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Emerging Challenges in Asset Protection Planning

Inga Ivsan

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Inga Ivsan[*]

J.D./LL.M. (Estate Planning),

University of Miami School of Law

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Manager, Swiss Private Wealth Advisors, LLC[**]

Asset protection planning has gained in popularity and acceptance among estate planners over the past two decades, and is now a headline topic at national legal conferences and a featured subject in law school curricula. While the self-settled

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[*] Inga Ivsan is a Vice President and Chief Marketing Officer for a Swiss-based financial services group that includes international trust companies, insurance management firms, and a wealth advisory organization registered with the U.S. Securities & Exchange Commission to provide services to U.S. clients. In this capacity, Ms. Ivsan supervises a global program of professional education and client outreach events.

For many years, Ms. Ivsan served as a Trust Manager in the Swiss headquarters of an international trust company. She has extensive experience with Swiss banking institutions that provide services to trust and LLC clients.

Ms. Ivsan holds a Juris Doctor cum laude and Master of Laws in Estate Planning from the University of Miami School of Law. She is also the manager of Swiss Private Wealth Advisors, LLC, a U.S.-based company that provides liaison services for lawyers seeking to procure international trust, LLC, family office, and insurance management services on behalf of their clients.

[**] Swiss Private Wealth Advisors, LLC was established by a team of wealth management professionals with two decades of experience serving the offshore financial services industry. They are recognized leaders in the field of international asset protection.

In addition to authoring LLC and trust legislation in several jurisdictions, members of their staff helped develop some of the leading professional education conferences centered on asset protection and offshore planning. The company is pleased to represent offshore service providers at some of the nation's leading conferences for estate planners, accountants, and insurance and wealth management professionals.

spendthrift trust was once considered the domain of a handful of offshore jurisdictions, sixteen American states have now enacted legislation to facilitate such planning closer to home.

This article examines the historical challenges and contemporary threats to asset protection planning, including: Past use of the contempt powers of the courts to compel debtors to repatriate assets held offshore; tort liability for civil conspiracy and civil RICO claims; attorney liability and ethical considerations; and the distinction between "fraudulent transfers" and "fraud." Recent cases point to the emergence of a new doctrine – the per se fraudulent transfer rule – affecting asset protection planning even in those states that recognize self-settled spendthrift trusts. Transitioning away from asset protection trusts to more modern, cutting-edge techniques – including captive insurance and LLCs – enable lawyers to offer a broader spectrum of solutions and better secure client assets from creditor threat.

I. INTRODUCTION AND UNANTICIPATED POLICY ARGUMENTS

Society instinctively fears what it does not understand. Asset protection is tinted with adverse connotations and fears of the unknown. Asset protection planning could be likened to tax planning: A field fraught with its own perks and pitfalls. Like tax planning that follows the guidelines of available tax authorities, asset protection planning that abides by the governing authorities on fraudulent transfers generally works. By contrast, antagonistic asset protection planning may be compared to antagonistic tax planning, which is likely to land both the client and the attorney in hot water.

Popular media, combined with the outcomes of a handful of cases featuring notoriously bad facts,[1] feed a fallacy that needs to be elucidated: Asset protection remains a legitimate and requisite device in individual estate planning when conducted within the boundaries of the law. Affirming this viewpoint, 16 states[2] have enacted domestic asset protection trust ("DAPT") laws to enhance certainty in this particular area of planning.[3]

This article reexamines historical challenges to asset protection planning and concludes that the emerging trend does not look auspicious for straightforward asset protection. If the primary reasoning for the structure is to achieve asset protection benefits, states like California will likely find the structure to be a *per se* fraudulent transfer. Even in those states that do not follow the California rule, courts are inclined to disfavor a structure created for asset protection reasons. One should look

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1 *See* Federal Trade Comm'n v. Affordable Media, LLC 179 F.3d 1228 (9th Cir. 1999) (where the Andersons ran a Ponzi scheme through their late-night telemarketing business and placed the money into a Cook Islands trust which was later challenged by the FTC).

2 Hawaii, Nevada, Missouri, New Hampshire, Alaska, Delaware, Oklahoma, Ohio, Rhode Island, Utah, South Dakota, Tennessee, Virginia, Wyoming, West Virginia and Mississippi. 7th Annual Domestic Asset Protection Trust State Rankings Chart, http://oshins.com/images/DAPT_Rankings.pdf.

3 State-approved DAPT laws override common United States public policy, as it was explained in the Restatement, and allow a settlor to form a trust benefitting himself to afford him with protection from future creditors. RESTATEMENT (SECOND) OF TRUSTS § 156(2) (1959).

ahead by considering the rationale of the ruling in *Kilker v. Stillman*[4] and the Section 548(e)(1) clawback rule of the Bankruptcy Code; these are the early warning signs as to what may come to be a majority approach in the future.[5]

"[E]ffective people are not problem-minded; they're opportunity-minded. They feed opportunities and starve problems. They think preventively."[6] Attorneys seeking to push back against this trend may have to look outside the traditional planning models of asset protection trusts and consider other approaches that do not signify an inherent asset protection motive. Captive insurance offers perhaps the most effective way for an operating business to realize profits inside an asset protective structure, while facilitating important estate planning goals at the same time. LLCs and foreign investment funds also offer a variety of indirect asset protection benefits while serving primarily business objectives.

This article seeks to consider the less publicized and yet to be articulated arguments in favor of asset protection planning. From a social policy standpoint, one may argue that, by deterring attorneys and clients from engaging in asset protection planning, the United States legal system emboldens economic waste. Spending one's money and becoming a debtor entails little consequence, whereas those who choose to preserve wealth through an asset protection trust face potential liability for years afterward.

From an economic standpoint, discouraging wealth preservation reflexively incites imprudent lending, conceivably leading to another market bubble. The last recession revealed the awesome scope of greedy creditors and slippery lenders who offered zero-down financing and "no document" mortgages to those with insufficient credit. Yet, when the bubble burst, creditors leaned on a legal bias built into the Uniform Fraudulent Transfer Act ("UFTA") and state court judges, who instinctively side with creditors at the expense of debtors. The UFTA, a set of uniform fraudulent transfer laws enacted in almost every state, provides a defined set of legal remedies to creditors. Among other things, a creditor may ask a court to set aside a fraudulent transfer under the UFTA, awarding the transferred property to the creditor instead of the debtor.

Moreover, the debtor historically has had a choice between preserving wealth and spending it, and public policy should not discourage the frugal in favor of the reckless. An individual should be allowed to spend his after-tax money notwithstanding the remote

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4 Kilker v. Stillman, 2012 WL 5902348 (Cal. Ct. App. Nov. 26, 2012) (unpublished).

5 11 U.S.C.A. § 548(e)(1) (2012).

6 STEPHEN R. COVEY, THE 7 HABITS OF HIGHLY EFFECTIVE PEOPLE: RESTORING THE CHARACTER ETHIC 154 (2004) (paraphrasing Peter Drucker).

possibility that one day a future creditor might come calling. Individuals should not be expected to compromise their estate plans and leave their life savings forever exposed to satisfy the claims of unknown and unanticipated creditors. Individuals who responsibly insure their home, automobiles, health, and wealth should not be any less worthy of legal protection than those who spend their earnings into oblivion.

The bias in the legal system, which favors creditors, creates a moral hazard in which creditors are immunized from their own poor decisions. It denies the lending industry the opportunity to learn from experience. Instead of requiring the creditor to bear the costs of bad loan decisions, policy judgments underlying the UFTA and state court rulings on fraudulent transfers instead shift the costs of credit to the community at large through clogged court dockets. Taxpayers are forced to incur, among other things, the high cost of incarcerating debtors, even though such incarcerations are blatantly illegal, because creditors hoodwink state court judges into thinking that contempt of court is a legitimate means to compel payment of a debt.

Social responsibility is likewise harmed by penalizing risk-averse behavior such as asset protection planning for those who seek to preserve their wealth when no liabilities are present or foreseeable. The layered complexity surrounding asset protection cannot be easily covered in a single article. However, this article will attempt to tackle the emerging issues through "simplicity without reduction"[7] and offer the unanticipated and less often publicized arguments in light of recent cases that seek to curb asset protection planning.

A. *Asset Protection Defined*

"Asset protection," first and foremost, serves to preserve wealth by erecting barriers between a creditor and one's assets. Asset protection planning advances on the basis of two guiding principles: First, the manner in which assets are titled generally defines the scope of creditor remedies and judicial discourse governing claims to such assets;[8] second, a creditor entitled to collect on a judgment may only reach those assets in existence at the time of collection – the creditor cannot reach back in time to attach assets that are no longer owned by the debtor.

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7 Göran Broman, John Holmberg & Karl-Henrik Roboèrt, *Simplicity Without Reduction: Thinking Upstream Towards the Sustainable Society,* 30 INTERFACES. 15 (2000) (stating "[A]nalysis begins at a level where complexity is naturally low, rather than at a level of detail where links to the principles of the system can be vague and difficult to discern. We use the simplicity-without-reduction method out of respect for complexity, in contrast to the common method of ignoring parts of reality to (seemingly) reduce complexity.").

8 BARRY S. ENGEL, ASSET PROTECTION PLANNING GUIDE 115-125.06 (3rd ed. 2013).

Traditional asset protection planning first looks to utilize the exemptions and protections available under domestic law, such as homestead, ownership by entirety, and retirement accounts.[9] After exhausting all available exemptions, asset protection seeks to protect the remaining assets by utilizing legal structures that typically entail the severing of legal ownership from beneficial ownership.[10] Asset protection planning is consistent with the freedom to dispose of one's property as one wishes, which is deeply rooted in American history and law.[11] For example, "New York law recognizes the right of individuals to arrange their affairs so as to limit their liability to creditors . . . ."[12] This is also consistent with Judge Learned Hand's renowned view that every person has the right to organize his endeavors to decrease his taxes.[13]

Asset protection, especially when accomplished offshore, has been equated with "hiding assets" and "immoral" or "illegal" activity.[14] Contrary to popular perception, however, asset protection planning tends to be a fairly transparent process, due in no small part to provisions requiring that ownership of foreign trusts, business entities, and bank

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9 *Id.* at 155.

10 *Id.*

11 "All men are born free and equal, and have certain natural, essential, and unalienable rights; among which may be reckoned the right of enjoying and defending their lives and liberties; that of acquiring, possessing, and protecting property; in fine, that of seeking and obtaining their safety and happiness." Mass. CONST. art. 1; *see also* FRANKLIN B. HOUGH, AMERICAN CONSTITUTIONS: COMPRISING THE CONSTITUTION OF EACH STATE IN THE UNION, AND OF THE UNITED STATES, WITH THE DECLARATION OF INDEPENDENCE AND ARTICLES OF CONFEDERATION; EACH ACCOMPANIED BY A HISTORICAL INTRODUCTION AND NOTES, TOGETHER WITH A CLASSIFIED ANALYSIS OF THE CONSTITUTIONS, ACCORDING TO THEIR SUBJECTS, SHOWING, BY COMPARATIVE ARRANGEMENT, EVERY CONSTITUTIONAL PROVISION NOW IN FORCE IN THE SEVERAL STATES; WITH REFERENCES TO JUDICIAL DECISIONS, AND AN ANALYTICAL INDEX. ILLUSTRATED BY CAREFULLY ENGRAVED FAC-SIMILES OF THE GREAT SEALS OF THE UNITED STATES, AND OF EACH STATE AND TERRITORY 576 (2d vol. 1872).

