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ASSET PROTECTION

SHIELDING ASSETS FROM CREDITORS AND CLAIMANTS

I. **PROPERTY AT RISK**:

1.1 **Overview:**

Many people are concerned about having their assets taken from them by creditors of all types. This memo outlines some of the basic techniques that can be used to insulate property from various claims. It is primarily intended for people who do not currently have problems with creditors, but who want to insulate their assets from potential claims. This memo focuses on legal, practical methods intended to discourage and defer creditors. The following does not apply to intentional torts, such as assault, rape or intentional infliction of emotional distress. These types of torts usually open up the individual tortfeaser to personal liability.

1.2 **Who Are My Creditors?**

You do not have to look very hard to find people and agencies who want your property. It is too easy to find yourself owing people money, and sometimes unwittingly. Some possible creditors include:

A. The Internal Revenue Service. This can include your obligation for personal income taxes, business taxes, etc.

B. Auto accident victims, perhaps even persons you believe were at fault.

C. Other accident victims, including victims whose injuries were caused by the actions of minor children or employees.

D. Doctors, hospitals, nursing homes, and other health-care providers.

E. Credit card issuers, including MasterCard, Visa, Discover, American Express, oil companies, department stores, etc.

F. Business creditors, including employees, governmental agencies, suppliers, accident victims, etc.

G. Creditors of others, where you have co-signed or guaranteed their obligations.

II. BASIC TOOLS:

2.1 Nevada Creditor Protected Trusts:

Nevada "Spendthrift" Trusts:

Since October 1, 1999, Nevada offers residents and non-residents a new irrevocable creditor protected trust. In the past, only an irrevocable trust for the benefit of someone else was protected from creditors. Now, a "self-settled" trust protects the settlor's assets from many creditor claims, even where the settlor (not someone else) is the beneficiary, too.

This type of trust is covered in Chapter 166 of the Nevada Revised Statutes. It cuts the statute of limitations in half (i.e., the time frame in which a lawsuit must be filed) to two years instead of four years for existing creditors. This time period can be even further reduced to six months from when existing creditors should have discovered the transfer of assets to the creditor protected trust. For this reason, we file a notice in a publication, which creditors should reasonably discover, to start the clock running.

For future creditors, assets titled in this type of trust are protected.

There must be a Nevada independent trustee. For Nevada residents, a separate Nevada trustee is not required. However, it is generally a better idea to have another Nevada company or individual serve as a "co-trustee" relating to distribution. This makes it absolutely clear that this is a creditor-protected trust.

This type of trust has an EIN number, rather than your social security number. This is a privacy enhancement tool.

This form of asset protection may be a less costly choice than investing your assets off-shore in foreign jurisdictions. For this reason, we sometimes refer to this trust as a Nevada On-Shore Trust, because you get the protection "on-shore" in the U.S. without having to move your assets to another country.

2.2 Irrevocable Trusts; Claims Against the Settlor:

Assets transferred to an irrevocable trust that do not belong to the creator ("Settlor") of the trust and are not subject to claims of the Settlor's creditors except possibly to the extent of any benefits retained by the Settlor, unless the transfer of the assets is considered a "fraudulent transfer". Fraudulent transfers are discussed in later in this memo.

2.3 Bank Accounts and Securities Accounts

There seems to be a great deal of confusion regarding FDIC and SIPC insurance for various accounts.

FDIC insurance applies to bank accounts, CD's and Money Market accounts in cases of bank failure. We are all aware of this problem in Las Vegas. The amount of insurance has been increased to $250,000 per person, per bank. However, most financial experts anticipate that the increased coverage will be extended to forestall a run on bank accounts by nervous Americans.

Due to repeated bank failures, the deposit insurance fund is down to its last $10 billion. The problem is so severe, that the FDIC may try to borrow $100 billion from the Treasury Department. Yikes ... even the bank bailout funds may need a bailout.

The coverage is per bank, per person. So if you have a checking account, CD, and money market at the same bank, your total insurance coverage totals $250,000 at that bank. There is a GIANT exception which allows you to increase your FDIC coverage. If your revocable trust owns the bank account, the coverage is automatically increased to $250,000 per settlor (i.e., person(s) who set up the trust) per trust beneficiary. For example, Joe and Lisa have a bank account which is titled in their trust name (see the bank statement for property titling). They have 3 children, who are equal beneficiaries of their trust. The coverage is $250,000 per settlor for each child. That is $1,500,000 total FDIC coverage at that bank!

