

Discovery and Treatment of Hidden Assets in Divorce Cases

by

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## Introduction<sup>i</sup>

From time to time, we have all been charged by our clients to "Find the money!" Some use the very phrase quoted; others are less direct. In any event, finding the money is our responsibility in every case. Sometimes, "finding the money" is not as easy as it should be, primarily because assets may be actively concealed from discovery by a party. More frequently is the circumstance in which assets are overlooked or not considered, either for lack of preparation or creativity on the part of counsel. Sometimes such assets are not what we normally consider to be "property," but may nevertheless be quantifiable financial circumstances which exist, which are divisible, and which provide distinct financial benefits to those who possess them.

Unfortunately, one who actively seeks to conceal the existence of an asset in a divorce case has a distinct advantage over the other who seeks to discover it. In this search, the "discoverer" must rely upon the veracity of the other party. This search is not a fair process, and typically requires the "discoverer" to be blindfolded. However, through diligence and effective preparation it is possible to discover assets not disclosed or acknowledged by the other party. The purpose of these materials is to analyze the methods available for discovering concealed assets, and encourage the practitioner to consider new, creative, and unusual assets for inclusion in the marital estate. Additionally, these materials summarize the procedural considerations related to the discovery of marital funds in the hands of a third party. Finally, the materials attempt to enumerate unusual assets which have been recognized around the country and should be considered for their applicability in every case.

### I. Methods of Discovery and Analysis

#### A. Income Tax Returns

Income tax returns are the first place to look for possible clues as to the existence of undisclosed assets. They provide the roadmap to the discovery of income earning assets and asset sales. Typically, the tax return should also describe the source of all income, whether it be rents received from rental property, interest on a bank account, dividends on stocks, gain or loss on the sale of stock, and the like. In reviewing the tax returns, the attached schedules are far more important than the summary entries on the first two pages. In any event, each page of the tax return should be carefully reviewed for the following information:<sup>ii</sup>

1. Form 1040, Page One.<sup>iii</sup>

- a. Income from wages.

Inquiry should be made as to the source of all income reported thereon. It is important to determine how many businesses are represented by the income reported. The W-2 forms filed with the tax return should also be examined carefully, because they detail not only the salary received by a party, but the existence of deferred compensation plans such as 401K or 403(b) or other plans, as well as other fringes.

- b. Interest income.

Entries here reveal whether there are income-earning investments which must be identified. Interest entries which exceed \$400.00 require the filing of a Schedule B with the return, which will specifically identify the income-generating corpus. The parties may also have income from nontaxable investments which are not otherwise disclosed. The income thereon should be reported on the first page of the return, and should lead to the discovery of such assets. It is also possible that tax-exempt income is reported on the state tax return, and not the federal. The existence of such income would lead once again to the existence of assets which generate it. Therefore, the state income tax returns should also be requested and considered when analyzing tax returns for this purpose. Dividend income exceeding \$400.00 also requires the filing of a supplemental Schedule B, identifying the source of the reported dividends.

c. Taxable Refunds of state and local taxes.

Entries on this line (10) indicate whether the parties were overwithheld the previous year, and may lead to an inquiry as to the withholding status for the present year. Sometimes the parties utilize their withholding as a forced savings plan; if so, the existence and whereabouts of overpayment on income taxes should be determined and included in the estate.

d. Retirement plan distributions.

There may be an indication that a party received a distribution from a deferred-compensation plan or IRA account. If so, the funds should be traced to determine their ultimate disposition. The return should also reflect gross income diverted to IRA or Keough plans. Such payments may be traced back, in returns for prior years, to the commencement date and should be followed forward through their ultimate disposition.

2. Form 1040, Page Two:<sup>iv</sup>

a. Carryforward loss or other credits.

The parties may be entitled to credit previous losses against income, and to carry this credit forward annually in increments. Such a credit is obviously of significant financial benefit to the parties and should be considered an asset of the marriage in appropriate circumstances.<sup>v</sup> Additionally, investment credits taken for years prior to 1987 (when the credit was eliminated) will reflect the purchase of an asset during that tax year. The asset may no longer appear on other schedules, having been depreciated off of the books. Therefore, where such credits appear, inquiry should be made as to the origin of the credit and the present status of any asset so acquired.

b. Other taxes.

