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A CATHARSIS FOR U.S. TRUST LAW: AMERICAN REFLECTIONS ON THE PANAMA PAPERS

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INTRODUCTION

In April 2016, a massive leak of confidential legal documents, now known as the "Panama Papers," attracted international scrutiny and condemnation of offshore asset protection trust arrangements.[1] Such trusts are legal to create but notoriously susceptible to abuse by wrongdoers seeking to hide assets from the peering eyes of tax collectors and creditors. The International Consortium of Investigative Journalists, a global network of more than 190 journalists,[2] claims to have uncovered 11.5 million documents revealing the secret use of offshore trusts and shell companies by "politicians, fraudsters and drug traffickers as well as billionaires, celebrities and sports stars," who used these arrangements to channel "dark money" around the world.[3] The Panama Papers offer compelling evidence of something long suspected but difficult to prove for lack of transparency—even though asset-offshoring techniques may be used for legitimate purposes, they are, in fact, too often abused as a cover for criminal activity and tax evasion.[4] Commentators have described these offshoring techniques as creating a "black hole for assets" because they attract vast amounts of capital into special purpose entities that are

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1. The International Consortium of Investigative Journalists, which obtained millions of leaked documents from a Panamanian law firm, has not released the raw contents of the leaked files. See Int'l Consortium of Investigative Journalists, About This Project, Pan. Papers (Apr. 3, 2016), http://panamapapers.icij.org/about.html [http://perma.cc/Y35L-WCWW]. Instead, it has established a central website for investigative reporting on the Panama Papers leaks. Int'l Consortium of Investigative Journalists, Pan. Papers, http://panamapapers.icij.org/ [http://perma.cc/CL38-GET4] (last visited July 29, 2016).

2. About the ICIJ, Int'l Consortium Investigative Journalists (Feb. 13, 2012, 5:19 PM), http://www.icij.org/about [http://perma.cc/8SCJ-M9EJ].

3. Int'l Consortium of Investigative Journalists, Giant Leak of Offshore Financial Records Exposes Global Array of Crime and Corruption, Pan. Papers (Apr. 3, 2016), http://panamapapers.icij.org/20160403-panama-papers-global-overview.html [http://perma.cc/9FAB-2W5H].

4. See id. (describing efforts to evade taxes and hide ties to criminal activity).

often invisible to, and unreachable by, the owners' claimants.[5] Offshore trust havens generally allow nonresident settlors to hide assets in secret trusts that are expressly immune from tax liens and liability judgments in the settlors' home countries.[6]

In response to the leak, the U.S. Department of Justice and several foreign law enforcement agencies opened investigations into the financial improprieties uncovered by the Panama Papers.[7] However, before criticizing offshore trust havens for capitalizing on fraudulent behavior at the expense of nonresident claimants, U.S. state lawmakers should first reflect upon the recent wave of domestic trust legislation authorizing similar conduct here at home.[8] This Piece, a patriotic catharsis, laments the recent trend of U.S. trust law to sanitize some of the most controversial and widely abused offshore trust practices and urges lawmakers to take steps toward its reversal.

Part I of this Piece summarizes the Panama Papers scandal and the public reaction to the uncovered offshore trust abuses. Part II examines three aspects of U.S. trust law that authorize asset protection techniques similar to those permitted in offshore trust havens: (1) self-settled asset protection trusts,[9] (2) nonresident tax shelters,[10] and (3) trust secrecy.[11]

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5. See Eric Lipton & Julie Creswell, Panama Papers Show How Rich United States Clients Hid Millions Abroad, N.Y. Times (June 5, 2016), http://www.nytimes.com/2016/06/06/us/panama-papers.html (on file with the *Columbia Law Review*) (describing how one wealthy family moved millions to overseas entities in order to avoid an array of U.S. taxes and limit potential tort liability).

6. See, e.g., International Trusts Act of 1984 § 13D (1999) (Cook Islands) (providing for the nonrecognition of foreign judgments). For an influential treatment of offshore asset protection trust legislation, see Lynn M. LoPucki, The Death of Liability, 106 Yale L.J. 1, 32–38 (1996). For a recent overview of the use of New Zealand trusts for offshore haven purposes, see generally Michael Littlewood, Using New Zealand as a Tax Haven: How Is It Done? Could It Be Stopped? Should It Be Stopped? (Apr. 11, 2016) (unpublished manuscript), http://ssrn.com/abstract=2761993 (on file with the *Columbia Law Review*).

7. See Rupert Neate, Panama Papers: US Launches Criminal Inquiry into Tax Avoidance Claims, Guardian (Apr. 19, 2016, 5:52 PM), http://www.theguardian.com/business/2016/apr/19/panama-papers-us-justice-department-investigation-tax-avoidance [http://perma.cc/UH2X-DCF9] (describing investigations by the U.S. Department of Justice).

8. Nyshka Chandran, Panama Papers Sequel Reveals Details of over 200,000 Offshore Entities, CNBC (May 9, 2016), http://www.cnbc.com/2016/05/09/panama-papers-sequel-reveals-details-of-over-200000-offshore-entities.html [http://perma.cc/VE7H-DG84] (noting that Delaware "boast[s] more secrecy laws than the British Virgin Islands, one of the most famous offshore havens").

