INTRODUCTION TO ASSET PROTECTION PLANNING

Presented By:
Jeffrey R. Matsen

© November, 2009, Jeffrey R. Matsen
What Is Fully Integrated Estate Planning?

Planning for the orderly disposition of assets at death in the most tax saving favorable manner, while at the same time preserving and protecting and increasing one’s assets during lifetime.
What Is Asset Protection Planning?

Setting up and arranging one’s assets and affairs in the most effective way so as to protect and safeguard them from risks and any creditors’ claims to which they would otherwise be subject.
Asset Protection Planning or Risk Management Planning has been practiced by attorneys, financial planners and accountants for several decades.
Business persons have always had concern over the exposure that personal assets have to claims against the business.
Corporate form of business entity with the shield of limited liability has been invoked for centuries

Over the last few decades expanding theories of liability and proliferation of litigation has given increased emphasis to asset protection planning to the extent that it is now a well recognized area of practice.

Potential liability is a major concern to doctors, other professionals and persons of high net worth.
Why the Increased Liability Exposure?

- Victim Oriented Society
- Deep pocket
- Plaintiff lawyers
- Increased media and society awareness
- High notoriety for malpractice and other errors and omissions type of action
Claimants or Creditors

- Clients of professionals, i.e., malpractice claims, doctors, dentists, lawyers, CPAs, architects, engineers, etc.
- Future claimants of real estate investor or business owner.
- Claims of spouse relative to potential divorce.
- Claimants and creditors of children or elderly parents.
- Claimants of high risk business owner.
- The buyer of a business who subsequently suffers buyer’s remorse and goes against seller for fraud, misrepresentation, etc.
- General tort claimants, i.e., traffic accidents, etc.
- Contract claimants, i.e., personal guarantees, bonding and other contractual claims.
- Government agencies, i.e., the IRS, state taxing authorities and environment base claims (extra care has to be taken with respect to planning to protect assets against governmental claims).
Typical Clients

- Professionals, doctors, dentists, lawyers, CPAs, architects, engineers, etc.
- Potential recipients of substantial inheritances from parents or other family members.
- Business owners
- Sellers of businesses.
- Individuals with high risk businesses or dealings with investors.
- Individuals who have to sign personal guarantees and bonds, i.e., contractors and other business owners.
- Officers and directors of public companies.
- Owners of boats, airplanes or extreme vehicles.
- Real estate investors and owners.
- Celebrities, high net worth and high visibility individuals.
- Wealthy spouse in second marriage.
- Children of wealthy individuals.
Business owners and real estate investors need to closely examine their own business entity structure

- C or S Corps
- LLCs
- Segregation of Assets
- Equity Stripping Devices
Doctor and dentist clients need to be aware of proper structure for practice

- Professional corporations
- Segregation of assets
- Sub S election
- Shareholder agreements
- Other practice structure items
The Use of Multiple Entities

What Types of Entities Are Available?

- The Corporation
- LPs
- LLCs
Segregate Business Assets

- Real estate should be held in LLC and leased to professional practice or business
- Equipment can be held in LLC and leased to professional practice or business
- Separate liability protected entity for different business or practice functions and operations
Information gathering is essential. Know your client and understand the client’s assets.

- Real estate investments
- Personal investments
- Business investments
Have detailed discussions and information gathering process.

Do your own due diligence.
Coordinate any asset protection and risk management planning with basic estate planning

- Trusts
- Wills
- ILITs
- Other estate planning techniques
Take into account marriage and family situation.

Know how assets are titled and be aware of other ownership issues.
What Are The Issues/Limitations That Must Be Addressed?

- Fraudulent Conveyance Statutes
- Bankruptcy Limitations
- Federal and State Criminal Violations
Inside Creditors

Definition:
Inside creditors are those creditors whose claim is directed against the business operation or real estate which is operated and owned inside a business entity.
Protecting Against Inside Debts or Claims

Operating Businesses:

- C Corporations
- S Corporations
- Limited Liability Companies
General Rules:

- If you own everything in one company or in your own name, one lawsuit can result in the loss of everything you own.

- If you own things in separate companies, then only the entity involved in the suit is at risk.

- Segregate your most valuable assets (i.e., real estate in separate LLC, equipment in separate LLC).
Real Estate assets need to be protected!

