Establishment, Jurisdictional Situs and Taxation of Foreign Asset Protection Trusts: Part 2

By William P. Elliott

In a two-part series, William Elliott examines the use of foreign trusts in asset protection planning. In this article, Bill examines the use of foreign trusts as part of a family limited partnership or a limited liability company in asset protection planning. In Part 1 of this series, which appeared in the February 2004 issue of Taxes, Bill laid the framework and discussed asset protection planning, foreign trusts and foreign asset protection trusts.

I. Practical Domestic and Offshore Applications of Asset Protection Arrangements

A. Coupling the APT & FLP

1. Background. An increasingly common technique for asset protection is the establishment of an offshore trust as part of a family limited partnership (FLP) or a limited liability company (LLC). The family limited partnership (hereinafter referred to as an “FLP”) is a means of transferring wealth at a discount and as a vehicle we recommend many of our clients consider to achieve a variety of estate planning goals, including wealth preservation and asset protection planning. This analysis can be applied not only to accommodate the basic needs of certain of high net worth individuals seeking both asset protection as well as wealth transfer efficiencies and includes an explanation of a more sophisticated technique involving “coupling” the FLP with a certain type of grantor trust to which we often propose an individual then transfer the limited partnership interests while retaining the ownership and control of the trust.

An FLP is a state-certified (i.e., “creature” of state statute) limited partnership in which all
of the limited partners are family members. The founders of an FLP are, typically, wealthy parents who contribute most—if not all—of the partnership property. The founders then transfer minority interests in the FLP as gifts to their children, often as part of an annual gifting program taking advantage of the $11,000-per-donee annual gift tax exclusion and as part of using their available unified credit, or estate tax equivalent exemption, during their lifetime rather than solely at death. Such an arrangement is recommended as a vehicle to achieve a variety of estate planning goals. The transfer of assets through an FLP may reduce estate and gift taxes because of valuation discounts associated with FLP interests, as well as providing transferee limited partners (children and grandchildren of the founders) with protection from creditors. Generally, the parent(s) are the general partner (GP) of the FLP but we often recommend that consideration be given to forming a limited liability company owned and controlled by the founders and other family members.

Although it might appear the primary consideration in forming an FLP is to benefit from substantial valuation discounts, it is a weak justification for forming such an entity—especially in light of the transactional and maintenance costs involved. To be weighed against its costs, the benefits of an FLP could include liability protection, capital preservation, and the desirability of involving younger members of the family in managing investment assets under supervision so as to foster responsible and knowledgeable dealings with the wealth that may ultimately inure to them. Because most FLP costs are incurred at the outset, while the entity’s benefits will only accrue over time, these vehicles make sense for long-term planning purposes but not for deathbed transfers.

2. Common Restrictions. The valuation discounts associated with the transfer of FLP interests are related to restrictions on the limited partners’ ability to participate in the operation and control of the FLP, as well as restrictions on the limited partners’ ability to liquidate their interest in the FLP or withdraw from the FLP. Generally, these restrictions are provided by a partnership agreement or by state law and commonly may contain the following provisions:

- The general partners have sole control over the time and extent of the partnership distributions.
- The limited partners are not able to assign or pledge their limited partnership interest as collateral.
- The general partners have sole control over the disposition or acquisition of partnership assets and the incidence of partnership liabilities.
- The partnership or the other partners have the right of first refusal if one of the limited partners seeks to liquidate or dispose of his or her interest in the partnership.
- The partnership’s life is a term of years (e.g., 30 or 40 years), and the limited partners may not liquidate their interest or withdraw from the partnership before the term expires.

These restrictions reduce the value of an FLP interest, which in turn reduces the value of any gift of such interest. For gift tax purposes, a gift is valued as of the date of the gift and is valued at the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts.

3. Types of Discounts. A willing buyer may consider a limited partnership interest in an FLP less valuable than a proportionate value of the FLP’s underlying assets because of the restrictions imposed by state law or the partnership agreement on the limited partner’s ability to control the FLP or alienate (pledge, assign, etc.). The difference between the net worth of the allocable portion of the FLP’s assets and the market value of the corresponding ownership interest is commonly referred to as a discount. A discount may take into account one or more (or all) the following:

- The partnership interest is a minority interest in the FLP.
- The interest lacks marketability.
- The limited partner’s right to liquidate his or her interest by demanding a distribution of a share of the FLP’s assets may be restricted.
- The limited partner’s right to receive income distributions may be at the complete discretion of the controlling general partner.

The discount for the transfer of a minority interest reflects a lack of control a limited partner may have over the operations of the FLP. The discount for lack of liquidity reflects the limited partner’s inability to obtain his or her percentage share of the value of the underlying assets owned by the FLP. The discount for lack of marketability is attributable to the economic fact that a lower value will be received for an asset with no established market. Overall, these factors may result in an aggregate discount, often ranging from 25 percent to 55 percent.
4. IRS Attacks on the Typical FLP Arrangement. The IRS often seeks to negate the tax benefits of an FLP both by attacking the form and substance of the FLP arrangement and by disputing the accuracy of the valuation of a transferred limited partnership interest. In recent Tax Court decisions, the IRS argued that the existence of the FLP’s should be disregarded because the FLP’s lacked economic substance. According to the IRS, for the purpose of federal estate and gift taxation, courts may disregard the form of an entity or a transaction that lacks economic substance.

By disregarding the existence of the FLP, the IRS urged the Tax Court to value the transfers according to a proportionate value of the FLP’s underlying assets, rather than the FLP interests. Consequently, the discount on the net asset value of the FLP’s, attributable to characteristics inherent in a valid limited partnership, would have been inappropriate. The Tax Court, however, applied the willing buyer/willing seller test and rejected the IRS’s position. According to the Tax Court, the existence of the FLP would not be disregarded by a hypothetical willing buyer and accordingly could not be disregarded by the court.

The IRS’s use of the economic substances doctrine to attack FLP’s is rooted in its suspicion of the validity of the valuation discounts associated with such entities. Specifically, the IRS views these discounts as inappropriate because it considers “illusory” the rights and restrictions imposed in a typical FLP arrangement. According to the IRS, such provisions are often ignored within the context of family dealings and thus have little economic effect. The IRS is not alone in this position. Those who believe that the creation of an FLP and the exchange of marketable property for restricted FLP interests can “magically” result in a valuation discount, usually in the range of a flat 40 percent, are numerous. This belief is mistaken. The rights and restrictions imposed in an FLP arrangement are real, and the discount associated with such provisions reflects an actual reduction in the market value of the assets contributed to the FLP.

