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**Asset Protection Planning**

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## Introduction

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| **Video Script** | |
| **Script** | **On Screen Text** |
| Noted American author, playwright, and humorist Mark Twain once said “No man’s life, liberty, or property are safe while the legislature is in session.” We’ll adapt Mr. Twain’s timeless quote with one of our own as we consider Asset Protection planning, and I quote “No one’s assets are safe from liability claims while a court is in session.” [repeat] and add “unless those assets are protected”]  Let’s consider a real world example. Names and facts were changed to respect the individual’s privacy. John Doe was a successful professional who rose in short order to become a Senior Tax Partner in the Seattle office of an iconic worldwide accounting and consulting firm.  He was living the American dream; happily married, earning considerable compensation and enjoying a significant net worth. His future was so bright he needed sunglasses!  John was an exceptional CPA and quite meticulous in his own personal financial planning, including comprehensive plans for investments, estate, risk management and retirement.  What happened next is not pretty. Through no fault of his own, lawsuits began rolling in against John’s firm alleging, among other things, fraud and “….faulty tax opinion letters” from a number of the firm’s US offices.  Under the crushing weight of massive liability claims and judgments by the courts, the firm ultimately filed for bankruptcy protection. [pause] It gets worse.  Because the firm’s assets were insufficient to pay claims, the individual partners’ assets were threatened. A number of senior partners, including John, were forced into personal bankruptcy.  There’s yet one more sad twist to this tragic story. John’s wife was forced into bankruptcy also, as the firm’s creditors threatened her assets under state community property laws. [next bullet point] The stress proved fatal to the marriage, leading to divorce [next bullet point] | “No one’s assets are safe from liability claims while a court is in session” *[add this last line when the quote is repeated]* unless those assets are protected.”  Real World Example - John Doe  Successful Professional, Senior Tax Partner, Worldwide Accounting Firm   * Living the American Dream, Family, Financial Success, Fulfilling Profession * Crafted personal financial plan that was considered comprehensive at the time   John’s employer forced into bankruptcy from liability claims   * John forced into bankruptcy as creditors attacked his personal assets * John’s wife forced into bankruptcy as creditors threatened her assets * Divorce followed |
| As we consider this troubling story, we should be sobered by John’s losses.  His fall from the pinnacle of the American Dream was the emotional and financial equivalent of plunging off of a cliff. The post mortem autopsy reveals the following:   * He lost a fulfilling and highly-respected job as Senior Tax Partner for a firm acclaimed worldwide. * He lost most of his personal net worth. * His marriage ended. * Heaven only knows how much stress he endured.   What lessons should we take away from John’s horror story?   * A comprehensive financial plan is incomplete without asset protection planning * Even sophisticated professionals can be blindsided by liability claims | Autopsy Report - John lost:   * Lucrative, highly-respected position * Personal assets * Wife   Lessons for Advisors and Clients   * A comprehensive financial plan is incomplete without asset protection planning * Even sophisticated financial professionals can be blindsided by liability claims |
| Let’s assume for a moment that John’s investment advisor outperformed the relevant index every single year. That’s cause to applaud the investment advisor.  Let’s further assume that John developed a zero estate tax plan, such a plan would make him, at least in the eyes of many, a genius.  [pause, lower voice] But what if you were John’s financial advisor? What if you could travel back into time before the liability claims? You would have counseled him to commit the same effort and enthusiasm into protecting his net worth from judgment creditors as was committed to investment and estate planning.  You would have not only been applauded or thought a genius, you would have been a hero to John and his family.  You are about to enter an asset protection course that could very well make you a hero or heroine to your family or your clients. The knowledge in this course could very well have saved John’s marriage and most of his net worth.  An oh, by the way, what do you, the advisor, receive from studying this course? You may feel the nobility of helping your fellow man, but there’s a potentially huge financial upside for you as well. Your efforts here may well preserve the very assets you’re currently managing and, because few advisors understand or discuss these concepts, lead to significant referrals.  The path to asset protection competency begins……right now! | Focusing exclusively on investment performance, managing taxes, or having the right insurance is important but overlooks the potential to lose EVERYTHING to judgment creditors.  Be the hero to your clients by raising awareness of potentially devastating liability claims.  Your Rewards   * Nobility of serving your fellow man * Preservation of assets you’re managing * Opportunity for referrals from existing clients |

## Purpose of This Course

Asset protection planning is in its infancy compared to traditional planning imperatives such as investment, tax, retirement, and estate planning.

* Infancy notwithstanding, thousands of books, articles, and blogs have already been penned on asset protection.
* As but one example written by an early pioneer, Barry S. Engels’ *Asset Protection Guide* is an 816-page tour de force on this subject.
* Our challenge, given the vast amount of data available, is striking the right balance between raising awareness and devolving into legal minutiae.

In seeking that balance, we have established the following purposes:

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| **Overview** | **Click on each purpose to view more information.** |
| **Awareness** | Raise your awareness of the sobering risks faced by you and your clients in what could be described as a litigious legal environment. |
| **Help Your Clients** | * Encourage you to direct your clients to legal counsel early * Help you assist your clients in protecting the majority of their net worth and future earnings power from liability claims using legal and legitimate strategies * **Introduce effective strategies for most of your clients that can be explained in everyday English and implemented relatively quickly at generally modest cost** * **Provide a brief discussion of advanced strategies that may be appropriate for ultra high net worth clients** |
| **Dispel Dangerous Misconceptions** | **Dispel commonly-held and dangerous misconceptions about strategies that can be ineffective or even backfire, such as secrecy, joint ownership, and corporate protection.** |
| **Develop Conversational Competence** | Communicate the crucial need for asset protection planning to your clients in a way that resonates. |

Success in this lesson is gaining the confidence and competence to engage your clients, make them aware of the risks, and motivate them to take action.

## Legal Disclaimer

Asset protection laws vary from state to state and, at times, even among different courts within a state. **Click** here **for an example.**

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| **Example of Variations in State Laws** A majority of the individual states allow a married couple to use the Tenancy by the Entirety (TBE) form of property ownership. The lion’s share of those states allowing TBE only permit real property to be owned while a few states restrict TBE ownership to only a couple’s personal residence.1   |  | | --- | | **Tenancy by the Entirety** This form of joint property ownership is available only to a married couple and generally provides a modest level of asset protection from each spouse’s individual creditors. We will dedicate significant analysis to this form of property ownership later in this course. | |

Hence, competent legal counsel should ***always*** be consulted in the formation of an asset protection plan.

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| **Legal Disclaimer**  ***Nothing in this course is intended to serve as legal advice. The content in this course should not be used as legal advice. An attorney should ALWAYS be consulted when asset protection is discussed.***  ***Engage your compliance team or an attorney to discuss the dividing line between delivering quality service to your clients and rendering legal advice. Rendering legal advice without a license to practice law is a criminal offense punishable by jail time and/or fine.*** |

*Engel, Barry S.,(2013). Asset Protection Planning Guide, 3rd Edition, ¶ 435.02. Chicago, Il: CCH*

## Litigious Environment

A national legal ad campaign in recent years featured two plaintiffs’ attorneys huddled over a table deciding which liability case to pursue. One of the lawyers commented that “the defendant has assets, so let’s proceed.”

* For a defendant with no assets, the statement could have been “the defendant has no significant assets, so let’s not bother.”

No one wants to become poor to avoid liability claims. Yet what if your clients could insulate their wealth? Insulating wealth is hardly a new concept and has been practiced for millennia.

* The ancient Egyptians built pyramids some 4,500 years ago to protect a Pharaoh’s fortune (and body) from looters. Grave robbing is probably not one of your greatest concerns, yet in our current litigious environment, you and your clients may need pyramid-like security to protect wealth.

**Click on each of the following contributing factors to a litigious legal environment to learn more.**

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| **Expanding Theories of Liabilities** |
| This legal evolution could be called the “if I can dream of a way to make more people liable, I’ll go after them in court” approach. Those dreams can turn to nightmares when the quest for deep pockets lands your client squarely in the crosshairs of a lawsuit. An example follows.   |  |  |  | | --- | --- | --- | | **Example**  Assume a CPA ran a stop sign in a wealthy residential neighborhood one night, crashed into another car, and caused injuries to the other driver. Further assume that the CPA had very little auto liability insurance, was retiring from a declining practice, and had limited net worth.  Not too many decades ago, it was unlikely that an attorney for the plaintiff would sue third parties for the defendant CPA’s actions.   |  | | --- | | **Plaintiff** The plaintiff is the party claiming damages. |  |  | | --- | | **Defendant** The defendant is the party being charged with liability for the damages. |   However, welcome to expanding theories of legal liability! The plaintiff’s attorney could very well target third parties such as those listed below, depending upon the facts and circumstances of the accident:   * A homeowner who allowed shrubbery to even partially block the view of the stop sign or whose nighttime security lights were distracting to drivers * The manufacturer of the stop sign for insufficient reflective material in the sign * The city for failure to 1) maintain the sign properly, 2) replace it according to the manufacturer’s recommendation, or 3) place it in an optimum position * The manufacturer of the car the CPA was driving (the allegation may be reduced visibility at some angles) * The CPA’s employer for hosting a party where alcohol was served to the CPA   And by the way, many of the potential targets just listed could be you, a family member, or your best client. | |
| **Trial by Jury of Peers, Myth or Right?** |
| The Seventh Amendment to the U.S. Constitution guarantees a right to jury trial in certain federal civil cases, such as liability claims, but does not guarantee the right to trial by a jury of one’s peers.   * Only criminal defendants have the right to trial by jury of their peers (under a separate Amendment). * In addition, the Seventh Amendment is binding only upon certain federal cases. * While the individual states are not always required to follow the imperatives of the Seventh Amendment, a number of state courts do indeed make the jury trial a part of certain state civil liability cases.   ***How likely is your high net worth client to receive a civil trial by a jury of peers?***   * Assume that your client, with a net worth of $5,000,000, is on trial for a massive liability claim. * As your client looks upon the jurors who will decide his fate, he will likely see a group with a median net worth of about $45,000.1 * Different studies have either confirmed or failed to confirm jury bias against wealthy defendants. However, be aware that a Director of the American Bar Association expressed concerns about anti-wealth bias in juries. *The National Law Journal* (1993) quotes the Director as follows: “[with regard to anti wealthy bias] The only answer I wouldn’t believe is one that says they [the jury] didn’t take defendant wealth into account…”   *Bottom line - Your client may not even have an unbiased jury, much less one comprised of peers.*  Luhbey, Tami. *America’s Middle Class, Poorer Than You Think.* June 11, 2014*.* <http://money.cnn.com/2014/06/11/news/economy/middle-class-wealth> |

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| **Frivolous Lawsuits** |
| We live in the land of the free, home of the brave, and origin of sublimely ridiculous warning labels.  This warning label testifies starkly to the risk of frivolous lawsuit in the United States.  As yet another example, jet skis now include a warning label which states “Do not use lighted match to check fuel level.” Why should the Darwinian act of using a lighted match to check the level of gasoline in a jet ski’s gas tank create liability for the jet ski manufacturer?   * The answer is simple - because in these United States of America you have the right to sue virtually anyone and virtually anyone has the right to sue you. * But theoretically, that should not be a great concern because if you are not at fault you need only prove that, right? * Sadly, the cost of proving oneself right can easily cause extreme stress and cost six figures in legal fees alone.  |  | | --- | | **Darwinian** In one interpretation of Charles Darwin’s theory of evolution, species (or individuals) that remove themselves from the gene pool will result in the eventual end of that particular gene pool. |   The following cases illustrate largely blameless defendants being subjected to unjust wasted time, emotional stress, and legal cost in proving themselves right. This very brief list is merely the tip of the frivolous lawsuit iceberg: **The $67 Million Pair of Pants**  |  | | --- | | **The $67 Million Pair of Pants** This cautionary tale is for your small business clients.  A disgruntled customer sued a family-owned drycleaner in Washington, DC, for $67 million for allegedly misplacing his slacks. The case was finally resolved in the drycleaner’s favor ***two years*** later, but at a staggering legal cost of over $100,000. |  * The Cocaine & Baking Soda Cocktail  |  | | --- | | The Cocaine & Baking Soda Cocktail  Even America’s largest businesses must deal with legal frivolity.  A prison inmate sued Arm and Hammer for **$425 million** for “failing to warn that it’s illegal to mix baking soda with cocaine to make crack.” Arm and Hammer paid attorneys tens of thousands of dollars in legal fees just to get this absurd suit tossed out. |  * The Professional Psychic  |  | | --- | | The Professional Psychic  A “professional psychic” filed a medical malpractice claim against individual physicians and Temple University Hospital claiming that an allergic reaction to the dye used for her CAT scan caused such extreme headaches that she could no longer work as a psychic.   * Three separate trials and $100,000 in legal defense costs were required for the defendants to win. * Rhetorically, one has to wonder why the psychic did not foresee the end result. |  * Unlucky in Romance  |  | | --- | | **Unlucky in Romance** One can be intoxicated by love or alcohol, but trying to combine the two was not very effective for one man.   * A beer drinker sued Anheuser-Busch for false advertising and claimed emotional distress in addition to mental and physical injury.   What dastardly harm did Anheuser-Busch inflict upon their customer?   * They ran a national advertising campaign saying, according to the drinker, that Anheuser-Busch beer would make him “lucky with the ladies.”   Predictably, he did not experience any romantic success after drinking beer and promptly filed suit. The suit was tossed out, but not before significant legal costs were incurred by Anheuser-Busch. |  |  |  | | --- | --- | | **Political Disclaimer**  The debate over frivolous litigation and tort reform rages in our country. This course is not intended to advance either side of that national debate. We respect and appreciate that litigation is frequently used to redress terrible wrongs. Our point in this discussion is merely to demonstrate your client’s vulnerability to the misuse of liability litigation.   |  | | --- | | **Tort** LAW.COM defines a tort as a “civil wrong…, whether intentional or unintentional, from which injury occurs to another.” | | |

## Settlement Pressure

Perhaps the greatest contributor to the rise of litigation is “settlement pressure.” The pressure to settle a lawsuit is so overwhelming that 95% of all lawsuits are settled before trial.1 If you are a claimant, those are extremely good odds, virtually assuring you that you will have some level of success in bringing suit.

