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The Offshore Trust: A Shield Against Certain Swords

by Nick Ravo

What do you do if you are a well-to-do professional, a wealthy entrepreneur or just plain filthy rich and you want to keep your assets safe from judgments and divorce decrees, but still within your reach?

Increasingly, members of the moneyed class are turning to offshore asset protection trusts. Since the trusts began about eight years ago, thousands of them worth hundreds of billions of dollars have been set up in a dozen or so offshore financial centers, far-flung fly-speck havens like the Cook Islands in the South Pacific and Nevis in the Caribbean.

The trusts came into vogue largely to protect professionals from huge jury awards. But they are not necessarily a panacea: they will not offer protection from the Internal Revenue Service; they are expensive and complex, and they can be cracked occasionally, too. And with some trusts that are offered at cut-rate prices, you may get what you pay for.

Still, an offshore asset protection trust created by an expert lawyer can create a large moat around your assets and may be an effective maneuver, if the assets are large enough and if you may be vulnerable to lawsuits.

"Our clients are really all over the board—business owners, physicians, lawyers—lawyers constitute a disproportionate percentage," said Barry S. Engel, a lawyer in Denver, Colorado, and an authority on asset protection trusts.

"Why lawyers?" he asked. "Well, I had a litigator from Southern California in my office once, and I asked him the same thing, and he said, 'I don't want someone to do to me what I do to people all day long.'"

Basically, these offshore trusts enable affluent Americans to be the beneficiaries (generally, in the United States, the creator of a trust cannot also be a beneficiary) and the trust's assets and income cannot be seized—at least not easily.

Assets in an offshore trust usually consist of cash accounts and securities. Domestic real estate held in a foreign trust becomes problematic because you cannot move the physical asset around; advisers often suggest taking the equity out of the property—for example, by taking out a second mortgage—and putting the proceeds in the trust.

The offshore trusts are not cheap. They cost $20,000 to set up and annual fees are about $3,000, and that is the low end, Mr. Engel said. The size of the typical trust is about $5 million, and the typical client who creates one is usually worth more; people rarely place all their assets in an offshore trust.

The Cook Islands, a New Zealand protectorate, is widely regarded as having the most protective provisions. United States judgments are not automatically recognized there, as they are in many other nations. Moreover, contingency fees for lawyers are not allowed, and local practitioners must be used.

The Cook Islands are also where the offshore trusts were created, with the help of American lawyers, including Mr. Engel, in the late 1980's. (There are also a small number of other offshore locales, like Britain's Jersey and Isle of Man, that do not have specific legislation in place for asset protection trusts, but their general trust laws make such trusts feasible.)

Despite the shady reputation of some offshore financial centers, the offshore asset protection trusts are legal—as long as they are not being used to evade taxes. Someone who has one is required to disclose the trust to the I.R.S.

And the trusts are effective—as long as they are in place for a reasonable period, one to three years, before any legal action to seize the assets is started. Setting up such a trust just before a divorce, a bankruptcy or lawsuit is filed is almost asking for a court to rule the trust a "fraudulent conveyance," Mr. Engel said.

He added that only about 5 percent of the more than 1,000 trusts his firm has created have been challenged by a creditor or spouse—and only once were assets from a trust even frozen, although the client eventually prevailed.

"Most clients understand it's like fire insurance—you hope you never need it, but if you do and you have it, you are protected," he said. "You have to put it in place before the fire. Once the fire starts, it's hard to get coverage."

The trusts, however, are sometimes criticized as ineffective, expensive and providing little more protection than is already offered through other avenues, said Tony Sagami, a money manager analyst in Austin, Tex., who devoted two recent issues of his newsletter to asset protection. Those avenues include limited family partnerships and limited liability corporations (both intended to limit the liability of investors in case things go wrong), as well as umbrella insurance policies, domestic trusts and, to a much lesser degree, prenuptial agreements and simply shifting assets to a spouse.

Then, Mr. Sagami said, there are the questionable companies that sell offshore trusts.

"We are very critical about the cheap, prepackaged, do-it-yourself offshore packages that are being marketed," Mr. Sagami said. "I was getting so many questions about them."

Mr. Engel countered that limited family partnerships, in particular, are often paired with asset protection trusts to make a more protective and flexible trust. But, he said, limited family partnerships and limited liability corporations alone are inherently less protective, in part because asset protection trusts are offshore; that in itself creates a strong logistical and legal disincentive for lawyers seeking to seize assets. Some experts say that a new form of trust created this year by the Alaska Legislature, so-called Tundra Trusts, may offer similar asset protection domestically. But lawyers believe the law is almost certain to face a long, tough fight in court.