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Hallock & Hallock, a professional corporation
*Estate Planning | Business Formation & Succession Planning
Asset Protection | Farm & Ranch Planning | Charitable Planning
Special Needs Planning | Trust Administration & Probate*

As the economy has slowed, asset protection planning has grown as an area of concern. In this issue of *The Counselor*, we will examine a variety of asset protection strategies - from rather simple to quite complex, how they work, the levels of protection they can provide, how these strategies can work together, and the advisor team approach to asset protection planning.

ASSET PROTECTION PLANNING

Asset protection planning is not about hiding or concealing assets. It is about using the existing laws appropriately to obtain the best possible level of protection in case an attack comes along. Asset protection planning is the process of analyzing ownership of assets and re-arranging ownership of those assets as needed to ensure maximum protection, maximum use of exemptions and to minimize risk of loss in future litigation. Asset protection is not evasion of taxes or defrauding current creditors. To be effective, asset protection plans must be properly designed, drafted and implemented. An asset protection plan is never stronger than its weakest link.

While most of us like to have a high degree of certainty in the outcome of a particular planning strategy, asset protection tends to be more art than science. Asset protection can be time consuming, but worthwhile and the end result should be considerably better than if you had done no planning at all. An effective plan will discourage lawsuits from the outset. We cannot

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"Truly nothing is to be expected but the unexpected."

-Alice James

make it appear as if your assets do not exist, but we can create a structure that will make it much less attractive for a potential plaintiff to come after you as opposed to someone who has done no planning.

Types of Risks

Professional Liability: Those who most often need asset protection planning have professional liability risks – such as physicians, surgeons, dentists and other health care professionals, lawyers, architects, accountants, and sometimes those involved with business enterprises that pertain to health care, such as skilled nursing facilities and assisted living facilities. Those in construction (builders, developers) also have concerns. Also, in a down economy, some people are concerned about having signed personal guarantees for real estate development or other purposes.

As a general rule, one cannot limit one's own professional liability through a legal device. Also, most state statutes do not permit non-professionals to own a portion of a professional practice. For those concerned about professional liability claims, the best first step is to have adequate malpractice insurance.

Professional Liability of Others: A professional needs protection against malpractice claims against others in their business. Putting that protection in place is a good second step beyond having adequate malpractice coverage.

Non-Practice Personal Liabilities: These could be business deals (possibly real estate) that have gone bad or tort claims (car accidents, etc.). Even within the business, there could be non-professional liability claims, such as employment practices, employment discrimination, sexual harassment claims, and even such things as slip-and-fall claims.

Other Liabilities: These include income and estate taxes; a spouse or ex-spouse claiming an ownership interest in the business or another entity; children's spouses and ex-spouses and their behavior which can lead to loss of family assets, etc.

When to Plan

The best time to plan is before the claim arises. There are different rules that apply for known creditors and unknown future creditors. But even with an existing claim, and sometimes even when a judgment has been entered, some options (such as an ERISA qualified plan) may still be available. It is highly important to avoid fraudulent transfers, which are transfers of assets not necessarily occurring with intent to defraud but without full and adequate consideration.

The 7 Levels of Asset Protection

Combinations of strategies often work best in asset protection. Also, it is important to crawl before walking. Therefore, asset protection planning is often done by levels, usually starting at the lowest. Not every level will be appropriate for every person. The

following are what we refer to as the seven levels of asset protection.

Level 1: Keep Quiet

The most basic asset protection planning technique we can share is to be discrete. The norm in society is to shout about your wealth. Be discrete! Beware of what you put on Facebook or other social media. Keep quiet! It is harder to take what you don't know about.

Level 2: Exemptions

Certain assets are automatically protected by state or federal exemptions. State exemptions include personal property, life insurance, annuities, IRAs, homestead, joint tenancy or tenancy by the entirety. Different states protect assets differently and amounts of the exemptions will vary greatly from state to state. For example, some states have an unlimited homestead exemption while others, like Utah are minimal; many states protect all IRAs; and many non-community property states recognize tenancy by the entirety, which is a great way to shelter the interests of the spouse who is not at risk. Federal exemptions include ERISA which covers 401(k) and 403(b) plan accounts, pensions, and profit-sharing plans. Creating and funding qualified retirement plans for clients can provide excellent shelters against creditors' claims.

Level 3: Liability Insurance

Obtain or increase professional liability insurance. Obtain or increase umbrella coverage. It is amazing how few people are carrying relatively inexpensive umbrella policies.

Level 4: Transmutation Agreements (in Community Property States)

These allow you to convert community property assets into the separate property of the spouse not at risk. Remember, there may be enhanced risk of loss in case of a divorce. It is also important to consider the loss of the double step-up in basis that occurs with community property.

Level 5: Entity Formation

Any entity will be better than a sole proprietorship or general partnership, but choosing the right entity can really make a difference. LLCs can be created to own specialized or valuable equipment and/or real estate to remove these assets from an operating entity. This allows us to segregate real estate, equipment and even securities accounts from malpractice or other exposure. It also allows for good estate planning by having the leasing LLCs owned by irrevocable trusts for the benefit of other family members. Consider the formation of a family limited partnership or family LLC in a favorable jurisdiction that has the charging order as the sole remedy.

Level 6: Domestic (U.S.-Based) Asset Protection Trusts

With a domestic self-settled asset protection trust, you irrevocably transfer assets to the trust and name yourself as a beneficiary to receive distributions within the discretion of an independent trustee.

The self-settled asset protection trust laws vary from state to state and, therefore, there may be advantages to selecting one state's

laws over another in your particular circumstances. Fortunately, you can elect to have your trust governed by a particular state's statute as long as you meet the requirements of that statute.

(Alaska, Delaware, Nevada and Wyoming are the most popular.)

This strategy becomes particularly powerful when coupled with entity planning. This is done when the Domestic Asset Protection Trust is the owner of an LLC. Remember that self-settled asset protection trusts are only effective for future creditors, as the fraudulent transfer laws of all states prohibit transfers to avoid existing creditors. Also, the trust must be in existence for at least 10 years to protect you against creditors in bankruptcy.

Level 7: Offshore Asset Protection Trusts

These are established under the laws of a foreign jurisdiction. (The Cook Islands, Bahamas, Bermuda and the Channel Islands are all popular choices.) With an offshore trust, the assets are in the hands of a local trustee and are outside the reach of any U.S. court. However, there may be tax issues. Also, if the court orders the assets repatriated and it can't be, you could be cited for contempt and even jailed.

Conclusion

Asset protection planning is a valuable and important part of estate and business planning. There isn't anyone who cannot benefit from implementing one or more of the seven levels of asset protection planning. If you would like to talk about any of these ideas in more depth we would love to speak to you further.

TRUST FUNDING TIP OF THE MONTH

You should notify your homeowner's insurance agent/company to change the ownership name to your Revocable Living Trust and to show you, individually, as an additional insured to cover liability exposure to third parties. If this change poses a problem, an alternative would be to leave your individual name on the policy as "owner" but to add your Revocable Living Trust as an additional insured.

To comply with the U.S. Treasury regulations, we must inform you that (i) any U.S. federal tax advice contained in this newsletter was not intended or written to be used, and cannot be used, by any person for the purpose of avoiding U.S. federal tax penalties that may be imposed on such person and (ii) each taxpayer should seek advice from their tax adviser based on the taxpayer's particular circumstances.

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