The Wealth Preservation Series
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Asset Protection Planning Part 1 –
Recognizing the Challenges of Wealth Preservation

(By: Scott G. Beattie, J.D., LLM)

Twenty years have passed since I handled my first asset protection case In the years since, I've drawn up scores of estate and business plans with asset protection features, attended classes and conferences around the State, and written five or six articles on the subject. Developments continue to occur in the law, making it worth revisiting this topic again (at least for those of us who still have assets to protect). In fact, the area of practice has grown to the point that it will take three or four articles to scratch the surface of this area of planning. So that will be my endeavor for my articles over the summer months (2011).

This month I'll start with some basic concepts and describe some of the legal entities (e.g., Limited Partnerships and Limited Liability Companies) that have been used in asset protection planning from the 1980s until the present. Next month I'll focus more heavily on Asset Protection Trusts and after that the role of more advanced planning techniques like private pension plans and captive insurance companies.

In the 1980s and early 90s the field of asset protection as a separate area of law was relatively new and few lawyers focused on it as a primary area of practice. The media helped that out by broadcasting the results of litigation matters which rolled into public consciousness like storm waves pounding boats against a dock. One day we heard about a $5.0 million judgment (hospital sponges left in a patient's abdomen), the next it was a $3.0 million judgment (spilled coffee at McDonalds), and then there was that billion dollar punitive judgment against Ford Motor Company (Ford Bronco rollover deaths).

With hundreds of stories such as these (some very legitimate lawsuits, others more questionable) it is no wonder a cottage industry developed around legal strategies for people to protect assets from risks of lawsuits and judgment creditors. After all, so many things are unpredictable in life. It's hard to tell how much damage could result from a faulty smoke detector in a rental property or an employee recklessly texting his pals while driving a 30,000 pound truck. Even people who drive safely, manage property well, and have good insurance have to worry about risks exceeding coverage limits.

Asset protection planning (APP) can be defined as structuring your asset holdings in such a way as to build legitimate legal barriers around your asset holdings, to move assets into safer harbors. The reason asset protection is possible is the law provides limits on the ability of a creditor to obtain and enforce judgments against certain types of assets either because those types of assets are part of a protected class of exempt assets (e.g., public and private retirement plans) or because assets are held in a legal structure such as a corporation, limited partnership or LLC which has legal barriers to entry designed to protect multiple owners.

Some structures used for such planning like qualified pension plans (401k and profit sharing plans) are virtually impregnable to judgments and debts (but have contribution limits which restrict the amounts that can be safeguarded). Other vehicles (e.g., limited partnerships) have no real limits as to the amount of wealth that can be contributed, but do not provide as strong a protective barrier.

In situations involving multiple owners of property, allowing a creditor to recover a debt against property owned by a group of people would affect innocent co-owners who hold rights in the property. That is the case with limited partnerships, LLCs, and certain multiple beneficiary trusts (involving equitable owners). In those situations there are other members of an ownership group who arguably should not be subjected to a judgment against "their" assets just because a co-owner has a problem.

For instance, assume that in 1995 Bryce, Ashton, and Casey each contributed $150,000 to a partnership (BAC Ltd) and BAC Ltd then purchased a thirty-five unit apartment building for $1.5 Million (with financing). Ashton and Casey ran BAC Ltd conservatively, paying down debt in the entity and investing their profits wisely. But in the roaring 2000s Bryce went wild with his share of the profits, leveraging his money to purchase 50 more properties with other investors. It all began to collapse for Bryce in 2007 and by 2009 he found himself subject to an IRS lien of $250,000 and by 2010 a judgment lien of $500,000 from his other ventures.

In this example, Bryce's creditors generally could not get a judgment against BAC Ltd, nor could they apply any lien against the apartment complex because the law protects Ashton and Casey from the risk of loss associated with the unrelated activities of their partner. However, if BAC Ltd makes distributions, Bryce's share will generally be subject to attachment by his creditors (unless he owned his interest in a private pension plan or other structure that provides additional protection).