Counsel should be sure to trace the origin of any withholding taxes. Additionally, an entry on the alternative minimum tax line (51) demonstrates the taxpayer may have tax preferences, which may indicate hidden assets.<sup>vi</sup> Form 6251 contains the alternative minimum tax calculation, which was designed to prevent taxpayers from using shelters and credits to reduce or

eliminate tax that would normally be due by providing for a separate taxing method, creating tax preferences.<sup>vii</sup> The tax preference items reflected on Form 6251 because they may reflect starting points for the discovery of hidden assets. For example, lines 4(c) and 4(d) reflect accelerated depreciation on real estate. Other lines report mining exploration and development costs, research and experimental expenditures, and incentive stock options.<sup>viii</sup> If a stock option received through employment or otherwise has been exercised, its value will be reflected at line 4(j) of the form.<sup>ix</sup>

Line 49 leaves space for recapture. An entry on this line will indicate the sale of a business item which is listed on Form 4797 (ordinary gain or loss from sale of business assets); such an entry necessitates examination of Form 4797 to determine the amount received from the sale of the asset and tracing of the disposition of the proceeds.<sup>x</sup>

c. Taxes due/Refunds.

Returns from previous years should be analyzed to determine the existence of prior tax refunds. Such refunds may be significant, and their disposition should be traced. An unscrupulous opposing party may overpay taxes for a previous year in the expectation of receiving the income after the divorce. The tax refund may be manipulated in other ways, as well. For example, in a recent case in the authors' experience, the husband and wife sold the marital home during the divorce and each bought a new home of his or her own. The husband did not disclose, on his return, that his share of the proceeds had been rolled over into his purchase of the subsequent home. Thus, he realized the gain and its attendant tax liability immediately. The taxes were paid from marital funds during the pendency of the divorce. In truth, however, the husband had purchased the replacement residence within the time frame allowed by law for the deferment of tax on gain. In deposition, his CPA acknowledged the husband's "blunder" and stated the return should be amended. Nevertheless, several months later at trial, the husband had still not amended the return. Such an amendment would have entitled him to a refund of approximately \$35,000.00<sup>xi</sup>

3. Schedule A- Itemized Deductions from Income<sup>xii</sup>

a. State and local income taxes.

Counsel should determine how these were paid, and which governmental entities are involved. It is possible such entries may reflect income generated in another state, as well as the presence of income-generating assets there.

b. Real estate and personal property taxes.

It should be confirmed that the taxes relate to property which has been disclosed. Where discrepancies exist, real property in other jurisdictions should be inquired into.

c. Interest paid, mortgage interest, and points.

Deductions of interest reflect the existence of loans. Such deductions may lead the practitioner to the disposition of loan proceeds, or to the loan application filed to obtain the loan in the first place. Either tidbit of information could prove to be highly valuable in locating undisclosed assets.

Entries in this section of the return may reflect refinancing, especially where points are deducted. Additionally, it should be confirmed that the mortgage interest is being paid on property previously disclosed. If a refinancing occurred, it should be determined what property was refinanced and the disposition of any cash received as a result. Where the parties own real property but no mortgage interest is deducted, counsel should inquire as to the manner of acquisition of the property and the source of payment.

Note also that not all real estate on which taxes are paid appears in Schedule A; property used to earn income or for business purposes would appear, instead, on Schedule E.

d. Investment interest paid.

This entry may reflect the existence of a liability related to an investment.<sup>xiii</sup> Such a liability might include a margin account.

e. Casualty and theft losses.

If a loss is reported, inquiry should be made as to the disposition of insurance proceeds, if any.

f. Miscellaneous deductions.

Typical deductions here include safe deposit box rental expense and other expenses incurred to produce income, as well as tax advice. Estate planning advice may be deductible, and such the presence of such deductions may lead to the existence of an estate planning file containing information about the entire estate.

4. Schedule B- Interest and Dividend Income

Schedule B lists specific sources of interest and dividend income, and when properly prepared should show the precise name of the investment upon which the income is generated. Counsel in the matrimonial proceeding should trace the origin and status of each investment listed to help obtain a comprehensive picture of the parties' assets.

Of particular interest are lines 11 and 12 of the return, regarding foreign accounts and foreign trusts. An entry in this space may be the only clue whatsoever about the existence of what is commonly called a "foreign asset protection trust." Such trusts are generally regulated only by the law of the jurisdiction which is the situs of the trust. Such trusts are treated as "grantor" trusts for U.S. tax purposes, and are described in detail later in these materials. It should be noted, however, that these trusts are very secret, and many of the jurisdictions which serve as the situs of such trusts actually have specific statutes barring disclosure of the existence of the trust by any governmental body.<sup>xiv</sup> Thus, this simple clue as to the existence of the trust should not be overlooked; it may be the only one you ever get.

5. Schedule C- Profit or Loss From Business

The existence of a Schedule C in the Form 1040 may reflect the existence of a side business. Author and accountant Kalman Barson has suggested that one reason for the existence of a side business may be to enable the creation of a Keogh plan to increase retirement plan deductions.<sup>xv</sup> Therefore, the schedule should be examined for this purpose.

