

Is Offshore the Right Asset Protection Choice?

By Robert J. Mintz

One of the first things most clients ask when we begin mapping out an asset protection plan is whether they should “go offshore.” In this context, they’re not referring to a resort in the Caribbean; they want to know whether an offshore entity or perhaps even an overseas account would be an appropriate element to add to their strategy.

Some attorneys suggest that “going offshore” has many tactical and legal advantages over strictly domestic plans. The premise of this argument is that property or other assets within an offshore structure are ultimately protected from the rulings of an unpredictable and unsympathetic US court (which hypothetically has entered and is now attempting to enforce a multimillion dollar verdict against you).

What I have found in my legal practice is that under some circumstances an offshore plan may provide worthwhile advantages. In other cases—perhaps a majority of the time—offshore options convey no measurable additional benefits because the proper level of protection can be achieved with a strictly domestic arrangement (typically

through the use of some form of trust; visit www.mdng.com/departments/mar_apr2004/assets.htm for a more detailed description of a domestic asset protection plan).

There is a great deal of misleading and distorted information on the subject of offshore accounts presented through public seminars, books, and (of course) the Internet. The conflicting, sometimes ill-informed, sometimes outrageous claims made by competing “experts” have left the public confused as to the true function of these instruments. Indeed, to most people the phrase “offshore account” connotes equal measures of dashing, high-stakes escapades and shady, perhaps even illicit goings on and intrigue. This installment in our series on asset protection will cut through the myths and misinformation and explain what can and cannot be accomplished through the use of offshore strategies. It will present a clear and straightforward discussion of the key legal issues, hopefully leaving the reader with a truer picture of this legal strategy and better able to make an informed decision with the help of an attorney or advisor.

What Offshore Won't Do for You

To better understand the benefits of an offshore structure, one must first understand what it's not good for. Many clients come to me expressly for the purpose of implementing an offshore scheme that they have heard about through a seminar or over the Internet, believing this seemingly exotic option to be the solution to all their woes. My first job is to disappoint them and tell them that what they hoped for can't be accomplished legally. Most of their queries fall into one of four general categories.

Tax Avoidance

This is possibly the most commonly asked about reason for wanting to investigate the offshore option in the first place. To save us all the trouble, let me state unequivocally and for the record: there are no legitimate offshore techniques for avoiding, reducing, or deferring any US taxes. There is a common but mistaken belief that earnings deposited in an offshore account or company are not taxable until those funds are returned to the US. That would be a wonderful system but it's not the one we have. All income and earnings in an offshore account must be reported, regardless of when they are brought back. There are exceptions to

this rule for corporations which are conducting active businesses totally outside the US but these exceptions are so infrequent and limited that they need not be considered here.

Divorce

It is very unlikely that any advantage can be achieved from an offshore structure that will protect you in the event of a divorce. Since all marital assets and separate property must be legally disclosed to the court, failing to report an overseas account will produce civil and possibly criminal penalties if the omission is discovered. And it is likely that it will be discovered since the movement of funds will always leave a trail from the US banking system directly to the point of destination. Perhaps the trail can be covered up once money has left the US (something I advise against attempting, by the way), but banking records will clearly demonstrate that a particular amount of money went someplace. In a divorce proceeding, where the judge may have nearly complete discretion to create an "equitable division" of property, the perception that you are engaged in any sharp dealings may damage your legal position immeasurably.

Litigation

You cannot create an offshore plan in order to defeat a claim against you. Even if no actual lawsuit has been filed or if you have not been officially notified, it is too late to do anything once the potential claim exists. This prohibition against "Fraudulent Transfers" applies as well to domestic asset protection plans, but many people think that the bank secrecy laws or the simple transfer of property out of the US is a worthwhile tactic that in some way allows you to circumvent a lawsuit. Similar to the divorce situation, a "Fraudulent Transfer" may produce civil and criminal penalties, or even jail time (see <http://rjmintz.com/anderson.html>). For any plan to be effective it must be established prior to the existence of any potential claim against you.

Bank Secrecy

There is less to bank secrecy than meets the eye. It is true that the financial institutions in Switzerland and other banking havens generally will not reveal account information, except under narrowly defined circumstances. But all US residents are required to report overseas accounts on their tax returns, which may also then be available in a litigation context. This level of privacy may be satisfactory for those whose goal is to lower their "visibility" as a potential lawsuit target or in a business context to preserve confidentiality for assets, but it won't keep what you have secret from the government or from an adversary in litigation.