This result occurs because generally the only avenue a judgment creditor can take against a limited partner in a partnership is to seek a "charging order" against his or her interest in the entity. A charging order attaches to distributions from the entity but not to the assets owned by the entity. The creditor with a charging order is paid only if and when distributions are made to the debtor partner.

If BAC Ltd reinvests most of its income and retains Bryce to live in an apartment and manage the complex, giving him perks such as free rent, a company car, and covering other living expenses, then Bryce's creditors will find it very difficult to do anything about that situation. They could go after his other assets, if any, or try to force him into an involuntary bankruptcy, but if they get a charging order against his interest in BAC Ltd it may actually do them more harm than good because they could be taxed on undistributed “phantom” income of the partnership.

So individuals concerned about risks of loss have used Limited Partnerships and LLCs as protective structures to segregate and shelter investments, often in combination with trusts or other legal structures. Where there is a business purpose to the entity (e.g., to pool and manage capital for mutual profit), where the entity is formed and funded well in advance of a liability, where the transfer to the entity is not a fraudulent conveyance (i.e., does not leave the transferor insolvent), then at a later date the assets of that entity (if not used as security for a loan) will generally be protected from the judgment liens and liabilities of any individual partner or member.

Without cash disbursements the judgment creditor may find it difficult to execute on his charging order. If the judgment debtor has any influence over the entity, he or she might find ways as described above to have various perks paid for separately by the partnership or trust (e.g., the use of an automobile for work or a home to live in) without pulling out distributions or principal which could be subjected to the charging order. The situation tends to encourage more favorable settlements for debtors.

A Bankruptcy Trustee might try to disrupt this situation, perhaps ordering the sale of Bryce’s partnership interest. The partnership terms may not make that very lucrative for the judgment creditor either. If Bryce has a retirement plan (e.g., a 401k or perhaps even an IRA or non-qualified retirement plan), then he may be able to use some of those exempt funds to buy out his interest in the entity from the Bankruptcy Trustee (upon approval of the court) or repurchase the interest after a discharge.

If this sounds too good to be true, you should know it can be. If the entity is set up at a time when the debtor already knows about a pending liability, or if the debtor basically renders himself insolvent at the time the entity was created, then the debtor may be in violation of fraudulent transfer laws and a judge may set aside transfers to the partnership. That might be the case if Bryce was the father of Ashton and Casey in the example and he gifted $150,000 to his children in order to form BAC Ltd. If the gifts rendered him insolvent at the time, then a judge might apply the fraudulent transfer rules to set aside the transfers and force a liquidation of BAC Ltd.

In some abusive cases involving Foreign Trusts where assets were outside of the jurisdiction of the court, judges have gone so far as to throw the debtor in jail for contempt of court for refusing to return assets (effectively a debtor’s prison). The debtor in these cases is generally released when he or she complies with the judge’s order (unless the matter involved a criminal act such as embezzlement).

However, in legitimate circumstances, legal structures must be respected. If Bryce, Ashton, and Casey owned three separate apartment complexes, it would be advisable for them to separate their holdings into three separate entities. If one property burned down and the liability exceeded insurance coverage, then the other two properties would generally not be subject to the resulting debt. In that case, the liability would be inside BAC Ltd #1, and its assets could be consumed by the judgment, but BAC Ltd #2 and BAC Ltd #3 would generally not be subject to the liability. If all properties had been held in the same entity, the entire portfolio would be at risk.

The asset protection plans developed over the last several decades didn't always work, but quite frequently they served their purpose and provided some defensive measures for wealth building and wealth management. As with most tax and legal subjects, the complexities to good asset protection planning are beyond the scope of this article. You should not attempt to implement an asset protection strategy without consulting tax and legal advisers.

