Asset Protection Planning

Just the FAQs

HELSELL FETTERMAN

From the Estate Planning & Probate Group

First things first, what is asset protection planning?

Asset protection planning is planning that is designed to apply a series of techniques to protect your assets from the claims of future creditors. The techniques are designed to deter potential creditors from going after you and to frustrate or impede their ability to seize your assets or collect judgments.

Is asset protection planning legal?

Asset protection planning is absolutely legal; however, planning to defraud creditors is not. There is a sharp dividing line between the two. For this reason, it is important to work with experienced advisors and discuss the timing of your planning prior to taking any action.

Who should consider asset protection strategies?

In this litigious era, individuals who are in high-risk professions, such as physicians and paramedics, contractors and architects, and pilots and recreational flyers are encouraged to consider asset protection strategies. In addition, political figures, entertainers, professional athletes, high net worth individuals, and others in the public eye are often the target for lawsuits and are individuals who should consider strategies to limit their exposure as well.

When should I start looking into asset protection planning?

If you have exposure, start right away. You should start planning prior to any significant claim arising against you. A claim does not arise when the lawsuit or judgment is made against you, but instead, it arises when the underlying circumstance or event that causes the claim occurred. If you suspect that you might be sued, but you have not yet been sued, it might be too late to do protection planning.

Washington State's Fraudulent Transfer Act (RCW 19.40) prohibits individuals from making gifts or conducting transactions that are intended to put assets out of the reach of creditors. A fraudulent transfer is (1) a transfer that is entered into with the actual intent to hinder, delay or defraud any creditor, or (2) a transfer of an asset for less than equivalent value with the reasonable belief that you will incur a debt beyond your ability to pay. Some factors the court will consider include (1) whether you transferred assets to an insider; (2) whether you retained possession or control of the asset after the transfer; (3) whether you disclosed or concealed the transfer; (4) whether you had been sued or threatened with suit before the transfer; and (5) whether you transferred substantially all of your assets. Additionally, fraudulent conversion laws limit a debtor's ability to put money into exempt assets such as retirement accounts or insurance. Because the timing of the transfer dictates the effectiveness of the protection, you should not delay your asset protection planning.

Does asset protection mean that creditors cannot seize any of my assets?

No. While some strategies offer full protection against liability, other strategies seek to either isolate and contain risks or make it difficult and expensive for creditors to reach assets. No technique is truly guaranteed; but if executed, implemented, and administered properly, certain strategies can be extremely effective.

If I do nothing, are all of my assets exposed to creditors?

While many assets are exposed to creditors, certain assets are protected under federal laws. For instance, federal law protects ERISA-governed qualified retirement plan accounts such as 401(k)s. These assets are entirely beyond the reach of creditors in all but a few circumstances.

In addition to federal protection laws, state laws protect various assets. Most states protect an individual's equity in his or her primary residence, but the level of protection varies between states. States such as Florida and Texas protect 100% of an individual's equity while other states cap such protection at a certain amount. Washington, for instance, as of 2010, protects up to $125,000 of an individual's equity.

Likewise, most states protect traditional Individual Retirement Accounts (IRAs). However, fewer states offer such protection to Roth IRAs. In Washington, both traditional and Roth IRAs are fully protected from creditors.

Many people carry life insurance policies to provide for their loved ones in the event of death. In Washington, residents can build an unlimited amount of cash value in life insurance policies, free of creditors.

Can I just put all of my assets in my spouse's name?

Putting assets in your spouse's name is not a recommended asset protection strategy. In Washington, in the absence of an agreement, all assets and debts brought to a marriage by one spouse are the separate property of such spouse. All income earned during marriage and all assets acquired with such income are community property and deemed to be owned 50% by each party, regardless of which party earned the income or which party's name may be on title of such asset. Washington State allows couples to enter into an agreement to re-characterize income or assets as one spouse's separate property, rather than community property. Therefore, it is possible for you to move all your assets into your spouse's name as his/her separate property. However, it is unadvisable for two reasons. First, you may be risking a fraudulent transfer challenge by your creditor, especially if you retain no separate or community assets to satisfy your future creditors. Second, in the event of a divorce, you will be in the untenable position of having to argue that a portion of your spouse's separate property should be awarded to you because you didn't truly intend for him/her to own all of your assets — the exact opposite argument you'd be making in order to avoid creditors. Because there are many other techniques that can provide protection without compromising your ownership of assets, characterizing all assets as your spouse's separate property is not recommended.

If only my spouse has liability exposure, do I need to worry about my assets?