6. Schedule D- Capital Gains and Losses

Schedule D reflects the sale of property for gain or loss. It is important, in the hidden asset context, because it provides a starting point for the tracing of proceeds from the sale of the property. Counsel should inquire as to the disposition of the proceeds from sale. It is entirely possible that, in a substantial case, new assets were purchased with the proceeds from a reported sale, and should be pursued.

7. Schedule E- Supplemental Income and Loss

Schedule E shows rental properties, as well as income from partnerships, S corporations, estates and trusts. Again, using the schedule as a starting point, counsel can begin the process of determining the existence and location of any property generating rents, as well as the existence of investments in partnerships and "S" corporations. The schedule may also reflect passive activity loss carryovers which should be considered an additional asset and factored into the prayer at trial or the settlement agreement.

The income from trusts and estates should also be analyzed. If the schedule reflects an interest in a trust or estate which precedes the marriage, and for which the beneficiary claims non-marital status, counsel should inquire as to the source of funds for income taxes incurred on the income generated by these entities. If substantial marital sums have been expended to pay the taxes, an argument for considering these payments as dissipation of marital property may be propounded, and the beneficiary required to assume the loss as part of his share of the marital property ultimately awarded.<sup>xvi</sup>

B. Personal Financial Statements or Loan Applications

Personal financial statements and loan applications are very powerful discovery tools in divorce cases. Such statements are typically prepared in anticipation of obtaining bank financing and show, in uncomplicated fashion, each asset the individual owns, along with his or her estimate of its worth. Also, it is typical that where the spouse maintains an ongoing relationship with lending institutions in business, the institution requires an annual financial statement from the spouse to maintain the line of financing in existence.

Since it is a federal crime to knowingly provide false information to a federally insured banking institution<sup>xvii</sup>, the applicant has a rather stringent obligation to provide truthful information. This, coupled with the practical fact that the applicant may elect to portray himself in the strongest financial light possible to obtain the necessary financing, make personal financial statements among the most important documents available in the discovery process.

By having first reviewed the tax return in the manner described in part "A", above, counsel may determine the existence of residential and rental property without even first seeing the property statement filed with the court. Counsel should inquire, in discovery, as to each and every lending institution with which the party has a loan obligation or a banking relationship. Each institution will probably have such a loan application or financial statement on file and available with the assistance of a subpoena.

A review of all such loan applications or financial statements made in conjunction with the property statement on file in the court proceeding may yield dramatic results. As a practical matter, it is likely the spouse will try to present his financial status in the best possible light for purposes of the divorce, and as a result the property values may be understated, or property may not even be listed. Any such discrepancy in values and specific property must be pursued in discovery to reconcile the difference, if reconciliation is even possible. If it is not possible to reconcile the variance in the loan applications, and if counsel have been unable to trace to the existence of additional undisclosed assets, at the very least it may be possible to present the variance to the court

as some manner of dissipation and asked the court to account for the dissipation in the division of property.

### C. Financial Records of the Business

#### 1. The Balance Sheet

While the balance sheet of a business enterprise is an attempt, for accounting purposes, to reflect the value of the assets and liabilities of the enterprise at a point in time, it should rarely be relied upon as an accurate representation of the existence and value of business assets. For any number of reasons, the balance sheet, by virtue of the very manner of its maintenance, is incapable of presenting a realistic asset picture. For example, the enterprise may carry assets on the balance sheet which have been depreciated over time to a value far below what the asset would bring on the open market. More pertinent to the scope of this presentation is the fact that assets of a going concern may actually never appear on the balance sheet because they were depreciated off of the books. Nor is goodwill typically stated on the balance sheet of a business.

It is generally preferable to prepare or obtain a schedule of fixed assets from the entity for several years running. It is necessary to review several years' worth because assets which have been fully depreciated may have been written off of the books entirely, despite the fact that the asset may still exist and be of substantial value. A walk-through inspection of the business is highly recommended for this purpose.<sup>xviii</sup> The walk-through inspection should be performed by someone knowledgeable about the business being reviewed, or a qualified appraiser of the equipment, machinery, or other business property being considered. The need for an appraisal may be particularly relevant in determining the value of inventory, an asset typically understated for tax purposes.

Another asset which will not appear on a typical balance sheet is unbilled work, or "work in progress" of a professional practice. Depending upon the billing practices of the firm, the work in

progress may represent from one month's billings to six months, or more. Work in progress should be evaluated for its collectability in much the same manner as the firm's receivables are.