12 *In re* Joseph Heller Inter Vivos Trust, 161 Misc. 2d 369, 370 (N.Y. Sur. Ct. 1994); *see e.g.* Public Health Trust of Dade County v. Lopez*,* 531 So.2d 946 (Fla. 1988) (noting that Florida recognizes the homestead exemption to preserve wealth); *see also* First Nat'l Bank of Leesburg v. Hector Supply Co., 254 So.2d 777, 779 (Fla. 1971) (noting that Florida recognizes asset protection when real estate is owned as tenants by the entirety).

13 "Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant." Commissioner of Internal Revenue v. Newman*,* 159 F.2d 848, 850-51 (2d Cir. 1947) (Hand, J., dissenting).

14 *See* Engel, *supra* note 8 at 176.02-175.03.

accounts be reported to the IRS on an annual basis.[15] In reality, modern asset protection planning is not about hiding assets; it is a foreseeable response to a liberal legal system that entertains frivolous litigation as much as it is an unanticipated reaction to irresponsible creditors who imprudently lend funds to unqualified borrowers on an insufficiently collateralized basis.

When properly implemented, asset protection planning enhances one's ability to fend off claims.[16] In this sense, one may analogize asset protection with an indispensable form of insurance for one's wealth, with a deductible measured by the settlement value of the creditor's claim. Thus, those who are risk-averse and seek to preserve their wealth may stand the greatest chance of benefiting from asset protection planning, as if obtaining a liability insurance policy.

B. *Asset Protection Using Trusts*

Asset protection planning is synonymous with the use of trusts. The underlying purpose of a trust is to give someone else—a trustee—assets to be held for the benefit of others. A self-settled spendthrift trust is the prevailing solution where a settlor, the owner of the assets, transfers legal ownership to a trustee but still enjoys the benefit of the assets.[17] Notably, a self-settled spendthrift trust is a trust in which the settlor is also the beneficiary under a spendthrift clause.[18] Historically, state courts have not permitted settlors to place their assets beyond the reach of creditors and enjoy the protection of a spendthrift clause, considering the self-settled spendthrift trust to be void against public policy.[19] The only trusts that were recognized were traditional trusts, where the beneficiary and settlor were not the same person.[20] Traditionally, the use of a trust allowed individuals to avoid probate and prevent direct access to the assets by beneficiaries. [21] Due to the enactment of recent laws in DAPT

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15 Laura Sanders, *Offshore Accounts: No Place to Hide?*, WALL STREET JOURNAL (Sept. 20, 2013), http://online.wsj.com/news/articles/SB10001424127887324807704579085511331606786.

16 *See* Engel, *supra* note 8 at 135-145.

17 *Id.* at 901.03.

18 BNA Portfolio 810-3rd, Asset Protection Planning, pp. A-51.

19 *Id*. at 901.04.

20 *Id.*

21 *See generally* STEPHEN J. CHOI, THE UNFOUNDED FEAR OF REGULATION S: EMPIRICAL EVIDENCE ON OFFSHORE SECURITIES OFFERINGS, 50 DUKE L. J. 663, 665 (2000).; A well-known historian, who focused on the study of English law, has notably said: "The idea of a trust is so familiar to us all that we never wonder at it. And yet surely we ought to wonder." *Id*. In England, during the Middle Ages, landowners devised the "*use*," a planning device that evolved with time into present-day trusts. *Id*. The donor was named a "*feoffee to uses*," and the intended beneficiary of the use was named a "*cestui que use*." *Id*. The beneficiary was allowed to take the profits and to convey per the instructions of

states and offshore jurisdictions, a settlor now can establish a self-settling spendthrift trust, name himself a beneficiary, and achieve wealth preservation. Most offshore jurisdictions and DAPT states acknowledge the necessity of having a spendthrift clause that would disallow the beneficiaries under duress from any future creditor re-assigning their interest.[22]

Attorney, first began to create self-settled spendthrift trusts as an asset protection device by seeking out jurisdictions where transfers in trust were likely to be shielded from creditor claims. The Isle of Man became a focal point for this type of planning after the 1859 ruling in *Corlett v. Radcliffe,* where the court found that fraudulent transfer claims must be handled with an *ad hoc* approach.[23] There, the Manx court upheld the trust where the settlor was solvent at the time the trust was funded and declined to set aside transfers in trust as fraudulent against future unanticipated creditors.[24] This principle was reinforced over 100 years later in *In re Heginbotham*, a 1999 decision sustaining transfers by a solvent settlor to a trust; at the time of trust funding, there were no reasonably foreseeable creditors, even though the settlor subsequently became insolvent.[25] As Winston Churchill stated "[T]he farther back you can look, the farther forward you are likely to see."[26]

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the feoffee. *Id*. Henry VII ratified the statute of uses to offset the adverse revenue consequences incurred by the popularity of the use, attaching ownership of legal title to the beneficiaries of the use to hold them liable for taxes. *Id*. Yet, the statute of uses provided some exceptions from taxation, such as where an feoffee held some form of ownership in "*active trust*," which led to the formation of the modern-day English trust. *Id*. Generations later, the United States Supreme Court equated the *use* and *trust. Id*.

[22] Engel, *supra* note 8 at 915.01.

[23] *See* Corlette v. Radcliffe, 14 Moo PCC 121, 15 ER 251 (1859) (Isle of Man).

[24] *Id*.

[25] *Re* The Petition Of Christopher Jollian Heginbotham, 2 ITELR 95 (1999) (Isle of Man).

[26] Margaret Brown, *Lost in Abbreviated History*, TIMES HIGHER EDUCATION (Aug. 7, 2014), http://www.timeshighereducation.co.uk/comment/letters/lost-in-abbreviated-history/2015018.article.

Indeed, several countries[27] have enacted trust laws meant to codify certain common law principles originating from the Isle of Man.[28]

Some countries have also enacted additional provisions to deter creditors and offer more protection for trusts registered in their particular jurisdictions.[29] For example, Belize offers immediate protection for transfers in trust, eliminating the applicability of fraudulent transfer law altogether.[30] Belize eliminated the concept of "badges of fraud" and any evaluation of the intent behind transfers in trust after consulting attorneys in England and the United States during the drafting of its asset protection laws.[31] Fraudulent transfer claims are disallowed against a Belize trustee, thus offering the ultimate asset protection. Consequentially, an irrevocable offshore trust is perhaps the most effective vehicle that affords ultimate asset protection: the owner irreversibly and permanently transfers the legal ownership of the assets to a trust and, after naming himself a beneficiary, as in a self-settling spendthrift trust, is able to enjoy the use of the property or assets under the supervision and discretion of a trustee, preferably residing in a foreign jurisdiction.[32]

C. *Codification of Modern Asset Protection Trust Law*

Following the success of offshore asset protection trusts, sixteen DAPT states[33] have enacted laws permitting and recognizing some form of self-settled spendthrift trust.[34] An extensive list of assets can be preserved via asset protection planning, including business interests, a professional practice, stocks, cash, real property, and most other forms of wealth. Non-DAPT states still permit creditors to reach assets of a self-settled spendthrift trust to fulfill judgments against the settlor "on the basis that the 'door to trust assets' remains open as a self-settled

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27 The Cook Islands passed laws codifying asset protection in 1989 to its International Trusts Act. Highlights of the law include recognition of self-settled spendthrift trusts, a shortened statute of limitations for fraudulent transfers, and a requirement that the credit prove beyond a reasonable doubt that the debtor acted with the requisite intent to establish a fraudulent transfer. In 1992, Belize enacted asset protection trust laws utilizing a slightly-different approach. In 1996, Nevis followed the Cook Islands and Belize by enacting its own asset protection law. Its laws duplicated to a large extent the laws enacted by the Cook Islands. Nevis legislation added another protective layer by requiring that a creditor post a bond of approximately USD 13,000 to file a complaint against a Nevis trustee. *See* BELIZE TRUSTS ACT, ch. 202 (2000).

28 *See, e.g.,* Cook Islands, Belize, and Nevis.

29 *See generally* BELIZE TRUSTS ACT, ch. 202 (2000).

30 *Id*.

31 *Id*.

32 Engel, *supra* note 8 at 1020.01.

33 *Supra* note 2.

34 Engel, *supra* note 8 at 945.

spendthrift trust; a judgment creditor would not need to [revert] the parties to their original position."[35] In non-DAPT states, if a settlor assigns a beneficiary other than himself, such a spendthrift trust would be afforded protection from creditors unlike a self-settled spendthrift trust, where the settlor and beneficiary are the same individual.[36] However, as seen in *Castellano*, the creditors of a beneficiary, which are not the same as the settlor, may still be able to reach the assets of even a traditional spendthrift trust.[37]

Until now, the absence of case law affirming the viability of domestic asset protection trusts have led most attorneys to recommend that their clients engage in asset protection planning primarily through offshore jurisdictions. The efficacy of asset protection planning should best be judged by its outcome. To date, the available case law suggests that ultimately no domestic self-settled spendthrift trust would be able to protect the trust assets,[38] although a domestic trust could theoretically work where the trustee, the debtor, and the creditor all reside in a state that recognizes domestic asset protection trusts.[39] However, that is an extremely narrow exception and, for the residents of the 34 states that have not enacted explicit DAPT statutes, offshore planning is arguably the only way to go. Moreover, offshore asset protection trust jurisdictions are governed by their own laws and do not always recognize other countries' judgments unlike states, which are subject to enforce each other's judgments under the Full Faith and Credit Clause.[40]

Many offshore jurisdictions offer user-friendly asset protection laws, and creditors are often unable to reach the trust assets.[41] Domestic creditors face more complicated and costly paths to go to the foreign

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35 *Id*. at 945-945.02.

36 *Id*. at 901.04.

37 *In re* Castellano, 514 B.R. 555, 557-58 (Bankr. N. D. Ill. 2014). The trust in Castellano was established by the settlor in 1997 for the benefit of her four children. To protect the trust assets from any one child's creditors, the settlor had thoughtfully included a conventional spendthrift clause before her death. The court was unmoved by the fact that the debtor had not settled a trust. The resulting arrangement was, in the eyes of the court, identical to a self-settled trust arrangement. Thus, Ms. Castellano's creditors found themselves the recipients of a $400,000 windfall never intended to have gone to Ms. Castellano for the benefit of her creditors in the first place.

38 Steven J. Oshins, *The Domestic Asset Protection Trust: Combining It with the Double LLC Strategy*, American Bar Association Section of Real Property Trust & Estate Law (2013), *available at* http://www.americanbar.org/publications/probate_property_magazine_2012/2013/january_february_2013/article_oshins_domestic_asset_protection_trust.html.

