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## Asset Protection

If you find this article useful, please feel free to contact me or go to our website to find even more articles and information on how to grow, protect, preserve, utilize and transfer your wealth.

Wealth Management is more than just investments. It encompasses a disciplined professional approach, using a broad range of services and an experienced team of advisers.

I can help you put together your specialized team of investment, tax, legal and insurance advisers and then lead the development and implementation of your integrated wealth management plan.

If you are within 10 years of retirement, let me help you understand how the retirement landscape has changed and how these changes can impact your current and future financial decisions.



## Asset Protection

### Introduction

If you haven't done any asset protection planning, your wealth is vulnerable to potential future creditors and, should the worst happen, you could lose everything.



Lawsuits, taxes, accidents, and other financial risks are facts of everyday life. And though you'd like to believe that you're safe, misfortune can befall even the most careful person. What can you do? First, identify your potential loss exposure, then implement strategies that are designed to help reduce that exposure without compromising your other estate and financial planning objectives.

### First, a word about fraudulent transfers

Part of your overall asset protection plan might include repositioning assets to make it legally difficult for potential future creditors to reach them. This does not, however, extend to actions that hide assets or defraud creditors. If a court finds that your asset protection plans were made with the intent to defraud, it will disregard those plans and make the assets available to creditors. How can you avoid running afoul of the fraudulent transfer laws?

- Make sure your plans are made for legitimate business purposes or to accomplish legitimate estate planning objectives
- Carefully document the legitimate business and estate planning purposes of any arrangements you make

- Put your plans into effect before you have any problems with creditors
- Do not implement a plan at a time when a lawsuit is imminent or pending or at a time when you have an outstanding debt that you believe you may be unable to pay

### Where the dangers lie

Unexpected liability can come from just about anywhere:

- The IRS and other tax authorities
- Accident victims, including victims whose injuries were caused by the actions of minor children or employees
- Doctors, hospitals, nursing homes, and other health-care providers
- Credit card companies
- Business creditors, including employees and former employees, governmental agencies, suppliers, customers, partners, shareholders, and the general public
- Creditors of other individuals, where you have co-signed or guaranteed obligations for those individuals
- Marital or other live-in partners

### Asset protection techniques

There are three basic asset protection techniques: insurance, statutory protection, and asset placement. None of these techniques is a complete solution by itself, but may make sense as one limited component of an asset protection plan.

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## Insurance

The simplest way to cope with risk is to shift the risk to an insurance company. This should be your first line of defense. Before you do anything else, review your existing coverage. Then consider purchasing or increasing coverage on your insurance policies as appropriate. You should be adequately insured against:

- Death and disability
- Medical risk, including long-term care
- Liability and property loss (both personal and business)
- Other business losses



## Statutory protection

Creditors can't enforce a lien or judgment against property that is exempt under federal or state law. While exemption planning can't offer total protection, it can offer some shelter for certain assets.

Both federal and state laws govern whether property is exempt or nonexempt in nonbankruptcy proceedings (separate federal and state laws govern whether property is exempt or nonexempt in bankruptcy proceedings). Generally, you can choose whether the federal exemption or the state exemption applies. When looking at exemption laws, be sure to find out how much of an exemption is allowed for a particular type of property--it may be completely exempt, or exempt only up to a certain amount or restricted in some way. Types of property often receiving an exemption include:

- Homestead (principal residence)
- Personal property
- Motor vehicle
- IRAs, pension plans, and Keogh plans
- Prepaid college tuition plans
- Life insurance benefits and cash value

- Proceeds of life insurance
- Proceeds of annuities
- Wages

**Tip:** *In those jurisdictions that recognize ownership by tenancy by the entirety (TBE), creditors of the husband or creditors of the wife cannot reach TBE assets.*

## Asset placement

Asset placement refers to transferring legal ownership of assets to other persons or entities, such as corporations, limited partnerships, and trusts. The basis for this technique is simple--creditors can't reach property that you do not own or control.

