"Asset Protection Due Diligence: What Lawyers, Accountants, Financial Planning and Investment Professionals Must do to Protect Themselves"

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I. Review of Voidable Transactions

A. What is a "voidable transaction"?

1. In regard to a Present of Future Creditor, Section 6, Section 3439.04 of the CA Uniform Voidable Transactions Act (UVTA)[1] states:
"(a) A transfer made or obligation incurred by a debtor is voidable as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
(1) with actual intent to hinder, delay, or defraud any creditor of the debtor.
(2) without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor either:
(A) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction.
(B) intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due."
2. Section 4, Section 3439.01(m) of the UVTA defines "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, license, and creation of a lien or other encumbrance."
3. Per the Model UVTA's Section 4[2] Official Comments: "Section 4 protects creditors of a debtor whose claims arise after as well as before the debtor made or incurred the challenged transfer or obligation."

[1] CA Civil Code Division 4, Part 2, Title 2.
[2] Section 4 of the Model UVTA corresponds to the language of Section 6 of the CA UVTA quoted above.

(a) Similarly, "There is no requirement in § 4(a)(1) that the intent referred to be directed at a creditor existing or identified at the time of transfer or incurrence."

(b) "'Hinder, delay, or defraud' is best considered to be a single term of art describing a transaction that unacceptably contravenes norms of creditors' rights. Such a transaction need not bear any resemblance to common-law fraud."

(c) "A transaction that does not place an asset entirely beyond the reach of creditors may nevertheless 'hinder, delay, or defraud' creditors if it makes the asset more difficult for creditors to reach. Simple exchange by a debtor of an asset for a less liquid asset, or disposition of liquid assets while retaining illiquid assets, may be voidable for that reason."

A. Badges of Fraud – Section 6, Section 3439.04(b) of the UVTA incorporates most of the Badges of Fraud which may be given consideration in determining actual intent under Section 3439.04(a)(1). Consider:

1. "Whether the transfer or obligation was to an insider;
2. Whether the debtor retained possession or control of the property transferred after the transfer;
3. Whether the transfer or obligation was disclosed or concealed;
4. Whether before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;
5. Whether the transfer was of substantially all the debtor's assets;
6. Whether the debtor absconded;
7. Whether the debtor removed or concealed assets;
8. Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
9. Whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
10. Whether the transfer occurred shortly before or shortly after a substantial debt was incurred; and
11. Whether the debtor transferred the essential assets of the business to a lienor that transferred the assets to an insider of the debtor."

B. Furthermore, in regard to Present Creditors, Section 7, Section 3439.05 of the UVTA states:

"(a) A transfer made or obligation incurred by a debtor is voidable as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a

reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.

(b) A creditor making a claim for relief under subdivision (a) has the burden of proving the elements of the claim for relief by a preponderance of the evidence.."

C. Ultimately, whether a transaction is a voidable transaction is fact specific to each situation.

II. **California's Uniform Voidable Transactions Act** (signed into law July 2, 2015, effective January 1, 2016). Notable differences from the California Fraudulent Transfer Act:

A. Name of the Act replaces the word "fraudulent" with the term "voidable" and the word "transfer" to the term "transaction" throughout the Act.

1. The term "fraudulent" has been used for many years but is misleading.
2. Fraud has never been a necessary element of a clause under the previous Act and the inclusion of the term has led to misconceptions about the intent and purpose of the law.
3. The term "transactions" was changed to "transfers" so as to pick up the incurrence of obligation by a debtor as well as transfers.

B. Presumption of insolvency imposes on the party who is presumed to be insolvent the burden of proving solvency.

1. Provides that a creditor making a claim for relief has the burden of proving the elements of the claim by a "<u>preponderance of the evidence</u>."

C. Authorizes a creditor to obtain remedies with respect to the asset transferred or other property of the transferee.

1. Allows a creditor to obtain an attachment or other legally available remedies;
2. Provides that a transfer or obligation is not voidable against a person who took the secured asset in good faith and for reasonably equivalent value.

D. Repeals the special insolvency test for partners in partnerships.

1. Ignores solvency of the partners and looks only to solvency of the partnership.

E. Changes in Burden of Proof:

1. The party seeking recovery under the Act has the burden of proving all of the elements of the defense.

2. A creditor seeking recovery under the Act has the burden of proving each element of the recovery that the creditor is seeking.
3. A transferee has the burden of proving that he or she is a transferee in good faith.
4. A party seeking an adjustment to the amount of a judgment that exceeds value of the asset that was transferred has the burden of proving the adjusted amount.

F. Provides that the governing law of a claim under the Act is that of the state where the debtor is located at the time the transfer is made or the obligation is incurred.
   1. A debtor who is an individual is located at the individual's principal residence.
   2. A debtor that is an organization and has only one place of business is located at its place of business.
   3. A debtor that is an organization and has more than one place of business is located at its chief executive office.

G. Allows a judgment to be entered against:
   1. the first transferee of the asset or the person for whose benefit the transfer was made; or
   2. a transferee who is down the chain of the transfer of the first transferee other than:
      (a) a good faith transferee who took the secured asset for value or
      (b) a good faith transferee of a person described in (a) and limits the recovery of claims.

