

ASSET PROTECTION

What is “asset protection?”

Generally, “asset protection” is a set of legal techniques and a set of laws (sometimes referred to as debtor-creditor law) that deals with protecting the assets of individuals and/or business entities from civil money judgments. A goal of asset protection planning is to insulate assets from claims by creditors, but without concealment or tax evasion.¹ Some examples of assets that are protected from creditors can be home equity, certain retirement plans and interests in LLCs

What is the best way to protect assets against the reach of creditors?

The best way to protect one’s assets from the reach of creditors is through a carefully planned program combining various tools, such as liability and life insurance plans, trusts, the choice of business form, and selected vehicles for funding retirement plans. The very best programs are structured so that they not only may protect one’s assets, but also make sense in the context of the individual’s business, lifestyle choices, financial goals and testamentary plans. The programs most likely to survive attack are those that make sense for the above reasons and are implemented well in advance of litigation being filed.

Transfers done on the eve of entry of an adverse judgment, and that are susceptible to no explanation other than a desire to remove the assets from the reach of a potential judgment creditor, are unlikely to succeed.

Great care should be taken before embarking on any “asset protection” program. Obtaining the advice of experienced legal counsel to help develop the appropriate estate and asset conservation plan is highly advisable. The assets one may protect purely under statute from the reach of creditors are limited.

What are the laws that govern asset protection?

The United State federal bankruptcy laws² and ERISA³ exempt certain assets from creditors. While they may vary, all fifty states also have laws that exempt certain assets from creditors. Creditors also have laws that work against the laws that provide asset protections. Those laws are at the state and federal⁴ level and are called “fraudulent transfer” laws. The

¹ Jacob Stein, *Importance of Trusts in Asset Protection*, California Trusts and Estates Quarterly, Vol. 12, No. 4, Winter, 2007, at 17.

² Title 11 of the United States Code.

³ 29 U.S. C. § 1102 *et seq.*.

⁴ 11 USC § 548.

federal fraudulent transfer law is referred to as the Bankruptcy Code. Most states have adopted the Uniform Fraudulent Transfer Act. The Act defines what constitutes a fraudulent transfer. Washington State has garnishment and other laws that addressed the treatment of assets that will be discussed below.

What assets are protected by state law from the reach of creditors?

State law exempts a series of assets from the reach of most creditors. The exemptions are not applicable against a voluntary security interest in the assets (e.g., a mortgage or deed of trust on one's home), certain tax claims, and judgments for the purchase price of the otherwise exempt item. Recent amendments to the state statutes further limit the homestead exemption so that it is not applicable to liens for labor or materials provided to the home or liens for homeowner association claims. As a general rule, assets are not exempt from claims for child support or, in some instances, claims for spousal maintenance.

A list of general exemptions under state law includes:

- \$125,000 in value of real or personal property utilized as the owner's principal residence (e.g., a house or mobile home).⁵ If homestead property is sold, the proceeds are entitled to the same protection as homestead property.⁶ This is commonly referred to as the "homestead" exemption.
- All wearing apparel is exempt, but the exemption for furs, jewelry, and personal ornaments is limited to \$3,500.⁷
- Each individual is entitled to an exemption for a private library, including electronic media such as audiovisual, entertainment or reference media in digital or analog format, not to exceed \$3,500 in value.⁸
- Professionals such as a physician, surgeon, attorney, or clergyman, have an additional \$10,000 exemption for the individual's library, office furniture, office equipment and supplies.⁹

To each individual or, as to community property of spouses or domestic partners maintaining a single household as against a creditor of the community, to the community:

⁵ RCW 6.13.030.

⁶ RCW 6.13.180.

⁷ RCW 6.15.010 (1)(a)).

⁸ RCW 6.15.010 (1)(b).

⁹ RCW 6.15.010 (1) (d).

- The individual's or community's household goods, appliances, furniture, and home and yard equipment, not to exceed \$6,500 in value for the individual, or \$13,000 for the community, said amount to include provisions and fuel for the comfortable maintenance of the individual or community.¹⁰
- Other personal property, except personal earnings, not to exceed \$3,000 in value, of which not more than \$1,500 in value may consist of cash, and of which not more than \$200 in value may consist of bank accounts, savings and loan accounts, stocks, bonds, or other securities for debts owing to the state or a state agency, or not more than \$500 of such assets for all other debts.¹¹
- For an individual, a motor vehicle used for personal transportation, not to exceed \$3,250, or for a community two motor vehicles used for personal transportation, not to exceed \$6,500 aggregate value.¹²
- Any past due, current or future child support paid or owed to the debtor, which can be traced.¹³
- All professionally prescribed health aids for the debtor or a dependent of the debtor.¹⁴
- The right to, or proceeds of, a payment not to exceed \$20,000 on account of personal bodily injury, but not including pain and suffering or compensation for monetary loss, of the debtor or an individual of whom the debtor is a dependent; or the similar rights to, or proceeds of, a payment in compensation for future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the reasonable extent to support the debtor or a dependent of the debtor. This exemption is subject to the rights of Washington State or its agents or assignees as lien holder or subrogee.¹⁵
- Tuition units purchased more than two years prior to the date of a bankruptcy filing or court judgment.¹⁶
- To each qualified individual, one of the following exemptions:¹⁷

¹⁰ RCW 6.15.010(1)(c)(i).

¹¹ RCW 6.15.010(1)(c)(ii).

¹² RCW 6.15.010 (1) (c) (iii).

¹³ RCW 6.15.010(1)(c)(iv).

¹⁴ RCW 6.15.010(1)(c)(v).