1. Insurance
2. LLCs or FLPs
Warning!!!

- Jointly owned real estate should generally not be held as individuals or in General Partnerships.
- Tremendous liability potential: You MUST consider LLCs or FLPs!
Outside Creditors

Definition:
Outside creditors are those creditors whose claims arise outside the purview of the business entity and are generally asserted against the business or real estate owner personally.
Fraudulent Transfer Issues

Under UFTA, fraudulent transfer may be boiled down to two basic theories:

1. Actual Intent (smoking gun or badges of fraud); or

2. Insolvency + Transfer for less than reasonably equivalent value

Limitations Periods – usually 4 years
Fraudulent Transfer Issues

Common Badges of Fraud:

- Transfer to an insider;
- Retention of possession or control
- Concealment
- Debtor had been sued or threatened with suit
- Transfer of substantially all the debtor’s assets
- Transfer occurred shortly before or shortly after a substantial debt was incurred
Fraudulent Transfer - Solvency

\[
\text{Net Worth for fraudulent transfer purposes} = \frac{\text{[Assets} - \text{Exempt Assets]} - \text{[Known Liabilities} + \text{Reasonably Anticipated Liabilities]}}{}
\]
Fraudulent Transfer Issues

Reasonably Equivalent Value

- UFTA does not define value
- “Reasonably equivalent value” does not necessarily mean fair market value
- Deferred or installment payments do not change the value analysis, so long as the present value of the deferred payments is reasonably equivalent to the value of the asset(s) transferred.
Fraudulent Transfer Issues

Planning Techniques Using Exchanges for Reasonably Equivalent Value

- Traditional Sales
- Installment Sales
- Private Annuities
- Factoring Arrangements
The Matsen Spectrum Of Fraudulent Conveyance Applicability

|-------------|----------------|-------------------|------------------|----------------------|---------|------------|
Bankruptcy Considerations

- Domicile
- Homestead
- Retirement Plans

- Self-Settled Trusts and “Similar Devices”
- LLC and LP Interests in Bankruptcy – what will the bankruptcy trustee get? Economic rights only? Or all rights – including voting rights?
Bankruptcy Considerations

(Continued)

- Any transfer within two years before the date of filing made with the actual intent to hinder, delay or defraud any present or future creditor may be voided by the Bankruptcy Court.

- Under the TALENT Amendment a special 10 year avoidance period exists for a transfer made with actual intent to hinder, delay or defraud a present or future creditor if the transfer was made by the debtor to a self settled trust or similar device.

- Debtor must have been domiciled for 730 days pre petition before seeking state’s local exemption laws.

- Debtor’s homestead exemption is capped at $125,000 if he/she acquired residence less than 1,215 days pre petition.
Qualified Retirement Plans and IRAs

Protection in Bankruptcy:

- Unlimited protection for qualified plans and rollover IRAs
- $1MM aggregate protection for IRAs

Protection outside of bankruptcy:

- Unlimited protection for qualified plans
- Widely varying state law protections for IRAs
Adequate Personal and Business Insurance is always the first line of defense

Personal

- Max out auto limits
- Be sure homeowner’s insurance is sufficient
- Always buy umbrella insurance

Business

- Be sure commercial general liability insurance is sufficient
- Buy umbrella insurance
- Consider as much professional liability insurance as client can reasonably afford
- Consider employment practices insurance

Read the policies!
Joint Ownership of Property

- Tenancy in common and joint tenancy interests can be reached by creditors.
- Tenancy by the entirety interests cannot be reached by the creditors of one spouse, but this protection is available only in a handful of states, and usually only for real estate.
- Tenancy by the entirety protection ends when the marriage ends, whether by divorce or death.
Exemptions

- Homestead – limited in most states; substantial protection in a few states
- Life Insurance – substantial protection of cash value in some states
- Annuities – substantial protection of cash value in some states; protection of annuity payments in a few states
Marital Property Planning

Consider possibility of transmuting separate property or jointly held interest of working spouse into separate property of non working spouse.
Marital Property Planning

Quid pro quo or fair market consideration is preferable
Marital Property Planning

Remember, what is good for the goose is good for the gander. What is good for asset protection planning will probably be good for divorce consequences.
Marital Property Planning

Generally, agreements between spouses may be subject to avoidance as a fraudulent conveyance.
Also, transmuting jointly held property or separate property of one spouse to another may cause the loss of step up in basis that would otherwise occur upon the death of the transferor.
The Charging Order

- Creditor of a partner or LLC member cannot reach partnership assets or seize partnership interest or LLC interest

- Limited to a court order “charging” the interest with the debt

- If distributions are made with respect to the charged interest, they must be made to the creditor

- Creditor gets only economic rights to distributions, not voting rights or other non-economic rights
Forum Shopping

- Why Forum Shop?
- The Charging Order and the “Exclusive Remedy” Issue
- “Most Favorable” Jurisdictions for LLCs
  1. Delaware, New Jersey (Florida for LPs)
  2. Alaska, Texas and Virginia
  3. South Dakota
  4. Nevada, Arizona and Wyoming

See “Merric and Comer,” Steve Leimberg’s Asset Protection Planning Newsletters #112 (8, Aug. ’07), #114 (28, Aug. ’07), #117 (19, Aug. ’07) and #127 (17, Apr. ’08)
Series LLCs

- Structure

SERIES LLC

Series 1  Series 2  Series 3
Series LLCs

- Liability Limitation Between Series
Series LLCs

- Uses
- Structural and Income Tax Problems
- California Courts Treatment?
- California Tax Treatment of Series LLCs
- Diversity Cases
- What Is the Current Status of the Series LLC?
DOMESTIC ASSET PROTECTION TRUSTS

- The general rule in most states is that creditors can reach the interest of the Trustor (the maker of the trust) of domestic self-settled trusts.