### **Shifting assets to the spouse who is less exposed to claims**

If you have high exposure to potential liability because of your occupation or business, it may be advisable for you to shift assets to your spouse. Your spouse would retain the assets that are subject to the exposure as his or her separate property, and you would retain assets that enjoy statutory protection, such as the homestead, life insurance, and annuities, as separate property. Furthermore, the shifting of assets to a spouse or children may help accomplish other estate planning goals.

**Caution:** *To avoid complications in the event that your marriage ends in divorce, both you and your spouse should agree to the division of assets in writing. This is especially important in community property states.*



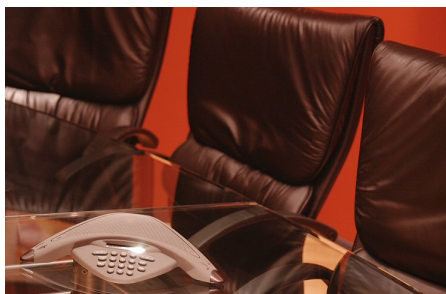
***The simplest way to cope with risk is to shift the risk to an insurance company. This should be your first line of defense.***

### **C corporations**

If you own a business and aren't already a C corporation, changing your business structure to a C corporation will make it a separate legal entity in the eyes of the law. As such, a C corporation owns the business assets and is responsible for all business debts. Thus, incorporating your business separates your business assets from your personal assets, so your personal assets will generally not be at risk for the acts of the business.

**Caution:** *The limited liability feature may be lost if, for example, the corporation acts in bad faith, fails to observe corporate formalities (e.g., organizational meetings), has its assets drained (e.g., unreasonably high salaries paid to shareholder-employees), is inadequately funded, or has its funds commingled with shareholders' funds.*

**Caution:** *A number of issues should be considered when selecting a form of business entity, including tax considerations. Consult an attorney and tax professional.*



### **Limited liability companies (LLCs) and partnerships (LLPs and FLPs)**

An LLC is a hybrid of a general partnership and a C corporation. Like a partnership, income and tax liabilities pass through to the members, and the LLC is not double-taxed as a separate entity. And, like a C corporation, an LLC is considered a separate legal entity that can be used to own business assets and incur debt, protecting your personal assets from other nontax claims against the LLC.

Professionals (e.g., doctors, lawyers, and accountants) face liability for damages that result from the performance of their professional duties. While no business structure will protect you from personal liability for your professional activities, an LLP will protect you from the professional mistakes of your partners. That is, if one of your partners is sued, and the LLP is also named in the lawsuit, any malpractice judgment is the personal liability of the partner who's been sued, but a business liability for you and the other partners. Your personal assets aren't at

stake if your partner commits malpractice, although your investment in the business may still be at risk.



An FLP is a limited liability partnership formed by family members only. At least one family member is a general partner; the others are limited partners. A creditor can't obtain a judgment against the FLP—it can only obtain a charging order. The charging order only allows the creditor to receive any income distributed by the general partner. It does not allow the creditor access to the assets of the FLP. Thus, a charging order is not an attractive remedy to most creditors. As a result, the limitation to seeking a charging order can often convince a creditor to settle on more reasonable terms than might otherwise be possible.

### **Protective trusts in general**

A protective trust can protect both business and personal assets from most creditors' claims. A trust works because it splits ownership of trust assets; the trustee has equity ownership and the beneficiaries have beneficial ownership. Essentially, a protective trust works like this:

**Example:** *Harry would like to leave property to Wendy. However, Harry is afraid that his creditors might claim the property before he dies and that Wendy will receive none of it. Harry establishes a trust with both himself and Wendy as the beneficiaries. The trustee is instructed to allow Harry to receive income from the trust until Harry dies and then to distribute the remaining assets to Wendy. The trust assets are then safe from being claimed by Harry's creditors, so long as the debt was entered into after the trust's creation.*

*Under these circumstances, any of Harry's creditors would be able to reach assets in the trust only to the extent of Harry's beneficial interest in the trust. Say that Harry's interest in the trust is a fixed income distribution each month in the amount of \$1,000. Assuming Harry's creditors obtained a judgment, they would only be entitled to the \$1,000 per month.*

### **Irrevocable trusts**

As the name implies, an irrevocable trust is a trust that you can't revoke or change. Once you have established the trust, you can't dissolve the trust, change the beneficiaries, remove assets from the trust, or change its terms. In short, you lose control of the assets once they become part of the trust. But, because the assets are out of your control, they're generally beyond the reach of creditors too. You may further protect those assets from your beneficiaries' creditors by using special language (known as a spendthrift clause) in the trust.