39 A court in a non-DAPT state may choose to disregard a DAPT created in a state other than the grantor's state of residence. *See In re* Huber, 493 B.R. 798, (Bankr. W.D. Wash. 2013).

40 U.S. CONST. art. IV, § 1.

41 *Supra* note 29.

jurisdiction and hope for a favorable local court order.[42] The offshore asset protection trust serves as a filter, deterring frivolous claims and requiring that the creditor be resourceful and committed before gaining access to the foreign courthouse. Asset protection trusts established under the laws of offshore jurisdictions, such as Belize or Nevis, effectively deter unreasonable and unfounded creditors and reduce the profile of the debtor as a desirable deep-pocketed target.[43]

II. HISTORIC CHALLENGES TO ASSET PROTECTION TRUSTS

Asset protection historically has been critiqued and scrutinized by a society that is unsympathetic to debtors' unwillingness or inability to pay creditors. The unremitting struggle between these two competing interests—those who may have a claim and those who have a right to dispose of their property as they wish—evades easy solutions. Both parties have rights which they can exercise within certain prescribed boundaries.[44] A person of means should not be condemned for seeking to preserve wealth any more than the unanticipated creditor pursuing a speculative claim. Each is acting within the scope of his own rights.

Asset protection is a reaction to a system that is often too liberal for not only tolerating meritless claims but also awarding extreme punitive damages.[45] However, the law holds a bias against those who dare guard their assets; uniform fraudulent transfer laws, which are found in 44 states and the District of Columbia, tilt the scales in favor of a creditor by affording special remedies where assets are transferred in an effort to defeat collection.[46] Judges reinforce this bias with contempt orders, incarcerating debtors for having created their own impossibility to pay, essentially bringing back the much scorned "debtors prisons" of old England.[47] Attorneys assisting with asset protection planning are also

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42 Engel, *supra* note 8 at 1020.06.

43 *See* Donald F Conway v. Queensway Trustees Limited (Civ. App. No. 11 April 3, 2000) (St. Kitts & Nevis).

44 Elizabeth Warren & Jay Lawrence Westbrook, *The Law of Debtors and Creditors* 4-6 (5th ed. 2006).

45 Lauren Pearle, '*I'm Being Sued For WHAT?'*, ABC NEWS (May 2, 2007), http://abcnews.go.com/TheLaw/story?id=3121086&page=1.

46 Legislative Fact Sheet—Fraudulent Transfer Act—now known as Voidable Transactions Act, UNIFORM LAW COMMISSION, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Fraudulent%20Transfer%20Act%20-%20now%20known%20as%20Voidable%20Transactions%20Act.

47 Fannie Mae v. Heather Apartments Ltd. P'ship, 2013 WL 6223564, *9 (Minn. App., Dec. 2, 2013).

being subjected to expanding scrutiny and experimental theories of liability, such as RICO, civil conspiracy, and common law fraud. [48]

A. Fraudulent Transfers and Common Misconceptions of the UFTA's Purpose

The primary remedy, Uniform Fraudulent Transfer Act ("UFTA"), for the creditors is also the source of common confusion and inconsistency among the courts due to its implied reference to fraud.[49] However, the UFTA is a legal remedy, a reversal of a transfer, and not necessarily a sign of fraud. The concept of "fraudulent transfer" of property originated from the English Statute of Elizabeth of 1571, otherwise known as the Fraudulent Conveyances Act, 1571[50] The Statute was enacted to combat fraudulent deeds, alienation, and other transfers made before an individual became insolvent.[51] Creditors were granted a special remedy through which the courts could void the conveyance of real property or chattels if the debtor was found to have acted with the intent of obstructing or defrauding creditors.[52] Notably, the Statute of Elizabeth had no statute of limitation, meaning that a debtor transferring assets at any time could potentially see the transfer set aside far into the future by a creditor who did not exist at the time the transfer was first made.[53]

Presently, the United States Bankruptcy Code and fraudulent transfer statutes enacted in most states follow many of the core principles first set out in the old English statute.[54] Most states have implemented the UFTA, which is concerned with the validity of transfers that leave an owner insolvent and are intended to defraud creditors.[55] Intent can be explicit or constructive, and there is a list of "badges of fraud" to guide courts in evaluating the transferor's intent.[56] If a transfer in trust is found to be fraudulent, the transfer is voidable in the hands of the trust and the expected protection fails.[57]

Historically, planning early and setting enough funds aside to avoid insolvency in the presence of known creditors have been the key

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48 18 U.S.C. § 1962(c) (2015).

49 Uniform Fraudulent Transfer Act ("UFTA") (2014), *available at* http://www.uniformlaws.org/shared/docs/Fraudulent%20Transfer/2013oct_AUFTA_InterimDraft_MASTER%20KCK(2).pdf.

50 13 Eliz 1, c 5.

51 *Id*.

52 *Id*.

53 *Id*.

54 11 U.S.C. § 548 (2012).

55 37 Am. Jur. 2d Fraudulent Conveyances and Transfers § 4 (2015).

56 UFTA *supra* note 49 at § 4(b).

57 *Supra* note 55.

guidelines for debtors to not run afoul of the UFTA. Common law fills in the gaps by clarifying the relevance of "future creditors."[58] For example, in *Klein v. Klein*,, the court explained:

> [T]here has been found no authority that an action such as this must fail for the reason that the grantor, who was without creditors, feared for future dangers, real or imaginative. Surely his hands were as clean as any one who ever came into equity. What he did amounted to no more than insurance against a possible disaster.[59]

Case law interpreting the UFTA reveals important distinctions among three classes of creditors: (i) Present creditors, (ii) reasonably foreseeable future creditors, and (iii) unknown future creditors.[60] Historically, those individuals who parted with their assets for the sake of peace of mind, and facilitated asset protection as a form of insurance, successfully overcame fraudulent transfer claims when such transfers were made before both present creditors and reasonably identifiable foreseeable future creditors, and the transferor retained sufficient assets so as not to become insolvent.[61]

But recently, such planning has not been so effective. For example, in California, the UFTA has been interpreted by at least one court to invalidate the transfer when assets are transferred years before any potential creditor was identifiable.[62] The California court invalidated a set of asset protection trusts specifically because, as part of the settlor's original intent in establishing the trusts, the settlor sought to preserve his wealth from the reach of any creditors by utilizing the asset protection trust laws of Nevada.[63]

The decision in California may perhaps be best explained as a combination of judicial bias against debtors unwilling or unable to pay their debts and a general misconception about fraudulent transfers. The finding of a fraudulent transfer is technically only a legal remedy that creditors rely on when pursuing a debtor's assets, giving the court leeway to grant a range of remedies in favor of the creditor.[64] But because many courts are not familiar with fraudulent transfer laws, they often misconstrue fraudulent transfers and equate them with common law

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58 *See* Klein v. Klein, 112 N.Y.S.2d 546 (N.Y. Sup. Ct. 1952).
59 *Id.* at 548.
60 See e.g. Kilker v. Stillman, *supra* note 4.
61 *See, e.g.*, Durant v. Durant, 439 A.2d 821 (Pa. 1982).
62 *See, e.g.*, *Kilker, supra* note 4 at *5-6.
63 *Id.*
64 *See* UFTA *supra* note 49 at §7(c).

fraud.[65] To avoid confusion over the term "fraudulent," the Uniform Law Committee has chosen to retitle the Uniform *Fraudulent* Transfer Act as the Uniform *Voidable* Transfer Act.[66]

B. Contempt & Incarceration

In addition to challenges presented by creditors asserting fraudulent transfers, some courts seek to punish the debtor for creating the circumstances by which it is impossible for the debtor to repay the creditor by incarcerating debtors in a modern-day version of debtors' prison for contempt of court. Civil contempt is defined as an act defying the justice of the courts and interfering with the administration of justice.[67] It may be punishable by a fine or imprisonment.[68] In the context of asset protection planning, civil contempt is often relevant. Typically, the debtor establishes an offshore irrevocable trust and permanently surrenders legal title and control of the assets to an offshore trustee.[69] When the creditor tries to enforce a judgment against the debtor, the creditor will often ask the court to compel the debtor to retrieve the assets under threat of contempt.[70]

What usually follows is the defense of impossibility: the debtor is commanded to bring the assets before the court and yet, the debtor has ceded ownership and control to someone else.[71] A judge may sometimes issue a court order directing the trust settlor to reverse transfers made in trust and to remit the trust assets to the court.[72] However, because the debtor does not control the trust, and the laws of the offshore asset protection trust jurisdiction invariably prohibit the trustee from remitting trust assets to satisfy creditor claims, the debtor is powerless to affect the result desired by the court.[73] Accordingly, in some instances, trust settlors have been held in contempt of court and placed in jail.[74]

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65 Engel, *supra* note 8 at 215.03.

66 Jay Adkisson, *The Uniform Voidable Transactions Act—What's With The Name Change?*, FORBES (July 18, 2014), http://www.forbes.com/sites/jayadkisson/2014/07/18/the-uniform-voidable-transactions-act-whats-with-the-name-change/#6036c9948f63.

67 Black's Law Dictionary 360 (9th ed. 2009).

68 Engel, *supra* note 8 at 215.03.

69 *See, e.g.*, Fannie Mae v. Heather Apartments Ltd. P'ship, 811 N.W.2d 596, 600 (Minn. 2012).

70 *Id*. at 599.

71 *See id*. (inferring that the defendant presented the Impossibility Defense; he should have not been found in contempt of the Court's Order to send the assets to the creditor, because he was in control of those assets and it was literally impossible for him to comply at that time.).

72 *Id*. at 598.

73 *Id*. at 599-600.

74 *Id*. at 600.

Notwithstanding that settlors of offshore asset protection trusts sometimes find themselves jailed for contempt of court, the Supreme Court has ruled that debtors cannot be incarcerated for the mere purpose of compelling payment of debts.[75] In some cases, judges appear to overlook the fact that the debtor has ceded control of his assets to an offshore trustee long ago and is powerless to affect their return.[76] In other cases, courts distinguish between (i) impossibility attributable to external circumstances and (ii) self-created impossibility, with the former serving as a valid defense to a contempt citation and the latter not.[77] Yet, this distinction between impossibility and *self-created* impossibility ignores Supreme Court precedent. A judge should think twice before taking a debtor's freedom away when such a delicate distinction between impossibility and self-created impossibility is the deciding factor. Impossibility is impossibility, even if *self-created* for foolish or immoral purposes. "*Impossibilium nulla obligation.*"[78]

At some point, domestic courts should recognize the limits of jurisdictional authority. Trustees residing in a jurisdiction such as Belize would never allow assets to be remitted to satisfy a creditor's claims: They would not risk the reputation of the jurisdiction as a reliable location for asset protection trust services by complying with foreign judgments.

