ACTEC NOTES

THE AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL

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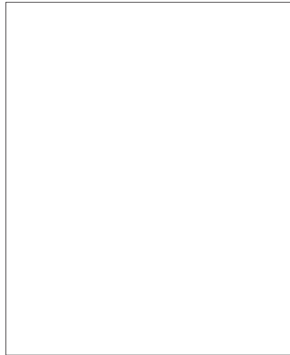
PLEASE NOTE

1999-2000 Pocket Tax Tables–A complimentary copy is enclosed along with an order form and return envelope.

"Death and Taxes," a 60-minute program on estate planning for PBS–This program, made possible by an ACTEC Foundation grant, features Fellows Carlyn McCaffrey and Max Gutierrez in a panel discussion with a financial planner, a banker and a financial journalist. The segment stresses to families the importance of seeking qualified professional estate planning advice.

Fellows are requested in the enclosed advisory from Norman J. Benford, ACTEC Foundation president, to contact their local PBS stations in May to encourage the broadcast of this valuable and timely program in their communities.



Hanson S. Reynolds

President's Message

After good weather in Montreal last June and outstanding weather in Boston in October, the notorious ACTEC weather curse returned to plague the last three days of our annual meeting in Scottsdale with rain and chilly temperatures. In fact when Sharon and I landed at Logan Airport on Thursday afternoon, March 9, we discovered that the temperature in Boston was 20° higher than it was when we left Phoenix.

We were fortunate to have scheduled our three outdoor events before the deluge came to the Valley of the Sun, and we found that a "good side" to the inclement weather was that there was record attendance at the seminars and the computer workshops.

Our athletes were frustrated. Only the golfers were stalwart enough to actually complete their tournament, while the tennis gurus had to hold a lottery in order to discover the winners of their match play.

By all measures (including the rain

(continued on page 283)

What ACTEC Fellows Should Know About Asset Protection

*by Duncan E. Osborne and Elizabeth M. Schurig**
Austin, Texas

ACTEC lawyers probably have a duty to engage in asset protection planning for their clients, but if they do not, then to protect themselves from potential malpractice liability, they should clearly communicate to their clients that their representation does not involve any advice regarding asset protection. While this hypothesis may seem outrageous, in a recent article of the *ABA Journal,* Peter Spero argues that, at least under California law, a lawyer engaged in estate planning may well have a duty beyond traditional trust, estate, and tax planning which would, in fact, extend to asset protection planning.[1] Whether or not one agrees with Mr. Spero, the mere fact that he has taken that position and has identified a possible "duty" should send a warning signal. The reality of our litigious society is that once a lawyer argues that a "duty" exists, judges often allow a plaintiff to pursue an argument based on that "duty." If this plaintiff is successful, juries are often quick to award generous damages to the injured party. Indeed, this constant identification of new theories of liability is the very aspect of our legal system which in large measure drives the asset protection industry.

There are certainly ACTEC Fellows who resist the notion that asset protection planning is a part of the service owed to clients. Some argue that the potential for unwittingly assisting a client in defrauding his creditors is enough of a risk that this representation should not be undertaken. Indeed, some argue that this risk may itself serve as the basis for a defense to a malpractice claim founded on a duty to provide asset protection advice. Some would go further and say that under the fraudulent conveyance and fraudulent transfer laws,[2] all potential creditors are protected, no matter how removed in time and events from a transfer, so it is wrong under all circumstances to engage in asset protection planning. In support of such a position, those Fellows might refer to the language of the fraudulent transfer laws dealing with the rights of present and future creditors. They might also cite the recent cases which have held against the debtor and have struck down foreign asset protection trusts and that have, in some cases, subjected the settlors to imprisonment in civil contempt proceedings.[3] Finally, they might argue the long-standing policies of Anglo-Saxon jurisprudence which generally tend to support creditors' rights to access self-settled spendthrift trusts.[4]

The problem with these arguments is that they are superficial and they do not withstand serious analysis

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[1] Peter Spero, *Search and Rescue Missions,* A.B.A. J. Oct. 1999 at 70; *See also* Samuel L. Braunstein and Carol F. Burger, *Protecting the Wealth,* A.B.A. J., Nov. 1999 at 58.