The relationship of general and limited partners to each other as well as their relationship and liabilities to third parties is controlled by state law and partnership agreements. The 1976 Revised Uniform Limited Partnership Act (RULPA) provides rules governing the operations of a limited partnership. These rules include the admission and withdrawal of limited and general partners, the liability of limited partners to third parties, the powers and liabilities of a general partner, the distributions of partnership property, the allocation of partnership profits and losses, the assignment of partnership interests, and the dissolution and windup of the partnership. Similarly, RULPA defines the rights and remedies of creditors against partners and partnerships, as well as the partner’s rights and remedies against each other. On admission to an FLP, these provisions bind a partner.

The partner’s ability to manage the partnership property, to receive a share of the partnership’s profits and losses, or to withdraw or liquidate his or her interest in the partnership is determined accordingly. Additionally, a partner can be held liable for breaching these provisions. No longer may a partner freely manage partnership property for the partner’s own best interest. To maintain limited liability, a limited partner must strictly refrain from participating in the control of the business. In this instance, “business” refers to the business of operating and managing the FLP, not any underlying business owned by the FLP and owned as an asset of the FLP if the limited partner holds a pre-existing management position with the underlying business, held as an asset of the FLP. In other words, a limited partner acting or “holding his or herself out” to creditors, the public, et al. as anyone or anything other than a limited partner, may lose the insulation afforded by statute.

The formation of an FLP has real economic effect as it imposes legal rights and restrictions on the partners, which are enforceable in a court of law. These rights and restrictions are among the relevant facts a willing buyer considers in determining the value of property. The IRS disputes the importance of these rights and restrictions by arguing that in a family context they are very often ignored. The IRS’s position, however, overlooks a fundamental principle of federal tax law: The value of property for transfer tax purposes is determined according to the willing buyer/willing seller standard. This standard disregards family attribution (ownership of other family members) and the IRS is prohibited from treating a family member as other than an independent third party when viewed as a hypothetical willing buyer of an FLP interest.

Based on the Tax Court’s well-reasoned opinion in several recent published cases (establishing precedent), FLP’s appear to remain an effective tool for the transfer of wealth at a discount providing
significant transfer tax savings assuming the opinion of a qualified independent appraiser is obtained.

5. Transferring Appreciating Interests in a Family Business. The family limited partnership is a technique often used in the process of transferring a family business from one generation to the next, shifting future appreciation to heirs and enabling valuation discounts for minority interests and lack of marketability while permitting continued control. In transferring a business to heirs, for example, parents usually contribute partial or complete ownership in the business entity to a limited partnership. While retaining some ownership of and perhaps control of the partnership, the parents transfer limited partnership interests to children.

The parents’ estate then has only limited opportunity to increase, and the small segments of the business spread among family members may be eligible for valuation discounts up to 25 percent to 55 percent for lack of control and marketability. Value and appreciation are shifted to the next generation, but parents continue to control the entity’s voting power through general partnership interests, resulting generally in the substantial reduction of transfer taxes and the successful transfer of a business enterprise to the next generation.

The IRS has given warning that it intends to disregard such partnerships in certain transfers of voting stock, however, by returning the stock to a business owner’s estate at death as a retained life estate under the Code (Code Sec. 2036). Accordingly, careful planning and the development of strategies are essential to navigating this “trap.” Presently, the threat is of concern to taxpayers who transfer shares of closely held corporate stock to an FLP. Rather than merely dispute valuation discounts, the IRS may completely disregard a family limited partnership or other entity under Code Sec. 2036(b) and return all transferred interests to the parents’ estate at their death, and at the then fair market value of the proportionate interest in the underlying assets of the FLP.

In general, Code Sec. 2036 applies to people who give away interests or property with “strings attached.” If the transferring individual retains the right to possess or enjoy property or to determine who will do so, Code Sec. 2036 returns it to the former owner’s estate at death. Although this does not apply to property the owner sells for full and adequate consideration in cash or the equivalent, it does apply to all other transfers, whether made outright to recipients or indirectly through a device such as a trust or limited partnership. Code Sec. 2036(b) simply increases the odds that this trap will apply to certain transfers of stock of small corporations into an FLP.

A transferee who retains the right to vote directly or indirectly, the shares of stock of a “controlled” corporation is deemed to retain for estate tax purposes the enjoyment of voting stock transferred. Congress has set a low threshold for control in that a transferee falls into the trap by retaining the right to vote, either alone or in conjunction with others, at least 20 percent of the total combined voting power of all classes of stock. Shares held by others owners must be considered. The constructive ownership rules of Code Sec. 318 apply, giving the transferee “ownership” of shares held by certain family members and business entities.

In the mind of Congress, the right to vote is the key. Within the context of the Code Sec. 2036 FLP trap, if a taxpayer can vote stock of a controlled corporation, it will be included in the taxpayer’s gross estate at death. The value of the stock and the size of the estate are not frozen on the date of the transfer, and all appreciation to the date of death is includible in the gross estate rather than shifted to descendants. On the other hand, giving up ownership and voting rights more than three years before death generally renders Section 2036 inapplicable. Taxpayers insisting on retaining voting rights, or who are unable to escape Section 2036 due to the “family attribution rules”, should consider transferring nonvoting stock into a family limited partnership. If all of a corporation’s stock has voting rights, consideration should be given to issuing nonvoting stock in a tax-free recapitalization.

6. Estate Freezes with “Defective Trusts” Funded with FLP Interests. A common estate planning objective for owners of closely held businesses is passing appreciation in value of property held by the older generation of a family to the younger generation at a minimal transfer tax cost through an “estate freeze” transaction. The sale of assets to an “intentionally defective” grantor trust in return for an installment note is an estate freeze technique capitalizing on both the income and transfer tax regimes and generally proves superior to more “traditional” estate freeze transactions. Estate freeze transactions are typically designed to freeze the value of the older generation’s interest in property at its current level, allowing future appreciation in the value of the property to pass to the younger generation outside of the transfer tax system.
A grantor trust is a trust in which property is transferred to a trust, usually for the benefit of a family member, with the grantor retaining the ownership and control of the trust. The trust is taxable to the grantor for income (or estate tax purposes) because there is no severance of ownership or control. A certain type of a grantor trust is referred to as a “defective grantor trust” or just a “defective trust.” A “defective trust” is treated as being owned by the grantor for income tax purposes, but excluded from the grantor’s gross estate. Accordingly, as the grantor is the owner of the defective trust for income tax purposes, he or she must report all the trust income, deductions and credits on his or her income tax return.