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Asset Protection Part 2 – The Wealth Preservation Features of Trusts.
(By: Scott G. Beattie)

Last month's article was the first in a series about Asset Protection Planning. We explored some history of this area of the law, some basic ideas and concepts of wealth preservation planning, and took a closer look at the legal entities commonly used to mitigate risks of property loss to owners.

In this month's article (Part 2 of my Wealth Preservation Series) I will continue to explore wealth preservation and will look in particular at the types of trusts which can include legitimate Asset Protection features. Before exploring trusts, let's revisit my definition of Asset Protection Planning (APP).

APP can be defined as structuring asset holdings in such a way as to build legitimate legal barriers around your wealth which would not otherwise exist if you owned your assets either individually (directly in your name) or in the type of revocable living trust commonly used for estate planning. Like moving a yacht to safe harbor in a storm, using Asset Protection strategies in combination with other Estate Planning tools allows individuals to build legal barriers to shelter wealth from various legal hazards and risks of loss. Extending the analogy, ignoring your planning options here is like failing to check the weather report before heading out to sea. You are leaving yourself open to trouble.

Asset Protection Planning is possible because the law provides limits on the ability of creditors (including litigation plaintiffs) to obtain and enforce judgments against certain types of asset holdings either because the assets in question are part of a protected class of exempt assets (e.g., public and private retirement plans); or because the assets are held in a legal structures (such as a certain types of trusts or legal entities) which present legal barriers generally designed to protect co-owners or co-beneficiaries of property from the liabilities and claims generated solely against one owner or one beneficiary.

There are several broad categories of Trusts which can be designed to include asset protection features. These include: (1) "Spendthrift Trusts" which are irrevocable trusts created by third parties (e.g., parents, grandparents, or a spouse) that contain spendthrift clauses; (2) "Domestic Asset Protection Trusts" which are irrevocable Spendthrift Trust which purportedly can be "self-settled" (created for your own benefit) in those specific States (such as Alaska, Delaware, Nevada, and a few others); and (3) Foreign or "Offshore" Trusts which can be created in those jurisdictions (e.g., the Caymans, Isle of Man, Vanuatu, etc.) with favorable "Anti-Creditor" laws.

In my opinion the type of trust with the best combination of asset protection features, certainty as to the application of the law, cost effectiveness to set up, and ease of operation and limited risk (because it is not set up in a small island foreign country), is the Spendthrift Trust.

All fifty states in the U.S. have Trust laws which protect assets held in Spendthrift Trusts created by a third party (such as a parent, grandparent or in some cases even a spouse). Such trusts must generally be irrevocable and must contain a spendthrift clause stating that the beneficiaries cannot unilaterally encumber, alienate, or assign their beneficial interests in the assets of the trusts for the benefit of another party. If set up correctly, Spendthrift Trusts provide very strong legal barriers against creditors (including a beneficiary's spouse in divorce). In most cases, this protection even prohibits governmental agencies seeking to collect taxes obligations of a beneficiary who did not establish the trust.

The reason Spendthrift Trusts work so well is that our property and probate laws allow each person to sell, give, or make a testamentary devises of property to whomever they choose. Further, the law creates a legal barrier separating trust owned property from property owned by the beneficiaries of the trust. So in combination a transfer of assets in a long term trust for multiple beneficiaries (spouses, children, and beneficiaries) allows a transferor to create long term legal barriers with strong asset protection features. Such trusts can even be designed to extend over multiple generations which allows for them to keep property out of the Estate, Gift, and Generation Skipping Transfer Tax system.

Where a trust is irrevocable and set up by a third party for multiple beneficiaries with restrictions on transfer, the law will not allow the creditor of one beneficiary to execute a judgment against the trust and strip the other beneficiaries of their property rights. So, for instance, a parent can create a trust which gives both children and grandchildren the right to use trust property, the right to income from the property, and the right to decide who receives benefits from the property on death. Such a trust can be designed so some beneficiaries have superior rights and more control than others while still preserving the APP features.