III. **Civil and Ethical Implications for the Asset Protection Planner**, excerpted from "Asset Protection Planning Guide," by Barry S. Engel, (3rd ed., 2013), unless otherwise stated

A. The asset protection planner must be alert to potential civil liability, sources of which include malpractice claims, fraud claims, conspiracy claims, aiding and abetting claims, and possibly a civil claim under the Racketeer Influenced and Corrupt Organizations Act (RICO).

B. Attorneys have been sanctioned by ethical panels and grievance boards when their conduct has been found to have gone too far.
   1. "A lawyer cannot escape responsibility by avoiding inquiry. A lawyer must be satisfied, on the facts before him and readily available to him, that he can perform the requested services without abetting fraudulent or criminal conduct and without relying on past client crime or fraud to achieve results the client now wants." ABA

Comm. on Ethics and Professional Responsibility, Informal Op. 1470 (1981).

2. Under the Model Rules of Professional Conduct, an attorney may not:
    (a) Engage in conduct involving dishonesty, fraud, deceit, or misrepresentation;
    (b) Engage in conduct prejudicial to the administration of justice; and
    (c) Counsel a client to engage in, or assist a client in, conduct that the attorney knows, or reasonably should know, is criminal or fraudulent.
3. That being said, an attorney is not bound to assert the rights or potential rights of an adversary, such as a creditor who may assert claims under a fraudulent conveyance statute. Doing so would amount to a conflict of interest.

C. Ethics Opinion 1993-1: Propriety of Asset Protection Planning

1. Question Presented:
    (a) To what extent may a member of the State Bar of California advise or assist a Client with respect to an avoidance of existing and identifiable creditors' rights and a protection of the Client's assets?
2. Summary:
    (a) A member who furnishes advice and institutes asset protection techniques may not do so unless the member complies with Rule 3-210 of the California State Bar Rules of Professional Conduct. The member may not participate in violations of criminal and civil law against fraudulent transfers.
3. Analysis:
    (a) Rule 3-210 of the State Bar of California Rules of Professional Conduct provides the following:
        (1) A member shall not advise the violation of any law, rule, or ruling of a tribunal unless the member believes in good faith that such law, rule or ruling is invalid. A member may take appropriate steps in good faith to test the validity of any law, rule, or ruling of a tribunal.
        (2) The commentary to Rule 3-210 indicates that the provision applies not only relative to the prospective conduct of the Client but also to the interaction

between the member and Client and to the specific legal service sought by the Client.

(b) Civil Implications

(1) The Uniform Fraudulent Transfer Act (Civ. Code § 3439 et seq.) ("UFTA") provides a remedy for creditors to whom its provisions apply for transfers deemed fraudulent (1) Under the Act, a "creditor" means a person who has a "claim", which means a "right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, unmatured, disputed, undisputed, legal, equitable, secured or unsecured." (Civ. Code §§ 3439.01(b), (c))

(2) Civil Code Section 3439.04(a) sets forth that a transfer made or obligation incurred by a debtor is fraudulent as to a creditor, in a civil sense, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation with the actual intent to hinder, delay, or defraud the creditor.

(3) In the instant hypothetical, the potential Client has stated to the Attorney an intent to defraud existing and identifiable creditors. The Committee therefore assumes that this admission constitutes "actual intent to defraud". The Committee likewise assumes, without deciding, that the UFTA applies to the hypothetical transaction and would find any transfer to be fraudulent.

(4) The Statement of Facts does not embody any supposition that any transfer would be made in contemplation of a bankruptcy filing. The Committee is aware of the difficulty in distinguishing between permissible pre-bankruptcy planning and fraudulent transfer doctrines. (For example, see disparate results in *In re Tvetan*, 70 B.R. 529 (Bankr. D. Minn. 1987), aff'd 848 F.2d 871 (8th Cir. 1988), and *In re Johnson*, 80 B.R. 953 (Bankr. D. Minn. 1988), aff'd 880 F.2d 78 (8th Cir. 1989)). Those considerations are beyond the scope of this opinion.

(5) Given the application of the UFTA, any transfer of assets the Client makes would be a transaction which would be the subject of civil remedies. The Attorney's assistance in such transfer would aid a "fraudulent" act

as that adjective is understood within the provisions of the UFTA.

(6) The UFTA does not expressly prohibit engaging in a fraudulent transfer, although it does provide post-transfer remedies. Nonetheless, the Committee views the Attorney's knowing assistance in such transactions as contrary to civil law, which therefore will subject the Attorney to discipline under Rule 3-210. In addition, since the remedy for a fraudulent transfer is avoidance (Civ. Code § 3439.07), the Committee is of the opinion that any professional fee for any legal assistance in completing a known invalid or ineffective transaction is unconscionable. See Rule 4-200 of the State Bar of California, Rules of Professional Conduct.

(c) Criminal Implications

(1) To the extent that the Attorney participates in the transfer, both the Attorney and the Client may be subject to criminal sanctions. Penal Code § 154 imposes a criminal misdemeanor on a debtor's fraudulently moving property out of state or transferring with the "intent to defraud, hinder or delay" creditors.

