

By Gideon S. Rothschild and Marlene Soukavanitch

## The United States Of Asset Protection

Stephen Lawrence walks free. Two more states adopt laws permitting self-settled trusts; other states refine their laws. Courts in Florida and New York stymie creditors

**A** sset protection grows ever more popular—and permanent.

After spending over six years in prison for civil contempt, Stephen Jay Lawrence is a free man once again. In the statement releasing Lawrence from prison, Judge Alan Gold for the U.S. District Court, Southern District of Florida, concluded that, “Lawrence has come to value his money (whatever may be left) more than his liberty.”

Back in 1991, Bear Stearns & Co., Inc. was awarded \$20.4 million in an arbitration proceeding against Lawrence. Shortly before the conclusion of the arbitration dispute, Lawrence transferred about \$7 million, or 90 percent of his net worth, into a newly created offshore asset protection trust. In 1997, before any payment was made to satisfy the judgment, Lawrence filed a bankruptcy petition.

The bankruptcy court held that, because Lawrence retained *de facto* control over the trust assets, the trust assets were part of the bankruptcy estate. The court believed that Lawrence had the power to repatriate the assets by replacing the trustee with one willing to comply with the court order. When Lawrence failed to repatriate the funds, he was held in civil contempt and sent to prison. Six years later, the court realized that no amount of time in prison would have forced Lawrence to relinquish the trust assets. Lawrence was freed.

Some say Lawrence’s tale portrays the worst-case

scenario for settlors of asset protection trusts; Lawrence was imprisoned because of a disbelieving judge and a true inability to comply with court orders. Others see the glass half full: The case is proof positive that asset protection trusts really can and do work. After all, Lawrence’s assets remained protected. The real lesson to be learned, however, is that once the horse is out of the barn, it is generally too late to engage in effective asset protection planning.

### New Laws

Certainly, asset protection trusts continue to grow in popularity in the United States. Last year, Tennessee and Wyoming became the eighth and ninth states, respectively, to permit self-settled trusts.

On July 1, 2007, the Tennessee Investment Services Act of 2007 went into effect. About the same time, Wyoming incorporated domestic asset protection legislation directly into its Uniform Trust Code. With these moves, the states join others with similar statutes: Alaska, Delaware, Rhode Island, Nevada, Utah, Missouri and South Dakota.

Under Wyoming’s and Tennessee’s new laws, an individual can fund a trust with his own assets yet remain a discretionary beneficiary as well as retain the right to receive certain distributions.

Although most of the powers that transferors may retain in both states are similar, they differ over the powers of appointments. Under the Tennessee statute, a transferor may retain a limited testamentary power of appointment over trust assets; under Wyoming’s, a transferor may retain an *inter vivos* or a testamentary general or limited power of appointment.

Wyoming also has a special exception providing that qualified trust property is not protected from the trans-



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feror's creditors if it is either: (1) listed on an application or financial statement used to obtain or maintain credit other than for the benefit of the qualified spendthrift trust; or (2) transferred into the qualified spendthrift trust by a transferor who received the property by fraudulent transfer.

To qualify as an investment services trust (IST) under Tennessee's statute or a qualified spendthrift trust under Wyoming's law, the trust agreement must expressly incorporate the respective state's laws to govern the validity, construction and administration of the trust; be irrevocable; and contain a spendthrift clause.

In both states, some or all of the trust property must be maintained in the state and the trustees must materially participate in the administration of the trusts. The trustees also must either be residents of the state or be authorized under such state's law to act as trustee. The transferor may not act as a trustee.

Before transferring assets to the trusts, transferors in both states must execute an affidavit attesting to several facts, including the fact that the transferor will not be rendered insolvent as a result of the transfer, does not intend to defraud a creditor, and does not contemplate filing for bankruptcy relief. Wyoming also requires that the affidavit contain a statement that the transferor will maintain personal liability insurance equal to the lesser of \$1 million or the fair market value (FMV) of assets transferred to the qualified spendthrift trust.

The new statutes set up standards and time limits under which creditors must make their claims, otherwise the claims will be barred.

In addition, Tennessee's law extends the state's rule against perpetuities period to 360 years, provided that at least one beneficiary of each generation in existence more than 90 years after creation of the trust is given (at a minimum) a testamentary power of appointment in favor of such beneficiary's descendants, although the class of permissible appointees may be broader.

In Wyoming, a trust may last as long as 1,000 years.

### Fine Tuning

Although Rhode Island passed the Qualified Dispositions in Trust Act back

in 1999 permitting self-settled spendthrift trusts, a new bill was passed on July 6, 2007, that makes some technical amendments to that law. Some highlights of the changes are:

- The transferor may appoint one or more advisors and he himself may be one of them. The advisors may have the authority to remove and appoint qualified trustees or trust advisors, as well as to direct, consent to or disapprove distributions from the trust.
- To void a transfer to a self-settled trust, a creditor must show by a preponderance of the evidence that the transferor acted in bad faith.
- If any court refuses to apply Rhode Island law in determining the validity, construction or administration of the trust in an action brought against the trustee, the trustee is automatically removed as trustee and a successor will be appointed pursuant to the terms of the trust instrument.