**Caution:** *Unlike an irrevocable trust, a revocable trust provides the assets in the trust with absolutely no legal protection from your creditors.*



### **Offshore (foreign) trusts**

It's possible to transfer assets to trusts that are formed in foreign countries (certain countries are preferred). While the laws of each country are different, they share one similarity--they make it more difficult for creditors to reach trust assets.

Here's how it works: In order for a creditor to be able to reach assets held in a trust, a court must have jurisdiction over the trustee or the trust assets. Where the trust is properly established in a foreign country, obtaining jurisdiction over the trustee in a U.S. court action will not be possible. Thus, a U.S. court will be unable to exert any of its powers over the offshore trustee.

So, the creditor must commence the suit in the offshore jurisdiction. The creditor can't use its U.S. attorney; it must use a local attorney. Typically, a local attorney will not take the case on a contingency fee basis. Therefore, if a creditor wants to pursue litigation in the offshore jurisdiction, it must be prepared to pay the foreign attorney up front. To make

matters even less convenient, many jurisdictions require the creditor to post a bond or other surety to guarantee the payment of any costs that the court may impose against the creditor if it is unsuccessful. Taken as a whole, these obstacles have the general effect of deterring creditors from pursuing action.

### **Domestic self-settled trusts**

The laws in Alaska, Delaware, and a few other states enable you to set up a self-settled trust. Alaska was the first state to enact such an anti-creditor trust act, and Delaware quickly followed. Hence, this type of trust is often called an Alaska/Delaware trust (sometimes also referred to as a domestic asset protection trust, or DAPT). A self-settled trust is a trust in which the person who creates the trust (the grantor) can name himself or herself as the primary beneficiary. These trusts give the trustee wide latitude to pay as much or as little of the trust assets to any or all of the eligible beneficiaries as the trustee deems appropriate. The key to this type of protective trust is that the trustee has the discretion to distribute or not distribute the trust property. Creditors can only reach property that the beneficiary has the legal right to receive. Therefore, the trust property will not be considered the beneficiary's property, and any creditors of the beneficiary will be unable to reach it.

**Caution:** *Domestic self-settled trusts may not be as effective as a foreign trust, because a judgment from an individual state must be honored by another state under the United States Constitution.*



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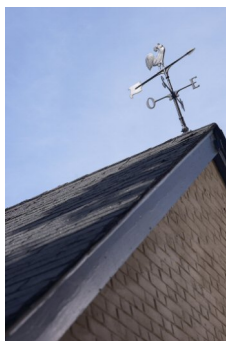
## State Homestead Laws

### The origin of state homestead laws

The federal Homestead Act, which was enacted in 1862, offered free 160-acre parcels of land to anyone willing to settle on them. After five years, these "homesteaders" would become the owners of the land, as long as certain conditions were met (such as building a house and living on the property). Though this act was repealed in 1976, many states have enacted their own homestead laws. If your state has one, it may protect some or all of the equity in your home against certain creditor claims.

**Caution:** *A homestead filing will protect your home from most debts (including judgments) that arise after the homestead becomes effective. It generally will not protect a home from debts incurred before the homestead status attaches.*

**Caution:** *While the homestead laws in some states may substantially protect your residence from unsecured creditor claims, even through a bankruptcy filing, this is not always the case. You should consult an attorney about the protection offered by your state's homestead laws and other asset protection strategies.*



### What homestead laws do

State homestead laws vary widely from state to state. Some offer property tax relief or other specific tax considerations to real estate owners. Generally speaking, however, most state homestead laws allow you to exempt a specified amount of the equity in your homestead property from attachment and seizure efforts by certain unsecured creditors. The intent of these laws is to ensure that you won't be forced to sell your home if you're otherwise unable to pay certain debts.

