

Asset Protection Strategies

LEON RITTENBERG III - POSTED ON APRIL 20, 2011 BY BALDWIN, HASPEL, BURKE & MAYER

ENERGY CENTRE - 36TH FLOOR
1100 POYDRAS STREET
NEW ORLEANS, LA 70163

Many clients are concerned about protecting their accumulated wealth from the claims of future creditors. Asset protection planning is not based on hiding assets or as a means to defraud existing creditors, but rather on sound wealth preservation strategies. The goals include the protection and preservation of assets, discouraging litigation by reducing the size of your assets and providing incentives for potential future creditors to seek an early and cheap settlement. The following are some of the typical asset protection strategies available to clients.

A. Convert Non-Exempt Assets into Exempt Assets

The ideal asset protection strategy is one which allows you to retain ownership and control over your own assets. Under Louisiana law, certain assets are "exempt" from creditor claims, except claims by the Internal Revenue Service and, in some instances, alimony and child support claims.

1. Family Home

The first \$25,000 of equity in your family home is exempt from seizure. You can borrow excess equity in your home and use the loan proceeds to invest in other exempt assets discussed below. However, the full value of the equity in your home as it existed one year before seizure is exempt from uninsured obligations to health care providers arising directly as a result of a catastrophic or terminal illness or injury which are in excess of \$10,000 and greater than 50% of your average federal adjustable gross income for the preceding three years.

2. Life Insurance

Louisiana provides a very liberal exemption for life insurance and endowment policies. The proceeds and avails of such policies, which includes both the death benefit and cash surrender value, generally are exempt from the claims of the creditors of: (a) the insured; (b) the policy owner; and (c) the estates of the insured or the policy owner. The proceeds and avails also are exempt from the claims of the heirs and legatees of the insured or the policy owner. Finally, the proceeds and avails are exempt from all liability for any debt of the beneficiary, payee or assignee existing at the time the proceeds or avails are made available to such beneficiary, payee or assignee (but not creditors whose claims arise subsequent to payment of the proceeds). Thus, an insured may die with an insolvent estate but the beneficiary may walk away with the entire death benefit. An insured may declare bankruptcy but retain his insurance and its cash value. A beneficiary may have creditor problems at the time he receives the death proceeds, but these creditors will have no claim against the proceeds. Of course, as policy owner you can waive the exemption by assigning or pledging the policy as security for a debt, such as a bank loan.

The life insurance exemption applies only to \$35,000 of the cash surrender value of any policy if the policy is issued within nine (9) months of seizure by the creditor or the filing of bankruptcy. However, this exemption applies to each policy if there is more than one.

3. Annuities

Louisiana also exempts annuities issued by life insurance companies from the claims of the same creditors mentioned above with respect to life insurance policies. However, a Louisiana federal district court recently wrestled with the \$35,000 limitation language in the Insurance Code which also refers to annuities, but concluded that the statutory reference was mistaken and, therefore, annuities were entirely exempt from seizure from the date of issuance. The exemption applies to all contracts labeled as an "annuity," including, but not limited to, deferred, fixed, equity indexed or variable annuities, irrespective of current pay status.

4. Tax-Deferred Arrangements

Generally, all pension plans, Keogh plans, traditional IRAs, Roth IRAs, simplified employee pension plans and all other tax-deferred plans authorized under the Internal Revenue Code are exempt from seizure by creditors other than alimony, child support and the IRS.

No contribution to a tax-deferred arrangement is exempt from seizure if made within twelve months of seizure by the creditor or filing of bankruptcy proceedings. The one year rule does not apply to a rollover contribution.

5. Establish Bona Fide Domicile in Another State

Other states may have more liberal exemptions. For example, the entire family home, regardless of value, is exempt for Florida and Texas domiciliaries. In order to benefit from more liberal exemptions, you must establish your domicile in such state, even though you still may maintain a temporary residence in Louisiana.