¹⁵ See RCW 6.15.010(1)(c)(vi).

¹⁶ RCW 6.15.010(e)

¹⁷ See RCW 6.15.10.

- To a farmer, farm trucks, farm stock, farm tools, farm equipment, supplies and seed, not to exceed \$10,000 in value.
- To a physician, surgeon, attorney, member of the clergy, or other professional person, the individual's library, office furniture, office equipment and supplies, not to exceed 10,000 in value.
- To any other individual, the tools and instruments and materials used to carry on his or her trade for the support of himself or herself or family, not to exceed \$10,000 in value.

It is important to note that, for the purposes of measuring exempt value under either the state or federal exemptions, "value" means the reasonable market value of the debtor's interest in the item, exclusive of any and all liens and encumbrances against the item.¹⁸ Thus, if a physician owns a \$30,000 automobile subject to a \$20,000 purchase money security interest, the value of his or her interest in the vehicle is at most \$10,000. The net amount of the value actually owned may be further reduced by the potential cost of sale of the vehicle.

The separate property of one spouse or domestic partner is also exempt from the claims of creditors of the other spouse or the community.¹⁹ Claims of separate property, however, are subject to rigorous analysis and challenge. Maintaining the integrity of the separate nature of separate property can be difficult and the separate nature of the property can easily be lost through commingling.

A wide range of government and private based pension, annuity, retirement and death benefits are also exempt.²⁰ Many of these otherwise exempt payments, however, are susceptible to efforts to collect back child support.

Washington wage garnishment statutes also provide a form of exemption, which generally makes 75 percent of a defendant's disposable earnings exempt.²¹ This amount is less if the garnishment action is based on unpaid family support obligations.²²

What assets are exempt in the bankruptcy context?

Physicians seeking to protect assets in the bankruptcy context, or contemplating bankruptcy protection, should seek expert legal advice.

¹⁸ RCW 6.15.010(2).

¹⁹ RCW 6.15.040.

²⁰ See RCW 6.15.020 - .030.

²¹ RCW 6.27.150(1).

²² RCW 6.27.150(2).

Means test and the homestead exemption. Federal laws may impact a physician's individual bankruptcy, including restrictions on an individual's ability to claim the generous homestead exemptions available in some states (e.g., Florida and Texas) without having lived in those states for at least 3 and 1/3 years before the bankruptcy filing,²³ and imposing a "means test" on individuals filing a Chapter 7 (straight liquidation) bankruptcy. The "means test" is intended to require individuals to pay some part of their debts back if their income exceeds the average of the given state that and their required expenses do not exceed certain amounts.²⁴ As applied, the means test is less draconian than it sounds, but nonetheless may be a significant factor in deciding whether, or how, to seek bankruptcy court protection.

An individual filing bankruptcy can choose to utilize either the state scheme of exemptions (described above) or the federal scheme, but not both. Spouses filing joint bankruptcy cannot, however, "stack" the exemptions by having one spouse claim the federal scheme and the other spouse claim the state scheme.²⁵

The federal exemptions (the dollar amount of which are adjusted by an inflation factor every three years) are basically as follows:²⁶

- Up to \$21, 625 in value of the debtor's interest in real or personal property that the debtor or dependent of the debtor uses as a residence or in a burial plot for the debtor or a dependent of the debtor. This is often referred to as the "federal homestead exemption."
- Up to \$3,450 in value in one motor vehicle.
- Up to \$550 in interest in any particular item of household furnishing, household goods, wearing apparel, appliances, books, animals, crops, or musical instruments held primarily for the person, family or household use of the debtor or dependent of the debtor. The aggregate value of these items cannot exceed \$11,525.
- Up to \$1,450 in value of jewelry.
- Up to \$2,175 of interest in any implements, professional books or tools of the trade of the debtor or the trade of a dependent of the debtor.
- Any unmaturred life insurance contract owned by the debtor other than a credit life insurance contract.

²³ 11 U.S.C. § 522(p)(1).

²⁴ 11 U.S.C. § 707(b)(2).

²⁵ RCW 6.15.050(8).

²⁶ See 11. U.S.C. 522(d).

- Up to \$11, 525 in loan value of a life insurance policy.
- Professionally prescribed health aids.
- Debtor's right to receive social security benefits, unemployment compensation, welfare benefits, veterans benefits, disability, alimony and payments under stock bonus, pension, profit sharing, annuity received on account of illness, disability, death, age or length of service to the extent reasonably necessary for the support of the debtor or the debtor's dependents.
- Right to receive criminal restitution, wrongful death payments, life insurance benefits, compensation for loss of future earnings and up to \$21, 625 for certain kinds of personal injury.
- Retirement funds to the extent that they are in a fund or account that is exempt from taxation.

Are exemptions automatic?

Unless one files bankruptcy, the federal exemptions are inapplicable. One can avail oneself of the state set of exemptions, however, without filing bankruptcy.

One's homestead is an automatic exemption as to the house in which one resides. If one wishes to claim the homestead exemption in property other than one's main residence, however, a specific filing must be made.

One claims exemptions under the state law as to personal property by delivering to the "officer making the levy" (usually the sheriff of the county in which the debtor resides) a separate list of the items claimed as exempt, along with certain other information.²⁷ An appraisal may be required prior to the sale.

Both the federal and state sets of exemptions are designed to give a debtor "a fresh start." They are certainly not significant enough to protect most physicians' assets from the reach of creditors. The best way to maximize one's chances of accomplishing that goal is through a timely, carefully thought out, and well-coordinated plan. Obtaining advice from experienced legal counsel is advisable.

²⁷ RCW 6.15.060(3)(d).