## [*Black's Law Dictionary, 2nd Ed., James Hirby, What Percentage of Lawsuits Settle Before Trial?*](http://thelawdictionary.org/article/what-percentage-of-lawsuits-settle-before-trial-what-are-some-statistics-on-personal-injury-settlements/)

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| **Overview** | Wide ranges of factors, including those explained below, are drivers to a pressured settlement. **Click on each factor to view more information.** |
| **Contingent Fees** | When you hire a surgeon to operate, you pay a fee regardless of the outcome. When you hire an investment advisor, you generally pay the investment advisory fee even if your returns fall below your expectations. How about your income tax return? You pay your CPA even if you do not receive the anticipated refund.   * But you may hire an attorney on a contingent fee basis and pay no attorney’s fees unless you collect an award or settlement! You will generally have to pay court costs, such as filing fees, however.  |  | | --- | | **Contingent Fee** The American Bar Association defines contingent fees thusly: “If you win the case, the lawyer's fee comes out of the money awarded to you. If you lose, neither you nor the lawyer will get any money, but you will not be required to pay your attorney for the work done on the case.” 1 |  * Contingent fees have both supporters and critics. Supporters claim that these fee arrangements give the common man access to legal redress in the courts, while critics believe such fees increase frivolous litigation.2 * Clearly, not all lawsuits involving the use of contingent fees are frivolous. However, that knowledge is cold comfort to a client subjected to a frivolous lawsuit that was even partially enabled by contingent fees.   1 [*American Bar Association, When You Need a Lawyer, Legal Fees and Expenses*](http://www.americanbar.org/groups/public_education/resources/law_issues_for_consumers/lawyerfees_contingent.html)  *2 Adam Shajnfeld, JD, Columbia University, A Critical Survey of the Law, Ethics, and Economics of Attorney Contingent Fee Arrangement, Volume 54|2009/10* |

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| **Loser Does Not Pay Winner’s Legal Fees** | Unlike the English legal system, the American legal system generally does not require the loser to pay the winner’s legal fees. There are perfectly legitimate arguments on both sides, but the impact to your client may well be one of frivolous litigation because there is little to no cost to a plaintiff who loses a lawsuit. This factor may exacerbate the risk of litigation created by contingency fees. |
| **Risk-Free Cash Even Before the Trial is Over** | How pervasive is the plaintiff litigation business? It is no longer necessary to even wait to win the case before taking a risk-free cash loan against the outcome.  One litigation lender advertises the following:   * “If you lose your case, you keep our money and owe nothing.” * “No credit check. No employment check. Fast approval.” |
| **Fear of Losing at Trial** | A famous old adage goes “better the devil you know than the devil you don’t.”   * The suppliers to a shuttered steel mill in Texas would wholeheartedly agree with that admonition. They collectively paid over $90 million in settlements to avoid a trial even though their liability was tenuous at best. * The suppliers were sued because the defunct steel mill had no significant assets to go after.   An excerpt from one of the plaintiff’s negotiating a settlement follows: “I heard that they were getting a suit up about stuff………so I wanted to get in on the party.” **Click** here **for details.**   |  | | --- | | **Details** The Lone Star Steel mill shut down, putting some 3,000 employees out of work. Those 3,000 employees sued the suppliers to the steel mill for “chemical AIDS” caused by “**unspecified substances**” (this was the exact language of the charge).   * Even suppliers selling nothing more than felt-tip markers, folding tables, and hand soap were named in the lawsuit. * Texas Monthly reported that “[John Doe], **a healthy worker** who received about $22,000 from settlements, stated ‘I heard that they were getting a suit up about stuff that we had breathed out here at the plant, and I figured I had been out there thirty-seven years and I breathed about everything everybody else breathed, and so I wanted to get in on the party.’ ” * One of the other plaintiffs worked in a sterile environment in the plant for a mere three months in 1945, yet joined the lawsuit some 50 years after working there!   Our purpose in this example is not to disparage any actual injuries or suffering of plant workers, but to illuminate a sobering risk. Not even suppliers to manufacturers are safe from liability claims. | |

## What Exactly Does “Asset Protection” Mean?

***Asset Protection*** is simply the strategic use of perfectly legal means to insulate the net worth and future earnings of your clients from future creditors. Asset protection is a process of moving assets from a vulnerable ownership form to a protected ownership form. An effective asset protection plan can protect virtually any asset.

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| **Future Creditors** One cannot legally use asset protection strategies to place assets beyond the reach of current creditors. However, an effective asset protection plan can indeed insulate a significant portion of a client’s net worth from future creditors. |

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| **Ownership Form** You will receive training later in this course on the key ownership forms. For now, be aware that an ownership form is nothing more complex than the manner in which property is owned. Examples of ownership forms include sole name ownership and joint ownership. |

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| **Any Asset** Examples of assets that may be protected include:   * Cash * Stocks * Bonds * Insurance proceeds * Jewelry * Art * Antiques * Real estate |

The adage “never bring a knife to a gunfight” could have been written to describe asset protection. Creditors have a “gun” in the huge body of law at their disposal to attack a debtor’s assets. Your clients need their own “gun” to fight liability claims; in other words, they need an effective plan that leverages plaintiff-friendly asset protection laws.

## Setting Client Expectations

The difference between being a hero or a disappointment begins with setting client expectations. Myth, rumor, and headlines conspire to foster misconceptions that the savvy planner should dispel. **Click on each of the following misconceptions to learn more.**

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| **Misconception # 1**  **Every Dollar of Wealth Must Be Protected.** | While it is prudent to protect most of a client’s assets, extreme care must be taken to avoid creating a fraudulent transfer (also referred to as a fraudulent conveyance or a voidable transfer).   |  | | --- | | Fraudulent Transfer  The transfer of property with the intent to defraud creditors. Noteworthy - This concept can apply even to future creditors in some cases! |   In deciding whether or not a fraudulent transfer has occurred, one of the factors taken into account by courts is whether or not the debtor (your client) “transferred substantially all of [his or her] assets.”1  The risk here is that the entire transfer can be voided (or reversed) because *all* assets were placed beyond the reach of creditors.   |  | | --- | | ***Compliance Alert***  One should be cautious about transferring 100% of assets to a protected form without discussing the fraudulent transfer dynamics with an attorney. |   1 *For example, Washington State’s Fraudulent Transfer Act (RCW 19.40)* |
| **Misconception # 2**  **Taxes Can Be Avoided.** | Asset protection plans are generally tax neutral for U.S. citizens. Income and transfer taxes (gift, estate, generation-skipping transfer) will have to be paid when due, even if assets are transferred to foreign jurisdictions.   |  |  | | --- | --- | | Foreign Jurisdictions  For most clients, the simple, tried, and true legal tools analyzed later in this course will more than suffice. For the ultra high net worth client, however, there are complex strategies available that involve trusts or other ownership forms outside of the United States. Even when a U.S. citizen’s income flows from foreign (“offshore”) assets, a federal law (FATCA) ensures that taxes are assessed.   |  | | --- | | FATCA  The Foreign Account Tax Compliance Act (FATCA) was enacted in 2010 and ensures income tax compliance by U.S. citizens with offshore assets.  One FATCA provision requires foreign financial institutions holding a U.S. citizen’s assets to report the U.S. citizen’s asset and income information to the IRS. | | |
| **Misconception # 3**  **Secrecy is Effective.** | **Question: What’s worse than having no asset protection plan?**  Attempting to hide one’s assets to defraud a creditor (such as a former spouse or judgment creditor following a trial) is highly likely to backfire in a most unpleasant way.  **Answer: Being caught hiding assets!**  The consequences of a judge discovering one’s attempt to hide assets include 1) the possibility of having the transfer reversed (voided), 2) the creditor gaining access to the “hidden” assets, or 3) the possibility of jail time if the assets are not surrendered by your client. **Click** here **for a 14-year jail term example.**   |  | | --- | | 14-Year Jail Term  Philadelphia attorney H. Beatty Chadwick served the longest contempt of court jail term in U.S. history for refusing to pay a court-ordered $2.5 million to his ex-wife.  The court ordered the $2.5 million payment after discovering the transfer of millions to accounts in Gibraltar, Switzerland, and Panama.\*  \**Justia, US Law, A0nalysis of U.S. Court of Appeals for the Third Circuit – 302 F.3d 107 (3d Cir. 2002)* | |

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| **Misconception # 4**  **Insurance Is No Longer Necessary**. | There are two equally dangerous schools of thought as to the proper place for insurance in asset protection planning: 1) the cancellation of all insurance if you have an effective asset protection plan, and 2) purchasing insurance and ignoring the need for an asset protection plan.  The most enlightened approach may be found within those two extremes and here is why:   * Certain insurance policy exclusions or exceptions are either uninsurable or insurable only at extreme cost. If you are sued for an uninsured risk, your asset protection plan may be the only guardian keeping the financial wolves at bay  |  |  | | --- | --- | | Certain Insurance Policy Exclusions and Exceptions  Consider the standard malpractice (professional liability) policy. Physicians, attorneys, therapists, engineers, accountants, and other professionals are exposed to malpractice claims.  By one estimate, less than 1 in 20 professionals actually read their professional liability policy. If they did so, they might find the following alarming policy exclusions and exceptions:   * Gross negligence  |  | | --- | | Gross Negligence  ***Gross negligence*** is defined by one state court as “the failure to exercise even a slight standard of care.”1 |  * Claims by members of a protected class (sexual harassment, racial discrimination, age discrimination) * Liability for acts of assistants not named in the policy * Punitive damages (a serious risk if gross negligence is proven) * Fines and penalties   1 *Gliemmo v. Cousineau, No. S09A1807 (March 15, 2010)* |  * While insurance is far from perfect, it offers a vital benefit found nowhere else. The insurance company is obligated to pay for the legal costs of defending a claim and pay (or settle) judgments up to the policy limits. Remember that legal defense costs can approach $100,000 (or more). * The ideal asset protection plan generally includes the use of both insurance and asset protection strategies. |
| **Misconception # 5**  **Asset Protection is Expensive.** | “Expensive” is a relative term. For example, “expensive” compared to what? In regards to asset protection, one must balance the expense of an asset protection plan against the potential loss of one’s net worth.  Top-notch legal talent costs money. The good news is that the largest cost is in the original design and implementation of the plan. In succeeding years, legal costs for maintenance of the plan tends to be minimal.  **Click** here **for a famous quote from America’s pioneering astronaut that may give insight.**   |  | | --- | | Quote from Astronaut John Glenn  When asked how it felt to be sitting on what amounted to a massive controlled-burn bomb, John was asked how it felt to be sitting in the module during countdown.  He replied, *“… I felt exactly how you would feel if you were getting ready to launch and knew you were sitting on top of two million parts -- all built by the lowest bidder on a government contract.”*  If you are sued, you want to be “sitting” in an asset protection plan crafted by the best asset protection attorney you can find. | |

## Review Exercise

1. Your client Kayla just read an online blog promoting “Absolute Creditor Protection for 100% of Your Assets.” Kayla just asked for your advice. Which of the following responses would NOT be appropriate?

* Consult an experienced asset protection (AP) attorney to discuss the pros and cons of “100% Protection.”
  + **Incorrect**. This is generally appropriate advice. Consult your compliance department for your firm’s position before discussing with clients. Whenever legal concepts are under discussion, any advice should generally begin with “Consult an experienced attorney.” Try again.
* Consult an experienced AP attorney to discuss the risk of making a fraudulent transfer.
  + **Incorrect.** This is generally appropriate advice. Consult your compliance department for your firm’s position before discussing with clients. Whenever legal concepts are under discussion, any advice should generally begin with “Consult an experienced attorney.” Try again.
* The blog is absolutely correct. I can begin opening new, fully-protected accounts for you right now.
  + **Correct!** This is almost never an appropriate response. Run, not walk, away from giving this “advice.”
* There may be a risk that transferring 100% of your assets could result in a charge of fraudulent transfer. Consult an experienced AP attorney for further information.
  + **Incorrect.** This is generally appropriate advice. Consult your compliance department for your firm’s position before discussing with clients. Whenever legal concepts are under discussion, any advice should generally begin with “Consult an experienced attorney.” Try again.