Business entities may prepay their taxes just as individuals do. Therefore, it is desirable to review the tax returns of the business over a period of time to insure that, to the extent taxes have been overpaid, that they are reflected as an asset.

Patents and copyrights are also problematic to locate. "In many cases, particularly with small companies, and especially where the patent or copyright was developed internally, the tax practicalities of business life typically dictate that all expenses relating to the development of patents and copyrights be expensed in the normal course of business. As a consequence, nowhere on the company's balance sheet is it reflected that t patent or copyright exists, even for the famous nominal one dollar."<sup>xix</sup>

The possibility of loans to the enterprise by the spouse should be considered and determined. A spouse who has made substantial loans to the business over the years may have "concealed" these funds--simply because no inquiry was ever made.

## 2. Accountant's Work Papers

A review of the work papers of the other spouse's accountant by an accountant you select may yield unanticipated results and information. Do not kid yourself into thinking that a review of these records by you may yield the same results. It is best to have a good working relationship with an accountant who is familiar with your objectives in divorce practice, and who can consult with you from time to time for such purposes.

In many states a codified "Accountant-Client" privilege exists which may prevent the disclosure of such information. It appears no such statutory privilege exists in the states of New York and California. However, representative statutes may be found in states such as Missouri, Pennsylvania, Illinois, Texas and Florida.<sup>xx</sup> In those states where such a privilege exists, it may be waived by the parties' placing his or her financial status in issue.<sup>xxi</sup>

#### D. Government and Public Records/Electronic Research

The advent of the "information superhighway" has yielded access to considerable information which had previously been considered private and unobtainable. Electronic research has also made it possible to search, from central locations, governmental records which would previously have required a physical trip to the office of the county's recorder of deeds for each county in the United States where it was suspected the spouse concealed property. Credit firms and other investigatory enterprises now have the ability to perform electronic searches of banking records, county property records, mortgage information, tax liens, debt and credit obligations, as well as state corporate and fictitious name information.<sup>xxii</sup> Such searches are now readily available at costs which are not unreasonable, given an appropriate case.

#### E. Cash Flow Tracing

It behooves the attorney to test the parties' cash flow for several years prior to the proceeding, up to and including the time of the trial. By examining the cash flow experienced by the parties, the attorney can determine whether all income and assets have been accounted for.<sup>xxiii</sup> A review of all cancelled checks will assist greatly in this undertaking. It is important, in reviewing all of the checks, to rule out payments to other family members, family friends, and determine their origin. Bogus loans to family members and friends, and sham transactions, have been known to occur. Only by performing a detailed examination of cash flow may such unauthorized payments be recognized and quantified.

The cash flow examination is conducted by preparing a spread sheet which lists each and every infusion of cash to the parties during the period in question. Cash infusions relevant to this purpose include income from employment, proceeds realized from the sale of assets, loans taken out from banks or from the parties' closely held or professional corporation, income tax refunds paid to the parties, and the like. After accounting for all cash coming in to the marriage during the relevant period, all known expenditures are deducted. Most of these are obtained from the parties' tax

returns or the adverse party's statement of income and expenses. Such expenditures might include, but not be limited to federal, state and city income taxes paid; social security tax and other deductions from payroll; the monthly expenses sworn to on the affidavit of income and expenses; IRA or profit sharing contributions made; investments known to have been purchased during the relevant period; and any existing order for temporary support obligations or other known support payments being made.

The excess of cash received over known expenditures may indicate the existence of an undisclosed asset such as a bank account or other investment.<sup>xxiv</sup> By studying the parties' cash flow, the attorney puts the burden on the moneyed spouse to account for the missing funds at trial. If the funds cannot be accounted for, the court may consider crediting them to the marital estate in the division of property and awarding them to the party unable to account for their whereabouts. Cash flow studies are a powerful tool for both trial and settlement negotiations.

## II. Procedural Considerations

### A. Joinder of Third Parties

Where third parties claim an interest in marital assets, they may and should be joined in the divorce case so that the interests of all the owners are protected. This is also true where there is no title interest, but there remains an issue as to whether a third party has an interest or possession of property. However, such an order is largely discretionary with the trial court. Where there is evidence that an asset titled in the name of another is in fact owned by one of the parties, a Missouri court included the asset in the estate even though the third party was not joined.<sup>xxv</sup> There is another case in which the divorcing parties, while not holding title to real property held in the names of the husband's parents, were found to have the equitable ownership of the parcel on a resulting trust theory.<sup>xxvi</sup>

In some cases, one of the parties may place assets in joint names with a family member or friend in the misguided notion that such a transaction removes the item from the marital estate. Counsel should also be sensitive to the possible existence of sham transactions, created solely to secret or conceal marital funds. In any circumstance in which a third party has either possession or title of assets believed to rightly belong to the marital estate, consideration should be given to joining the holder as a third-party defendant so the court may adjudicate the ultimate right of ownership of the asset.

