Subject: Jerry Wolf & Amendments to Bahamian Trust Law
Enhance Gifting to Offshore, Self-Settled Spendthrift Trusts

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Moreover, even if a judgment creditor’s claim is obtained in a non-DAPT state, it may be significantly more difficult, administratively and legally, to enforce that claim against an offshore trustee, or in the Bahamian courts. Thus, the settlor can effectively transfer assets to achieve tax savings, yet be secure in the knowledge that assets may be accessible in the event the client falls on financial hard times.”

In his commentary, Jerry Wolf explains why recent amendments to Bahamian trust law make gifts to offshore, self-settled spendthrift trusts more attractive for certain clients.

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Here is his commentary:

**EXECUTIVE SUMMARY:**

A taxpayer concerned with asset protection and the minimization of transfer taxes upon his death should consider a gift to a self-settled spendthrift trust established in an offshore jurisdiction. Although Private Letter Ruling 200944002 established the IRS position that assets transferred to an Alaskan self-settled spendthrift trust will not be included in the settlor’s gross estate absent an implied agreement that the settlor would benefit from the trust, (a) private letter rulings cannot be cited as precedent, and (b) even if they could, not every taxpayer has the benefit of residing in a state with a DAPT statute, let alone a DAPT statute as strongly worded for creditor protection purposes as is Alaska’s. Further, other authorities, such as Revenue Ruling 77-378 and Private Letter Ruling 9332006, indicate that the analysis applied under Private Letter Ruling 200944002 should similarly apply to a U.S. settlor who wishes to establish a self-settled spendthrift trust in an appropriate offshore jurisdiction.

Absent a fraudulent scheme, the assets transferred to an offshore asset protection trust are protected from creditors’ claims and, therefore, the gift should be complete for federal gift tax purposes, and the property should not be includable in the settlor’s gross estate. Moreover, even if a judgment creditor’s claim is obtained in a non-DAPT state, it may be
significantly more difficult, administratively and legally, to enforce that claim against an offshore trustee, or in the Bahamian courts. Thus, the settlor can effectively transfer assets to achieve tax savings, yet be secure in the knowledge that assets may be accessible in the event the client falls on financial hard times.

**FACTS:**

Section 40 of the TRUSTEE ACT (*Ch. 176*), 1998 of the Commonwealth of the Bahamas, entitled “Restriction against Alienation,” provides:

40. (1) Notwithstanding any rule of the law or equity to the contrary, it shall be lawful for an instrument or disposition to provide that any estate or interest in any property given or to be given to any individual as a beneficiary shall not during the life of a beneficiary, or such lesser period as may be specified in the instrument or disposition, be alienated or pass by bankruptcy, insolvency or liquidation or be liable to be seized, sold, attached, or taken in execution by process of law and where so provided such provision shall take effect accordingly.

(2) Where property is given subject to any of the restrictions contained in subsection (1), the right to derive income from such property by a beneficiary and any income derived therefrom shall not pass by bankruptcy, insolvency or liquidation or be liable to be seized, sold, attached, or taken in execution by process of law.

(3) Where property is given subject to a restriction against alienation then the right to derive income from that property shall not be alienable for as long as that restriction remains in force.

(4) A restriction imposed pursuant to this section may at any time by removed in accordance with any provisions for such removal in the instrument or disposition and in the manner specified therein.

(5) *Neither the settlor nor any other person donating property to a trust may benefit from the provisions of this section.* [emphasis added]
In summary, under Bahamian law, a provision in a trust that prevents a beneficiary’s interest from being alienated, passing by bankruptcy, being seized, sold, attached or taken in execution by process of law is valid, lawful and enforceable. This provision codifies the common law “spendthrift trust” which is a trust that prohibits a beneficiary’s interest from being assigned by such beneficiary and also prevents a creditor from attaching that interest.

Of concern to the international estate planning community is subsection (5), which directs that “neither the settlor nor any other person donating property to a trust may benefit from the provisions of this section.” The net effect is that to satisfy a judgment, a creditor of a settlor who is a beneficiary of a Bahamian trust may seize or attach assets the settlor transfers into the trust.

Considering the commercial implications of its international banking, trust and financial services industries, all of which compete against jurisdictions whose laws had been modernized to accommodate the needs of the international high net worth community, the Bahamian Financial Services Board in conjunction and with the assistance of the Bahamas legal community, considered several proposed revisions to its trust law to reverse the existing public policy against self-settled spendthrift trusts.