[2] All states have laws to protect creditors from fraudulent transfers. Thirty-five have some version of the Uniform Fraudulent Transfer Act, six have a version of the Uniform Fraudulent Conveyance Act, and nine have some other statutory or common law derived from the Statute of Elizabeth. *See Duncan E. Osborne, Asset Protection: Domestic and International Law and Tactics,* §§2:01-2:06 (1999). In this article, fraudulent transfer and fraudulent conveyance are used interchangeably.

[3] *In re B.V. Brooks,* 217 B.R. 98 (Bankr. E.D. Conn. 1998); *In re Larry Portnoy,* 201 B.R. 685 (Bankr. S.D. N.Y. 1996); *Federal Trade Commission v. Affordable Media, Inc.,* 179 F.3d 1228, 1999 WL 387259 (9th Cir. 1999) (This case is usually referred to as "the *Anderson* case" in asset protection circles); *In re Stephan Jay Lawrence, Debtor, Bankruptcy No. 97-14687-BRC-AJC* (Bankr. S.D. FL. Miami D.V. Sept. 8, 1999). *See also* Duncan E. Osborne and Elizabeth M. Schurig, *Asset Protection Trusts: Impact of Recent Case Law,* 5 J. Asset Prot. No. 2 at 24 (Nov./Dec. 1999).

[4] *See, e.g., In re B.V. Brooks, supra* note 3; *see also, In re Larry Portnoy, supra* note 3.

of the statutes and of the case law. Fraudulent transfer law is extraordinarily complex.[5] While it is absolutely true that the fraudulent transfer law of any given state may, on its face, appear to be susceptible to the interpretation that future creditors, remote in time and circumstances from the "transfer" are protected, that is not, and never has been, the way in which the courts have interpreted those laws.[6] Courts have always fixed on the relative proximity of the various creditors to the events that led to the insolvency or to the financial injury to the creditors. Indeed, for those who take the time to study the bankruptcy cases, the creditors' rights cases, and the articles written by the creditors' rights bar, it is almost alarming what the courts do permit in relation to the federal fraudulent transfer law applied in a bankruptcy context. There is even an area of the law called pre-bankruptcy planning which allows asset transfers far beyond what these authors have ever advocated.[7] In short, a serious legal analysis of what can and cannot be done to protect assets from creditors under both state and federal law reveals wide latitude for asset protection planning.

One reason that there is such wide latitude for protecting assets is that the law (either common law or federal or state statutory law) has never required an individual to preserve his or her assets for the benefit of future creditors. Fraudulent transfer statutes focus on "intent" and one cannot "intend" to defraud a creditor who does not exist. If the law did require individuals to preserve assets for the benefit of future creditors, then gratuitous transfers of all kinds (to family members, to charities, etc.) would be prohibited and the ability to use limited liability entities, e.g., corporations, limited liability partnerships, and limited liability corporations, would not be allowed.[8] However, from the earliest times in our history, persons have had the ability to limit their liability, and creditors have had fraudulent transfer laws and bankruptcy laws to protect them.

What has changed, and what has consequently fueled the debate about asset protection planning, is the legislative evolution in jurisdictions in which individuals may legally protect assets from their creditors by establishing and funding trusts for their own benefit, the assets of which are statutorily protected from the settlor's creditors. At least since 1989, when the Cook Islands enacted its asset protection legislation, individuals settling trusts in the Cook Islands or other jurisdictions with similar asset protective legislation have been able to settle assets in trust and benefit from those assets even though such assets were not available to their creditors.[9] Some lawyers and legal scholars argue that this result is a wrenching departure from Anglo-Saxon jurisprudence and simply should not be allowed. These authors disagree with those lawyers and scholars. Anglo-Saxon jurisprudence simply does not dictate that individuals should not be permitted to settle assets in trust for their own benefit and thereby protect those assets from their creditors.

Anglo-Saxon jurisprudence has evolved in much the same way that the use of trusts has evolved into a legal institution.[10] However, the law governing trusts has historically been governed by the courts of equity rather than the courts of law.[11] This is because a trust is not really a legal entity, it is a "trust" relationship and therefore defining the relationship and its legal components historically required the application of conscience rather than strict legal principles that was better accomplished by ecclesiastics than lawyers.[12] Though courts of equity do not exist in our country, it is important to remember that a trust is a relationship rather than an entity and that in the absence of a compelling reason to

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[5] Confusion results, in part, from the difficulty in understanding the distinction between a fraudulent transfer, which may be grounds for a civil law remedy, and a fraud, which may be a tort or grounds for a criminal proceeding. In a way it is unfortunate that the word "fraud" is included in both. See also Ronald L. Rudman and David L. Lockwood, *Asset Protection Planning: Why it Works* and *Ethical/Liability Considerations for the Practitioner,* Financial and Estate Planning, §31,501 at 25,709 (Commerce Clearing House, 1994).