1. Kayla referred her mother Dana (a U.S. citizen) to you based upon your advice in the previous question. Dana recently attended a seminar entitled “Financial Freedom, Protect Your Assets from All Creditors and Pay No Taxes.” Dana is very skeptical and asks you to confirm which of the following statements, if any, made at the seminar is/are correct.

* Income taxes may be completely avoided by transferred income-producing assets to a foreign country.
  + **Incorrect.** A federal law closed this loophole in 2010. Try again.
* One can transfer assets to a foreign country and escape liability from current creditors.
  + **Incorrect.** This transaction could be the poster child for a fraudulent transfer. Your client could be held in contempt of court and jailed for refusal to return the assets to the U.S. Try again.
* Transfer taxes, such as gift, estate, and generation-skipping taxes, may be completely avoided by transferring assets to a foreign country.
  + **Incorrect.** A federal law closed this loophole in 2010. Try again.
* None of the above is correct.
  + **Correct!**

1. Which of the following is a correct statement regarding why a client with significant insurance coverage would create an asset protection plan?
2. Insurance policies have exclusions and exceptions that leave many insureds with liability exposures.
3. A liability award from a jury may exceed the policy’s limits.
4. The asset protection plan may incent a plaintiff to settle the claim relatively quickly for the amount of the policy limit or less, even if the claim is much higher.

* A only
  + **Incorrect.** This is a correct statement, but this is not the only correct answer. Try again.
* A and B only
  + **Incorrect.** Try again.
* B and C only
  + **Incorrect.** Try again.
* A, B, and C
  + Correct!

1. Dr. Mel Prectize, net worth $3 million, accidentally amputated the wrong arm of a patient. The operating room nurse clearly marked the arm to be removed with a bold, red marker. Mel has a standard professional liability policy. Which of the following should be among Mel’s legal concerns if he is found guilty of gross negligence?
2. His professional liability policy may not provide coverage to pay for a jury reward.
3. He may be subject to punitive damages.
4. His entire net worth may be vulnerable to payment of a judgment awarded by a jury unless he has an effective asset protection plan implemented *before* the surgery.

* A only.
  + **Incorrect.** This is a correct statement, but this is not the only correct answer. Gross negligence may be excluded from coverage. Try again.
* B only.
  + **Incorrect.** This is a correct statement, but this is not the only correct answer. Gross negligence may open the doorway to punitive awards intended to penalize grossly negligent behavior. Try again.
* C only.
  + **Incorrect.** This is a correct statement, but this is not the only correct answer. An AP plan is only effective if implemented before the amputation. Try again.
* A, B, and C
  + **Correct!**

## Elements of an Effective Asset Protection Plan

Asset protection (AP) plans follow the same imperatives as virtually any effective financial plan. We begin with client goals and then develop strategies to meet those goals.

The temptation is often to make AP plans overly complex. Like many temptations, this is a good one to resist. ***The most effective AP plan emphasizes the simplest tactics required to achieve client goals.***

How do you know when the plan is too complex?

* Your client cannot clearly and confidently explain the plan to a plaintiff’s attorney (this could imply the plan is a sham to a judge).
* Your client struggles with “living the plan.” As but one example, if business assets are used to pay personal expenses from a business partnership, then the business purpose of the partnership may be challenged.

The process of creating an effective AP plan must include an analysis of the elements summarized below.  **Click each element to learn more.**

|  |
| --- |
| **The Porcupine Effect** |
| No one hugs a porcupine. Why? The endeavor is fraught with risk yet offers no reward. Similarly, your client’s AP plan should be so legally prickly to the plaintiff as to 1) discourage litigation, 2) empower your client, and 3) remain effective against most claims.   |  | | --- | | Discourage Litigation  The plaintiff’s attorneys working on a contingent fee contract must generally secure an award or settlement to get paid.   * An award or settlement must generally come from the defendant’s assets if no insurance coverage applies. Even when coverage applies, the award may exceed the limits of your client’s policy. * If the client does not legally own assets or there exist significant legal barriers around the assets, a plaintiff’s attorney may well choose not to invest his or her time into what could become a fruitless legal pursuit of your client. |  |  | | --- | | Empower Your Client  The emotional stress of a lawsuit cannot always be measured in dollars. Litigation stress, such as in malpractice claims, can lead to depression, feelings of losing control, and the perception of helplessness.1 Measurable costs include reduced productivity and legal fees.  An effective AP plan can reduce emotional stress by more equally balancing power between defendant and plaintiff. How is that accomplished?   * The plaintiff must not only prove your client’s liability, but must then also pursue assets guarded by an AP plan. * The process may become just as daunting for the plaintiff as for the defendant.   Your client’s AP plan may, therefore, lead to settlement of judgments for mere pennies on the dollar.2  *1 Sandra Tunajek, CRNA, DNP, Director, Council for Public Interest in Anesthesia, AANA NewsBulletin, July 2007*  *2 Engels, Para 185, Alberts* |  |  | | --- | | Effective Against Most Claims  Consider the case of the successful real estate magnate who established an effective AP plan to insulate himself from the possibility of future toxic waste claims.  The toxic waste claims never materialized, but another claim did. His wife filed for divorce and the divorce settlement was significantly reduced due to the strong nature of his AP plan.1  *1 Engels, Para 185, Donahue.* | |
| **Bulletproofing** |
| A bulletproof vest only prevents injury if worn before the bullet is fired. An AP plan is effective against creditors only if it was implemented ***before*** the liability event!   |  | | --- | | Liability Event  The liability event is simply the act (or failure to act) that created a liability claim. For example, a surgeon amputating the wrong leg creates a liability event at the moment of amputation. |  |  | | --- | | **Compliance Alert**  **Attempting to transfer assets after the liability event has occurred could very well subject the client and the planner to both civil and criminal liability.** | |
| **Transferring Assets to a Protected Form** |
| Property owned in your client’s name or property over which your client has complete control may not be protected from creditors. Hence, the key AP imperative is to move assets from an unprotected form of ownership to a protected form of ownership.   * While the strategy is simple, the tactical implementation can range from straightforward to very complex. * The remainder of this course is substantially dedicated to understanding and using protected ownership forms. |

## Foundations of Property Ownership

The highest building in the world - the Burg Dubai - rises one-half mile into the sky and weighs a billion pounds. The Burg Dubai sits atop a foundation system of concrete and steel reaching 164 feet deep. Just as the success of the Burg Dubai began with a strong foundation, your competence in AP planning demands a strong foundation in property ownership. There is simply no substitute for understanding the basics of property ownership. The chart below summarizes our approach for developing your knowledge in this vital area of AP. The pages that follow will analyze these foundations.

|  |
| --- |
| **The Foundations of Property Ownership**   * Types of Property * Forms of Property Ownership   + Individual Ownership   + Shared Ownership     - Joint Tenancies - Joint Tenancy With Right of Survivorship, Tenancy by the Entirety, Tenancy in Common     - Community Property     - Entities - Corporations, Partnerships, Limited Liability Companies, Trusts |

## Types of Property

***The foundation of property ownership begins with knowing the types of property.***

An asset’s protection from creditors may depend substantially upon the type of property owned. For example, a judge may be more inclined to enforce a judgment against an individual’s brokerage account than to force the sale of a married couple’s personal residence to satisfy the husband’s judgment creditors.

As you will learn later in this course, it not generally possible in some states to force the sale of a jointly-owned personal residence to enforce a judgment against an individual spouse.

There are only two broad types of property. ***All*** property is either "real property" or "personal property."

**Property**

**Real Property**

Land and whatever is erected upon it (house), growing on it (crop), or affixed to it (fence)

**Personal Property**

All property other than real property

While all real property is tangible, personal property may be tangible or intangible as illustrated in the chart below.

**Property**

**Personal Property**

**Real Property**

**Tangible Property**

Property that can be felt or touched; having physical form. Real property is by its very nature tangible. Tangible personal property would include items like jewelry, furniture, automobiles, artwork, etc.

**Intangible Property**

Property that has no intrinsic and marketable value. It represents or gives evidence of value, such as stocks, bonds, patents, life insurance, etc.

## Review Exercise

**Select the correct answer to each question.**

1. **An automobile is an example of:**

A. Real property only

**Incorrect**. Real property is land and whatever is erected upon it, growing on it, or affixed to it. Try again.

B. Tangible property only

**Incorrect**. While an automobile IS tangible property, this is not the ONLY acceptable choice. Try again.

C. Personal property only

**Incorrect**. While an automobile IS personal property, this is not the ONLY acceptable choice. Try again.

D. Both A and B

**Incorrect**. Real property is land and whatever is erected upon it, growing on it, or affixed to it. Try again.

**E. Both B and C**

**Correct**. An automobile is both personal property and tangible property.

1. **A stock certificate is an example of:**

A. Personal property only

**Incorrect**. While a stock certificate IS personal property, this is not the ONLY acceptable choice. Try again

B. Tangible property only

**Incorrect**. Although the certificate itself has physical form, its value is not intrinsic. Therefore, it is not classified as tangible property. Try again.

C. Intangible property only

**Incorrect**. While the certificate IS intangible property, this is not the ONLY acceptable choice. Try again.

D. Both A and B

**Incorrect**. Although the certificate itself has physical form, its value is not intrinsic. The real value lies in the intangible ownership interest represented by the stock certificate. Therefore, it is not classified as tangible property. Try again.

**E. Both A and C**

**Correct**. A stock certificate is personal property and also intangible property.

1. **Which of the following is a not a possible property type?**

* Intangible real property

**Correct**. Land and property attached thereto are by definition tangible.

* Tangible personal property

**Incorrect**. Try again.

* Intangible personal property

**Incorrect**. Try again.

***You have now completed the study of types of property. Next up you will learn how forms of property ownership contribute to an effective AP plan.***

## Forms of Property Ownership

The form of property ownership is merely the legal form chosen by your client to own property. Form of property ownership differs from the type of property, as shown in the example below.

|  |  |  |
| --- | --- | --- |
| **Example**  An apartment building is real property, not personal property. Yet the apartment building can be owned in any number of ownership forms including the following:   * Individually in one person’s name  |  | | --- | | Individually  Individually-owned property is referred to as “sole name” ownership for personal property and “fee simple” (or “fee simple absolute”) for real property. |  * In a joint tenancy among multiple people  |  | | --- | | Joint Tenancy  Three types of ***joint tenancy*** will be reviewed in this course, including 1) Joint Tenancy with Right of Survivorship, 2) Tenancy by the Entirety, and 3) Tenancy in Common. |  * As community property in a community property state * Through an entity such as partnership, corporation, limited liability company or trust   ***While the ownership form may differ, the apartment building remains real property***. |

## Individual Ownership

The most complete form of property ownership is individual ownership. This form is characterized by the key factors in the chart below.

|  |  |
| --- | --- |
| **INDIVIDUAL OWNERSHIP** | |
| **Factor** | **Explanation** |
| **Ownership Interest** | The owner has complete control of the property subject only to law, such as zoning ordinances over real property. |
| **Control** | **Lifetime** - During life, the owner may sell, gift, or encumber the property without anyone else’s permission.   |  | | --- | | Encumber  To ***encumber*** property is to make it subject to a claim or a lien. For example, a home mortgage loan encumbers the home as collateral for the loan. |   **Death** - your client retains testamentary control of the property: at the owner’s death, the property passes to whomever the decedent chose in his or her Last Will and Testament.   |  | | --- | | Testamentary  ***Testamentary*** simply means “of or relating to a Last Will and Testament.” | |
| **Taxes and Probate** | **Gift Tax -** Gifts may be subject to gift tax and/or generation-skipping transfer tax.  **Estate Tax** - The value of the property is included in the decedent’s gross estate for estate tax purposes.  **Income Tax** – All income generated by the property is included in the owner’s gross income.  Probate – The property is subject to the probate process.   |  | | --- | | Probate  ***Probate*** refers to the process of validating and administering the decedent’s Last Will and Testament in accordance with state and local law. | |

### Asset Protection Verdict

|  |
| --- |
| ***Sole name ownership*** provides the owner with the highest degree of control over the property. Generally, the more control retained by the owner, then the more vulnerable the asset becomes to creditors. Creditor protection is, therefore, not achieved with individual ownership. |

## Joint Tenancy with Right of Survivorship (JTWROS)

A Joint Tenancy with Right of Survivorship is a joint undivided ownership of property between an unlimited number of persons who may or may not be related. This form of property ownership is characterized by key factors described in the chart below.