9. See Jay A. Soled & Mitchell M. Gans, Asset Preservation and the Evolving Role of Trusts in the Twenty-First Century, 72 Wash. & Lee L. Rev. 257, 289–92 (2015) (describing the effectiveness of domestic self-settled asset protection trusts in protecting trust assets from creditor claims).

10. See Max M. Schanzenbach & Robert H. Sitkoff, Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust, 27 Cardozo L. Rev. 2465, 2466–70 (2006) (documenting the favorable federal transfer-tax incentives for authorizing and using

Finally, Part III discusses existing federal law protections against domestic trust abuse and offers recommendations for reform.

I. The Panama Papers

The Panama Papers are a collection of confidential client files and internal documents of the Panamanian law firm Mossack Fonseca.[12] An early pioneer in offshore asset protection techniques, Mossack Fonseca grew its profitable practice into one of the largest global firms in its industry.[13] While offshore trusts can be used for legitimate purposes, many of Mossack Fonseca's ultrawealthy clients retained the firm to safeguard assets of questionable origin.[14] The Panama Papers revealed that "ponzi schemers, diamond traders, drug kingpins, Ukrainian oligarchs, Saudi Kings, and close associates of Russian President Vladimir Putin" were among the firm's clients.[15] The firm was even linked to an "infamous 1983 gold heist" and is alleged to have been aware that it was managing funds tainted by the "notorious theft."[16] Name Partner Jürgen Mossack, whose father was a member of the Waffen-SS wing of the Nazi Party during World War II, is regarded as a member of the Panamanian elite and reportedly owns significant real estate holdings, a teak plantation, an executive helicopter, and a yacht.[17]

"John Doe," the anonymous source who leaked the Panama Papers, said he released the files to call attention to the criminal activities concealed by Mossack Fonseca's asset protection techniques: "I decided to expose Mossack Fonseca because I thought its founders, employees and clients should have to answer for their roles in these crimes, only some of which have come to light thus far."[18] In a manifesto, John Doe declared that "[i]ncome inequality is one of the defining issues of our time" and

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perpetual trusts); Soled & Gans, supra note 9, at 277–78 (describing the use of nonresident trusts to avoid state income tax imposed by the state of the settlor's residence).

11. See Frances H. Foster, Trust Privacy, 93 Cornell L. Rev. 555, 566 (2008) (describing privacy as a central consideration in American trust law reform).

12. See Kirk Semple et al., Panama Papers Leak Casts Light on a Law Firm Founded on Secrecy, N.Y. Times (Apr. 6, 2016), http://www.nytimes.com/2016/04/07/world/americas/panama-papers-leak-casts-light-on-a-law-firm-founded-on-secrecy.html (on file with the *Columbia Law Review*).

13. See, e.g., Martha M. Hamilton, Panamanian Law Firm Is Gatekeeper to Vast Flow of Murky Offshore Secrets, Pan. Papers (Apr. 3, 2016), http://panamapapers.icij.org/20160403-mossack-fonseca-offshore-secrets.html [http://perma.cc/XB3S-WCZV].

14. Tess Owen, The VICE News Guide to the Panama Papers, VICE News (Apr. 5, 2016), http://news.vice.com/article/panama-papers-mossack-fonseca-leak-tax-haven-shell-company-money-laundering [http://perma.cc/S3RH-BDN3].

15. Id.

16. Id.

17. See Hamilton, supra note 13.

18. John Doe, John Doe's Manifesto, Süddeutsche Zeitung, http://panamapapers.sueddeutsche.de/articles/572c897a5632a39742ed34ef/ (on file with the *Columbia Law Review*) (last visited July 29, 2016).

the problem of economic disparity is largely caused by "massive, pervasive corruption."[19] He explained that the Panama Papers reveal "a wide array of serious crimes that go beyond evading taxes," and he condemned lawyers for their culpability in facilitating illegal conduct under the guise of providing legal counsel.[20]

The Panama Papers scandal sparked an international public outcry, with perhaps the strongest expressions of dissent leveled against high-ranking government officials directly implicated by the Panama Papers.[21] Icelandic Prime Minister Sigmundur David Gunnlaugsson resigned after the Panama Papers revealed that he and his wife had established an offshore company in the British Virgin Islands.[22] Former British Prime Minister David Cameron found himself stumbling to respond to questions about the existence and tax treatment of inherited assets once held in an offshore unit investment trust.[23] He eventually acknowledged his interest in the offshore trust but flatly denied that he (or his father) had used the entity to avoid paying taxes in the United Kingdom.[24] Yet Prime Minister Cameron's denial failed to quiet calls for his resignation,[25] which he later tendered in the wake of the "Brexit" referendum, the public referendum for the United Kingdom to exit the European Union.[26] New Zealand Prime Minister John Key, whose personal attorney maintained a foreign trust practice that worked with Mossack Fonseca and lobbied the Minister of Revenue to retain New Zealand's tax haven laws, was ejected from Parliament following a heated exchange about New Zealand's role in the Panama Papers scandal.[27]

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19. Id.