Most commonly these features are added by a parent to allow children and grandchildren to have benefits from property in the trust without outright ownership. As a result, the child's creditors (including an ex-spouse) will not have access to trust property. The assets will be protected from creditors, from divorce, from certain types of tax liabilities and from future indiscretion, all while ensuring that ultimately the assets will still be made available to future generations of family members.

Spendthrift protection is not new. It arose out of the common law of Britain, was accepted across the United States in case law, and is now codified in the various probate codes of the States. While there are intricacies and limitations in the laws of various states, in general there is a great deal of certainty which can be used to advantage by well-informed estate planning attorneys.

Because of the benefits described above, people often have tried to create Spendthrift Trusts for themselves (using their own assets and making themselves a beneficiary). Before 1997 such Self Settled Spendthrift Trusts were not allowed in any of the states. Some people turned to foreign "Offshore Trusts" to obtain such protection for assets they want to hold for their own benefit.

"Offshore Trusts" are generally established in jurisdictions with favorable anti-alienation and spendthrift laws like Vanuatu, the Cayman Islands, the Isle of Man, and other foreign jurisdictions. Generally assets have to be transferred to the foreign country jurisdiction for these trusts to be viable (making cash and securities easier to protect than real estate). Usually a foreign trustee or co-trustee is also required which gives some people pause. Is the banking system on these "small islands" really safe?

Offshore Trusts can be valid asset protection instruments, but have often been set up in abusive situations where they were used to illegally shelter assets from income and estate taxes. IRS outbound transfer reporting requirements and new foreign asset reporting requirements (FBAR) have curbed some of the abuses, but have also added complexity and cost to using offshore trusts.

Offshore Trusts can be a legitimate means of Asset Protection Planning. However, in my mind they are generally not the first consideration in designing an asset protection plan, but rather are only implemented after other planning is considered and only for those persons who (1) can afford the planning; (2) understand and live with the complexities involved; (3) comply with the outbound reporting and FBAR reporting requirements of the IRS; and (4) who aren't trying to use the Offshore Trust as illegitimate tax shelters.

In the late 90s and early 2000s some highly publicized court cases occurred which resulted in persons being jailed for contempt of court for failure to bring assets back home from their offshore trusts. More than a few judges (generally in some pretty abusive situations involving fraud and embezzlement) were angered by the failure of the thief (I mean debtor) to return funds that had been wrongfully hidden away. A few debtors were put in jail for contempt for lengthy periods of time. So Offshore Trusts have limitations of cost, compliance, and in some cases are not respected by the courts.

In 1997 new "Domestic Asset Protection Trust" structures became available starting with adoption of a new trust law in Alaska which allowed self-settled Domestic Asset Protection Trusts to be created (the transferor creates the trust for him or herself and others). These DPATs are now available in Alaska, Delaware, Nevada and a few other States. There has been some controversy as to whether these structures would be respected by the courts in a litigation matter. Changes to the Federal bankruptcy laws cut both ways on this argument: (1) they seem to legitimize the Domestic AP Trusts provided they were created more than ten years before a bankruptcy filing, but (2) they provide a means to set the trust aside in a bankruptcy if the BK filing occurs within the designated 10 year period. So these are long term planning devices at best.

Another note of caution involves the fraudulent transfer laws. A court can ignore any of these structures if the transfer to the trust or entity involved a "fraudulent transfer." The fraudulent transfer laws allow transfers to be set aside if made at a time when the debtor already had an existing or suspected liability, or if the transfer rendered the transferor insolvent.

Needless to say Asset Protection Trusts are not good do it yourself projects. As with most tax and legal subjects, the complexities of good asset protection planning are well beyond the scope of this article. You should not attempt to implement an asset protection strategy without consulting tax and legal advisers.