### How to obtain homestead law protection

The process of acquiring homestead law protection varies from state to state. Some states require you to live in the state for a certain length of time before

you become eligible for homestead law protection. In a few states, coverage is automatic. In most states, however, someone who is named on the deed to the property and who lives there must file a notarized declaration of homestead form with a local government office, such as a registry of deeds.

Generally, the property you homestead must be property that you own and occupy as your primary residence. In most states, property eligible for homestead law protection includes a single-family or multifamily home (and its lot), a condominium unit, or a mobile home.

### Protection limits

Homestead laws exempt from attachment a certain amount of the equity value in the homestead property. A few states offer unlimited protection; in Florida, for example, the homestead law completely exempts a multimillion-dollar mansion's total value from attachment by certain unsecured creditors. Most states, however, assign a limit to the amount of protection offered by their homestead laws. These limits vary widely. For instance, an individual homeowner in California may be eligible for only \$50,000 in exemption protection, while the same homeowner in Massachusetts would receive \$500,000 in protection.

**Example:** *You are a single individual, your home is valued at \$450,000, and it carries a mortgage lien of \$200,000 against it. Your equity is then \$250,000 (\$450,000 - \$200,000). If you live in California, you may use the homestead law there to protect \$50,000 of that equity, leaving \$200,000 unprotected. However, if you live in Massachusetts, your state's homestead declaration exempts all \$250,000 of your equity from unsecured creditor attachment.*

It's important to note that the homestead laws do not automatically prevent a forced sale of your primary residence to satisfy a creditor claim. In the example above, if you live in California, the sale of your home could be forced to satisfy such a claim, since the creditor could be paid from the sale's equity proceeds over and above the amount the homestead law exempts from attachment. If you live in Massachusetts, however, the homestead law would exempt up to \$500,000 of a sale's equity proceeds from attachment; in this case, there would be no point in a creditor forcing a sale of the property to satisfy a claim.

**Caution:** *If the equity value of your property increases over time (as your mortgage balance decreases and/or property values rise), it may exceed the exemption protection allowed by your state's homestead law. In that event, should a forced sale occur to satisfy a creditor claim, the homestead law would protect some, but not all, of the equity in your home.*

## Some creditors are not subject to homestead law protections

Homestead laws do not protect your home from all creditors. Generally, these laws exempt a portion of the equity in your principal residence from attachment by creditors to whom you owe unsecured debts (e.g., medical bills, credit card balances, and personal loans), even if the creditor has obtained a court judgment against you.

Other debts are simply not subject to the exemption protection homestead laws offer. These include:

- Mortgages, second mortgages, home equity loans or lines of credit secured by the property
- Mechanic's liens for labor and/or materials provided to construct, alter, improve, or repair the property
- Federal, state, or local income taxes; property taxes; or other assessments
- Debts owed to government agencies, such as federal student loans or state Medicaid liens
- Court-ordered support of a spouse or minor children

## Homestead laws and bankruptcy

State homestead laws can profoundly affect whether or not you may keep your home in bankruptcy. In bankruptcy, you are not required to surrender exempt property to satisfy the claims of creditors. The federal government allows individuals a \$20,200 (as of 4/1/07) exemption in bankruptcy for real estate used as a primary residence. This federal exemption can vary significantly from what you may be allowed to keep under your state's exemption laws.

Some states require you to follow their exemption laws when filing for bankruptcy. In such cases, you'll have no choice about the amount of your home exemption; you'll be able to keep what your state's homestead law allows. Other states allow you to choose between the federal and state exemption laws. In states where you have a choice, your decision about how to file for bankruptcy may turn in part on which set of rules allows you to keep the greatest amount of your home's value. In such cases, if your state homestead law allows a more liberal home exemption than the one allowed by the federal law, filing for bankruptcy under the state exemption laws may increase the probability that you'll keep your home, particularly if you have substantial equity in it.

