

ASSET PROTECTION

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What is Asset Protection?

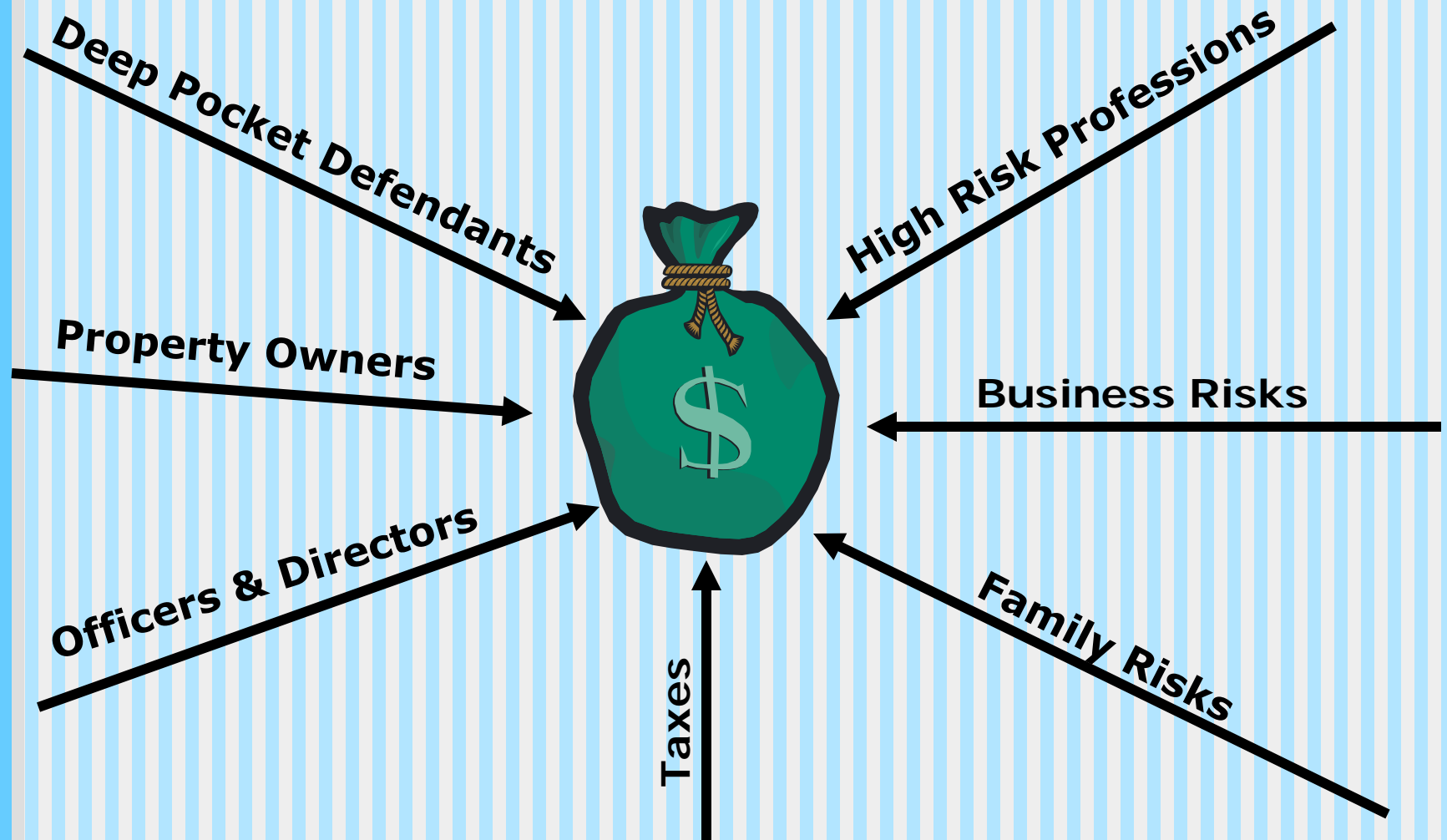
Creating Hurdles to Prevent Creditors from Seizing Your Assets

- Minimize Risk of Personal Liability
- Own Property in Protected Form to take away the economic incentive for a lawsuit against you



Threats to Your Assets

The Litigation Explosion!!!



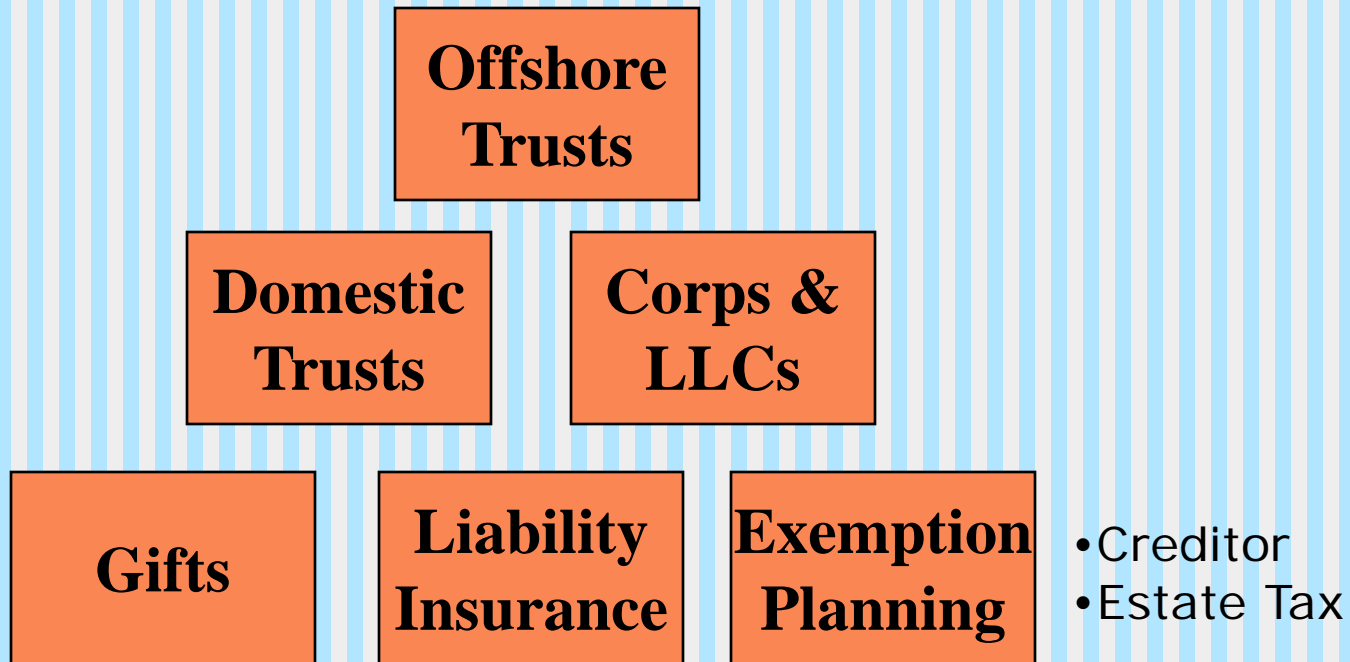
Asset Protection Goals

- Favorable Settlement of Law Suits
- Place Assets Beyond Reach Creditors
(Are you worth suing?)
- Maintain Control of Assets
- Avoid or Minimize
 - Fraudulent Conveyances
 - Probate
 - Taxes
- Avoid Bankruptcy