A sale to a defective trust using limited partnership interests is a premier strategy. To effectuate such a sale to a defective trust, the donor must first make a gift to the trust of at least 10 percent of the value of the asset to be sold to the trust. If this is not done, the IRS may argue that the sale is a sham transaction, as the trust would have no present assets to pay for the transferred asset. The trust should have a variety of other assets in it in addition to the “sale” asset, so Code Sec. 2036 will not bring the asset back into the donor’s estate. After formation, funding and valuation of the FLP interests is accomplished, the donor enters into a sales agreement conveying the FLP interests with the trust at their fair market value (as appraised).

The sales agreement should be structured as an “interest-only” agreement with a balloon payment at the termination of the agreement. The interest rate applied to this transaction is the “applicable federal rate” (AFR). Assuming this rate (i.e., less than five percent currently) is less than the growth or income-producing rate of the asset transferred, the technique is successful. Further, this technique freezes the value of the FLP (say, 99-percent limited partnership units) sold to the defective trust, eliminating the need for further annual valuations of the FLP interests.

Structuring of a sale to an intentionally defective grantor trust transaction is not complex. First, the senior family member (the “grantor”) creates an intentionally defective grantor trust and selects the beneficiaries (typically the grantor’s descendants). Next, the grantor funds the trust with cash or other assets. After the trust is funded, the grantor sells selected assets (FLP interests) to the trust in exchange for cash down payment and an installment note representing the balance of the purchase price. Because transactions between the grantor and the grantor trust have no income tax consequences, there is no gain or loss recognized on this sale of assets to the trust. Nor is the grantor taxed separately on interest payments on the note. However, the grantor continues to be taxed individually on all income or loss generated by assets held by the trust as though the trust did not exist. The estate and gift (and GST) tax savings of this transaction result if the assets held by the trust have a total net return (income and capital appreciation) that exceeds the interest rate of the note.

7. General Partner Considerations (Continuity). Generally, an FLP dissolves automatically on the death of a general partner. Therefore, the donor’s estate technically would own the value of the donor’s share of a “dissolved” FLP’s underlying assets, assuming the FLP is subject to this section of RULPA. Accordingly, the estate would receive virtually no discount for estate tax purposes. Under RULPA §801, a partnership will not dissolve if, within 90 days after a general partner’s death, all partners agree to the continuation of the partnership and to the admission of a new general partner. This provision saves the partnership from dissolution only if certain action is taken after a general partner’s death. It will not provide support for discounting the general partner interest because, in the absence of affirmative actions and agreement by the remaining partners, the partnership will dissolve.

Another strategy that appears to allow for discounting of a general partner interest involves using an S corporation or LLC as the sole general partner. If this is done, the donor should own no more than a 50-percent interest in the S corporation (or LLC) with one or more family members (or even a trust) owning the other 50 percent. This enhances the discounting potential because the donor no longer would be in sole control of the FLP. Further, perpetuation of the FLP is more assured in advance using such entities as the general partner of the FLP.

8. Exit Strategies and Dissolution. Should existing transfer tax laws be repealed or should other events and circumstances, including family discord, dictate the advisability of discontinuing the FLP, relevant provisions of the FLP agreement governing the dissolution of the FLP are triggered. Partnership agreements typically provide for the requisite vote of the partners to dissolve the partnership, either by a majority vote or a “supermajority” (i.e., 80 percent or more), if desired.
Under most revised limited partnership acts, a limited partnership dissolves (and its affairs shall be wound up) upon the first of the following events to occur:

- The occurrence of events specified in the partnership agreement to cause dissolution (time or happening of events)
- The written consent of all the partners to dissolution
- The withdrawal of a general partner (with certain continuation exceptions)
- Entry of a decree of judicial dissolution

Additionally, a limited partner may withdraw from an FLP at the time or upon the occurrence of events specified in the partnership agreement. A general partner may withdraw from a limited partnership at any time by giving written notice to the other partners, but if the withdrawal violates the partnership agreement, the FLP may recover from the withdrawing general partner damages for breach of the partnership agreement and may “offset” the damages against the amount otherwise distributable to the general partner.⁷

Upon the “winding up” of an FLP, the assets are distributed first to creditors, including any partners who are creditors, in satisfaction of the liabilities of the FLP. Thereafter, amounts remaining are distributed to partners first for their return of their contributions and second for their partnership interests in the proportions in which the partners share in distributions (i.e., at fair market value based on capital accounts of the respective general and limited partners). With certain exceptions (inventory, unrealized receivables, etc.), the distributee partners in dissolution receive a carryover basis in partnership property, thereby deferring the ultimate recognition of gain until the distributed property is later disposed of.

B. Emergence of Integrated Estate Planning Trusts (IEPTs)

Integrated Estate Planning Trusts (IEPTs), the emerging successor to traditional estate planning trusts traditionally funded with life insurance on grantors’ lives, now are being effectively coupled with contemporary estate freezes that use family limited partnerships (FLPs) and limited liability companies (LLCs). After transferring appreciated assets to the FLPs and LLCs, interests may be valued by a qualified appraiser and then sold at discounted values (for lack of control and lack of marketability) ⁸ via installment sales to defective (irrevocable) grantor trusts (DGTs). That effectively joins the mitigation of estate tax with an asset protection structure. Offshore asset protection arrangements create difficulty for potential claimants to pursue an action physically or legally. Protective features make use of the portfolio diversification theory. Financial resources are diversified across domestic and international investments. In addition, two asset protection entities, offshore asset protection trusts (APTs) and family limited partnerships (FLPs) provide benefits that compliment each other.⁹

1. Establishment and Formation. Foreign asset protection trusts are tax neutral; they are generally established to protect assets and not to save income or estate taxes. The U.S. tax law no longer allows income tax savings with a foreign trust that has a U.S. grantor and/or beneficiary, or a foreign grantor and a U.S. beneficiary. However, some strategies remain to accumulate earnings offshore and minimize the accumulation tax penalty that applies when earnings are repatriated. A foreign asset protection trust generally is created as a domestic trust with the switch to a foreign mode triggered by a threat from a creditor or a similar event that jeopardizes trust assets. When established, an asset protection trust generally is created as an irrevocable trust, as opposed to a testamentary trust, even though the latter is permissible. If revocable, the trust does not exist as a separate entity, but is deemed an extension of the creator. The Isle of Man, Nevis and the Cook Islands are three platforms from which to launch wholly owned corporations that hold a settlor’s transferred assets. Following the decision to “export the assets” or “import the law,” a number of trust structures may be used. After the formation of the trust, a popular structure is for the independent trustee to establish a “drop-down” corporation that usually is the sole asset of the trust. In turn, the newly formed corporation holds assets.⁰