**Example:** Jimmy, a single individual, lives in Georgia, where he owns a modest home valued at \$100,000. When he files for Chapter 7 bankruptcy against \$97,000 in unsecured debt, he is required to do so under the Georgia exemption laws, which al-

low him to keep a homestead worth only \$5,000. Since the value of his home exceeds that amount, he must sell his home, keep \$5,000 of the sale proceeds as allowed by the state exemption laws, and distribute the remainder to the creditors named in his bankruptcy petition to partially satisfy their claims.

Meanwhile, George, a single individual, lives in Texas, where he owns a ranch valued at \$750,000. When he files for Chapter 7 bankruptcy against \$325,000 in unsecured debt, he is allowed to elect either the federal or the state exemption laws. Since Texas homestead law exempts a residence of unlimited value, George chooses to file under the state exemption laws. He is not required to sell his ranch to raise money to satisfy the creditors named in his bankruptcy petition.

For bankruptcy filings made on or after April 20, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 imposes certain restrictions on state homestead exemptions.

- Even if your state allows for a larger exemption, you may only exempt up to \$136,875 (as of 4/1/07) if you acquired your home within the 1,215-day period (about 3 years, 4 months) prior to filing bankruptcy. This limit does not apply to equity you rolled over from one home to another within the same state during this period.
- If you made an addition to your home in the 10-year period prior to filing with the intent to hinder, delay, or defraud creditors, your allowable exemption is reduced by the value of the addition.
- An absolute cap of \$136,875 applies if you (a) have been convicted of a felony that demonstrates that the bankruptcy is "abusive," or (b) owe a debt arising from violations of securities laws, fiduciary fraud, racketeering, or crimes or intentional torts that caused death or serious bodily injury in the preceding five years. This provision, however, will not apply if the homestead is reasonably necessary for your support and the support of your dependents.

**Caution:** For bankruptcy filings made on or after October 17, 2005, there is a two-year residency requirement for using state homestead exemptions. Specifically, to use a state's exemption, you must have resided there for 730 days (about 2 years) prior to filing bankruptcy. If you resided in more than one state during this 730-day period, the governing exemption law will be the state in which you resided for the majority of the 180-day period (about 6 months) preceding the 730-day period.