Common Mistakes

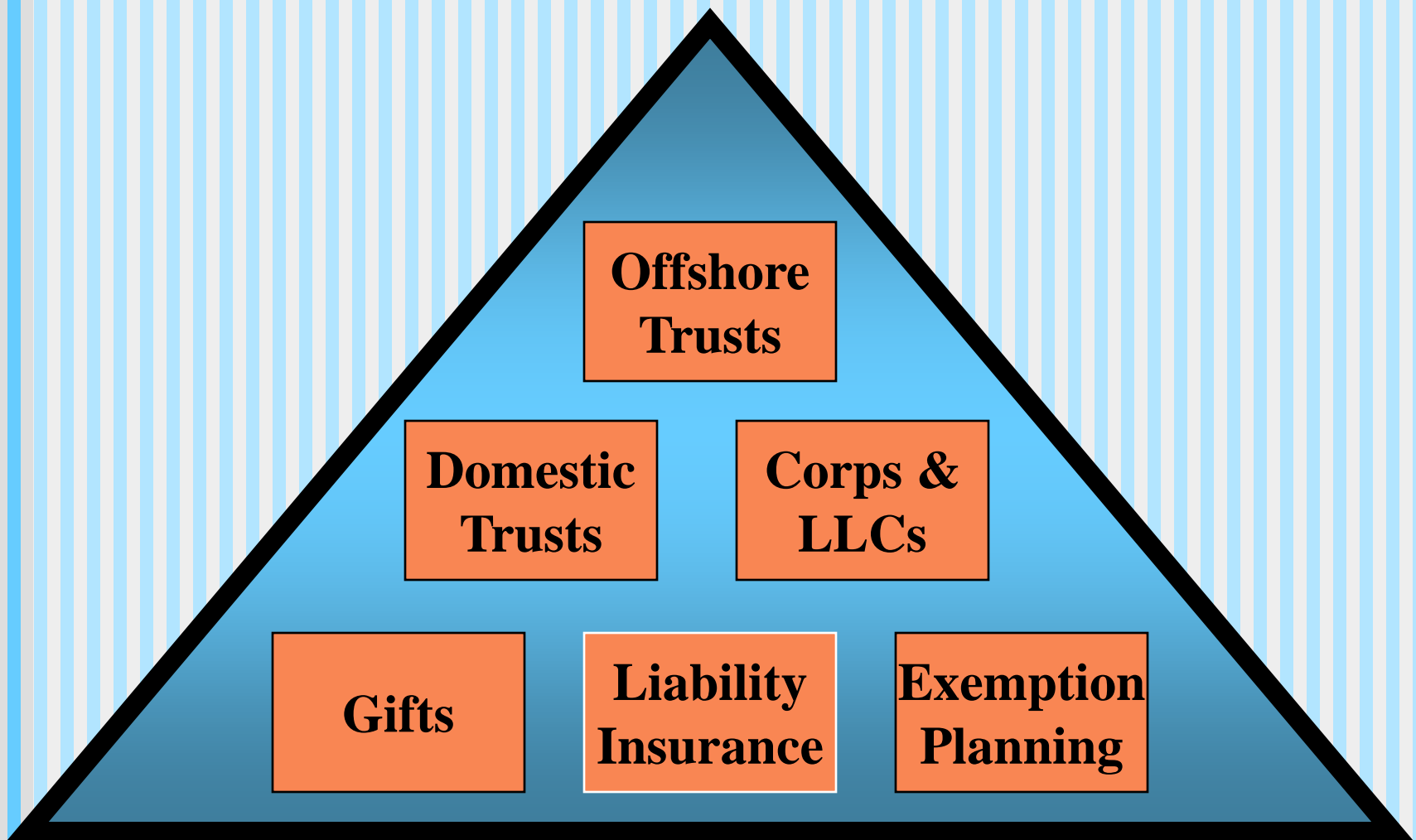
- General Partnerships (not LLPs/LLCs)
(Joint & Several Liability Other Partners)
- Spouse Involved in Business
- Personal Guarantees
- Delinquent Employment Taxes
- Commingling of Assets
- Non-Separation of Risks

Asset Protection Pyramid



Fraudulent Transfer?

Asset Protection Pyramid



Gifts



- Simple
- Outright or Gifts in Trust
- Gifts to Less Vulnerable Spouse
- Gifts to Children (in trust?)
- Problems
 - Loss of Control
 - Divorce
 - Donee is Sued
 - Gift Tax (N/A spousal or incomplete gifts)?
 - Constructive Trust? (implied promise return)
 - Fraudulent Transfer?

Example #1

Is this a Fraudulent Transfer?

- Dr. Smith
 - \$2M Investments Merrill Lynch (non-retirement account)
 - \$1M Malpractice Insurance
- 4/8/05- removes wrong Kidney
- 4/10/05 – Dr. Smith transfers \$2M account to Mrs. Smith
- 10/10/05 – Lawsuit Filed
- 10/10/07 - \$10M Jury Verdict

YES –
Fraudulent Transfer

LESSONS - DO NOT:

- Wait to create your Asset Protection Plan
- Make Fraudulent Transfers

IL Fraudulent Conveyance Act

(Creditor Tool to Reverse Asset Transfer)

■ Actual Fraud (Intent to Hinder, Delay Defraud Creditor)

- **Debtor Admits Intent**
- **“Badges” of Fraud (Smell Test)**
 - Transfer Concealed
 - After Claim Arose or during Litigation
 - For Less than “Reasonably Equivalent Value”
 - Substantially all assets
 - to “Insiders” (family members)
 - Absence Post-Transfer Solvency
 - Debtor retains controls

■ Constructive Fraud

- Debtor Insolvent
- No receipt “Reasonably Equivalent Value”

■ **KEY: SOLVENCY, VALUE & INTENT**

Fraudulent Transfer Keys

■ Solvent Debtor

- Issue of “Intent”

■ Insolvent Debtor

- Did Debtor receive Reasonably Equivalent Value?

Avoiding Fraudulent Transfers

- **Document** non-Asset Protection Reasons
 - Transfers for Retirement/Business Reasons
(i.e., avoid Probate; reduce estate taxes; shift income)
- Leave Yourself **Solvent**
 - Gift = Fraudulent if Debtor is Insolvent
- Get back **“Reasonably Equivalent Value”**
 - Salaries, lease payments, loans
 - FORMING AN LLC
- **Disclosure**
- Passage of **Time** between Transfer & Claim
(Generally 4 year Statute of Limitations)

Solvency Analysis

■ Balance Sheet Test

- Assets greater than Liabilities
- Don't count
 - "Exempt" Property
 - Encumbered Property
 - Tenants by Entireties Real Estate
- Count Insurance Protection

