

## WHAT YOU NEED TO KNOW TO PROTECT YOUR ASSETS FROM CREDITORS!

The number one concern of most individuals, after the fear of outliving their money, is having their assets taken from them by creditors. Creditors and potential creditors are all around us today in our credit driven society and it is easy to find yourself owing money. The list of your potential creditors may include the IRS, victims of accidents and negligence, doctors, hospitals, nursing homes, health-care providers, credit card companies and other individual or family member creditors if you cosigned or guaranteed their debt obligations. Your first line of defense, in order to avoid any potential liability from these and other creditors, should consist of the following:

1. **Liability Insurance:** Most individuals purchase "umbrella" coverage through their insurance policy. These policies do not cover business-related liability and in order to protect yourself in that arena you should purchase Officer and Directors insurance coverage. Be advised that insurance policies will only protect you if you are sued.
2. **Miscellaneous Exemptions:** The law in many states provides limited exemptions from execution by judgments. Several of these exemptions are as follows:
  - **Homestead :** Florida, Iowa, Kansas, South Dakota and Texas have unlimited homestead exemptions. This protects all of the equity in your personal residence from creditor claims and judgments. In other states, the homestead exemption law may protect none or only protect up to \$125,000 of the equity in your personal residence. Under Nevadalaw, the homeowner of a single-family dwelling that is unencumbered by a mortgage or other lien is eligible to apply for what is known as an "allodial title".
  - **Medical Exemption:** Your primary residence may be protected from a creditor for medical bills, regardless of the amount of equity you have in the residence.
  - **Wages from garnishment.** In several states, all of the disposable earnings of a head of family are exempt unless they have agreed otherwise in writing. An individual who is not the head of family may not have their disposable earnings attached or garnished in excess of the amount allowed under the Consumer Credit Protection Act, 15 U.S.C. s. 1673.
  - **Disability income benefits.** Disability income benefits under any policy or contract of life, health, accident, or other insurance of whatever form are exempt, unless they were procured for the benefit of such creditor.
  - **Medical Savings Account.** This exemption covers funds that are paid into or out of a Medical Savings Account by or on behalf of a person depositing the funds into such account or a qualified beneficiary.
  - **Other property.** An interest in a motor vehicle, professionally prescribed health aids or an interest in a refund or a credit received or to be received pursuant to s. 32 of the Internal Revenue Code of 1986, as amended.
3. **Cash surrender value of life insurance policies.** The cash surrender values of life insurance policies issued upon the lives of citizens or residents of the state are exempt to any person whose life is so insured, unless the insurance policy was effected for the benefit of a creditor.

4. **Annuity contracts.** The proceeds of annuity contracts are exempt, unless the contract was procured for the benefit of such creditor.
5. **ERISA plans, pension money and retirement or profit-sharing benefits.** The Employee Retirement Income Security Act of 1974, (ERISA) protects qualified plan assets and the benefits that you receive from them. ERISA requires all plans to include provisions that prohibit the assignment of plan assets to a creditor. The U.S. Supreme Court has ruled that ERISA plans are protected from creditors even when you are in bankruptcy. This includes funds received within 3 months preceding the issuing of an execution, attachment, or garnishment process when debtor states via affidavit that the funds are necessary for the maintenance of their support or a family supported wholly or in part by the funds. However, the plan may not be exempt from the claims of an alternate payee under a qualified domestic relations order.
6. **Individual Retirement Account (IRA) and non-qualified plans.** IRA's are described under Section 408 of the Tax Code and have their own rules. An IRA is not automatically protected from creditors under federal law or ERISA; however, many states have put safeguards in place that specifically protect their assets. These safeguards may apply whether or not you are in bankruptcy. It is currently an open issue as to whether state law will protect a SEP or SIMPLE IRA. A recent Sixth U.S. Circuit Court of Appeals case implies that a SEP will not be protected from creditors.
7. **Prepaid College Programs, 529 Plans and Education Savings Plans.** Assets in these programs may be protected from creditors of the owner or beneficiary of the plan. For individuals with children or grandchildren this might be a useful way to save for their education and have it grow tax-free.
8. **Corporations, Limited Partnership and Limited Liability Companies:** A properly established and maintained legal entity will protect its shareholders and members from the entity's debts and liabilities. In order to establish personal liability of an entities shareholder or member, a creditor must "pierce the corporate veil".
  - **Division of your Assets:** It may be advisable to divide your assets or place them all into the name of your spouse or a trusted family member. In order for this plan to work, it must be agreed upon by the individuals before any problems should even be on the horizon.

Your next line of defense should consist of any one or all of the following more advanced protection options:

**A. Irrevocable Trust:** An irrevocable trust involves relinquishing all of your rights, title and benefits to the trustee of the trust. As a result, the assets that you transfer will no longer be considered yours and will not be subject to your creditor claims, unless the transfer of the assets is considered a "fraudulent transfer".

**B. Qualified Personal Residence Trust (QPRT).** A QPRT is a form of irrevocable trust that is established with the grantor retaining the right to use a residence for a specified term of years. Upon expiration of that term the residence will belong to the Trust. The Trust instrument will have designated remainder beneficiaries who will then, through the Trust, own the residence outright.

### **C. Spendthrift Trust or Domestic Asset Protection Trusts ("DAPT").**

A "spendthrift trust" or DAPT is a trust unique to only several states (Nevada, Alaska, Delaware, South Dakota and Rhode Island) and is established for the benefit of the grantor. The Trust is restrictive in that the grantor may not be the trustee, some of the assets must be located in the state of establishment and all distributions to the grantor are solely discretionary.

**D. Offshore Trusts and Investments:** These Trusts are typically irrevocable and are created in a foreign situs. The assets that are transferred to the Trust and the trustee are not subject to the laws of the United States but that of the foreign jurisdiction. Be advised that many of these jurisdictions do not automatically honor judgments that are granted outside of their own courts. Although the trust assets can be invested in U.S. assets in order to insure that they are no longer subject to the control of the U.S. courts the trust should invest solely in offshore investments.

### **Recommendations:**

- Always use a separate entity for each liability-generating asset and never mix liability-generating assets.
- Avoid general partnerships and handshake agreements. In a partnership, any general partner can commit the partnership to a legal contract making all general partners jointly and severally liable.
- Do not flaunt your wealth or put everything in your name. If people are of the opinion that you are wealthy you may be a target for a lawsuit.
- The law in every state is different and the law of your state will often control what a creditor can get.
- No country in the world automatically recognizes U.S. based judgments or tax liens.
- Never ignore a lawsuit!
- Maintain insurance because often the main value of a good policy is that the insurance company must provide you a defense.

### **Conclusion**

Depending upon the level of your future exposure to creditor claims, adequate insurance and a homestead exemption may be all that you require as protection. However, as your potential creditor exposure increases, you may consider asset transfers and domestic trusts as your form of asset protection. Alternatively, at the highest level of creditor exposure, you may utilize a foreign situs trust.

Please be advised that this article is intended solely for individuals that do not currently have any creditor problems and want to insulate their assets from potential but currently unknown creditor claims. Be advised that these legal methods are solely intended to discourage and defer creditors and do not guarantee that they cannot be breached. There are NO "bullet-proof" methods to absolutely prevent creditors from breaching the fortress that you have established. The hope is that if you make life very difficult for them they may just go away.