



## The Advisor's News

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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*

Asset protection planning is a growing area of concern for our clients and, as a result, a growing area of practice for members of the estate planning team. Because of the variety of issues and concerns involved, asset protection planning is not something that one member of the team can do alone. In addition to specific legal strategies, there are financial strategies that will substantially increase the likelihood that an asset protection plan will achieve its intended objective. Without cooperation among the advisor team, there is great likelihood that the plan will fail to be implemented or fail in practice.

In this issue of *The Advisor's News*, 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.

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### ASSET PROTECTION PLANNING

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Asset Protection is not about hiding or concealing assets. It is about using the existing laws appropriately to obtain the best possible level of protection for the client's assets in case an attack comes along. Asset protection planning is the process of analyzing ownership of assets and re-arranging ownership of those

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

-Alice James

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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.

### ***The Advisor Team: The Three-Meeting Approach***

Asset protection planning starts with awareness. A member of the advisor team must have that initial conversation with the client to help the client become aware of their personal need for asset protection. One of the biggest misconceptions we run into is the client's belief that their revocable living trust is providing asset protection. Becoming aware of the problem, of course, is not enough. For the client to be successful, the client must move from awareness to implementation. Moving from awareness to implementation is best accomplished through a logical sequence we call the "Three Meeting Approach." Here's how it goes:

*1. Initial Meeting - Awareness:* In this meeting, the client (or prospective client) and a member of the advisor team first discuss asset protection. That first discussion may be with any team member – financial advisor, CPA, life insurance agent, retirement plan administrator, attorney or some other. If this is the first meeting between the advisor and a prospective client, the central purpose of the meeting will be to gather basic financial information, discuss the client's objectives and establish a relationship with the client. Asset exposure is just one facet of that discussion. In this meeting, it is important to lay the groundwork and set some reasonable expectations for how asset protection planning works. It is useful to explain what asset protection is and isn't, how the laws work, and what they can expect.

*2. Advisors' Meeting:* After the initial meeting, the advisor team meets together without the client present to brainstorm. They review the client's objectives, discuss various legal and financial solutions, and determine a consensus solution to meet the client's need. It is critically important to "vet" all potential ideas and concerns here and determine a unified approach. If there is dissension in the team, the client will sense it and often end up doing nothing.

*3. Client Solution Meeting:* With a plan in agreement among the advisor team, the final meeting is to present that plan (including all of its legal and financial components and costs) to the client and get the client's approval to proceed. The probability of success at this meeting is enhanced by having more than one team member present.

### ***Client Objectives and Establishing Reasonable Expectations***

As early as possible in the planning process we must understand our client's objectives, but also help establish reasonable expectations about what can and cannot be done.

- Most clients would like to have a high degree of certainty of the outcome. You will have to temper their expectations by explaining how the law works and that there may be circumstances that nobody can effectively control. Asset protection is time consuming, but worthwhile - the end result should be considerably better than if the client had done no planning at all.
- Many clients want to maintain control rather than shift assets to some unknown third party in a foreign land. The preferred approach is to maintain control or at least oversight over the assets, but for some asset protection strategies to be effective at least a degree of control must be relinquished.
- An effective plan will discourage lawsuits from the outset. We cannot make it appear as if the client's assets do not exist, but we can create a structure that will make it much less attractive for a potential plaintiff to go after our client than to go after someone who has done no planning.
- Clients should avoid liability traps such as owning assets in general partnerships or in joint ownership where they are exposed to problems and risks another owner may have.

### ***Types of Risks***

Each client will come with a different risk profile. It is important for us as advisors to understand the various types of risk a client faces.

*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 physician or surgeon needs protection against malpractice claims against others in the practice. They will want to know what can be done to protect themselves from that exposure. 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 practice 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 practice member's spouse or ex-spouse claiming an ownership interest in the practice or another entity; children's spouses and ex-spouses and their behavior which can lead to loss of family assets, etc.

All of these are meaningful risks that should be addressed in that initial meeting.

### ***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. If there is a fraudulent transfer claim, the advisors who helped implement the plan are likely to be dragged in and forced to defend themselves and in some instances may be personally liable.

**Planning Tip:** Clients may misrepresent their legal difficulties, and none of us wants to subsidize a plaintiff's claim through the use of our own malpractice insurance because of not asking the right questions or doing a thorough discovery. An excellent practice is to have in your file a solvency certificate from your client in which the client represents to you in writing that their net worth is a positive number and that the planning they are going to do will not render them insolvent. In some instances it is useful to obtain permission from the client in order to do due diligence and independently investigate to make sure you know the information provided is accurate.

## **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 client. 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 with our clients 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. Typically these plans must also include one or more non-owner employee participants in order to be covered by ERISA. Skillful pension actuaries can be very helpful with this. Also, the Pension Protection Act protects up to \$1 million in IRAs for bankruptcy purposes.

#### *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 clients to convert community property assets into the separate property of the spouse not at risk. Make sure the client is aware that once transferred, it stays separate property and cannot become community property again without another transmutation agreement. Separate counsel may be needed to make this work. Plus, 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 helping our clients choose the right entity is where the planning team can really make a difference. LLCs can be created to own specialized or valuable equipment and/or real estate to remove these assets from the 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 they can't be, the client could be cited for contempt and even jailed.

### **Funding the Asset Protection Plan**

The advisors independently and collectively will make a list of the assets and determine where they need to go. It can easily take six months to a year to fully fund a comprehensive asset protection plan, and it's usually done in steps and pieces. During the funding process, it's very important to keep the client informed and keep the advisors on a timeline.

### **Conclusion**

Asset protection planning is a valuable, challenging and rewarding area in which the advisor team has many opportunities to work together for the benefit of the team members and their clients. By understanding our client's objectives and establishing reasonable expectations we can properly assess their risk profile and implement 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.

*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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