

---

THE LAW FIRM OF  
**BOVE & LANGA**  
A PROFESSIONAL CORPORATION

---

TEN TREMONT STREET, SUITE 600 – BOSTON, MASSACHUSETTS 02108  
Telephone: 617.720.6040 – Facsimile: 617.720.1919  
[www.bovelanga.com](http://www.bovelanga.com)

## **The United States As An Offshore Asset Protection Trust Jurisdiction – The World’s Best Kept Secret\***

**By Alexander A. Bove, Jr.**

[Published in Trusts & Trustees, Vol. 14 Issue 1 (Oxford Journals, 2008)]

With the huge increase in wealth the world over and the concomitant increase in lawsuits chasing much of that wealth, more and more individuals are seeking means to protect their wealth while at the same time retaining enjoyment of it – such is the theme of asset protection planning.

Though asset protection can take many forms, one of the most flexible and popular is the asset protection trust (the APT). Typically, an APT is established in a jurisdiction other than that of the settlor and one that has enacted laws validating such trusts. The more popular jurisdictions are the Cook Islands, Liechtenstein, the Isle of Man, Jersey, and Gibraltar. For settlors in and around Europe and the European Union, however, many of these jurisdictions give rise to concerns due to their proximity and the fact that a reciprocity of judgment recognition scheme is rapidly developing in the EU area, so that a judgment in the UK, for instance, may be recognized in Germany.<sup>1</sup>

---

\* This article is excerpted in large part from the author’s lecture materials prepared for the conference “Il Trust in Italia”, which he presented in Rome, Italy, October 2007.

Almost totally overlooked by such settlors as a favorable jurisdiction in which to settle their APT is the United States. As of this writing ten US states have adopted special laws favoring the self-settled APT,<sup>2</sup> and although the focus has up to now been on the US settlor, the fact is that the USAPT may be the ideal asset protection strategy for the non-US settlor.

### **Non-US Settlers of US Asset Protection Trusts – The Issues**

In determining whether a non-US person should consider establishing and funding a US trust to protect his assets, numerous issues must be taken into account. First, there should be an understanding of the selected US state's laws regarding asset protection trusts. Then there are conflict of laws questions, such as which jurisdiction's law will apply for purposes of determining whether a fraudulent transfer has occurred, and which period of limitations will apply? And if the non-US creditor obtains a judgment against the non-US settlor in a non-US jurisdiction, will he be able to sue on and enforce that judgment in the US? Finally, what are the US tax implications where a non-US person is a beneficiary of his US trust? In this presentation I offer some thought and guidance on these and related issues.

NOTE: For all purposes of this discussion, the term, "non-US settlor" means a person who is not a US citizen and not a US person, as that term is defined in the Internal Revenue Code,<sup>3</sup> also referred to as a non-resident alien. Further, the asset protection trusts discussed here are presumed to be US trusts and not "foreign" trusts as that term is defined in the Internal Revenue Code.<sup>4</sup> This is on account of two very important reasons. First, if the trust is truly a foreign trust (i.e. not subject to a US Court and not controlled by a US person), it will be subject to the laws of another jurisdiction. This would defeat the entire purpose and strength of the idea proposed herein, because we want the trust to be settled and governed by the laws of a favorable US jurisdiction. Second, we also want US tax laws to apply, as they can be very favorable to non-resident alien settlers.

## **The Basics of US Asset Protection Trusts**

The first state to adopt formal asset protection trust legislation was Alaska, in 1997.<sup>5</sup> Alaska was quickly followed by Delaware in the same year, then over the next several years both were followed by Nevada, Oklahoma, Rhode Island, Utah, South Dakota, and Missouri. And in mid-2007, Wyoming and Tennessee joined the group. Except as noted, all the states' laws allowing self-settled domestic asset protection trusts are substantially the same.<sup>6</sup>

The typical US Asset Protection Trust ("USAPT") legislation<sup>7</sup> provides that a creditor of a settlor/beneficiary will not be able to reach assets of the self-settled trust so long as:

- The trust is not revocable by the settlor;<sup>8</sup>
- The settlor was not in default of a child support or alimony payment by 30 days or more;
- The trust contains a spendthrift clause, basically providing that the assets of the trust will not be reachable by a creditor of any beneficiary, nor may any beneficiary anticipate, assign, or encumber his beneficial interest;
- Distributions to the settlor are at the discretion of the trustee;
- The transfers to the trust were not fraudulent;
- The settlor may not retain a lifetime power of appointment (though retention of a testamentary special power by the settlor is permissible<sup>9</sup>);
- The trust provides it will be governed by the laws of the USAPT state; and
- At least one trustee resides in the USAPT state.