20. Id. (characterizing lawyers as "deeply corrupt" individuals who "exploit" their understanding of the law instead of using their understanding of the law to "uphold" it).

21. See Steven Erlanger et al., Iceland's Prime Minister Steps Down amid Panama Papers Scandal, N.Y. Times (Apr. 5, 2016), http://www.nytimes.com/2016/04/06/world/europe/panama-papers-iceland.html (on file with the *Columbia Law Review*) (describing calls for resignations of the Prime Ministers of Iceland and Pakistan and a government inquiry into the Prime Minister of the United Kingdom's undisclosed wealth).

22. Id.

23. Rowena Mason, David Cameron's Terrible Week Ends with Calls for Resignation over Panama Papers, Guardian (Apr. 8, 2016, 1:57 PM), http://www.theguardian.com/news/2016/apr/08/david-cameron-panama-papers-offshore-fund-resignation-calls [http://perma.cc/X868-D5E8].

24. Id.

25. Id.

26. See Stephen Castle & Sewell Chan, Theresa May, New British Prime Minister, Gives Boris Johnson a Key Post, N.Y. Times (July 13, 2016), http://www.nytimes.com/2016/07/14/world/europe/david-cameron-theresa-may-prime-minister.html (on file with the *Columbia Law Review*) (noting that Prime Minister Cameron tendered his resignation to Queen Elizabeth II).

27. See David Reid, New Zealand PM Thrown Out of Parliament over Panama Papers, CNBC (May 11, 2016), http://www.cnbc.com/2016/05/11/new-zealand-pm-thrown-out-of-parliament-over-panama-papers.html [http://perma.cc/NNU9-4QST].

Panamanian President Juan Carlos Varela, who was not personally implicated by the Panama Papers, insists that critics should avoid singling out Panama for disproportionate blame.[28] President Varela is correct. Even though a Panamanian law firm features prominently in the scandal, the broader problems of the offshore asset industry can only be understood within the context of a global scourge of tax evasion and money laundering. For the U.S. public, this means that before pointing a sanctimonious finger at Panama for sheltering funds from suspect sources, we ought to reconsider and reflect on the wisdom of domestic trust law reforms within our own borders. Any critique of Panama, or any other foreign trust haven jurisdiction for that matter, is belied by the fact that many reforms in U.S. state trust law were enacted for the purpose of competing against offshore trust havens in the market for out-of-state trust business.[29] This interjurisdictional competition, described by some trust law scholars as a race to the bottom,[30] pits state legislatures against each other as they vie for the status of "most favored" domestic legal forum for out-of-state residents to establish a trust.[31]

II. ASSET PROTECTION FEATURES OF U.S. TRUST LAW

This Part will explain how U.S. states compete against foreign trust havens in the global legal market for nonresident trust business. It will examine, in particular, three asset protection features of U.S. trust law that provide settlor-friendly features similar to those available in foreign trust havens: (1) self-settled asset protection trusts, (2) nonresident tax shelters, and (3) trust secrecy.

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28. Juan Carlos Varela, Opinion, Don't Blame Panama. Tax Evasion Is a Global Problem., N.Y. Times (Apr. 11, 2016), http://www.nytimes.com/2016/04/11/opinion/dont-blame-panama-tax-evasion-is-a-global-problem.html (on file with the *Columbia Law Review*).

29. See infra Part II (discussing the similarities between U.S. state trust law reforms and foreign offshore trust havens).

30. See Stewart E. Sterk, Asset Protection Trusts: Trust Law's Race to the Bottom?, 85 Cornell L. Rev. 1035, 1038 (2000) (discussing how U.S. states have been enacting more provisions that attract trust settlors); cf. Robert M. Sitkoff & Max M. Schanzenbach, Perpetuities, Taxes, and Asset Protection: An Empirical Assessment of the Jurisdictional Competition for Trust Funds ¶ 1400.1 (Harvard John M. Olin Ctr. for Law, Econ. & Bus., Discussion Paper No. 609, 2008), http://ssrn.com/abstract=1095421 (on file with the *Columbia Law Review*) (providing an empirical study of the movement of trust assets in the United States).

31. See H.B. 356, 139th Gen. Assemb., 1st Sess. (Del. 1997) (describing Delaware's authorization of self-settled asset protection trusts as "intended to maintain Delaware's role as the most favored domestic jurisdiction for the establishment of trusts"). Indeed, practitioners now publish annual rankings of state trust law reforms based on settlor-friendly criteria. See Dynasty Trusts and Other Advanced Estate Planning Tools, Law Offices of Oshins & Assocs., LLC, http://www.oshins.com/ [http://perma.cc/7V3U-DTUV] (last visited July 30, 2016) (containing ranking charts comparing state laws on domestic asset protection trusts, dynasty trusts, trust decanting, and nongrantor trust exposure to state income tax).

A. *Self-Settled Asset Protection Trusts*

The authorization of self-settled asset protection trusts, also known as self-settled spendthrift trusts, is perhaps the most profound and pernicious legislative development in the race among U.S. states to compete against foreign trust havens. As explained below, self-settled asset protection trusts are a perversion of traditional rules governing the alienation of trust interests under the common law doctrine of spendthrift trusts.