Yes. In the absence of any marital agreement, all income earned during marriage is considered community property and belongs to you and your spouse, equally. Likewise, all debt incurred during a marriage is considered a community debt. Therefore, if your spouse is in a high-risk career, then your earnings, your share of his or her earnings and your other community assets, may be exposed to any claims made against your spouse during the course of your marriage.

Would it help to transfer most of my assets to my children's names?

Putting assets in your children's names is not a recommended asset protection strategy. First, giving away assets means that you lose control of those assets. If your children are minors, you may still have control of the funds as their guardian; however, once they reach age 18, they will have full control. Second, transfers of more than $13,000 per child, per year (in 2010) may result in gift tax consequences. While you can transfer an unlimited amount of assets between you and your spouse under the marital deduction, there is no such deduction covering transfers to children. Third, there are income tax consequences to moving passive investments into your children's names. Passive income earned by children over a certain amount is subject to income tax at your tax bracket (the "Kiddie Tax"). Effectively, transferring the bulk of your assets to your children means that you will have paid to give away your assets, you will no longer have use or control of these assets, and you will not get the benefit of your children's lower income tax bracket.

My assets are held in trust. Aren't they protected from creditors?

For estate planning purposes, you may have established a revocable living trust to hold and manage your assets during your lifetime and to transfer assets following your death. If you establish a trust and name yourself as the beneficiary, then the trust is considered a "self-settled" trust, and it offers no creditor protection. Likewise, if the trust is revocable by you at any time, no asset protection is available. Moreover, these trusts will be included in your estate for estate tax purposes under Internal Revenue Code (IRC) Section 2036. Except for Offshore Trusts and Alaska Trusts, only carefully drafted irrevocable trusts, under which you retain no right to distributions or control of the trust assets, will offer any level of asset protection.

What protections should I consider for my business activities?

If you have any business activities that may give rise to liability or losses, you should consider conducting those activities through an entity such as a corporation or limited liability company. While the entity will be responsible for the liability created, you personally will be insulated from such liability unless you are personally negligent. If you conduct more than one business, you may want to consider a separate entity for each business so that claims arising from one activity will not jeopardize the other activities. To get the full liability protection, each entity should be appropriately capitalized and carry a reasonable amount of liability insurance.

Can I put personal assets into the business?

All assets held by the business should have a business purpose, such as the operation of a store, the renting of a multi-unit apartment complex, or a simple investment purpose. You should not place personal assets into the business unless you intend to have the business treat you as it would treat a third party. For instance, if you place your house into a business, you will need to rent this house for fair market value and the entity may need to pay income tax on the rental income received. If you use the business assets for personal gain, a court may allow the entity shield to be pierced and your liability protection will be lost.

What protections should I consider for my real estate investments?

If you invest in real estate, you should consider holding title to your real estate in a limited liability company (LLC). An LLC will protect you against personal liability arising from claims against the underlying property, and it will protect your property from claims against you personally. For instance, if you cause a car accident and incur personal liability, your real estate LLC is insulated from such liability. Conversely, if a tenant of your real estate LLC wants to sue, he must sue the LLC. This creates two results: (1) it shelters your personal assets, such as your savings accounts and your house from the tenant's claims, and (2) it limits the tenant's recovery to the value of the LLC itself. Moreover, in Washington, if the tenant successfully sues the LLC, he still cannot seize or take control of your interest in the LLC to enforce his judgment; instead, he can only obtain a "charging order" against your interest. A charging order is akin to a garnishment order and entitles the creditor to receive any amounts distributed to the debtor/owner. However, the creditor cannot compel distributions, force liquidation or sale of your LLC interest, or otherwise interfere with your management of the real estate. The tenant's only recourse is to try to seize your distribution, if and when you make one to yourself. If you decide to keep reinvesting profits into the business, you can keep the creditor waiting indefinitely. For this reason, LLC interests are one of the last interests that creditors will pursue for recovery.

Is there anything I can do to protect my personal assets from creditors?

First, before you start any advanced planning to protect your personal assets, you should make sure you have a good, solid foundation. The cheapest, most effective foundation that will protect against unforeseen liability events is insurance. This doesn't just mean having basic homeowner's insurance, car insurance, and umbrella insurance – it means delving into the coverage of these policies to make sure you're fully covered. Many people have their home and cars covered by one insurance company and their vacation house covered by another insurance company. Certain assets, like Jet Skis at a vacation house, inevitably fall through the cracks and remain uncovered by either policy. These gaps are rarely discovered until someone gets injured on your Jet Ski and both insurance companies deny coverage. For this reason, it is important to have a good property and casualty insurance broker sit down with you, review your assets, and ensure that there are no gaps in coverage. Moreover, don't just buy these policies and stash them in a drawer. Your insurance company will periodically strip benefits from your coverage in order to keep any increase in your annual premium minimal. Chances are, you are not paying attention to the fine print pamphlets they send you periodically. Having a broker shop these policies among various companies every few years will ensure that you are getting the best coverage for your money.

