Practical Asset Protection Planning

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Techniques used in Asset Protection Planning "APP"

- Utilization of Entities
  - Corporation
  - Limited liability Company
  - Limited partnership
  - Trusts

Techniques

1. Titling Assets in name of entity (**sweat the small stuff they are essential to success**)
2. Operating the entity separate and distinct from the owner's personal affairs

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Entity Issues

- Annual filings (secretary of state and each required jurisdiction);
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- Minutes and reports with annual appointment of directors, officers, managers and advisors;
- Financial statements and tax returns;
- Review of entity with eye to separate from personal.

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Entity Issues

- Ultra-Ego Theory
  - Piercing the entity veil
    - » If the owner disregards the entity; the owner's creditors may also disregard
    - » Payment of personal expenses directly
    - » Failure to observe the structure
    - » **Single Member LLC status in Colorado case law!!**

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Entity Works Because

- Statutory separation from personal affairs precludes access by creditors to assets outside of the entity
  - Inside and outside liabilities

- Statutory restrictions
  - Limited Liability Company versus Corporation
  - Charging Order
  - Jurisdiction; state of formation

Entity Works Because

- Statutory and Agreement restrictions:
  - Involuntary transfers (divorce/judgment creditors)
  - First right of refusal (member may not transfer, pledge, encumber or otherwise alienate their interest except in compliance with terms of):
    - Operating Agreement
    - Close Corporation Agreement
    - Buy-Sell arrangement
    - Partnership Agreement
    - Spendthrift provisions of trust

Entity Options

– Holding Company arrangements
  - Segregate a business' activity that has liability exposure from other business' activities of the closely held entity
  - Separate assets and activity of the risky venture from the others
  - Maintain separate books, financial statements and titling of assets
  - Must be cognizant of **undercapitalization;** may allow a creditor to pierce the entity's veil of protection/separation

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Asset Protection Trusts (APT)

- Classic Irrevocable Trust
  - Grantor transfers assets for the benefit of spouse, children, grandchildren…multiple generations
  - Commonly known as a generation skipping trust ("GST")
  - Avoids estate taxation in subsequent generation's estates
  - Since Grantor is NOT a beneficiary various restrictions on alienation (commonly known as spendthrift provisions) preclude the corpus of the trust from being attached by or conveyed to creditors of the beneficiaries

Asset Protection Trusts

- If created during lifetime of grantor (gift tax return is required which evidences separation of assets from grantor); appreciation from date of trust creation avoids estate taxation
- May be created upon death of grantor or grantor's spouse; allows access to grantor and spouse until death
- May be utilized for entire inheritance to be passed on or only a portion

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Self-settled APT

Domestic Self-settled APT

- Available in Alaska, Colorado, Delaware, Hawaii, Michigan, Mississippi, Missouri, Nevada, New Hampshire, New York, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah, Virginia, West Virginia, and Wyoming. **Not in Colorado**
- Statutory prohibitions regarding fraudulent conveyances (example, the transfer renders the grantor unable to pay their debts) and a period of time from date of creation before effective.
- May NOT avoid spousal support, child support
- There is little case law to evaluate effectiveness

Domestic APT

Elements

- Trustee from Jurisdiction
- Grantor may be a beneficiary of trust (self-settled)
- Assets generally titled/transferred to entity (such as LLC); entity in turn is owned by the DAPT
- Not an income or estate tax saving device (generally treated as grantor trust for income and estate tax purposes)
- Remainder beneficiary's spouse and lineal descendants

Domestic APT

Grantor benefits

- May be discretionary beneficiary of trust
- Designed to thwart access to the corpus by creditors of grantor provided establishment of trust met statutory requirements
- If grantor's interest must be given up (spendthrift clause) the corpus is preserved for the grantor's designated beneficiaries and creditors are denied access

Domestic APT

- **Bankruptcy Abuse Prevention and Consumer Protection Act of 2005**.
  - Bankruptcy trustee may reach assets transferred within 10 years if: self-settled trust designed to "hinder, delay or otherwise defraud creditors of grantor"
  - May hinder conduct of new business enterprises and access to credit….banks are not enthusiastic
  - Constitutional full faith and credit applicability