## **Fraudulent Transfers and Periods of Limitations**

*1. US Transfers.* In all of the USAPT states except Nevada, existing creditors (those having a claim at the time of the transfer to the trust, or the creation of the trust, or both) must attack the transfer by the later of four years from the transfer or one year from the time the transfer was or could reasonably have been discovered by the creditor. (In Nevada it is two years, and six

months, respectively.) Future creditors must make a claim within four years (two years in Nevada). For future creditors, there is no extension of time for discovery.

**2. *Foreign (Non-US) Transfers.*** Where the settlor is a non-US person (a non-resident alien or NRA) and the transfer is made from a situs outside the US to the USAPT, the question arises as to which jurisdiction's law will apply to the transfer, and thus, what would be the applicable limitations period on the transfer. As a general rule of law, the law of the situs of the transfer should govern.<sup>10</sup> In that event, if a non-US person transferred assets to a USAPT, the non-US person's creditors could attack the transfer in accordance with local law regarding fraudulent transfers. The problem for the creditor in such an event, however, is that he would then have to attempt to apply the foreign law in the US in pursuing the assets in the USAPT.

For example, say that Swiss law provides for a five year period of limitations on fraudulent transfers. In 2008, Marco, a Swiss resident, wires US \$4 million from Switzerland to Delaware to fund his newly created USAPT. In 2012, four years later, Marco's creditor (whose unforeseen claim arose after the establishment of the USAPT) obtains a judgment against Marco in Switzerland, but the creditor finds that the bulk of Marco's funds had been transferred to the US four years earlier. The creditor's attorney then advises the creditor that although the period of limitations for reaching the funds in Switzerland had not yet expired, the corresponding period of limitations for the USAPT (in Delaware) is four years from the transfer to the USAPT, and that period had expired. May the creditor still pursue his claim based on the Swiss law or will he be precluded by the US (state) law? As noted above, the general rule is that the law of the jurisdiction where the transfer is initiated will apply unless the parties contract otherwise, or unless a court determines otherwise. Therefore, in this case, it may be that Swiss law would apply, provided the judgment meets certain criteria discussed below. If that is the case, and if the creditor brings his action in the US within the Swiss period of limitations, can he enforce the Swiss judgment against the USAPT? (See discussion below.)

## **Revocability**

All of the USAPT states except Oklahoma (and, indirectly, Wyoming) require the trust to be irrevocable, but this refers only to the settlor's power to revoke. As noted below, the trust may be revocable by someone other than the settlor. Oklahoma law, on the other hand, expressly provides that the trust may be revocable by the settlor, but the settlor may not be a beneficiary, and creditors may not force the settlor to revoke or reach the settlor's right to revoke.<sup>11</sup>

Wyoming requires that the trust be irrevocable but at the same time allows the settlor to retain a general power of appointment, meaning that he can revoke the trust simply by appointing the property to himself or to another,<sup>12</sup> providing, of course, that he retains such a power under the provisions of the trust.

## **Spendthrift Clause**

The USAPT must contain a spendthrift provision, which provision must restrict both voluntary and involuntary transfers by a beneficiary, as well as anticipation, assignment, or encumbrance of the beneficial interest.

## **Moving a Pre-Existing USAPT**

Trusts created in other jurisdictions, whether US or non-US, may be moved to a USAPT state, provided the trust meets the requirements of the target state. In other words, a USAPT established, say, in the Isle of Man, Gibraltar, or the Cook Islands, may be moved to Delaware (for example) and administered under its law, provided the trust qualifies under Delaware USAPT law. One advantage of such a move is that the original date of establishment of the trust will stand as the determining date for fraudulent transfers under Delaware law, so that a trust established four years or more before its move to Delaware would be protected (to the extent Delaware law applies) against creditors existing at the time the trust was originally created.<sup>13</sup> Such a provision is typical in USAPT statutes, since the objective is to attract the "foreign" trust money to USAPT states.

