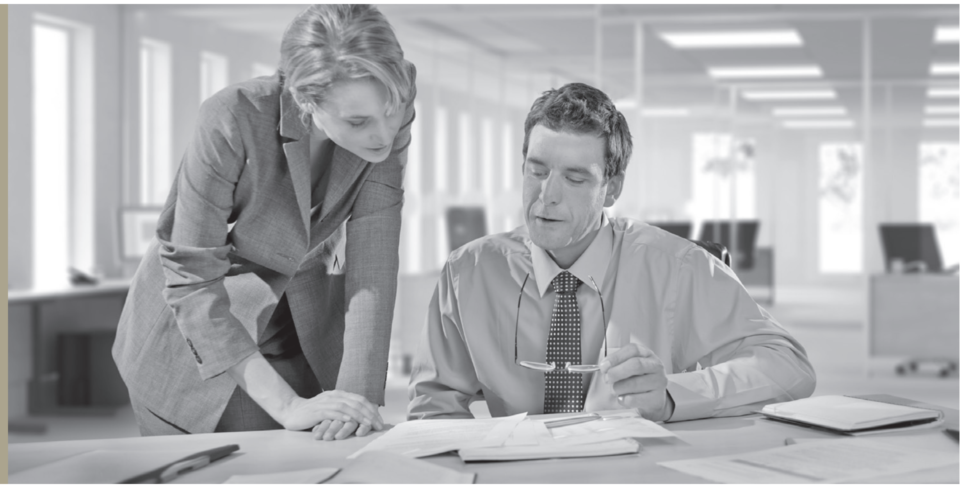
Let’s talk



The importance of asset protection planning

The need for proper asset protection planning has grown significantly in the past decade as wealthy individuals, business owners, and professionals, such as physicians, face an increasingly litigious society and divorce rates in excess of 50%. While most individuals have focused on protection from losing assets due to poor money management or tax issues, many remain exposed to risks associated with litigation and divorce. However, a number of planning strategies exist that can help wealthy individuals protect the assets they have worked so hard to earn from these types of threats.

What is asset protection planning?

Asset protection planning is organizing one’s affairs to protect against risks that would otherwise threaten those assets. In other words, the primary focus of asset protection is minimizing exposure against future litigants.

This type of planning is most effective when it is established prior to liability being imposed. The goal of such planning is not only to protect against the consequences of an adverse judgment, but to also serve as a deterrent to litigation – or at least an incentive for a more reasonable settlement. The goal is not to hide assets but to protect them.

Part of a comprehensive planning strategy

Asset protection is a big part of the financial and estate planning process. Seeking advice on asset ownership, beneficiary designations, and financial strategies are often the beginning of a

Key takeaways:

- The need for comprehensive asset protection planning has become increasingly important for wealthy individuals, business owners, and professionals, such as physicians.
- An increasingly litigious society, a divorce rate of more than 50%, tax issues, and poor money management are the most common risks for loss of assets and wealth to individuals.
- Asset protection planning has become a necessity for many wealthy individuals today. Most individuals employ several strategies to effectively reduce their risk exposure and protect the wealth they have worked so hard to earn.

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bigger discussion about insulating one's assets from known or potential future creditor claims. Most individuals also want their beneficiaries protected from creditor claims, so these objectives must also be considered in the estate planning process.

There are a number of strategies available to consider when planning for protection from creditors. The actual strategies used will depend on the individual's personal situation and appetite for risk. The following are some of the tools or strategies you might consider in a discussion with your Key Private Bank team and other professional advisors:

