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Guest Article

Asset Protection Planning - It's Everywhere, Part I

By Jeffrey A. Baskies

According to the Wall Street Journal, doctors, accountants, lawyers, business executives and many others are all "putting their money where creditors can't get to it." See Rachel E. Silverman, "Litigation Boom Spurs Efforts to Shield Assets", Wall Street Journal (Oct. 14, 2003.)

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Moreover, the article points to a recent survey indicating a dramatic increase in asset protection plans. The story cites a survey of millionaires, performed by Prince & Associates of Redding, Conn. According to that survey, 35 percent of all millionaires claimed to already have some form of asset protection plan (an increase from just 17 percent in 2000). Of those respondents to the survey who said they didn't yet have an asset protection plan, over 61 percent said they were interested in creating one (an increase from only 42 percent in 2000).

Those statistics point to a very powerful trend that impacts all practicing estate planners. Simply put: estate planners who want to continue representing millionaires (and who doesn't?) must be (or must become) comfortable talking about asset protection planning. There is no choice.

That doesn't mean you need to create asset protection plans in exotic locales like Nevis or the Cook Islands - unless of course you want to.

But you must be comfortable addressing the rising tide of concerns among our wealthier clients. For example, you should be familiar with your state law asset creditor protections, you should be conversant in domestic asset protection trust planning, and finally you should at least know the pros and cons of off-shore planning. Further, if you do not wish to draft asset protection plans, then it may be wise to make friends with someone who will do so - without taking your client altogether.

It is impossible to adequately cover all the issues involved in asset protection planning in an article of this nature, but below is a quick overview to help set out the key issues to consider further. This article will focus on the issues traditionally brought forth in performing asset protection planning for a doctor or corporate executive client (in trying to protect his own assets). A subsequent article will address inter-generational family asset protection planning.

Fraudulent Transfers and Conversions

At its core, asset protection planning involves transferring assets from a form in which a creditor can access them to a protected form. Thus, in order to properly advise clients on any asset protection plan, you must be familiar with the fraudulent transfer statute in your state.

Essentially, a fraudulent transfer of assets occurs when a debtor transfers (gifts, assigns, sells) assets that were otherwise available to creditors in a way that makes them now unavailable to creditors with the purpose being to thwart creditors' collections efforts.

Key questions to consider are:

- What constitutes a transfer?
- Did the transfer occur before or after a claim arose?
- Did the transfer leave the debtor insolvent?
- Was there adequate consideration?
- Was the transaction entered into in good faith?

These are the types of questions to ask to help understand what sorts of transfers will be considered fraudulent. This is the key threshold question. If a transfer isn't fraudulent, then a creditor cannot successfully attach the transferred assets.

Unfortunately, the issue of the nature of the transfer (was it fraudulent or not) is not decided until after the fact, with the court looking back with 20/20 hindsight. Thus whenever entering into asset protection plans, it is vital to explain to clients that we can never be sure if their plans will succeed as we can't predict how courts will view the transfers necessary to implement the plans. This is exacerbated by the fact that the courts would already have ruled against the clients and might be inclined to help the prevailing parties satisfy the judgments that the courts issued.

State Creditor Exemptions - The Real Silver Bullet

Every state has its own unique set of asset protection options. You should be sure you are conversant in your state's rules.

In some states, for example, a homestead (residence) is exempt from creditors' claims. In other states, a homestead is exempted, but only up to some defined value.

Often, retirement fund assets are exempt from creditor claims - although in some states pension plans may be exempt, while IRAs (or perhaps Roth IRAs) are not.

Annuities and cash value life insurance may be exempt.

Jointly owned property (often limited to tenancy by the entireties property) may be exempt from creditors of only one joint tenant. However, there is a risk that a joint owner might die, and thus void the asset protection qualities. So as an asset protection plan, joint ownership may have

unique risks.

The options are limited only by your state legislature's collective imagination.

Why are the state exemptions so important?

They are of primary importance because assets held in that form (under statutory exemptions) are virtually impossible to "pierce" by an aggressive creditor. While creditors may chase after an exotic asset protection plan involving multiple corporate and/or partnership entities, they will rarely pursue statutorily exempt assets.

The only real risks with the statutory exemptions are claims for fraudulent transfers to exempt form.

Offshore Asset Protection Plans

For years, the truly wealthy (and doctors) have known about offshore asset protection planning and foreign havens. These plans may involve trusts, partnerships, corporations and/or some combination of them. The entities used and the jurisdictions selected may make a significant impact.

