Asset Protection Strategies

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Asset Protection and Estate Planning

What Is Asset Protection?

Asset protection is about protecting assets before the need arises; it is about protecting assets from existing creditors. In other words, the implementation of asset protection strategies is appropriate in situations where an individual is concerned about the claims of future creditors.

Asset protection strategies have piqued the interest of wealthy Americans as the legal system has become increasingly subject to unwarranted litigation. As a result, creditor protection can play a significant role in planning for many individuals. It is important to have a balanced approach, emphasizing both tax planning AND asset protection, not one to the exclusion of the other.

Avoid Fraudulent Transfers

- For asset protection to be effective, it is critical that there is no fraudulent transfer of assets. If a court finds a fraudulent transfer has occurred, the court can undo the transfer and force a transfer of assets to the individual's creditors. The key factors considered in a fraudulent transfer case are:
- Timing: If a creditor's claim existed prior to the transfer, the transfer will likely be considered fraudulent.
- Sales and exchanges: If the individual receives

Estate Planning Tips

All good wealth management includes estate planning as a component. Changes in the tax laws, modern trust conventions and family changes make periodic reviews of estate plans a real necessity. While the contemplation of a your demise is never at the top of anyone's list, there is satisfaction from the feeling that you have taken care of issues and that you have provided for your loved ones. But unwitting mistakes can wreck your careful planning and even lead to family fighting and estrangement.

- ✓ Don't Keep Your Estate Plan A Secret
- ✓ Consider Using Modern Inclusive Definitions of Issue/Descendants
- ✓ Avoid Conflicts of Interest When Selecting Executors/ Trustees
- ✓ Don't Hamstring Your Trustees But Ensure Accountability
- ✓ Consider Trust Protectors for Irrevocable Trusts
- ✓ Trust Beneficiaries Should Not Be Left in the Dark
- ✓ Edit Your Estate Plan Along the Way
- ✓ Consider Possible Changes in Family Circumstances
- ✓ Dispute Resolution Mechanisms

equivalent value in exchange for the transfer, the risk of a fraudulent transfer is lessened.

- Insolvency: If the individual is insolvent (unable to pay debts) before the transfer, the transfer may well be considered fraudulent.

Asset Protection Opportunities

Every state has statutes that protect certain business and personal assets from creditors.

- Many states have enacted homestead exemption laws to protect all or part of a debtor's primary residence from the claims of creditors. Generally, these laws require that the homestead be personally owned as opposed to being held in a family limited partnership or some other entity.

- Some states have statutes protecting life insurance and annuities from creditor's claims. Statutes vary from state to state as to the amount of protection afforded to life insurance and annuity cash values and death benefits.

- Qualified retirement plans are generally protected from judgment creditors. In bankruptcy, qualified retirement plan assets should be protected from almost all creditors, while IRA and Roth IRAs are protected up to an inflation - adjusted $1,000,000 per person. However, in some circumstances, non-bankruptcy creditors may have access, such as alimony/child support or federal tax claims.

Asset protection can also be provided through the use of certain business entities, such as:

- Limited and Family Limited Partnerships: Only general partners are personally liable for partnership debts. A limited partner's liability is limited to his/her investment. State laws vary as to creditors' rights. In many states a creditor's sole remedy against a limited partner is to get a charging order from the court. With a charging order, the creditor can get partnership distributions but has no right to vote or ability to get to the underlying partnership assets.

- Limited Liability Company (LLC): In general, no member of the LLC is liable for LLC debts unless the member makes personal guarantees. States' laws vary, but in most states judgment creditors of an LLC member cannot reach LLC assets. They can only petition the court for a charging order, and protection varies by state. The creditor only has access if a distribution is actually made. Some states have enacted legislation that would allow a court to liquidate the LLC interest to the extent necessary to satisfy creditors.

- Corporations: Generally, shareholders are not personally liable for corporate debts unless the shareholder makes personal guarantees. However, corporate stock may be subject to attachment by a creditor of the shareholder. A Buy-Sell Agreement may allow the company or other shareholders to buy stock that a Court orders transferred to a shareholder's creditor.

Another possible strategy is to use a trust arrangement, such as:

- Foreign Asset Protection Trusts (Offshore Trusts): A significant benefit of a foreign trust is that the creditor will generally have to commence an action in the foreign jurisdiction. Since foreign law controls the availability of those assets, there is considerable discouragement for any creditor who seeks recovery in the foreign jurisdiction.

- Domestic Asset Protection Trust: Normally, if a trust is "self-settled" (i.e., the grantor is also a beneficiary), the grantor's creditors will be able to access trust assets. However, several states have adopted laws that allow a grantor to be a beneficiary of a discretionary trust to some extent without jeopardizing creditor protection. *The trust must be irrevocable*. Generally, some of the trust assets and the trustee must actually be located in the governing state. The grantor can receive distributions from the trust, but only at the discretion of an independent trustee.

- Discretionary Domestic Trust: In a discretionary domestic trust, the grantor makes contributions to the trust, and a third party trustee (who is not the grantor) has complete discretion as to distributions to the beneficiaries, e.g., family members. The protection of the discretionary trust is based upon the nature of the beneficiary's interest, i.e. distributions are made only if the trustee decides to make them. Normally, if a beneficiary has no legal claim to trust property, then neither does the creditor. Discretionary trusts can be created during the grantor's life or at death. When the beneficiary is the trustee, distributions should be limited to those needed for the beneficiary's “health, education, maintenance and support.”

- More About Irrevocable Trusts: Irrevocable trusts shelter assets from creditors and tax. When done correctly, these trusts place your assets beyond the reach of creditors and the IRS. The assets in the irrevocable trust are not included in the value of your estate which is taxed currently at 55%. There are several types of these trusts. Some of these are a GRAT (Grantor Retained Annuity Trust); QTIP (Qualifying Terminable Interest Property Trust); CRT (Charitable Remainder Trust); QPRT (Qualified Personal Residence Trust); SPAT or SPA (Special Power of Appointment Trust) to only name a few.

- Special Power of Appointment Trust (SPA Trust) is an irrevocable trust in which *the settlor is not a beneficiary and no distributions can be made to or for the settlor’s benefit* and includes a special power of appointment which allows the settlor to change trustees, beneficiaries, or terms of the trust (except assets cannot be distributed to or for the settlor’s benefit).

- Qualified Personal Residence Trust provides a means for significantly reducing the estate tax consequences of the family home and one vacation home. The QPRT also provides an excellent asset protection vehicle since you no longer own the property once the trust is established. A QPRT is an irrevocable trust created by the Grantor (yourself) for your own benefit. The Grantor transfers a primary or secondary residence into the trust and retains the continued right to use the residence for the term of the trust. You, as Grantor, select a term of years that the trust will exist. After the trust ends, the residence will pass to the named trust beneficiaries.

There are advantages and disadvantages to each of the above asset protection opportunities as well as complex and significant tax complications that must be discussed with your attorney, financial advisor and CPA and thoroughly understood by you prior to executing these documents.

“Navigating and charting a map of the waters and currents you need to sail to bring you safely home to your particular harbor.”

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