

ASSET PROTECTION: FREQUENTLY ASKED QUESTIONS

By: David A. Holmes

April 2004

Increasingly, clients ask about how to protect their assets from lawsuits and whether they can take steps to insulate assets in the event they are sued. The most frequently asked questions about asset protection are discussed below:

1. Why is asset protection necessary? Our nation has seen a litigation explosion in recent years. Essentially no business or professional activity is exempt from the increasing risk of being sued. Each year, more and more suits are filed. At the same time, jury verdicts have skyrocketed. In this environment, planning for a potential lawsuit must be part of the business and estate planning process.

2. What is asset protection? Asset protection planning is the legal and ethical process of reviewing financial holdings and restructuring those holdings to take advantage of legal exemptions that may place those assets beyond the reach of potential future creditors or at least make those assets more difficult for a creditor to reach. In addition to insulating assets from creditor attack, asset protection planning can allow you to deal with future creditors from a position of strength, rather than defensively when your assets are at risk.

3. Who needs asset protection? Anyone who has accumulated assets (real estate, stocks, bonds, and other investments) is a target and should review their holdings from the perspective of "What will happen if I get sued?"

4. What strategies are available? Asset protection techniques range from the simple to the complex. No single document can cover all of the options; however, asset protection planning generally includes a review of the legal exemptions available and consideration of one or more protective entities. Some of the issues covered in an asset protection review are summarized below:

EXEMPTIONS

Nearly every state has asset exemptions that are intended to protect certain holdings by placing them beyond the reach of judgment creditors. Florida has some of the most generous exemptions. A number of those exemptions are discussed below. Each exemption has a number of technical requirements that must be discussed before action is taken.

- **Homestead.** The Florida constitution protects the homestead from most judgments against the owner of the homestead. Unlike other states, Florida's homestead exception is not capped at any dollar amount.
- **Entirety Ownership.** Florida law recognizes the doctrine of tenancy by the entirety. Tenancy by the entirety is a specific form of joint ownership available

only to husband and wife. When husband and wife own property as tenants by the entirety, that property cannot be reached by a party obtaining a judgment against one spouse or the other. The property is only at risk to a party obtaining a judgment against both spouses. The protection afforded by tenancy by the entirety is limited. First, entirety ownership provides no protection against joint creditors. Moreover, a tenancy by the entirety only survives as long as the marriage remains intact.

- **Wages.** The wages of a head of household are generally exempt from attachment or garnishment. Moreover, disposable earnings of a head of household deposited into a financial account are exempt for six months after the earnings are received, so long as the funds can be traced and identified as wages. Through a properly structured and funded “wage account” up to six months of wages can be continuously protected.
- **Retirement Plans.** Another statutory exemption relates to specific types of retirement plans. Money held by or payable to a participant in such plans is exempt from all claims of the participant’s creditors; however, only specified plans are protected.
- **Other Exemptions.** Florida law also protects annuity contracts and life insurance policies. Specifically, proceeds of annuity contracts issued to citizens or residents of the State of Florida are generally exempt from the claims of the creditors of the party holding or benefiting from the annuity contract. Cash surrender values of life insurance policies issued upon the lives citizens or residents of the State of Florida are also exempt from creditors claims. There are a number of other exemptions available under Florida law that can be specifically reviewed on an individual basis.

ASSET PROTECTION ENTITIES

Because the exemptions discussed above are inherently limited, it is often necessary to look to other structures for the protection. Two of the most frequently adopted structures are summarized below:

- **Limited Partnerships.** Limited Partnerships are the cornerstone of asset protection planning under Florida law. A limited partnership divides ownership of property among groups of partners that include general partners and limited partners. The general partner or partners retain control over the partnership property and the business of the partnership. Limited partners maintain an interest in the partnership property and distributions from the partnership, but exercise no control over the assets held in the partnership. Parties obtaining a judgment against the holder of a general or limited partnership interest in a Florida limited partnership obtain only a limited remedy known as the charging order. Once issued by the court, a charging order will entitle the judgment holder to receive

whatever distributions or other payments the partner against whom the order is entered would receive, until the judgment is paid in full. The charging order will not permit the creditor to take partnership property or exercise control over the partnership assets—which is far preferable to having the property taken after a judgment is entered. Limited partnerships can also provide a number of tax and estate planning benefits.

- **Asset Protection Trusts.** A number of jurisdictions outside of the United States have long recognized the validity of trusts that protect the trust assets from the creditors of the individual establishing the trust—even when that individual is the only beneficiary of the trust. Many of these jurisdictions have a number of other favorable laws, and permit the individual establishing the trust to exercise a significant measure of control over the trustee and trust property without voiding the trust. Moreover, the protection afforded by these trusts is rarely dependent upon domestic judges and juries. Taken together, these factors make offshore trusts perhaps the most effective method of asset protection. These trusts can be established in a way that allows the trust assets to remain in the United States until a time when they are under attack. Moreover, unlike partnerships, an asset protection trust can preserve the ability of the client to regularly access the protected funds, even when a judgment is in place. Such trusts can also be qualified as domestic for tax purposes and do not impose any tax burden when properly established.

5. Is it ever too late to start? Like all states, Florida has a Fraudulent Transfer Statute. This statute prohibits transfer of assets from a holding in which they are subject to creditor's claims to a holding in which they are exempt from creditor's claims, when the transfer is undertaken with the intent to avoid, hinder or delay creditors. In simplest terms, once a claim is made or litigation is commenced, the ability to transfer assets beyond the reach of creditors is significantly limited. Accordingly, advance planning is the key to a successful asset protection strategy. Once a claim is made, it is often too late to pursue many of the options discussed above.

6. What is the best solution? There is no single asset protection plan that works for everyone. Establishing an effective plan involves a thorough examination of assets, liabilities, family relationships, risk tolerance, and a number of other factors. Formulating the appropriate plan is best accomplished in consultation with an experienced team of legal and financial advisors.