■ Cash Flow Test

- Deemed Insolvency = Not paying Debts as come Due

Fraudulent Transfers -

Boundary Lines are Unclear



Henbest vs. Meyer

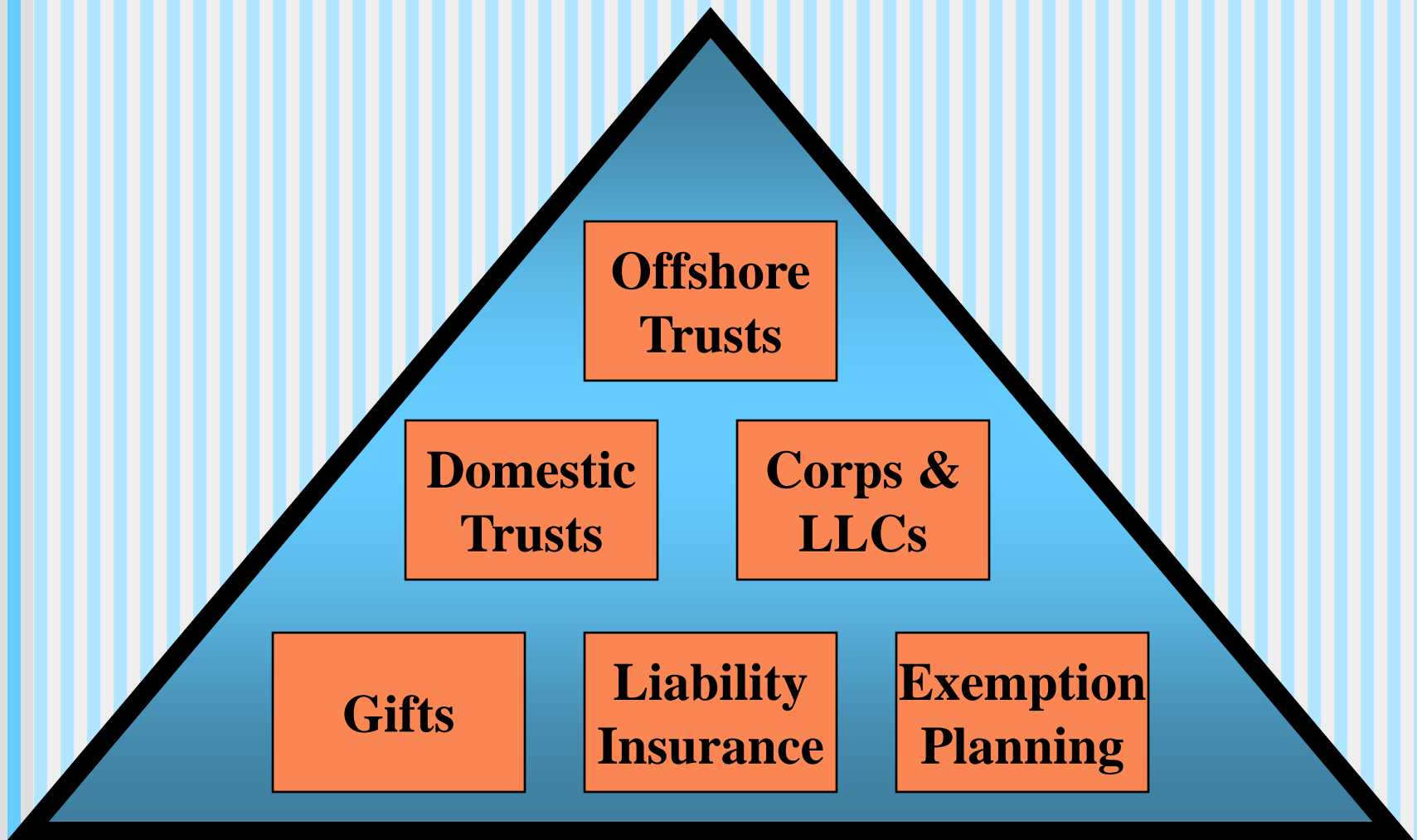
307 B.R. 87; 2004 Bankr. LEXIS 286

- 1998 – Lawsuit
- 2000 – Meyer sees estate planning attorney
- May 2002 – Meyer transfers all assets to his wife
- June 2002 - \$6.8 Million Judgment against Meyer
- August 2002 – Meyer files for bankruptcy

Bankruptcy Court:

NO FRAUDULENT TRANSFER!??

Asset Protection Tools



Is Insurance Enough?

■ Does Not Cover All Events

- Intentional Torts
- Grossly Negligent Acts
- Contract claims
- Criminal Acts
- Punitive damages
- Dangerous equipment (guns, pools, trampolines, dogs?)
- Events outside "Scope of Employment"

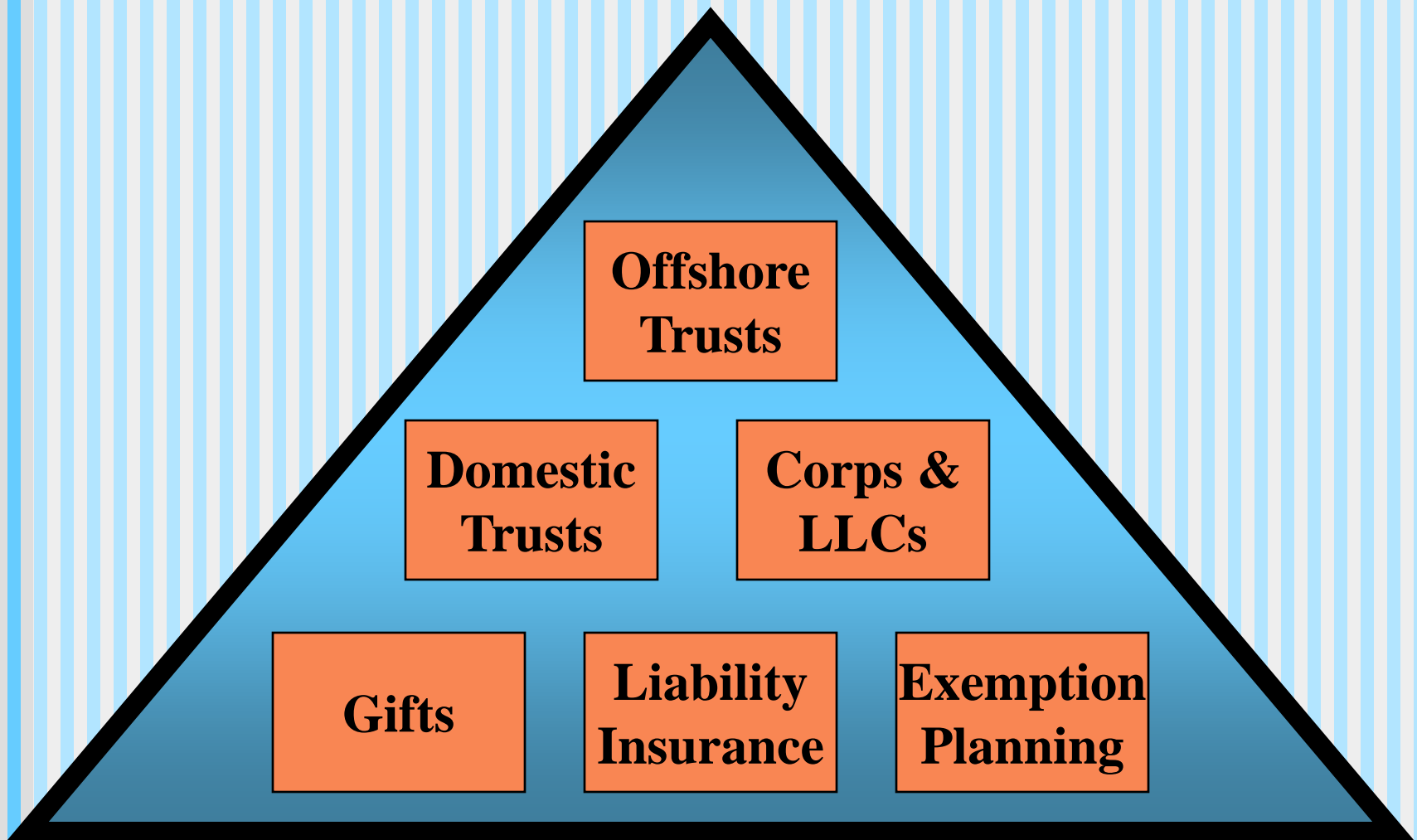
■ Claim Exceeds Policy Coverage

■ Insurance Company Bankruptcy

■ Paints a Target? (but creates Solvency)