SIPC (Securities Investors Protection Corp.) is a different type of coverage altogether, which may be provided by the financial institution. SIPC covers securities accounts and mutual funds. The amount of insurance may vary for different investment houses, but typically it only protects from $250,000 to $500,000 against broker fraud or theft, NOT market downturns or failures. Big difference.

Unfortunately, we have all seen recent examples of institutional fraud and theft, such as Bernie Maddoff. However, don't count on SIPC coverage, as much of us have been hit by market downturns, not theft.

2.4 Corporations:

A properly established corporation can protect its shareholders from the corporation's liabilities. A corporation must have adequate assets and insurance or it will be ignored. If a corporation's employee (including an officer) does something that harms someone else, that employee can be sued individually, and the corporation offers no protection to that employee. However, it does offer protection to the shareholders, officers, and other employees who were not responsible for the actions of the employee.

Only the officers of a corporation are registered with the Nevada Secretary of State on an annual basis. This means that owners who are not officers may be difficult to trace to a corporation. Although this is not really asset protection, it does make an asset trail more difficult for creditors.

2.5 Limited Liability Company (LLC):

Members of an LLC are protected like shareholders of a corporation. The designated manager typically is responsible for running the business. The members do not need to be named as managers. The same liability rules apply as are used for corporations. So long as the LLC has adequate assets, its liability to creditors or other plaintiffs in a lawsuit will be limited to the LLC's assets. Most often, the members' personally-owned assets are not accessible to creditors of the LLC. Only the manager of an LLC is listed on the officer's list with the Nevada Secretary of State on an annual basis. This means that actual ownership by members may be difficult to trace. The manager does not have to be an owner-member, it can be a trust, corporation or another LLC. Often LLC owners name a stand-alone management trust to provide privacy as to the people (trustees) who actually manage the LLC and also to name successor "managers" for continuity in the business. I prefer to not name yourself as manager, as that information, including your address is easy to find. The use of LLC's to hold title to certain assets in conjunction with other planning techniques, such as Nevada spendthrift trusts, can be an especially effective technique.

2.6 Limited Partnership:

Limited partners are protected similarly to shareholders in a corporation, and the same guidelines and limitations apply. They have no personal liability with respect to partnership obligations. A limited partnership must have at least one general partner who is personally responsible, but that general partner can be a corporation.

A. Under Nevada's Revised Uniform limited Partnership Act (NRS Chapter 88), a judgment creditor of a limited partner cannot force the liquidation of the limited partnership. A judgment creditor can obtain a court order directing the partnership to make the debtor partner's income distributions to the creditor, but the creditor has no other rights. If the partner is allocated income for income tax purposes, the creditor may even be forced to report the income and pay the resulting tax without ever receiving an actual distribution from the partnership.

B. The assets of the limited partnership itself are at risk to partnership liabilities. Separate limited partnerships for different assets can insulate one partnership's assets from the claims against another.

C. Partnerships, LLCs and corporations should exist for valid business purposes, and personal use assets, such as homes and vehicles, should not belong to business entities in the absence of valid business agreements. For example, your home should not belong to a partnership or corporation unless you are paying rent.

2.7 Qualified Retirement Plans:

Retirement plans, whether a 401(k), profit sharing, money purchase, or defined benefit plans, are 100% creditor protected. Generally, no matter what bad deed or who the creditor is, these assets are bulletproof.

The only caveat relates to a retirement plan with no employees other than the owner. Technically, such "single participant" plans are not covered by ERISA (the federal law which protects retirement assets). Thus, it may be a good idea to add an employee, other than the owner or spouse, to guarantee full asset protection. Of course, such an employee must be a qualified employee (over 21 years of age, works at least 1,000 hours a year, has been employed for one year or more).

2.8 IRAs:

Traditional and Roth IRAs may be creditor protected depending on your state's specific laws. In Nevada, IRAs are protected up to $1,000,000 for IRA owners and beneficiaries who live in Nevada. In California, it is not a dollar amount, but is protected only in an amount necessary for the IRA owner to live on. This is a minimal amount, not whatever the owner's lifestyle costs are.