2. Safeguards for APTs. The trustee has discretion to distribute income to named beneficiaries and to remove or add beneficiaries. The trust document can give the trustee several discrete/joint options. During the “no-interest” term, the settlor has no rights to principal or income. Therefore, claimants are excluded from reaching the trust’s resources via the settlor. The no-interest time frame can be tied to the occurrence of a predefined event or to a foreign jurisdiction’s statute of limitations period for claimants. An event-triggered feature gives the settlor beneficiary status until an event happens. Following an event, such as a claimant securing a judgment, a new class of beneficiaries is established and the settlor’s ben-
The second approach uses an in-the-value of the settlor's estate. nongrantor status, to stabilize appropriate level, before switching to the taxable estate to the appro a tax-free basis, while devouring having its assets compound on maximize the IDIT's growth by gift tax purposes. The intent is to additional gift to the IDIT for U.S. payment is not treated as an ad tax that the IDIT would otherwise classified as a foreign and a grantor trust. First, the settlor's power can cover removal and replacement of the trustee. With the appointment of a foreign trustee that possesses substantial decision-making authority, the trust fails the control test and is then classified as a foreign trust for tax purposes. Alternatively, the trustee can be given the power to change the applicable law of the trust; that would change the trust from domestic to foreign. As a foreign trust, it acquires grantor trust status for income tax purposes. Both approaches avoid harmonious toggling; toggle power resides with one party—the settlor or trustee. Therefore, it is less likely that the IRS can assert successfully a tax avoidance toggling agreement, or assert that the trust lacks an underlying business or investment purpose.12

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Illustration 5   Estate Freezes with “Defective Trusts” Funded with FLP Interests: A Common Estate

- A planning objective for owners of closely held businesses is passing appreciation in value of property held by the older generation of a family to the younger generation at a minimal transfer tax cost through an “estate freeze” transaction. The sale of assets to an “intentionally defective” grantor trust in return for an installment note is estate freeze technique capitalizing on both the income and transfer tax regime and generally proves superior to non-traditional estate freeze transactions. Estate freeze transactions are typically designed to freeze the value of the older generation's interest in property at its current level, allowing future appreciation in the value of the property to pass to the younger generation outside of the transfer tax system.

- A grantor trust is a trust in which property is transferred to a trust, usually for the benefit of a family member, with the grantor retaining the ownership and control of the trust. The trust is taxable to the grantor for income tax purposes because there is no severance of ownership or control. A certain type of a grantor trust is referred to as a “defective” grantor trust or just a “defective” trust. A “defective” trust is treated as being owned by the grantor for income tax purposes, but excluded from the grantor’s gross estate. Accordingly, as the grantor is the owner of the defective trust for income tax purposes, he or she must report all the trust income, deductions and credits on his or her income tax return.

- A sale to a defective trust using limited partnership interests is a premier strategy. To effectuate such a sale to a defective trust, the donor must first make a gift to the trust of at least 50 percent of the value of the asset to be sold to the trust. If this is not done, the IRS may argue that the sale is a sham transaction, as the trust would have no present assets to pay for the transferred asset. The trust should have a variety of other assets in it in addition to the asset, so Code Sec. 2036 will not bring the asset back into the donor’s estate. After formation, funding and valuation of the FLP interests is accomplished, the donor enters into a sales agreement conveying the FLP interests with the trust at their fair market value (as appraised).
C. FLPs and Defective Trust Arrangements—Foreign Context

1. Background. Generally, a single foreign trust owning as its sole asset all of the capital stock of an international corporation will be appropriate for most integrated estate planning and asset protection arrangements. The use of a private trust company places trusteeship in an entity established by the settlor, the shares of which are owned by the trust established for the sole purpose of holding the company’s shares (there are no beneficiaries of such a “purpose” trust1), with the settlor serving as director of the private trust company without compromising the arrangement and affording the settlor the opportunity to exercise a higher degree of control over the trusteeship of the trust.13

The structure of the arrangement typically will involve not only an offshore trust, but also an ancillary foreign corporation, with a foreign trust typically using an ancillary corporation to hold title to trust assets. This ownership method is useful for control issues, limitation of liability, additional anonymity, facilitation of business transactions, ownership of assets in civil law jurisdictions which do not recognize the trust form of ownership, as well as for participation in foreign bank and mutual funds as well as other investments not available to U.S. individuals. Such a “drop-down” corporation is a foreign corporation that is created and wholly owned by the trust for the purpose of holding title to one or more assets.

The settlor can be one of a permissible class of beneficiaries with the trustee of the foreign trust having complete discretion as to whom distributions of income would and would not be made, and the trustee may be given the authority to remove at its discretion a beneficiary from the permissible class and to substitute new beneficiaries, including charitable beneficiaries. A no-interest trust term can be established which creates a term during which the beneficiaries are persons other than the settlor, during which this term, the settlor has no rights to income or principal or upon the happening of certain events. This term can be extended, resulting in the settlor having no interest that claimants can reach during this term, which could be designed to coincide with, or at least be sensitive to, the foreign jurisdiction’s statute of limitations period.

Another option is to allow the settlor to be a beneficiary until the happening of an event, which triggers a new class of current beneficiaries (i.e., if a claimant secures a judgment against the settlor, then the settlor’s beneficial interest in the trust automatically becomes the last to be recognized under the terms of the trust, and a new class of beneficiaries is established). Finally, an “abeyance period” is yet another possibility giving the trustee the power to hold the settlor’s right to income and principal of the trust in abeyance until the “danger” to the trust assets is passed. Recent case law has found in favor of the party seeking to penetrate offshore asset protection arrangements, including two in federal bankruptcy courts13 and the Ninth Circuit Court of Appeals case involving the Andersons.15 Of particular note, the Andersons were both co-trustees and protectors of their Cook Islands trust and, as previously mentioned, the more control a settlor has, the less asset protection he or she has.16

The settlor should not serve as trustee, co-trustee, protector or co-protector, nor retain a power to appoint a trustee or protector, individually or in some other device through another entity. Thus, settlers wanting viable asset protection trust structures must be willing to forgo control. The offshore trust arrangement should be part of an overall estate plan and should have purposes beyond asset protection, as additional valid and appropriate reasons for creating an offshore arrangement help defend against fraudulent transfer claims. In selecting a jurisdiction in which to locate the offshore arrangement, great weight should be given to political and economic stability, the cost and availability of local fiduciary, legal and accounting services, the existence of modern communication and transportation facilities, banks and investment advisors, the ability of the U.S. to influence the jurisdiction via economic and political influence (i.e., many Caribbean island countries) and, finally and most importantly, the existence of criminal activities such as drug dealing and money laundering, resulting in the existence of unscrupulous professionals in the foreign jurisdiction.