(2) Penal Code § 531 provides the following: Every person who is a party to a fraudulent conveyance of any lands, tenements, or hereditaments, goods, or chattels, or any rights or interest issuing out of the same, or to any bond, suit, judgment, or execution, contract or conveyance, had, made or contrived with intent to deceive and default others, or to defeat, hinder or delay creditors or others or their just debts, damages, or demands; or who, being a party as aforesaid, at any time wittingly and willingly puts in, uses, avows, maintains, justifies, or defend the same, or any of them, as true, and done, had, or made in good faith, or upon good consideration, or aliens, assigns or sells any of the lands, tenements, hereditaments, goods, chattels, or other things before mentioned, to him or them conveyed as aforesaid, or any part thereof, is guilty of a misdemeanor.

(3) Business and Professions Code § 6128 further indicates that an attorney is guilty of a misdemeanor when "guilty of any deceit or collusion, or consents to

any deceit or collusion, with intent to deceive the court or any party". Bus. and Prof. Code § 6128(a).

(4) The Committee is of the opinion that the subject conduct would result in criminal penalties relative to both the Client and the Attorney.

(d) Conclusion

(1) We conclude, therefore, after consideration of both the civil ramifications and the criminal prohibitions, that the Attorney cannot render the services requested by Client, at the risk of discipline pursuant to Rule 3-210. This opinion is not intended to preclude any other permissible alternatives to the giving of advice or furnishing of proper services. In the absence of permissible alternatives, declination of employment would be appropriate, or withdrawal therefrom is warranted. See Rule 3-700(B)(2) of the State Bar of California, Rules of Professional Conduct.

(2) This Committee does not wish to impose a duty on the Attorney to the creditors of Client, and this opinion should not be so construed. Nonetheless, an Attorney does maintain a duty to protect the public and to promote respect and confidence in the legal profession. Rule 1-100. A client's creditors are but one class within the public to whom an attorney's ethical responsibilities are owed. *Coppock v. State Bar* (1988) 44 Cal.3d 665, 687. At a minimum, and quite aside from the restrictions of Rule 3-210 and the criminal statutes herein, the Attorney's assistance with, and facilitation of the Client's expressed, wrongful intent is intolerable as a matter of public policy.

(3) This opinion is advisory only. It is not binding on the San Diego County Bar Association, its officers, agents, the State Bar of California or any court.

(4) The committee does not find an express prohibition against making transfers within the body of the Uniform Fraudulent Transfer Act. The thrust of the act provides a mechanism for creditors to reclaim value as against the transferees of the debtor. Thus, the committee believes that mere advice about the legal effect of the subject transfer does not, without more, subject an attorney to discipline.

D. South Carolina Bar Ethics Advisory Committee, Opinion 84-02 (1984)

1. The Committee was asked whether an attorney may participate in the transfer of a client's property in anticipation of the possibility of a judgment being entered against the client where the sole purpose of the transfer is to place the property out of the claimant's reach.
2. The Committee concluded that the transfer would not violate the applicable provisions of the Code of Ethics if there does not exist the "immediate reasonable prospect" of a judgment being entered against the client.

E. Committee on Professional Ethics, Connecticut Bar Association, Informal Opinion 91-22
   1. An attorney had a client who had debts that the client could not repay. The client wanted to convey his interest in his home to his wife.
   2. The committee opined that, where the attorney knows that the transaction will constitute a fraudulent transfer and that either the purpose of the transfer is to deceive creditors or it has no "substantial purpose" other than to burden or delay creditors, the attorney may neither counsel nor assist the client in carrying out the transfer.
      (a) Doing so would violate the attorney's duty not to engage in conduct involving dishonesty, fraud, deceit, or misrepresentation.
   3. However, the opinion suggests that, if there were a "demonstrable and lawful estate planning purpose" in making the otherwise fraudulent transfers, the attorney's conduct would not violate ethical standards.

IV. **Due Diligence Procedures**, excerpted from "Asset Protection Planning", Rothschild, G. and Rubin, D., BNA Tax Portfolio 810-3rd

A. Since all of the ethical proscriptions against assisting in a fraudulent conveyance, as well as the potential for civil or even criminal liability, rest upon the attorney having acted "knowingly" (which term is almost always also deemed to include what reasonably *should* have been known by the attorney), due diligence will serve as the asset protection attorney's best defense against the potential for liability. At a minimum, the asset protection attorney's due diligence procedures should include the following:
   1. The attorney's receipt of a retainer letter, signed by the prospective client, which clearly sets forth:
      (a) What constitutes a fraudulent conveyance under local law;
      (b) The potential consequences to the client of the making of a fraudulent conveyance;

(c) That the attorney will not assist the client in any transfer which the attorney believes might constitute a fraudulent conveyance;
(d) That the attorney is necessarily relying upon full and continuing disclosure by the client in the attorney's assessment of whether the transfers at issue are, in fact, permissible; and
(e) That a breach of the client's required full and continuing disclosure will constitute grounds for the attorney to resign as counsel.