|  |  |
| --- | --- |
| Joint Tenancy with Right of Survivorship  The Legal Information Institute (LII) of Cornell University Law School defines a Joint Tenancy (with Right of Survivorship) as: “A type of shared ownership of property, where each owner has an undivided interest in the property.  This type of ownership creates a [right of survivorship](http://topics.law.cornell.edu/wex/right_of_survivorship), which means that when one owner dies, the other owners absorb the deceased owner's interest.” **Click** here **for an example from the LII.**   |  | | --- | | Example  “For example, if A and B own a house as joint tenants, both have undivided ownership of the property and the full right to occupy and use all of it.  If A dies, B gets sole ownership of the house because of the right of survivorship.” | |

|  |  |
| --- | --- |
| Undivided Interest  An ***undivided interest*** is where each co-owner has an **interest in the entire property**, not just ownership of a piece of the property.   |  | | --- | | **Example**  If two individuals own an undivided interest in an acre of land, each owner has an ownership interest in the entire acre, rather than one owning the northern half and the other owning the southern half. Each owner, therefore, has the right to make use of the entire acre, not just a piece of it. | |

|  |  |
| --- | --- |
| **JOINT TENANCY WITH RIGHT OF SURVIVORSHIP (JTWROS)** | |
| **Factor** | **Explanation** |
| **Ownership Interests** | The joint tenants must all have ***equal ownership*** ***interests***. For example, a JTWROS with 20 joint tenants results in each joint tenant owning 5%. |
| **Control** | **Lifetime** - During life, each joint tenant generally has full access to and control over the property. **Click** here **for an example.** Additionally, each joint tenant can usually gift or sell their interest in the property without permission of the other joint tenants. This may vary by state law.   |  | | --- | | Example  Father opens a JTWROS bank account with his daughter and deposits $100,000 into the account. Daughter may generally withdraw the entire $100,000 without permission from Dad. |   **Death** - your client loses testamentary control of the property: the property passes to the surviving joint tenants automatically by operation of law. |
| **Taxes and Probate** | **Gift Tax -** Gifts of JTWROS interests may be subject to gift tax and/or generation-skipping transfer tax.  **Estate Tax** - The value of any JTWROS property owned by your client is included in his or her gross estate for estate tax purposes.  **Income Tax** - Income generated by the JTWROS is allocated equally among the joint tenants: a JTWROS with $1,000,000 in profits and with 10 joint tenants would result in each joint tenant including $100,000 in gross income.  **Probate** does not apply because the JTWROS property passed automatically, outside of the probate process, to the surviving joint tenants. |

### Asset Protection Verdict

|  |  |
| --- | --- |
| **Joint Tenancy with Right of Survivorship** provides little effective asset protection and **may actually increase the risk of successful attack by creditors**. Creditor risk varies proportionally with number of joint tenants; the greater the number of joint tenants the greater the risk of attack by their creditors. Some practitioners would argue this form provides even less asset protection that sole name or fee simple ownership.  A common and potentially disastrous misconception is that property in a JTWROS is protected from the individual creditors of the joint tenants. ***The reality is that property held as JTWROS may be subject to attack by creditors of any one of the joint tenants!***1  How could that be? The reason is simply that because any one of the joint tenants may have access to and control over the entire JTWROS property, creditors of any one of the joint tenants may be granted the same access. **Click** here **for an example.**   |  | | --- | | Example  A father opens a JTWROS bank account with his daughter and deposits $100,000 into the account. Daughter may withdraw the entire $100,000 without permission from Dad. Daughter has $100,000 in outstanding judgments from a jury award. In many states, the daughter’s judgment creditor could generally sue for collection against the entire $100,000 in the bank account. |   ***1*** *http://trusts-estates.lawyers.com/asset-protection/blogs/archives/7456-joint-ownership-open-door-to-litigation.html* |

## Tenancy by the Entirety (TBE)

A Tenancy by the Entirety (TBE) can be viewed as a JTWROS-like form of ownership reserved exclusively for spouses. Only spouses may title property in a TBE. Each spouse owns a joint undivided interest in the property. Not all states permit this form of property ownership. Among those states allowing TBE, this form of property ownership is generally characterized by key factors described in the chart below.

|  |  |
| --- | --- |
| **TENANCY BY THE ENTIRETY** | |
| **Factor** | **Explanation** |
| **Ownership Interests** | Each spouse owns an undivided 50% interest in the property.  Only real property can generally be owned and some states limit the type of property to only a personal residence. |
| **Control** | **Lifetime** - The sale, gift, or encumbrance of TBE property is generally allowed only with the consent of the other spouse.  **Death** - Your client loses testamentary control of the property: the property passes to the surviving spouse (joint tenant) automatically by operation of law. |
| **Taxes and Probate** | **Gift Tax -** Gifts of TBE interests to a U.S. citizen spouse are not generally subject to gift tax and/or generation-skipping transfer tax.  **Estate Tax** - The value of any TBE property owned by your client is included in his or her gross estate for estate tax purposes. Because the property must transfer to the surviving spouse, no estate taxes are generally due because of the unlimited marital deduction from estate taxes.  **Income Tax** - Income generated by the TBE is allocated equally between the spouses.  **Probate** does not apply because the TBE property passes automatically, outside of the probate process, to the surviving spouse. |

### Asset Protection Verdict

|  |
| --- |
| This form of ownership does provide a modicum of asset protection. Normally, only joint creditors of the couple may successfully attack TBE property. Individual creditors of the individual spouses are usually unable to reach TBE property. Some states may even protect a personal residence from joint creditors (exceptions apply).  Thus, the TBE form, if available, is marginally more effective against certain creditors than the JTWROS form. Noteworthy, however:   * This form does nothing to insulate a client from divorce claims. * Not all states permit this form. * Even among states permitting TBE, the type of property allowed is often severely restricted.   ***Bottom line - this form of property ownership should be evaluated but may not be appropriate as the cornerstone of an AP plan.*** |

## Tenancy In Common (TIC)

A Tenancy In Common is a joint undivided ownership of property between an unlimited number of persons who may or may not be related. This form of ownership appeals to clients seeking maximum control over a shared ownership interest during lifetime and at death - it is characterized by key factors described in the chart below.

|  |  |
| --- | --- |
| Tenancy in Common  The Legal Information Institute (LII) of Cornell University Law School defines a Tenancy in Common as “a type of shared ownership of property, where each owner owns a share of the property. These shares can be of unequal size, and can be freely transferred to other owners both during life and via a will.  Even if owners own unequal shares, however, all owners have the right to occupy and use all of the property.” **Click** here **for an example from the LII.**   |  | | --- | | Example  “If A and B own a house as Tenants in Common, there is no problem if A owns 1/3 of the house and B owns 2/3, and no problem if A decides to sell his share to C.” | |

|  |  |
| --- | --- |
| **TENANCY IN COMMON** | |
| **Factor** | **Explanation** |
| **Ownership Interests** | Each joint tenant owns a specified percentage of the TIC. Unequal ownership interests are allowed. The TIC is the only shared ownership form that permits unequal ownership interests. For example, one joint tenant in a TIC may own 7% while another owns 93%. Remember that all other shared ownership forms require equal ownership among the joint tenants. |
| **Control** | **Lifetime** - The sale, gift, or encumbrance of TBE property is allowed without the consent of the other joint tenants.  **Death** - Your client controls the disposition of property at death, generally through provisions in the Last Will and Testament. The property does NOT pass automatically to the surviving joint tenants at the death of a tenant. |
| **Taxes and Probate** | **Gift Tax -** Gifts of TIC interests may be subject to gift tax and/or generation-skipping transfer tax.  **Estate Tax** - The value of any TIC property owned by your client is included in his or her gross estate for estate tax purposes.  **Income Tax** - Income generated by the TIC is allocated based upon the ownership percentage of each of the joint tenants. **Click** here **for an example.**   |  | | --- | | Example  Assume your client is a 17% joint tenant in a TIC with $1,000,000 in profits. TIC income in the amount of $170,000 will be reported as gross income on your client’s income tax return. |   **Probate** - TIC property is part of the probate estate and is therefore fully subject to probate expenses and delays. |

### Asset Protection Verdict

|  |
| --- |
| Tenancy in Common is generally not an effective means of asset protection.  Creditors may wield relatively more power than the debtor (your client). Because the TIC can be impacted by a creditor of any one of the joint tenants, the risk of creditor attack multiplies as the number of joint tenants increases. Some practitioners would argue this form provides even less protection that sole name or fee simple ownership.  We will analyze creditor protection from this form with a case study on the following page. |

## Case Study – Tenancy In Common (TIC)

|  |  |
| --- | --- |
| **Fact Pattern** | You and your brother Alan own an apartment building as Tenants in Common. Alan has a 25% interest and you have a 75% interest. **Click on each of the three circumstances that could threaten your assets.** |
| **Forced Sale of the Apartment Building** | Alan’s creditors may, in many states, request the forced sale of the apartment building to satisfy Alan’s unpaid debts. This process may be referred to as a foreclosure. Consequently, you may lose ownership of the apartment building although you will receive 75% of the proceeds of the forced sale. Such forced sales may not always yield the highest sales price. |
| **Forced Substitution of Joint Tenants** | What if Alan’s creditors seek to keep Alan’s 25% ownership interest rather than force a sale? Assume that a judge grants their request. Congratulations, you are now in business with Alan’s creditors. |
| **Exposing Your Other Assets to Creditors** | ***You can lose even more than your 75% interest.*** Suppose Alan is manager or co-manager of the apartment building. Someone is injured as a result of his negligence. As joint tenants in the property (in some states), you may be liable for any judgments, even if the judgment exceeds the value of the apartment building. This disastrous result may occur as a result of the legal principle of joint and several liability.   |  | | --- | | Joint and Several Liability  This legal principle holds that each party is individually (severally) and jointly liable for debts. Joint ownership forms of property ownership may run the risk, in at least some states, of becoming subject to joint and several liability. | |
| **Who Has the Negotiating Power?** | Creditors may wield the power to force partition and sale of the property, substitute themselves for existing joint tenants, and even reach for personal assets outside of the TIC. These powerful weapons may threaten your client during settlement negotiations. |

## Review Exercise

**Select the correct answer to each question.**

1. **Which of the following is (are) disadvantages of the Joint Tenancy with Rights of Survivorship form?**

A. The joint tenant loses testamentary control over the property.

**Incorrect**. This is a true statement; however, this is not the only disadvantage. Try again.

B. The joint tenant may lose lifetime control of the property.

**Incorrect**. This is a true statement; however, this is not the only disadvantage. Depending upon state law and the type of asset, each joint tenant may have complete control over the asset. Try again.

C. The entire JTWROS property may be exposed to claims of any of the joint tenants.

**Incorrect**. This is a true statement; however, this is not the only disadvantage. The greater the number of joint tenants, the greater the risk of attack by their creditors. Try again.

**D. All of the above**

**Correct**.

**E.** A and B only

**Incorrect**. Try again.

1. **Your client seeks asset protection and has heard that a Tenancy by the Entirety is the best way to protect marital assets. Which of the following cautions, if any, would you express to your client?**

A. Tenancy by the Entirety is not allowed in all states

**Incorrect**. This is a true statement; however, this is not the only true statement. Try again.

B. Tenancy by the Entirety may not be an effective protection from divorce claims.

**Incorrect**. This is a true statement; however, this is not the only true statement. Try again.

C. The type of property allowed in a Tenancy by the Entirety is severely restricted.

**Incorrect**. This is a true statement; however, this is not the only true statement. Try again.

D. A personal residence owned in a Tenancy by the Entirety may not be fully protected from joint creditors.

**Incorrect.** This is a true statement; however, this is not the only true statement. Remember that not all states allowing the TBE form provide complete protection for a personal residence against joint creditors. Try again.

**E. All of the above**

**Correct**.

1. **Which of the following, if any, could be viewed as an advantage of a Tenancy in Common over a Joint Tenancy with Rights of Survivorship?**
2. Protection from creditors of individual joint tenants

**Incorrect**. Try again.

1. Ability to control the property at death through provisions in the decedent’s Last Will and Testament

**Incorrect. This is a true statement, but not the only true statement.**

1. Desire for unequal ownership interests

**Incorrect. This is a true statement, but not the only true statement.**

1. **B and C only.**

**Correct**.

1. None of the above

**Incorrect**. Try again.

## Community Property

There are two basic types of states1 with respect to marital property ownership - common law property states and community property states. The distinction between these two types of states lies in the general presumption of ownership.