[6] Osborne, *supra* note 2, at §20:02. *See also* materials cited at note 7, *infra.*

[7] *See* Peter Spero, *Prebankruptcy Planning,* 5 J. Asset Prot. No. 2 at 73 (Nov./Dec. 1999). The following articles and speeches by Neal L. Wolf, a leading bankruptcy and creditors' rights attorney, are also very helpful in this regard: Neal L. Wolf, *Understanding the Uniform Fraudulent Conveyance Act and Its Application in Creditor Attacks,* 1 J. Asset Prot. No. 4 at 34 (March/April 1996); Neal L. Wolf, *Fraudulent Conveyance Law as Contained in the U.S. Bankruptcy Code,* 1 J. Asset Prot. No. 6 at 25 (July/Aug. 1996); Neal L. Wolf, *The Right of 'Future Creditors' Successfully to Maintain Actions Under the Fraudulent Conveyance Statutes,* 2 J. Asset Prot. No. 5 (May/June 1997); Neal L. Wolf, *Fraudulent Conveyance Law: The Tool By Which The Aggrieved Creditor Attacks the Asset Protection Plan,* Address before the American Bar Association 9th Annual Spring CLE and Committee Meeting (May 14, 1998).

[8] Osborne, *supra* note 2, at §20:02.

[9] *See,* The International Trusts Act (1984), as amended by the International Trusts Amendment Act (1985), the International Trusts Amendment Act (1989), the International Trusts Amendment (No. 2) Act (1989) and the International Trusts Amendment Act (1991) (Cook Is.).

[10] Austin Wakeman Scott and William Franklin Fratcher, The Law of Trusts, § 1 at 12 (4th ed. 1987).

[11] *Id.* at 9-11.

[12] *Id.* at 8-11.

disturb this relationship, the relationship should be honored. Indeed, trusts (or "uses" as they were originally termed) have been used historically to avoid the application of laws that had become outdated (for example, in the fifteenth century uses were employed to defeat feudal doctrines).[13] While "[t]he use of the trust to evade the claims of creditors has been resorted to for some six hundred years [and such] purpose is to be condemned," the trust has also been an historical "instrument of law reform" when the laws required modernization.[14] While "[t]he trust has often served as a means of evading the law . . . [t]he evasion that in the long run proves successful is usually a reform."[15] The evolution of the asset protection trust and its statutory framework is in answer to a shifting legal and economic environment that is demanding change. If the planning is done with due and careful regard for creditors' rights, there is nothing inherent in Anglo-Saxon jurisprudence that necessarily condemns asset protection trusts. Planning must be done within the bounds that protect creditors but if those creditors worthy of protection are protected then the asset protection trust should be able to comfortably take its place among the other vehicles available to protect one's assets and limit liability. For example, at the core, there is really no distinction between an asset protection trust and an ERISA qualified plan, and no one has seriously condemned ERISA's anti-alienation provisions.

In addition to the fact that there is planning flexibility under creditors' rights law, there are some powerful forces working in favor of asset protection. First and foremost is client demand; the interest in protecting assets is not universal, but it is both widespread and incessant, and it is driven in large measure by a serious lack of faith in our legal system to render fair results. Many persons of wealth perceive themselves to be at risk no matter what sort of professional, business, or personal activities they undertake. They genuinely believe that the plaintiff's bar can make a case and generate liability under the most absurd and unlikely set of facts. This concern reaches across the spectrum of those who have wealth: doctors, lawyers, accountants, architects, entrepreneurs, entertainers, professional athletes, heirs to fortunes, etc. Whether the perceptions are well-grounded or not, they are real, and they drive the decisions of these individuals. As a result, most wealthy clients are interested in asset protection advice.