■ Umbrella Liability Insurance

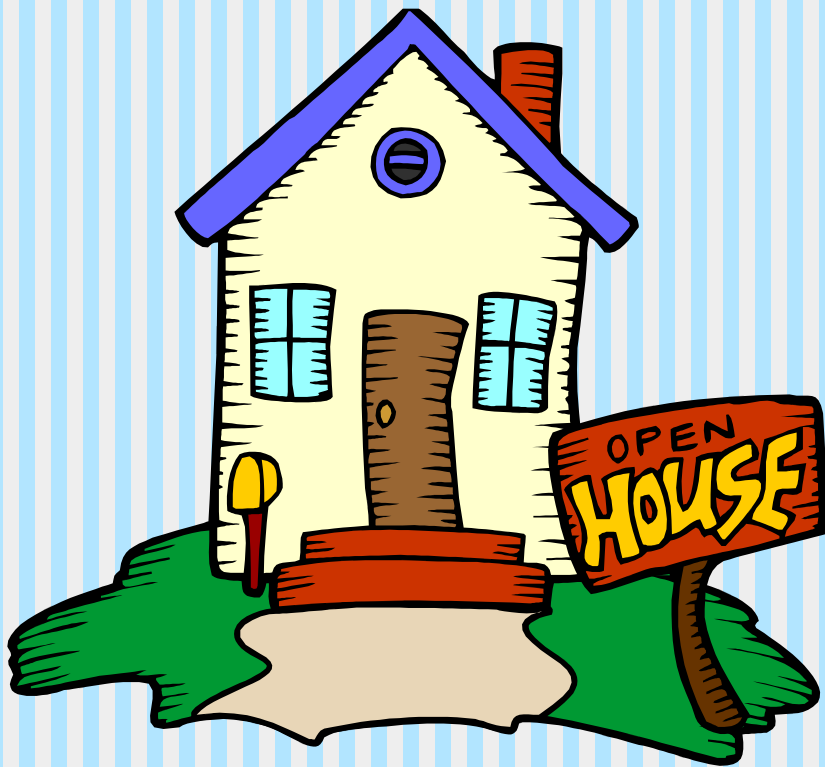
Asset Protection Tools



Major IL Creditor Exemptions

- Only Available to Natural Persons
- Life Insurance & Annuities payable to Spouse & “Dependents” (minor children)
- Retirement Plans
 - ERISA Plans (401(k); Profit Sharing; DBP)
 - At least 1 non-owner employee
 - Non-ERISA Plans
 - SEPs & Keogh Plans
 - 401(k) & other plans without 1 non-owner employee
 - IRAs
 - Erosion?
- Tenancy by Entireties - Real Estate

Tenancy By the Entireties



- Real Estate
 - Husband and Wife
 - Principal Residence
- Creditor of One Spouse Cannot Enforce Judgment During Marriage
- Debts not Protected
 - Injuries on premises
 - Dog bites
 - Teenager's Actions
 - IRS debts

Planning: Convert “Non-Exempt” Assets to “Exempt” Assets

- Fraudulent Transfer Concerns
- Some conversions probably OK
- Pigs get fat...Hogs get slaughtered
- Nothing ventured nothing gained?
- How much is Debtor trying to convert at the last minute?

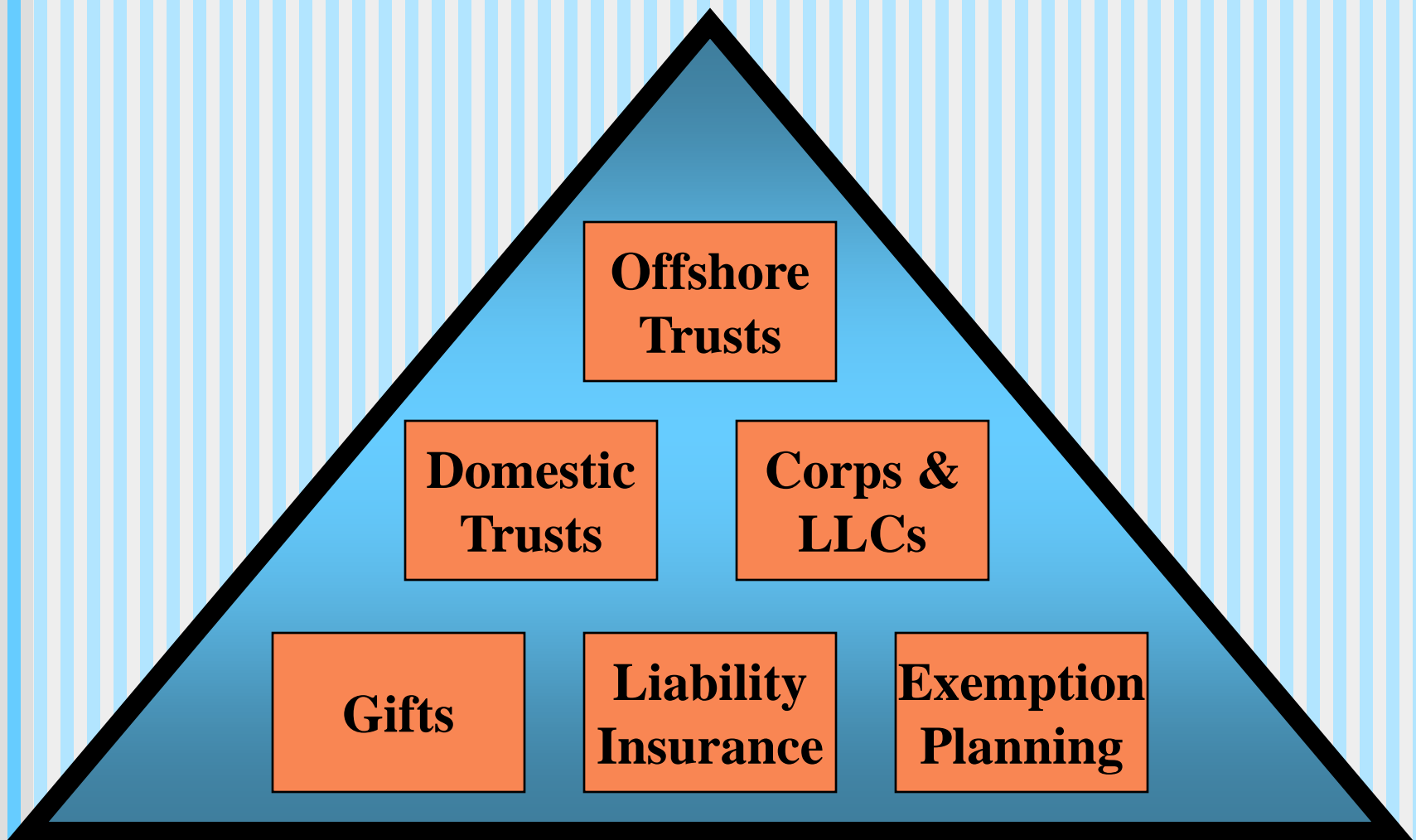
Estate Tax Exemption Planning

The Substantial Cost of Not Planning

Husband & Wife die in Illinois 2005:

