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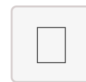

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Blog for Estate Planning Professionals

BLOG

Top Ten Asset Protection Mistakes Attorneys Make

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By Steven J. Oshins Esq., AEP (Distinguished)

Asset protection has become one of the hottest areas of practice, especially over the last decade. Although asset protection planning should be a fixture in every estate planner's repertoire, there are still many asset protection opportunities that are missed. This article describes ten asset protection opportunities that are often overlooked.

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Asset Protection Mistake #1: Not discussing asset protection planning.

Nearly every estate planning attorney makes a will and revocable trust discussion a given in every estate planning meeting, yet asset protection is often merely an afterthought. For many attorneys, unless the client or prospective client asks about asset protection, it never gets discussed. This hurts both the client and the attorney since there is usually some asset protection to be done. The client is often looking to the attorney to be an advisor, not just to take direction from the client.

Asset Protection Mistake #2: Not using charging order protection.

People often use charging order protected entities such as limited liability companies and limited partnerships to protect assets. The assets don't have to be business assets. They can be cash, brokerage accounts, life insurance, real estate, promissory notes receivable and just about any other asset class. Owning these assets in your own name subjects them to attachment by a personal creditor, except to the extent a state statute exempts some or all of an asset from attachment. There is no reason to hand these assets over to a creditor when it is so simple and cost-effective to form and maintain a charging order protected entity. A charging order is a type of lien, so the creditor will likely settle the dispute at a lower dollar value rather than risk getting a lien over an entity that may not make any distributions.

Asset Protection Mistake #3: Using single member LLCs rather than multi-member LLCs.

The philosophy behind charging order protection is that it would be unfair for the other member if that member has to be in business with the creditor of the debtor member. Thus, state laws generally provide that the creditor merely gets a charging order which is an economic interest that doesn't include any voting powers. However, when there is only one member of the LLC, the philosophy of protecting another person does not exist. There have been multiple court cases arriving at this conclusion and, thus, allowing the single member LLC be pierced.

Asset Protection Mistake #4: Failing to use Domestic Asset Protection Trusts.

Domestic Asset Protections Trusts have become one of the most popular and widely-used asset protection techniques. Although many attorneys are taking advantage of these, many others are not. Some have failed to use this technique because of the uncertainty about whether it will work. This is often based upon a misunderstanding about the objectives of an asset protection structure. The goal is to put the client into a better position than the client was in without the structure. There is one bad case (*In re Huber*) and one good case (*Dahl v. Dahl*), as well as countless other disputes where the debtor was able to successfully use the structure to negotiate a favorable settlement. Thus, there will not be a 100%

success rate, but in almost all situations, this technique will help the client significantly.

Asset Protection Mistake #5: Using staggered distribution trusts.

Most trusts are drafted to give the beneficiaries staggered distributions at different ages. For example, a common design is to distribute one-third at age 25, one-half of the balance at age 30 and the balance at age 35. This needlessly subjects the trust assets to the creditors and divorcing spouses of the beneficiaries. Instead of this design, the trust can instead be drafted to continue for the beneficiary's lifetime with the beneficiary being named as a trustee upon reaching a selected age.

Asset Protection Mistake #6: Failing to use Dynasty Trusts.

Dynasty Trusts aren't just estate tax savings vehicles. They are also used to provide asset protection and divorce protection for the beneficiaries for as many generations as applicable state law allows. This type of trust is commonly known as a Dynasty Trust. Just as attorneys should use lifetime trusts for the first generation, the same concepts apply to more remote generations as well. There is no reason not to protect the assets for grandchildren, great-grandchildren and other beneficiaries.

Asset Protection Mistake #7: Using support trusts rather than discretionary trusts.

Many trusts are drafted to give the trustee the power to make distributions to the beneficiaries for their health, education, maintenance and support. These trusts are often called support trusts. Depending upon state statutes and case law, support trusts are often available to certain classes of creditors, including divorcing spouses. A discretionary trust, on the other hand, gives the trustee absolute discretion over distributions and thus generally protects the assets from all classes of creditors.

Asset Protection Mistake #8: Failing to use third-party discretionary trusts.

A third-party trust is a trust that is set up for beneficiaries other than the settlor. For example, a trust set up for the benefit of the settlor's spouse and descendants is a third-party trust. There is no stronger asset protection technique than a transfer to an irrevocable trust in which the settlor is not a beneficiary. Unless the transfer was a fraudulent conveyance, there is almost no challenge to this technique. Transfers to the trust need not even be completed gifts for gift tax purposes to be protected. As discussed above, the trust should be a discretionary trust rather than a support trust.

Asset Protection Mistake #9: Failure to take advantage of state law exemptions.

Each state has different statutory exemptions. These include homesteads, IRAs, life insurance, annuities and other asset classes. The extent of the protection depends upon the state where the debtor resides. The attorney should consider these exemptions in planning the estate.

Asset Protection Mistake #10: Failure to take advantage of ERISA-protected retirement plans.

The Employee Retirement Security Act ("ERISA") protects 100% of certain qualifying retirement plans, such as profit sharing plans and pension plans. In order to obtain this protection, the rules generally require there to be at least one non-family employee. Not only should retirement plans be used for income tax deferral purposes, but the asset protection is often even more valuable.

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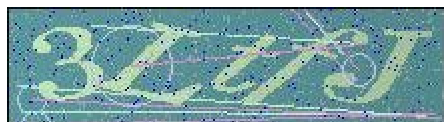

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