for the simple reason that such trusts are not subject to the jurisdiction of any U.S. court. But, of course, the story doesn't end there, because the debtor and likely some of his assets typically are here, subject to a U.S. court's jurisdiction.

If our client does decide to place his protective bet on a DAPT, how do we advise the client when choosing among the 17 states? The answer is, carefully and knowledgably, because many of them differ in important respects, beginning with the period of limitations on a claim as noted above. As noted above, Ohio has the shortest at the moment, and Virginia, the longest.

Nevada and South Dakota are favored because of their 2 year statues, but 16 of the 17 states give existing creditors (existing at the time the DAPT is settled) additional time to sue tied into the creditor's reasonable discovery of the trust. Only West Virginia fixed its statute at 4 years for both existing and future creditors.

Then there is the level of proof a creditor must meet to challenge a transfer. For some of the states, such as New Hampshire and Tennessee, it is only a "preponderance of the evidence," while in others, such as South Dakota or Delaware, the creditor must meet the harsher standard of "clear and convincing" evidence. (For the commonly used offshore jurisdictions, the burden of proof is "beyond a reasonable doubt.") Furthermore, even if a creditor met the required burden of proof, some states, such as South Dakota and Ohio, will only apply the proof to the specific creditor making the challenge, while others, such as Utah, New Hampshire, and Missouri allow all creditors to benefit from the proof of one, opening a large door to attacks.

There are many other distinctions among the DAPT state group, but a few of the states have sort of risen to the top of practioners' lists—they are, Alaska, Delaware, Nevada, Ohio, and South Dakota. That's the good news. The bad news is that there are as yet no reported cases that have tested the strength of a properly established domestic asset protection trust in any of the 17 states.

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