FEATURED · ASSET PROTECTION — CREDITOR PROTECTION & ESTATE PLANNING

FROM THE SHORE *The swell arrives whether or not you prepared for it — which is the entire point of asset protection.*

ASSET PROTECTION & ESTATE PLANNING

Protect It *Before You Need To*

Asset protection works against future creditors, not existing ones. Here are three steps you can take right now — and the structures behind them when you are ready to go further.

TAMARA L. HARPER, ESQ. • 8 MIN READ • ASSET PROTECTION · ESTATE PLANNING

A common misconception is that only wealthy families and people in high-risk professions need an asset protection plan. In reality, anyone can be sued.

A car accident, a foreclosure, unpaid medical bills, or an injured tenant can each produce a monetary judgment large enough to decimate your finances. **Asset protection planning** is the use of legal structures and strategies to safeguard property a creditor might otherwise reach — fully in some cases, partially in others. What it is not is a quick fix for a problem that already exists. Move assets to shield them from a creditor whose claim has already arisen and the transfer can be unwound as fraudulent, with penalties on top. The plan has to be in place before a lawsuit is imminent, let alone filed. And it belongs alongside your tax and estate planning, not instead of it.

AT A GLANCE **What this issue covers**

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FIRST PRINCIPLES

Timing is the whole strategy

Asset protection strategies have drawn steady interest as the legal system has become increasingly subject to unwarranted litigation. Whether they work comes down almost entirely to when you put them in place.

WHAT IT DOES

Protects against future creditors

Planning done while the water is calm

Implementing asset protection is appropriate where you are concerned about the claims of **creditors who do not yet exist** — the accident that hasn't happened, the tenant who hasn't been injured, the deal that hasn't gone wrong. Done early, the structure is simply part of how you hold your property.

WHAT IT CAN'T DO

Undo an existing claim

Transfers made under pressure

It is not a way to move assets beyond the reach of **creditors who already have a claim**. If a court finds a fraudulent transfer occurred, it can undo the transfer and order the assets delivered to those creditors — leaving you worse off than if you had done nothing.

FACTOR	WHAT A COURT LOOKS AT Fraudulent transfer analysis	PRACTICAL EFFECT On your planning
TIMING	Whether the creditor's claim **existed before the transfer**	If it did, the transfer will likely be treated as **fraudulent**
SALES & EXCHANGES	Whether you received **equivalent value** in exchange	Fair-value exchanges **lessen the risk** considerably
INSOLVENCY	Whether you were **unable to pay your debts** beforehand	Transfers made while insolvent are **readily unwound**

> *It is important to have a balanced approach, emphasizing both tax planning and asset protection — not one to the exclusion of the other.*
>
> TAMARA L. HARPER, ESQ.

Creditor protection can play a significant role in planning for many individuals, and it rarely stands on its own. The structures that shelter assets from a judgment are frequently the same ones that move value out of your taxable estate, name who receives it, and decide who administers it. That overlap is an advantage — but only if the documents are drafted to work together. Later in this issue we look at where asset protection and estate planning meet, and the mistakes that quietly undo both.

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START HERE

Three tips you can use now

Before any trust or holding structure, three moves protect most people most of the time — and none of them require exotic planning.

01

TIP ONE

Load up on liability insurance

The first line of defense is insurance — homeowner's, automobile, business, professional, malpractice, long-term care, and umbrella policies. Liability coverage not only provides a means to pay money damages, it often covers all or part of the **legal fees** of defending the claim. If you do not have an umbrella policy, now is the time: it is inexpensive compared with more advanced protection. Check that your policy limits are in line with your **net worth**, and review every policy annually to confirm coverage is still adequate and that benefits haven't been stripped to hold premiums flat.