<u>Taxable Estate</u>	<u>Estate Taxes No Planning</u>	<u>Estate Taxes With Planning</u>
\$1,500,000	\$0	\$0
\$1,750,000	\$173,700	\$0
\$2,000,000	\$299,700	\$0
\$2,500,000	\$569,100	\$0
\$3,000,000	\$841,500	\$0

Asset Protection Tools



Domestic Trusts by Debtor

For the Benefit of:

- Debtor ("Self-Settled" Trusts)
- Another Person

“Self-Settled” Trust

Created by Debtor for benefit of Debtor

- General Rule: NO Creditor Protection
- Exceptions:
 - Domestic Asset Protection Trusts?
 - Various States (AL; DE; NV...)
 - Irrevocable Trusts
 - Resident Corporate Trustee
 - Will it work for Nonresidents???
 - Foreign Asset Protection Trusts

Trusts for Benefit of Others

Creditor Protection?

■ **Spendthrift Trusts**

- Beneficiary cannot Transfer Trust Interest

■ **Discretionary Trusts**

- Trustee's Discretion Make Distributions
- "Spray" Trust Strongest

■ **Specialized Trusts**

- "Credit Shelter" Trusts
- QTIP, QPRT, CRT, SNT, GST Trusts
- Irrevocable Gift Trusts

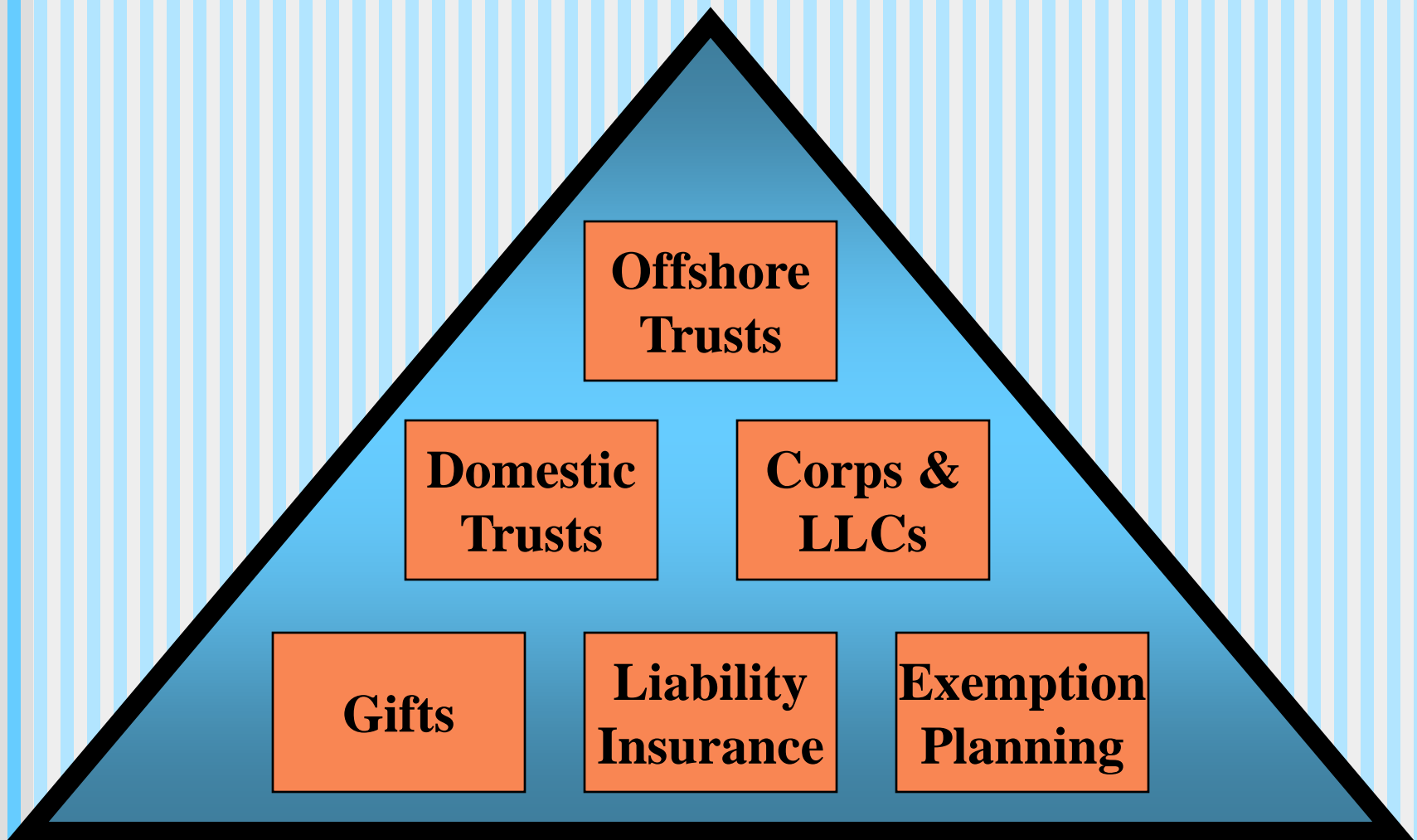
■ **Fraudulent Transfer?**

Beneficiary Controlled Trust



- Superior Asset Protection vs Outright Gift
- Independent Trustee or Co-Trustee?
- Initially 3rd Party Controlled
- Beneficiary Controlled at Certain Age

Asset Protection Tools



Corporations

- State Law
- **“Inside Out”** Liability Protection
 - Corporate debts not responsibility of owner
 - N/A to personal guarantees
- Tax Benefits
 - Accumulate Income
 - “S Corporation” – Employment Tax Planning
- Personal Creditors can Seize Stock
(Transfer Stock to LLC?)