Of course, the simplest approach was to merely repeal subsection (5), so that “the settlor nor any other person donating property to a trust” would no longer be excluded from the benefits provided under Section 40. The concern, however, was that a general repeal of subsection (5) left open the possibility of a settlor, in his capacity as a beneficiary, circumventing the provisions of the Fraudulent Disposition Act.

Section 4 of Chapter 78, FRAUDULENT DISPOSITIONS ACT (Ch. 78), 1991 of the Commonwealth of the Bahamas, provides:

4. (1) Subject to the provisions of this Act, every disposition of property made with an intent to defraud and at an undervalue shall be voidable at the instance of the creditor thereby prejudiced.
(2) The burden of establishing an intent to defraud for the purposes of this Act shall be upon the creditors seeking to set aside the disposition.

(3) No action or proceedings shall be commenced pursuant to this Act unless commenced within two years of the date of the relevant disposition.

Accordingly, in order to allay the concern that the settlor might otherwise be able to circumvent the Fraudulent Disposition Act, the TRUSTEE (AMENDMENT) ACT, 2016, was enacted by the Parliament of the Bahamas on December 29, 2016, and provides for an amendment to Section 40 of the TRUSTEE ACT. Section 3 of the Act includes:

Section 40 of the principal Act is amended by deleting subsection (5) and substituting therefor the following as new subsection (5) –

(5) Subject to the Fraudulent Disposition Act (Ch. 78), the settlor or any other person donating property to a trust may benefit from the provisions in this section.

**COMMENT:**

**Tax Planning With Self-Settled Spendthrift Trusts.** [Note: The published tax policy of the new Trump Administration is to “repeal the death tax, but capital gains held until death and valued over $10 million will be subject to tax to exempt small businesses, and family farms”. At the time of this publication, the actual significance of such policy on planning under current law remains unclear.] The Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010 increased the lifetime gift tax exemption from $1 million to $5 million for 2011 and, as a result of an inflation adjustment, to $5,490,000 in 2017. This increase presents planners and their clients with a tremendous opportunity to transfer significantly more wealth without paying any federal transfer tax. However, a significant hurdle to gifting has always been the client’s reluctance to transfer assets without the possibility of receiving them back in the future if faced with hard economic times. We believe the solution to this age-old problem lies with gifting to irrevocable trusts established in jurisdictions
that allow the settlor to be a discretionary beneficiary of his own trust
and, so long as the gift to such trust is not part of a fraudulent scheme,
prohibit the creditors of the settlor from reaching the trust assets. Such
trusts are commonly referred to as **self-settled spendthrift trusts.**

Aside from the asset protection advantages of self-settled spendthrift
trusts, the transfer of assets to a self-settled spendthrift trust, under
certain circumstances, can be structured as a completed gift for federal
transfer tax purposes. Whether such a transfer is treated as a
completed gift, and thereby causes the exclusion of the trust assets from
the settlor’s gross estate for federal estate tax purposes, depends on the
trust law of the state or country in which the trust is sitused, as well as
the applicable sections of the Internal Revenue Code and the rulings
and case law interpreting such sections. While 16 states\(^1\) have adopted
legislation that validates self-settled spendthrift trusts (sometimes
referred to herein as Domestic Asset Protection Trusts, or “DAPTs”),
there is evolving legal authority that a taxpayer who resides in a non-
DAPT state might not be deemed to have made a completed gift to a
trust he settles in a DAPT state.

**Completed Gifts.** Treasury Regulation Section 25.2511-2(b) provides
that a gift is complete if the donor "has so parted with dominion and
control as to leave in him no power to change its disposition, whether for
his own benefit or for the benefit of another…." Courts have consistently
held that gifts to self-settled spendthrift trusts are not complete in
jurisdictions that allow a settlor’s creditors to reach the maximum
amount that the trustee could distribute to the settlor.\(^2\) These courts
reasoned that the settlor retained a beneficial interest in the assets,
because the settlor **could** incur debt, and the settlor’s creditors could
thus reach the trust assets to satisfy these obligations. Another way to
describe the courts’ view is that the settlor, indirectly, has retained the
economic access to the trust assets through the ability to “run up” debt.

The Internal Revenue Service (the “IRS”) reached a similar result in
Revenue Ruling 76-103, holding that a transfer to a self-settled
spendthrift trust was an incomplete gift because local law subjected the
entire property of the trust to the claims of the grantor’s creditors
whenever such claims arose.\(^3\) Thus, when determining whether a
transfer is a completed gift, the focus of the IRS and the courts is on
whether the settlor’s creditors *could* have reached the discretionary income or principal distributable to the settlor/beneficiary.