The proper response, in the face of a genuine impossibility defense is for the domestic court to grant the creditor the requested judgment and to then encourage the creditor to utilize the procedures of the foreign jurisdiction in which the trust assets are held. Greater judicial deference to other countries and their legal systems would empower a domestic judge to better find that, while the grantor did create the circumstance of impossibility by transferring assets to a third party, the fact remains that the debtor is unable to reverse the transfer. Rather than holding the debtor in contempt and imprisoning the debtor to secure payment of a debt, an abhorrent practice that was abolished centuries ago, domestic courts must instead recognize the limits of their authority and the reality of the legal landscape that confronts the creditor.

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[75] Bearden v. Georgia, 461 U.S. 660, 671, (1983) (noting that imprisoning one who, with no fault of his own, is incapable of paying his debts despite making good faith efforts, violates the Equal Protection Clause of the Fourteenth Amendment.).

[76] *See e.g.*, Fannie Mae v. Heather Apartments Ltd. P'ship, *supra* note 47.

[77] *See e.g.*, *In re* Coker, 251 B.R. 902, 905 (Bankr. M.D. Fla. 2000).

[78] JAMES T. BRETZKE, CONSECRATED PHRASES: A LATIN THEOLOGICAL DICTIONARY; LATIN EXPRESSIONS COMMONLY FOUND IN THEOLOGICAL WRITINGS 101 (3rd ed. 2013) (meaning "Nothing impossible can oblige.").

C. *Attorney Liability—Ethics Violations*

One consequence of effective asset protection planning, particularly offshore, is pressuring creditors to find new avenues for recovery, including suing those attorneys who engage in asset protection planning on behalf of their clients. The United States has historically afforded the freedom to dispose of one's property, and this right ought to be given adequate weight when it has been exercised when no identifiable third party claimants may be affected.[79] Moreover, legal counsel, advising within the boundaries of the law, should not have to fear the legal consequences of asset protection. Yet, creditors occasionally sue attorneys, and such lawsuits may have a chilling effect on asset protection planning.

Attorneys who engage in asset protection planning frequently lean on Rule 1.2(d) of the Model Rules of Professional Conduct, which states:[80]

> A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.[81]

Here, "fraud" or "fraudulent" refers to purposeful behavior to deceive.[82] Assisting a client in defrauding known or foreseeable creditors

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79 Adler v. Fenton, 65 U.S. 407, 411-12 (1860).

> "Our laws determine with accuracy the time and manner in which the property of a debtor ceases to be subject to his disposition, and becomes subject to the rights of his creditor. A creditor acquires a lien upon the lands of his debtor by a judgment; and upon the personal goods of the debtor, by the delivery of an execution to the sheriff. It is only by these liens that a creditor has any vested or specific right in the property of his debtor. Before these liens are acquired, the debtor has full dominion over his property; he may convert one species of property into another, and he may alienate to a purchaser. The rights of the debtor, and those of a creditor, are thus defined by positive rules; and the points at which the power of the debtor ceases, and the right of the creditor commences, are clearly established. These regulations cannot be contravened or varied by any interposition of equity."

Id. (*quoting* Moran v. Dawes, 1 Hopk. Ch. 365, 367 (N.Y. 1825).

80 MODEL RULES OF PROF'L CONDUCT 1.2(d) (2002).

81 *Id*.

82 *See* The New York Rules of Professional Conduct, 1.0(i) (2011) (" . . . does not include conduct that, although characterized as fraudulent by statute or administrative rule, lacks an element of scienter, deceit, intent to mislead, or knowing failure to correct

would be fraudulent and a violation of the model rules, and the attorney would face disciplinary charges for such actions.[83] By contrast, asset protection planning meant to preserve wealth—and not intended to avoid a known creditor—does not fall within the scope of "fraudulent" behavior prohibited by the Model Rules.[84] In an ironic twist, some attorneys argue that an attorney could be liable for professional malpractice if the attorney does not recommend asset protection planning to clients in need of such planning.[85]

D. Civil Conspiracy / Aiding & Abetting

In a desperate effort to overturn the efficacy of asset protection planning, some creditors have embraced theories of recovery based on common law tort claims, such as civil conspiracy, or by seeking statutory remedies originally intended to fight against organized crime.[86]

These emerging theories of liability may prove to be of limited utility to creditors.[87] Setting aside the merits of any particular claim, as a general principle of law, it is very difficult for a creditor to hold an attorney liable for asset protection planning advice. For example, the majority approach on civil conspiracy, exemplified by Texas and Florida, is that a fraudulent transfer, without a showing of badges of fraud, exonerates the asset protection attorney from liability.[88] Creditors may pursue the transferee of the fraudulent transfer but are limited only to the conveyed assets.[89] In *Freeman vs. First Union National Bank,* the Supreme Court of Florida made clear the legal distinction between a "fraudulent transfer" and a "fraud."[90] In a unanimous ruling, the court found that:

> To adopt the [creditor's] position in this case would be to expand the [Florida] UFTA beyond its facial application and in a manner that is outside the purpose

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misrepresentations that can be reasonably expected to induce detrimental reliance by another.").

83 *See* Elie v. Smith, 2011 WL 9349985 (Cal. App. Supp. Oct. 13, 2011).

84 *See* Peter Spero, Asset Protection: Legal Planning, Strategies and Forms § 2.03-6-b (vol. 1, 2001).

85 Daniel S. Rubin, *Asset Protection Planning – Ethical? Legal? Obligatory?* 18-1, 18-12, Institute of Estate Planning (2014), *available at* http://www.mosessinger.com/site/files/asset_protection_planning_rubin.pdf.

86 United States v. Turkette, 452 U.S. 576, 588 (1981).

87 *See, e.g.,* Reeves v. Ernst & Young, 507 U.S. 170, 178-79 (1993) (holding that aiding and abetting claims are not sufficient to satisfy the element that the defendant operated the enterprise.).

88 *See* Freeman v. First Union Nat. Bank, 865 So.2d 1272, 1277 (Fla. 2004).

89 *Id*.

90 *Id*. at 1277.

> and plain language of the statute. Consistent with this analysis we conclude that [Florida] UFTA was not intended to serve as a vehicle by which a creditor may bring a suit against a non-transferee party . . . for monetary damages arising from the non-transferee party's alleged aiding-abetting of a fraudulent money transfer. Accordingly, we answer the certified question in the negative and return this case to the Eleventh Circuit.[91]

On the other side of the country, California has outlined a minority view, where attorneys may be liable for civil conspiracy even if they were not the transferee of the debtor's assets.[92] Unlike the UFTA implemented in Florida, the UFTA implemented by California is silent on civil conspiracy when engaging in a fraudulent transfer.[93] The minority approach equates a fraudulent transfer with a tort theory of fraud; accordingly, the fraudulent transfer forms the element of fraud needed to bring a cause of action for conspiracy.[94] Thus, a fraudulent transfer can give rise to liability for the asset protection attorney, even if the attorney is not a transferee of debtor assets.

The differences between the majority and minority approach are significant, especially when California courts have interpreted the UFTA to make asset protection planning a *per se* fraudulent transfer against future unanticipated creditors.[95] Asset protection attorneys in California may be compelled by the combination of civil liability for fraud based on a fraudulent transfer and an expansive definition of fraudulent transfers to rethink the jurisdiction they practice in. Alternatively, attorneys in California may consider referring asset protection planning clients to attorneys in one of the fifteen states that has enacted a domestic asset protection trust law.

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91 *Id*.

92 *See, e.g.,* Durant Software v. Herman, 255 Cal. Rptr. 250, 256 (Cal. Ct. App. 1989), *reh'g granted, opinion not citeable* (Feb. 24, 1989), *vacated*, 257 Cal. Rptr. 200 (Cal Ct. App. 1989) *review granted and opinion superseded*, 775 P.2d 1034 (Cal. 1989) (when attorneys exceed their role as an advocate and conduct in a intentionally fraudulent way, that the attorney will not escape liability).

93 CAL. CIV. CODE § 3439, *available at* http://www.leginfo.ca.gov/cgi-bin/displaycode?section=civ&group=03001-04000&file=3439-3439.14.

94 Courts often mistakenly equate a "fraudulent transfer" with "fraud," and handle a fraudulent transfer as a common law fraud. See, e.g. Mack v. Newton, 737 F.2d 1343 (5th Cir. 1984); Freeman v. First Union Nat'l Bank, *supra* note 88.

95 See e.g. Kilker v. Stillman, *supra* note 4.

E. Civil RICO

The latest strategy to implead attorneys when challenging transfers in trust is under the Federal Racketeer Influenced and Corrupt Organizations Act ("RICO").[96] This potentially overbroad interpretation of RICO disregards the legislative intent of the Act and may lead to manipulation by opportunistic plaintiffs and become the case of "be careful of what you wish for." This is a more creative cause of action against the attorney as it surprisingly equates his advocacy of asset protection with organized mafia activities, which inspired Congress to enact RICO.[97]

Even though any person or business damaged under RICO may seek relief, RICO was enacted to fight organized crime, not to permit a cause of action in federal courts for any tort claim.[98] RICO prohibits any individual employed by or linked to a qualifying enterprise "'to conduct or participate in the conduct of such enterprise's affairs through a pattern of racketeering activity . . . .'"[99] RICO provides a civil cause of action against a defendant who acts through or administers an enterprise through a pattern of racketeering.[100] To succeed in a civil RICO action, a plaintiff must establish on the part of the defendant (1) conduct (2) of an enterprise (3) through a pattern (4) of racketeering activity; (5) causing injury to his 'business or property.[101] The successful claimant is allowed to recover treble damages, attorneys' fees, and other expenses under RICO.[102]

RICO section 1962(c) proscribes defendants from operating or managing an enterprise through a pattern of racketeering activity.[103] The term "enterprise" is defined quite broadly as "any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity."[104] Under such a broad definition it is conceivable that a law firm, or an attorney, working in association with a client engaged in asset protection planning may become a target of a civil RICO claim.

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96 *See generally* 18 U.S.C. §1962(c) (2015).

97 *See* Handeen v. Lemaire, 112 F.3d 1339, 1349 (8th Cir. 1997); *see also* Fortney v. Kuipers, No. 98C5387, 2001 WL 1539143 (N.D. Ill. Dec. 3, 2001).

98 Oscar v. Univ. Students Co-op. Ass'n, 965 F.2d 783, 786 (9th Cir. 1992).

99 Alexander v. Incway Corp., No. CV 11-8851 DSF (VBKX), 2013 WL 5603932, *17 (C.D. Cal. Oct. 11, 2013) (quoting 18 U.S.C. § 1962(c)); *see also* Sedima, S.P.R.L. v. Imrex Co., Inc., 473 U.S. 479, 496 n.14 (1985).

100 18 U.S.C. § 1964(c) (2015).

101 *Sedima*, 473 U.S. at 496; 18 U.S.C. § 1962(c) (2015).

102 18 U.S.C. § 1964(c) (2015).

103 18 U.S.C. § 1962(c) (2015).

104 18 U.S.C. § 1961(4) (2015).