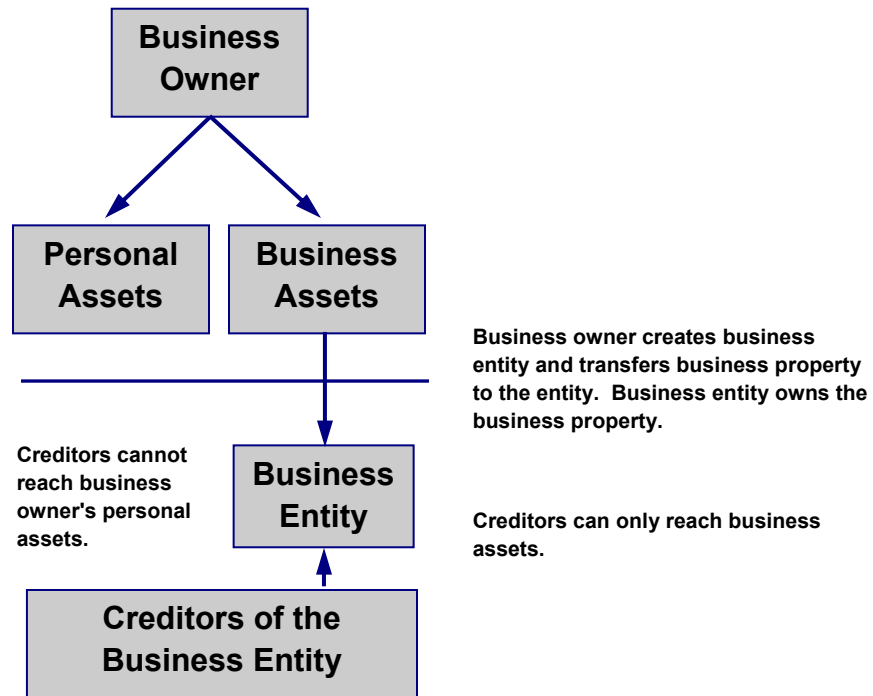
## How Insurance Preserves Assets



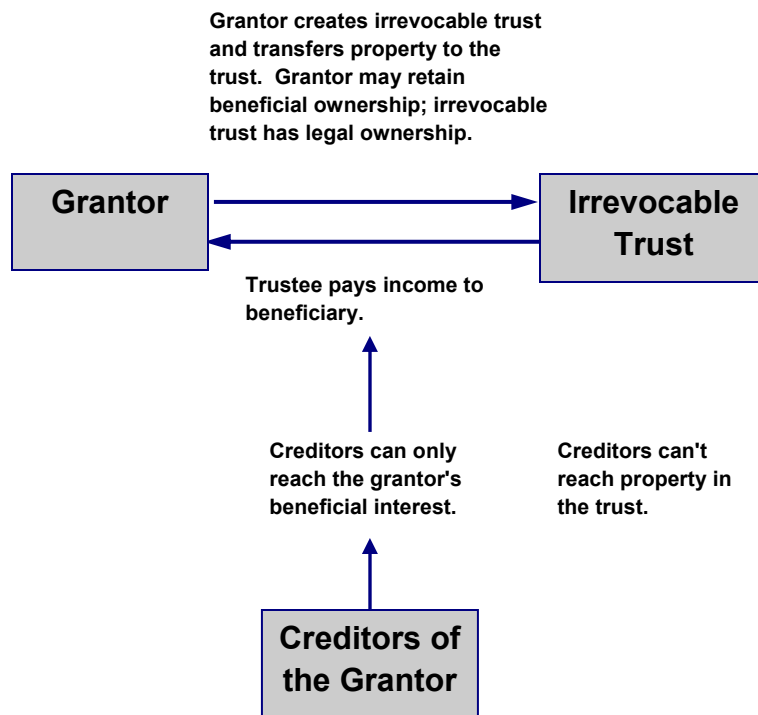
Type of Insurance	How Does It Work?
<b>Life insurance</b>	Provides the beneficiaries of your life insurance policy with funds upon your death so that your assets will not need to be used to pay final expenses and estate taxes.
<b>Disability income insurance</b>	Pays benefits to replace part of your earned income while you can't work due to illness or injury so that you continue to meet your financial obligations (e.g., mortgage).
<b>Health insurance</b>	Pays medical expenses incurred as a result of an illness or injury, so that you do not need to use your assets to pay for them.
<b>Long-term care insurance</b>	Pays for certain in-home and nursing home care expenses, preserving your assets for your heirs.
<b>Homeowners insurance</b>	Pays for certain property damage and losses so that the property can be repaired or replaced without you having to use other assets to do so. Also covers certain liability claims.
<b>Automobile insurance</b>	Pays for damage to your automobile so that you can fix or replace it (collision/other-than-collision coverage). Also covers certain liability claims (liability coverage).
<b>Umbrella liability insurance</b>	Provides liability protection above and beyond basic coverage provided by homeowners and automobile policies.
<b>Business or professional insurance</b>	Pays for certain business losses (e.g., property damage, business interruptions, liability claims).