Foreign Asset Protection Trust ("FAPT")

- **The elements which are different from the DAPT**

Trustee and Jurisdiction:

-Trust is governed by law of foreign country (**a sovereign which does not recognize the laws of the United States**)

-Sovereign status eliminates the full faith and credit provisions of the US Constitution

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FAPT

- **Sovereign Law status**

  - Creditor must file suit in foreign jurisdiction (de novo claim in foreign jurisdiction)

  - Sovereign statutes preclude contingent fee attorney arrangements

  - FAPT use trust protector language which may have a requirement that the trust protector transfer the assets to another sovereign jurisdiction if a judgment is secured against the trust

  - myth….FAPT are income tax and estate tax avoidance devices…**THEY ARE NOT**

FAPT

- **Mechanics of FAPT**

  Client and advisors (attorney, CPA, financial planner) should document:

  - that creation of FAPT is not a fraudulent conveyance; and
  - attend to the creation of entity (often an LLC which will own the assets to be sheltered); and
  - proper documentation of the transfer of assets and acceptance by foreign trustee
  - generally, the custodian may be a foreign institution with banking facilities in the US
  - care should be taken in using experienced advisors

FAPT

- Estimated fees to establish trust, set up entity, arrangement of custodian situation, draft documents and perform due diligence on client/grantor…. $25,000 to $50,000

- The annual maintenance of a FAPT.

  -Tax returns, reports and various other maintenance as to records and related planning…$15,000 to $25,000

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Other APP Retirement Accounts

- Retirement Plans
  - ERISA spendthrift protections
  - Unlimited accumulation exempt from claims
  - If possible, limit to RMD's

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RETIREMENT ACCOUNTS

- Client funding at maximum levels (could that be a fraudulent conveyance??)

- Utilizing the statutorily available plans
  - Cash Balance

  - Defined Benefit

  - Use entities to facilitate funding

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Retirement IRA's

IRA

- Not ERISA protected but is state protected in Colorado
- Use of self-directed plans to make otherwise prohibited investments

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Retirement Accounts

- IRA and Roth IRA limitations on protections afforded under 2005 Bankruptcy Act
  - Exemption is limited to $1,362,800; April 2019 (adjusted for inflation every 3 years; next change 2022)
  - June 12, 2014, in Clark v. Rameker; the US Supreme Court Decision declared Inherited IRA's subject to bankruptcy

Retirement Accounts

Examine file documents to be certain qualification letter exists and plan is in compliance.

- Examine beneficiary designations to be certain they are up to date
- Should the assets remain in the qualified plan

State Law Exemptions disclaimer Mr. Aussem is not licensed in Colorado

- Homestead Exemption
  - Colorado $75,000
  - Florida "unlimited"
  - Cannot use Federal as alternate in Colorado
- Retirement accounts under ERISA, IRA, Roth IRA unlimited in Colorado

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State Law Exemptions

- Life Insurance
  - Colorado $100,000 CSV is exempt if beneficiary is "other" than insured
  - Can't "super fund" CSV for 4 years prior to claim
  - Death benefit exempt if non-insured beneficiary
  - Not exempt if owner is not the insured
    - Example, father owns policy on son or business partner as part of succession plan

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The Simple Things

Examine ownership of assets:

- If one spouse is a physician and one a home maker; re-title assets….stay married of course….
- Consider SLAT (spousal limited access trust) for asset protection purposes

Simple Things

- **Do not accumulate unnecessary liquid assets in a business entity**
- Maintain adequate insurance coverage and umbrella coverage
- Examine documents
  - Do restrictive covenants exist
  - What are trigger issues
  - Do call provisions exist with payment terms

Simple Things

Consider timing of transactions

Sale of business/liquidity event:

perfect time to fund trust, transfer assets

Marriages and Re-marriages:

pre-nuptial fund trusts before event

re-arrangement of estate plan based upon beneficiary's situation (divorce)

Simple Things

APP is facts intensive; need to know:

1. Existing debts and possible claims
2. Assets of client (do valuation to prove transfers are not fraudulent)
3. Determine “exact ownership” of assets
4. Client’s unique facts and circumstances

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