Under traditional U.S. trust law, the spendthrift doctrine provided potent asset protection against dissipation of the trust corpus by validating the settlor's instruction to restrain a beneficiary's voluntary and involuntary alienation.[32] A spendthrift provision disabled two aspects of a beneficiary's interest in trust property: (1) voluntary alienation, which is a beneficiary's assignment, sale, or other disposition of the right to receive a trust distribution; and (2) involuntary alienation, which is a demand asserted by a creditor against the trustee seeking repayment of a beneficiary's debt obligation.[33] The traditional law of spendthrift trusts permitted the trustee to honor a settlor's instruction to prohibit the distribution of trust assets to anyone aside from the beneficiary. Thus, it was only after a trust distribution had reached the beneficiary's hands that creditors could pursue collection against the erstwhile trust assets.[34]

The original purpose of this body of law was not to protect the beneficiary from her own creditors but rather to expand the *donor's* power to dictate the terms of a voluntary gift.[35] All else equal, no legal relationship exists between a donor and a donee's creditors, so a prospective donor contemplating a gift has no obligation to indemnify the donee's debts and the donee's creditors have no recourse against the donor.[36] Thus, a donor who wishes to make an outright gift to an indebted donee may do so free from attachment by the donee's creditors until after the gift reaches the donee's possession.[37] The spendthrift doc-

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32. See Restatement (Third) of Trusts § 58(1) (Am. Law Inst. 2003) ("[I]f the terms of a trust provide that a beneficial interest shall not be transferable by the beneficiary or subject to claims of the beneficiary's creditors, the restraint on voluntary and involuntary alienation of the interest is valid.").

33. See id. § 58 cmt. a ("A spendthrift trust does not involve restraint on alienability or creditor's rights with respect to property after it is received by the beneficiary from the trustee, but rather is merely a restraint with regard to his rights to future payments under the trust." (quoting George T. Bogert, Trusts § 40 (6th ed. 1987))).

34. See id. § 58 cmt. d(2) ("After the income or principal of a spendthrift trust has been distributed to a beneficiary, however, it can be reached by creditors through the same procedures and in accordance with the same rules that apply generally to property of the beneficiary.").

35. See In re Morgan's Estate, 72 A. 498, 499 (Pa. 1909) ("Spendthrift trusts can have no other justification than is to be found in considerations affecting the donor alone.").

36. See Restatement (Third) of Trusts § 58 cmt. a (explaining the definition and providing a background on spendthrift trusts).

37. Id.

trine expands upon the donor's freedom of disposition by providing similar treatment for gifts in trust. The spendthrift doctrine allows a trustee to distribute assets directly to an indebted beneficiary—free from legal interference by creditors—because creditors could not have attached an outright gift before it reached the donee's possession.[38]

To prevent abuse of spendthrift trusts, the traditional doctrine included an important public policy protection: When a settlor retained a beneficial interest for herself, the settlor's creditors could attach the entirety of the retained interest.[39] By prohibiting self-settled spendthrift trusts, the traditional doctrine prevented individuals from insulating their own assets from their own creditors. Absent this rule, spendthrift trusts could be used to undermine a basic principle of civil liability that limits the enforcement of judgments to the debtor's property.[40] A venerable tradition of U.S. law has long prohibited peonage and imprisonment for nonpayment of debts, so the primary mechanism for enforcement of a civil judgment is a creditor's collection remedy against a debtor's property.[41] Debtors who have no assets, therefore, may escape civil liability because they are effectively judgment proof.

Foreign trust havens, like the Cook Islands, were the first jurisdictions to distort this traditional spendthrift doctrine by abandoning the public policy protections for creditors and openly authorizing self-settled asset protection trusts.[42] This innovation enabled individuals to immunize their *own* assets from their *own* creditors by transferring property to judgment-proof offshore trust havens beyond the jurisdictional reach of the settlor's unpaid creditors. It is, therefore, unsurprising that offshore spendthrift trusts have been used to shelter the illegal fruits of tax evasion, fraud, and money laundering.[43]

Trust havens themselves benefit economically by hosting a lucrative cottage industry of firms catering to the administration of foreign trusts.[44] For example, Mossack Fonseca, the Panamanian law firm targeted by the leak, reportedly maintained a payroll of more than 500

38. Id.

39. Id. § 60 cmt. f.

40. See LoPucki, supra note 6, at 9 ("Courts will enforce a judgment for civil liability against specific property of the debtor, but not against the person of the debtor.").

41. Id. ("[I]mprisonment for debt offends deeply held American values.").

42. Id. at 32–38 (explaining the mechanics of offshore self-settled asset protection trusts in the Cook Islands).

43. See, e.g., FTC v. Affordable Media, LLC, 179 F.3d 1228, 1243 (9th Cir. 1999) (affirming a finding of civil contempt when settlors of a Cook Islands self-settled spendthrift trust refused to repatriate trust assets for restitution owed to victims of the settlors' fraudulent Ponzi scheme).