When Offshore Tactics Should Be Used

Now that I've initiated this discussion of offshore plans by describing what they aren't, I'll complete the exercise by explaining what they are, outlining the legitimate uses of an offshore strategy, and revealing what can clients seeking to incorporate them into an overall asset protection plan can honestly hope to accomplish through their use.

General Uses

Since domestic plans can be created which afford very strong asset protection as well as estate planning benefits (www.mdnetguide.com/departments/sept_oct2004/assets.htm), I generally only use an offshore structure primarily to correct a potential weakness in an individual plan that arises because of the particular facts associated with that case. Certain types of potential liabilities cannot be adequately protected with a strictly domestic plan and in those cases offshore sometimes provides a satisfactory solution (see www.rjmintz.com/offshore-llc.html for a full discussion of one popular offshore strategy).

Avoiding Asset Freezes

One situation where an offshore strategy might be warranted is if the client

has assets that can be subject to a "freeze" in the event of litigation. The legal term for a "freeze" is a "Writ of Attachment," which can be issued either before, during, or after a trial. In cases involving business disputes, leases, loans, and breach of contract claims, a common strategy is for the plaintiff to ask the court for a "Pre-Judgment Writ of Attachment," which places all accounts and property under the control of the court until the outcome of the case has been decided. In a medical practice context an asset freeze may be sought by the government in a dispute over Medicare billing.

An asset freeze is the most powerful weapon available to a legal adversary. If assets are frozen and money is not available for a legal defense or to meet continuing business and personal obligations, the plaintiff has effectively won the case without a trial. Without access to funds there is no ability to contest the claims or to negotiate the outcome. The granting of a Writ—or even the *threat* of one—can create such uncertainty and vulnerability that the defendant may be forced to settle a case fast, early, and on the most unfavorable terms. A plaintiff with the ability to obtain a Writ has all of the legal leverage he or she needs for success.

In planning with clients, I analyze the possible sources of liability and consider whether there is any potential for an asset freeze type of action. If so, I may choose an offshore strategy will protect funds and allow payment of business and personal expenses during the course of the litigation. Often, without a freeze and the ability to achieve a large, quick settlement, the plaintiff may have no incentive to pursue the case. Certainly, in such a case the relative bargaining power of each side has dramatically shifted away from the plaintiff.

Using Trust Income

I also consider offshore planning when a client needs asset protection, but also requires the income from his or her savings for living expenses. For example, a physician handling pediatric cases may have continuing liability until the children he or she treats reach age eighteen—a time frame that may extend well past the physician's intended retirement date. Upon retirement, he or she would no longer have the income from his or her practice and would need the income from savings for living expenses. If adequate or affordable continuing insurance tail coverage is not available, his or her retirement savings would be exposed to claims for these prior acts for many years.

An asset protection plan along the lines of those discussed in previous articles would at first glance appear to be the proper solution, but in most states there is no protection for an individual who retains the right to receive income from the plan. In general, you can't put your assets in trust, keep the right to the income, and still have the property protected. For most physicians this is not a problem. While they are working and earning an income, they don't need the income from the assets for living expenses. They will, however, need the income later on at retirement, when their liability exposure has diminished. But for any physician treating infants or children, this extended liability period creates a financial dilemma.

There are some states that specifically allow asset protection trusts with permitted income distributions to the settler (the person creating the trust), including Delaware, Alaska, and Nevada. If you live in one these states, at least theoretically your problems would be solved (see <http://rjmintz.com/delaware-trust.html> for an explanation of the basic tenets of the Delaware Trust). However, the laws surrounding the application and interpretation of these trusts are unfortunately still too new and as yet untested. These trusts might provide excellent protection for residents or even non-residents, but we won't be able to reach a firm and definite conclusion until they have been challenged in a court and definite judgments have been rendered.

With this in mind, a person in this situation might want to consider an offshore arrangement. A structure can be created in a country that encourages asset protection, permits the settler to be a beneficiary of income distributed by the trust, and provides strong protective features under most circumstances (other than fraud). The advantage of the offshore option is that a creditor will have great practical difficulty mounting a legal challenge in a foreign country that will not enforce US judgments and is governed

by specific laws intended to defeat his or her claim.

Closing Arguments

In most of the cases I analyze for my clients, an offshore component is not necessary and is unlikely to produce sufficient benefits to justify the additional cost, complexity, and legal issues that may arise. However, there are circumstances in which an offshore strategy may be sensible. Examples of such cases include avoiding the risk of an asset freeze and retaining income from protected assets in order to meet living expenses. Although one may be completely comfortable with domestic asset protection plans in most situations, in these cases, offshore techniques may actually be necessary to achieve all of the client's objectives. **MDNG**

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