One offshore jurisdiction for consideration as the situs of an asset protection trust is the Cook Islands, which are located in the South Pacific Ocean east of Australia and south of Hawaii. The capital is Rarotonga, home to a modern international airport and regular air services to Los Angeles, Hawaii, Tahiti, Fiji and Auckland. The islands are remote from the world’s major financial centers, but have modern communication systems. The Cook Islands are self-governing and their closest link is with New Zealand;
they use New Zealand currency. English is the official language, and there is a common law legal system. The Cook Islands banking laws mandate secrecy about client information, with the penalty of one-year imprisonment for a violation, although in certain situations, the Cook Islands’ courts may have access to protected documents.¹⁷

So long as an international trust organized in the Cook Islands does not do business there, it is exempt from tax and for these purposes, the Cook Islands permits a trust’s affairs to be administered by a Cook Islands trustee company, without violating the “doing business” rule for tax purposes. The Cook Islands enacted comprehensive trust legislation in the International Trust Amendments Act of 1989 addressing international trusts (IT) and the effect thereon of fraudulent dispositions and bankruptcy. With respect to fraudulent dispositions, a creditor seeking to set aside a disposition must prove beyond a reasonable doubt that the disposition was made with intent to defraud that particular creditor; and the transferor was rendered insolvent by the transfer. If the creditor meets this burden, the transfer is not void or voidable, but instead, the transferor must pay the creditor’s claim from property, which would have been subject to its claim but for the transfer, that is, from property, in respect of which the action is brought. Further, the statute expressly states that an international trust will not be void by virtue of the settlor’s bankruptcy.¹⁸

This new trust legislation also contains limitations provisions to the effect that if5(283,685),(378,754) a creditor’s cause of action accrues more than two years before a transfer to an IT, the transfer will be deemed not to be fraudulent, unless proceedings in respect of that cause of action had been commenced at the date of the relevant transfer. Also, if a creditor fails to bring an action within one year from the date of the transfer to an IT occurs, the action is barred. Furthermore, if the transfer (whether initial or subsequent) to an IT occurs before a creditor’s cause of action accrues, such a disposition will not be fraudulent as to that creditor. Finally, an amending act to this relatively new legislation provides that for redomiciled trusts, the limitations period commences at the time of original transfer, even when the transfer was to an offshore center other than the Cook Islands.

Unlike other offshore financial centers, the economies of which are tied closely to the United States or United Kingdom, the Cook Islands presumably are not subject to economic or political pressure to relax secrecy provisions or reduce the benefits of entity formation for protective purposes, as are many so-called “tax havens” such as Cayman Islands, Bahamas, Nevis, et al. Additionally, based upon many reviews of commonly selected offshore jurisdictions, the Cook Islands have one of the most comprehensive bodies of statutory law governing trusts and fraudulent conveyances, with this level of comfort being a factor to weigh against the inconvenience of traveling to this venue, if at all.

Should one decide to pursue such an integrated offshore arrangement, the trust generally should be treated as a grantor trust for U.S. income tax purposes, although it will be fully irrevocable and effective for legal as well as U.S. transfer tax purposes. Under Code Sec. 679, if a U.S. person directly or indirectly transfers property to a foreign trust which at any time during the transferor’s tax year has a U.S. beneficiary, such transferor will be treated as the owner for such tax year under the grantor trust rules, of the portion of the trust attributable to such property. In general though, Code Sec. 679 does not apply to transfers by reason of death of the transferor, nor does it apply to any sale or exchange for fair market value consideration.¹⁹

2. Intentionally Defective Irrevocable Trusts. The phrase “intentionally defective” denotes that the trust is designed and drafted such that the grantor is responsible for the income tax attributable to the irrevocable trust; otherwise, the trust, being irrevocable, would be responsible for its own taxes at compressed rates. Various methods are used in drafting the typical IDIT to make it into a grantor trust, including giving the settlor the power to substitute property of equivalent value or giving the settlor the specific power to borrow from the trust without interest or security. This gives the settlor an added estate planning benefit of paying all income taxes on the income generated by the trust, without such payment of taxes from the settlor’s funds constituting an additional gift to the beneficiaries of the trust; thus, the trust corpus compounds on a tax-free basis. Later, in the event the settlor no longer wishes for the IDIT to be classified as a grantor trust for tax purposes, the settlor may release the power to substitute property of equivalent value, or such other power intentionally given the settlor to make the trust arrangement defective for income tax purposes.
From an estate tax perspective, an IDIT provides two tax-saving planning tools involving gifts and installment sales, with the first being the generally recognized premise that the income tax paid by the settlor is itself not an additional gift to the IDIT for gift tax purposes. The settlor pays the income tax, the IDIT’s assets grow income-tax-free and the settlor’s assets are reduced by the amount of the income tax paid, but the settlor incurs no gift tax liability for what is in effect a transfer of the amount of the income tax that the IDIT otherwise would have been obligated to pay, resulting in an IDIT providing an additional way to make gifts of property to a trust without incurring any current gift tax.

Second, rather than selling assets directly to the IDIT (which is ignored for income tax purposes due to the “grantor trust” rules), an individual transfers property to a domestic limited partnership (LP), with these LP interests appraised and discounted typically 40 to 50 percent, for lack of marketability and minority status. These limited partnership interests then can be sold to the IDIT using an installment sale, typically a balloon note for a term-certain, which can either be self-canceling or due at maturity. We generally recommend the trust have additional assets equal to at least 10 percent of the initial value of the LP interests sold to it, to avoid IRS attacking the structure as a sham, for not having economic substance. In this article you will find diagrams depicting such an arrangement and the tax savings possible with this structure.

3. The Offshore IDIT Alternative. The problem with a traditional domestic IDIT is turning off the grantor trust feature once it has been turned on. An IDIT is generally designed via intentional drafting, so that it will grow to be a monstrous trust in terms of size that is designed to devour a taxable estate, even if one does not exist. If the settlor and the trustee had the ability to control the timing of when the trust was classified as a grantor trust, through a type of “toggle switch,” they would also have more control over the dollar amount removed from the settlor’s estate, through the payment of the income tax attributable to the IDIT. Such a “toggle switch” option allows the settlor to retain enough assets for a long life but at the same time to reduce the estate to a nominal amount.