B. Transfer of Assets to Others

1. Spouse

You can transfer assets to your spouse gift tax free. The asset then becomes your spouse's separate property. If you incur a community obligation or even a separate obligation, the separate property of your spouse is not liable for such obligation. Alternatively, couples may consider either a modification or termination of the community property system during marriage with court approval or a voluntary partition of existing assets without court approval, particularly if one spouse is concerned about some risky venture. For those contemplating marriage, a pre-nuptial agreement can modify or reject the community property system, which is particularly useful where one spouse already has substantial debts or creditor problems incurred before marriage. You need to consider the implication of a future divorce or the death of the donee spouse before embarking upon a spousal transfer strategy.

2. Children

A traditional asset protection strategy is to transfer assets to children or trusts for their benefit. There are several drawbacks to this strategy. First, you lose ownership (and perhaps control) of the asset. Secondly, the transfer may be subject to state and federal gift tax, depending upon the value of the transfer and your available gift tax exemptions. In addition, there is no step-up in tax basis for donations of appreciated assets which would occur if your children inherit such assets. Finally, property donated outright to children will be subject to the claims of their creditors, including alimony and child support, and if the child dies prematurely, will be inherited by your child's heirs or legatees.

3. Creditor Challenges of Transfers to Others

If you donate all of your property to others without reserving enough for your own subsistence, the donation is a nullity. Furthermore, if the donation causes or increases your insolvency, a creditor may upset the donation if the creditor institutes a legal action within one year from the time the creditor knew or should have known of the donation (but in

no event more than three years after the donation). Your intent in making the donation is immaterial since the only test is whether you were or became insolvent as a result of the donation.

If you become bankrupt (voluntary or involuntary), the bankruptcy Trustee can upset donations made within one year of filing or, in egregious situations, the bankruptcy court can deny the discharge of your debts in bankruptcy.

C. Operate an Enterprise in a Protected Entity

Various legal entities, such as corporations, limited liability companies and limited partnerships offer creditor protection. These entities are particularly useful to protect personal assets from debts and liabilities arising from the operation of a business or professional practice and from investments which have liability risk, such as commercial or residential real estate or working interests in mineral properties. Generally, any debts or liabilities are limited to the assets of the entity itself and not your other personally-owned assets.

Nevertheless, you still may incur personal liability if you fail to pay state and federal trust fund taxes or Louisiana sales and use taxes, personally guarantee debts, or if you, acting through the entity, commit fraud or deceit on third parties. You remain liable for personal injury damages caused by your own negligence, regardless of the legal form of your business or professional practice.

D. Use an Entity to Shelter Investment Assets

Assets, such as real estate, cash and cash equivalents, stocks and bonds are easily reachable by creditors. The transfer of assets to an entity, such as a limited liability company, limited partnership or corporation, limits the creditors' rights to seizing your "interest" in the entity, rather than the underlying assets themselves, subject to all of the limitations and restrictions which apply to such interests under Louisiana law and the governing instruments of the entity. The asset protection strategy is to convert liquid investment assets into an unattractive asset so that a seizing creditor will settle quick and cheap.

E. Offshore Protection Trust

Trusts may be established and funded in a foreign jurisdiction whose laws are specifically designed to place both physical and legal obstacles in the path of creditors seeking to collect judgments. These trusts can be complicated and expensive. Many clients feel uncomfortable about placing cash or securities in a strange country, thousands of miles from home. Some assets, such as real estate, may not be well-suited for transfer to a foreign trust since it is unlikely that a local judge could be convinced that he has no jurisdiction to adjudicate a creditor's claim over real estate located a few blocks from the courthouse on the theory that it is owned by a foreign trust which you created and remain a beneficiary.

F. Domestic Protection Trusts

Several states, such as Missouri, Alaska and Delaware, have enacted favorable legislation encouraging the use of asset protection trusts, even in situations where you remain a beneficiary of the trust. In order to take advantage of these laws, usually some trust administration must take place in the state and at least one Trustee must be a resident of the state or a local bank or trust company. As with most asset protection devices, these trusts are designed to protect from claims of future creditors, not to defraud or hinder existing creditors.

G. Conclusion

Generally, asset protection involves a combination of the various strategies discussed above. The degree of protection will depend entirely on your particular circumstances. There is no guarantee that creditors will not challenge some

forms of asset protection, particularly when they have nothing to lose but everything to gain if successful. The first line of defense to protect your assets is to obtain adequate levels of insurance