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Number Three

Asset Protection

AN OVERVIEW

1. What client might need this technique?

In our litigious society, it is hard to identify a client who could not use some asset protection planning. However, it is certain that any business owner, anyone with a substantial estate and professionals subject to malpractice claims should investigate asset protection planning.

2. How does asset protection planning work?

In general, asset protection planning attempts to organize the ownership and location of a client's property in such a manner as to make it as difficult as possible for a creditor to acquire the property in satisfaction of a judgment against the client. It must be remembered, that the techniques discussed following are not necessarily 100% successful, but "reasonable" settlements are frequently obtained. The particular techniques that planners use vary, but the "general techniques" are:

- **Family Limited Partnerships or Limited Liability Companies:** The primary benefit of these forms of ownership of a client's property is the limitation on the rights of a creditor suing a partner or member ("partner"), "outside protection," in that a creditor is not able to attach partnership assets from events occurring at the partner level. Also, a creditor of the partnership may not attach assets of the partners. Special planning is needed for the general partner because a general partner is normally liable for partnership debts.
- **Forms of marital property ownership:** If spouses hold property as the separate property of one spouse, creditors of the other spouse have very limited rights against the separate property spouse. Likewise, spouses holding property as tenants by the entireties, where such ownership is allowed, can frustrate a creditor's attempt to acquire the property in satisfaction of a liability of one of the spouses for which the other bears no responsibility.
- **Trusts to own property:** There is a doctrine termed "spendthrift" used in the administration of a trust.

If someone other than the beneficiary transfers property to a properly designed trust for the benefit of a beneficiary, creditors of the beneficiary are generally not able to use the assets of the trust to satisfy liabilities of the beneficiary. This is a frequently used technique for leaving property to children who lack the financial ability to manage money. Some states are enacting statutes that allow beneficiaries to transfer property to a trust in which they are one of the beneficiaries and still allow protection from creditors. These new laws are untested and there is disagreement as to whether they will be successful in protecting donor-debtors from creditors.

- **Offshore entities to own property:** U.S. courts have considerable power to enable creditors to successfully attach and liquidate a debtor's property. Even though some courts might exceed their authority, that is always a concern to the asset protection planner. Therefore, some planners use offshore jurisdictions with debtor friendly rules to protect their client's property from being used to satisfy a judgment. Many of the offshore jurisdictions that are used have developed local laws that make a U.S. creditor's attempts to enforce a judgment very expensive and time consuming.
- **Statutory protections:** Most states have statutory protections that limit a creditor's rights to seize certain types of property, even though held in the name of the debtor. The most common exemptions are:
 - **Homestead exemption:** Generally, a dollar amount of a personal residence of the debtor is protected from the claims of creditors, some states even protect the entire residence, without regard to value.
 - **Wage exemptions:** States generally allow only a limited amount of compensation to be protected from garnishment by a creditor.
 - **Annuity exemptions:** Some states exempt annuity payments from creditor claims.
 - **Qualified plans:** There is federal protection of a qualified plan's assets from claims by creditors of the employee beneficiary. However, this protection does not extend to federal tax claims.
 - **Individual retirement accounts:** Most states provide a degree, or complete, protection from creditor claims for the debtor's IRA accounts, although, there is no protection from federal tax claims.
 - **Life insurance cash value:** Some jurisdictions provide considerable protection for the cash value of life insurance owned by the debtor.

3. What if a law suit is pending?

If a lawsuit is pending, transferring property to protect it from a successful lawsuit will not be effective. There is a concept in the law termed a "fraudulent conveyance." Essentially, a fraudulent conveyance is any transfer which:

- Is intended to interfere with the ability of a particular creditor to collect on any successful lawsuit, or
- Makes the person making the transfer insolvent after the transfer.

If either of these conditions are present, a court may require that the recipient of the transferred property return the property so that the creditor has access to satisfy the creditor's judgment.

4. What does the planner do in these engagements?

The planner reviews the client's circumstance, determines the potential for liability, the client's outlook toward "offshore," as opposed to "onshore," planning and recommends the technique that seems to best suit the client's needs. Once decided, the attorney executes the documents needed to implement the planning decided upon. This is a balancing technique that requires careful communication between the planner and the client. Using separate property ownership as the technique, in some circumstances, may be a foolhardy

choice by the client. Likewise, using an offshore jurisdiction may be overkill in other situations. The planner and the client must balance the risks against the costs of the plan and the client must decide.

5. What are the client's responsibilities?

Primarily, the client must provide a forthright disclosure of any existing potential lawsuits. After that, it is the typical relationship between an attorney.