44. See Adam J. Hirsch, Fear Not the Asset Protection Trust, 27 Cardozo L. Rev. 2685, 2687 (2006) ("States are vying for trust business . . . . Local banks and trust companies comprise the true beneficiaries."); Sterk, supra note 30, at 1060 ("Jurisdictions seeking to become trust havens . . . appear content to draw business to local financial institutions and lawyers, even without direct benefit to the public fisc.").

employees and generated $42 million in revenue in 2013.[45] But trust havens have been rightly criticized for extracting these gains at the cost of undermining broader liability principles, predicated on the enforceability of judgments, and enabling nonresidents to shelter assets associated with illegal conduct.[46] Indeed, the most craven trust havens, like the Cook Islands, protect their own citizens from these abuses by disqualifying local residents from using the local asset protection trust laws.[47]

In the 1990s, with Alaska and Delaware taking the lead, U.S. state legislatures started authorizing domestic self-settled spendthrift trusts.[48] Other states soon followed, with sixteen states now permitting some form of domestic asset protection trust.[49]

This was a problematic development. Prior to the authorization of domestic self-settled trusts, a creditor could set aside a U.S. self-settled spendthrift trust and reach the protected assets by showing that the trust was actually a sham to hinder creditor collection—a fraudulent transfer.[50] Under state fraudulent transfer laws, a creditor could obtain relief by establishing circumstantial proof of the sham—for instance, the debtor's retention of control over assets previously given away to others.[51] However, in twelve of the sixteen states authorizing self-settled asset protection trusts, the trust legislation displaces generally applicable fraudulent transfer law and requires creditors to prove the settlor's *actual* intent to defraud under the highest civil evidentiary standard: clear and convincing evidence.[52] Thus, absent the limitations imposed by federal law (dis-

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45. See Hamilton, supra note 13.

46. See, e.g., Sterk, supra note 30, at 1073 ("Asset protection trusts do, nonetheless, undermine the impact of background legal rules by sheltering from liability tortfeasors who would otherwise be required to compensate their victims.").

47. See, e.g., International Trusts Act of 1984 § 22 (1999) (Cook Islands) ("The provisions of this Act shall not have any application to a beneficiary who is domiciled in the Cook Islands or who is ordinarily resident in the Cook Islands.").

48. See, e.g., Robert H. Sitkoff & Max M. Schanzenbach, Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes, 115 Yale L.J. 356, 381–82 (2005) [hereinafter Sitkoff & Schanzenbach, Jurisdictional Competition] (describing the enactment of the Alaska and Delaware asset protection trust statutes).

49. See Steven Oshins, 7th Annual Domestic Asset Protection Trust State Rankings Chart, Law Offices of Oshins & Assocs., LLP (Apr. 2016), http://www.oshins.com/images/DAPT_Rankings.pdf [http://perma.cc/UW6Q-NGMW] (enumerating and ranking each domestic asset protection trust statute in the United States as of April 2016).

50. See, e.g., Unif. Voidable Transactions Act § 4 (Unif. Law Comm'n 2014) (providing that a debtor's transfer of property is voidable as to a creditor if made with actual intent to hinder creditor collection or made without receiving reasonably equivalent value in exchange for the transfer).

51. Id. § 4(b) cmt. 5.

52. See Oshins, supra note 49 (summarizing the fraudulent transfer standard for each jurisdiction). For an illustrative statutory provision, see Alaska Stat. Ann. § 34.40.110(b)(1) (West 2015) ("[T]he creditor [must] establish[] by clear and convincing evidence that the settlor's transfer of property in trust was made with the intent to defraud that creditor.").

cussed in Part III), many domestic self-settled spendthrift trust state statutes purport to provide a level of asset protection against creditor collection on par with the protections available in offshore trust havens.

B. *Nonresident Tax Shelters*

Trusts are routinely and legitimately used for the purpose of minimizing wealth transfer and income taxes. Estate planning techniques that comply with applicable tax laws are, indeed and unquestionably, legal.[53] To entice nonresident trusts, however, trust havens often seek to complement asset protection laws with tax-friendly techniques that allow nonresident settlors to reduce taxes imposed by sovereign jurisdictions outside the trust haven.

In the offshore trust context, foreign trust havens offer favorable tax treatment for nonresident settlors by imposing no tax on trust income or principal and by creating loopholes that can be used to avoid or minimize a nonresident settlor's tax liability outside the haven. Professor Michael Littlewood recently described how foreign settlors can use New Zealand trust laws to avoid taxes in their home countries with a hypothetical illustration.[54] Suppose a citizen of Portugal who operates an income-producing business in Indonesia conveys title of the Indonesian business to a New Zealand trust.[55] The business is not subject to income tax in New Zealand because, although legal title is now owned by a New Zealand trustee, the settlor's nonresident status exempts the trust from local taxes. The business is not subject to income tax in the high-tax jurisdiction of Portugal because it is not owned by anyone in Portugal.[56] The business is, therefore, only subject to income tax in the low-tax jurisdiction of Indonesia.[57] When the trustee later distributes accumulated income back to the settlor in Portugal, the trustee can use New Zealand trust law techniques to minimize Portuguese income taxes imposed on the trust distributions.[58] By holding title to the foreign income-producing asset in a New Zealand trust, the business owner pays less income tax to Portugal than he would have paid by owning the business outright in Portugal.[59]

Likewise, over the last thirty years, U.S. state legislatures have raced to authorize domestic tax shelters known as "dynasty trusts." Dynasty trusts enable trust settlors (particularly, although not exclusively, nonresident trust settlors) to exploit a loophole of federal wealth transfer tax

53. See Unif. Trust Code § 416 (Unif. Law Comm'n 2010) (authorizing modification of a trust to achieve the settlor's tax objectives).