2. The prospective client should be required to complete a client questionnaire which will collect information regarding:
   (a) Any lawsuits in which the client is named as a party;
   (b) Whether the client, or any company with which the client has been closely connected, has ever filed for relief in bankruptcy;
   (c) Whether the client's federal, state and local tax reporting is current;
   (d) Whether the client is currently being audited by any tax authority;
   (e) Whether the client is aware of any legal actions threatened to be brought against the client;
   (f) Confirming that following any intended transfers the client will be in a position to pay all of the client's current bills as they come due and settle all outstanding debt, and that the client will retain sufficient assets to cover both the client's current and anticipated obligations and any potential personal emergencies;
   (g) Whether the client has any direct or indirect liability for any loan; and
   (h) Whether the client or any company with which the client has been closely connected has ever been convicted of a crime.
   (i) Any issues which are brought to light by reason of the information obtained would obviously require further examination.
3. The prospective client should be required to provide the following documentation for the attorney's review:
   (a) Copies of the client's most recent personal income tax returns, as well as a current personal financial statement; and

(b) If the client is closely connected with any company, copies of that company's most recent income tax returns, as well as a current financial statement of the company.

4. The prospective client should be required to provide personal references from one or more of the client's primary banker, the client's personal attorney, the client's personal accountant, and, if different, the client's personal tax return preparer, as well.
5. Notwithstanding the information provided by the prospective client, an independent search should be undertaken to uncover:
   (a) Any lawsuit in which the client or any company with which the client is closely connected is named as a defendant;
   (b) Any judgment under which the client or any company with which the client is closely connected is named as a judgment debtor;
   (c) Any liens which have been filed against the client; and
   (d) Any bankruptcy filings which may have been made by the client or any company with which the client is closely connected, at any time.

B. In the end, and in the absence of hindsight, the question of what steps will be deemed to constitute an appropriate level of due diligence will always remain subject to the facts and circumstances of the matter at issue, as well as to differences of opinion. The potential consequences of a failure to conduct a sufficient due diligence in the area of asset protection planning, however, seemingly warrants an excess of caution.

C. If claims or obligations come to light in the due diligence process, the attorney and the trustee should make sure that the client will retain sufficient funds to satisfy the reasonably anticipated value of these claims.
   1. This does not mean 100 cents on the dollar must be reserved, as discounts are allowed to reflect the likely value of the claim. However, reserve calculations should be realistic and, if anything, it is better to over-reserve against the anticipated likely value of the claim. (BNA Portfolio 868-1st)

V. **Affidavit of Solvency**

A. BNA Portfolio 868-1st suggests that although not all statutes require the client to sign a solvency affidavit, the attorney and trustee should insist that the client furnish written proof of solvency, and, if he or she refuses, they should not proceed.

B. In an affidavit of solvency, the client represents that there are no pending, threatened, or expected claims or outstanding judgments.

1. *Goldberg v. Rosen (In re Akram Niroomand)*, 493 Fed. Appx. 11 (11th Cir. Fla. 2012)
    (a) The debtor filed for bankruptcy protection after she created and funded an asset protection trust. The bankruptcy trustee, Mr. Goldberg, filed a claim against the attorney who assisted with creating the trust, Mr. Rosen, seeking to recover $45,000.00 in attorney fees and costs paid to Mr. Rosen as legal fees, as being fraudulent transfers under 11 U.S.C. Section 548.
    (b) The bankruptcy trustee argued, among other things, that the debtor was insolvent at the time of the debtor's transfer to the trust. The trustee only presented oral evidence of the debtor who stated that she was insolvent at the time of the transfers. The trustee did not provide any expert testimony or other evidence on the issue of solvency.
    (c) Mr. Rosen, however, had obtained an affidavit of solvency from the debtor when the debtor retained Mr. Rosen's services. Mr. Rosen impeached the testimony of the debtor with Affidavits of Solvency in which the debtor stated that she was solvent at the time of the transfers, and could pay her anticipated debts, including lawsuit judgments.
    (d) The bankruptcy trustee lost at the bankruptcy court level and appealed to the District Court, which also found against the trustee. The trustee then appealed to the United States Court of Appeals for the 11th Circuit, which found that there was no establishment of insolvency with respect to potential constructive fraud or fraudulent transfer claims, and stated:
        (1) "In fact, the record is abundant with records of solvency. The witness signed a solvency affidavit, which she said she did not read, but the Court notes—noted that the witness could remember some things in the way of financial numbers of a rather complicated structure down to the penny, and other things, she couldn't remember at all. But aside from that, it's the opinion of the Court that the [Trustee's] case is woefully lacking in any proof on any of the counts, and therefore, [Rosen's] motion to dismiss should be granted."

C. Definitions of Insolvency:
    1. Bankruptcy Definition

(a) "Insolvency" is defined under 11 U.S.C. § 101(32)(A) as the financial condition of a person such that the sum of such person's debts is greater than all of such person's property, at a fair valuation, exclusive of (i) property transferred, concealed, or removed with intent to hinder, delay or defraud such entity's creditors; and (ii) property that may be exempted from property of the estate under 11 U.S.C. § 522. The definition of "insolvency" for bankruptcy purposes excludes any exempt assets from such calculation.

2. State Law Definition of Insolvency
   (a) State law generally defines insolvency similarly to bankruptcy law.
   (b) For example, CA Civil Code § 3439.02 states:
      (1) A debtor is insolvent if, at fair valuations, the sum of the debtor's debts is greater than all of the debtor's assets.
      (2) A debtor which is a partnership is insolvent if, at fair valuations, the sum of the partnership's debts is greater than the aggregate of all of the partnership's assets and the sum of the excess of the value of each general partner's nonpartnership assets over the partner's nonpartnership debts.
      (3) A debtor who is generally not paying his or her debts as they become due is presumed to be insolvent.
      (4) Assets under this section do not include property that has been transferred, concealed, or removed with intent to hinder, delay, or defraud creditors or that has been transferred in a manner making the transfer voidable under this chapter.
      (5) Debts under this section do not include an obligation to the extent it is secured by a valid lien on property of the debtor not included as an asset.