In contrast, when local law prevents a settlor’s creditors from reaching the assets of a self-settled spendthrift trust, courts have held that a gift to such trust, absent some retained interest or power, is complete for federal gift tax purposes. The IRS took a similar approach in Revenue Ruling 77-378, where local law prohibited a settlor’s creditors from reaching the assets of a self-settled spendthrift trust, despite the fact that the trustee was given “absolute and uncontrolled discretion” to distribute income and principal to the settlor. The ruling concluded that even though a trustee may have an unrestricted power to distribute all of the trust assets to the settlor, if the settlor’s interest in the trust is not enforceable either by the settlor or on his behalf, the settlor has parted with dominion and control, and the gift is complete. The ruling further states that a mere expectancy that the trustee will distribute the trust assets to the settlor does not prevent the completion of the gift or reduce its value.

**PLR 200944002.** PLR 200944002 (10/30/2009), issued in 2009, is a determination relied upon to endorse the use of a DAPT as an estate tax planning strategy. This ruling indicates that gifts to an Alaskan DAPT are complete, and, absent an implied understanding or other factors that would result in estate tax inclusion, the trust assets will not be included in the settlor’s gross estate. In the letter ruling, an Alaska resident established an Alaska law DAPT. Alaska adopted legislation that validates self-settled spendthrift trusts and provides that a self-settled spendthrift trust is not subject to the settlor’s creditors unless: (1) the settlor may revoke or terminate the trust; (2) the transfer to the trust was made with the intent to defraud a creditor, (3) the settlor is in default of child support payments at the time of the transfer into the trust, or (4) the trust requires the income or principal to be distributed to the settlor. The terms of the trust at issue in the ruling provided that the settlor could not compel distributions to himself, and therefore, the settlor’s creditors could not reach any of the assets held in the trust, absent a fraudulent transfer. A key fact in the ruling is that the settlor was a resident of the state in which the trust was sitused; i.e., in that circumstance the trust would likely be upheld by the state of the settlor’s residence.
Thus, it appears the rationale for this private letter ruling is based upon the law of the state where the trust is established. In contrast to the Alaska self-settled spendthrift trust statute, other DAPT states have legislated certain exceptions to its law, such as to fulfill the settlor’s obligation under a divorce decree or other “family” claims, or for claims for personal injury or property damage (i.e., claims in tort). Consequently, the potential relegation of the trust principal to discharge the settlor’s legal obligations could cause a gift to a DAPT to be deemed incomplete.

Choice of Law Concerns. For taxpayers who reside in non-DAPT states, some planners are concerned about the uncertainty surrounding whether a court will apply the law of the nonresident settlor’s domicile rather than the DAPT law selected in the trust instrument. Assume, for example, a nonresident of a DAPT state establishes a self-settled spendthrift trust in a DAPT state. Subsequently, the settlor is sued in either the state of his residence or in federal court. The federal court may be located in the settlor’s state or in the DAPT state. Further assume that the court obtains jurisdiction over the trustee of the DAPT. The party suing the settlor (referred to herein as the “creditor”) will argue that the court should choose the spendthrift trust law of the settlor’s state of residence, rather than the law of the DAPT state. If the court opts to apply the law of the settlor’s state of residence—which does not provide asset protection for DAPTs—to the question of whether the settlor's creditors can attach the trust assets, the creditor may be allowed to reach the trust assets, with the tax consequence of causing all of the trust assets to be included in the settlor's gross estate.\(^6\)

Substantive due process protections under the Fifth and Fourteenth Amendments to the United States Constitution restrict a forum state’s ability to apply its own law to disputes between outsiders.

(a) The forum state must have “significant contact” with the dispute that creates “state interests,” such that the use of the forum’s law is not “arbitrary or unfair.”

(b) The Restatement of Conflict of Laws states that the forum state should apply another state’s laws if that state has the dominant interest in the question of exemption. If the debtor and creditor are domiciled outside the forum state, “a state to which
they both have substantial relationships . . . may be the state of dominant interest.”

(c) The Due Process Clause merely mandates that the forum state must have sufficient interests in the matter that the application of its laws would not be arbitrary or unfair.

**Florida Jurisdiction.** In Florida, the determination of personal jurisdiction over a nonresident is based on the two-part test promulgated in *Venetian Salami Co. v. Parthenais*, 554 So.2d 499 (Fla. 1989). The plaintiff must first allege sufficient facts to justify bringing an action within one of the criteria under Florida’s long arm statute. Secondly, if the long arm jurisdiction is properly plead, sufficient minimum contacts must be demonstrated to satisfy the requirements of federal due process.