* In **common law (CL) property states**, the general presumption for marital property ownership is that the purchaser of an asset may title that asset in any manner he or she chooses.
* In **community property (CP) states**, the general presumption for marital property ownership is that any property, including earnings of either spouse, coming into the community (the marriage) becomes community property. Some exceptions apply.

|  |
| --- |
| Exceptions  The following property is separately owned by the spouses in a community property state:   * Property acquired before the marriage * Gifts and inheritances received during the marriage * Personal injury awards * Property acquired with separately-owned property * Property converted from community property to separate property by mutual agreement of the spouses   Separate property must remain segregated from community property to maintain its separate status. Commingling separate property with community property may create the rebuttable presumption that the separate property is part of the community. |

This form of ownership is characterized by key factors described in the chart below.

|  |  |
| --- | --- |
| **COMMUNITY PROPERTY** | |
| **Factor** | **Explanation** |
| **Ownership Interests** | Each spouse has an undivided 50% ownership of all community property. |
| **Control** | **Lifetime** – The sale, gift, or encumbrance of community property generally requires permission of both spouses.  **Death** - Your client retains testamentary control of the property; thus, the property passes according to the Last Will and Testament of the decedent spouse. This is a huge difference between JTWROS and TBE ownership forms. CP does NOT pass automatically to the surviving spouse. |
| **Taxes and Probate** | **Gift Tax** **–** A spouse changing separate property into community property makes a gift to his or her spouse. Such gifts are generally fully excluded from the gift tax as long as the donee spouse is a U.S. citizen.  **Estate Tax** – One-half of the total value of CP owned by your client at his or death is included in his or her gross estate for estate tax purposes. However, 100% of the CP is stepped-up in basis for income tax purposes. **Click** here **for an** **example.**   |  | | --- | | Stepped-Up in Basis  The tax value of an asset is referred to as its basis. When an asset is sold, taxable gain is calculated as sales price less basis (with some adjustments). Therefore, an increase in basis generally reduces income tax in a subsequent sale.  When a decedent dies, his or her property may be eligible for an increase in income tax basis to fair market at death, as reported on the federal estate tax return. This process is referred to as a step-up in basis. |  |  | | --- | | Example  Bill Portals is one of the wealthiest persons in America. He and his wife Lucinda reside in a CP state. At his death, $100 billion was owned as CP by Bill and Lucinda. A total of $50 billion will be included in Bill’s gross estate and the full $100 billion will be stepped-up to fair market value at date of death for income tax purposes. |   **Income Tax** - Income generated by CP is allocated equally among the spouses.  **Probate** – Any property disposed of by the decedent’s Last Will and Testament must generally go through the probate process. Hence, the decedent’s one-half of CP becomes a probate asset at death. |

### Asset Protection Verdict

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| --- | --- | --- |
| A popular misconception is that all states protect CP from separate creditors of the spouses. This misconception is the Achilles heel of many informal “AP plans.” The reality is sobering. Some state laws actually increase the risk of losing assets to creditors!   |  | | --- | | Separate  ***Separate*** debt is debt acquired by an individual spouse. The opposite of separate debt is joint debt - debt acquired by both spouses. |  * ***A number of states allow the creditors of an individual spouse to claim CP even if the debt was acquired before the marriage.*** * ***Over one-half of the CP states allow a separate debt of one spouse, acquired during the marriage, to be satisfied from CP.*** * ***Still other states allow only*** tort ***claims against CP.***  |  | | --- | | Tort  **A *tort*** is a civil wrong and may include negligence, trespass, product liability, assault, battery, and intentional infliction of emotional distress. |   Thus, CP is not generally an effective AP strategy and may actually increase vulnerability to claims from separate creditors of the spouses. |

*1 9 states are community property states, 40 states are common law states, and Alaska is a hybrid.*

## Corporations

Your clients may have heard the drumbeat promoting liability protection using corporations for decades. Yet corporations are primarily designed to protect personal assets from corporate, not personal, creditors. Consider the following before joining the drum line of supporters of the corporate form for AP:

* Personal creditors may lay claim to any asset one owns personally, including shares in a corporation.
* Hence, transferring personally-owned assets to a corporation merely exposes those assets to additional threat from corporate creditors.

There is a potential, though less than ideal, solution. Your client may choose to indirectly (instead of personally) own the shares. What would that look like? One merely titles the corporate shares in the name of an entity, such as a Limited Liability Company, Partnership, or Trust. This approach solves one problem and creates at least one new one.

* **Problem solved** - Because the shares are no longer owned personally by your client, a measure of asset protection is achieved through indirect entity ownership.
* **Problem created** – This approach adds unnecessary complexity, cost, and administrative burden to the AP plan. Why not simply transfer the personally-owned assets to an LLC, Partnership, or specialized Trust? Remember that your client must be able to live the plan AND explain it to a judge!

If that were not enough, there may be increased income taxes from double taxation and personal holding company status.

|  |
| --- |
| Double Taxation  Corporations come in two flavors - the C Corporation and the S Corporation. In a C Corporation, the profits of the business are subject to corporate income taxes. When dividends are distributed to the shareholders, the dividends are also taxed to the shareholders.  S Corporations are not exposed to double taxation - their earnings flow through to the shareholders without corporate taxation. S Corporation earnings are only taxed to the shareholder. |

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| Personal Holding Company  In addition to regular corporate income taxes, personal holding companies are subject to a penalty tax of 20% of earnings retained by the corporation. A personal holding company is a business that derives half or more of its income from investments (or other passive sources) and is owned by relatively small number of shareholders. |

### Asset Protection Verdict

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| Transferring personally-owned property to a corporation owned indirectly by your client may reduce the risk of losing the assets to personal creditors. The assets remain exposed to corporate creditors.  Bottom line – As you will see subsequently in this course, there are simpler and more effective strategies to protect your client’s assets. |

## Family Limited Partnership (FLP)

A partnership consists of two or more persons (or entities) engaged in a business. All partnerships must have at least one general partner. Partnerships containing one or more limited partners are referred to as limited partnerships. Limited partnerships in which only family members are allowed to own partnership interests are referred to as Family Limited Partnerships (FLPs).

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| Business  Partnerships require a valid business purpose. Among the purposes deemed a valid business purpose are centralized management of family assets, income tax management, and a host of other rationales. |

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| General Partner  The general partner(s) manage the partnership. General partners are personally liable for the claims against the partnership. Therefore, a general partner’s personally-owned assets may be exposed to the claims of partnership creditors. |

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| Limited partners have no management power in a partnership; they are merely investors in the partnership. The liability of a limited partner is usually limited to his or her investment in the partnership. Happily, a limited partner’s personally-owned assets are not usually exposed to the claims of partnership creditors. |

The beauty of the FLP lies in its ability to give your client significant control as a general partner, while also providing significant asset protection. ***This is the first property ownership form studied that features control and asset protection simultaneously.*** The chart below analyzes these features. **Click on each feature to learn more.**

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| **Partnership Assets Not Subject to Seizure by Partner’s Creditors** |
| Partnerships enjoy a compelling legal protection. A judgment creditor of an individual partner may not seize partnership assets to collect on the judgment. Remember that judgment creditors can generally seize assets from the property ownership forms studied previously in this course. |
| **Your Client’s Friend – The Charging Order** |
| A *charging order* (defined below) generally prevents a judgment creditor from gaining control of the partnership or seizing partnership assets. But how then can a judgment creditor enforce a judgment?  The remedy (in most states) is an order from the court assigning the partner’s (debtor’s) future distributions from the partnership to the judgment creditor.  Such an order is referred to as a charging order. Sounds ominous, right? But consider that a “charging order does not entitle the creditor to accelerate any distributions or to otherwise interfere with the management and activities of the limited partnership.”1  *1 http://www.americanbar.org/content/dam/aba/publishing/probate\_property\_magazine/rppt\_mo\_premium\_rp\_publications\_magazine\_2004\_ja\_kleinbergeretal.authcheckdam.pdf* |
| **The Stalemate** |
| The judgment creditor, charging order in hand, awaits distributions from the FLP. However, the general partner controls distributions from the FLP, not the judgment creditor. Distributions can merely be suspended (subject to state law) until a settlement with the judgment creditor is reached.   |  | | --- | | **Negotiation Caveat**  Some states permit foreclosure upon the debtor partner’s interest in the partnership as an alternate remedy to the charging order. In such states, the debtor’s negotiating position may be diminished yet generally remains significant. | |
| **Paying Income Tax on Uncollected Judgments** |
| Based on the facts and circumstances of each case, the IRS1 may find that the judgment creditor is an assignee of partnership profits. Since partnership profits are generally taxed to the partners whether distributions of profits are made or not, the judgment creditor may find themselves paying income tax on a judgment they have not collected. This may add one more chip to the partner’s negotiating position in reaching a settlement.  1 *Revenue Ruling 77-137* |
| **General Partners Unlimited Liability** |
| A client holding a general partnership interest has theoretically unlimited liability to creditors of the partnership itself. One solution to this serious risk is to have a partner own the general partnership interest as a limited liability company or corporation. Limited Liability Companies will be discussed subsequently. |

### Caution: Respect the Entity!

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| The significant protections afforded by the FLP form may be lost completely by clients who fail to respect the FLP as a separate and distinct entity. For example, any of the following actions by a partner may cause a court to find the FLP was a mere sham and never existed:   * Purchasing personal items or personal travel using partnership assets * Signing partnership contracts as an individual instead of as a general partner of the partnership * Failure to hold partnership meetings as required by state law * Using partnership assets to secure personal loans |

## What Types of Property May be Owned by an FLP?



In most states, a wide range of property types may be held in an FLP as denoted in the chart to the right..

However, not every asset should be transferred to FLP ownership as denoted below:

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| **Asset** | **Consequence of Ownership in an FLP** |
| **S Corporation Stock** | * Will generally void the S Corporation election. * Only natural persons, estates of natural persons, and certain trusts are generally permitted as shareholders.  |  | | --- | | Natural persons  ***Natural persons***are human beings. | |
| **Personal Residence** | * Ownership of a personal use non-income-producing asset may void the business purpose of the FLP. * The exclusion of gain from sale of a personal residence may be lost. * Mortgage interest may no longer be deductible. |
| **Annuity** | * Loss of income tax deferral. * Only a natural person (not an entity) is eligible to receive income tax deferral from an annuity. |
| **IRA** | * Immediate taxation of all deferred income. * The transfer of the IRA to an FLP may be deemed a taxable distribution from the IRA. |

Taxes can be significantly reduced through the use of the FLP. Because the FLP is a “flow-through” entity for income tax purposes, partnership income is taxed only to the partners and the partnership itself generally pays no income taxes.

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| Flow-Through  The IRS ignores the entity itself and taxes each partner on his or her share of partnership income. From an IRS perspective, the income flows through to the individual partners as if the partnership did not exist. Contrast this with the corporate form in which corporate profit is subject to corporate income tax and dividends are subject to taxation when received by the shareholders. |

FLPs are a long-term favorite of estate planners as well. Through creative use of the limited partnership estate tax laws, transfer taxes can be sharply reduced. A thorough discussion of the transfer tax reduction strategies is out of scope for this course, but a follow-up with your internal planning team, attorney, CFP® professional, or CPA is highly recommended.

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| Transfer Taxes  A tax assessed against the value of property transferred as a lifetime gift or as a testamentary conveyance is referred to as a transfer tax. The gift tax, estate tax, and generation-skipping transfer tax are examples of transfer taxes. |

Sadly, a common creditor is a spouse in a divorce proceeding. FLPs can be effective against ex-spouses as creditors as well. **Click** here **to know more.**

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| Ex-Spouse as Creditor  A limited partnership interest awarded to an ex-spouse as part of a divorce proceeding is the award of an illiquid asset. Because the asset may be restricted to ownership by family members (or ex-family members), it may be very difficult for the ex-spouse to sell the limited partnership interest. This dynamic may well open the door for your client to settle divorce claims at discounted values. |

We close our discussion of this powerful asset protection tool with an emphasis on its reliability for planning purposes. There is a century1 of law supporting the design, operation, and protections inherent in the limited partnership. Virtually no other effective AP tool offers this level of reliability.

### Asset Protection Verdict

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| The FLP is an effective and reliable ownership form for clients willing to both respect the entity and transfer only appropriate assets to the FLP. A huge bonus is reliability of a century of law.  A significant caveat is the ownership of the general partner’s interest. A general partner’s personally-owned assets are subject to the claims of partnership creditors. Therefore, a protected form of property ownership should be used to own the general partnership interest. One candidate for ownership of the general partner’s interest is the Limited Liability Company discussed immediately after the exercises that follow. |

1 *Uniform Limited Partnership Act, 1916 plus subsequent amendments and a vast body of case law.*

## Review Exercise

**Select the correct answer to each question.**

1. **Your newest prospect has significant net worth and recently attended an asset protection seminar promoting Family Limited Partnerships. Which of the following statements made at the seminar, if any, is FALSE?**

* The sole remedy of a judgment creditor in some states is the charging order.

**Incorrect**. This is a true statement. Some states limit the collection of a judgment to the distributions actually made by the partnership to a partner. Try again.

* Some states also allow a judgment creditor to foreclose upon a partner’s interest in the FLP.

**Incorrect**. This is a true statement. Some states allow either a charging order or foreclosure. Try again.

* If the IRS determines that a judgment creditor is an assignee, the partner’s undistributed share of partnership profits may be taxed to the creditor.

**Incorrect**. This is a true statement. Under certain facts and circumstances, the judgment creditor may be subject to income tax on the debtor partner’s undistributed partnership profits. Try again.