D. Examples of Affidavit of Solvency
   1. See Exhibit A and Exhibit B

VI. **"Tips to Live by When Counseling Clients on Asset Protection Strategies"** by Jonathan Gopman, Esq., partner at Akerman, LLP:
   A. Counsel clients to establish wealth protection plans as part of the estate planning process.

1. We live in a litigious society because of a justice system that permits the use (if not abuse) of the contingency fee. It is possible that any client who has amassed wealth will become involved in litigation. Will such a client return one day to the office of the client's estate planning attorney inquiring why the client did not receive advice regarding wealth protection strategies? Wealth protection planning should be part of the general estate planning process in the same manner that estate planners counsel clients in legally reducing their estate and gift tax liabilities.

B. As a corollary to the foregoing, clients should plan only at appropriate times and under appropriate circumstances and attorneys should only assist clients under such conditions.
    1. Many people seek advice about wealth protection strategies because they are involved or concerned that they are about to become involved in serious litigation. This may be the wrong time to plan or valuable opportunities may be foreclosed without raising serious fraudulent transfer issues. As a general rule, if assisting a client with a particular strategy raises an issue as to a fraudulent transfer, do not proceed or proceed with a great caution. Bad things can happen to good people if planning is done under inappropriate circumstances. This does not mean that we cannot ethically assist clients who are involved in litigation (or concerned that litigation is imminent). However, it does mean exercise discretion. As a result of the jurisdiction where a client resides or may want to reside, the manner in which a client owns certain property interests (for example, homestead or tenancy by the entirety) or expected inheritance or gifts, it may be possible to achieve significant wealth protection for a client involved in litigation or concerned that litigation is imminent.
C. Any client who implements a foreign trust should receive written advice regarding the preparation of and filing of all appropriate tax compliance with the IRS.
    1. It should be clear to a client implementing a foreign trust that it is not an income tax savings or tax avoidance device. A US taxpayer who creates and funds a foreign trust is responsible under the grantor trust rules for paying the income tax liability on all of the income generated by the foreign trust and will be required to file certain information returns with the IRS. Failure to comply with these filing requirements can result in significant penalties.
D. Following the creation and funding of a foreign trust or any other wealth protection strategy filing bankruptcy should be viewed as an option of last resort notwithstanding that the planning may have been completed under appropriate circumstances.

1. This is not to say that a properly implemented foreign trust structure or other wealth protection strategy cannot survive a challenge in a bankruptcy proceeding. Nonetheless, it is clear from a few bad fact cases that the present environment in the Bankruptcy Court system is hostile toward certain wealth protection strategies. Unfortunately, bankruptcy judges typically have the pleasure of reviewing bad fact cases involving foreign trusts. Additionally, bankruptcy counsel and judges typically possess insufficient knowledge of trust law, property law and conflicts of law rules to reach the proper technical result in most cases. Experience demonstrates that judges in bad fact cases usually reach the proper result; however, the legal analysis is faulty. This faulty analysis has significantly damaged public perception regarding legitimate wealth protection planning.

E. A foreign trust should not be used as a tool to violate any law.
    1. An individual who attempts to use a foreign trust to evade tax or violate any other law should be prepared to pay the ultimate price for such conduct. Reputable offshore service providers would never knowingly assist an individual in violating the law of any sovereign nation. The IRS or any other government agency is never a desired litigant. As important, however, bad people can violate the law using domestic as well as foreign planning vehicles. The foreign aspect may make reporting a bit more exciting though.
F. An individual should be prepared to answer questions candidly and produce any documentation related to a wealth protection plan that may be required in a court proceeding.
    1. This does not mean that it is necessary to disclose such information if it is not required in a legal proceeding, however, a quality wealth protection plan will withstand scrutiny and should not require or be based upon any concealment.
G. When implementing a foreign trust structure, a client should be strongly counseled not to serve as a co-trustee, protector, advisor or in any other fiduciary capacity.
    1. A client should be prepared to relinquish control of the client's assets that will be transferred into the structure. Use only reputable trustees and reputable financial institutions located in an appropriate foreign jurisdiction that maintain nominal or no contact with the US. It may also be prudent not to retain any investment discretion and to custody the assets in such a structure in an appropriate foreign jurisdiction. Importantly, a provincial statement by an individual intimating that a logical person would not relinquish control of millions of dollars to an offshore service provider ignores reality and implies that quality wealth management only exists in the US.

Sophisticated investors understand that there is no validity to such a position.

H. A client should always be prepared to use a wealth protection structure as a tool to forge a favorable settlement with a creditor.
    1. Most bad fact cases prove that even a foreign trust structure with a faulty design can provide significant protection for the assets held in the structure. The case *Federal Trade Commission v. Affordable Media* (179 F.2d 1228 (9th Cir. 1999) is a perfect example. The FTC spent years pursuing a nominal sum held in this foreign structure. It is believed that the corpus of this trust never exceeded $2,000,000 in value. Arguably, that structure had significant design faults. Furthermore, the trust had the world's worst creditor pursuing its assets (that is, an agency of the US government). In the end, the FTC could not bust the trust. The agency settled with the trustee of the Cook Islands trust. It is believed that following this settlement a substantial portion of the original corpus remains under administration of the trust. While *Affordable Media* involved bad facts, it should serve as an excellent example of how well (and economical) a properly implemented offshore structure works to protect the assets held in the structure. Any creditor represented by qualified counsel should immediately recognize the insurmountable barrier that stands between the creditor satisfying its judgment.