Predicate offenses, such as wire fraud, mail fraud, and other state and federal crimes, are referred to as racketeering activity by RICO.[105] A "pattern of racketeering activity," demarcated by as at least two acts of racketeering activity, marks a distinction from the isolated act.[106] Attorneys who commit at least predicate offenses may be subject to a RICO claim on the basis of a pattern of racketeering.

Fortunately for attorneys, a critical element of any RICO claim is the last element: proximate causation.[107] The most common defense cited by attorneys who have been charged with civil RICO liability is the absence of a causal link between the asset protection planning services provided by the lawyer and the injury suffered by a creditor who was not reasonably foreseeable at the time of the planning.[108] As the Supreme Court has observed, "At bottom, the notion of proximate cause reflects 'ideas of what justice demands, or of what is administratively possible and convenient.'"[109]

The proximate cause requirement for civil RICO liability echoes a similar requirement found in the Sherman and Clayton Acts and is based on a policy decision to limit liability to instances when the plaintiff establishes legal causation.[110] As the Supreme Court noted, "Here we use 'proximate cause' to label generically the judicial tools used to limit a person's responsibility for the consequences of that person's own acts."[111] According to the Sixth Circuit, monetary loss alone is insufficient to establish proximate cause.[112] Rather, proximate causation under RICO requires a direct relationship between the injury suffered and the alleged injurious conduct.[113] Thus, the concept of direct injury refers to the relationship between the injury and the defendant's actions and should not be based on the plaintiff's ability to pay.[114] There is also a requirement that an attorney must be a director or officer of the enterprise to incur liability.[115] Therefore, it follows that an attorney who simply refers business to an offshore trust company will not fall under

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105 18 U.S.C. § 1961(1) (2015).
106 18 U.S.C. § 1961(5) (2015).
107 *See, e.g.*, Holmes v. Sec. Inv'r Prot. Corp., 503 U.S. 258 (1992).
108 *Id.*
109 *Id.* at 268 (quoting W. Keeton, D. Dobbs, R. Keeton, & D. Owen, *Prosser and Keeton on Law of Torts* § 41 (5th ed. 1984).
110 Firestone v. Galbreath, 976 F.2d 279, 285 (6th Cir. 1992).
111 *Holmes*, 503 U.S. at 268 (quoting W. Keeton, D. Dobbs, R. Keeton, & D. Owen, *Prosser and Keeton on Law of Torts* § 41 (5th ed. 1984).
112 *Id.*
113 *Id.* at 259.
114 *Firestone*, 976 F.2d at 285.
115 *See, e.g.,* Reeves v. Ernst & Young, 507 U.S. 170, 179 (1993).

the reach of RICO because he is not a director or an officer of the challenged entity.

Civil RICO claims are wholly inapplicable to the field of asset protection. Congress enacted RICO with the purpose of eradicating organized crime.[116] Accordingly, the Supreme Court has ruled that RICO's far-reaching text should be interpreted narrowly as to not exceed the Act's scope.[117] Courts should also consider:

> [W]hether the plaintiff has 'alleged such a personal stake in the outcome of the controversy' as to warrant his invocation of federal-court jurisdiction and to justify exercise of the court's remedial powers on his behalf.[118]

To permit an extension of RICO into the asset protection planning sphere distorts the purpose of RICO and invites Congress to curtail its reach at the expense of those who are legitimate victims of organized crime.

III. EMERGING DOCTRINE: THE "*PER SE*" FRAUDULENT TRANSFER RULE

Courts increasingly scrutinize the motives of debtors engaged in asset protection planning. Recent case law reveals the rising challenges for those exercising the right to protect their wealth and taking precautionary steps, such as advance planning. The minority approach, emerging from states like California, finds that when one transfers assets to protect assets, the transfer is fraudulent under the UFTA as to present and reasonably foreseeable future creditors, as well as unknown future creditors.[119] This approach raises the fear that residents of minority-view states cannot engage in asset protection planning whatsoever.

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116 H. J. Inc. v. Northwestern Bell Tel. Co., 492 U.S. 229, 245 (1989).

117 *Id*.

118 Warth v. Seldin, 422 U.S. 490, 498-99 (1975) (*citing* Baker v. Carr, 369 U.S. 186, 204 (1962)).

119 *See, e.g.*, Kilker v. Stillman, 2012 WL 5902348, *4 (Cal. Ct. App. Nov. 26, 2012). *See also In re* Castellano, *supra* note 37. It must be noted that this is not the most recent decision in this case; however, this article was written before the latest decision was made and the law is still unclear as to whether the asset protection trusts will not be biased in the bankruptcy context. *See* Safanda v. Castellano, No. 14 CV 07094, 2015 WL 1911130 (N.D.Ill. April 27, 2015). *See also* Jay Adkisson, *Estate Planning Bar Breathes Sign of Relief As Castellano Gets Turned Around*, FORBES (May 25, 2015), http://www.forbes.com/sites/jayadkisson/2015/05/25/estate-planning-bar-breathes-sigh-of-relief-as-castellano-gets-turned-around/#57a02b9d455f.

In light of California trial and appellate court rulings in *Kilker v. Stillman*[120] and *In re Cutuli*,[121] the forecast is stacked against domestic asset protection trusts. Non-DAPT states may choose to ignore the DAPT structure and the legal rules that protect DAPT assets, whether using the UFTA or applying the "alter ego" doctrine to disregard the DAPT.[122] In addition, creditors may reach the assets of a DAPT by relying on the Full Faith and Credit Clause to enforce judgments obtained against a DAPT in a non-DAPT state.[123] In *Kilker*, a California court regarded the selection of Nevada asset protection trust laws as the governing law for a trust settled by a California resident to be *per se* fraudulent against future unknown creditors.[124] Employing a very similar rationale, a bankruptcy court in Washington refused to honor the selection of Alaska DAPT laws to govern a trust established by a resident of Washington even though no present or known creditors existed at the time of trust creation.[125] Finally, in *In re Cutuli*, a Florida bankruptcy court approved the use of a warrant to seize attorney-client correspondence where the client, a petitioner in bankruptcy, engaged a law firm which advertised its services in asset protection planning.[126] All three cases present glimpses of how courts remain skeptical of asset protection planning motives and, in the case of the rulings in Washington and California, the viability of DAPT planning for residents of non-DAPT states. Responsible practitioners would be wise to consider the merits of a foreign asset protection trust ("FAPT") in light of the risks associated with DAPTs.

A. Kilker v. Stillman

This unpublished yet critical case signifies perhaps the greatest threat the domestic asset protection trust industry faces today. *Kilker* represents an emerging trend that would functionally impose "strict liability"

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120 *See Kilker*, *supra*.

121 *In re* Cutuli, No. 11-35256-BKC-AJC, 2013 WL 5236711 (Bankr. S.D. Fla. Sept. 16, 2013).

122 *See, e.g., Kilker*, 2012 WL 5902348 at *6; *see also In re Castellano*, 514 B.R. at 559-60.

123 *See, e.g.,* IMO Daniel Kloiber Dynasty Trust, No. CIV.A. 9685-VCL, 2014 WL 3924309 (Del. Ch. 2014); U.S. CONST. art. IV, §§ 1, 2; *Cf.* Litchfield Asset Mgmt. Corp. v. Howell, 799 A.2d 298, 304 (Conn. App. Ct. 2002); BNA Portfolio 810-3rd, Asset Protection Planning, pp. A-53-54.

124 Kilker v. Stillman, 2012 WL 5902348 at *4.

125 *In re* Huber, 493 B.R. 798 (Bankr. W.D. Wash. 2013).

126 *In re* Cutuli, *supra* note 121.

through a *per se* fraudulent transfer rule:[127] Namely, that planning to protect assets constitutes "actual intent" to defraud future unforeseen creditors.[128] Technically, the case is non-binding and reflects only a minority view. One may also quarrel with the appeals court's reasoning on choice of law issues. Nevertheless, the court's rationale in *Kilker* sends out the message of disapproval of asset protection.

In 2000, the Kilkers engaged Curcies Coordinated Construction ("Curcies") to erect a swimming pool on their land.[129] Curcies employed Stillman to execute soil testing prior to the pool's construction.[130] Based on Stillman's report, the pool was built.[131] In 2008, the Kilkers filed a lawsuit against Curcies and Stillman, seeking damages due to a parting in the mastic seal of the pool.[132] The Kilkers settled with Stillman for $92,500.00.[133] After Stillman failed to pay the settled amount, a trial court in California entered a judgment against Stillman.[134]

The Kilkers attempted to enforce the judgment by levying on a property, the Railroad Street property, only to find that the ownership had been conveyed to an irrevocable trust, the WWG Trust.[135] In 2004, Stillman created a Nevada asset protection trust and transferred most of his assets into it.[136] The Kilkers sought to invalidate Stillman's original transfer of the Railroad Street property, claiming that the transfer in trust was a fraudulent conveyance under the UFTA.[137] Stillman attested that, after the transfers in 2004, he was insolvent and received no consideration in return for conveying the properties.[138] Additionally, he was blunt in stating that his intention in establishing and funding the trust was to engage in asset protection planning and shield himself from any creditors.[139] The original trustees of the WWG Trust were employees of

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127 *Analyzing The Recent Fraudulent Transfer Case of Kilker,* ENGEL & REIMAN PC (Jan. 12, 2013), http://www.engelreiman.com/asset-protection-developments/analyzing-the-recent-fraudulent-transfer-case-of-kilker.

128 *See* United States v. Townley, 181 F. App'x 630, 631 (9th Cir. 2006) (where the debtor testified that he transferred assets, hoping to shield them from future creditors. Such testimony was found to be evidence of fraud. This court's reasoning would be consistent with California's approach.).

129 *Kilker*, 2012 WL 5902348, at *1.

130 *Id*.

131 *Id*.

132 *Id*.

133 *Id*.

134 *Id*.

135 *Id*. at *2.

136 *Id*.

137 *Id*.

138 *Id*.