Section 736.0202, Florida Statutes, is entitled “Jurisdiction over trustee and beneficiary” and provides:

1. **In rem jurisdiction.** – Any beneficiary of a trust having its principal place of administration in this state is subject to the jurisdiction of the courts of this state to the extent of the beneficiary’s interest in the trust. [emphasis added]

2. **Personal jurisdiction –**

   (a) Any trustee, trust beneficiary, or other person, whether or not a citizen or resident of this state, who personally or through an agent does any of the following acts related to a trust, submits to the jurisdiction of the courts involving that trust:

   3. Serves as trustee of a trust created by a settlor who was resident of this state at the time of creation of the trust or serves as trustee of a trust having its principal place of administration in this state. [emphasis added]

   (b) A court of this state may exercise personal jurisdiction over a trustee, trust beneficiary, or other person, whether found within or outside the state, to the maximum extent permitted by the State Constitution or the Federal Constitution.

Therefore, any person who serves as trustee of a trust established by a settlor who was a resident of the state of Florida at the time the trust was
created is subject to Florida’s long arm statute. Consequently, even if a Florida resident creates a self-settled spendthrift trust in a DAPT state, the trustee of that DAPT trust is subject to Florida’s long arm statute.

Similarly, even if personal jurisdiction cannot be obtained over the DAPT trustee under the long arm statute, subsection (2)(b) ensures the trustee may be subject to federal diversity jurisdiction.

Assuming the Florida courts are able to obtain personal jurisdiction over the DAPT trustee, or the proceeding is brought in the federal courts, there must still be a determination as to whether there are sufficient contacts with the state of Florida so that its law, rather than the law chosen in the DAPT’s governing law provision, will prevail.

Section 736.0107, Florida Statutes, entitled “Governing law” provides:

The meaning and effect of the terms of a trust are determined by:

(1) The law of the jurisdiction designated in the terms of the trust, provided there is sufficient nexus to the designated jurisdiction at the time of the creation of the trust or during the trust administration, including, but not limited to the location of real property held by the trust or the residence or location of an office of the settlor, trustee, or any beneficiary; or

(2) In the absence of a controlling designation in the terms of the trust, the law of the jurisdiction where the settlor resides at the time the trust is first created.

Notwithstanding subsection (1) or subsection (2), a designation in the terms of a trust is not controlling as to any matter for which the designation would be contrary to a strong public policy of this state. [emphasis added]

Recent Cases.


(a) The debtor, Donald Huber, was a real estate developer and a lifelong resident of the State of Washington. When Mr. Huber realized that many of his real estate projects were about to fail and be foreclosed upon, and his personal guarantees called, he transferred substantially all
of his assets into an Alaska limited liability company ("LLC"), and transferred a 99% LLC membership interest into the Donald Huber Family Trust, an irrevocable self-settled spendthrift trust in Alaska. The assets with which the LLC was capitalized were situated in Washington, and the trust was funded with the LLC membership interest and a $10,000 certificate of deposit situated in Alaska. The beneficiaries of the trust were Mr. Huber and his descendants, all of whom were residents of Washington.

(b) The bankruptcy judge granted summary judgment to the bankruptcy trustee, finding that the trust did not protect its assets from the settlor’s creditors. In determining the choice of law rules, the court pointed to the fact that the Ninth Circuit, to which the case would be appealed, applies the choice of law rules set forth in the RESTATEMENT (SECOND) OF CONFLICT OF LAW (the "Second Restatement"). The Second Restatement directs that a provision in governing instrument of an inter vivos trust that declares that the validity of the trust will be controlled by the laws of a specific state will be followed only if (a) the state declared in the trust instrument as controlling has substantial relation to the trust, and (b) the application of its local law does not violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationships. Alaska law would apply if Alaska had a substantial relation to the trust. However, Alaska was determined to have had only a minimal relation to the trust, despite the LLC being formed under Alaska law and the certificate of deposit being situated in Alaska; whereas, Washington had a strong public policy against self-settled spendthrift trusts. Therefore, since the trust was a self-settled trust, the transfers into the trust were void.

2. In re Zuckerkorn, 484 B.R. 182 (Bankr. 9th Cir. 2012).

(a) Sally Zuckerkorn created a revocable inter vivos trust for herself, naming American Trust Co. of Hawaii, Inc. as the corporate trustee. Sally’s trust contained a spendthrift provision and directed that the trust shall be construed and regulated by the law of Hawaii. Upon Sally’s death, the trust divided into separate subtrusts for each of her sons, Herbert and Jack. Herbert had filed for bankruptcy in the State of California, and, under California law, the bankruptcy trustee was entitled to 25% of the distributions from the trust. Herbert claimed that Hawaii
law governed the trust, and, based upon its spendthrift provision, the bankruptcy trustee was entitled to nothing.