* **A general partner is always fully protected from liabilities of the FLP.**

**Correct. This is a false statement. If your client owns his or her GP interest personally (an unprotected form), then his or her personal assets are exposed to the claims of partnership creditors.**

* None of the statements is false.

**Incorrect**. There is an false statement.

1. **Which of the following are potential advantages of the FLP?**

* Significant asset protection

**Incorrect**. This is a true statement; however, this is not the only true statement. Try again.

* Income tax efficiency.

**Incorrect**. This is a true statement - partnership profits are taxed only to the partners. However, this is not the only true statement. Try again.

* Transfer tax efficiency.

**Incorrect**. This is a true statement - the FLP is a long-time favorite of estate planners to reduce gift, estate, and generation-skipping transfer taxes. However, this is not the only true statement. Try again.

* A century of supporting law

**Incorrect.** This is a true statement. However, this is not the only true statement. Try again.

* **All of the above**

**Correct**.

1. **You are mingling among the local glitterati at a Charity Ball. The Chairman of the Ball, one of your long-term prospects, turns to you and asks for insights into the FLP. Which of the following should you NOT express to the Chairman?**

* The FLP offers a powerful blend of control for the general partner and asset protection for all partners.

**Incorrect**. This statement may be expressed. Try again.

* FLPs require the partners to strictly respect the separateness of the FLP.

**Incorrect.** This statement may be expressed. The use of partnership assets for personal purposes may cause a judge to void the FLP as a sham. Try again.

* Personal residences, annuities, IRAs, and S Corporation stock should not generally be transferred into an FLP.

**Incorrect.** This statement may be expressed. The ownership of these assets by an FLP will generally have unwanted income tax consequences. Try again.

* In some circumstances, judgment creditors may be subject to income tax on the uncollected judgment amount, thereby increasing the pressure on the creditor to settle with the debtor.

**Incorrect**. This statement may be expressed. Try again.

* **Partners in an FLP pay no income tax on partnership profits.**

**Correct. You should not express this to the Chairman. Partners are taxed on their share of partnership profits even if there are no distributions from the partnership.**

## Limited Liability Company (LLC)

What if your client could gain the asset protection power of the FLP and avoid the unlimited liability of the general partner? The LLC promises to do just that. Legally, an LLC is neither a partnership nor a corporation - it is an unincorporated association owned by its managers and members.

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| Association  A group of persons banded together for a common purpose under state law is referred to as an ***association***. Requirements vary by state. |

LLCs have both similarities and differences when compared to FLPs. **Click on each factor in the chart below to learn more:**

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| **Ownership Structure** |
| |  |  | | --- | --- | | **LLC** | **FLP** | | * **Members** are nonmanaging owners. * **Managers** are owners that control and manage the LLC. * Ownership may generally be limited to family members in many states, thereby creating a family LLC. | * **Limited Partners** have no management authority. * **General Partners** manage and control the FLP. | |
| **Liability of Owners** |
| |  |  | | --- | --- | | **LLC** | **FLP** | | The personal assets of both managers and members are generally protected from the claims of the LLC’s creditors. | * Personal assets of limited partners are protected from partnership creditors. * Personal assets of general partnership interests owned as a natural person are fully exposed to partnership creditors. | |

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| **Taxation** |
| |  |  |  | | --- | --- | --- | | **Tax** | **LLC** | **FLP** | | **Income Tax** | The LLC occupies a unique position with the IRS and may generally elect to be income taxed as a C Corporation, Partnership, or Sole Proprietor.1 | The FLP itself is not taxed. Income flows through the FLP to the individual partners. | | **Phantom Income** | Judgment creditors generally run the same risk of phantom income as do FLP judgment creditors. | Judgment creditors deemed assignees of a partner may be subject to income tax on the partner’s share of partnership profits even if profits are not distributed. | | **Transfer Tax** | Member interests generally enjoy approximately the same transfer tax benefits as limited partnership interests. | Limited partnership interests may be used by estate planners to transfer assets to family members at discounted valuations for gift, estate, and generation-skipping transfer tax purposes. The valuation discounts provide transfer tax savings. |   *1 https://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/Limited-Liability-Company-LLC* |
| **Asset Protection** |
| |  |  | | --- | --- | | **LLC** | **FLP** | | LLC managers and owners are generally subject to charging order and foreclosure risk, as in the FLP form. | Judgment creditors are entitled to either a charging order or, in some states, foreclosure against the partnership interest of the debtor. Note that some states allow only charging orders as sole remedy and do not allow foreclosure against a partner’s interest. | |

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| **Reliability** |
| |  |  | | --- | --- | | **LLC** | **FLP** | | LLCs are the new kids on the block, legally speaking. The state of Wyoming enacted the first LLC statute in 1977. By 1996, all states had some form of LLC statute on the books.  While the LLC form has not been tested by the courts for 100 years, many practitioners believe that the LLC provides a significant legal barrier to judgment creditors.1 | FLP law is relatively reliable and includes a body of statutory and case law stretching back to 1916. |   *1 Asset Protection Strategies for Organization and Individuals, Kenneth J. Laino, 2008* |
| **Divorce** |
| |  |  | | --- | --- | | **LLC** | **FLP** | | LLC owners generally enjoy the same AP benefits as partners in a partnership. | A limited partnership interest awarded to an ex-spouse as part of a divorce proceeding is the award of an illiquid asset.   * Because the asset may be restricted to ownership by family members (or ex-family members) it may be very difficult for the ex-spouse to sell the limited partnership interest. * This dynamic may well open the door for your client to settle divorce claims at discounted values. | |

### Asset Protection Verdict

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| The LLC may well be an AP plan cornerstone worth considering. The advantages of the FLP’s AP are retained and the disadvantage of the general partner’s unlimited liability is generally avoided. The one caveat is the absence of a century’s worth of law for the LLC. |

## Review Exercise

**Select the correct answer to each question.**

1. **Why would you recommend an LLC ownership form *over* an FLP ownership form?**

* **Personal assets of an LLC manager are not exposed to creditors of the LLC, while a natural person general partner’s personal assets *are* exposed to partnership creditors.**

**Correct**!

* Personal assets of an LLC member are not exposed to creditors of the LLC, while personal assets of a limited partner *are* exposed to partnership creditors.

**Incorrect**. The personal assets of a limited partner are not exposed to partnership creditors. Try again.

* Flow-through taxation

**Incorrect**. This is not a distinguishing factor as the LLC may generally elect flow-through taxation. Try again.

* Legal reliability

**Incorrect**. FLPs have a century of statutory and case law to rely upon. LLCs began with enactment by one state in 1977 and have not been tested by the courts as has the FLP. Try again.

* **All of the above**

**Incorrect**. Try again.

1. **Some states allow an LLC owner’s judgment creditors to use foreclosure as an alternative to a charging order. What strategy is a potential countermeasure?**

* Use an FLP ownership form instead

**Incorrect**. Generally, if foreclosure is allowed against an FLP interest, it is also allowed against an LLC interest. Try again.

* Use a corporate ownership form instead

**Incorrect**. Corporate assets are generally subject to seizure by judgment creditors - this provides approximately as great a risk as foreclosure upon FLP and LLC assets. Try again.

* **Form the LLC in a state that limits the remedy of a judgment creditor to a charging order and does not allow foreclosure.**

**Correct. Most states recognize LLCs formed in other states.**

* Rely upon the concept of phantom income to discourage foreclosure

**Incorrect.** The concept of phantom income applies primarily to holding an uncollected charging order and generally applies equally to both LLCs and FLPs. Try again.

* **All of the above**

**Incorrect**.

## Domestic Asset Protection Trust (DAPT)

A ***Domestic Asset Protection Trust*** (DAPT) is an Irrevocable Trust created under the laws of one of the states. While an entire course could be written around DAPTs, we have distilled many of the key factors for your review in this brief discussion. Be aware that state law varies significantly and the scope of this course does not permit a review of all permutations of the DAPT across the states.

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| Irrevocable Trust  An ***Irrevocable Trust*** cannot be amended or revoked by the creator of the trust. The creator may also be referred to as the settlor, trustor, grantor, and other terms. We will use the term settlor in this discussion.  A valid Irrevocable Trust requires the following:   * Settlor * Trustee having legal ownership and management responsibility over the trust * Corpus (also referred to as principal or simply trust assets) * Beneficiary (who receives benefits from the trust) * Written trust document |

We begin by dispelling a dangerous DAPT misconception.

* Conventional wisdom would have us believe that assets owned by any Irrevocable Trust are immune from attack by creditors.
* While seductive, this is simply not the case under the laws of most states when the trust is “self-settled.” A self-settled trust is a trust for which the settlor is a primary beneficiary. **Click** here **for an example.**

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| Example  Patti created two Irrevocable Trusts. In Trust #1, Patti is the sole beneficiary. In Trust #2, Patti’s daughter Amy is the sole beneficiary.  The assets in Trust #2 are generally protected from Patti’s creditors because Patti has no access to trust assets. Trust #2 is not a self-settled trust because Patti did not ***settle*** the trust for her***self***.  The assets in Trust #1 are generally exposed to Patti’s creditors under the laws of most states. This is because Patti has access to trust assets as sole beneficiary AND Patti created (settled) the trust. Trust #1 is a self-settled trust. |

A minority of the states permit a specialized form of Irrevocable Trust called a Domestic Asset Protection Trust. While state law varies, DAPTs are usually characterized by the factors in the table below.

**Click on each factor to know more.**

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| **Limits on Settlor’s Access** | Even in DAPT states, the settlor is not allowed unfettered access to trust assets. The legal mechanisms used to limit access include the following:   * **Spendthrift Provision** - The spendthrift provision prevents the settlor and the settlor’s creditors from accessing trust assets by specifically limiting the settlor’s rights to trust assets. * **Independent Trustee** – The Trustee must be independent of the settlor and not subject to the settlor’s control. The Trustee should have absolute discretion over the timing and amount of distributions to the settlor as beneficiary. |
| **Fraudulent Transfers** | The DAPT is not designed to protect assets from current creditors and is intended only to protect assets from future creditors. Generally, assets transferred to a DAPT to attempt protection against current creditors will be voidable (reversible). See also the “Look Back Period” discussion below. |
| **Statute of Limitations** | A person’s creditors have a limited time to contest a transfer of assets to a DAPT or file a claim against trust assets. This contestability period, legally referred to as the statute of limitations, varies significantly by state and by creditor type.   * The statute of limitations for future creditors ranges from 0 years to 4 years * The statute of limitations for current creditors ranges from 1-½ years to 5 years.   Assets are generally protected from the settlor’s creditors when the contestability period expires without a contest by the settlor’s creditors. |
| **Exceptions to Statute of Limitations** | **Alimony and Child Support** - A number of the DAPT states allow alimony and child support claims against trust assets without a time limit. Some states do not. Still other states allow claims only if alimony and child support were payable at the time the settlor’s assets were transferred to the DAPT.  **Federal Bankruptcy** – Federal statutes permit federal bankruptcy creditors to claim DAPT assets for ten years after the settlor transfers assets to the trust. |

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| **Residency** | Arguably, the ideal use of a state’s DAPT statutes is by a resident of that state.1 The legal issue in play here is whether or not a resident of State A can create an effective DAPT in State B. At its core, the question is whether or not State B’s statutes will apply to residents of State A. This is an evolving area of DAPT law.  1 *Comparison of the Domestic Asset Protection Trust Statutes, Edited by David G. Shaftel, September 2010* |

Income tax management is not usually the primary motivator for settling a DAPT. However, it should be noted that a number of DAPT states exempt trust income from state income tax.

### Asset Protection Verdict

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| DAPTs hold out great promise on the surface, yet the relative lack of significant case law should compel thorough due diligence. While DAPTs may have a place in an AP plan, it may be wise to avoid putting all of the AP eggs into this one basket.  One approach worth discussion with legal counsel is to transfer an LLC to a DAPT. This approach would establish an additional legal hurdle without relying exclusively on the DAPT statutes. |

## Review Exercise

**Select the correct answer to each question.**

1. **Which of the following is NOT a potential benefit to the settlor of creating a DAPT?**

* **The transfer of assets to a DAPT is immediately effective against current creditors.**

**Correct**! This transfer may constitute a fraudulent transfer, which is voidable by a judge.

* A transfer of assets to the DAPT may be effective against future creditors**.**

**Incorrect**. This is a potential benefit. Try again.

* Protection from most creditors after compliance with the Statute of Limitations.

**Incorrect**. This is a potential benefit. Try again.

* Protection from bankruptcy creditors under the federal bankruptcy statutes after the assets have been held by the trust for 10 years.

**Incorrect**. This is a potential benefit. Try again.

* Potential reduction of state income taxes on trust earnings in certain states.

**Incorrect**. This is a potential benefit. Try again.

1. **Your client is considering the use of a DAPT. Which of the following cautions should you express to your client?**

* Consult an experienced asset protection attorney before making any decisions.

**Incorrect**. This is more than just a true statement, it is an imperative! However, this is not the only caution you should express. Try again.