54. Littlewood, supra note 6, at 2.

55. Id.

56. Id.

57. Id. at 2–3.

58. Id. at 2.

59. Id.

law. As the name suggests, dynasty trusts are multigenerational gifts in trust authorized by states that allow settlors to avoid federal estate taxes imposed on the transfer of wealth from one generation to the next.[60]

A more detailed explanation of this loophole requires some background on U.S. wealth transfer tax law. The federal estate tax is generally imposed on gratuitous transfers of property at death "to the extent of the interest therein of the decedent at the time of his death."[61] The decedent's estate, however, does not include the value of a life tenancy or income interest enjoyed by the decedent during life because, "at the time of his death," a decedent has no interest in such property.[62] Before 1986, a trust settlor could minimize estate taxes by creating a dynasty trust with multigenerational successive life interests (e.g., income to the settlor's children for life, then to the grandchildren for life, and so on).[63] A gift or estate tax might apply to the establishment of the trust, but once settled, the corpus would escape further estate taxation as the trust passed from one generation to the next. To close this perceived loophole, in 1986, Congress enacted the Generation-Skipping Transfer Tax (GST Tax), which imposed a transfer tax equal to the highest estate tax rate on transfers that skip a generation.[64] The GST Tax included an exemption amount equal to the estate tax exemption, currently $5.45 million.[65] To prevent trust settlors from using the GST Tax exemption to make large transfers that would be perpetually exempt from the federal wealth transfer tax system, Congress relied on the state law rule against perpetuities then in effect in almost every state.[66]

At common law, the venerable rule against perpetuities curtailed dead-hand control of property by invalidating contingent future interests that were not certain to vest within a life in being upon the creation of the interest plus twenty-one years.[67] But under the new GST Tax exemp-

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60. Sitkoff & Schanzenbach, Jurisdictional Competition, supra note 48, at 373–77 (explaining the development of dynasty trusts in certain U.S. states).

61. I.R.C. § 2033 (2012).

62. See, e.g., Boris I. Bittker & Lawrence Lokken, Federal Taxation of Income, Estates and Gifts ¶ 125.5 (2d ed. 2016) (explaining that the value of a life estate or income interest enjoyed by the decedent during life is not includable in the decedent's gross estate at death).

63. Sitkoff & Schanzenbach, Jurisdictional Competition, supra note 48, at 370–71.

64. I.R.C. §§ 2601–2663.

65. I.R.C. § 2631(c) ("[T]he GST exemption amount . . . shall be equal to the basic exclusion amount under section 2010(c)."); Rev. Proc. 2015-53, 2015-44 I.R.B. 615.

66. "When Congress originally enacted a tax on generation-skipping transfers, it noted that '[m]ost States have a rule against perpetuities which limits the duration of a trust.'" Staff of J. Comm. on Taxation, 109th Cong., Options to Improve Tax Compliance and Reform Tax Expenditures 394 (Comm. Print 2005) (quoting Staff of J. Comm. on Taxation, 94th Cong., General Explanation of the Tax Reform Act of 1976, at 565 (Comm. Print 1976)).

67. See John Chipman Gray, The Rule Against Perpetuities § 201, at 174 (Roland Gray ed., 3d ed. 1915).

tion, it soon became clear that jurisdictions willing to abolish or abrogate the rule against perpetuities would be the most attractive trust fora for settlors seeking to maximize the long-term value of the GST Tax exemption.[68] A majority of U.S. states have since eliminated the Rule or substantially expanded the vesting period,[69] and an empirical study in 2005 estimated that "roughly $100 billion in trust funds have moved to take advantage of the abolition of the rule."[70] Given that the primary purpose for states to abolish the rule against perpetuities was to attract out-of-state trust business, it should come as no surprise that many of the jurisdictions that abolished the rule also authorized self-settled spendthrift trusts.[71]

Thus, the race among U.S. states to authorize dynasty trusts and other tax-friendly trust law policies[72] share a common purpose and objective with their foreign trust haven counterparts. These policies are designed to give the trust haven a comparative advantage in the competitive market for nonresident trusts and generally complement the jurisdiction's liberal rules on self-settled asset protection trusts.