## **Powers of Appointment**

Although the settlor may not retain a lifetime power of appointment (except in Oklahoma and Wyoming), such a power (which could include the power to amend, which is equivalent to a power of appointment) may be held by any other party. In this regard, planners should consider providing in the USAPT for a protector with a range of powers appropriate under the circumstances. With applicable powers, the protector could amend the trust to adjust for changing circumstances, add or delete beneficiaries, or move the situs and governing law of the trust. Furthermore, as noted in the discussion on taxes below, it is usually advisable for the settlor to retain a special testamentary power of appointment in the USAPT.<sup>14</sup>

## **What If a Creditor's Attack Is Successful?**

In the event a creditor of the settlor:

1. persists through the courts of at least two different states (in the case of a US creditor) and one or more federal courts; or
2. in the case of a non-US creditor, obtains a judgment from the appropriate court(s) in the non-US jurisdiction, then overcomes the very complicated obstacles to a US court's recognition of the foreign judgment, and presses his case through the US courts (likely more than one court); and in either case (1) or (2),
3. bears the huge legal expense associated with such time-consuming and complicated litigation; and
4. is ultimately successful in his attack against the trust,

then the result would be that only that creditor's judgment would be paid from the trust.<sup>15</sup> The trust would otherwise continue as before, ready to defend against any future attacks.

### **Administration of Assets and Transfer of Assets to the Trust**

To qualify as a USAPT at least some of the trust assets must be deposited and administered in the USAPT state, and at least one trustee must be a “qualified person”. A qualified person under the USAPT statutes is a resident of the USAPT state or (more commonly) a bank or trust company with a principal place of business in that state. As a general rule, it is inadvisable to have a co-trustee outside of the USAPT state as it merely increases the exposure of the trust to an additional jurisdiction.

Furthermore it would appear to be important to have all of the intangible assets held by the USAPT trustee in the USAPT state to avoid the exposure of court jurisdiction in a non-USAPT state as a result of trust accounts held there. But what about real estate situated in a foreign state or jurisdiction, or closely held business interests, especially where the entity was formed in a non-USAPT jurisdiction? As for real estate, perhaps the best of a number of possibilities is to transfer the real estate to an LLC or corporation and make the USAPT the member of the LLC or shareholder of the corporation. Though the real estate itself is still subject to the local court’s (in rem) jurisdiction, there are substantial hurdles for a creditor to overcome before the property can be reached, if at all.

### **Income, Gift, and Estate Tax Consequences for Non US Settlers**

*The following tax commentary is necessarily brief and not offered as a substitute for expert tax advice from both or all relevant jurisdictions in each individual circumstance. Furthermore, where a non-US settlor establishes a USAPT, it is extremely important to determine whether there is a tax treaty between the US and the domicile country of the non-US settlor. In such cases, the US tax liability, if any, may be offset by the tax paid on the income or property taxed in the non-US settlor’s domicile or vice-versa. It is also important that the non-US settlor is not treated as a US person on account of spending more than 183 days in the US in a calendar year (the “substantial presence test”).<sup>16</sup>*

**1. Income Tax.** For US settlors of a USAPT, the US tax code treats the USAPT as a “pass-through” or transparency for income tax purposes under the so-called “grantor trust” rules.<sup>17</sup>

This means that all items of income, gain, or loss are passed through to the settlor, whether or not any distributions take place. For a non-US settlor of a USAPT the income tax consequences will vary somewhat from those of a US settlor, but the pass-through (grantor trust) rules still apply. In fact, it is the pass-through rules that give the non-US settlor a distinct income tax advantage over a US settlor. This is because a non-US settlor would enjoy special tax benefits for making certain investments in the US. For instance, “portfolio interest,” which generally includes interest paid on bank deposits, government and corporate bonds, and the like, may be received income-tax free by a non-US settlor.<sup>18</sup> And since the USAPT is a pass-through trust, such interest received by the trust is treated as if it was received by the non-US settlor. Similarly, most US capital gains (except for those on US real estate) are tax-free to the non-US settlor, unless the non-US settlor is present in the US for 183 days or more in the year of the gain.<sup>19</sup>

Income from a trade or business carried on in the US, rental income from US real estate, and dividends from US corporations are subject to US income tax and are generally subject to 30 percent withholding to apply towards the tax. Where such income is received by the trustee of a USAPT for the benefit of a non-US grantor, the US trustee must withhold the tax.<sup>20</sup>

It is important not to confuse a US grantor trust established by a foreign settlor (which we have here) with a foreign grantor trust or a foreign non-grantor trust, which we want to avoid. As noted at the outset of this discussion, we do *not* want a foreign trust and certainly not a foreign grantor (or non-grantor) trust, as the latter may cause a loss of some of the US income tax benefits discussed above, and worse, a loss of the asset protection offered by the USAPT. What we *do* want is a US grantor trust established by a foreign person. Although there are some restrictions, it is this type of trust which will accomplish the objectives discussed in this article. The required restriction applicable here is fairly simple. In order for a trust with a non-US settlor to be treated as a “grantor” trust for US income tax purposes, only the settlor and his spouse can be beneficiaries during the settlor’s lifetime.<sup>21</sup> Thus, the USAPT should not provide for distributions to the settlor’s children while the settlor is alive.