Next, as the population lives longer, health care providers are quickly becoming the most common creditor. While long term care insurance is expensive, it is worth considering. It is a simple and effective way to retain your estate for your personal use and pass wealth to the next generation without erosion by health care expenses.

In addition to insurance, what other techniques are available to shelter my personal assets such as my residence and my children's education accounts from creditors?

You may want to consider setting up an irrevocable trust. While self-settled and revocable trusts are not protected from creditors, irrevocable trusts established for the benefit of family members usually are beyond the reach of your creditors. Again, timing is important, and these trusts must be implemented before any financial problems arise. Life insurance trusts, college education funds and other trusts established for children, trusts for the support of elderly parents, personal residence trusts, and charitable remainder trusts can be designed and implemented to accomplish various objectives while simultaneously protecting against creditors.

My son has a rocky marriage. I'm worried that if I pass away and leave him an inheritance, his wife will receive half of it if they eventually divorce. Is there any way I can protect my son from a potential ex-spouse's claim?

With proper estate planning, you can protect your assets as well as assets that you pass to a spouse or descendants. In fact, the protections that you can set up for a spouse or children are greater than the protections they can establish for themselves. For example, you can leave funds in a trust for your son, rather than an outright bequest. You can allow the funds to be managed and controlled by your son and he can have access to the funds as needed for his health, support, maintenance, and education expenses, including the education expenses of his children. With a properly drafted trust, these funds will be entirely insulated from all of your son's creditors, including an ex-spouse.

I've heard about offshore trusts. What are they?

An offshore trust is a trust established in a foreign jurisdiction that has bank secrecy laws and no income, gift, or estate taxes. Some common jurisdictions used for offshore planning are the Cook Islands, the Bahamas, and the Channel Islands. Contrary to the laws in most states, these jurisdictions protect self-settled trusts. Thus, a person can establish a creditor-protected trust, place cash, securities, and other assets into the trust, and still be able to access these assets for his/her own benefit. While the person establishing the trust is subject to federal income tax during his/her lifetime, after death, these trusts are exempt from income tax. Because these jurisdictions also allow trusts to last indefinitely, these trusts will never be subject to tax until the funds are repatriated. To stop the abuse of offshore trusts, Congress has recently passed legislation designed to control the use of these trusts and to increase foreign trust reporting requirements. Because of the many requirements imposed on these trusts, they are expensive to establish and operate. Further, the political and economic stability of countries with these laws is always a concern.

I've heard about Alaska Trusts. What are these?

In an attempt to capture some of the money that was flowing out of the country into offshore trusts, Alaska passed legislation designed to give certain trusts the same economic benefit as offshore trusts. The Alaska Trust Act: (1) protects certain self-settled trusts from creditor claims and (2) allows trusts to last indefinitely. Additionally, the State of Alaska does not have an income tax.

Under this Act, you can establish a trust, name yourself as the primary beneficiary (together with your spouse, if married) and name your children as the contingent beneficiaries. You then select a qualified Alaska Trustee who has the discretion to make (or not make) distributions to you. Under the Act, all assets transferred into this type of self-settled trust will be protected from creditors.

Not all self-settled trusts will qualify for asset protection. The Trust must have a certain amount of trust assets located in Alaska, and it must be administered by a "qualified person," who is an Alaskan resident, bank, or trust company. The Trustee's responsibilities include record maintenance and tax return preparation, and part of the administration must occur in Alaska. A few states such as Delaware and Nevada have followed Alaska's lead and have passed legislation to permit some form of asset protection over certain self-settled trusts. However, because of the significant loss of control over the assets placed into these types of trusts, many individuals are wisely hesitant to use these trusts for their asset protection planning.

To learn more about asset protection and the strategies that may be right for you, please don't hesitate to contact any of the Estate Planning and Probate attorneys at Helsell Fetterman.

To learn more, contact our

Estate Planning & Probate Group

Helsell Fetterman LLP
Seattle 1001 Fourth Avenue, Suite 4200 Seattle, WA 98154
Bellevue 10900 NE Fourth Street, Suite 2300 Bellevue, WA 98004