



Asset Protection Basics

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The importance of asset protection was dramatically underscored by the financial crisis of 2007 and 2008, and asset protection planning continues to be a high priority for wealthy individuals. This short article focuses on the basics of asset protection planning.

Anticipated Threats

Many legal threats to an individual's wealth, such as those related to consumer and bank debt or resulting from the breach of an obligation, are usually easy to anticipate. Others, such as those arising from personal guarantees, contingent liabilities, and partnership obligations, can be unexpected. In addition to these contract creditors, business claimants and tort creditors can give rise to personal liability judgments. Asset protection serves to protect one's wealth not only from unanticipated legal threats, but also from economic and political threats.

Unanticipated Threats and Fraudulent Transfer

Needless to say, many Americans experienced financial turmoil during the 2008 recession and its fallout. Individuals' substantial net worths were depleted in wild market swings and threatened by restricted liquidity. For example, many real estate developers found themselves in a difficult position because of personal guarantees. In a recent case in Bankruptcy Court [In re Hymas, 2010 WL 3932042 (Bkrtcy.D.Idaho 9/30/2010)], a couple made personal guarantees in connection with their real estate projects. When the projects started to falter, they created several Nevada LLCs and LPs and funded them with proceeds from the liquidation of their remaining assets. Because the Court found the transfers to be fraudulent, the couple was denied a bankruptcy discharge, meaning that creditors can pursue the debts until paid in full.

Rules against fraudulent conveyance do not allow transfers that are designed to delay, hinder, or defraud a creditor. These rules are designed to protect known and reasonably identifiable creditors. However, unknown, future creditors who are removed in years and events from the transfer have not been protected by the courts. If a transfer to a trust does not render the transferor insolvent, there is no claimant on the

horizon, and there has been no misrepresentation to creditors or claimants, the transfer is generally allowed.

Settlor Control

Maintaining control has an inverse relationship to achieving asset protection. When a trust is designed to allow the settlor some measure of control, the possibility that the trust can be attacked as a sham arises, and the trust becomes vulnerable if the settlor is aggressive about retaining control. If the arrangement is ultimately controlled by the settlor and if the settlor has, in effect, complete beneficial enjoyment, a court could easily render the entire structure a sham and order turnover of the assets upon a judgment creditor's demand. The more the client relinquishes control, the more effective the asset protection of the structure becomes. There are a number of specific methods of addressing the control issue; for example, protectorships, letters of wishes, advisory committees, and co-trusteeships.

Multiple-Entity Approach

The sources and extent of an individual's wealth can dictate the nature and scope of asset protective safeguards. Also, a multiple-entity approach allows for not only tax planning and the transfer of wealth, but also facilitates asset protection planning. Multiple-entity planning entails the segregation of wealth into isolated protected compartments, making use of limited partnerships, corporations, foundations, trusts, and the like.

U.S. Asset Protection Planning

In the U.S. domestic context, there are many opportunities for asset protection planning. Arrangements that have historically been driven by tax considerations can provide a shield from creditors. These arrangements include life insurance, annuities, marital property planning, retirement plans, inheritances, foundations, corporations, limited partnerships, limited liability companies, limited liability partnerships, and trusts for the benefit of third parties.

The laws of the fifty states vary widely in what they offer in terms of protection from the claims of creditors. In most states, there are common law rules against self-settled spendthrift trusts. However, some states have enacted statutes specifically intended to allow for the protection provided by such trusts.

Texas and Florida provide a high degree of statutory protection from the claims of creditors, especially related to homesteads and life insurance and annuities. In addition, the advantages of corporate and partnership law in Delaware and Nevada can make those jurisdictions an attractive option for an asset protection trust, particularly under the trusteeship of a solid corporate trust company.

Foreign Asset Protection Planning

In cases where domestic strategies do not provide adequate asset protection, a foreign trust can serve that role. There are many foreign jurisdictions that offer a high degree of asset protection. These include the Channel Islands, the Isle of Man, Liechtenstein, Bermuda, Nevis, and the Cook Islands.

The most protective foreign trust planning includes the placement of assets in a trust governed by the laws of a foreign jurisdiction that names a foreign trustee. Such an arrangement serves to sever all jurisdictional ties with the United States federal and state judicial systems. If the assets are physically offshore, a claimant or creditor pursuing the assets typically will have to do so in the jurisdiction that is the situs of the trust.

Most jurisdictions will not enforce foreign judgments or will only do so after the case is retried under local law. In some countries, contingent fee contracts are not permitted, and plaintiffs are required to make substantial down-payments as a condition precedent to filing a lawsuit. Obviously, the difficulty in penetrating a foreign trust might deter a potential future claimant from pursuing action in the first place.

A foreign trust can also facilitate economic diversification. For example, a foreign money manager operating on behalf of a foreign trustee can direct investments in assets not normally open to or considered by U.S. investors. Finally, a foreign trust is conducive to new financial and legal relationships that facilitate the relocation of a client's wealth in the event of expatriation.

Asset protection and economic diversification are the leading reasons for establishing a foreign trust but are not the only reasons. Others include:

- Financial privacy or anonymity;
- avoiding forced dispositions (for citizens of certain civil law countries);
- premarital or marital property planning;
- tax planning (for example, with private placement life insurance); and
- planning strategies in the framework of an active trade or business abroad.

Unanticipated threats to clients' wealth and rules against fraudulent transfers may preclude clients from protecting assets after a claim has arisen. There's no time like the present to engage in asset protection planning.

GBGR lawyers have extensive knowledge of, and more than 20 years of practical experience implementing, various techniques to protect assets and preserve wealth. Please let us know how we can assist with your asset protection planning.