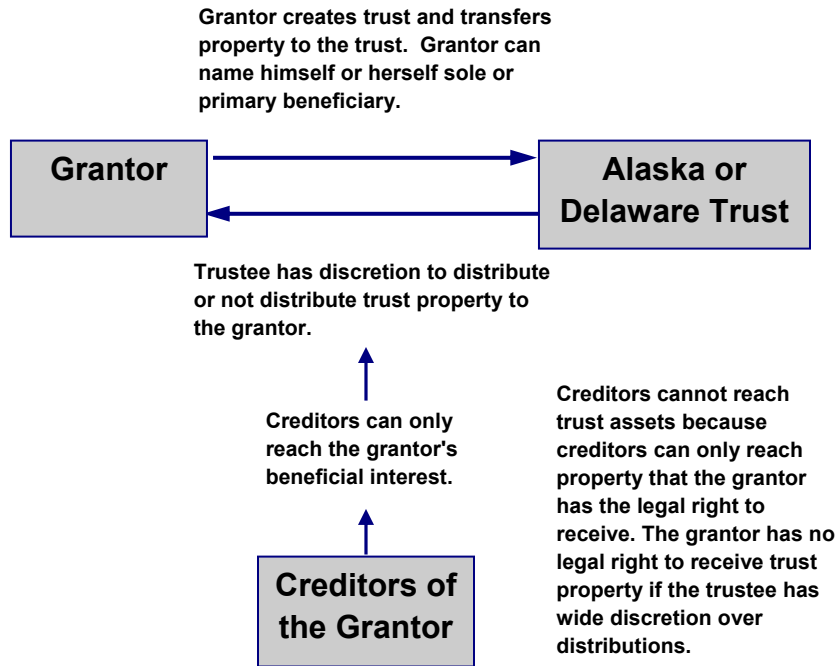
## How C Corporations, Limited Liability Companies, and Limited Liability Partnerships Protect Personal Assets



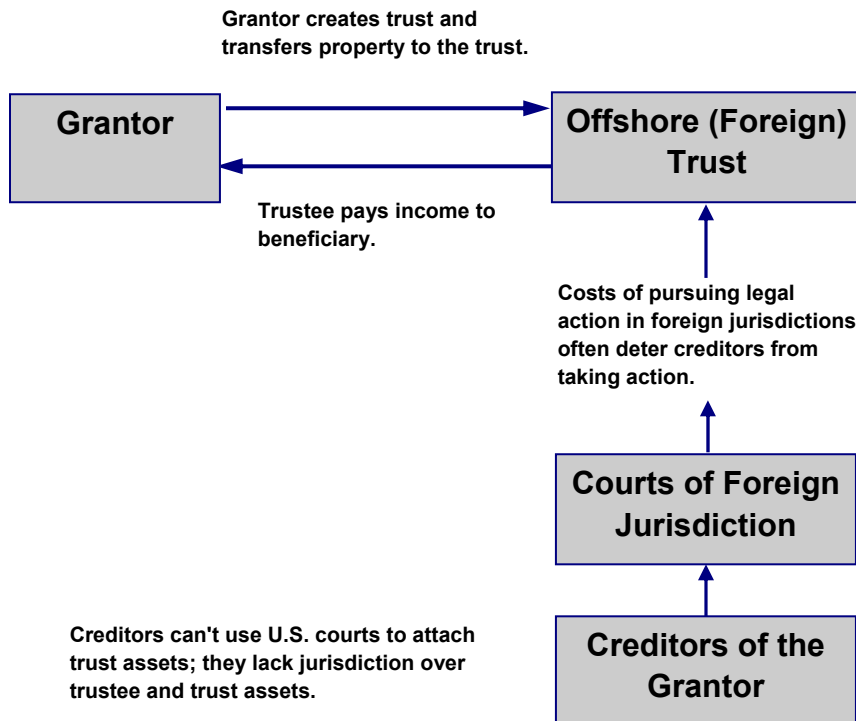
## How an Irrevocable Trust Protects Assets



## How Alaska and Delaware Trusts Protect Assets



## How an Offshore (Foreign) Trust Protects Assets





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State, national and international laws vary, as do individual circumstances; so always consult a qualified investment advisor, attorney, CPA, or insurance agent on all investment, legal, tax, or insurance matters.

The effectiveness of any of the strategies described will depend on your individual situation and on a number of other factors. After reviewing your personal situation, we may recommend that you not use any strategy in this document but instead consider various other strategies available through our practice.

Please feel free to contact me to discuss your particular situation.

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