### B. Restraining Orders

Sometimes, the client suspects the other party of hiding cash, bearer bonds, jewelry, or other valuable assets in a separate safe deposit box. Such property is so portable that it may not be feasible to advise the unscrupulous party of a desire to inventory the contents of the box. While a restraining order may be obtainable in most states, they are typically worded in general language and many times the banking institutions involved never receive a copy of the order; the parties leave it to each other to abide by the terms of the order.

It is advisable to provide a copy of the restraining order to each and every financial institution known to be involved with the parties' finances. It may be further advisable to specifically mention the parties' safe deposit box in the terms of the order.

It has also been suggested that ex parte relief may be appropriate in a given case in which a notice of hearing, alone, may be enough to spur the other party into action to conceal assets before the hearing.<sup>xxvii</sup> In such cases, the ex parte request should request specific relief, such as a freeze of the box for long enough to perform an inventory in the presence of all counsel and the parties. The application should stress the minimal intrusion being sought, since the inventory can be accomplished in a matter of a few business days.<sup>xxviii</sup> "No one is likely to need access to a safe deposit box during such a short period in the ordinary course of business or for daily living expenses [the necessities of life] --the usual reasons for exceptions to an ongoing restraint on the use of assets."<sup>xxix</sup> Such pre-emptive action requires careful planning. Most family court judges are reluctant to enter specific restraining orders, absent mutual consent, without some showing of imminent harm. Therefore, such motions should not be used injudiciously. The authors have utilized this tool with varying success, in that while the order was obtained, no items of substantial value were discovered.

#### C. Protections Against Dissipation and/or Hiding of Assets

It may be that a cash flow study, such as the one described in part I. D. of these materials, reveals substantial income which cannot be accounted for by the other party. In the example, some \$404,000 was received over five years of the marriage for which the party could not account. Where the dissipation can be determined and quantified, the court may consider it in the division of property.<sup>xxx</sup>

Some courts condition the available relief upon a consideration of different factors, such as whether there was a restraining order in effect or not, what the funds were used for, and the like. In

a recent Michigan case, Sands v. Sands,<sup>xxx1</sup> the appellate court affirmed the trial court's disposition of certain assets, with one exception:

The case before us is a prime example of the burden one spouse's reprehensible behavior can impose upon not only the wronged spouse but also the court system. Under the circumstances revealed by the extensive record presented to us, we find it an abuse of discretion for the trial court not to have taken some sort of punitive action in light of Mr. Sands' persistent attempts to conceal assets...[t]hus, we find it inappropriate for the court to award Mr. Sands any share of assets that he attempted to conceal. Once a spouse intentionally has misled the court or the opposing spouse regarding the existence of an asset, that spouse should be estopped from receiving any part of that property...Accordingly, we remand...We direct the court to award full ownership of these particular assets or their equivalent value to Mrs. Sands before making an equal split of the remaining assets. This course of action should have the salutary effect not only of adjusting the equities in this case but also of serving as a warning to all divorcing parties.<sup>xxxii</sup>

The Sands court followed the recommendations of the Michigan Supreme Court Task Force on Gender Issues in the Courts, which stated "[i]f undisclosed assets are later discovered, there should be a rebuttable presumption that they were deliberately concealed, resulting in the award of 100% of such assets to the injured party unless the presumption is overcome by the non-disclosing party."<sup>xxxiii</sup> The Michigan Supreme Court affirmed the determination of the Court of Appeals, but not without first criticizing its apparent "automatic" rule of forfeiture of the concealed assets.<sup>xxxiv</sup> Nevertheless, the strong language of the Michigan appellate court may prove useful in a case of concealment.

### III. Unusual Assets

#### A. Tax Credits and Carryovers

As stated previously, the parties may be entitled to credit previous tax losses against income and to carry this credit forward annually in increments. Such a credit is obviously of significant financial benefit to the parties and should be considered an asset of the marriage in appropriate circumstances. Additionally, investment credits taken for years prior to 1987, when the investment tax credit was eliminated, will reflect the purchase of an asset during that tax year. The loss carryover may be used annually in increments of up to \$3,000.00 per year. Such an offset against income is a valuable item, and should be considered an asset of the marriage in the division of the property.<sup>xxxv</sup>

#### B. Inchoate Interests

The term "property" should include inchoate interests. For example, an interest in a tax refund to be received the year after filing the joint tax return entitling the parties to the refund, would be an inchoate interest which should be accounted for and divided.<sup>xxxvi</sup>

#### C. Contracts Not Yet Performed

Inquiry should be made as to whether either party is the party to a contract which has not yet been performed. Such contracts may have substantial value and should be considered in dividing the property.