* Be aware that this form of property ownership has relatively little case law supporting it.

**Incorrect**. This is a true statement but not the only true statement. Try again.

* Be aware that certain debts such as alimony and child support may be collected against DAPT assets.

**Incorrect.** This is a true statement but not the only true statement. Try again.

* Be aware that some states may not recognize the DAPT statutes of other states.

**Incorrect.** This is a true statement but not the only true statement. Try again.

* **All of the above**

**Correct**.

***You have now completed the study of forms of property ownership. Next up you will learn how exempt property contributes to an effective AP plan.***

## Exempt Property

Here is a cheerful insight. Some of your client’s existing assets may already be protected (exempt) from creditors.

The chart below analyzes exemptions against both non-bankruptcy creditors and bankruptcy creditors. **Click on each of the exemptions to know more.**

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| Bankruptcy Creditors  The rights of ***bankruptcy creditors*** depends upon whether state law or federal law applies. Many states require the use of state statutes in bankruptcy but a number of the states allow either the state or federal bankruptcy statutes. |

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| **Qualified Plan Assets** | Federal law protects, or exempts, an unlimited amount of assets held inside of qualified retirement plans, Section 403(b) Plans, and Section 457 Plans (hereinafter collectively referred to as “**exempt plans**”).  The exemption protects assets from most judgment creditors in addition to exempting the assets from most bankruptcy creditors.   * Noteworthy - “owner only” exempt plans, such as solo 401(k) Plans, generally also enjoy unlimited protection from most creditors.   The protection is not absolute, however. **Click** here **to learn more.**   |  |  | | --- | --- | | Protection is Not Absolute  The following claims may be enforceable even against exempt plans:   * Federal levies for unpaid income tax, interest, penalty, and/or fines * Enforcement of a qualified domestic relations order (generally representing unpaid alimony, child support, and/or property settlement) * Rights of a spouse to a portion of the participant’s qualified pension category plan.  |  | | --- | | Qualified pension category plans  *Qualified pension category plans* include defined benefit plans, cash balance plans, target benefit plans, and money purchase plans. | |  |  | | --- | | **Caution**  The exemption is effective only as long as the assets are in the exempt plan. Amounts distributed from the plan may be available to creditors. | |
| **IRA Assets** | Traditional and Roth IRAs have significant but limited asset protection.   |  |  | | --- | --- | | **Bankruptcy Exemption** | **Exemption from Judgment Creditors (Nonbankruptcy Creditors)** | | There is an exemption in bankruptcy - the maximum exemption is the greater of the federal limit ($1,245,475 in 2015, as indexed) or the state limit. | While state law varies, balances in an IRA may not be protected from judgment creditors as in exempt plans. |   Be aware that even the limited IRA exemptions may be lost if your client has an inherited IRA.1  **Click** here for insights into SEP IRAs, SIMPLE IRAs, and Rollover IRAs.   |  | | --- | | SEP IRAs, SIMPLE IRAs, and Rollover IRAs  **SEP IRAs and SIMPLE IRAs**   * Balances are exempt without limit from most bankruptcy creditors under federal law.2 * Federal law may not protect balances from judgment creditors. Check your state’s laws to determine if state protections apply.   **Rollover IRAs**   * Assets rolled over from an qualified plan to an IRA are generally exempt from judgment creditors and bankruptcy proceedings without limit. * The unlimited exemption may be lost if Traditional IRA or Roth IRA balances are commingled with Rollover IRA balances. |   *1* *Clark v. Rameker*, 134 S. Ct. 2242 (2014)  2 *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* |

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| **Life Insurance** | The diversity of law in these United States of America is on vivid display as we consider the life insurance exemption under various bankruptcy and nonbankruptcy laws.   |  |  | | --- | --- | | **Bankruptcy Exemption** | **Exemption from Judgment Creditors (Nonbankruptcy Creditors)** | | **State Exemptions**  State exemptions range from $4,000 to an unlimited amount. **Click** here **to know more.**   |  | | --- | | Knowing More  In some states, the exemption only applies to surviving spouses or children of the decedent.  A number of states permit claims for unpaid child support or alimony to be made against death benefit proceeds. |   **Federal Exemptions**  Federal bankruptcy statutes exempt policies with a policy loan value up to $12,250. **Click** here **to know more.**   |  | | --- | | Knowing More  The death benefit is generally exempt if the debtor’s policy was “unmatured” at the time of the bankruptcy filing. A policy “matures” when the insured dies. | | Exemption of life insurance assets from judgment creditors varies by state. | |
| **Personal Residence** | The legal term for this exemption is the “Homestead Exemption.” The individual states vary dramatically in the exemption provided.   |  |  | | --- | --- | | **Bankruptcy Exemption** | **Exemption from Judgment Creditors (Nonbankruptcy Creditors)** | | **State Exemptions**  Some states provide an unlimited Homestead Exemption while others limit the exemption to as little as $2,500.  **Federal Exemptions**  The federal Homestead Exemption is $15,000. | Exemption of these assets from judgment creditors varies by state. |   https://www.greeneconsults.com/topclass/greene/cfp/course05/lesson04/test_tip_icon.gif **Planning Tip – Do Not Lose the Homestead Exemption**   |  | | --- | | The Homestead Exemption may only be valid if your client has filed for it. The states have differing requirements so direct your client to competent counsel to ensure the Homestead Exemption is claimed properly. | |
| **Other Exemptions** | The following exemptions, while not all-inclusive, are noteworthy.   |  |  | | --- | --- | | **Bankruptcy Exemption** | **Exemption from Judgment Creditors (Nonbankruptcy Creditors)** | | **State exemptions**   * Annuities within certain limits * Earned income within limits * Section 529 Qualified Tuition Plans (exempted only in certain states)   **Federal exemptions**   * Social Security benefits, unemployment compensation, veterans benefits, and disability benefits * Alimony and child support payments * Other personal property (example, jewelry with a $1,000 exemption) | Exemption of these assets from judgment creditors varies by state. | |

https://www.greeneconsults.com/topclass/greene/cfp/course05/lesson04/test_tip_icon.gif **Planning Tip**

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| **Exemptions May Not Be Valid Against Secured Creditors**  Neither federal nor state exemptions may be valid against secured creditors. A secured creditor has collateral that secures the loan.   * An example is a mortgage on a residence that secures (or collateralizes) the mortgage loan. * If a clients defaults on his or her home mortgage, the home may be subject to foreclosure. |

### Asset Protection Verdict

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| Exemptions generally cost nothing and should be utilized as part of virtually every client’s AP plan. Keep the following cautions in mind, however:   * For most clients, exemptions will not protect all assets. * Extreme care should be taken to understand applicable state law, which drives the type of property exempted and the amount exempted. * Remember that exemption from bankruptcy creditors does not always equate to exemption from nonbankruptcy creditors (judgment creditors).   Once again, consultation with an experienced AP attorney is an absolute requirement when planning for exemptions. ***The bottom line is that exemptions alone may not be sufficient to protect all of your client’s assets.*** |

## Review Exercise

**Select the correct answer to this question.**

**Your client won a $10 million jury award in a civil trial for wrongful death of a family member. Which of the following assets of the defendant, if any, is most likely to yield payment of the judgment?**

* $5 million home in a state with an unlimited Homestead Exemption

**Incorrect**. Try again.

* $3 million in a solo 401(k) Plan

**Incorrect**. Exempt plans are exempt without limit to such judgments. Try again.

* **$1 million balance in an IRA (not a Rollover IRA)**

**Correct!** **Such IRA balances are not generally exempt from judgment creditors, but are exempt within limits from bankruptcy creditors.**

* $2 million in a Rollover IRA (transferred from an exempt plan)

**Incorrect**. IRAs containing only transfers from exempt plans are generally exempt from judgment creditors. Try again.

* None of the above

**Incorrect**. Try again.

***You have now completed the study of exemptions. Next up you will learn how liability insurance contributes to an effective AP plan.***

## Liability Insurance

As we begin our discussion around liability insurance, let us first address a couple of myths:

**Click each myth to learn more.**

* **Myth #1 – Liability insurance is unnecessary when your client has an effective AP plan.**

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| **Myth** **#1**  Liability insurance is unnecessary when your client has an effective AP plan.  **Reality**  Liability insurance is a vital part of AP planning for most clients. A number of practitioners consider liability insurance the best initial defense against liability claims. **Click** here **for the benefits.**   |  | | --- | | Benefits of Liability Insurance   * Legal defense costs are paid by the insurance company. * Settlement of the claim up to the policy limit is the insurer’s expense, not your client’s. * Liability insurance is not subject to fraudulent transfer rules. | |

* **Myth #2 – An effective AP plan is unnecessary when your client has liability insurance.**

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| **Myth** **#2**  An effective AP plan is unnecessary when your client has liability insurance.  **Reality**  Liability insurance is no panacea. There are a number of risks in relying solely upon insurance, including 1) policy exclusions, and 2) policy limits. **Click** here **for an example.**   |  | | --- | | Example of Policy Exclusion  Assume your client is sued for age discrimination. The client’s standard business liability policy may exclude coverage for claims from protected classes (age, race, gender, etc.). Such suits are notoriously expensive to defend and can involve litigation at both the state and federal level. | |

The fact remains that liability insurance is an important part of an effective AP plan. While not an exhaustive list, the following key policies should generally be considered: **Click each policy to learn more.**

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| **Standard General Business Liability** |
| This policy is a must for all operating businesses. A general business liability policy usually covers the following business risks:   * Bodily Injury * Property Damage * Personal Injury (such as slander and libel)  |  | | --- | | Slander and Libel  There two civil wrongs (torts) involve defamation. Defamation occurs when one party communicates damaging and false information about another person or organization. Slander refers to oral defamation while libel refers to written defamation. |   Ominously, such policies may exclude risks that could bankrupt the business. **Click** here **for examples.**   |  | | --- | | Examples of Exclusions from Coverage Under A Standard Policy   * Damage caused by an employee’s injuring or killing another person while driving his car on a company errand * Injury caused by one employee striking another employee * Age, gender, or racial discrimination claims | |
| **Standard Malpractice (Professional Liability)** |
| These policies usually cover negligence of the professional and employees listed as covered persons under the policy.   |  |  | | --- | --- | | Cornell University Law School’s Legal Information Institute defines ***negligence*** as “a failure to behave with the level of care that someone of ordinary prudence [also referred to as ‘reasonable care’] would have exercised under the same circumstances…” **Click** here **for an example.**   |  | | --- | | Example of Negligence  Your daughter suffers a slight laceration to her leg during a rugby game. You take her to your pediatrician for treatment. The pediatrician mistakenly uses infected instruments previously used to treat another child with a severe infection. Your daughter’s slight injury now escalates into a severe infection requiring hospitalization. The pediatrician is open to charges of negligence for failure to exercise ordinary prudence by selecting only sterilized instruments. | |   https://www.greeneconsults.com/topclass/greene/cfp/course05/lesson04/test_tip_icon.gif**Planning Tip**   |  |  |  |  | | --- | --- | --- | --- | | **Rude Awakening**  Your professional clients, such as physicians, may have a rude and unwelcome awakening as they read their malpractice policy for coverage gaps. Such coverage gaps can include exclusion for product liability (faulty pacemaker, for example), gross negligence, and more.   |  |  | | --- | --- | | Gross Negligence  Cornell University Law School’s Legal Information Institute defines gross negligence as “a lack of care that demonstrates **reckless disregard for the safety or lives of others**…” **Click** here **for an example.**   |  | | --- | | Example of Gross Negligence  Your best friend suffered severe injury to his left arm during an auto accident. The arm is so seriously damaged that is must be amputated to preserve your friend’s life.   * The emergency room physician mistakenly amputates your friend’s undamaged right arm. * The physician may be open to charges of gross negligence for amputating the wrong arm. | |  |  | | --- | | More  The policy may also contain exclusions for 1) willful misconduct, 2) fines, 3) penalties, and 4) employees not specifically listed by name on the policy. | | |
| **Standard Personal Umbrella** |
| If this key policy were the subject of a text message, the message would read “we Macintosh HD:Users:brucestarks:Pictures:iPhoto Library.photolibrary:Masters:2015:01:20:20150120-114343:Unknown.jpg umbrella policies.” Here are just a few of the powerful reasons to consider an umbrella policy:   * **Cost-efficient** – These policies are generally among the lowest cost liability policies available. Depending upon the facts and circumstances of each client, annual premium rates can be as low as $200 per $1 million of coverage. * **High policy limits** – Coverage may generally be obtained by most clients for their entire net worth (recommended) or more to cover future earnings as well. * **Broader Coverage** – Umbrella policies usually cover liabilities excluded from homeowners and personal auto policies such as slander, libel, or claims related to service as a volunteer Board member for a charity.   Sadly, umbrella coverage is not all-inclusive. **Click** here **for examples of potential exclusions from umbrella coverage.**   |  | | --- | | Potential Exclusions from Coverage Under A Standard Personal Umbrella Policy   * Liability resulting from dangerous pets, dangerous sports, or activities involving guns and certain equipment, such as chainsaws * Liability due to owning non-traditional watercraft, such as jet skis * Damages intended by the insured (generally resulting from intentional acts by the insured) * Business activities (a business umbrella should be purchased for businesses)1   *1 Riders and endorsements may be available to cover some of these risks excluded from a standard policy.* |   https://www.greeneconsults.com/topclass/greene/cfp/course05/lesson04/test_tip_icon.gif **Planning Tip**   |  | | --- | | **The Wealthiest 1% Lack Umbrella Coverage**  Do not assume that your wealthy clients have adequate umbrella coverage. According to the March 5, 2012, edition of Forbes/Taxes, 2 in every 5 individuals with a net worth of $5 million or more have ***no umbrella coverage*** or lack sufficient coverage. |   Noteworthy - Umbrella policies generally require significant underlying liability coverage (above state minimums) on both automobile and homeowners policies. |
| **Standard Directors and Officers Coverage (D & O)** |
| This coverage is a must for your clients in corporate, educational, and not-for-profit leadership roles. Simply put, D & O policies cover liability resulting from management decisions that have adverse financial consequences. The coverage may exclude some bodily injury claims, property damage claims, and fraud.  If your client is in a senior leadership role, he or she should generally have D & O insurance. But here’s a **huge caveat** – your client’s attorney should review the policy to confirm that your client, and not just the organization, is covered. any?) |

The multitude of policy types for differing liabilities can be confusing to clients. A quick example will underscore the point.