The major concern with the IDIT is that the time may come when the settlor no longer wishes or cannot afford to pay the income tax liability generated by the income on the IDIT’s assets. Although the settlor may release those powers intentionally given him or her to render the IDIT defective initially, thus making the trust no longer classified as a grantor trust for income tax purposes, the trustee in its sole discretion may re-grant such power to the settlor at a later date to render the IDIT once again defective for income tax purposes. Once the trustee has re-granted the power, the trustee has “toggled” the switch and turned on grantor trust status. If it becomes necessary again to toggle the switch, the question that arises is, how many times may the settlor and trustee work in harmony, releasing and re-granting such a defective power, before there is an estate tax inclusion issue for the settlor? If the settlor and trustee are viewed as working in harmony, their interaction could support an IRS argument that the trustee will follow the settlor’s wishes, and therefore are includable in the settlor’s estate under Code Sec. 2036 as a retained life estate.

To avoid the appearance of the settlor and trustee working in harmony as described above, there is another way to provide such a “toggle switch” without including language that appears to have only a tax motive and without giving the appearance that the settlor and the trustee are working together in harmony, via an implied agreement or in an agency relationship, any of which could subject the settlor to estate tax inclusion on the trust assets. Only one grantor trust section in the Code does not depend on powers held by the settlor or a nonadverse trustee, that being Code Sec. 679, for which only three requirements need be met for a trust to be classified as a grantor trust:

1. A U.S. person transfers property.
2. The transfer is to a foreign trust.
3. There is a U.S. beneficiary.

Two simple methods may be used to accomplish the intended result of either the grantor or the trustee (but not both in harmony) exercising a power that results in the IDIT being classified as a foreign trust, such that it will be classified as a grantor trust. The first is to vest in the settlor the power to change the trustee to a foreign trustee, via the settlor having the power of removal and replacement over the trustee. Should the settlor remove a domestic and substitute a foreign trustee, with all substantial decisions no longer being made by U.S. persons, the trust will fail the control test and will be classified as a foreign trust for tax purposes. Since a U.S. person is now deemed to have transferred property to a

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foreign trust with U.S. beneficiaries, the trust is classified as a grantor trust under Code Sec. 679. The second method to change the tax classification of the domestic trust to a foreign trust vests the power to make this change in the trustee with the trustee changing the applicable law of the trust to a foreign jurisdiction, and the trust then being classified as a grantor trust for income tax purposes.

The result under both approaches is that solely the settlor or solely the trustee has the power to toggle the trust from nongrantor status to grantor status and they are not working in harmony, with less likelihood that the IRS successfully can assert an implied agreement argument. Further, these approaches avoid the appearance that traditional toggle switches have no other purpose other than a tax motive, thus there being no business or investment purpose for the re-granting and re-leasing of “defective powers.” There may well be a fiduciary purpose (i.e., to protect the trust assets) for the trustee to change the applicable law of the trust to a foreign jurisdiction, as many “integrated” offshore irrevocable trusts are currently being designed with many of the asset protection provisions found in offshore trusts.

A second nontax reason for changing the applicable law of the trust to an offshore jurisdiction, and thus justifying the classification of the IDIT as a foreign trust, is to take advantage of a foreign jurisdiction (i.e., Cook Islands) that has abolished the rule against perpetuities, with the purpose of changing or using the applicable law of the trust such that the trust may continue, and its assets will not have to vest within the period allowed under this rule. Finally, another nontax reason the trust may be classified as a foreign trust for tax purposes is the change of the trustee to a foreign investment/manager trustee (it is estimated that Swiss financial institutions hold close to 35 percent of all offshore assets), as the investment expertise of a foreign trustee supports a jurisdictional change and justifies the IDIT’s classification as a foreign trust for tax purposes.

Gain is recognized (under Code Sec. 684(a)) when a U.S. person transfers appreciated property to a foreign trust, but these gain recognition rules do not apply if the foreign trust is a grantor trust. If either the settlor changes the trustee to a foreign trustee or if the trustee changes the applicable law to a foreign situs, then the trust will be classified as a foreign trust and as a grantor trust under Code Sec. 679 since there is a U.S. settlor and U.S. beneficiaries. At the settlor’s death, there will be a deemed transfer by the settlor to the foreign trust for tax purposes, and if the grantor should die when the grantor trust status has been “toggled on,” all of the appreciation inherent in the trust’s assets will have to be recognized for U.S. income tax purposes. This is usually planned and very beneficial, assuming the settlor’s potential taxable estate is too large, and it is advantageous to remove assets through the payment of income tax attributable to the IDIT’s income, and the income tax attributable to the settlor’s death will be considered a liability of his or her estate, and this income tax liability will reduce any estate taxes ultimately payable at this time.

The combination of one or two IDITs (if husband and wife) with a family limited partnership, integrated in an appropriate offshore arrangement as described above, is probably at the present the single most powerful tool for reducing respective separate taxable estates potentially to zero over time, while transferring the entire amount to the “objects of one’s bounty.” One of the greatest advantages of this integrated offshore IDIT approach is the flexibility that occurs when the self-settled asset protection trust (located in a favorable jurisdiction such as the Cook Islands or Nevis) can be toggled between grantor and nongrantor status for U.S. income tax purposes and is coupled with a domestic IDIT (with the toggle switches mentioned above) incorporating these same features, thus providing a much greater ability to time properly the reduction of respective taxable estates to zero.

This integrated offshore IDIT offers a new approach as an alternative to more traditional methods, including an FLP structured in tandem with the more traditional installment sale to a defective grantor trust, for turning grantor status on and off, with the trustee and settlor not required to work in harmony to toggle the switch. Instead, either the trustee or the settlor alone will be given the power to control the toggle switch by making the IDIT a foreign trust for tax purposes (grantor trust status “on”) or a domestic trust for tax purposes (grantor status “off”). Further, additional nontax reasons exist for changing the IDIT from a domestic trust to a foreign trust, such as asset protection or to avoid the rule against perpetuities.

D. Private Annuity Transactions With OPPLI and IEPTs

1. Background. This multi-faceted approach involves pooling the theory and techniques associated with income, estate and asset protection planning and using
the “legally-structured” compartments that exist within each. Three discrete elements are brought together here. First, a U.S. domestic “mainland” or foreign “offshore” irrevocable trust arrangement is properly structured. Second, a custom-tailored privately-placed life insurance arrangement is created, which qualifies under the Code and serves as the “wrapper” for holding a diversified portfolio of investments, selected by the trustee of the irrevocable trust. Finally, the latter is paired with the simplicity and predictability of a traditional “private-annuity” transaction that has been infused with new sophistication. These elements comprise the core of a multiple-entity plan that affords domestic as well as offshore asset protection, the deferral and/or elimination of income tax and material estate tax mitigation and liquidity.