(b) The Ninth Circuit and California adopt the Second Restatement to determine the applicable choice of law rules. In determining which state - Hawaii or California - had the most substantial relation to the trust, and whether the application of the law of either state would violate a strong public policy of the state with which, as to the matter at issue, the trust has its most significant relationship, the court found that the assets were originally maintained in Hawaii and not California. However, the court distinguished the fact that the trust was not self-settled as it related to Herbert, because “self-settled trusts are void against the public policy in California…” and if a self-settled trust had been involved, California law would have applied instead of Hawaii.


(a) The IRS was seeking to recover taxes from the settlor of an irrevocable trust he created for the benefit of his two sons in 1992 (note: not a self-settled spendthrift trust). At the time, the settlor was estranged from his wife and argued that the trust was established for the purpose of ensuring that the assets would pass at his death to his children and not his wife. The trust was funded with the settlor’s residence; however, the settlor remained as the named payee on the homeowners insurance policy. The trustees of the trust were a series of the settlor’s friends and business associates. There was little evidence that any trustee ever managed the trust – in fact, one trustee testified that he thought he would become trustee only when the settlor died. The accounting for the trust was done for free by the accountants for the settlor’s law firm.

(b) The court held that the IRS could recover from the trust on three separate grounds: (i) fraudulent conveyance, (ii) the settlor retained too much control over the trust assets (**nominee theory**), and (iii) the settlor retained too much control over the trust itself (**alter ego theory**). The take-aways from this case are that although the alter ego theory is rarely seen outside of the business entity context, there appears to be a trend towards application of the theory to trusts; and, courts are looking to see whether defeating creditors’ claims is a “significant motivation” for the
planning, and not necessarily whether it was the only motivation, or even the primary motivation.

**Summary.** The authorities cited above suggest that a taxpayer concerned with asset protection and the minimization of transfer taxes upon his death should consider a gift to a self-settled spendthrift trust established in an offshore jurisdiction. Although Private Letter Ruling 200944002 established the IRS position that assets transferred to an Alaskan self-settled spendthrift trust will not be included in the settlor’s gross estate absent an implied agreement that the settlor would benefit from the trust, (a) private letter rulings cannot be cited as precedent, and (b) even if they could, not every taxpayer has the benefit of residing in a state with a DAPT statute, let alone a DAPT statute as strongly worded for creditor protection purposes as is Alaska’s. Further, other authorities, such as Revenue Ruling 77-378 and Private Letter Ruling 9332006, indicate that the analysis applied under Private Letter Ruling 200944002 should similarly apply to a U.S. settlor who wishes to establish a self-settled spendthrift trust in an appropriate offshore jurisdiction.

Absent a fraudulent scheme, the assets transferred to an offshore asset protection trust are protected from creditors’ claims and, therefore, the gift should be complete for federal gift tax purposes, and the property should not be includable in the settlor’s gross estate. Moreover, even if a judgment creditor’s claim is obtained in a non-DAPT state, it may be significantly more difficult, administratively and legally, to enforce that claim against an offshore trustee, or in the Bahamian courts. Thus, the settlor can effectively transfer assets to achieve tax savings, yet be secure in the knowledge that assets may be accessible in the event the client falls on financial hard times.

**HOPE THIS HELPS YOU HELP OTHERS MAKE A POSITIVE DIFFERENCE!**

*Jerry Wolf*
CITATIONS:


3 See, e.g., Commissioner v. Vander Weele, 254 F.2d 895 (6th Cir. 1958); Outwin v. Commissioner, 76 T.C. 153 (1981); Estate of Paxton v. Commissioner, 86 T.C. 785 (1986); In re Estate of Uhl, 241 F2nd 867 (7th Cir 1957) (the settlors' retained rights under local law was viewed as a retention of the economic benefit and enjoyment of the entire trust income and corpus because the trust assets could be relegated to the settlors' creditors).


5 See Estate of Uhl, 241 F2nd 867 (7th Cir 1957); Estate of German v. United States, 7 Ct. Cl. 641 (1985).


7 Some commentators recently have argued that "[S]ection 2036(a)(1) does not apply where the grantor retains something that is merely speculative and/or contingent." That is, the fact that a court may choose to apply the law of the settlor's domicile and allow a creditor to reach the assets of the trust is not "retention" under Section 2036(a)(1).

8 IRC §6110(k)(3).