I. As mentioned previously, know your client and document the reasons your client is establishing an offshore structure.
    1. Reputable banks, trust companies and other financial institutions in quality foreign jurisdictions are required to conduct extensive due diligence before accepting a new client relationship. This process is generally far more extensive and impressive than the due diligence required by domestic institutions. A client may be required to prove source of wealth and substantiate that funding the structure will not result in a fraudulent transfer issue.

VII. **"Asset Protection Audit Checklist,"** by Gideon Rothschild and Daniel S. Rubin (Estate Tax Planning Advisor, Vol. 4, No. 6, March 2003)

A. Determine the client's potential sources of liability
    1. Different planning considerations will apply, depending upon the client's potential creditor exposure. As an example, a court might find a general tort creditor's claims to be more compelling than the claims of a contract creditor who, presumably, should have done his or her due diligence prior to entering into the contract. Potential classes of creditor exposure include the following:
        (a) Professional malpractice
        (b) General torts

(c) Contract claims
(d) Creditor exposure
(e) Officer and director liability
(f) Environmental liability
(g) Divorce
(h) Forced heirship
(i) Existing lawsuits

B. Attempt to resolve the client's issues through simple and commonplace techniques before suggesting complicated and exotic planning.
    1. Consider, as a start, whether the client's potential exposure can be negated, or at least mitigated, by having adequate insurance to protect himself or herself. Some types of insurance to consider include:
        (a) Homeowners
        (b) Auto
        (c) Umbrella
        (d) Commercial risk
        (e) Directors and officers
        (f) Disability
        (g) Life
C. Prepare a solvency analysis.
    1. Determine whether asset protection planning techniques that involve the transfer of property can be ethically undertaken. In addition, undertake appropriate due diligence in order to avoid ethical and legal pitfalls that might exist in connection with assisting a client in protecting his or her assets from creditors.
D. Maximize the creditor exemptions permitted by state statute and/or federal statute.
    1. The courts might not interpret statutory exemptions in a literal manner if application of the statutory exemption under any particular set of circumstances does not appear to coincide with the avowed legislative purpose. Potentially significant creditor exemptions might include one or more of the following:
        (a) Retirement plans
        (b) Individual retirement accounts
        (c) Life insurance
        (d) Annuities
        (e) Homestead exemption
            (1) Ascertain how title is held.
            (2) Consider the tax and nontax consequences of changing title.
            (3) Joint ownership (tenancy by the entirety)
            (4) Community property

E. Review the client's estate plan, business organization, and the documents relating to each with an eye toward maximizing creditor protection.
    1. In particular, consider each of the following items:
        (a) Anticipated inheritance:
            (1) Consider disclaimer if outright inheritance.
            (2) Consider requesting expected inheritance to be retained in trust.
        (b) Wills and trusts should provide for continuing spendthrift trusts:
            (1) QTIP trust instead of outright marital trust.
            (2) Perpetual trusts in non-rule against perpetuities jurisdictions.
            (3) Continuing GST nonexempt trusts for asset protection benefits.
        (c) Business activities:
            (1) Consider type of entity (*e.g.*, general partnership vs. LLC vs. corporation).
            (2) Consider reorganizing client's holdings to segregate assets.
            (3) Consider reorganizing business to obtain "outside-in" protection.

F. Consider which of the more sophisticated asset protection planning techniques might be appropriately applied to the client's circumstances.
    1. Domestic Trusts
        (a) Non-self-settled trusts and trust techniques:
            (1) Qualified personal residence trust
            (2) Charitable remainder trust/charitable lead trust
            (3) *Inter vivos* QTIP trust
            (4) *Inter vivos* discretionary trusts
            (5) *Inter vivos* power of appointment trust
            (6) Sale to a "defective" grantor trust
        (b) Trusts created by a family member for the benefit of the debtor/client
            (1) Non-Self-settled trusts (Alaska, Delaware, Nevada, Cook Islands, Nevis, Belize
            (2) Beneficiary may act as a co-trustee without creditor grabbing strings to invade income or corpus
            (3) Offshore life insurance

VIII. **Question and Answer Session**

EXHIBIT A

(Sample Form)

AFFIDAVIT OF SOLVENCY

RE: THE [ ] TRUST

The undersigned, _____ , who being first duly sworn upon oath, deposes and states as follows:

1. That to the best of my knowledge and belief the information provided, and any attachments hereto, are true and correct.

2. I am a Settlor of the_____Trust and I contemplate making transfers of property thereto in addition to my initial nominal contribution thereto.

3. That there are no pending or threatened claims or proceedings that I reasonably anticipate may result in a judgment against me, and I am not a named defendant in any law suit or involved in any administrative proceedings as of this date, or a judgment debtor [other than as disclosed in any attached schedule].