To both protect income and provide for transfer tax efficiency, one of the best holding entities for a domestic or offshore asset diversification vehicle is a strategically custom-tailored irrevocable trust arrangement that serves as insulation for its sole or principal asset, an offshore or domestic variable life insurance policy. Asset diversification includes investing in traditional portfolio investments as well as private equity or hedge fund investments, all within the relatively secure environment of a variable universal life insurance policy. Combining the preceding produces, in effect, a tax-free exchange of appreciated property to a taxpayer’s “self-settled” asset protection trust (APT), the optimal form being a dynasty-type trust “wrapper” within the APT. The entire proceeds are reinvested in a life insurance policy “wrapper” within the APT, achieving the goal of insulating the principal and upside potential for long-term appreciation from further income, estate or gift taxation as well as prospective known and unknown creditors and judgments.

2. Offshore Private Placement Life Insurance (OPPLI) Arrangements. OPPLI arrangements, although somewhat complex, represent a sophisticated estate and asset protection strategy whose unique benefits are not easily obtained elsewhere and include generally lower life insurance premiums and lower internal overhead costs, greater investment choices, increased confidentiality, better asset protection and a decided tax advantage when assets are lodged within a variable life insurance policy “wrapper.” Securing favorable tax treatment rests solely on the contract qualifying as a “life insurance policy” under Code Sec. 7702. Code Sec. 7702 defines a life insurance contract as one that meets applicable domestic or foreign law, but only if such contract satisfies either the cash value accumulation test (CVAT) or both the guideline premium test and the cash value corridor test (CVCT). The taxpayer is allowed to choose the methodology by which the contract qualifies. However, once selected, the methodology must be used for the duration of the contract. OPPLI policies—typically those within the variable universal life family—primarily serve the policy owners as investment vehicles for lifetime wealth accumulation. Life insurance qualifying under Code Sec. 7702, which receives favorable tax treatment, makes it suitable as a repository for passive investments. As such it can be employed to address a significant portion of the prospective client’s wealth accumulation. Properly structured, an OPPLI provides two benefits:

- Tax-deferred growth of the policy’s cash value
- Tax-free access to cash value, although caution should be exercised in this regard to avoid IRS assertion of “constructive receipt”

OPPLIs asset protection features, when properly established and maintained, shelter the assets within the policy from claims and judgments while simultaneously permitting the policyholder access to such assets in difficult times. Owner control issues stem from policy owners retaining an “impermissible degree of control” over OPPLI investments contained within domestic or offshore variable life contracts. OPPLI policyowners may choose from a broad array of investment strategies; they are permitted to be informed of the general investment strategy to be followed; and they may possess a contractual claim for cash as a direct consequence of purchasing the life insurance contracts. Generally, to qualify for favorable treatment under the Code, the investments selected should not be available to the general public, even via a private offering, as the IRS, in recent private letter rulings, has expressed its sensitivity to investor control issues and the use and abuse of such policies masquerading as structures analogous to personal holding companies or incorporated pocketbooks; such investments should be exclusively limited to the variable life policy at hand (i.e., a private equity or hedge fund offered exclusively to arrangements such as these).

3. Traditional Private Annuities. A traditional private annuity transaction (PAT) involves the transfer of property by an “annuitant” in exchange for an unsecured
promise to pay the annuity by an obligor. The initial transfer from annuitant to obligor is a nontaxable sale or exchange because an unsecured promise to pay an annuity has no value. IRS General Counsel Memorandum (GCM) 39503 describes a private annuity as “generally an arrangement whereby an individual transfers property, usually real estate, to a transferee who promises to make periodic payments to the transferee for the remaining life of the transferor.” A private annuity may also include a transaction whereby the transferee agrees to make periodic payments until a specific monetary amount is reached or until the transferor’s death, whichever occurs first. According to the GCM, if the specific monetary amount will be reached within the transferee’s life expectancy as determined under Reg. §1.72-9, Table V, the transaction will not be treated not as an annuity but as an SCIN (self-canceling installment note). Basic authority for taxing private annuities can be found in Rev. Rul. 69-74, pertaining to the transferor or seller, and Rev. Rul. 55-119, pertaining to the transferee or purchaser. If the fair market value of the property sold exceeds the present value of the annuity, the excess is a gift. The realized gain is a capital gain if the property transferred was a capital asset.

4. An Offshore Private Annuity Transaction for IEPTs. The essence of this nonrecognition transaction follows. Although cast within the context of an offshore trust/offshore “drop-down” corporation holding structure that purchases a foreign life insurance policy (OPPLI), the effects are essentially equivalent to a U.S. domestic context that uses a domestic ILIT and a domestic life insurance contract. The settlor/grantor (hereinafter, “Taxpayer” or “Annuitant”) forms an ILIT in either a domestic self-settled jurisdiction or an offshore jurisdiction with solid asset protection trust laws and reputable and competent trustee companies. Generally, the most appropriate integrated estate planning and asset protection arrangement is one that makes use of a single offshore foreign trust formed by the trustee (foreign trust company) of an international ILIT in the same or similar jurisdiction. The offshore foreign trust has as its sole asset the capital stock of an international corporation. Making use of this more popular structure, the taxpayer forms and funds (“settles”) a trust in an appropriate jurisdiction, and the independent trustee then forms a “drop-down” corporation or company in the same or another appropriate jurisdiction. The trustee of the ILIT purchases a foreign variable life insurance policy (OPPLI) to form and fund its wholly owned corporation through a reputable offshore insurance company in an appropriate jurisdiction. The policy is designed to meet the minimum requirements of a “life insurance contract” under Code Sec. 7702.

This policy then serves as a “wrapper” to shield from taxation the proceeds from the “sale” of the appreciated property transferred by the settlor (as the annuitant) in a private annuity transaction with the proceeds now suitable for investing in a private equity or hedge fund that is not otherwise available or offered to the general public and that is designed exclusively or primarily for these types of arrangements. Alternately, the proceeds could be placed in deferred annuities; here, the underlying investments must meet the diversification and investor control requirements of Code Sec. 817. Since an unsecured promise to pay an annuity has no value, this initial transfer of property from the taxpayer/annuitant is not a taxable sale or exchange. The trustee, the recipient of the appreciated property via the irrevocable trust owning it, receives a step-up in basis for the property acquired from the taxpayer/annuitant that is equal to the sum of (1) the total of the annuity payments made under the private annuity contract up to the date of disposition, and (2) the value of the prospective payments remaining to be paid at the date of such disposition. Prospectively, the earnings from the reinvested proceeds, coming from the sale of the appreciated property, accumulate on a tax-free or tax-deferred basis as a result of Code Sec. 7702 treatment accorded such earnings within a “life insurance policy.” The obligor makes the annuity payments as stipulated in the previously executed exchange agreement to the taxpayer/annuitant for life from the earnings generated by the investments that reside in the drop-down corporation. Each payment is made up of three elements: recovery of basis, long-term capital gain and ordinary income.