C. *Trust Secrecy*

Foreign trust havens, mostly located in common law jurisdictions, observe a tradition of respecting trust confidentiality derived from British banking secrecy rules.[73] Under British common law, a banker owed his client an implied contractual duty of confidentiality.[74] Many former

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68. See Sitkoff & Schanzenbach, Jurisdictional Competition, supra note 48, at 373–77 ("As the practicing bar digested the Act and grasped the nature of the GST tax, it became apparent that making use of the transferor's exemption in a perpetual trust had significant long-term tax advantages."); Reid K. Weisbord, Trust Term Extension, 67 Fla. L. Rev. 73, 108 (2015) ("This reform was driven, for the most part, by the desire of state legislatures to attract out-of-state trust business and the perceived economic benefits associated with locating the trustee's situs within the state's jurisdiction.").

69. Howard M. Zaritsky, Am. Coll. of Tr. & Estate Counsel, The Rule Against Perpetuities: A Survey of State (and D.C.) Law 7–8, http://www.actec.org/assets/1/6/Zaritsky_RAP_Survey.pdf [http://perma.cc/KRD4-9QKU] (last updated Mar. 2012).

70. Sitkoff & Schanzenbach, Jurisdictional Competition, supra note 48, at 420.

71. Comparison of the Domestic Asset Protection Statutes, Am. Coll. of Tr. & Estate Counsel (David G. Shaftel ed., 2016), http://www.actec.org/assets/1/6/Shaftel-Comparison-of-the-Domestic-Asset-Protection-Trust-Statutes.pdf [http://perma.cc/E5EZ-GUL8] (last updated Sept. 2015) (noting total number of states that have abolished the rule against perpetuities).

72. For another state trust law tax planning technique, see Soled & Gans, supra note 9, at 277–78 ("One popular technique involves locating so-called incomplete nongrantor . . . trusts in a state (e.g., Delaware) that does not impose an income tax. The goal of establishing an ING trust is straightforward: the elimination of state income tax on the investment income generated by the assets conveyed to the trust.").

73. See Douglas J. Workman, The Use of Offshore Tax Havens for the Purpose of Criminally Evading Income Taxes, 73 J. Crim. L. & Criminology 675, 679 (1982).

74. Id.

British colonies codified and expanded this principle to attract nonresident trust settlors seeking to maintain their assets in strict secrecy.[75]

Following the Panama Papers scandal, New Zealand, a country known for its trust secrecy rules, commissioned a government review of its disclosure requirements for foreign trusts.[76] The inquiry found that trust companies had been marketing nonresident New Zealand trusts by touting the "very limited disclosure requirements around foreign trusts"[77] and concluded that New Zealand's current disclosure regime is inadequate to prevent the abuse of foreign trust arrangements.[78]

The United States does not observe the British common law tradition of banking secrecy, but most states nevertheless impose minimal requirements for trust documentation and generally protect trust information against disclosure to third parties.[79] On the international stage, the United States is one of only a handful of members of the Organization for Economic Cooperation and Development (OECD) that has yet to adopt the most recently recommended standards for combating money laundering and financing terrorism, which include several significant recommendations for stricter documentation and disclosure requirements for trusts and trustees.[80] The Financial Action Task Force's most recent mutual evaluation concluded that U.S. law was not compliant with international standards governing trust documentation and disclosure.[81]

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75. Id.

76. John Shewan, Government Inquiry into Foreign Trust Disclosure Rules 48 (June 20, 2016), http://www.treasury.govt.nz/publications/reviews-consultation/foreign-trust-disclosure-rules/pdfs/report-giftdr-27jun2016.pdf [http://perma.cc/L9UQ-2V73].

77. Id. at 25.

78. Id. at 47.

79. See generally Frances H. Foster, Privacy and the Elusive Quest for Uniformity in the Law of Trusts, 38 Ariz. St. L.J. 713, 716, 728 (2006) ("[R]eformers have balanced privacy against competing concerns and . . . privacy has prevailed.").

80. See Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29,398, 29,444 (May 11, 2016) (to be codified in scattered parts of 31 C.F.R.) ("The United States . . . is currently one of a very small number of FATF members that are not in compliance with its core standard requiring that financial institutions identify and verify the identity of the beneficial owners of legal entity accounts."); Jesse Drucker, The World's Favorite New Tax Haven Is the United States, Bloomberg: BloombergBusinessweek (Jan. 27, 2016), http://www.bloomberg.com/news/articles/2016-01-27/the-world-s-favorite-new-tax-haven-is-the-united-states [http://perma.cc/9R36-HQAE] ("Of the nations the OECD asked to sign on, only a handful have declined: Bahrain, Nauru, Vanuatu—and the United States.").

81. Fin. Action Task Force, Summary of the Third Mutual Evaluation on Anti-Money Laundering and Combating the Financing of Terrorism: United States of America 15 (June 23, 2006), http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20US%20ES.pdf [http://perma.cc/4XDF-ZHQL] (concluding the United States had "no measures in place" to ensure timely access to information on beneficial ownership of trusts by authorities and that such available information was "minimal").