For reasons discussed in greater detail below under Estate Tax, it will be advisable for the USAPT to make virtually all of its US investments through a foreign (non-US) corporation. This arrangement will not affect the pass-through nature of the trust nor will it affect the income tax benefits available to the non-US settlor for the foregoing types of investments. If the non-US settlor anticipates investing in US real estate through the USAPT, the tax rules are considerably more complicated and outside the scope of this presentation.<sup>22</sup> And if the real estate is located in a state other than that of the USAPT, the asset protection rules can get more complicated as well. Thus, while an investment in US real estate through the USAPT is not impossible, it will require some special planning techniques and tax considerations.

Lastly, where there is taxable income to the non-US settlor, it appears that the deductible expenses in administering the trust may be allocated entirely to such income, since the regulations are silent on this point. Note, however, that where there is rental income from US real estate, the non-US settlor should make an election to treat such income as if it was “effectively connected” (and therefore, taxable) US income, since without the election, he would be taxed on the gross rents without any deduction for depreciation and other expense related to the property.<sup>23</sup>

**2. Gift Tax.** A non-US settlor will only be subject to a US gift tax on gifts of US situs assets. Such would include gifts of tangible personal property (e.g., works of art, jewelry, cash) situated in the US, and US real estate. Gifts of intangible property (e.g., securities, such as stocks or bonds, and regardless of whether the corporation is US or foreign) by a non-US settlor are not subject to a US gift tax. Gifts of “cash” in the form of a check drawn on a US bank, however, may be subject to a gift tax. Thus, if the trustee of the non-US settlor’s USAPT makes a distribution of money (e.g., a check drawn on a US bank) to a beneficiary other than the settlor, the distribution could be subject to a US gift tax, subject to the exemptions noted below.<sup>24</sup> Note that this may be the result even though the distribution is to another non-US person, with the possible exception where the distribution satisfied a legal obligation of the settlor.

Although a US person enjoys a large credit towards gift tax, a non-US settlor does not. The non-US settlor, however, is entitled to the \$12,000 per donee per year annual exclusion.<sup>25</sup> If the

donee is the donor's spouse and is a US citizen, the qualifying gifts to her or him may be unlimited in amount.<sup>26</sup> If the donee spouse is not a US citizen, annual tax-free gifts to that spouse are limited to \$100,000, but this is adjusted for inflation (for 2007, it is adjusted to \$125,000).<sup>27</sup> Thus, the USAPT could make gift tax-free distributions of up to \$12,000 per year each to any number of other beneficiaries and up to \$125,000 (for 2007) for gifts to his non-US citizen spouse. Note that the \$12,000 exclusion is unlikely to apply to distributions directly from the USAPT because of the rule stated above that the beneficiaries of a US grantor trust settled by a foreign person can only be the settlor and his spouse. However, if the settlor (or his spouse) makes the transfer to another party, the exclusion will apply.

Again, for US gift tax purposes (and only to illustrate the concept, as it would not normally apply to the trust contemplated in this discussion) it is only gifts of US situs assets that we are concerned about for a non-US settlor. Thus, if a non-US settlor makes a gift to his USAPT of an interest in an Isle of Man limited liability company that owns real estate in the UK, or makes a gift of shares of a Dutch corporation, there is no US gift tax exposure as these assets are not situated in the US.

**IMPORTANT NOTE:** Before making large transfers to an irrevocable USAPT, the non-US settlor should be careful to check the gift tax laws of his own jurisdiction, because a number of European countries have their own gift tax laws. For example, a UK domiciliary who makes such a transfer will be subject to a UK inheritance tax. Similarly, domiciliaries of Italy and Germany would likely be subject to a gift tax on this type of transfer, even though under US gift tax law, it may not be considered a completed gift.<sup>28</sup> In such cases, it may be that the tax could be avoided if the respective tax authorities would recognize that no gift should be declared because the settlor who is also the trust beneficiary is really giving the assets to himself through the trust, or perhaps, for example, by transfers through an intermediary corporation formed in another jurisdiction. However, such planning must be done by local experts and is beyond the scope of this discussion.