2.9 Homestead:

Nevada's homestead exemption law (NRS Chapter 115) protects up to $550,000 of equity in a person's or married couple's primary residence. This includes the land and the home, and the home can be a mobile home even if the owner rents rather than owns the land. In addition to the homestead exemption, a primary residence is protected from execution upon a judgment for medical bills, regardless of equity, but this protection ends when no one living in the residence qualifies as the debtor, the debtor's spouse, or the debtor's child who is a minor or a disabled adult (NRS 21.095).

In California, the homestead exemption is only $50,000 in most cases.

2.10 Irrevocable Trusts' for Children or Others:

A beneficiary's interest in a trust is generally an asset of the beneficiary and subject to claims unless (1) the beneficiary's interest is contingent upon the occurrence of an event which has not occurred; (2) the beneficiary's benefits are determined by the trustee at the trustee's discretion; or (3) the trust contains a provision making it a "spendthrift trust" within the meaning of Chapter 166 of the Nevada Revised Statutes or the similar law of the state having jurisdiction over the trust. Under Nevada law, it is usually enough to say that "the trust is a spendthrift trust" or "the trust is not subject to attachment or other involuntary anticipation" for it to qualify as a spendthrift trust.

You can make annual gifts of up to $14,000 per person to these irrevocable trusts. Additionally, life insurance policies can be owned by this type of trust.

2.11 Exceptions:

The protection of these various entities can be nullified as to any debts for which personal guarantees are given. Also, as stated above, no entity can protect a person from his or her own negligence or intentional wrongdoing.

III. FRAUDULENT TRANSFERS:

3.1 Generally:

When people feel threatened by creditors or even potential creditors, it is a natural reaction to try to transfer assets to trusted persons to try to shelter those assets. NRS Chapter 112 contains Nevada's Uniform Fraudulent Transfer Act. The law allows creditors to ask a court to allow them to ignore fraudulent transfers for collection purposes. Proof of fraudulent intent is not always required for a transfer to be considered "fraudulent" for the purposes of this statute.

3.2 Problem Areas:

Fraudulent transfers come in all varieties:

A. T owes money to C. T transfers assets to his children, S & D. Since the transferor made himself insolvent (i.e., his debts exceed the fair market value of assets), the transfer is fraudulent and can be set aside. The result would be the same if the transfer was made to a trustee of an irrevocable trust instead of the children.

B. T owes money to C. T, who is insolvent, transfers assets to his children, S & D, to satisfy a debt T owed to them. If S & D have "reasonable cause to believe" that T was insolvent, the transfer can be set aside. Since S & D are "insiders", the fact that there was adequate consideration does not protect this transfer.

C. T is in an auto accident. C was injured, and T was at fault. T is concerned that C may sue and ask for more than the limits of his insurance policy. Before C sues T, T transfers all of his assets to his children, S & D. If C files a lawsuit and wins a judgment, the transfer can be set aside because the statute refers to the time "the claim arose" and not to the time of the judgment. Since the transfer received after the "claim arose", the transfer can be set aside.

D. T has no debts and transfers all of his assets to S & D. T then makes credit purchases to the extent of his available credit limits. The transfer would probably be set aside, since it would appear that T incurred the debts with full knowledge that he could not pay them.

3.3 Other Issues:

Transfers for full fair market value are not fraudulent conveyances, but transfers to "insiders" are subject to closer scrutiny. "Insiders" include relatives and family controlled business entities. If the transferor transfers title, but retains possession or control of the transferred assets, the statute allows the inference to be drawn that the transfer was intentionally fraudulent.

3.4 **Future Creditors:**

Transfers are not usually set aside as fraudulent transfers if a creditor's claim arises after the transfers; however, they can be if (1) the transfer was made with actual intent to defraud any creditor; or (2) the debts were incurred without reasonable expectation that they would be paid.

IV. **CONCLUSION:**

Nevada offers many exciting ways to maintain your privacy and protect your assets from creditors. A close examination of your particular assets, as well as an understanding of your potential creditors, is necessary before the right vehicle can be recommended for you.