02

TIP TWO

Maximize contributions to your 401(k) or IRA

Under federal law, tax-favored retirement accounts — including 401(k)s and IRAs, but **excluding inherited IRAs** — are protected from creditors in bankruptcy, subject to certain limits. Maximizing contributions to your company's 401(k) is therefore both a smart way to build retirement savings and a way to move those investments out of reach. If your employer offers no plan, fund an IRA for the same reasons. Note that non-bankruptcy creditors can still reach retirement assets in narrow circumstances, such as alimony, child support, or federal tax claims.

03

TIP THREE

Move rental or investment real estate into an LLC

If you are a landlord, flipper, or investor, then aside from good liability insurance, holding real estate in a **limited liability company** is one of the most effective steps available. Work with an attorney who knows the LLC law of the state where the property sits — protection varies, and single-member LLCs are treated differently from multi-member LLCs in some states.

LIABILITY TYPE ONE

Inside liability

The property is the source of the claim

A slip and fall on the property, or a fire caused by faulty wiring. The creditor wants to reach the member's **personal** assets. An LLC limits that exposure to the value of the property itself.

LIABILITY TYPE TWO

Outside liability

The owner is the source of the claim

A creditor of the LLC's owner wants to seize **LLC** assets to satisfy a personal debt. In many states they cannot reach the ownership interest at all — at most they receive the member's share of distributions, with no voting or management rights. This is **charging order** protection.

Properly structured, that combination means a creditor has to look to your liability insurance and any unprotected assets to collect — not to the LLC. It is the clearest illustration of the principle behind this entire issue: the protection has to exist before the claim does.

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WHAT THE LAW ALREADY GIVES YOU

Statutory exemptions

Every state has statutes that protect certain business and personal assets from creditors. Knowing which apply to you is free — and it changes what else you need.

01

Homestead exemptions

Many states protect all or part of a debtor's primary residence. These laws generally require the homestead be owned personally, rather than through a family limited partnership or other entity.

02

Life insurance & annuities

Some states shield life insurance and annuities from creditors' claims. The amount of protection afforded to cash values and death benefits varies considerably from state to state.

03

Qualified retirement plans

Generally protected from judgment creditors. In bankruptcy, qualified plan assets are protected from nearly all creditors; IRAs and Roth IRAs are protected up to an inflation-adjusted cap per person.

04

The exceptions that remain

Even protected accounts are not absolutely safe. Outside bankruptcy, certain creditors may still have access — alimony and child support obligations, and federal tax claims, among them.

ENTITY STRUCTURES

Protection through how you hold the business

Asset protection can also come from the entity itself. State law governs how far each shield extends.

ENTITY	PERSONAL LIABILITY For entity debts	WHAT A CREDITOR CAN REACH Varies by state
LIMITED & FAMILY LIMITED PARTNERSHIPS	Only **general partners** are personally liable; a limited partner's exposure is capped at their investment	In many states the sole remedy is a **charging order** — distributions only, no vote, no access to partnership assets
LIMITED LIABILITY COMPANY	No member is liable for LLC debts **unless they give a personal guarantee**	Usually a **charging order**, payable only if a distribution is made. Some states allow a court to liquidate the interest to satisfy creditors
CORPORATION	Shareholders are generally not liable absent a **personal guarantee**	Corporate **stock can be attached**. A buy-sell agreement can let the company or other shareholders purchase shares a court orders transferred

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GOING FURTHER

Trust arrangements

Where insurance and entities are not enough, a trust can place assets beyond the reach of a future creditor — and, correctly drafted, outside your taxable estate as well.

1 Domestic asset protection trust

Ordinarily a **self-settled** trust — one where the grantor is also a beneficiary — is reachable by the grantor's creditors. Several states now permit a grantor to be a discretionary beneficiary without losing protection. The trust must be irrevocable, some assets and the trustee generally must sit in the governing state, and distributions come only at an **independent trustee's** discretion.

2 Discretionary domestic trust

The grantor funds the trust and a **third-party trustee** holds complete discretion over distributions to family beneficiaries. Protection follows from the nature of the interest: if a beneficiary has no legal claim to trust property, neither does their creditor. Where the beneficiary serves as trustee, limit distributions to **health, education, maintenance and support**.