As for US gift tax on initial transfers to the USAPT by the non-US settlor, in most cases, the trust would be funded with non-US situs property (e.g., a transfer from an offshore bank), and

therefore, no gift tax would apply. In the event US situs property was inadvertently used (see discussion below under US estate tax for the seriousness of such an oversight) the retained power of appointment by the non-US settlor would avoid a completed gift for US gift tax purposes.

**3. Estate Tax.** Similar to the gift tax, the estate tax for a non-US settlor will depend on the amount of his US situs property. Unlike the gift tax, however, shares of US corporations and certain US debt obligations are considered to be US situs property. Therefore, if the non-US settlor's USAPT has a portfolio directly owning shares of US corporations and US mutual funds, the full value of those shares will be included in the non-US settlor's estate for US estate tax purposes, despite the fact that the non-US settlor may have no other connection with the US.<sup>29</sup> On the other hand, shares in a foreign (non-US) corporation would not be US situs property and therefore, not subject to US estate tax. Generally, US securities producing "portfolio interest" (described above) which are income tax free to non-US settlors would not be subject to US estate tax.<sup>30</sup> Further, the proceeds of life insurance on the non-US settlor's life are not considered to be US situs property.<sup>31</sup> The situs of a US LLC interest is not always so simple to determine. The consensus seems to be that a US situated LLC carrying on a "trade or business" here in the US is situated in the US. Further, despite the "intangible" argument, if the USAPT trustee holds the membership interest, the US LLC (or partnership) is likely to be considered US situs property, at least for US estate tax purposes.

For those US securities which are subject to US estate tax and which would seem to pose the greatest tax threat to the non-US settlor, the good news is that the **US estate tax on such securities can be completely avoided**, provided certain simple but specific procedures are followed.

The suggested procedures are based on two important facts: first, we want to ensure that the USAPT holds no US situs property, and second, we want to be sure that the present assets held by the USAPT were not acquired with proceeds from the sale of US situs assets. This is because the US tax code contains an unusual provision (**a hidden tax trap**) resulting in an estate tax for non-US persons where the property of a trust such as a USAPT contains either US situs property, or non-US situs property that was converted from US situs property **at any time**.<sup>32</sup> Therefore, if

the USAPT of a non-US settlor held US situs property at one time, later sold it and invested all the proceeds in non-US situs property, the full value of the converted property would nevertheless be included in the non-US settlor's estate for US estate tax purposes. [Understand that shares of a non-US corporation registered in the name of the USAPT trustee may be non-US situated property for US tax purposes, but at the same time they may be treated as property "held" in the USAPT state for creditor protection purposes. Thus, both the estate-tax-free status and the creditor protection status may be realized.]

Accordingly, if a non-US settlor wishes to invest in US securities but avoid US estate tax, all he would need to do is arrange for a non-US corporation to be formed (often referred to as an "IBC" – International Business Corporation) and transfer the funds to the IBC. He would then transfer the shares of the IBC to the USAPT, and the USAPT would then proceed to acquire a portfolio of US securities through the IBC. Of course, there may be different circumstances to be accommodated. For instance, if the non-US settlor already holds US securities and wants to transfer them to his USAPT, he should not make the transfer directly, but rather he should establish an IBC on his own, transfer the US securities to the IBC, and then transfer the shares of the IBC to the USAPT. In another situation, the non-US settlor could transfer funds to the USAPT, and the trustee of the USAPT could form the IBC, transfer the funds to it, then proceed to acquire the portfolio through the IBC. (When the trustee of the USAPT acquires the shares of the IBC, it should file an election to have the IBC disregarded for US income tax purposes.<sup>33</sup> This may not technically be necessary, since the trust is a grantor trust, and the grantor, the non-US settlor, is not a US person, but most US corporate trustees would probably want to be on the "safe side." Furthermore, making the election may ensure that any treaty relief would apply to the grantor.) Lastly, the IBC should be established in a "tax-haven" jurisdiction that imposes no tax on the IBC.

If the non-US settlor's US estate exceeds \$30,000 (of US situs property) a US estate tax return must be filed (whether or not an estate tax may be due). The non-US settlor's estate is only allowed a credit equal to \$60,000 in property value (compared to \$2 million for a US person).<sup>34</sup> Property that passes to a surviving spouse (whether or not the spouse is a US citizen) and qualifies for the US marital deduction will not be taxed.<sup>35</sup>

In light of the above, where the USAPT and its portfolio are properly structured, achieving a plan that produces minimal or no US income tax and no US gift or estate tax is quite possible.