#### D. Stock Options

Stock options, even though as not yet exercised, may have value and should be considered property. In many cases, the options may have been given as part of a compensation package to an employee of a corporation. Cases which have addressed the issue of valuation and distribution of stock options in dissolution matters are listed in the endnotes to these materials.<sup>xxxvii</sup>

#### E. Insurance Premium Renewals

In a Missouri case, a State Farm agent was allowed to keep his renewals earned during the marriage as part of his share of the marital estate, although speculative in amount. The renewals were denominated as marital property by the trial court.<sup>xxxviii</sup>

In a North Dakota case, hail insurance commissions and estate commissions were held to be in the nature of accounts receivable and included in the marital estate.<sup>xxxix</sup>

#### F. Choses in Action

In a Massachusetts case, the husband's pending claim for monetary damages against his former employer was a chose in action subject to division as marital property, since the loss of income and assets related to the claim affected both spouses during the marriage.<sup>xl</sup>

#### G. Tax Exemptions for Minor Children

Although typically the issue of tax exemptions for minor children arises in considering support issues, an Ohio court considered the value of the tax exemptions to be property and divided them.<sup>xli</sup>

#### H. Baseball Card Collection

In a Montana case, a baseball card collection that the husband began as a child was considered marital property subject to division based on that state's statute. The husband was entitled to credit for the value of cards brought in at the time of the marriage, but the wife, who contributed to maintenance and the growth of the collection was entitled to share in its post-marital appreciation in value.<sup>xlii</sup>

#### I. Riparian and Mineral Rights

Riparian and Mineral Rights were held to be part of the marital estate in a Montana case.<sup>xliii</sup>

#### J. Lawfirm Draw Account

A draw account maintained by an attorney at his lawfirm, which was available to him at any time as if it were a bank account or other cash asset, was held to be property for purposes of division by an Oregon court.<sup>xliv</sup>

#### K. Foreign Asset Protection Trusts<sup>xlv</sup>

Foreign Asset Protection Trusts are extremely discreet entities, and few, if any, clues may exist as to their creation and presence. The only clue may be foreign trust income which is declared on Schedule B of the Form 1040, at lines 11 and 12. Since these trusts are treated as "grantor" trusts for U.S. Tax purposes, the income generated on the trust should be reported. These trusts are typically established in remote offshore financial centers such as the Cook Islands, the Bahamas, the Caymans, Gibraltar, Mauritius, and Turks and Caicos. Such Asset Protection Trusts are attractive to individuals desiring minimize personal exposure to liability in a variety of contexts. Typically, these trusts are established under the laws of a foreign jurisdiction providing more favorable and protective treatments for the individual establishing the trust than do the laws of the United States. The trusts are governed by the law of the jurisdiction in which the trust is created. United States law does not apply.

Of special interest is the fact that the trust assets, themselves, need not be located in the remote jurisdiction which is the situs of the trust. So long as the title to the asset is placed in the name of the trust, the trust has ownership of the asset. Such assets even if located in a bank account across the street, may be impossible to locate when titled in the name of such a trust which has not been disclosed.

Most of these jurisdictions do not recognize United States judgments. The trust documents themselves may contain anti-duress provisions which call for the automatic resignation of any U.S. trustee who becomes subject to service of United States process, leaving the international trustee in charge. The foreign trustee has no significant contacts to the United States which would warrant the imposition of United States jurisdiction. While the jurisdiction which is the situs of the trust may recognize causes of action for fraudulent conveyances to defraud creditors, the statutes of limitation on those causes of action are usually very short and, thus, may be of little consequence.

Discovery undertaken in the jurisdictions themselves is rarely fruitful, primarily because those jurisdictions have express secrecy and non-disclosure provisions in their respective international trust legislation. Such provisions prohibit governmental authorities from disclosing the existence of such trusts.<sup>xlvi</sup> In a substantial case, counsel should inquiry directly as to the existence of such a trust with specificity, and should follow-up diligently upon any indication of foreign income appearing on Schedule B to the Form 1040. Otherwise, the existence of such a Foreign Asset Protection Trust will most likely never be discovered, absent voluntary disclosure.

#### IV. Conclusion

Where all else fails, and one spouse successfully conceals the existence of an asset from another, the court may set the decree aside on the basis of fraud for the failure to disclose the asset. Some states, however, have time limitations within which post-judgment relief may be obtained. If the existence of the concealed asset is discovered after the divorce, counsel should immediately seek to set aside the judgment and obtain whatever other relief may be available in equity.