- Recently, several states have adopted legislation somewhat similar to various offshore jurisdictions that provide by statute various degrees of asset protection for a trustor’s interest as a beneficiary in a self-settled trust.

- Alaska, Delaware, South Dakota and Nevada seem to have the best laws. The big advantage of Nevada is the shorter statute of limitation (2 years).

- If properly set up and maintained, the Domestic Asset Protection Trust will be a significant barrier to creditors and will afford significant leverage to the debtor with respect to its negotiations with the creditor. This is especially true if the assets of the trust that need to be protected are domiciled in a state which is the domiciliary of the Asset Protect Trust.
The problem is that the courts of the non domiciliary state may not give effect to the Asset Protection features of the trust.

However, there is no question that a significant degree of protection is afforded by utilizing the Domestic Asset Protection Trust especially when it comes to negotiating for a settlement with the creditor.

It is recommended that a professional Trustee be utilized with respect to a Domestic Asset Protection Trust and, in fact, it may be mandatory in many instances.
Modular Structuring

The Modular Structure

DAPT or FAPT

95% Member

5% Member

LLC#1

Real Property

LLC#2

Liquid Investments

5% Member

95% Member
Why Go Offshore?

1.) To set up your nest-egg and protect your liquid funds

2.) International Connections
   - Relatives or Family Offshore
   - Own Property Offshore
   - Doing Business Offshore
A Foreign Asset Protection Trust is a trust that is set up in an offshore jurisdiction which has enabling trust legislation providing for substantial protection against creditors of the trustor.

One of the greatest advantages of the Foreign Asset Protection is the fact that by its very nature any legal attack against its assets are transferred abroad to a different legal system.

A foreign Trustee is necessary for the efficacy of the Foreign Asset Protection Trust.
Some of the advantages of the Offshore Trusts are as follows:

a. Most foreign jurisdictions do not recognize U.S. judgments. This may force a new trial on the merits in the foreign situs country

b. Some foreign situs jurisdictions require a much more difficult burden of proof for a creditor to challenge asset transfers to Foreign Asset Protection Trusts

c. Some jurisdictions have a statute of limitations for challenging asset transfers to a trust that begins to run on the date of transfer

d. Fees and expenses in litigating in the foreign jurisdictions are going to be substantial thereby serving as a strong deterrent to foreign litigation
Implementing the plan and putting it all together

How do you Approach Asset Protection Planning?

- Selling a product
- Checking off the checklist
- Addressing a concept
- Focusing on the potential creditor
- Addressing the assets
- Reviewing the client’s risk management objectives
Basic Checklist of Techniques and Strategies

Fundamental Estate Planning Techniques and Strategies:

- Outright gifts
- Irrevocable Spend Thrift Trusts
- QPRTs
- ILITs
- Charitable Trusts
- By-Pass (Exemption) and Marital (QTIP) Trusts with spend thrift clauses, qualified retirement plans and IRAs
Basic Checklist of Techniques and Strategies

Core Domestic Asset Protection Techniques:

- Adequate Insurance umbrella
- Lease not Buy (9)
- Equity stripping
- Marital Planning
- Entity shield for business operation, i.e., corporation or LLCs
- Multiple legal entities
- LLCs for real estate investments
Basic Checklist of Techniques and Strategies

The More Substantial Asset Protection Planning Techniques:

- Domestic Asset Protection Trusts
- Foreign Asset Protection Trusts
- Modular Planning Using Asset Protection Trust and LLCs
Case Study

Dr. Harry Hands is a licensed physician certified and specializing in cosmetic surgery. He was recently affiliated with a medical group but has since ventured out on his own. He has not incorporated but has a working relationship with a Surgery Center that is operated by a group of other plastic surgeons and anesthesiologists.

Dr. Hands is 42 years old and is married to his wife, Pricilla Prudent, who is 40. The couple have two minor children ages 13 and 10. Their personal financial statement reads as follows:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Residence, fair market value of $2,000,000 less $500,000 mortgage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vacation Home:</td>
<td>$1,500,000 fair market value</td>
</tr>
<tr>
<td>Residential Rental Property:</td>
<td>$1,000,000 less $400,000 mortgage</td>
</tr>
<tr>
<td>Pension Plan:</td>
<td>Harry: $350,000</td>
</tr>
<tr>
<td>IRA:</td>
<td>Pricilla: $50,000</td>
</tr>
</tbody>
</table>
Dr. Hands and Pricilla contact you to assist them with Asset Protection Planning. Dr. Hands has recently had difficulty obtaining mal practice insurance because of a previous litigation that has now been settled.