### **What Happens at Death?**

On the death of the non-US settlor, the terms of the trust will govern the further disposition of the funds. One would assume that counsel who advised the settlor on the formation of the trust would integrate the disposition of the USAPT assets on the settlor's death. Typically, if the settlor's beneficiaries are non-US persons the USAPT would distribute its remaining assets either to them or to other entities for their benefit. If they happen to be US persons and the settlor wishes to continue long term tax planning for future generations, he may provide for a transfer of the trust assets to a foreign non-grantor trust which could accumulate income without US income tax exposure. Given the myriad of objectives and family situations, it would be impossible to suggest which of the foregoing options may be appropriate.

### **Possible Attacks on US Asset Protection Trusts Established by a Non-US Settlor**

In addition to the obvious attack on a USAPT that a transfer to it was fraudulent (which actually is not an attack on the trust at all, but on the nature of the transfer), there has been a good deal of discussion and commentary on such attacks based on a number of other theories. Most of these particular theories, however, are based on a US creditor dealing with a US trust established by a US settlor. As such, they include arguments based on jurisdiction, conflict of US state laws, and most forcefully, US constitutional issues, the last including the full faith and credit clause, the supremacy clause, and the contract clause of the United States Constitution. But where a non-US person is the settlor of the trust, all of the US constitutional issues become irrelevant, and the only issues that would seem to apply are: 1) whether a non-US court has jurisdiction over the USAPT; 2) the conflict of US versus non-US laws (i.e., which jurisdiction's laws will apply to the trust and the protection it purports to offer); 3) which fraudulent transfer law would apply; and 4) whether the US state court will recognize the non-US judgment. Each of these is briefly examined here from the perspective of the non-US settlor.

## **Jurisdiction**

Of course, if the (non-US) forum court could exercise jurisdiction over the USAPT trust assets themselves, it may be able to reach those assets even though technically held in the USAPT. For instance, if real estate held in the USAPT is situated in a jurisdiction that is subject to the non-US court, then the court may attempt to exercise jurisdiction “in rem” even though the property is titled in the name of the USAPT. The situs of intangibles, however, such as publicly traded securities, bank accounts, and closely-held business interests may not be so obvious. For instance, if an Italian resident transferred shares of his Italian company to a USAPT, the question arises as to whether an Italian court rendering a judgment against the Italian settlor could exercise jurisdiction over the Italian company and order the shares held by the USAPT to be cancelled and re-issued to the creditor pursuant to the judgment. It is extremely important to note, however, that under normal rules of litigation, the owner of the shares, here the trustee of the USAPT, would have to be given the opportunity to be heard in the matter (through a special appearance, without submitting to the jurisdiction of the non-US court), thus, reaching the shares through a court’s jurisdiction over the corporation itself may not be as simple as it may first appear.

Another question of jurisdiction is whether the trustee of the USAPT has sufficient contacts with the non-US court so as to be subject to the court’s jurisdiction. For instance, if the trustee has a branch office or maintains representatives in the non-US jurisdiction in question, that could be regarded as “doing business” there and subject the trustee to the jurisdiction of the non-US court. To avoid this exposure, attorneys selecting a USAPT trustee for their clients should seek to avoid a trustee that has any permanent contacts with or regularly solicits business in the client’s jurisdiction.

## **Conflict of Laws**

If jurisdiction over the trust is somehow exercised by the non-US court as suggested above, which law applies? The law of the foreign jurisdiction or the law of the USAPT state? There is

substantial law to the effect that a settlor may designate the law to be applied to the validity, construction, and administration of the trust, provided “the selected jurisdiction has a material connection with the transaction.”<sup>36</sup> Where a trust is established, funded, and administered all in a single jurisdiction (the USAPT state), it would seem difficult to argue there is no “material connection” with the USAPT state. But must the non-US court recognize the trust if the designated law conflicts with its own? The Restatement Second Conflict of Laws at section 270 provides, in part, that in addition to the material connection rule, the application of the designated law must not violate a strong public policy of the forum state, assuming the forum state has a more significant relationship to the matter than the designated state. As suggested above, where the trust assets are actually held and administered in the US by the trustee of the USAPT it would seem that the USAPT state clearly has the more significant relationship to the validity, construction, and administration of the trust.