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Asset Protection Part 3 – Private Pension Plans

By: Scott G. Beattie

After last month's interruption to my Asset Protection Series I'm back and ready to move on with the discussion. If you are reading this article without having read the prior two, check them out online at www.cvbizjournal.com. The first two in the series will provide helpful background if you are serious about engaging in this type of planning as part of a broader estate or wealth preservation plan.

In Part 1 of the series I took you through some of the basics of wealth preservation planning, including a focus on the types of entities that are commonly used to secure liability protection in various situations. In Part 2, we looked at the types of trusts which are commonly used for asset protection, including spendthrift trusts and so called "Domestic Asset Protection Trusts" and Offshore Trusts.

This month I'd like to focus on the use of Private Pension Plans as a means of sequestering assets. Private Pension Plans can be a safe harbor for your future retirement needs because assets set aside for retirement in such plans (including "qualified" pension and profit sharing plans) are a statutorily protected class of assets. Such plans are exempt from creditors under California Code of Civil Procedure (CCP) Section 704.115. As a statutory safe harbor, private pension plans subject to Section 704.115 are generally thought to be unassailable. IRAs are also protected, but not quite to the same degree.

An interesting point about Section 704.115 is that a plan can be protected even if it is not an ERISA qualified plan. So the statute protects qualified retirement plans (such as 401ks) as well as non-qualified plans. One detriment to nonqualified plans is that they do not qualify for income tax deductions and deferral of income. However, an important benefit to such plans is that they do not need to meet the requirements and limitations of the Internal Revenue Code, including the requirements which limit the amount of annual employee contributions to the plan and others which require broad based employee participation.

Section 704.115 is an exemption statute which exempts debtors from creditor claims. The purpose is to "safeguard a stream of income for retirees." Assets in a safeguarded retirement plan are protected in both bankruptcy and non-bankruptcy situations if they meet this retirement purpose. Therefore a key element of any non-qualified private plan that seeks creditor protection is that it be designed for long term retirement purposes. So for a non-qualified plan to be protected, it should have terms similar to a qualified pension or profit sharing plan. These might include specific limitations on the age at which funds can be pulled from the plan as well as limitations on the total amounts that can be contributed (e.g., a judge might not protect the plan in whole or in part if he or she feels the amounts contributed greatly exceed amounts reasonably necessary for retirement).

So it is best to design such plans with age restrictions, beginning payout dates, maximum contribution formulas, payout formulas and other features similar to qualified plans. The age restrictions and other formulas don't have to exactly match those of qualified plans (allow distributions without penalty as early as age 59 and mandate distributions after the participant reaches the age of 70.5 years). Rather other ages and terms can be selected to help blend the plan with more conventional plans.

For best creditor protection design, however, a non-qualified plan should not be subject to early withdrawal except in strictly limited circumstances, would preferably include at least one independent trustee or co-trustee, should clearly spell out the powers and authorities of the

Trustee(s) as to investment and other decisions, should contain a spendthrift clause that directs the trustee not to assign plan assets for the benefit of creditors of the participant, and should contain beneficiary designations so the participant may appoint his or her interest among heirs. Many other terms, conditions, and features are common to such plans which are beyond the scope of this article to discuss in sufficient detail.

A nonqualified plan can be set up using a trust, or by contractual agreement, or a combination of the two. To provide additional layers of protection, the Trust could be set up in a state such as Alaska or South Dakota which has Domestic Asset Protection Trust laws, but the broad protection of a state statute such as CCP 704.115 provides protection without having to go to another state jurisdiction.

As with other asset protection, transfers to private pension plans which render the participant insolvent, or which are made after the occurrence of an event giving rise to liability, will likely be set aside under the fraudulent transfer laws. The fraudulent transfer laws allow transfers to be set aside if made at a time when the debtor already has an existing or suspected liability, or if the transfer renders the transferor insolvent. So such plans need to be set up in advance of known or suspected claims based on prior acts of the transferor.