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| **Example**  Your clients, George and Martha, have a net worth of $15 million. They are doting grandparents of their sole grandchild, Sarah, age 17.   * On a recent trip to their beachfront condo overlooking Kaanapali Beach on Maui, Martha purchased a new jet ski for Sarah. * George assumed the Jet Ski was covered under their homeowners policy and believed he had two weeks to report the purchase to their insurance company. Coverage would then, he assumed, be automatic and retroactive to the purchase date. * Martha assumed the jet ski was covered automatically by their standard personal umbrella policy.   Regretfully, Sara became distracted by the Maui firemen shooting their annual calendar on the beach and grazed a swimmer with the jet ski. As fate would have it, the swimmer was a surgeon and his operating hand was permanently damaged by the accident.  George and Martha were horrified to learn that the jet ski was not covered by liability insurance.   * Their homeowners liability policy excluded watercraft with the horsepower of the Jet Ski. * Their standard personal umbrella policy excluded jet skis from coverage.   They should have purchased personal watercraft coverage for the jet ski and sought a rider or endorsement to add the jet ski to their umbrella policy.1  ***Without an effective AP plan, the couple’s entire net worth could be exposed to liability claims resulting from Sarah’s accident.***  1 *Cost and availability of coverage varies by insurance company.* |
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### Asset Protection Verdict

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| Liability insurance is a vital part of AP planning for the vast majority of clients. If nothing else, the insurance company generally pays for the legal defense costs of covered claims. Keep in mind that legal defense costs can exceed $100,000, as we revealed in the introduction to this lesson.  The type and amount of insurance coverage should be based upon a risk analysis by your client’s Property and Casualty Agent in coordination with an experienced AP attorney.  ***Your analysis of these policy types will illustrate that insurance policies have gaps in coverage. Those gaps in coverage could represent sobering financial risks that may be managed by the other AP strategies covered in this lesson.*** |

## Review Exercise

**Select the correct answer to this question.**

**Which of the following risks is MOST likely to be covered by liability insurance?**

* Libel and slander in a standard General Business Liability policy

**Correct**!

* Fraud in a standard Directors and Officers Liability Policy

**Incorrect**. Try again.

* Damages caused by operation of a jet ski under a standard Homeowners Policy or standard Personal Umbrella Policy

**Incorrect**. Try again.

* Gross negligence under a standard Professional Liability (malpractice) Policy

**Incorrect**. Try again.

* Claims by a member of protected class under a standard General Business Liability Policy

**Incorrect**. Try again.

***Congratulations, you have now completed your study of asset protection tools and strategies. Our focus now turns to the key steps in building an effective AP plan.***

## The Asset Protection Elevator – Building an Effective AP Plan

The preceding knowledge has hopefully equipped you to raise your client’s awareness of unmanaged liability risks. Now, your role turns to empowering your client to have a meaningful dialog with his or her AP attorney. As a reminder, review your firm’s policy and discuss that policy with your compliance department before discussing AP concepts with clients.

Before considering AP strategies, your client needs to identify likely threats. Ironically, even management of likely threats is not always effective. Consider Frank and Jamie McCort of Los Angeles. Depending upon whom you believe, either Frank or both Frank and Jamie owned the Los Angeles Dodgers. An error in a prenuptial agreement opened the way for Jamie’s legal team to claim co-ownership of the Dodgers in the couples’ infamous divorce.

A record-setting $20 million in legal fees were expended and Frank ultimately settled with Jamie for a reported $130 million. What is the moral of the story? Had Frank developed an effective AP plan before marriage, then the settlement, not to mention the stress of the bitter divorce struggle, may have been far less.

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| **Overview** | The process of building the right AP plan for your client can be compared to an elevator. We begin at the ground floor and rise as high as needed to reach the destination.  Before punching the button for the first floor, ***remember that no transfer of assets to a protected form after the liability event has occurred is immune from challenge as a fraudulent transfer!***  **Click on each “floor” in the chart below to know more.** |
| **1st Floor – Exemptions** | An alternate title for this section could be “***take what is already provided by the law!***”   * State and federal law provide exemptions from bankruptcy creditors and nonbankruptcy creditors. * Generally, these exemptions are provided without cost. However, be sure your client has taken affirmative steps where needed to obtain the exemption, such as filing for the Homestead Exemption. * Remember that exemption against bankruptcy creditors frequently differs from exemption against nonbankruptcy creditors. |
| **2nd Floor –**  **Liability Insurance** | Your client now assesses any risks not covered by exemptions. These risks can include divorce risk, professional liability risk, business risk, and other risks. To the extent these risks are insurable, appropriate coverage should be purchased.  You learned that liability insurance, while vital, is no panacea. There will be policy limits and exclusions to manage. |
| **3rd Floor –**  **Protective Forms of Property Ownership** | Your client arrives at this floor if there remains significant unmanaged risk after liability insurance is purchased.  ***Many clients will find the relative simplicity and strength of using the right protective form of property ownership sufficient to meet their AP needs.***  First, let us remind you of what is generally ineffective. You were trained to recognize the lack of meaningful asset protection in many of the popular ownership forms.   |  | | --- | | Popular Ownership Forms  These include:   * Sole Name (personal property) and Fee Simple (real property) * Joint Tenancy With Rights of Survivorship (JTWROS) * Tenancy By The Entirety (TBE) * Tenants In Common (TIC) * Community Property (CP)   In fact, JTWROS and TIC forms can actually lead to increased liability risks from creditors (resulting from creditors of other joint tenants) while TBE and CP do little or nothing to safeguard assets. |   The remaining unmanaged risk as we left the second floor can frequently be addressed through the use of a Family Limited Partnership (FLP) or a Limited Liability Company (LLC). ***The FLP strategy, in particular, is reliable because of its 100-year statutory and case law history.***  To address the liability risk to the general partner (GP) in the FLP, consider owning the GP’s interest in an LLC.  The serious hurdle presented to creditors by the charging order relative to FLPs and LLCs is generally an deterrent to litigation and/or incentive for early and inexpensive settlement.   |  | | --- | | Charging Order  An order from the court assigning the debtor’s future distributions from the partnership (or LLC) to the judgment creditor is referred to as a charging order. |   For even more protection, consider separating businesses from each other to limit liability.   |  |  | | --- | --- | | Separating Businesses  A single LLC or FLP would not generally be appropriate to own both low-risk businesses (managing family wealth) and high-risk businesses (a manufacturing firm using toxic chemicals). Far better to separate these businesses into separate entities so that liability from the high-risk business does not threaten assets in the low-risk business.  Clients with numerous businesses may be attracted to the holding company to manage the separate companies for administrative purposes.   |  | | --- | | Holding Company  USLegal.com defines a holding company as “a…… company, usually a corporation, which is created to own the stock of other corporations, often using the stock holdings to control the management and policies of all of them.”  Certain types of holding companies can cause increased taxes. Consult with AP legal counsel, a CPA, and/or CFP® Certificant when considering the use of a holding company. |   Creating separate entities or transferring existing assets into different entities should be considered only with the advice of a CPA, CFP® professional, and AP planning attorney. |   While the use of the Corporation holds allure for many clients, the pitfalls of this ownership form may reduce its efficacy as effective AP.   |  | | --- | | Pitfalls of the Corporate Form   * Personal creditors may lay claim to any asset one owns personally, including shares in a corporation. * Transferring personally-owned assets to a corporation merely exposes those assets to a new threat from corporate creditors. * Earnings are taxed twice in C Corporations (once to the entity and again when dividends are paid to shareholders) * S Corporations avoid double taxation, but prohibit FLPs and LLCs from owning shares. | |
| **4th Floor –**  **Asset Protection Trusts** | There will be clients who seek even more AP than the 3rd floor offers. In the spirit of full disclosure, we have erred on the side of caution in our presentation of the 4th floor.  Advisors encouraging the formation of Asset Protection Trusts would be well-served by refraining from an unqualified endorsement while referring the discussion to experienced AP planning attorneys.  Asset protection trusts are established under the laws of one of the states in the U.S. (Domestic Assets Protection Trust or DAPT) or in an international jurisdiction (International Asset Protection Trusts or IAPTs). We will discuss DAPTs first.  DAPTs may be appealing but can be fraught with risks, such as lack of case law and competing states agendas.   |  | | --- | | Lack of Case Law  DAPT legislation was first passed by Alaska in 1997. Case law is relatively thin. Hence, this form of asset protection lacks the legal reliability of the FLP and LLC. |  |  | | --- | | Competing States Agendas  The well-respected American College of Trust and Estate Council (ACTEC) advises that “if implemented correctly, the DAPT approach may be used successfully by *residents of states with DAPT statutes [emphasis added]*.”1  But what if a resident of a state with no DAPT statute wishes to create a DAPT? And what if South Dakota has better DAPT creditor protection than Delaware? Can a person pick and choose which DAPT state statute to use without regard to his or her state of residence?  In large measure, this remains an unsettled legal issue in many states. In effect, the issue is the potential conflict of law when residents of State A use DAPT statues of State B to create DAPTs. ACTEC opines that “unless the resident’s state has ‘a strong public policy’ against DAPTs, then the likelihood [not certainty] is that the DAPT will be effective if implemented correctly.”  *1ACTEC Comparison of the Domestic Asset Protection Trust Statues, Updated through April 2014, edited by David G. Shaftel* |   An International Asset Protection Trust (IAPT) is a trust established under the laws of another country.   * These trusts offer the promise of increased control to your client (the settlor). * This added control stems from, among other things, relaxed self-settled rules in which the settlor of the trust may become the beneficiary without an elaborate control structure in place.  |  | | --- | | Control Structure  The ***control structure*** in DAPTs frequently requires an independent trustee with sole discretion in making distributions to the settlor. |   While IAPTs can be effective, remember that while the money may be in the Cook Islands, your client may reside in the U.S. and could be jailed for ignoring a judge’s repatriation order.   * Remember that H. Beatty Chadwick served 14 years in prison under a contempt of court order for refusing to repatriate $2.5 in international accounts.  |  | | --- | | Repatriation  *Repatriation* is the return of assets to the U.S. from an international jurisdiction. |   IAPTs are subject to fraudulent transfer rules, just as any other AP plan. |

## Conclusion

Perfection can become the enemy of the effective. That idea has seldom been truer than in asset protection planning. Trying to protect the very last dollar of net worth can prove expensive, complex, and could very well backfire.

The ideal asset protection plan is the simplest plan that provides effective legal obstacles and impediments to judgment creditors. Such a plan should discourage litigation or incent reasonable settlement during litigation.

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| * An effective AP plan must be clear enough to explain to a plaintiff’s counsel before a judge. If your client cannot articulate why a domestic asset protection trust was used, then a judge may well regard the trust as a mere device to defraud creditors. * Your client has to live with the AP plan daily. Flying the family to Fiji on a purely personal vacation should never be funded from corporate, FLP, or LLC funds. To do so invites a judge to regard the entity as your client’s alter ego and ignore the entity completely. * AP planning is effective and legal only against ***future creditors***. Transferring assets to a protected form after the liability event occurs may only accomplish judicial antipathy and mistrust. * Transferring 100% of one’s assets into a protective form even before a liability event may be subject to challenge of fraudulent transfer with respect to future creditors. |

We hope that the insights, opportunities, and risks shared in this lesson will help you inform your client’s discussion with legal counsel. The ultimate goal of AP planning is peace of mind for your clients. Peace of mind may be enhanced by reducing the risk of losing net worth to judgment creditors in a litigious legal environment.