139 *Id*.

an accounting firm that helped establish the trust.[140] Stillman's brother was the sole trust beneficiary.[141] Throughout the history of the trust, Stillman regularly used the assets of the trust to cover his personal expenses, including cell phone and credit card bills, personal attorney fees, XM radio bills, and newspaper subscriptions.[142]

The trial court ruled for the Kilkers, invalidating the transfer in trust based on Stillman's testimony that he intended to hinder future unforeseen creditors by setting up the Nevada trust.[143] The court also found that the WWG Trust was the "alter ego" of Stillman, as the trust was used by Stillman as a personal pocketbook for so many years.[144] The key to the trial court's ruling, which was upheld on appeal, was a novel interpretation of California UFTA section 3439.04(a), which provides:

> A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, *whether the creditor's claim arose before or after the transfer was made or the obligation was incurred,* if the debtor made the transfer or incurred the obligation as follows: (1) With actual intent to hinder, delay, or defraud *any* creditor of the debtor. (2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor either: (A) Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction. (B) Intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.[145]

The trial court found the Kilkers to be "reasonably foreseeable" creditors, despite the fact that their claim arose four years after the establishment of the trust and eight years after Stillman had produced the report that gave rise to the cause of action.[146] The court reasoned that because soil engineers are frequently sued, all customers of a soil engineer constitute reasonably foreseeable future creditors.[147]

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140 *Id.*
141 *Id.*
142 *Id.*
143 *Id.* at *5.
144 *Id.* at *3.
145 CAL. CIV. CODE § 3439.04(a) (2016) (emphasis added).
146 Kilker v. Stillman, 2012 WL 5902348 at *7.
147 *Id.*

On appeal, the reviewing court upheld the finding of a fraudulent transfer by interpreting the UFTA broadly.[148] Even though section 3439.04(a) does not reference future creditors, the appeals court extended the meaning of creditor to include *any* creditor, both present and future.[149] The appeals court eliminated any distinction between known or reasonably foreseeable creditors and future unknown creditors.[150]

By interpreting the statute to protect future unforeseen creditors, the appeals court then needed to decide whether the prior transfer in trust of the Railroad Street property was a fraudulent transfer at the time it was made.[151] The court considered evidence that Stillman's actual intent was to defraud his "creditors," including the fact that he was insolvent following the transfer in trust, had received no consideration in exchange for the transfer in trust, and continued to exercise control over the trust assets following the transfer.[152] The California court treated such facts as proof of "*actual intent* to hinder, delay or defraud any creditor of the debtor."[153]

Stillman contended that because the WWG Trust had been established under Nevada law, the issue of a fraudulent transfer should have been determined under Nevada law.[154] Furthermore, Stillman argued that Nevada's domestic asset protection trust laws protected such transfers against claims from future unknown creditors, and his retained powers over the trust were permitted under Nevada law.[155] The California court did not engage in a conflict of laws discussion and simply pointed out that Nevada's UFTA must be interpreted the same way in Nevada due to the identical verbiage of the UFTA, which was meant to achieve uniformity among the states in regard to the law of fraudulent transfers.[156] Because the UFTA in both California and Nevada contained similar wording, the appeals court determined that a Nevada court would inevitably reach the same conclusion as the trial court in California, to wit, evidence of actual intent to avoid future creditors constituted a fraudulent transfer under the UFTA.[157]

California courts blatantly disregarded the very premise of Nevada's asset protection trust laws ratifying such structures for general asset

148 *Kilker*, 2012 WL 5902348 at *6.
149 *Id*.; *see also* CAL. CIV. CODE § 3439.04(a).
150 *Kilker*, 2012 WL 5902348.
151 *Id*. at *1-2.
152 *Id*. at *2.
153 *Id*. at *1 (emphasis added).
154 *Id*. at *6.
155 *Id*. at *6.
156 *Id*.
157 *Id*.

protection purposes. Asset protection trust laws in Nevada would generally cut off creditor claims two years after any transfer in trust. California, however, does not have asset protection trust laws, giving rise to a direct conflict of laws that was not addressed by the court in this case.

The better approach would have been that the UFTA only protects *known or reasonably foreseeable* creditors and *not unforeseen future* creditors. This interpretation of the UFTA would arguably yield the same result in cases brought in both asset protection trust states, such as Nevada, and those states that do not confer any particular asset protection trust benefits, like California. If the California court were correct, it would be impossible to have any asset protection trust in Nevada. While the California appellate court relied on the underlying purpose of the UFTA,[158] the court should have simultaneously looked into the purpose of asset protection trust laws enacted in Nevada.

Unfortunately for residents of California and other non-DAPT states, the choice of law issue is not critical to the creditor's fraudulent transfer argument.[159] By applying the "alter ego" doctrine, the *Kilker* ruling provides an avenue whereby creditors may sidestep uncomfortable questions regarding choice of law. Instead, a finding under local law that the trust is a sham frees the court to disregard Nevada domestic asset protection trust law completely. After all, if the trust does not exist, there is no context by which Nevada law applies.

Those in the DAPT industry in Nevada and other states ignore the *Kilker* ruling by pointing to the unpublished status of the appeals court's ruling, or the *mea culpa* delivered by Stillman in his deposition. However, it is folly to ignore the significant threat imposed by *Kilker*. Asset protection attorneys would better serve their clients by considering the impact of this ruling and evaluate alternate structures and jurisdictions for planning.

The sad irony is that Stillman would have been better served by wasting his assets. By disclosing that he had tried to preserve his wealth, Stillman set himself up to be punished. The *Kilker* ruling places residents of California in a permanently disadvantaged position compared to residents of the sixteen states that have enacted DAPT laws. Notwithstanding precedent allowing the disposition of property in the absence of claims and creditors, the healthy distinction between (i) present foreseeable creditors and (ii) future unknown creditors appears to have evaporated in some non-DAPT states, like California. In addition to

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158 *Id*.

159 APEC COMPARISON OF THE DOMESTIC ASSET PROTECTION TRUST STATUTES (David G. Shaftel ed.) (2012), *available at* https://www.naepc.org/journal/issue12f.pdf.

protecting creditors' rights, courts should weigh other factors as a matter of public policy, including the rights of people to know where their liability begins and where it ends.

> As the security of property ownership declines, investments flee and the economic environment becomes unstable, no one wants to invest where earning will be heavily taxed, or even the possibility of direct confiscation on the allegation of having violated a plethora of *unknowable, unobservable laws*.[160]

Arguably, the Kilkers should not have been permitted to bring claims that dated back eight years. Statutes of limitations exist to draw a line at some point and cut off liability, giving people certainty and predictability in the law. Individuals should not feel threatened to spend their savings on desired commodities because some potential creditor may have a claim against them eight years later. Otherwise, rational people may avoid becoming soil engineers, like Stillman, and steer clear of occupations that incur frequent litigation. Courts in non-DAPT states may eventually demand mandatory reserves for the relief of unforeseeable creditors.

Stillman may have sought protection of his wealth,[161] but his formulation of intent was oversimplified, which prejudiced the outcome. His desire to preserve his wealth was equated with an intent to defraud future creditors. By finding his planning as constituting a fraudulent transfer, even as to future unforeseen creditors, the California appeals court took away a valuable property right previously found to exist at law. After all, in 1861, the Supreme Court properly conferred the timing of when creditors are allowed to exercise their rights:

> Our laws determine with accuracy the time and manner in which the property of a debtor ceases to be subject to his deposition, and becomes subject to the rights of his creditor. A creditor acquires a lien upon the lands of his debtor by a judgment; and upon the personal goods of the debtor, by the delivery of an execution to the sheriff. It is only by these liens that a creditor has any vested or specific right in the property of his debtor. Before these liens are acquired, the debtor has full dominion over his property; he may convert one species of the property

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[160] John Loeffler, *The Sad Road to Socialism*, NEWSWITHVIEWS.COM (July 23, 2008), http://www.newswithviews.com/loeffler/loeffler21.htm (emphasis added).

[161] *See In re* Huber, *supra* note 125.

> into another, and he may alienate to a purchaser. The rights of the debtor, and those of a creditor, are thus defined by positive rules; and the points at which the power of the debtor ceases, and the right of the creditor commences, are clearly established. These regulations cannot be contravened or varied by any interposition of equity.[162]

B. In re Huber

Another case prejudiced against asset protection arose out of a Washington bankruptcy court and its decision to decline applying the asset protection trust laws of Alaska to the transfers made in trust by a resident of Washington.[163] The rationale behind this bankruptcy court's decision foreshadows a trend of hostility toward asset protection trusts settled by residents of states that do not recognize asset protection trusts.[164] The *Huber* ruling offers a glimpse into understanding similar California and Washington state court rulings that disregard transfers into self-settled spendthrift trusts.

Donald G. Huber worked in real estate development and management for 40 years.[165] His customers ranged from individual homebuyers to large builders.[166] In the typical deal, Huber used a corporation or limited liability company to direct his investment in the project, often owning the entire project through the business entity.[167] Huber also served as a personal guarantor on loans advanced by banks to entities in which he was a principal.[168]

According to the bankruptcy examiner in the case, Huber must have known about the "gathering storm clouds" that were about to hit the real estate industry in late 2007 and early 2008.[169] In 2008, Huber settled an Alaskan spendthrift trust and conveyed almost all of his assets into the trust.[170] As revealed in subsequent discovery, emails among Huber, his son, and his estate planning attorney indicated that the sole purpose of the trust was to "protect a portion of assets from creditors."[171] The emails also conveyed a significant degree of urgency in setting up the trust.

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162 Adler v. Fenton, 65 U.S. at 411-12 (1860) (*quoting* Moran v. Dawes, 1 Hopk. Ch. 365, 367 (N.Y. 1825)).
163 *In re* Huber, at 803.
164 *Id*.
165 *Id*. at 802.
166 *Id*. at 803.
167 *Id*. at 802.
168 *Id*.
169 *Id*. at 803.
170 *Id*.
171 *Id*.

In 2011, Huber filed for bankruptcy and, in 2012, the bankruptcy trustee sought to invalidate the Alaskan spendthrift trust, claiming that Huber had transferred assets to the trust in violation of sections 548(e)(1) and 544(b) of the U.S. Bankruptcy Code.[172] At trial, Huber contended that he had transferred his assets to the trust at a time when there were no claims or known creditors.[173] Nevertheless, the bankruptcy court found that Huber had constructive knowledge of potential creditors and an awareness of the distinct likelihood that he would be unable to repay his creditors following the transfers to the trust.[174] Accordingly, the bankruptcy court found a fraudulent transfer under both state law and section 548(e) of the U.S. Bankruptcy Code.[175] Additionally, by finding a fraudulent transfer to a self-settled spendthrift trust, the bankruptcy court invoked the 10-year clawback rule of section 548(e)(1) of the U.S. Bankruptcy Code, requiring all transfers from the debtor to the trust for the ten-year period preceding the bankruptcy filing to be included in the bankruptcy estate.[176]

The bankruptcy trustee originally asked that the court nullify the trust under the laws of Washington, notwithstanding that the trust had been formed under the laws of Alaska.[177] The bankruptcy court addressed the conflict of laws issue by first turning to the Restatement on Conflicts of Laws.[178] Under the reasoning of the Restatement, the choice of Alaska law would be sustained if Alaska had an extensive relation to the trust. Restatement section 270(a), comment b, provides that:

> [A] state has a substantial relation to a trust if at the time the trust is created: (1) the trustee or settlor is domiciled in the state; (2) the assets are located in the state; and (3) the beneficiaries are domiciled in the state. These contacts with the state are not exclusive.[179]

Huber did not reside in Alaska, the trust assets were not located in Alaska, and none of the beneficiaries were residents of Alaska.[180] Only one of the trustees resided in Alaska, and the trust was administered in Alaska.[181]

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172 *Id*. at 810-15.
173 *Id*. at 815.
174 *Id*. at 816.
175 *Id*. at 810-11.
176 *Id*. at 811.
177 *Id.* at 807-08.
178 *Id*.
179 *Restatement section 270(a), comment b.*
180 *In re* Huber, at 808.
181 *Id*.