Upon the death of the taxpayer/annuitant, the accumulated earnings within the trust/corporation arrangement can be distributed tax-free. These distributions, along with trust corpus, can provide liquidity to the estate of the taxpayer for the purchase of assets from the probate estate. Alternatively, depending on the trust’s provisions, these resources can be used for the benefit of or distributed to the taxpayer’s descendants. For federal estate
tax purposes, the policy proceeds and accumulated earnings are excluded from the taxpayer/annuitant/insured’s gross estate. In a private annuity transaction, the annuity has no further value upon the death of the annuitant because payments cease at the annuitant’s death; the ILIT is designed to exclude policy proceeds paid at death from the estate of the insured because the insured never possess any “incidents of ownership” over the life insurance policy. Superb asset protection has been achieved for the life of the insured, the taxpayer/annuitant, and the trust benefit carries for the duration of the ILIT. The essence of the “private annuity transaction” described here is that it is true to its statutory safe harbor. It is intentionally cast within a more preferred holding structure made up of an offshore irrevocable trust that owns as its sole asset a drop-down corporation. In turn, the drop-down corporation purchases a foreign life insurance policy through a reputable offshore insurance company in a suitable offshore jurisdiction; the policy must be designed to meet the minimum requirements of a “life insurance contract” under Code Sec 7702.3

In turn, the policy serves as a “wrapper” to shield the proceeds from the “sale” of the appreciated property transferred by the settlor (as the annuitant) from taxation via a private annuity transaction. Once the sale of appreciated property is consummated, the proceeds will be invested in such a manner so as to be sure that the “diversification” and “owner control” requirements of Code Sec. 817 are continually met.4 The drop-down corporation/trust arrangement receives a step-up in basis for the property acquired from the taxpayer/annuitant.

And, if the corporation/obligor sells the appreciated property immediately after the private annuity exchange, the corporation/obligor would recognize no gain. The drop-down corporation makes stipulated annuity payments to the taxpayer/annuitant for life from the earnings generated by the investments that reside in the corporation. These annuity payments comprise the following elements: recovery of basis, long-term capital gain and ordinary income. When taxpayer/annuitant dies, the trust/corporation’s corpus, along with accumulated tax-exempt earnings, can be distributed. This provides liquidity to the taxpayer’s estate to purchasing assets from the probate estate or to distribute benefits to descendants. Proceeds from the policy and accumulated earnings are excluded, for federal estate tax purposes, from the gross estate insured taxpayer/annuitant. This affords superior asset protection during his or her life as well as the trust’s beneficiaries for the duration of the ILIT. If carefully established and properly maintained, OPPLI’s asset protection features shelter the assets within the policy from claims and judgments, while simultaneously allowing the insured policyholder access to such assets when most needed.

II. Conclusion and Cautionary Note

Asset protection planning using foreign trusts is a growing field and there exists a keen interest among the public in these types of arrangements. However, the professional advisor must be extremely careful when dealing with clients on this type of planning, as the advisor also can find himself or herself in the precarious position of being held liable under civil and criminal statutes for aiding and abetting the defrauding of a creditor. Accordingly, to avoid this type of unsavory exposure, due diligence must be performed on each client requesting such planning as with tax planning in general—tax avoidance and/or reduction is acceptable and legal, but tax evasion is not. Thus, clients should be prepared to attest that the transaction establishing the asset protection plan is not done with the intent or purpose of defrauding, delaying or evading creditors, past or present; that after the transfer the client will still be solvent; that he or she is not a defendant in any action, and is not aware of any pending or threatened action; that he or she is not contemplating bankruptcy; and that he or she is not in violation of the Money Laundering Act, which besides drug activity, covers many forms of unlawful acts, such as environmental liability.

Asset protection planning may be defined as simply the process of organizing one’s assets and affairs in advance so as to safeguard them against risks to which they would otherwise be subject, with emphasis placed on the advance nature of such planning. It is important to remember that a fraudulent transfer is a transfer that is viewed as fraudulent to present and subsequent creditors, as it is made with the actual intent to hinder, delay or defraud a creditor and it is a transfer that otherwise might be deemed valid, except for the fact that there is a creditor involved at the time, and this creditor is left in a worse position because of the transfer. The impact of the U.S. Federal Bankruptcy Act, The Crime Control Act of 1990, criminal aspects of the Internal Revenue Code, The Money Laundering Act, aiding and
abetting against the United States, conspiracy to defraud the United States, mail fraud, Racketeering Influenced and Corrupt Organizations Act (RICO) and the heretofore untested U.S. PATRIOT Act are strong deterrents to the unscrupulous or otherwise careless or lax professional advisor not willing to conduct substantial due diligence or client credibility screening, or attempting to promote asset protection arrangements as anything other than “tax neutral” or virtually void of income tax benefits.

**ENDNOTES**

1. See generally Revised Uniform Limited Partnership Act (RULPA).
3. See generally Craig Stephanson and Jeff Bae, Family Limited Partnerships Must Jump the Section 2036 Hurdle, EST. PLAN. J. (Sept. 2003).
5. Please include citation.
6. Id.
7. Please include citation.
9. Please include citation.
10. Please include citation.
11. Under Code Sec. 684, the transfer of property by a U.S. person to a foreign trust is treated as a sale or exchange for an amount equal to the fair market value of the property transferred and, accordingly, requires the transferor to recognize gain on the excess of the fair market value over the adjusted basis of the transferred property. That rule does not apply to the extent that any person, including the transferor, is treated as the owner of the trust under Code Sec. 671.
13. FTC v. Affordable Media, Inc. CA-9, 179 F3d 1228, 1999-1 TRADE CASE (CCH) ¶72,547.
14. Id.
16. Please include citation.
17. See generally Alan S. Gassman, Practical Asset Protection Strategies and Considerations, ALI-ABA Course of Study MATERIAL, SOPHISTICATED ESTATE PLANNING TECHNIQUES, VOLUME II (Sept. 1999).
20. See generally Tax Havens of the World, supra note 16.
21. Please include citation.
22. See generally Tax Havens of the World, supra note 16.
24. GCM 39503 (May 7, 1986).
27. Lawrence Brody, Life Insurance is like a box of chocolates: You never know what you’re going to get until you open it up: A perspective on contemporary Life Insurance products and their uses, 30 U. MIAMI INST. ON EST. PLAN. 7 (2000).