

Asset Protection - Beyond Just Trusts



Jeremiah Barlow, JD, WealthCounsel

RISING DEMAND

Expanding theories of liability and rising threats of litigation make asset protection more valuable and more demanded than ever. Today's victim-oriented climate fuels plaintiff attorneys' hunger for deeper pockets, and increased media exposure elevates client concern regarding anonymity. Powerful asset protection tools provide an additional layer of protection and safeguard privacy. Some asset protection tools come with a higher price tag. Such tools may be suitable only for a certain subset of clients such as those in highly litigious careers (e.g., doctors, lawyers, architects) and business owners who assume risk and threat of malpractice. By the same token, greater asset protection remains salient for individuals with litigious threat, such as potential recipients of a substantial inheritance; individuals who deal with investors; owners of boats, airplanes, and other extreme vehicles; real estate owners; celebrities; high net worth and high visibility individuals; wealthy spouses in second marriages; and parents of teen drivers.

BEWARE OF FRAUDULENT TRANSFERS

It remains imperative for estate planning attorneys to keep a sharp eye out for situations involving fraudulent transfers of assets. The common badges of fraudulent transfers include the following: (i) transfers to insiders, (ii) retention of possession or control, (iii) concealment, (iv) threats of a lawsuit or a lawsuit itself, (v) insolvency (i.e. transfer of essentially all the debtor's assets), and (vi) a transfer that occurred shortly before or after a substantial debt was incurred.

Avoiding fraudulent transfer requires due diligence by the attorney before offering these asset protection tools to the client. Best practices for due diligence include gathering information from the client such as state and federal tax returns; the names and contact information of the client's attorney, accountant, bank, and financial consultant; a description of any current or anticipated litigation; employment history; legal documents; and a thorough background check.

VARIOUS ASSET PROTECTION PLANNING OPTIONS

As most practitioners are aware, estate planning offers a level of asset protection through outright gifts, irrevocable spendthrift trusts, charitable trusts, and marital trusts. However, asset protection includes much more than just trusts. In this regard, attorneys should be familiar with and advise clients on other techniques of asset protection, such as the following:

ADEQUATE INSURANCE

Adequate personal and business insurance should be considered the first line of defense. For personal insurance, ensure that your client's homeowner's insurance is sufficient and that they purchase umbrella insurance. For businesses, ensure that commercial general liability insurance is sufficient and that they hold umbrella insurance. Additionally, consider as much professional liability insurance as your client can reasonably afford, as well as employment practices insurance. Finally, advise your client to read the fine print of all of these policies.

MARITAL PROPERTY

Transmuting jointly held property to separate property interests often yields significant protection. Beware, however, that transfers between spouses may be considered fraudulent if not carefully planned. A professional spouse may transmute separate property or jointly held interests into separate property of the non-working spouse as long as it is not fraudulent. Nevertheless, although marital planning provides greater asset protection, it is

important to note to clients that it could be detrimental in the event of divorce.

SETTING UP A BUSINESS ENTITY

Creating a business entity lends protection against debts and claims. If a client owns everything in one company or in one's own name, a single lawsuit can result in catastrophic loss. If assets are held in separate companies, then only the entity involved in the suit is at risk. As a result, it is important to segregate a client's most valuable assets, such as real estate or equipment, in separate LLCs. Additionally, it is important to instruct clients regarding proper corporate governance practices, such as maintenance of LLC and corporation corporate formalities. This ensures that creditors remain unable to "pierce the corporate veil."

LLCS FOR REAL PROPERTY

Real property requires special protection. Tremendous liability potential exists for jointly owned real estate. Thus, placing real property in an LLC or FLP is more advantageous in terms of asset protection. Conversely, clients lose tax benefits by placing property in an LLC.

CHARGING ORDER

A charging order is an order by the court in favor of the creditor requiring that distributions from the LLC be made to the creditor who obtained the charging order. However, if there are no distributions from the LLC and the charging order is the exclusive remedy for the creditor, the creditor will not receive anything. Thus, this is advantageous for clients seeking greater asset protection.

FORUM SHOPPING

There are many favorable jurisdictions for LLCs, including the following: DE, AK, SD, AZ, NV, and WY.

DOMESTIC ASSET PROTECTION TRUSTS (DAPT)

Domestic asset protection trusts are favored as an asset protection tool because probate is avoided, confidentiality is maintained, and transfer of assets can be more efficient. However, in most states settlor's creditors can reach the trust assets while the settlors are alive. Regardless, DAPTs form a significant barrier against creditors and afford significant leverage

to the debtor with respect to negotiations with the creditor.

SPENDTHRIFT CLAUSES

A spendthrift clause protects a beneficiary's interest from creditors' claims. However, these clauses are generally unenforceable for a settlor who is a beneficiary, i.e. while settlor is alive. Nevertheless, 14 states now have legislation providing spendthrift protection to a settlor-beneficiary. The recommendation remains to have significant connections with one of the 14 states to establish a DAPT in that jurisdiction.

FOREIGN ASSET PROTECTION TRUSTS (FAPT)

A foreign asset protection trust is a trust that is formed in an offshore jurisdiction. Offshore trusts place assets out of the reach of US courts. Some believe that offshore trusts provide maximum protection for clients seeking to protect assets because creditors are now required to litigate in foreign jurisdictions, subject to foreign laws and justice systems, rather than being able to more easily sue the debtor in the American court system. Offshore trusts may be appropriate for individuals who have liquid assets, connections abroad, and the ability to sustain an offshore trust structure since these entities require more reporting and maintenance. One of the key advantages is that most foreign jurisdictions do not recognize US judgments; thus, the creditor would need to litigate a new trial in a foreign jurisdiction where the burden of proof is often far higher than in the US judicial system.

In the end, it is important to consider all of the above strategies when working with clients to design a comprehensive asset protection strategy. Although no strategy can prevent a lawsuit, they will certainly help clients' chances of settlement or dismissal of a lawsuit.

About the Author

Jeremiah Barlow is part of the Legal Education faculty at WealthCounsel. He has extensive experience in estate planning as in-house estate planning attorney for a national wealth management firm, and as founder of a law firm that focused exclusively on estate and asset protection planning. Before joining WealthCounsel's education faculty, Jeremiah was a member of WealthCounsel.

Jeremiah loves the outdoors and traveling. He, his wife, Kym, and their two sons live in Santa Barbara, California. 