By comparison, the bankruptcy court found that Washington has a robust public policy barring the use of self-settled spendthrift trusts.[182] Explicitly, transfers to self-settled spendthrift trusts are invalidated if made for the purpose of avoiding present or future creditors of the settlor.[183] According to the bankruptcy court, this view is consistent among the vast majority of states.[184] In support of this observation, the court referred to the oft-cited case of *Marine Midland Bank v. Portnoy*, in which a bankruptcy court reflected on New York's public policy disapproving the use of self-settled trusts.[185]

The bankruptcy court accordingly chose to apply Washington law to determine the validity of the trust and transfers to the trust.[186] The court considered each of the badges of fraud at the time Huber funded his trust, focusing specifically on the following badges of fraud: (1) Real or upcoming litigation; (2) an unsubstantiated transfer of most of the debtor's property; (3) insolvency or other indebtedness of the debtor; (4) a distinct relationship between the debtor and the transferee; and, after the transfer, (5) retaining control of the assets transferred by the debtor.[187] The bankruptcy court found five badges of fraud.[188] The court also concluded that Huber had acted out of a desire to protect his wealth.[189] Huber proclaimed that he had established the trust for estate planning purposes, but the court found that the circumstances and timing of the formation of the trust, along with the assets transferred into the trust, revealed his true motive: asset protection.[190]

The bankruptcy trustee argued that Huber was motivated by the corrupt pursuit of asset protection.[191] Huber failed to properly articulate sound arguments in his own defense. Nevertheless, the rationale of the bankruptcy court in *Huber* comes as no surprise when compared with the ruling in *Kilker*: If asset protection planning is identified as the primary motive for the transfers undertaken by the debtor, modern courts are inclined to grant relief to the creditor. While the decision in *Huber* may be limited to those circumstances in which a debtor avoids present creditors or guarantors, *Kilker* illustrates that even unknown future creditors may be able to challenge transfers in trust.

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182 *Id.*
183 *Id.*
184 *Id.*
185 *Id.* at 809.
186 *Id.*
187 *Id.* at 811.
188 *Id.* at 812.
189 *In re Huber*, 493 B.R. at 815-16.
190 *Id.*
191 *Id.*

C. *In re Cutuli*

In re Cutuli is one of those bad cases involving bad actors and bad facts, giving asset protection planning a bad reputation. The parties in this case intentionally sought to hide assets, employing all possible means to defraud a judgment creditor.[192] The actions of the debtor in *Cutuli* serve as a vivid example of how not to engage in asset protection planning. As explained below, the debtor should have never been assisted by the attorneys in her case.

The debtor, Kathleen Smith-Cutuli ("Smith"), had been a partner in a winery business, Napa Smith Brewery & Winery, LLC, for 17 years with "Elie."[193] Their partnership ended in 2005, when their joint business was sold.[194] Litigation ensued between the two thereafter, and Elie obtained a judgment against Smith in August 2009, for roughly $6 million.[195]

Rather than waving the white flag and giving up to Elie whatever funds she had left, Smith decided to take a different, much more aggressive course of action.[196] The scheme that she concocted with the assistance of California counsel involved several steps.[197] First, Smith entered into a pre-marital agreement with her fiancé, Cutuli, that made clear that each of them would maintain their pre-marital assets and liabilities separate of each other once they married.[198] Next, Cutuli brought a quiet title action against Smith relating to real estate located in California.[199] Smith declined to wage any form of defense, and Cutuli obtained a $10 million default judgment against his fiancé.[200] In the intervening period between the execution of the pre-marital agreement and Cutuli obtaining the default judgment, Elie sued Smith in a California court and procured a judgment against her on the $6 million debt.[201] As Elie prepared to collect on his judgment, Smith transferred her assets to Cutuli, supposedly to satisfy Cutuli's judgment against Smith.[202]

When Elie conducted discovery to try and collect on his judgment, Elie learned that Smith and Cutuli had worked in concert to transfer

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192 *Id*.
193 Elie v. Smith, 2011 WL 9349985 (Cal. App. Supp. Oct. 13, 2011).
194 *Id*.
195 *Id*.
196 *In re* Cutuli, No. 11-35256-BKC-AJC, 2013 WL 5236711 (Bankr. S.D. Fla. Sept. 16, 2013).
197 *Id*. at *1.
198 *Id*.
199 *Id*.
200 *Id*.
201 *Id*.
202 *Id*. at *4-5.

assets as part of Cutuli's judgment against Smith.[203] Smith left California, failing to respond to the ongoing proceedings in Elie's action and incurring a bench warrant for her arrest.[204] In a novel move, Elie brought a claim for abuse of process in California against Smith, Cutuli, and the attorney who had advised them on the quiet title action.[205] The essence of Elie's complaint was that the quiet title action had been fraudulently obtained and was intended as a ruse to hide Smith's assets from Elie.[206]

In September 2011, Smith, who had relocated to Florida with Cutuli, filed a voluntary petition in bankruptcy.[207] Smith and Cutuli hired a law firm of "asset protection experts," the Andersen Firm, and one of their attorneys, Matt Harrod, to help further their ambitious scheme.[208] Harrod recommended the formation of a Wyoming LLC with an offshore bank account in the Isle of Man.[209]

Back in California, the evidence of fraudulent transfers unveiled by the court was overwhelming.[210] Weeks after learning of the original California judgment, Smith had transferred three luxury vehicles to her fiancé, valued at over $300,000.[211] Smith and Cutuli also took out a mortgage of $1 million against their real estate.[212] The quiet title action was found to be a bogus attempt to hide assets.[213] The California court ruled in favor of Elie and further awarded treble damages against Smith and her cohorts.[214] The court further ordered that Smith's and Cutuli's assets be held in a constructive trust pending Elie's collection of the awards.[215]

When news of the California action reached the attention of the bankruptcy court in Florida, the bankruptcy court issued a warrant to seize Smith and Cutuli's books, records, and computers, including email correspondence with the Andersen Firm and Harrod. Cutuli challenged the warrant on grounds of privileged attorney-client communications. However, the court sustained the warrant on the basis that the *prima facie* record called for application of the crime fraud exception to

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203 *Id*.
204 *Id*.
205 *Id*.
206 *Id*. at *5.
207 *Id*.
208 *Id*. at *2.
209 *Id*.
210 Elie v. Smith, 2011 WL 9349985 (Cal. App. Supp. Oct. 13, 2011).
211 *Id*.
212 *Id*.
213 *Id*.
214 *Id*.
215 *Id*.

attorney-client privilege. The bankruptcy court focused on the fact that the debtor had hired a law firm that promoted its services in asset protection planning, as it was considered evidence of bad intent.

As a result of an accumulation of critically poor decisions, Smith, Cutuli, and their Florida attorneys were now looking at potential bankruptcy fraud—a crime—for having conducted Wyoming and offshore asset protection planning. This is in addition to the treble damages Smith, Cutuli, and their California counsel faced from the bogus quiet title action back in California.

At this point, *Cutuli* should be contrasted with *Kilker*: The debtor in *Cutuli* acted with actual intent to defraud known creditors, whereas the debtor in *Kilker* was acting consistent with the DAPT laws of Nevada well ahead of any reasonably foreseeable creditors. The "asset protection" planning conducted by the attorneys in *Cutuli* was not legal planning but rather a fraudulent attempt to hide assets. By comparison, debtors such as in *Kilker* are generally transparent in their planning, intending to rely on the protections afforded under DAPT or FAPT laws, not the creditor's inability to locate debtor assets.

While the debtor in *Cutuli* was assessed treble damages, one should not conclude that this outcome would apply in other cases involving fraudulent transfers. The sizable punitive damages were awarded based on a finding of common law fraud alongside the fraudulent transfers made by the debtor: "[A] far-reaching scheme to defraud creditors including findings of 'actual' or 'intentional' as well as 'constructive' fraud."[216] Had the debtor not conspired to file the sham quiet title action, the creditor's claims might have been more strictly limited to those remedies afforded under the UFTA.

Competent counsel would caution a client engaged in asset protection planning to consider the consequences if the client later files for bankruptcy. Inevitably, the bankruptcy court will learn of the asset protection planning and deny the debtor a discharge. Worse, the debtor may learn that asset protection planning pursued in contemplation of an imminent bankruptcy filing, or following a bankruptcy filing, may entail criminal prosecution of the debtor for bankruptcy fraud.

IV. BUILDING THE BETTER CASE FOR ASSET PROTECTION

The common theme running through the rulings in *Kilker, Huber,* and *Cutuli* is the court's intense focus on asset protection motives

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216 *In re* Cutuli, No. 11-35256-BKC-AJC, 2013 WL 5236711, at *4 n.3 (Bankr. S.D. Fla. Sept. 16, 2013).

underlying the debtor's actions. This raises an important question: Does the presence of an asset protection motive profoundly affect the outcome of the case? Recent case law indicates that a finding of an asset protection motive on the part of the debtor is a significant factor, if not the determining factor, in considering whether the court will honor the debtor's planning arrangements or disregard them entirely.

A. "Integrated"[217] and Vigilant Estate Planning

As recent case law indicates, early planning may not be enough in certain jurisdictions like California.[218] Factors such as the solvency of the debtor, the presence of one or more badges of intent, and whether any consideration is received in exchange for the debtor's assets will be scrutinized on an *ad hoc* basis.[219]

At a minimum, attorneys advising clients in asset protection planning should conduct thorough due diligence on the solvency of their clients.[220] The lawyer should request financial statements, preferably prepared by a certified public accountant, detailing the client's net worth and cash flow.[221] In addition, the lawyer should obtain an affidavit of solvency from the prospective client confirming the facts surrounding any existing or potential liabilities.[222]

In addition to obtaining a client's signed affidavits and statements, proper due diligence dictates that the attorney should not rely on such representations alone but should verify the client's financial records with third party sources. Recording Internet search records—or the absence thereof—helps to reinforce records produced by the client and referees. Attorneys should preserve records describing the facts of any case in which the lawyer declines to represent the potential client.[223]

Attorneys may consider focusing on those client goals for which asset protection is an incidental benefit the better approach to modern asset protection planning. For example, a client without an estate plan may benefit from having a will and trust prepared.[224] At the same time, the lawyer should ensure that the memoranda and file records prepared in the course of the representation demonstrate a genuine need for estate planning benefits. If a trust is put in place to minimize estate taxes, one should expect to see an estate the size of which would be subject to an

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217 *See generally* Engle, *supra* note 8.
218 Kilker v. Stillman, 2012 WL 5902348 (Cal. Ct. App. Nov. 26, 2012).
219 Engel, *supra* note 8 at 185.
220 *Id.*
221 *Id.*
222 *Id.*
223 Rubin, *supra* note 85 at 18-22.
224 Engel, *supra* note 8 at 301.03.

estate tax absent such planning, along with a file memorandum identifying the estate tax savings goals to be served through the plan.