Some offshore venues have actually been "fighting" to make their laws most favorable for asset protection planning. The Cook Islands, Nevis, Gibraltar, the Cayman Islands, the Bahamas, and several other jurisdictions have passed debtor-friendly legislation. Primarily, these new statutes:

1. Limited their statutes of limitations, so a creditor may have missed the filing deadline before it ever even knew the assets were located there; and

2. Refused to recognize foreign judgments, so a creditor has to re-litigate the case from scratch.

Having an offshore plan is not per se a problem. Anyone can set one up. The trouble comes in dealing with a client who created such a plan but who has creditors claiming the plan was created with the intent to hinder, delay or defraud their collection efforts.

Generally, offshore asset protection plans take a great deal of sophisticated planning. There are tax issues, reporting issues, offshore trust companies and resident agents to deal with, and complex documents to draft. Moreover, they are very expensive. Fees to set up these plans can often exceed $20,000 and annual administrative fees can exceed $5,000 or more. Thus, clients considering such plans should know they are not simple and cheap.

Moreover, all planners in the field should know that recently offshore asset protection plans have been under "attack" by U.S. courts. In particular, clients hoping to use an offshore trust should be very wary of the so-called *Anderson* case - *FTC v. Affordable Media LLC*, 179 F.3d 1128 (9th Cir. 1999).

In the Anderson case, the 9th Circuit affirmed the decision of the U.S. District Court for the District of Nevada, holding a couple, Michael and Denyse Lindaalyce Anderson, in contempt of court for failing to return assets that were held in a foreign asset protection trust. The Andersons' offshore trust was located in the Cook Islands.

While the Cook Islands has tried hard to attract asset protection funds, it appears the 9th Circuit used that against the Andersons. The court held the fact that they chose the Cook Islands was evidence of their intent to hinder, delay or defraud their creditors. Moreover, when the Andersons claimed they couldn't force their trustee to send their assets back (to satisfy the judgment), the court found the entire asset protection scheme a "charade" and sent them to jail.

I don't know about your clients, but I know mine wouldn't be very pleased if we did a plan that landed them in jail.

Domestic Asset Protection Plans

In response to developments abroad, several U.S. jurisdictions took steps to make their states favorable havens for asset protection plans. First Alaska and later Delaware, Nevada and other states all passed asset protection "friendly" statutes. Generally, these statutes allow grantors from anywhere to create trusts in their states with local trustees and to avail themselves of the debtor-friendly statutes.

Domestic asset protection plans generally involve establishing discretionary trusts in one of those states. Again, while having such a trust isn't per se a problem, if a client transfers assets to such a trust and the transfers are challenged subsequently, they may be unwound as fraudulent transfers.

Proponents of domestic trust plans argue that they are the best we can do. They argue there are tax reasons to create these trusts, too. Clients can transfer assets to irrevocable trusts so any future appreciation of assets will occur outside their taxable estates, but the assets can be used to support the clients in the trustees' discretion.

However, opponents of domestic asset protection trusts point to Article IV of the Constitution known as the "full faith and credit" clause. They argue that a judgment issued in one state should be given full faith and credit in every state, including the ones with asset protection trust laws. Could a creditor of a Florida resident enforce its judgment against a Nevada asset protection trust? Unfortunately, we don't know. These laws have not been around long enough and have not been challenged enough to define how the constitutional argument will be applied.

Further, to what extent should the *Anderson* case worry clients considering domestic asset protection plans? It seems likely that if the court in *Anderson* required foreign situs assets returned and jailed the Andersons for failing to repatriate the funds, a court could do the same thing to someone creating a domestic asset protection plan.

But there are other ways to perform domestic asset protection planning. For example, creating a family limited partnership or limited liability company for estate planning purposes may also provide an asset protection benefit. Creditors of limited partners generally can only receive a "charging order" against the debtor's limited partnership interest. That's not a very attractive way to collect a judgment and may help lead to a settlement.

Conclusion

As it appears more and more wealthy clients are interested in asset protection planning, it is imperative that estate planners become accustomed to the most important issues. We don't all need to be experts on the statutes of limitations on Gibraltar, but we should all be comfortable talking about the costs and benefits of various approaches to asset protection planning.

If you want to learn more about the subject, there are many good websites that can help. One excellent resource is www.fraudulenttransfers.com, where Jay Adkisson and Chris Riser offer a tremendous amount of information including state-by-state guides to key asset protection cases. Moreover, Jay's "Three-Step/Four-Test Analysis of UFTA" is a terrific resource. Another helpful aggregator of asset protection content is the Asset Protection Law Center (www.rjmintz.com).

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