Finance Talk: Asset Protection

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Part I

Damages from a maritime casualty can easily exceed your liability coverage.

This is especially true if you are carrying a lot of passengers who are not employees, if there is substantial environmental damage, or if your insurance company files bankruptcy.

Because your liability exposure may not be limited to your liability insurance, asset protection should be an important consideration for vessel owners. Interest in asset protection has grown in recent years as a result of the substantial increase in litigation and the amount of jury awards.

The first layer of asset protection is to have the appropriate liability insurance in place, including pollution and automobile coverage.

It is a good idea to find a strong and solvent insurance carrier and to make sure that you have the right coverage in place to match your business risks. Most insurance policies also cover legal defense cost, which can be high. (Usually, if you can afford it, it is better to have higher deductibles and higher liability limits). Lenders and customers often impose minimum insurance requirements. These levels may not offer the level of coverage you need. You should review coverage levels periodically with a knowledgeable insurance advisor.

The second layer of asset protection is to isolate the liability exposure by using separate entities to operate distinct businesses with their own risks. For example, it is common for vessel owners to operate their own vessels and to operate or broker vessels owned by others.

If both businesses are run through the same legal entity, then a casualty on a non-owned vessel can lead to claims against owned vessels.

The third layer of asset protection involves segregating assets among your family. In many states, separate assets of one spouse are not subject to claims from creditors of the other spouse. Assets owned by children or trusts for their benefit are not subject to the claims of their parent's creditors, except if assets are given to children. Creditors may have a relatively short period in which to revoke the gift, usually no more than four years.

Giving money to children or trusts for their benefit can also reduce the family's overall income and estate taxes.

Part II

In Part I, three simple asset protection measures were discussed. There are other more sophisticated strategies, such as converting assets subject to claims from creditors into assets that are exempt from creditor seizure in bankruptcy.

For example, in Louisiana the first $25,000 of your homestead, tools of your trade, arms military accoutrements, poultry, and one cow kept for use of the family are exempt. In addition, most retirement plan assets, annuities and life insurance are exempt. In Texas, one's entire homestead is exempt from creditor seizure if you have lived in the state for more than 1,215 days. Recent aments to the Federal Bankruptcy Code limit your ability to move to Texas prior to filing bankruptcy.

These exemptions from creditor seizure may not apply to government efforts to collect taxes, fines, and penalties. Still, investing in exempt assets can be an excellent creditor protection vehicle.

Two other common asset protection measures are the use of domestic asset protection trusts (DAPTs) and offshore trusts. The use of these trusts may be limited under recent amendments to the Bankruptcy Code that allow certain creditors to unwind transfers to DAPTs for up to 120 years after the transfer.

In most states, an individual cannot transfer assets into a trust and have those assets protected from creditors. However, at least seven states, including Alaska and Delaware, have changed their laws to offer creditor protection for DAPTs. In those states, DAPTs can also be used to facilitate estate tax planning as well as asset protection planning. However, creditors are attacking them saying the laws of the state where the person resides applies rather than where the trust is created. Thus, the transfers are fraudulent.

Although not bullet proof, these trusts can present an effective barrier between a debtor and a creditor.

Offshore trusts are typically created under the laws of foreign countries that do not recognize the authority of U. S. courts. However, judges in several recent cases successfully attacked offshore trusts by basically putting debtors in jail for contempt until the debtors agreed to remit some of the assets that were transferred offshore.