4. That I do not anticipate filing for relief under the provisions of the applicable bankruptcy or insolvency laws, nor am I involved in any situation that I reasonably anticipate would cause me to file for relief under the applicable bankruptcy or insolvency laws in the future.

5. That following any transfer of my property to the trust structure, I will be solvent and able to pay my reasonably anticipated debts (including any claims or lawsuits against me) as they come due from the balance of my property after such transfer.

6. That I have full right, title and authority to transfer the assets to the trust.

7. That I have read and understood the annexed description of unlawful activities, and confirm and represent that none of the assets which I may transfer to the trust was derived from any of the activities described therein.

8. That I am not to my knowledge, nor do I reasonably expect to be, under investigation by any Federal or State agency, or in violation of any statutes administered by, or empowering, the Internal Revenue Service, the Federal Trade Commission, the Securities Exchange Commission, the United States Postal Service, the Drug Enforcement Agency, or the Federal Bureau of Investigation.

9. That I am not engaged in or about to become engaged in a business or transaction for which remaining assets will be unreasonable in relation to the business or transaction.

10. That I do not intend to incur or reasonably believe that I will incur debts beyond my ability to pay as they become due and I do not have the actual intent to hinder, delay, or defraud any creditor.

_____

(insert name of deponent)

(Notarial Certificate)

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

State of California

County of _____

SUBSCRIBED AND SWORN to (or affirmed) before me, on this this _____ day

of _____ 20 ____, (1) _____,

and (2) _____(names of signers) , proved to me on the basis of satisfactory evidence to be the person(s) who appeared before me.

(Notary Public Seal/Stamp) Signature: _____

Signature of Notary Public

ANNEXURE TO AFFIDAVIT OF SOLVENCY

CONCERNING UNLAWFUL ACTIVITIES

The law of a jurisdiction may contain legislation (the "legislation") making it criminal for anyone to conduct or attempt to conduct certain financial activities which involve the proceeds of unlawful activities. The transfer of assets into a limited partnership, trust, or other entity may constitute a criminal activity within the scope of such legislation if the assets transferred to such entities were derived from any of the unlawful activities specified in the legislation.

The unlawful activities under the legislation commonly consist primarily of drug-trafficking offenses, financial misconduct and environmental crimes. Drug-trafficking offenses include the manufacture, importation, sale, or distribution of controlled substances; the commission of acts constituting a continuing criminal enterprise; and transportation of drug paraphernalia.

Financial misconduct includes the concealment of assets from a receiver, custodian, trustee, marshall, or other officer of the court, from creditors in a bankruptcy proceeding, or from a statutory corporation or similar agency or person; the making of a fraudulent conveyance in contemplation of a bankruptcy proceeding or with intent to defeat the bankruptcy law; the giving of false oaths or claims in relation to a bankruptcy proceeding; bribery; the giving of commissions or gifts for the procurement of loans; theft, embezzlement, or misapplication of bank funds or funds of other lending, credit, or insurance institutions; the making of fraudulent bank or credit institution entries or loan or credit applications; and mail, wire, or bank fraud or bank or postal robbery or theft.

Environmental crimes include violations of statutory or regulatory laws. Other specified unlawful activities in such legislation could include counterfeiting, espionage, kidnapping or hostage-taking, copyright infringement, entry of goods by means of false statements, smuggling, removing goods from the custody of customs, illegally exporting arms, and trading with a country's enemies.

EXHIBIT B

(Sample Form)

AFFIDAVIT OF FINANCIAL STATUS

The undersigned, _____ (the "Affiant"), who being first duly sworn upon oath, deposes and says:

1. **Balance Sheet**. Attached hereto as Exhibit "A-1" is a true and correct copy of an estimated statement of the combined financial net worth of the Affiant and the Affiant's spouse, dated as of _____, (the "Marital Balance Sheet"). Each such Balance Sheet reflects the net equity in all material respects as of the date of this Affidavit of Financial Status.

2. **Assets**. The Marital Balance Sheet indicates that, as of the date of such Balance Sheet prior to any business and/or estate planning, the Affiant had a joint estimated net asset value (fair market asset value less liabilities) combined with his spouse of $_____ but such valuation excludes the cash, accounts receivables and goodwill owned by _____ and notes owed by _____ to the Affiant and his spouse. The value of such assets is materially the same as of the date of this Affidavit of Financial Status. Immediately after any business and/or estate planning by Affiant contemporaneously done with the execution of this Affidavit of Financial Status, the Affiant and his spouse had the same joint estimated net asset value and individual asset value because the Affiant did not divest any property in connection with such planning.

3. **Actual Liabilities**. The Balance Sheet indicates that, as of the date of the Balance Sheet, the Affiant's only significant liability in which a debt exceeded the collateral and/or mortgage pledged to collateralize the debt was (i) a potential _____ contingent liability owed to _____ with respect to a joint and several guaranty granted to _____ by the Affiant and his spouse for a debt owed by _____ (the "Loan") representing the potential deficiency if _____ foreclosed on the mortgaged property and sought to obtain a deficiency judgment against the guarantors and (ii) _____ debt owed by the Affiant and his spouse but recorded in the books and records of _____ as a loan by _____ to the Affiant and his spouse. Such liabilities are materially the same as of the date of this Affidavit of Financial Status. Except as referenced in the Affidavit of Financial status, (a) there are no assessments, tax liens or other liens against the Affiant that remain unpaid, (b) there are no notice of defaults, breaches or acceleration of any liability made upon the Affiant, (c) there are no judgments, decrees, or orders which have been entered against the Affiant, which, as of this date, are unsatisfied of record in any court located in California or any other state, or in any federal court, and (d) there are no

suits now pending in any court located in California or any other state, or in any federal court against the Affiant other than a lawsuit brought by _____ against the Affiant and his spouse as guarantors of the Loan.