Limited Liability Companies ("LLCs")

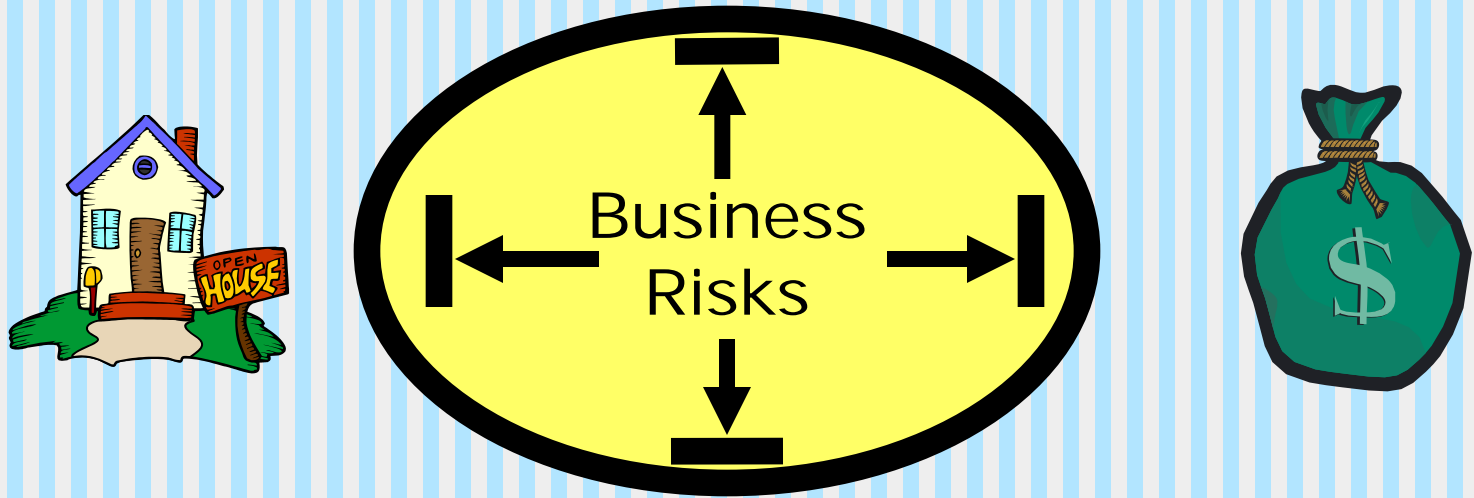
- State Law = Corporation
 - **"Inside Out"** Protection
(Business Creditors can't Seize Personal Assets)
- Tax Law
 - Partnership (2 or more members...Preferred)
 - Sole Proprietorship (1 member)
- "Charging Order" Creditor Remedy
 - **"Outside In"** Protection
(Personal Creditors can't Seize Business Assets)

LLC Liability Protection:

2 Levels of Protection:

- **“Inside Out”** Protection (Business Debt)
 - Corporations
 - LLCs
- **“Outside In”** Protection (Personal Debt)
 - LLCs

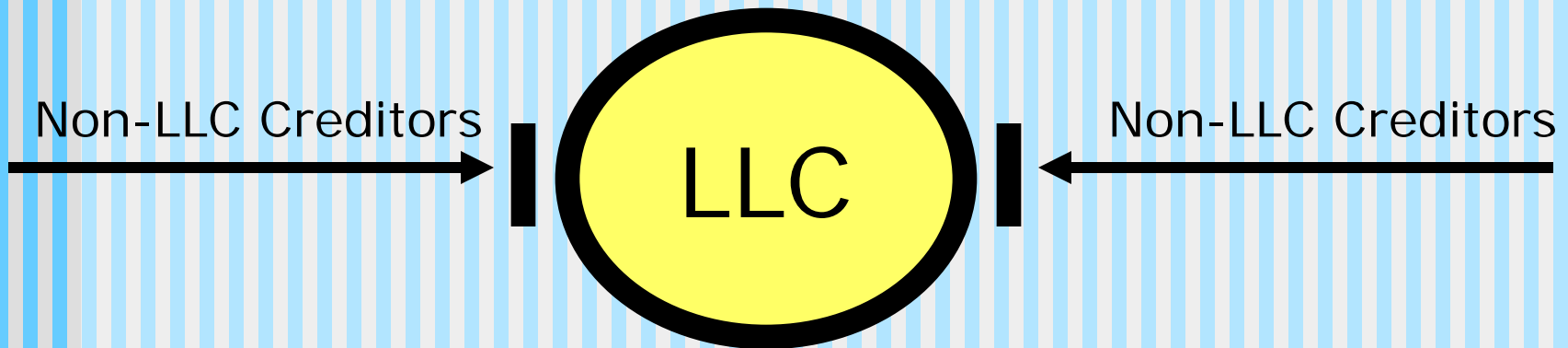
"Inside Out" Protection



- Business Risks Do Not Taint Personal Assets
(Owners no Personal Liability for Business Liabilities)
- Traditional Corporate Protection
 - Corporations & LLCs
- No Protection for Torts & Malpractice

"Outside In" Protection

The LCC Advantage



- Non-LLC Risks Do Not Taint LLC Assets
- Not Available to Corporations
(Creditors can Seize Stock)
- Charging Order = Creditor's Remedy

What is a "Charging Order"



**"Mr. Creditor - Go Away
so I'll be Left
with my Money"**

LLC Creditor:

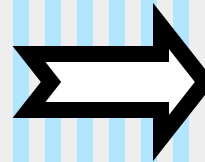
- Can't Reach LLC Assets!
- No Control of LLC
- Rights to Distributions IF and When Made
- Phantom Income?
- Forced to Wait & Settle Cheaply?

Charging Order Erosion

But LLC Still = Significant HURDLE to Creditors

Judicial Foreclosure Sale of LLC Interests?

- LLC Interest Auctioned off
- Debt Reduced by Proceeds
- Debtor Negotiates with Two Creditors



Solution?:

- Form LLC in "Sole Remedy" State
(i.e., Alaska or Arizona)
- Bankruptcy?

Veil Piercing

- Commingling Funds
- Failure observe formalities
- No arm's length relationship
- Poor Capitalization

Single Member LLC

- Albrecht Case
(LLC assets sold in bankruptcy)