Needless to say Private Pension Plans and Nonqualified Plans are not good do it yourself projects. As with most tax and legal subjects, many of the complexities and nuances of good asset protection planning are beyond the scope of this article. You should not attempt to implement an asset protection strategy without consulting tax and legal advisers. But if asset protection and wealth preservation is a goal, you should certainly consider the structures discussed in this series of articles.

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Asset Protection Planning Part 4 – Summing It Up

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Over the last several months I've provided you with an overview of the most commonly used strategies for asset protection planning. I've tried to provide useful insights derived from twenty years of experience creating, managing, restructuring, and in some cases unwinding various types of wealth preservation and wealth transfer plans. In this final article of the series I'd like to sum it up and leave you with my thoughts on the fundamentals people should consider to be the foundation of any sound wealth preservation plan. Without a solid foundation, even the best strategies will topple over.

What we've seen time and time again is that the best protection comes from advance planning. Trying to implement a strategy after disaster strikes does not work. Whether a liability is a result of a tragic accident, over exposure to financial risks, a lawsuit for damages, or other causes, trying to hide away and protect assets at the last minute does not work. Strong Federal and State fraudulent transfer laws are in effect in every domestic jurisdiction and measures can be taken (such as jailing a non-cooperative debtor for contempt) to force debtors to pull assets back from foreign jurisdictions and offshore trusts.

Nevertheless, the cases over the years have confirmed that (1) advance planning engaged in for legitimate purposes (e.g., estate planning, good business planning, risk reduction, etc); (2) that occurs well in advance of a liability; and (3) that uses a legitimate legal structure not involving a transfer that renders the transferor insolvent (i.e. not a fraudulent transfer), will generally be respected.

There are quite a number of legitimate and pragmatic planning techniques that have asset protection or wealth preservation features and which don't require exotic and risky planning. Here are some rules of thumb to build a solid foundation for your wealth:

1. **Always maintain adequate levels of liability insurance** (I know, a plug for the insurance industry, but its common sense protection);

2. **Invest in assets which are exempt from creditors in most states or have a reduced risk of creditor's claims.** Where possible, contribute to Qualified Pension and Profit Sharing Plans (including 401k plans) rather than IRAs. O.J. Simpson got it right with this one -- reports indicate he had over $3,000,000 sheltered in an NFL sponsored pension plan that couldn't be subjected to judgment. Avoid rolling over your qualified plan into a less protected IRA or SEP-IRA if you are seriously worried about protecting the investments held in the plan. Only qualified pension and profit sharing plans are fully protected from creditors under the bankruptcy laws. In states like California, IRAs receive partial protection, but only if you can demonstrate the assets in the IRA will be necessary for your support during retirement.

3. **Make and receive testamentary bequests in trust rather than as outright distributions.** Particularly for professionals (e.g., doctors, dentists, accountants, and lawyers) and others with high liability risks (e.g., developers, truck company owners) inheritances should be received in trust for your benefit rather than outright if you want your inheritance to be a nest egg that won't be exposed to creditors or divorce. Spendthrift clauses in such trusts protect assets from a child or grandchild's creditors. The trustee can then provide beneficiaries with direct lifetime benefits (e.g., purchase vacation homes in the trust) and income without making outright distributions that would expose the trust principal to creditors (including an ex-spouse).

4. **Always plan early, before litigation arises.** Fraudulent transfers designed to leave you insolvent shortly before creditors can get their hands on your assets will be readily set aside by the courts. Some exceptions exist (e.g., high homestead exemptions for Florida and Texas

residents), but most are inadequate. Recent revisions to the Bankruptcy laws suggest a transaction occurring less than ten years before the liability arises may be ignored. Have a business or estate planning purpose and design transactions to be arms-length.

