

Asset Protection Basic Primer

By,

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In estate planning, one recurring theme of clients is asset protection. Unfortunately, expensive lawsuits and costly judgments are becoming more common. Asset protection can take many forms, from simple to complex and the proper approach will vary from client to client based on their respective needs. While complex estate planning methods such as off shore trusts exist, often less expensive options are available and effective. Below I review typical asset protection strategies from simple to complex.

Asset Titling.

One inexpensive method for protecting assets is to have assets owned by a low-target individual. For instance, in a marriage where one spouse is in a high risk occupation and another spouse is not, it is quite common to see the residence and other personal assets owned solely in the name of the low risk spouse. In so doing, should the high-risk spouse be sued personally, the family assets are less likely to be subject to the lawsuit because they are in the name of the spouse. For instance, if one spouse is a surgeon (high risk) and the other spouse is a secretary at a large corporation (low risk), titling of the home in the name of the secretary provides an additional layer of asset protection.

When engaging in this form of asset protection planning, there are a few things to keep in mind. First, titling of the assets should not go contrary any premarital agreement or other form of marital asset ownership planning. In addition, removing assets from one

individual's name may reduce that individual's asset base for financial purposes, such as for qualifying for loans.

Umbrella Insurance.

Another inexpensive form of asset protection is the purchase of umbrella insurance. Umbrella insurance is offered through the homeowner's insurance policy. Umbrella Insurance is typically inexpensive and can increase the insurance coverage of the individuals, thereby reducing the risk of personally liability in the event of a lawsuit.

When purchasing Umbrella Insurance, it is important to review the exclusions from the insurance to know what the insurance covers and what it does not. The costs and coverage of different policies should be reviewed for cost effectiveness.

Limited Liability Companies for Risky Assets.

To the extent that the client owns assets which are potentially more prone to liability risk, you should consider placing those assets in a limited liability company. For instance, rental real estate is a good candidate for ownership in a LLC because of the risk of lawsuit of renters and their invitees. By holding these assets in a LLC, the potential for personal liability associated with the property owned by the LLC is greatly diminished.

When working with limited liability companies, it is important to also consider the cost versus benefit of the companies. In many states, such as Utah and Colorado, the formation and maintenance of a LLC is very inexpensive. However in other states, such as California, which has a minimum franchise fee of \$800 per year, limited liability companies can be cost prohibitive. In addition, LLCs do not protect an individual from all claims. The client needs to respect the formalities of the LLC to avoid having the veil pierced.

Gifts to children and others.

To the extent the client has assets in excess of that client's foreseeable needs, the client may consider gifting assets to children or others in order to reduce the overall net worth of the client. This serves two purposes. First, a lower net worth reduces the attractiveness of the client as a potential lawsuit target. In addition, by having multiple owners of assets, obtaining a judgment against the assets for the claims of a single owner is more difficult when there are multiple owners of the asset.

When considering gifting it is important to keep in mind that once a client gifts the assets to others, the client no longer has ownership of those assets. This means the assets are not considered the client's for financial purposes, such as obtaining loans. In addition those assets are not available to care for the client should such a need arise. There may be transfer tax consequences associated with these gifts.

Domestic Asset Protection Trusts.

A relatively new asset protection tool is the use of Domestic Asset Protection Trusts. DAPT's are a new vehicle which allows a client to place certain assets in this trust but still have some access to or use of the assets. Assuming the formalities and legal requirements of the DAPT have been followed, the assets therein would not be subject to the claims of the client's creditors, even though the client is both the grantor and a beneficiary of the trust. (In the past, such self-settled trusts were subject to the claims of creditors).

When forming a DAPT, it is important to follow all of the requisite requirements for the formation and the operation for the trust. Since these trusts are state law governed, it is important to determine the desired state and follow the requirements of that state. In

addition, please note that these states have various time frames for fraudulent conveyances, meaning that the assets must be held by the trust for a certain period of time before those assets are outside the reach of creditors. In addition, some state such as Utah, exempt certain claim from the protection of the DAPT. For instance, in Utah a DAPT cannot be used to avoid state income tax or child support obligation. Also, DAPTs require an independent trustee and as such access to and use of the assets by the client may be limited in some respects. For instance, currently, in Utah, the trustee must be a financial institution. DAPTs are fairly new and as such the ability of these trusts to protect the client against creditors is unsettled, especially with respect to federal lawsuits; clients should be made aware of this prior to forming a DAPT. Also, there are substantial costs in forming and maintaining a DAPT.

Foreign Asset Protection Trusts

Finally, a client may form a Foreign Asset Protection Trust. This type of trust, as the name suggests, maintain in a jurisdiction other than the United States. The ability to collect on a judgment against the asset of an FAPT is limited based on the laws of the foreign country. Hence assets held in an FAPT may be difficult to reach for satisfying a judgment.

However, the risk likewise is that the client must give up control of the assets, and further, does not have the benefit of United States law against the abuses or potential abuses of a foreign trustee. There are substantial costs in forming and maintaining an FAPT. Also FAPTs should not be used as a method to attempt to circumvent federal income taxes.

Summary

There are a number of methods of Asset Protection Planning available to the client. Cost and complexity are factors to be considered when suggesting which Asset Protection Planning methods are best in a given situation.