

Asset Protection Planning



Asset protection planning recognizes that preservation and protection of a client's assets during his or her life is as important (and in the view of many, more important) as preserving and protecting them after death. Asset protection planning is the process of organizing assets and affairs in advance to safeguard them from loss or dissipation. While many clients appreciate the confidentiality that can be obtained through an Asset Protection Plan ("APP"), a proper plan does not rely on secrecy for its efficacy.

For the client's (and planner's) sake, any asset protection planning must take into consideration applicable fraudulent conveyance law. Although there may be additional government reporting obligations (depending on the nature and design of the overall plan), neutrality in terms of tax liability will generally result under an APP.

Some of the practical applications of an APP are as follows:

- a. When coordinated with the estate plans of family members, an APP can be very useful in protecting an inheritance that otherwise may be at risk when distributed to the beneficiary. For example, it would make little sense for an inheritance received by an APP client from his parent to be exposed to the same risks the client seeks to avoid.
- b. A number of jurisdictions have "forced heirship" laws dictating the percentage of an estate that certain heirs must receive, and the timing of such distributions. APPs have proven quite useful for clients who desire testamentary freedom as to the ultimate disposition of their property.
- c. It is not uncommon for a person who sells his or her business or professional practice to be concerned with protecting the sale proceeds. One concern is that the buyer may not be as successful with the business or practice as was the seller; the buyer may reappear several years later to claim that the purchase price was excessive.
- d. APPs have been used as a replacement or supplement to liability insurance (e.g., professional malpractice insurance, tail coverage, errors and omissions insurance, or directors' and officers' liability coverage). A professional (e.g., a physician) may be able to eliminate or reduce liability coverage once an APP is in place. Many insurance policies contain coverage exclusions and exceptions; an insurance carrier might suffer economic reversals. APPs may provide back-up insurance coverage. APPs have been used for covering periods during a lapse in insurance coverage.



- e. Many people believe that a large insurance policy serves as a magnet for litigation. APPs allow such individuals to either eliminate or reduce coverage. However, in Florida the cash values of insurance and annuities are exempt from creditors.
- f. Many business people and professionals are often involved in business or investment activities outside the scope of their main area of work. An APP affords protection against risks that can arise from these other activities. For example, an architect or surgeon who is a general partner in a real estate investment may be surprised to learn that he or she is 100% liable for all partnership debts. This sort of risk may pose a greater problem for this investor than his or her professional activities.
- g. Many wealthy people believe that their financial profile may encourage litigation. APPs have been used to reduce one's financial profile to discourage lawsuits.
- h. APPs have been used as an alternative to a prenuptial agreement. They can be particularly attractive to a client who is facing a second (or higher) marriage and does not wish a marital agreement with his or her intended.
- i. APPs can also be used to protect retirement plan and benefit interests.
- j. A person with creditor problems may be able to use an APP to increase his or her strategic position in creditor negotiations. However, this is fraught with traps for the unwary. For example, an individual might transfer a small apartment building owned for many years to a planning structure as a creditor threat looms. The individual is left solvent following the transfer. The creditor would be hard-pressed to complain, given the transferor's remaining solvency. By protecting this parcel of real property, the debtor would be spared the taxable gain recognition that would result from the creditor proceeding against the property.
- k. APPs have been used to rebuild wealth free from a client's past or current financial problems. This "business opportunities approach" involves a planning structure designed to exploit business opportunities the client other-wise might exploit personally.

The presence of the foreign element in a foreign-situs trust will have a definite effect on a creditor's decision to either institute suit or pursue assets. The following factors will likely deter a creditor from pursuing foreign APP assets:

- a. Many foreign jurisdiction trust laws provide that judgments of another country are not given force and effect. Thus, a new trial on the merits under the foreign jurisdiction's law may be required to adjudicate the settlor's liability and the trust's



liability for the settlor's separate debt. The trust law in a number of foreign jurisdictions provides that the burden of proof in challenging asset transfers to a trust is always on the party making the allegations, and does not shift to the transferor. Additionally, the trust law usually provides that the standard of proof to be met by the party making the allegations is the American criminal standard of "beyond a reasonable doubt."

- b. The trust law of most jurisdictions provides that the statute of limitations (SOL) for challenging asset transfers to the trust begins to run from the transfer date. Unlike American law, there is no separate SOL that begins to run from the date the transfer is "discovered" by someone with a claim against the transferor. Additionally, a number of jurisdictions have SOLs shorter than the four- year statute under American law.
- c. It is expensive to pursue a claim out of state, let alone in a foreign country, particularly when there is no recognition of foreign judgments or court orders. In addition, there may be a large bond required before proceeding. The psychological barriers of dealing with foreigners and foreign legal systems, the added uncertainty of prevailing under foreign law, the increased time involved, and the geographical distance serve to enhance the protection of trust assets. It is one thing to obtain a judgment, and quite another to collect it. The procedural quagmire created by a foreign-situs trust makes the collection process more difficult.

The trust law of certain foreign jurisdictions is simply more specific and protective than U.S. state trust law; accordingly, even if a creditor is not dissuaded by the many hurdles erected by a proper foreign-situs trust, protective foreign statutes make it difficult to pierce a trust to satisfy the settlor's separate debts. A proper foreign-situs trust will ultimately succeed because it is legally sound, not because of secrecy. While most of us do not expect to experience bankruptcy, Federal investigation or the like, reliance on the trust statutes of Alaska, Delaware or Nevada may result in otherwise protectable assets being exposed. In the absence of a treaty or similar agreement, while Federal law preempts state law, it does not preempt foreign law.

This document is intended to convey to you the principal characteristics of Asset Protection Planning as it applies to common situations. For this reason we have deliberately simplified technical aspects of the law in the interest of clear communication. Under no circumstances should you or your other advisors rely solely on the contents of this document for technical advice nor should you reach any decisions with respect to this topic without further discussion and consultation with an attorney.