- Insurance – Insurance is probably the most common strategy that people think about when talking about asset protection. While it is an important piece of the asset protection puzzle, it does have some limitations, so it may need to be used in conjunction with other asset protection strategies.
- Exempt assets – These are a class or type of property that can be wholly or partially off limits to creditors. These assets include an individual's homestead, cash value life insurance, annuities, and IRA and ERISA plans. However, the exemptions may be limited and can vary from state to state.
- Joint interests – Although there are several types of joint interests available, the only one that provides effective asset protection is "tenancy by the entireties." However, this also has limits as a strategy because it is only available between spouses and, therefore, terminates upon the dissolution of the marriage through death or divorce. It also does not offer protection from a joint creditor of both spouses, either spouse filing for bankruptcy or either spouse's federal tax lien.
- Gifting – While gifting can be an effective asset protection strategy, it also has some limitations. For example, gifts to children cannot be significant because it could impose a significant tax burden on the child, the parent will no longer be able to control the gifted property, and, if the assets are later gifted back to the parents, it could be considered a fraudulent conveyance. Gifts to spouses can also be problematic as an asset protection strategy because the spouse can be subject to a lawsuit as well, transfers to the spouse could be considered a fraudulent conveyance, and these types of gifts are generally excluded from the definition of marital property, which could become an issue in the event of a future divorce.
- Contractual arrangements – Contractual arrangements, like confidentiality agreements and pre- and post-marital agreements, can be very effective asset protection strategies if they are properly designed and established. For example, in order for a premarital arrangement to be effective, the following must occur: Each party must be represented by independent counsel to avoid accusations of duress or coercion; the agreement must be fair at the time of execution and enforcement; and there must be full financial disclosure. These strict rules can, at times, limit the effectiveness of these strategies as asset protection strategies.
- Entities such as Family Limited Partnership (FLP) and Limited Liability Companies (LLC) – These types of entities can protect an individual or business owner from a creditor who attempts to seize the underlying assets held in the entity because most state statutes only provide a creditor with an economic benefit when, and if, a distribution is made. Most state statutes do not allow a creditor to obtain any other rights of a partner, including the right to force a distribution. This limitation to a "charging order" may convince a creditor to settle on more reasonable terms than if the assets were held outright.
- Irrevocable Trusts for the benefit of others – Irrevocable discretionary trusts with spendthrift clauses are generally very effective asset protection tools. However, once the trust is established, it may be difficult to dissolve, amend or change. Therefore, while they are highly effective for family members, they offer little benefit to the person who creates the trust.

- **Domestic Asset Protection Trusts (DAPT) –** Certain states (e.g., Delaware, Alaska, Ohio) allow individuals to establish trusts for their own benefit and still be protected from future creditors. Since distributions back to the trust creator are controlled by an independent trustee, trust assets should be protected from future creditor claims. While some interstate issues are still unresolved, DAPTs are increasingly becoming an important asset protection tool. Unlike most other irrevocable trust designs, DAPTs can be established without using up any lifetime gift tax exclusion. Also, traditional trust planning tools like Charitable Remainder Trusts (CRATs) and Grantor Retained Annuity Trusts (GRATs) can double as DAPTs for an additional layer of creditor protection.
- **Foreign Asset Protection Trusts or Foreign Civil Foundations –** These structures are very similar in concept to DAPTs but provide extra protection, since many foreign jurisdictions will not recognize a U.S. judgment against a trust in their jurisdiction. This would then force a creditor to re-litigate and cross international lines to "break" a structure.

Conclusion

As you can see, there are a variety of strategies and tools available for asset protection planning. They all have benefits and limitations, so it is important to work with your advisors to understand any potential risks and how a particular strategy might benefit your particular situation. It is important to consult with all of your advisors, including financial and insurance professionals, accountants and business and estate planning attorneys, to ensure your planning is coordinated and comprehensive. In many cases, individuals may want to employ several strategies to effectively reduce risk exposure.

In today's litigious society, asset protection planning has become a necessity for most wealthy individuals, business owners, and professionals. Even those individuals who are not involved in obvious liability-producing activities may want to consider this type of planning to protect their assets for themselves and future generations from unforeseen future events and situations.

Contact your Key Private Bank Relationship Manager to discuss asset protection planning.

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