Second is legislative reaction. In response to these concerns regarding the inability of the legal system to render fair results, beginning in 1989 in the Cook Islands and proceeding apace on a global basis, jurisdictions have enacted laws to compete for and service the asset protection work.[16] In addition to the so-called offshore jurisdictions, no less than four states, Alaska, Delaware, Nevada, and Rhode Island, have now made it possible to settle asset protection trusts in their respective jurisdictions.[17] And finally, while the anti-asset protection advocates have cited with delight the imprisonment of the settlors in the *Anderson* case and the *Lawrence* case, no less an authority than the Supreme Court of the United States has, at a minimum, expressed understanding for and acceptance of, if not actually sanctioned, asset protection planning.[18] All that is to say that while the legal debate about the appropriateness of asset protection planning may rage, neither side has a clear winner, and there is substantial statutory and case law facilitating asset protection planning.

It may well be true that some of the client's concern is paranoia. It may also be that the paranoia is fed by marketers of asset protection structures, both foreign and domestic. Indeed, clients may come to an ACTEC Fellow with an asset protection plan that someone has sold or is trying to sell. Lawyers may not be competent to understand, much less evaluate, all the subjective factors that motivate clients, but if an attorney is engaged to provide counsel regarding asset protection planning, that attorney must be prepared to respond to the vagaries of the client's agenda, including the client's perceived asset risk. Because so many clients have asset protection high among their priorities, this issue will be even more important in the ACTEC Fellow's practice in the ensuing years.

As a practical matter, what does all this mean for the ACTEC Fellow? It is submitted that asset protection advice and asset protection trusts do not inherently violate the foundational principles of Anglo-Saxon jurisprudence and that they will eventually find their place and their boundaries in our current legal system either by virtue of legislative change or judicial recognition. Therefore, the "duty" identified by Mr. Spero at the outset of this article is a concern to be taken very seriously. The estate planning bar is particularly at risk in terms of a potential duty, because various aspects of the estate planning representation inherently involve asset protection activities, i.e., tax planning, creation of

[13] *Id.* at 16.

[14] *Id.* at 7.

[15] *Id.*

[16] Osborne, *supra* note 2, at §§27:01-47:93.

[17] Alaska Trust Act, Alaska Stat §§ 13.36.105-220 (1997); Qualified Dispositions in Trust Act, Del. Code Ann. tit. 12, §§3570-3575 (1998); Spendthrift Trust Act, 1999 Nev. Stat 299; Qualified Dispositions in Trust Act, 1999 R.I. Pub. Laws 402.

[18] *See Grupo Mexicano de Desarrolo S.V. v. Alliance Bond Fund, Inc.,* 119 S.Ct. 1961 (1999).

trusts for spendthrift children (or spouses) or other beneficiaries who may need assistance with asset management, retirement plan work (ERISA qualified plans under federal law enjoy the best of all asset protection, but some states also protect non-qualified plans) and the inevitable involvement with client's assets and solutions to their problems which produce, for example, limited liability structures such as family limited partnerships. What is all this work, if not, at least in part, the exercise of limiting exposure to liability, *i.e.,* asset protection planning? It would be easy for a creative plaintiff's lawyer to argue that an estate planner has a duty to engage in asset protection planning.[19]

Of course, an ACTEC Fellow may well decide that he or she does not want to do asset protection work. Prudence suggests that in such a case the lawyer should raise the issue with the client and make it clear that this legal service is not being rendered and should articulate that position in conferences and confirm it in writing, preferably in an engagement letter that is acknowledged by the client. If estate planning representation is underway, the ACTEC Fellow should consider modifying the engagement letter to reflect the understanding that asset protection advice is not being rendered.

If the ACTEC Fellow does decide to engage in asset protection planning, he or she must be educated about the fraudulent transfer laws applicable in the jurisdictions in which that person practices. At a minimum, the lawyer should have a working knowledge of the statutes and the cases decided under them. Knowledge of the federal bankruptcy statutes that protect creditors is also necessary, although as a practical matter, state statutes are usually *more* protective of creditors' rights than the bankruptcy laws. If a lawyer plans under the guidance of the state laws, the resulting plan is *generally* more conservative than would be the case under the federal laws. Finally, a lawyer must know the so-called shield laws of his or her state, i.e., those laws that exempt certain assets from the claims of creditors.

