

CHAPTER 10

ASSET PROTECTION PLANNING

Introduction

Asset protection planning is a subspecialty of estate planning that involves the implementation of various strategies designed to protect assets from the claims of creditors. Provisions may be made for the protection of assets during the lifetime of the owner, or after the death of the owner, but during the lifetimes of the intended beneficiaries, or both.

Protection from creditors involves a wide variety of potential claimants and depends a great deal on an individual's personal situation. As an example, physicians and other professionals may be interested in taking steps to avoid the personal financial consequences of malpractice claims. Others may be worried about potential lawsuits arising out of the ownership and operation of a business. Still others are less concerned about their own potential creditors but are fearful that the inheritance that they leave to their children will be lost to a child's creditor, failed marriage, or mismanagement.

Asset protection planning is not a substitute for comprehensive estate planning for all individuals and business planning for business owners. Instead it involves a thorough review of the factors that would lead a person to believe that he or she is more susceptible and/or more sensitive to the likelihood of substantial or repeated exposure to the claims of creditors. Furthermore, asset protection planning cannot be implemented in a vacuum; all of the other factors that are relevant in an estate plan (such as proper tax planning) must be considered as part of the process.

It is also important to note that asset protection planning should not be utilized for the purpose of avoiding known creditors or creditors that can be reasonably anticipated. In all likelihood, any effort to avoid the claims of known or reasonably ascertainable creditors will fail and may subject anyone participating in such an effort to additional legal sanctions.



Protected assets

Certain categories of assets are protected without necessity of additional planning. Identifying the exempt assets that you own is the first step in establishing any asset protection plan.

The exempt assets and the maximum value of the exemption vary from state to state, and certain assets are exempt under federal law as well. Some of the exempt assets include:

RETIREMENT ACCOUNTS

Qualified Retirement Plans (such as a 401(k) Plan) and Individual Retirement Accounts are protected under federal law. Protections for IRAs are also available in many states.

LIFE INSURANCE

The cash value of a life insurance policy is not subject to the claims of the insurance policy owner's creditors. In addition, on the insured's death, the death benefit may, with proper planning, be protected from the deceased owner's creditors as well as the creditors of the beneficiary(ies).

PERSONAL PROPERTY

Certain personal property is exempt from creditor claims. The type and value varies from state to state.

HOME EQUITY

A portion (if not all) of the equity of a home is exempt from creditor claims. Again, the amount of the exemption varies from state to state.

Strategies for protecting other assets

For assets that are not exempt from the claims of creditors, there are many strategies available to accomplish your asset protection objectives. Caution must be exercised that the strategies are not be implemented in an effort to avoid known or reasonably ascertainable creditors. Furthermore, many attorneys advise that you should retain sufficient assets to meet your current and anticipated future expenditures. Only excess assets should be included in part of an asset protection plan.

BUSINESS ENTITIES

One or more forms of business entities may be used to protect assets. Business assets can include an active business or the passive ownership of assets such as rental real estate. Corporations are commonly utilized for the ownership of active business entities. Limited partnerships or limited liability companies are often used for rental and investment real estate.

The use of a business entity is intended to insulate your personal assets from the claims of any creditors of the business. For example, if a rental home is owned in a limited liability company and a liability arises with regard to the rental property, the claim of the injured party is likely to be limited to the value of the rental.

If a creditor has a personal claim against an individual who owns a business entity, the ownership interest in the entity is merely one more asset that the creditor can pursue. However, certain provisions can be included in the legal documentation creating the entity that makes it very difficult for the creditor to force payment of the claim out of the assets of the entity or to force the sale of the assets held by the business entity in order to satisfy the claim.

THIRD-PARTY TRUSTS

A trust established for the benefit of another person (such as a spouse or child) is free from the claims of the beneficiary's creditors, if properly structured. Third-party trusts are often included in the estate plan to protect an inheritance from the claims of the beneficiary's creditors or divorce.

Sometimes called a "spendthrift trust," a third-party trust can be drafted to provide benefits to the beneficiary for a period of years or for the lifetime of the beneficiary. The beneficiary may also be given the power to control the disposition of the trust property at the time of his or her death (called a "power of appointment"). The beneficiary may serve as a co-trustee of the trust as long as an independent party is appointed as the other co-trustee. The independent trustee should have all of the decision-making authority over the amount and the timing of the distributions from the trust to the beneficiary.

MARITAL PROPERTY AGREEMENTS

Marital property agreements (such as premarital agreements or postnuptial agreements) can be used to help insulate the assets of one spouse against the claims of the other spouse's creditors. For example, if a spouse of a physician is concerned that his or her assets might be made subject to a malpractice claim, the couple may enter into an agreement to afford the non-debtor spouse greater asset protection.

DOMESTIC ASSET PROTECTION TRUSTS

Many states have enacted laws that allow for self-settled asset protection trusts. These laws allow, within certain guidelines, a person to establish a trust that allows the assets of the trust to be used for his or her benefit but will not be subject to the claims of the Trustor's creditors.

Generally, the trust must be located in a state that allows for the creation of self-settled asset protection trusts and one of the trustees of the trust must be a resident of that state. Thus, a Washington resident can create a self-settled asset protection trust in Alaska but the trustee must be a resident of Alaska.

The benefits of self-settled asset protection trusts have been significantly limited as a result of the Bankruptcy Reform Act of 2006. However, they remain viable planning tools in many circumstances.

OFFSHORE ASSET PROTECTION TRUSTS

Similar to the self-settled domestic asset protection trust, many foreign countries have favorable rules regarding the establishment of offshore asset protection trusts. Jurisdictions such as the Cayman Islands and Isle of Man have become popular for the establishment of self-settled trusts.

There can be significant tax and non-tax consequences associated with the exporting of assets to foreign jurisdictions. In addition, the location of the assets in a foreign jurisdiction presents a significant hurdle for any creditor wishing to be paid from such assets.

Conclusion

The protection of assets can be a significant part of your estate plan. Asset protection planning can be as simple as properly structuring your will and estate plan in order to take advantage of state and federal laws or may involve more complicated strategies such as transferring assets to other jurisdictions, including foreign countries. Due to the highly complex sets of rules in this area, you should seek the advice of an attorney with experience in asset protection planning before pursuing any of the advanced strategies described above.