Shell companies, which feature prominently in the illegal activities uncovered by the Panama Papers, can also enhance trust secrecy. A settlor desiring trust secrecy, for example, might establish a Limited Liability Company (LLC) in Delaware without identification, then transfer ownership of the Delaware LLC to a newly created Nevada LLC, and then convey ownership of the Nevada LLC to a Nevada trust.[82]

It is, perhaps, due to these lax documentation and disclosure requirements that the United States is now considered one of the most favorable international trust havens and has attracted assets from offshore jurisdictions that recently tightened their trust-disclosure rules.[83] For example,

> Rothschild [& Co.], the centuries-old European financial institution, has opened a trust company in Reno, Nev., a few blocks from the Harrah's and Eldorado casinos. It is now moving the fortunes of wealthy foreign clients out of offshore havens such as Bermuda, subject to the new international disclosure requirements, and into Rothschild-run trusts in Nevada, which are exempt.[84]

Nevada was undoubtedly attractive to Rothschild because it offers the trust haven trifecta: self-settled asset protection trusts, dynasty trusts coupled with no income tax, and minimal documentation and disclosure requirements.[85] Likewise, South Dakota, another trust haven trifecta state, reported $175 billion in trust assets in 2015, a figure representing a forty-five percent increase over the prior two years.[86]

III. Federal Protections and Policy Recommendations

Part II described three aspects of U.S. *state* trust law resembling the offshore trust haven regimes uncovered by the Panama Papers and excoriated by the press. However, an important U.S. *federal* protection constrains the potential for domestic trust abuse. Federal bankruptcy law, which preempts conflicting state trust law, imposes criminal liability for bankruptcy fraud[87] and expands the two-year lookback period for fraudulent transfers to ten years for creditor claims against a debtor's interest in

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82. See J. Weston Phippen, Nevada, a Tax Haven for Only $174, Atlantic (Apr. 6, 2016), http://www.theatlantic.com/national/archive/2016/04/panama-papers-nevada/476994/ [http://perma.cc/LLD3-6LBJ].

83. Drucker, supra note 80.

84. Id.

85. Nev. Rev. Stat. § 111.1031(3)(b) (2015) (providing for a perpetuities period of 365 years); id. § 166.040(1)(b) (providing for self-settled spendthrift trusts with no requirement of a solvency affidavit).

86. Drew Matthews, Why South Dakota Is a Tax Haven for the Rich, Rapid City J. (Apr. 10, 2016), http://rapidcityjournal.com/news/local/why-south-dakota-is-a-tax-haven-for-the-rich/article_bfe0d2ee-56c4-58fe-a7d0-32354c0b28f8.html [http://perma.cc/9DE5-8THJ].

87. 18 U.S.C. § 157 (2012).

a self-settled spendthrift trust.[88] These federal law protections place the enforceability of state law asset protection trusts in serious doubt: Very few challenges involving domestic self-settled trusts have been litigated in court, and those that have been litigated resulted in the invalidation of state law trust protections asserted by the settlor.[89]

Legal recourse against domestic trust abuse, however, should not have to rely upon federal law prohibitions to preempt state trust laws that enable financial misconduct. Rather, state trust laws should be internally sound and consistent with responsible public policy. For state legislatures willing to reconsider the wisdom of creating domestic trust havens, this Piece offers three guiding principles for reform: first, settlors should not be permitted to use trusts to shelter their own assets from their own creditors; second, states should not enact trust laws for the purpose of allowing nonresidents to exploit out-of-state tax loopholes; and third, states should join the world community by enacting trust documentation and disclosure laws that comply with international standards.

These recommendations are admittedly implausible—states that have succeeded in attracting nonresident trust business are unlikely to now reverse course and unilaterally withdraw from the interjurisdictional race to create the most settlor-friendly trust haven. At the very least, however, lawmakers in those states should reflect on the trust arrangements that have been enacted within their borders and avoid the hypocrisy of blaming offshore trust havens for the abuses revealed by the Panama Papers.

CONCLUSION

Without a doubt, the abuse of offshore trust arrangements uncovered by the Panama Papers leak should be a cause of concern for both the United States and Congress. That said, the leak should also prompt concern and reflection about the growing domestic trust law trend in which state legislatures have attempted to replicate settlor-friendly features of offshore trusts that pose similarly significant risks for abuse here at home. A full appreciation of the Panama Papers scandal is impossible without those in the United States acknowledging that the abuses uncovered are products of a larger global problem of which the United States itself has become a part. Ultimately, the international outcry sparked by the Panama Papers hopefully will serve as a cathartic

88. Compare 11 U.S.C. § 548(a)(1) (2012) (providing for a two-year lookback period for fraudulent transfers), with id. § 548(e)(1) (providing for a ten-year lookback period for fraudulent transfers involving self-settled trusts).

89. See In re Mortensen, No. A09-00565-DMD, 2011 WL 5025249, at *7–8 (Bankr. D. Alaska May 26, 2011) (setting aside Alaska self-settled asset protection trust as a fraudulent transfer under 11 U.S.C. § 548(e)(1) (2006)); Ronald J. Mann, A Fresh Look at State Asset Protection Trust Statutes, 67 Vand. L. Rev. 1741, 1764–66 (2014) (concluding that domestic asset protection trust legislation is unreliable and rarely litigated).

catalyst for reversing this harmful trend in trust law here in the United States.