It is also suggested that the Separation Agreement specifically provide that each party actively represent that he or she has made full disclosure of all property in which either has an interest, and that each party should acknowledge that the other party has relied upon this disclosure in reaching the agreement. Such language helps to establish the fraudulent misrepresentation necessary to set aside the decree in a subsequent action.

Finally, counsel should attempt to create realistic expectations in the client as to the ability to discover assets which have been actively concealed. The client should be advised of every step counsel has taken to attempt to discover any suspected concealment, and that despite the best efforts, it is sometimes impossible to locate assets which have been hidden. An educable client is generally a satisfied client.

## ENDNOTES

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Mr. Kaiser has an L.L.M. degree in tax law and is an expert on the creation and management of foreign asset protection trusts. He is a member of the Isle of Man-based Offshore Institute. He provided the authors with the information herein relating to offshore trusts, as well as certain relevant statutes which are otherwise unobtainable.

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Ms. Yannakakis has an L.L.M. degree in tax law and performed a considerable amount of the research used in the preparation of these materials.

ii. See generally Kalman A. Barson, Investigative Accounting in Matrimonial Proceedings, (Prentice Hall Law and Business, 1993); Peggy E. Podell and M. Dee Samuels, editors, The 1040 Handbook: A Guide to Income and Asset Discovery, (American Bar Association Section of Family Law, 1990); R. Victor Haas, Jr., Analysis of Corporate and Personal Tax Returns, in Valuation Strategies in Divorce (Robert D. Feder, Editor, John Wiley and Sons, Inc., 1993).

iii. See Phyllis G. Bossin and Richard J. Kruse, Form 1040, Pages 1 and 2 in The 1040 Handbook: A Guide to Income and Asset Discovery, Podell and Samuels, eds., note 2, above.

iv. Id. at p. 3.

v. The leading case nationally is Mills v. Mills, 663 S.W. 2d 369, (Mo. App.1983), a Missouri appellate court which held such a carryforward constituted a divisible asset of the marriage.

vi. Id. at p. 3.

vii. Id.

viii. Lines 4(a) through (l), Form 6251.

ix. See Bossin and Kruse, Form 6251: Alternative Minimum Tax Computation, in Podell and Samuels, The 1040 Handbook: A Guide to Income and Asset Discovery, supra.

x. Bossin and Kruse, supra, at p. 3.

xi. Unfortunately, despite the presentation of evidence on the issue and a request for allocation of the refund, the trial judge failed to provide for the \$35,000 asset in the decree.

xii. See generally Richard H. Wels and Steven D. Zerlin, Schedule A: Itemized Deductions, in Podell and Samuels, The 1040 Handbook, described above.

xiii. Barson, supra, at p. 247.

xiv. See, for example, the International Trusts Act of 1984 for the Cook Islands, as amended in 1985, 1990, and 1991, at Part V, par. 23:

23. Secrecy- (1) Except where the provisions of this Act require and subject to subsection (2) of this section, it shall be an offense for a person to divulge or communicate to any other person information relating to the establishment, constitution, business undertaking or affairs of an international trust.

(2) All judicial proceedings, other than criminal proceedings relating to international trust shall, unless ordered otherwise be heard in camera and no details of the proceedings shall be published by any person without leave of the Court or person presiding.

xv. Barson, supra, at p. 249.

xvi. Barson, supra, at p. 251.

xvii. 18 U.S.C. §1014 (1989).

xviii. Barson, supra, at p. 111; See also Robert D. Feder, Valuation Strategies in Divorce, (John Wiley and Sons, Inc., 1993) at p. 102.

xix. Barson, supra, at p. 117.

xx. For representative statutes, see Chapter 5533 Illinois Revised Statutes, §27:

A public accountant shall not be required by any court to divulge information or evidence which has been obtained by him in his confidential capacity as a public accountant.

In Texas, Article 41a-1 of the Revised Civil Statutes, Sec. 26, states as follows:

A licensee or a partner,...may not voluntarily disclose information communicated to the licensee by a client in connection with services rendered to the client by the licensee in the practice of public accountancy, except with the permission of the client or a duly appointed representative of the client. This section does not prohibit disclosure by the licensee of information required to be disclosed:...(2) in a court proceeding;...

Therefore, the Texas statute does not preclude the accountant's testimony in court like the Illinois statute, above.

