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Recommended Citation
Available at: http://lib.dr.iastate.edu/aglawdigest/vol8/iss9/1

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ASSET PROTECTION TRUSTS

— by Neil E. Harl*

Owners of farm or ranch property are accustomed to assuming the risks associated with property ownership. Some of those risks are insurable including casualty loss to the property, crop loss1 and losses from tort liability. Some potential losses, although insurable, may exceed the limits of coverage and thus pose special planning problems.

One planning strategy to catastrophic risks in recent years has been to establish “asset protection trusts” in a foreign jurisdiction to shield assets from U.S.-based creditors.2 The key issues are whether such a strategy is likely to be successful and, if so, whether it is a good idea to establish such trusts.

Features of asset protection trusts

Although the so-called asset protection trusts vary widely in detail, such trusts tend to have several features in common. The trusts tend to be irrevocable for their term, with a foreign trustee or trustees appointed to manage the trust. The trustee or trustees typically have sole discretion to make (or not to make) trust distributions. The trust usually recites that trust administration is governed by the law of the foreign country. Some contain classes permitting assets to be shifted to another country at the direction of the trustee.

Although some have tried to use asset protection trusts to hold real property in the United States, most asset protection trusts involve intangible personal property located outside the United States.

Effectiveness against creditors

As noted, the key issue is whether asset protection trusts afford genuine protection from creditor action. The answer, in short, is that protection from creditors is far from complete. A determined creditor, willing to go to any length to collect on a judgment, can often succeed even in the face of an asset protection trust. However, such trusts do offer modest protection.

In general, for “self-settled” trusts there is no protection from creditors.3 Those include trusts with the settlor as beneficiary other than possibly as a contingent reversionary beneficiary.4 Several states have codified that result.5 This is usually the case even if there is a spendthrift clause in the trust.6

If there is an identifiable creditor problem, the planning opportunities to avoid creditor action are greatly limited. In general, transfers with an intent to defraud creditors are invalid.7 The key is “intent.”8 Moreover, transfers by an insolvent (or soon to be insolvent) settlor are a matter of constructive fraud on creditors. The Uniform Fraudulent Transfers Act covers, basically, all reasonably foreseeable creditors and claimants.9 The provision in the Uniform Fraudulent Conveyance Act (UFCA) is similar.10

In order to provide the maximum possible protection against creditor action, several countries11 have enacted legislation designed to frustrate the actions of creditors.

• Countries endeavoring to attract asset protection trusts have in several instances, enacted statutory provisions overriding the forerunner of the UFCA and the UFTA, the Statute of Elizabeth. Those acts undercut transfers intended to defeat the claims of creditors.

• A few foreign countries, notable for their aggressive efforts to entice asset protection trusts to the jurisdiction, have provisions specifying that foreign judgments are not recognized.

• Several countries have enacted relatively short statutes of limitations for bringing actions against a trust.12 For example, in the Cook Islands actions must be brought by the later if two years after the creditor’s cause of action accrues or within one year of the transfer of the assets.13

Preferred jurisdictions

Largely because of provisions enacted in recent years to frustrate actions of creditors from outside the country, several jurisdictions have come to be recognized as particularly attractive locations for asset protection trusts.14 Those establishing such trusts typically look also for relatively stable governments, a common-law based legal system and a government with a reasonably friendly attitude toward asset protection trusts.

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Countries frequently mentioned are the Cook Islands, the Bahamas, Belize, Cayman Islands, Cyprus, Gibraltar, and the Turks and Caicos Islands.\(^{15}\)

**Ethical aspects**

One hotly debated issue in recent years has been whether it is ethical for attorneys to establish asset protection trusts. The American Bar Association Model Rules of Professional conduct specify that it is unethical to represent a client with intent to defraud a creditor.\(^{16}\)

**Other considerations**

Several risks are inherent in asset protection trusts. One important risk is that such trusts often take the form of discretionary spendthrift trusts with a foreign trustee given discretion in making distributions. The potential risks to the settlor are obvious.

Another important consideration is cost to establish (and maintain) the trust.\(^{17}\) The costs involved often run into five figures.\(^{18}\)

Possible political and economic instability in the country (or a change in the attitude of the country toward asset protection trusts) is an important additional consideration. Organized groups of creditors can be expected to lobby the U.S. Government to use whatever leverage can be exercised to discourage statutory protection measures.

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**FOOTNOTES**

4. Id.
5. E.g., Wis. Stat. Ann. § 701.06(1).
6. Id.
10. UFTA § 7.
11. See ns. 13-14 infra and accompanying text.
15. Id.
17. See Marty-Nelson, *supra* n. 2 at 68.
18. Id.

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**CASES, REGULATIONS AND STATUTES**

by Robert P. Achenbach, Jr.

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**ANIMALS**

**HORSES.** The plaintiff was injured when the plaintiff’s motorcycle struck a horse on the highway. The plaintiff sued, under 510 ILCS 55/1 et seq. and a theory of negligence, the owner of the horse and the previous owner of the horse. The plaintiff also sued, under a theory of negligence only, the owner of the land on which the horse was kept. The previous owner had sold the horse to the current owner under an installment contract under which $170 was still owed at the time of the accident. The sale was recorded on the Certificate of Foal Registration. The court held that the previous owner had insufficient interest in the horse to be liable under the statute for the accident. The court held that liability for an animal at large on a highway had to be based upon the statute because under common law, landowners were not liable for damages done by escaped animals. Therefore, an action based solely on a theory of negligence against the defending landowner was properly dismissed. *Douglass v. Dolan*, 675 N.E.2d 1012 (Ill. Ct. App. 1997).

**BANKRUPTCY**

**GENERAL-ALM § 13.03.**

**EXEMPTIONS**

**HOMESTEAD.** The debtors owned six parcels of land, including one used for the residence and five used for farming. Prior to filing for Chapter 12, the debtors had transferred title to three parcels to a family partnership. A creditor argued that the five parcels were not eligible for the rural homestead exemption because the parcels were located within city limits. However, the creditor failed to provide any evidence of the location of the parcels and the debtors testified that the parcels were all used for farming; therefore, the court held that all parcels were eligible for the rural homestead exemption. The creditor also argued that the three parcels transferred to the partnership were not eligible for the exemption because the parcels were not owned by the debtors. The court held that the debtors’ partnership interest in the three parcels was insufficient for eligibility for claiming a homestead exemption in the parcels. *In re Cole*, 205 B.R. 382 (Bankr. E.D. Tex. 1997).

**GRAIN STORAGE FACILITY.** The debtor’s business consisted primarily of purchasing grain for