Asset Protection Planning: Shoot Before the Buzzer

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May 19, 2010

Planning for Asset Protection

In today's litigious society, protecting assets from creditors has become a hot topic. Commonly filed lawsuits involve divorce, business disputes, failed real estate investments, medical malpractice, etc. The list of potential legal claims that any individual or business can face is virtually limitless. Although "asset protection planning" may conjure up images of off-shore trust accounts in exotic locales, such planning often can be accomplished "on-shore" and with less cost and complexity.

Planning to protect your assets from future claimants should be undertaken carefully, with a comprehensive consideration of the costs, risks, and benefits of such planning and with the aid of an experienced advisor. The planning often can be simpler than anticipated. If you can insure against a risk, then acquiring insurance is likely to be the least expensive and easiest method of protecting your assets. In some cases, however, insurance may be insufficient or unavailable. This can necessitate further planning.

Asset protection planning always should take into account the tax consequences of any proposed course of action. Certain transfers of assets may generate gift taxes, run contrary to an established estate plan, or have unanticipated income tax effects. Consultation with a tax advisor is critical to an asset protection plan.

After considering appropriate insurance for anticipated risks and the potential tax consequences of any proposed course of action, additional steps to protect assets from creditors should be taken now, rather than later. Completing asset protection steps well before any potential claim surfaces serves only to strengthen the protection. It avoids the possibility of so-called "fraudulent conveyance" actions designed to reverse asset protection steps if such steps are taken at a time when you should have anticipated a claim.

Tools of Asset Protection

Numerous asset protection opportunities are available. Many of them are not complex but nevertheless are powerful. Some of these techniques are as follows:

- *Transfer of Assets to Spouse*. If you are married and have a higher risk potential than your spouse, you can transfer assets to your spouse. If you are sued, your spouse's assets likely would be out of the potential creditor's reach. However, there are significant estate planning and domestic law issues that must be considered before using this strategy. Otherwise, a subsequent divorce, for example, could impact your assets even more than the actions of another creditor.

- *Real Estate Owned as Tenants By The Entirety*. In North Carolina, if a married couple owns real property jointly as "tenants by the entirety," then a creditor of only one of the spouses typically cannot reach the real property. Therefore, ownership of real estate by your spouse and you in this manner can be an effective asset protection tool. Again, however, careful planning should be considered because, for example, death of the less-at-risk spouse would result in automatic ownership of the entire asset by the higher-risk spouse alone.

- *IRAs and Retirement Plans*. IRAs and qualified retirement plans are exempt from the claims of creditors under federal and North Carolina law. Accordingly, one asset protection technique is to maximize your contributions to such retirement accounts. There are circumstances, however, when assets ultimately must be removed from these protected retirement accounts. At that point, the amounts withdrawn could become subject to the claims of creditors.

- *Limited Liability Business Entities*. Another form of asset protection planning is to segregate the ownership of your assets into multiple limited liability business entities such as corporations, limited partnerships, or limited liability companies rather than maintaining direct ownership. For example, if your real estate is placed in a limited liability company ("LLC"), with you retaining only an ownership interest in the LLC, then your creditors typically would not be allowed to reach the real estate asset now owned by the LLC. Moreover, your other assets would be protected from liabilities arising from the real estate now owned by the LLC. This asset protection technique can be enhanced if your assets are segregated among several limited liability business entities.

The above are powerful asset planning techniques. Once all of those techniques are considered and implemented, more sophisticated techniques also are available if additional protection is warranted. Some examples of more complex techniques are as follows:

- *Domestic Asset Protection Trusts*. In North Carolina, you cannot create a trust for yourself and have the trust assets protected from your creditors. However, several states, such as Delaware and Alaska, have changed their laws to allow an individual to establish a trust benefiting that individual and protecting the assets of the trust from the individual's creditors. Complexity arises from establishing a trust under another state's law and complying with the regulatory requirements of such law, such as using a corporate trustee located in, and transferring assets to, the state whose trust laws are being used. However, the use of a trust created under a state's laws rather than a foreign nation's asset protection trust laws can be appealing because the trust and the corporate trustee are subject to U.S. laws and regulations.

- *Off-shore Asset Protection Trusts*. Off-shore (non-U.S.) asset protection trusts work in a similar fashion to domestic asset protection trusts, except that the legal location of the trust and investment assets are outside of the United States. These trusts typically are formed in smaller countries that have enacted special legislation limiting the rights of creditors to entice owners to shelter their property in that country to the benefit of those countries' economies. These off-shore trusts typically are not effective and are not legal U.S. income tax avoidance vehicles. Extreme due diligence is necessary when considering off-shore trusts to ensure that the risk of placing assets in another country is not greater than the risk of creditor liability in the United States.

Conclusion

Asset protection planning may be accomplished in a multitude of ways, with varying degrees of complexity and expense. The most important factors are to plan very carefully and to take action before actual claims may arise. In asset protection as in basketball, to earn the points, you must take the shot before the buzzer sounds.

For further information regarding the issues described above, please contact John R. Sloan.

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