Other representative statutes are §326.151 Missouri Revised Statutes, which precludes compulsion to be examined by judicial process or proceedings without the consent of the client, but states "[t]his privilege shall exist in all cases except when material to the defense of an accountant"; See also Title 63, §9.11a Pennsylvania Statutes Annotated.

xxi. See, for example, State of Missouri, ex rel. Southwestern Bell Publications v. Ryan, 754 S.W. 2d 30 (Mo. App. E.D. 1988).

xxii. As a representative example of the types of services of this nature which are generally available, see the addendum from Milliken & Michaels Commercial Credit Services, 3850 N. Causeway Blvd., 3rd Floor, Metairie, Louisiana 70002, attached to these materials at pp. 29-31.

xxiii. See page 32 for an example of an actual cash flow analysis used by the authors.

xxiv. The Chart at page 32 was prepared for an actual case involving substantial assets and income, and the reader will see it reflects some \$404,000 of incoming cash which is not accounted for on the list of expenditures.

xxv. Cochran v. Cochran, 716 S.W.2d 275 (Mo.App. 1986).

xxvi. Ham v. Ham, 791 S.W.2d 944 (Mo.App. 1985).

xxvii. Robert Kirkman Collins, Box in the Opposition: Freeze Safe Deposit, The Matrimonial Strategist, May, 1990.

xxviii. Id.

xxix. Id.

xxx. See generally Lee J. Russ, Spouse's Dissipation of Marital Assets Prior to Divorce as Factor in Divorce Court's Determination of Property Division, in 41 A.L.R. 4th 416 (1993 Supp.).

- xxxi. 482 N.W. 2d 203 (Mich. App. 1992).
- xxxii. Sands, 482 N.W.2d at 206.
- xxxiii. Final Report of the Michigan Supreme Court Task Force on Gender Issues in the Courts, December, 1989 at 70-71.
- xxxiv. Sands v. Sands, 497 S.W. 2d 493, 496-7 (Mich. 1993).
- xxxv. The leading case nationally is Mills v. Mills, 663 S.W.2d 369 (Mo.App. 1983).
- xxxvi. In Re Summer, 777 S.W.2d 267 (Mo.App. 1989).
- xxxvii. See generally Deborah Akers, The Valuation of Stock Options in Divorce and Dissolution Cases, in American Bar Association Section of Family Law - 1990 Annual Meeting Compendium, (1990). Cases cited and described therein are as follows:
- Baum v. Baum, 584 P.2d 604 (Ariz.App. 1978);  
Warren v. Warren, 407 P.2d 395 (Ariz.App. 1965);  
Richardson v. Richardson, 659 S.W.2d 510 (Sup.Ct.Ark. 1983);  
In Re Marriage of Harrison, 179 Cal.App.3d 1216 (1986);  
In Re Marriage of Nelson, 177 Cal.App.3d 150 (1986);  
In Re Marriage of Hug, 154 Cal.App.3d 780 (1984);  
Cooper v. Cooper, 269 Cal.App.2d 6 (1969);  
Andrews v. Andrews, 409 Su.2d 1135 (Fla.App. 1982);  
In Re Marriage of Moody, 119 Ill.App.3d 1043 (1983);  
Green v. Green, 64 MD.App.122 (1985);  
Lomen v. Lomen, 433 N.W.2d 142 (Minn.App. 1988);  
Salstrom v. Salstrom, 404 N.W.2d 848 (Minn.App. 1987);  
Smith v. Smith, 682 S.W.2d 834 (Mo.App. 1984);  
Mey v. Mey, 149 N.J.Supr. Ct. 188 (1977);  
Chen v. Chen, 416 N.W.2d 661 (Wis.App. 1987).
- xxxviii. Whitworth v. Whitworth, 806 S.W.2d 145 (Mo.App. 1991).
- xxxix. Jondahl v. Jondahl, 344 N.W.2d 63 (N.D. App. 1984).
- xl. Hanify v. Hanify, 526 N.E.2d 1056 (1988).
- xli. In Re Lee, 567 N.E.2d 1350 (1989).
- xlii. In Re Keedy, 813 P.2d 442 (Mont. App. 1991).

xliii. In Re Marriage of Jenson, 631 P.2d 700 (Mont.App.1981)

xliv. In Re Marriage of Franzke, 624 P.2d 232 (Ore. 1981).

xlv. The information in this section was provided by Mr. Philip A. Kaiser, Attorney at Law. Mr. Kaiser practices at 14528 South Outer Forty Drive, Suite 300, St. Louis, Missouri 63017. He has an L.L.M. degree in tax law and is an expert in the creation and management of Foreign Asset Protection Trusts. He is a member of the Isle of Man Based Offshore Institute.

xlvi. See Note 14, above for the International Trust Act of 1984 of the Cook Island and its secrecy provision.