With respect to any given case, the lawyer should do a serious in depth analysis of the client's solvency.[20] This project begins with a listing of all assets, a subtraction of all debts, liabilities, claims, and contingent liabilities *and* a subtraction of assets which are already protected from creditors' claims under applicable state and federal law, *e.g.,* homestead, ERISA qualified plans, etc. Be aggressive about identifying liabilities and contingent liabilities, *i.e.,* list not only debts, but guarantees, contingent claims, pending lawsuits, and even potential claims. In some cases, it may be appropriate to engage a CPA to produce an audited financial statement. Also, inquire about the client's business and professional reputation. For example, does the physician client have a history of malpractice claims? Does the business client have a history of disputes with creditors, associates, etc.?[21] (The information on the Internet can be tremendously helpful here.) If anything untoward arises in the course of the solvency analysis, the lawyer should secure the relevant facts and evaluate them. If a serious problem appears, the attorney might either withdraw from the representation or retain as co-counsel an attorney with expertise in creditors' rights.[22]

Finally, at the end of the solvency analysis, devise a methodology which is sure to protect creditors. These authors typically implement a plan with a limited percentage of the solvency figure. For example, assume a client with the following:

$ 10,000,000	total assets
- 2,000,000	debts, claims, guarantees, contingent liabilities, threats, etc.
- 3,000,000	protected assets, e.g., ERISA plan, homestead, annuities, life insurance[23]
$ 5,000,000	SOLVENCY
x 30%	
$ 1,500,000	available for further asset protection planning

There is no magic to the 30% figure shown in the example; it is a matter of subjective judgment. However, only in very rare cases do these authors exceed 50%, and the figure is usually less. The influencing factors are the size of the assets (*i.e.,* the absolute dollars involved), the nature of the client's business and professional activities, the potential source of any claims and the additional tools that might be available. But the primary point here is: leave something signif-

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[19] Braunstein and Burger, *supra* note 1.

[20] Duncan E. Osborne, *Asset Protection and Jurisdiction Selection,* 33 Univ. of Miami Philip E. Heckerling Institute on Estate Planning 14-1, 14-4 (1999).

[21] As a practical matter, uncovering a serious problem generally occurs within the first client conference and does not take serious digging.

[22] These authors have on occasion proceeded with creditors' rights co-counsel and completed planning that permitted the implementation of some asset protection tools and rejected others.

[23] States vary in the protection from creditors that is afforded annuities and life insurance, but in many states, the cash surrender value is protected. Osborne, *supra* note 2, at 8:01- 8:53.

icant on the table. Such an approach minimizes, if it does not eliminate, the possibility of a fraudulent transfer argument because there are necessarily adequate reserves for all possible claimants.

Not all asset protection planners are as conservative as the foregoing example suggests, and many attorneys will go much further and employ *"in toto"* arrangements where virtually all of a client's wealth is placed in one or more asset protection structures. Such plans bring clients to the very brink of solvency and pose risks for the client and his or her attorney. The nature and extent of asset protection planning calls for a serious exercise of professional judgment.

In summary, what should an ACTEC Fellow know about asset protection planning?

- You may well have a duty to deal with it either by undertaking it or expressly confirming that you are not undertaking it.
- Clients want it. More and more clients are interested in asset protection counsel. There is a demand, and it is being encouraged by marketers of asset protection plans. Do not be surprised by clients asking for it.
- If you undertake asset protection planning on behalf of a client, educate yourself on the applicable state and federal laws that protect creditors and identify and establish a relationship with a leading creditors' rights attorney in your locale.
- Undertake an in depth solvency analysis of the client's assets, liabilities, and creditor protected assets. Make sure you know the extent of your client's real and likely risks.
- Educate yourself about the asset protection options in your state. Domestic solutions frequently work in debtor friendly states like Texas and Florida, but even in *creditor* friendly states, you may be able to achieve all that is necessary, for example, with a life insurance plan, a retirement plan, and a family limited partnership. Offshore trusts and out-of-state trusts can be complex and expensive and may not really be necessary.
- Always be aware that you may be at risk for potentially engaging in a conspiracy to commit a fraudulent transfer and plan conservatively.
- Remember, in the context of asset protection planning, you are damned if you do (under a potential conspiracy theory) and damned if you don't (under a theory that you have a duty to your client to render asset protection advice). No one ever said the practice of law was not challenging!

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