B. Alternatives to Gifting

Asset protection trusts have the capacity to be the victims of their own success. Any time the creditor is told that no assets are available to satisfy a debt, it forces the creditor to find other ways to attack the asset protection structure and undermine the trust planning. If the *Kilker* decision is followed by other states, it is fair to say that asset protection trusts will have reached a tipping point, with creditors gaining the upper hand in both state and federal bankruptcy courts.

While trusts have been used to sever legal and beneficial ownership for centuries, there are more modern vehicles for achieving many of the same benefits, such as planning structures that confer valuable asset protection benefits, including captive insurance,[225] limited liability companies, and foreign investment funds. These modern alternatives to the common law trust primarily serve important business purposes while incidentally conferring asset protection benefits that rival or, in some cases, surpass those of an asset protection trust. More importantly, such structures owe their success to the arm's length nature of transfers made into such structures, which are less gratuitous and suspect than transfers made in trust.

1. Captive Insurance

Captive insurance is a strategic planning alternative by which an insurance company assumes the property and casualty risks of a related business.[226] Born out of the need to secure reinsurance for large steel mills, captive insurance exploded in popularity as insureds learned to manage their insurance claims and capture profits from underwriting their own business activities. In addition, captive insurance enables a business to obtain the full spectrum of coverage, including protection against cyberfraud, reputational risk, and business interruption that are not readily available in the commercial marketplace at reasonable rates, without excessive limitations or exclusions in coverage.[227]

A central tenet of captive insurance planning is that premium payments made by the insured business to the captive insurance company

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[225] Jay Adkisson, *Ten Favorite Things About Captive Insurance Companies,* FORBES (Aug. 10, 2013), http://www.forbes.com/sites/jayadkisson/2013/08/10/ten-good-non-tax-things-about-captive-insurance-companies.

[226] Engel, at 755-755.08.

[227] *Id.*

for insurance coverage must be at arm's length.[228] If the insured business manages its claims experience to minimize payouts, the profits accumulated inside the captive insurance company constitute a significant wealth transfer from the operating business to the captive insurance company.[229] This is particularly useful if the operating business incurs higher than normal risks in its operations or accumulates significant cash.

Captive insurance offers important asset protection benefits.[230] First, when a business purchases insurance coverage from a captive, insurance premiums flow from the business to the captive to pay for that insurance coverage. Those premium dollars are no longer in the business, where they might otherwise be exposed to creditor claims. Instead, those premium dollars now belong to the captive.[231] This can be analogized to severing legal and beneficial ownership in a trust setting: while legal ownership of funds used to pay premiums shift from the operating business to the captive, the beneficial ownership remains with the owner of the captive, who, most often, owns the operating business.

When the captive insurance company is formed, consideration should be given to the ownership structure of the captive. For example, if an individual becomes an owner of a captive, then that ownership interest is a personal asset of the individual. By comparison, if that same individual created an asset protection trust to take on ownership of the captive, the individual's creditors may have limited or no recourse against the assets of the trust.[232] The funds accumulated inside the captive reflect earned income from underwriting activities, depriving creditors of the opportunity to pursue a gratuitous transfer from the business owner to the captive or its trust owner.

Third, captive insurance companies are most often established offshore, although an increasing number are formed domestically.[233] Many offshore jurisdictions that are popular for captive insurance planning are also well-known asset protection jurisdictions, such as Belize and Nevis.[234] A creditor pursuing premium payments made to a captive must prove that premium payments were not at arm's length; the creditor must also accomplish this in a foreign legal setting with different rules, under an English "loser pays" rule for legal expenses, and with a

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228 *Id.*

229 *Id.*

230 *Id.*

231 *Id.*

232 *See* Wy. Stat. § 4-10-517 (1997).

233 http://worldcaptiveforum.com/Onshore_Offshore.html.

234 *Which are the best international jurisdictions?*, THE PRESSER LAW FIRM, P.A. (June 1, 2015), http://www.assetprotectionattorneys.com/Asset_Protection_Blog/2015/June/Which_are_the_best_international_jurisdictions_.aspx.

bond requirement to gain access to the courthouse in many jurisdictions.[235]

At the same time, asset protection benefits rarely drive the captive insurance market. Captive insurance is premised on the benefits that can be achieved by managing claims and conserving premium income that otherwise might be lost to a third-party carrier. These financial benefits are magnified if ownership of the operating business belongs to the older generation of family members and the captive belongs to the younger generation; properly structured, wealth may shift transfer tax free from one generation to the next.[236]

The benefits of captive insurance may be compounded because of important tax savings realized in the operating business in the form of premium expense deductions, as well as the manner in which the captive *insurance* company recognizes income for tax purposes.[237] Smaller captive insurance companies may even enjoy an exemption on up to $1.2 million[238] of premium income under current law.[239]

Under Section 831(b) of the Internal Revenue Code, a small captive insurance company that collects no more than $1.2 million in premium may elect exemption from corporate income tax on insurance income.[240] Instead, the small captive is only taxed on its non-insurance income, such as dividends, capital gains, and interest income.[241] These benefits must be balanced against the increased tax cost of investment income realized inside the captive, including capital gains, which do not enjoy a reduced rate of tax.[242]

Captives are taxable as C corporations, which do not enjoy as many graduated tax brackets as individuals.[243] Additionally, the owners of the captive incur corporate- and shareholder-lever taxation on the distribution of appreciated property, as well as a tax liability on cash

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[235] *See Review of Civil Litigation Costs: Preliminary Report*, TSO (May 2009), *available at* https://www.judiciary.gov.uk/wp-content/uploads/JCO/Documents/Guidance/jackson-vol2-low.pdf at 639 et seq.

[236] PATH ACT OF 2015, § 333 (2015).

[237] Robert E. Bertucelli, *The benefits of captive insurance companies*, JOURNAL OF ACCOUNTANCY (Mar. 1, 2013), http://www.journalofaccountancy.com/Issues/2013/Mar/20126102.htm.

[238] $1.2 million increases to $2.2 million with tax years beginning on or after January 1, 2017 and the intergenerational wealth transfer prohibition takes place, denying an 831(b) premium exemption if the owners of the insured business and the owners of the captive are family members who do not own identical proportions of each business. *See* PATH ACT OF 2015, § 831(b).

[239] *Id*.

[240] 26 U.S.C. § 831(b) (2015).

[241] 26 U.S.C. § 831(b).

[242] *See* 26 U.S.C. § 11.

[243] *Id*.

dividends.[244] Finally, liquidating a captive may incur taxes for both the captive and its shareholders. While the tax savings of a captive may not be overwhelming, the after-tax profits captured through a successfully managed captive insurance company provide compelling non-asset protection reasons to implement a captive insurance company.[245]

2. LLCs

In addition to captive insurance companies, asset protection planners widely utilize limited liability companies ("LLCs") as an alternative to a traditional DAPT.[246] The limited liability company is perhaps the most popular form of business entity in use today. LLCs are formed for the purpose of engaging in a wide variety of activities, from pursuing an active, operating business to pooling assets as part of a common investment strategy.

First introduced in Wyoming in 1977,[247] LLC statutes now exist in all fifty states and many foreign jurisdictions. Built upon important concepts from partnership, limited partnership, and corporate law, many states have taken significant steps to help ensure that LLCs have the best of everything that business entity law has to offer.[248]

Asset protection benefits derive from the legal relationship between the LLC and its members.[249] Members contribute to the capital of an LLC in exchange for the equivalent value in the form of a membership interest issued by the LLC.[250] Capital and income inside the LLC are generally shielded from interference by an outside creditor, who may be limited in many jurisdictions to a charging order remedy against a debtor-member's LLC interest.[251] The charging order is akin to a wage garnishment, only entitling the creditor to receive distributions if and when made voluntarily by the LLC to its members.[252] LLCs are viable and rather efficacious alternatives to asset protection trusts that erect firewalls against unanticipated future creditors.

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244 *Id.*
245 Engel, *supra* note 8 at 755.07-755.08.
246 BNA Portfolio 810-3rd, Asset Protection Planning, pp. A-57.
247 Richard M. Horwood & Jeffrey A. Hechtman, *The Better Alternative: The Limited Liability Company*, 20 J. OF REAL EST. TAX'N 348, 22-24 (1993).
248 Engel, *supra* note 8 at 890.01.
249 Richard M. Guerard, *Asset Protection Planning: An Important Resource For Clients in Difficult Times*, DCBA BRIEF (February 2011), *available at* http://www.dcba.org/mpage/vol230211art2.
250 *Id.*
251 *Id.*
252 *Id.*

3. Foreign Investment Funds

One may consider foreign investment funds, as they offer a solid alternative to asset protection trusts.[253] By pursuing an international investment opportunity not available in the client's home jurisdiction, or where the debtor cannot directly participate, such as Regulation S offerings, a client may attain asset protection benefits while also experiencing financial benefits from the investment fund.[254]

Many foreign investment funds prohibit transfers of ownership interests to third parties and limit redemption requests as to timing and amount.[255] Creditors in the United States may be prohibited from gaining any interest in a fund that has offered interests under the Regulation S exemption.[256] Many of the common forms of creditor limitations applicable to LLCs also apply to foreign investment funds, many of which are organized as LLCs: Creditors may be limited to a charging order against an investor's interest, and creditors are normally denied the ability to demand redemptions or interfere with management of the investment fund.[257] A combination of these factors may have the effect of reducing the perceived value of the investment interest in the eyes of the creditor.

V. CONCLUSION

Asset protection planning has become a hot topic at national legal conferences and occupies an entire industry of attorneys. Yet, case law over the years has enshrouded this important area of practice in a fog. Estate planning attorneys are simply incapable of giving complete legal advice to their clients without evaluating the need for asset protection. As more states enact DAPT laws, the risk of inconsistent consequences from asset protection planning and fraudulent transfers among states increases. Responsible social policy and sound legal principles require that attorneys and their clients be able to engage in asset protection planning,

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253 Stan Choes, *More investors are saying 'hola' to foreign funds as US hedge,* ALASKA JOURNAL OF COMMERCE (Oct. 17, 2013), http://www.alaskajournal.com/Alaska-Journal-of-Commerce/October-Issue-3-2013/More-investors-are-saying-hola-to-foreign-funds-as-US-hedge.

254 *Regulation S* enables domestic and foreign issuing companies to raise capital by selling securities abroad. Such securities are excluded from SEC regulations under the Securities Act of 1933.

255 *See* Investment Funds, Practical Law Company (2012), http://www.homburger.ch/fil eadmin/ publications/ PLCIF2012.pdf.

256 See 17 CFR 230.902(h) (no offer can be made to a person in the United States as part of any "offshore transaction").

257 Engel, *supra* note 8 at 801.01-801.06.

even if planning means that future unanticipated creditors may be denied access to client assets. At the same time, residents of non-DAPT states may be denied the same planning opportunities as residents of DAPT states. Attorneys engaged in asset protection planning in non-DAPT states should therefore explore the use of alternative planning techniques where asset protection is an incidental benefit rather than the primary planning objective served by the structure.