3 Foreign (offshore) trust

A significant benefit is procedural: a creditor generally must bring its action in the **foreign jurisdiction**, under that jurisdiction's law. The cost and difficulty of doing so is considerable discouragement. These trusts carry substantial reporting obligations and should never be entered into casually.

4 Irrevocable trusts, generally

Done correctly, an irrevocable trust shelters assets from creditors and removes them from the value of your taxable estate. The family includes the **GRAT** (grantor retained annuity trust), **QTIP** (qualifying terminable interest property trust), **CRT** (charitable remainder trust), **QPRT**, and **SPA** trust, among others.

5 Special power of appointment trust

An irrevocable trust in which the settlor is **not** a beneficiary and no distributions may be made for the settlor's benefit. A special power of appointment lets the settlor change trustees, beneficiaries, or the terms of the trust — everything except directing assets back to themselves.

6 Qualified personal residence trust

A QPRT significantly reduces the estate-tax consequences of a family home and one vacation home, and protects the property because you no longer own it once the trust is established. You transfer the residence in, keep the right to use it for a term of years you select, and at the end of the term it passes to the named beneficiaries.

BEFORE YOU SIGN ANYTHING

Every one of these carries trade-offs and significant tax consequences

There are advantages and disadvantages to each strategy above, along with complex tax implications that must be discussed with your attorney, financial advisor, and CPA — and thoroughly understood by you — before any document is executed. Irrevocable means irrevocable.

Sheltered water, a few feet from the open ocean.

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WHERE THE TWO MEET

Your estate plan is part of the shield

All good wealth management includes estate planning. Changes in tax law, modern trust conventions, and shifting family circumstances make periodic review a necessity — and unwitting mistakes can wreck careful planning, or start a family fight.

- **Don't keep your estate plan a secret.**
  Beneficiaries left in the dark are the ones who contest. Tell the people who need to know what you have planned, and why, while you are here to explain it.
- **Use modern, inclusive definitions of issue and descendants.**
  Adoption, assisted reproduction, and blended families all turn on definitions written decades ago. Update the language so your plan includes the people you intend.
- **Avoid conflicts of interest when naming executors and trustees.**
  A fiduciary who is also a beneficiary — or a beneficiary's spouse — invites the appearance of self-dealing even when none exists.
- **Don't hamstring your trustees, but do ensure accountability.**
  Give them the discretion to respond to circumstances you cannot foresee, paired with reporting duties. For irrevocable trusts, consider a trust protector to make changes you no longer can.
- **Edit the plan along the way.**
  Marriage, divorce, disability, a beneficiary's creditors, a move out of state — each is a reason to revisit the documents rather than assume they still fit.
- **Build in dispute resolution mechanisms.**
  A mediation or arbitration clause keeps disagreements among fiduciaries and beneficiaries out of court, and out of the public record.

LET'S TALK

You worked hard for it. Don't let one lawsuit take it.

We evaluate your exposure, coordinate protection with your tax and estate planning, and build a plan that fits your situation — for your business and your family, from beginning to end.

BOOK A MEETING →

CALL 805-409-0530 ↗

FOR YOUR READING LIST

- → California homestead exemption — CCP § 704.730
  leginfo.legislature.ca.gov · indexed annually for inflation
- → Retirement plans in bankruptcy — IRS
  irs.gov · protection limits for qualified plans and IRAs

A note from counsel

Navigating and charting a map of the waters and currents you need to sail to bring you safely home to your particular harbor — that is what this work is. Contemplating your own demise is never at the top of anyone's list, but there is real satisfaction in knowing the issues are handled and your people are provided for.

This article is provided for general informational purposes and does not constitute legal advice. Asset protection and estate planning strategies vary significantly by state, carry substantial tax consequences, and are ineffective — or unlawful — if implemented after a claim has arisen. For guidance specific to your situation, please contact our office in Westlake Village, California.