5. **Operate your business in an entity for which you are not personally liable** (to the extent allowed by law) and follow the technical requirements for forming, funding, and maintaining that entity (e.g., registering business assets in the entity, holding annual meetings, etc.). Use separate entities for separate functions. Segregate investment assets from business entities and if you have a large number of real estate investments, consider segregating them into multiple entities such as Limited Liability Companies (LLCs) or Limited Partnerships with a corporate or LLC general partner. Segregation of separate assets and business activities into separate entities will reduce potential liability exposure spreading from one asset or activity and spilling over into others. **This is the principal of "don't put all your eggs in one basket" carried into the world of legal entities.** If one entity is exposed to a liability (e.g., for a tort or environmental hazard), the assets properly segregated into the other entities can be protected from the claim.

6. **Add hurdles for creditors** which will encourage a more favorable settlement. For example you may hold investment assets in entities such as limited partnerships or limited liability companies and split the ownership among family members. Such entities contain features which are not desirable to creditors and restrict access through charging orders.

7. **Consider holding non-qualified investments in Domestic Asset Protection Trusts** in those states which have designed laws for such purposes such as Alaska, Nevada, and Delaware.

8. If you still have excess wealth exposed after doing all of the above, then **consider some of the more esoteric strategies**, starting with Private Pension Plans (non-qualified plans), offshore trusts (subject to special reporting requirements) and captive insurance companies for presently uninsured risks.

9. **Beware of exotic and complex schemes that promise guaranteed asset protection.** There aren't any magic pills here. The perfect asset protection plan does not exist and what you might get is a very costly magic bullet with bad tax consequences. Be aware of the outbound transactions reporting requirements before considering Foreign Asset Protection Trusts. Be aware that fraudulent transfers can be set aside whereas techniques that have other legitimate estate and business planning purposes may be respected.

Whether true or not, the public perception is that for every lawyer who will not take on a frivolous case, three will appear who are only too happy to file suit. Frivolous litigation is a modern day Hydra -- three heads spring up for every one that is chopped off. The "American Rule" that each party bears the cost of his or her own legal expenses is a major part of the problem. The "English Rule" requires that the loser pay the winning parties legal expenses.

Here there isn't much downside risk to filing suit and litigants don't have to think twice before entering the fray.

It is no wonder that a virtual cottage industry has sprung up in the area of "asset protection" and "wealth preservation" planning. Such planning is designed to protect wealthy and upper middle class individuals from losing hard earned assets to creditors and litigants. However, because of the widely varying levels of competency and ethics among planners, there have been a number of abuses. For every legitimate asset protection plan, there are others that won't pass muster due to poorly thought out planning.

And remember, even well thought out plans can be challenged. Structures have been overturned or subjected to equitable recoupment and some judgment creditors have successfully challenged asset protection plans based on fraudulent transfer rules. In an article I wrote in 1999 ("Asset Protection – Fleeting Fantasy or Hard Won Reality") I replied to the doubts being expressed by some professionals who suggested asset protection had become a pure fantasy by showing there were still many situations in which asset protection strategies provided a lot of protection. Time and case histories have proven my opinion correct.

What I pointed out then which has held true to today is that given bad enough facts (e.g., you embezzled funds and then tried to hide them away), it is highly unlikely your asset protection plan will be successful. Judges will use everything in their power (including esoteric equitable recoupment theories) to ignore protective provisions in the law and set aside such schemes set up by persons engaged in fraudulent and unlawful activities.

Nevertheless, the cases over the years have confirmed that (1) planning engaged in for other legitimate purposes (e.g., estate planning, good business planning, risk reduction, etc); (2) that occurs well in advance of a liability; and (3) that uses a legitimate legal structure not involving a fraudulent transfer that renders the transferor insolvent, will generally be respected. In addition, several states such as Alaska, Nevada, and Delaware have now made laws for to Domestic Asset Protection Trusts that allow self settled trusts to be created. However, the 2005 Bankruptcy Act gives some concern about the legitimacy of the protection unless the trust is established 10 years before the liability or insolvency event occurs.

As with most tax and legal subjects, the complexities to good asset protection planning are well beyond the scope of this article. You should not attempt to implement an asset protection strategy without consulting tax and legal advisers.

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