GENERAL NEWS

Nest Egg Trusts
A new arrow becoming popular in the quiver of the overall estate or financial plan designed for wealthier clients is the establishment of an offshore asset protection trust (or “APT”), commonly referred to as a “nest egg trust”.

To begin this discussion, it must be clearly understood that if a transfer of assets is made for the purpose of and with the intent to hinder, defraud or delay a creditor, then any such transfer will be deemed a fraudulent transfer and can be overturned by a United States Court. Among the relevant “badges of fraud” are transfers of so much of one’s assets so that the individual will be rendered insolvent.

A nest egg trust is an irrevocable trust established in a jurisdiction outside the United States for the primary purpose of protecting assets of the individual creating the trust. The trust isn’t intended to shelter all of the individual’s assets, but only provide a level of financial security, or a “nest egg”, in the event of a catastrophic financial crisis.

It is important to remember that this is not a fraudulent scheme or a strategy to avoid creditors or evade taxes. In fact, a nest egg trust is not appropriate for an individual already engaged in litigation or actively trying to avoid payment of an enforceable obligation.

APT’s are usually established with banks or trust companies which are chartered in foreign jurisdictions where local laws provide very favorable conditions. For example, the Cayman Islands have very strict bank secrecy laws which statutorily prohibit any financial institution from divulging information pertaining to its customers and their accounts. Furthermore, the local laws of many of these jurisdictions make it more difficult for a creditor to challenge the validity of property transfers into the trust. As in the U.S., however, the trust is established by the execution of a written trust agreement, or “settlement”, between the creator of the trust and the financial institution serving as trustee.

From an income tax perspective, the arrangement is deemed a “grantor trust”, which means that all of the income must be reported by the creator of the trust. It must be clearly understood that there is no income tax benefit, shield or protection to be accomplished by establishing a nest egg trust.

Furthermore, depending upon how the trust is structured, the creator can be deemed to have made a completed gift for federal gift tax purposes at the time he transfers property into the trust. Notwithstanding the gift tax issue, so long as the creator is included in the class of beneficiaries among whom the trustee many distribute income and principal of the trust, the value of the trust will remain excluded from his estate for federal estate tax purposes. The trust, therefore, should be structured and coordinated as part of the creator’s overall tax and estate plan.

A negative to this planning strategy is that a nest egg trust has to be irrevocable, because if the individual retains the power to change or revoke the terms of the trust, a court will generally allow a creditor the same access to the trust as reserved by the debtor.

To preserve some degree of indirect control and accountability, the trust arrangement can be structured to allow the creator to appoint a “trust protector”, who must approve all actions taken by the trustee. So long as the protector is independent from the creator, the trust will maintain its irrevocability insofar as the creator is concerned.

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