Meanwhile, in Delaware, effective Aug. 1, 2007, changes were made to Title 12 of the Delaware Code.

Section 3536 provides that if the grantor's sole interest in the trust is the right to be reimbursed by the trustee in the trustee's discretion for income taxes payable by the grantor against income of the trust, the grantor shall not

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be treated as a beneficiary of the trust. This provision was added to permit non-self-settled trusts from qualifying as completed gifts notwithstanding the grantor's ability to be reimbursed for income taxes.

Section 3572 provides that, with respect to a creditor whose claim arises after a qualified disposition, such qualified disposition can be set aside only if the creditor proves that the transfer was made with actual intent to defraud the creditor; it is insufficient to prove that the intent was to hinder or delay the creditor.

A new clause was added to Section 3574 that limits a creditor's rights against a trust when a beneficiary's interest is only a right to authorize the trustee to pay some or all of the trust property to satisfy the beneficiary's estate or inheritance taxes or the debts and administration expenses of the beneficiary's estate.

### First in Nation

Nevada stepped ahead of the pack with new legislation that will make life more difficult for creditors of individuals

who own shares of private companies.

On July 1, 2007, Nevada became the first state to enact a statute limiting the exclusive remedy for judgment creditors of stockholders in certain corporations to a charging order with respect to the shares in the corporation. As a result of this law, creditors will have a claim only against actual dividends paid from the corporation, not against the corporate assets. Before the statute was enacted, this exclusive remedy was available only for Nevada's limited liability companies and limited partnerships.

Not all corporations can take advantage of this extra protection. The corporation: (1) must have fewer than 75 shareholders; (2) must not be a subsidiary of a publicly traded corporation; and (3) may not be organized as a professional corporation to render a professional service.

Planners should be aware of this extra asset protection provided under Nevada law when considering where to incorporate clients' businesses. It'll be interesting to see how long it will take before other states follow suit in competing for additional corporate business.

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## From the Courts

Two cases decided in 2007 should interest the asset protection community: Florida's *Cocke*<sup>1</sup> and New York's *Evseroff*.<sup>2</sup>

In *Cocke*, the U.S. Bankruptcy Court for the middle district of Florida allowed the homestead exemption for a house held in a revocable trust. On appeal, the district court stated that the bankruptcy court should not look at the legal title to the real property, but instead should focus on whether the debtors: (1) had legal or equitable interest giving them the right to use and possess the property; (2) had the intention to make the real property their homestead; and (3) actually maintained the real property as their principal residence. More specifically, the district court stated that legal or equitable interest may be satisfied if the debtors were the grantors of the trust and the trust was revocable. Accordingly, the bankruptcy court held that by retaining the right to revoke the trust at any time, the debtors had equitable title in the property irrespective of the fact that title was legally held by the revocable trust.

In New York, meanwhile, a district court held that a transfer to an irrevocable trust was not fraudulent because the settlor was not rendered insolvent. In *Evseroff*, a taxpayer transferred \$220,000 and a house to a newly created irrevocable trust—right after an IRS audit in which he was assessed about \$700,000 in taxes, interest and penalties. But even after that transfer, the taxpayer still had more than \$1 million in other assets, including several retirement accounts.

The IRS argued that the retirement accounts should not be included in determining the taxpayer's solvency, and the taxpayer was, in fact, rendered insolvent as a result of the transfers.


The court rejected this argument because federal law would allow the IRS to place a levy on the retirement accounts and seize any distributions from them. Therefore, the court held that, because the taxpayer had sufficient funds to cover the tax liability even after the transfers were made to the trust, the taxpayer did not commit actual or constructive fraud. The trust

assets could not be used to satisfy the judgment against the taxpayer.<sup>3</sup>

## Lawrence, the Sequel?

We now have 10 states that have domestic asset protection laws (in addition to the nine states we've mentioned, Oklahoma allows a grantor to set up a revocable asset protection trust for the benefit of the ancestors and descendants of the grantor or the grantor's spouse, the spouse of the grantor, and/or a nonprofit organization.) Yet there hasn't been any reported case deciding on the efficacy of these trusts.

Despite this fact, an educated guess of how many self-settled trusts have been created would put the number in the thousands. Clients are inclined to transfer assets to these trusts because of the trust's ease of administration, and because the client often is reassured by the fact that his assets remain within the jurisdiction of the United States.

Perhaps what all this adds up to is that it's only a matter of time until we have a domestic version of the Stephen Jay Lawrence standoff. 

### Endnotes

1. *In re Cocke*, 371 B.R. 554 (Bankr. M.D. Fla. 2007).
2. *In re Evseroff*, 2006 U.S. Dist. Lexis 69575 (E.D.N.Y. Sept. 27, 2006).
3. For a more detailed discussion of this subject, see Gideon Rothschild and Daniel S. Rubin, "Rules of Engagement," *Trusts & Estates*, November 2006, at pp. 48-53.



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