Constructive Trusts

- Donee holds Property for Donor
- Concealment
- Alter Ego Theory

Entity Protection Strategies

■ Separation

- Divide and Separate Different Risks

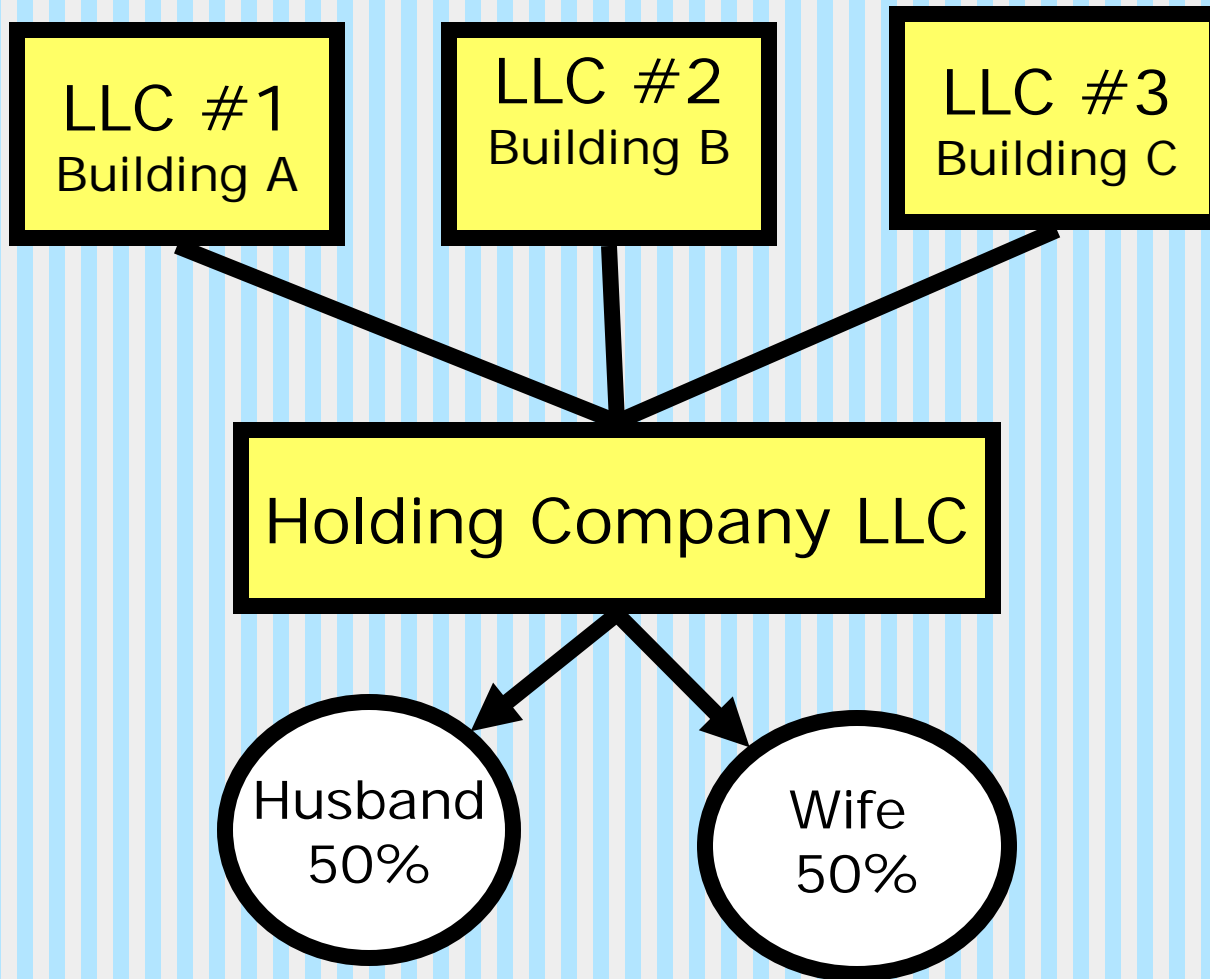
■ Unbundling

- Operating Entity
 - Conducts Business
- Non-Operating Entity
 - Rents Assets to Operating Entity
 - Borrows \$\$\$ to Operating Entity (Liens)