4. **Contingent Liabilities**. As of the date of this Affidavit of Financial Status, the Affiant's only contingent liability was a guarantee of the Loan to _____. The Affiant and his spouse executed a joint and several guarantee of the Loan.

5. **Solvency**. Immediately after any business and estate planning by Affiant contemporaneously done with the execution of this Affidavit of Financial Status, the Affiant is solvent, the value of his assets exceed his actual and contingent liabilities, and he is able to pay his debts as they become due.

6. **No Bankruptcy**. The Affiant has not received any notice of a petition in bankruptcy actually filed or threatened to be filed against him, nor is he considering filing a petition in bankruptcy.

7. **Some of the Principal Purposes for Business and Estate Planning**. The Affiant is contemplating doing some business and estate planning (a) to create _____ Family Holdings, LLLP, a California limited liability limited partnership (the "Partnership"), and _____ General Partner, LLC, a California limited liability company (the "General Partner"), to serve as the sole general partner of the Partnership and (b) to transfer the following assets to the Partnership: (i) the Affiant and his spouse's membership interest in _____, (ii) _____ acres located on _____, and (iii) the office building formerly owned by _____. Some of the reasons for the business and estate planning include, but are not limited to, creating and funding the Partnership (1) to allow for the transfer of limited partnership units to the children of the Affiant and his spouse in lieu of directly transferring assets owned by the Partnership to such children in connection with estate planning, (2) to reduce the value of the Affiant and his spouse's estate for federal transfer tax purposes and thereby reduce the estate tax liability of the Affiant and his spouse and increase the net after-tax estate transferred to the children of the Affiant and his spouse, and (3) to simplify the Affiant and his spouse's estate for probate purposes.

8. **Financial Status after Estate Planning**. After any business and estate planning by Affiant contemporaneously done with the execution of this Affidavit of Financial Status, the Affiant (a) has retained assets that are not unreasonably small in relation to his debts or business transactions, (b) has retained assets with a fair valuation that exceeds his actual and contingent liabilities, and (c) will have sufficient assets to pay his debts as they become due. Further, the assets being transferred in connection with any estate planning by Affiant contemporaneously done with the execution of this Affidavit of Financial Status do not represent all or substantially all of the assets owned by the Affiant immediately prior to such estate planning.

9. **Purpose of Affidavit**. This Affidavit is made in connection with the business and estate planning of the Affiant.

FURTHER AFFIANT SAYETH NAUGHT.

AFFIANT:

Date: _____

_____

(Notarial Certificate)

A notary public or other officer completing this certificate verifies only the identity of the individual who signed the document to which this certificate is attached, and not the truthfulness, accuracy, or validity of that document.

State of California

County of _____

SUBSCRIBED AND SWORN to (or affirmed) before me, on this _____ day of

_____ 20 ____, (1) _____,

and (2) _____(names of signers) , proved to me on

the basis of satisfactory evidence to be the person(s) who appeared before me.

(Notary Public Seal/Stamp) Signature: _____

Signature of Notary Public

Exhibit "A-1"

Estimated Statement of Joint Financial Condition with Affiant's Spouse as of _____ prior to Business and Estate Planning

Assets		Liabilities
Description of Asset	**Market Value**[1]	
Bank Accounts		Contingent Liability to _____[2]
Stocks and Bonds net of liabilities		Debt owed to _____
Annuities		**Total Liabilities**
Real Estate net of liabilities		
Personal Property		
Total Est. Asset Value		**Estimated New Worth**

Estimated Statement of Joint Financial Condition with Affiant's Spouse as of _____ after Business and Estate Planning

Assets		Liabilities
Description of Asset	**Market Value**[1]	
Bank Accounts		Contingent Liability to _____[2]
Stocks and Bonds net of liabilities		Debt owed to _____
____ Family Holdings, LLLP		**Total Liabilities**
Annuities		
Real Estate net of liabilities		
Personal Property		
Total Est. Asset Value		**Estimated New Worth**

[1] The market value is an estimate made by Affiant and is not based upon any independent third party appraisals. Accordingly, such value may be overstated or understated when compared to a qualified appraisal. The assets exclude excludes the cash, accounts receivables and goodwill owned by _____ and notes owed by _____ to the Affiant and his spouse which notes will be transferred to the Partnership.

[2] The Affiant and his spouse have personally guaranteed a debt owed to _____ with respect to the Loan (as defined in the foregoing Affidavit). Such Loan is secured by a first mortgage on real estate. The Affiant estimates his and his spouse's net deficiency due on such Loan after reduction for the market value upon foreclosure of the real estate mortgaged to collateralize the Loan is $_____. Such an estimate is being made only in connection with this estate and business planning contemplated herein and is not an admission of liability owed by the Affiant with respect to the Loan.