### **Recognition of Foreign Judgments in the US**

Although the US has never enacted a national law regarding the recognition of non-US judgments, a body of case law did develop, and subsequently a “Uniform” law was promulgated calling for recognition of non-US money judgments where certain requirements are met.<sup>37</sup> Since there is no national law in this regard, it was and is left to the individual US states as to whether they will follow the precedent set and the requirements established in the landmark US Supreme court case of *Hilton v. Guyot*.<sup>38</sup> These requirements are in principal reflected in the Uniform Act.<sup>39</sup> The fact that a particular state may not have expressly adopted the Uniform Act does not necessarily mean that it would not recognize a non-US money judgment if all of the criteria from the *Hilton* case are met and it would serve the interests of justice to do so.

The criteria established by the *Hilton* case are:

- The judgment is final and conclusive in the foreign court;
- The judgment is for a sum of money;
- The foreign court had jurisdiction over the action and over the parties; and

- The judgment was the result of a full and fair trial on the merits, reflected in a “clear and formal record.”

Reciprocity of the applicable jurisdiction in its recognition of US money judgments is also an important factor. Note also that the Uniform Act specifically precludes US recognition of foreign judgments for taxes, fines or penalties, and domestic relations orders.

If the foreign judgment is final and the US proceedings for enforcement of that judgment are undertaken, the defendant (here, the trustee of the USAPT) then may raise defenses showing that one or more of the required criteria noted above have not been met. In the case of a non-US person who establishes a USAPT, undoubtedly the most effective defense would be that the foreign court did not have jurisdiction over the relevant party: the trustee of the USAPT. That is to say, in this case, the suit for the money-judgment must be against the US trustee of the USAPT (assuming there is no foreign trustee subject to the non-US court’s jurisdiction – which should be avoided at all cost). But the US trustee presumably had no legal presence in the foreign jurisdiction, was therefore never under the jurisdiction of the foreign court, and therefore it could not be bound by the judgment. Accordingly, the foreign judgment against the non-US settlor of the trust would have no effect and would not be enforceable against the trustee of the USAPT, regardless of the fact that the judgment may have otherwise been enforceable against the settlor individually in the US or anywhere else.

In the event the foreign creditor’s claim is that the settlor’s transfer to the USAPT was fraudulent, he would still be required to follow the proceedings for enforcement of the foreign judgment in the USAPT state, and, assuming the US state recognized the judgment, the creditor would then have to prove in the US court that the settlor’s transfer was fraudulent. This may require, among other things, the production of witnesses from the foreign jurisdiction as well as qualification of other evidence to be submitted. An expensive and oftentimes formidable task.

### **Going “Offshore” to the United States**

It is well established that one of the tenets of asset protection planning is to make it as difficult as possible for creditors to reach the assets. If we compare a non-US settlor who has his assets, say, in his home jurisdiction which does not recognize self-settled spendthrift trusts or which does not recognize trusts at all, with another non-US settlor who has most of the same type of assets in a USAPT, we have the legal equivalent of night and day. In the former case, once a creditor has a judgment and takes discovery to identify and locate the debtor’s assets, he can simply execute the judgment against all the debtor’s assets in that jurisdiction. In the latter case, any attachments against the foreign (USAPT) trust during the process of the initial claim against the settlor in his home jurisdiction are highly unlikely for lack of jurisdiction, and after the creditor obtains a judgment, the creditor would then have to bring a new action in the USAPT state in an attempt to enforce the foreign judgment. Further, even if the creditor were successful in a USAPT state court, there would undoubtedly be at least one appeal by the USAPT trustee to a US federal court. Lastly, it is not at all impossible that the matter would find its way to the United States Supreme Court. The huge amount of time and expense associated with such an undertaking would likely discourage even the most determined creditor.

### **Conclusion**

While US Asset Protection Trusts (USAPTs) offer an attractive vehicle for US settlors who wish to protect assets from creditors while still being able to enjoy them, they are even more attractive to non-US settlors. First, the biggest and most debated issue facing US settlors of a USAPT is the “full faith and credit” doctrine of the US Constitution. This issue simply would not apply to a non-US settlor facing a non-US judgment. Second, creditors of non-US settlors would have to first obtain a judgment in their home jurisdiction and then attempt to enforce that “foreign” judgment in the US against the trustee of the USAPT, who was not a party to the original action. Therefore, except in unusual cases, this would mean that the only issues to litigate would be whether a fraudulent transfer has taken place, and in turn, which jurisdiction’s fraudulent transfer laws would apply. Despite that, the non-US creditor must still seek to first have the foreign

judgment recognized, because without formal legal acknowledgment of the judgment in the US court, there would be no basis on which to question the transfer.

In the face of such obstacles, creditors are bound to be discouraged from taking on the time and huge expense of such a task where the likelihood of success is questionable, at best. Perhaps it comes down to the question of who seizes what, first. That is to say, will the creditor seize the assets of the non-US settlor in his home jurisdiction before the non-US settlor seizes the opportunity to protect those assets by transferring them to a USAPT?

Copyright © 2007 by Alexander A. Bove, Jr. All rights reserved.

---

1 See Oxford, Diana, *Enforcing Trust Judgments Within the European Union*, Trusts & Trustees, Vol. 12, No. 10 2006.

2 Alaska, Delaware, Missouri, Nevada, Oklahoma, South Dakota, Rhode Island, Utah, Wyoming, Tennessee .

3 IRC §7701(b).

4 IRC §7701(a)(31)(B).

5 Alaska Stat. §34.40.110 (1997).

6 Alaska Stat. §34.40.110; Del. Code Ann. Tit. 12 §§3570 - 3576; Mo. Ann. Stat. §456.5-505; Nev. Rev. Stat. §§166.010 – 166.170; R.I. Gen. Laws. §§18-9.2-1 – 18-9.2-7; S.D. Codified Laws §§55-16-1 – 55-16-17; Utah Code Ann. §25-6-14; OK Stat. Ann. Tit. 31 §10; Wyo. Stat. §§4-10-510 – 4-10-523; Tenn. Code Ann. §35-15-505 & §66-1-202..

7 Alaska Stat. §34.40.110.

8 Oklahoma law allows the settlor to reserve the right to revoke the trust. OK Stat. Ann. Tit. 31 §13.

9 Wyoming allows the settlor to retain lifetime general and special powers of appointment, the exercise of which could terminate the trust. Wyo. Stat. §4-10-510(a)(iv)(B)..

10 111 A.L.R. 787, §III; see also, *Hutchison v. Ross*, 187 NE 65 (N.Y. 1933).

11 Okla. Stat. Ann. Tit. 31 §§11-18.

12 Wyo. Stat. §4-10-510(a)(iv)(B).

13 Del. Code Ann. Tit. 12 §§3572(c).

14 A special (sometimes referred to as a non-general) power of appointment is one where the powerholder may not appoint in favor of himself, his creditors, his estate or the creditors of his estate. A general power has no such restrictions, and so allows the powerholder to appoint to himself, etc. See Restatement Second Property, §§11 & 12.

15 Del. Code Ann. Tit. 12 §3574(a).

16 IRC §7701(b)(3).

17 IRC §671-679.

18 IRC §871(h).

19 IRC §§871(a)(1) and (2).

20 IRC §871(a)(1).

21 IRC §672(f)(2)(A).

22 IRC §897.

23 IRC §871(d).

24 See IRS General Counsel Memorandum 36860.

- 
- 25 IRC §2503.
- 26 IRC § 2523(a).
- 27 IRC §2523(i), but note, the amount is adjusted for inflation.
- 28 US Treas. Reg. §25.2511-2(b) & (c).
- 29 IRC §§2104(a) and (c).
- 30 IRC §2105(b).
- 31 IRC §2105(a).
- 32 IRC §2104(b). The basis for estate inclusion rests on IRC §§2035 – 2038 causing transfers with retained interests or retained control over trusts, and certain transfers within three years of death to be included in the transferor’s gross estate for tax purposes. If any one of those sections applied at the time of the transfers of US situs assets, then the subject property will be included in the non-US settlor’s estate at death regardless of subsequent changes to the property. Admittedly, there are problems in administering such a law, but the IRS has applied it where the opportunity arose. See, e.g., PLR 9507044.
- 33 See Internal Revenue Form 8832 and instructions.
- 34 IRC §2102(c).
- 35 IRC §§2001(c), 2056, 2056A.
- 36 *Wilmington Trust Co. v. Wilmington Trust Co.*, 24 A. 2d 309 (Del. 1942).
- 37 *Uniform Foreign Money-Judgments Recognition Act*, National Conference of Commissioners on Uniform State Laws (1962), available at their website: [www.nccusl.org/update](http://www.nccusl.org/update).
- 38 *Hilton v. Guyot*, 150 US 113 (1895).
- 39 *Supra*, note 37. There have been several Uniform Acts proposed, 1962, and 2005. The 1962 Act was adopted by 32 states, and the 2005 Act (which was re-titled: Uniform Foreign-Country Money Judgments Recognition Act) by only 2 states to date. The 2005 Act is also available at the National Conference of Commissioners on Uniform State Laws website: [www.nccusl.org/update](http://www.nccusl.org/update).