■ Equity Stripping

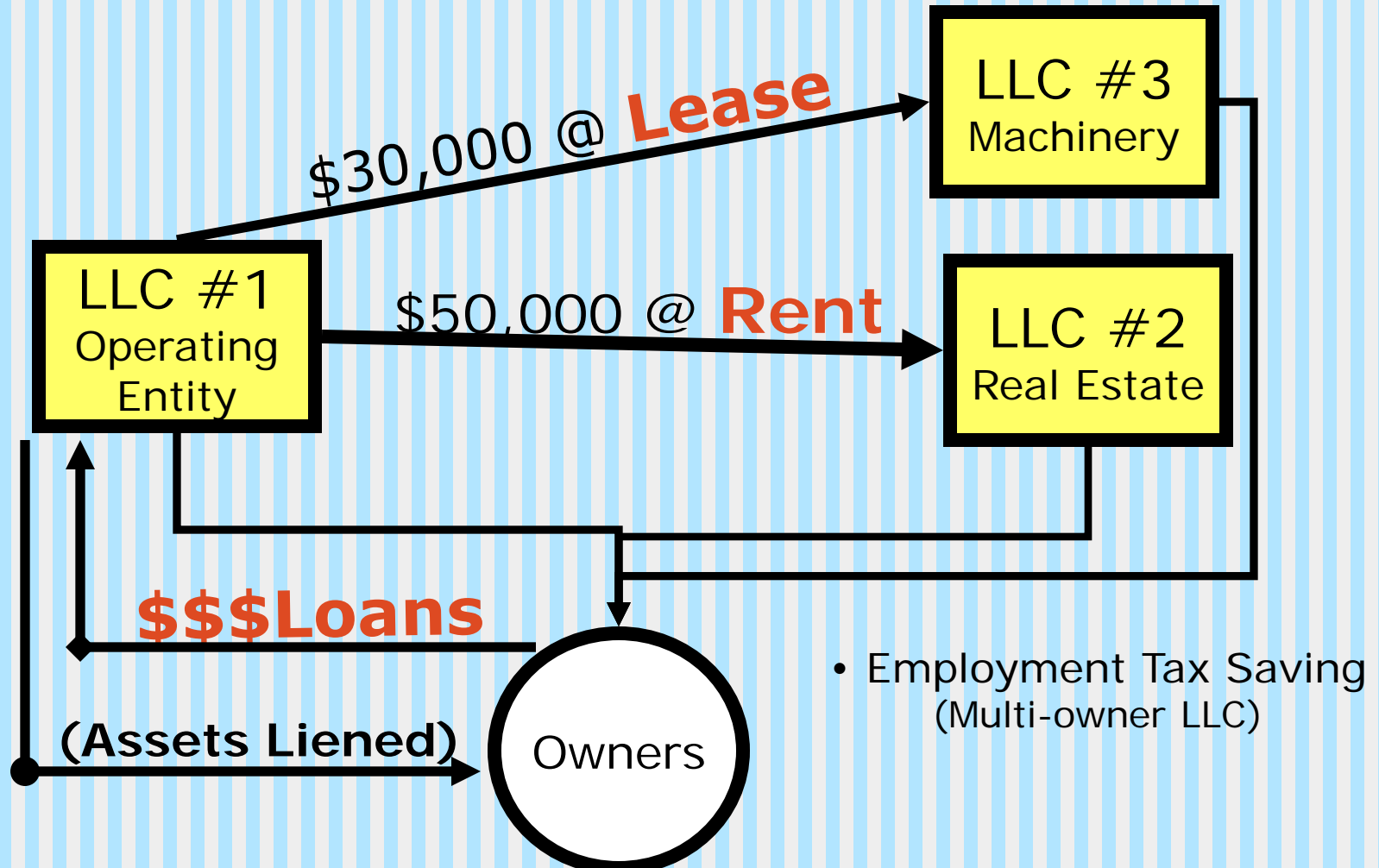
Separation

Separate High Risk Assets



Unbundling

Minimize Value of Operating Entity



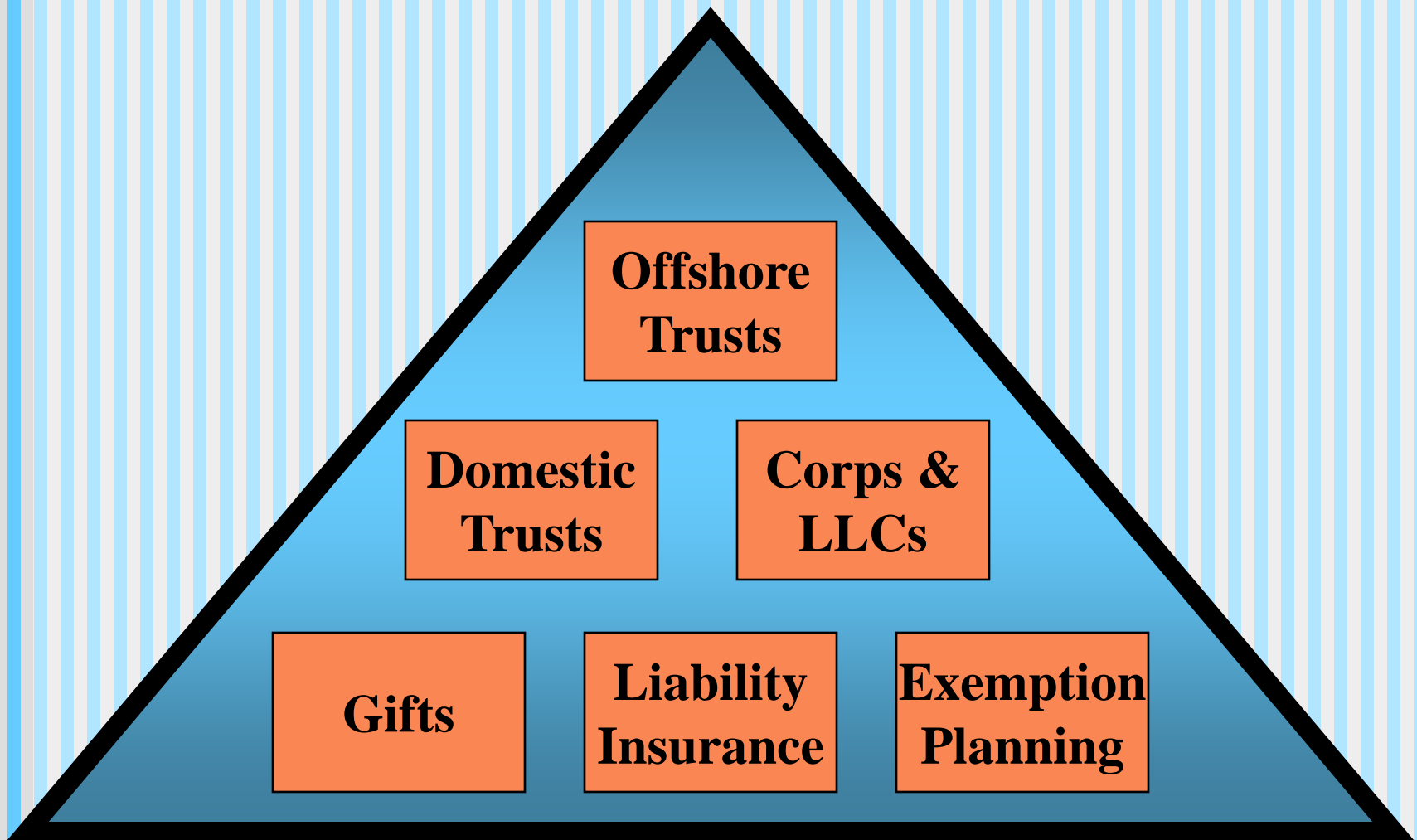
Equity Stripping



Borrow Against

- Real Estate
- Inventory
 - Owner receives UCC-1 Security Interest
- Account Receivables
 - Bank Loan
 - Owner
 - buys Cash Value Life Insurance Policy
 - borrows against policy on Income Tax Free basis at Retirement

Asset Protection Tools



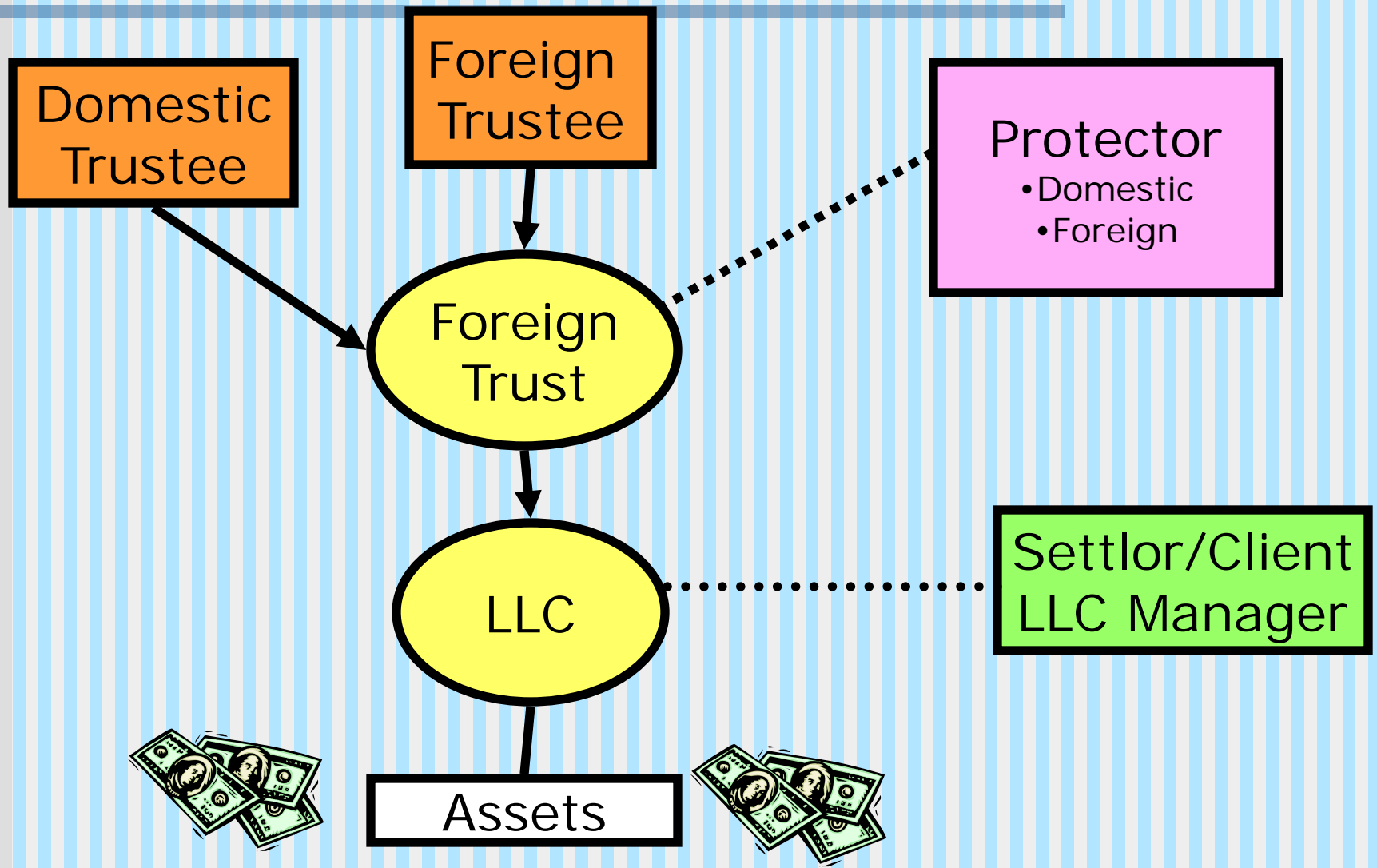
OFFSHORE ASSET PROTECTION TRUSTS



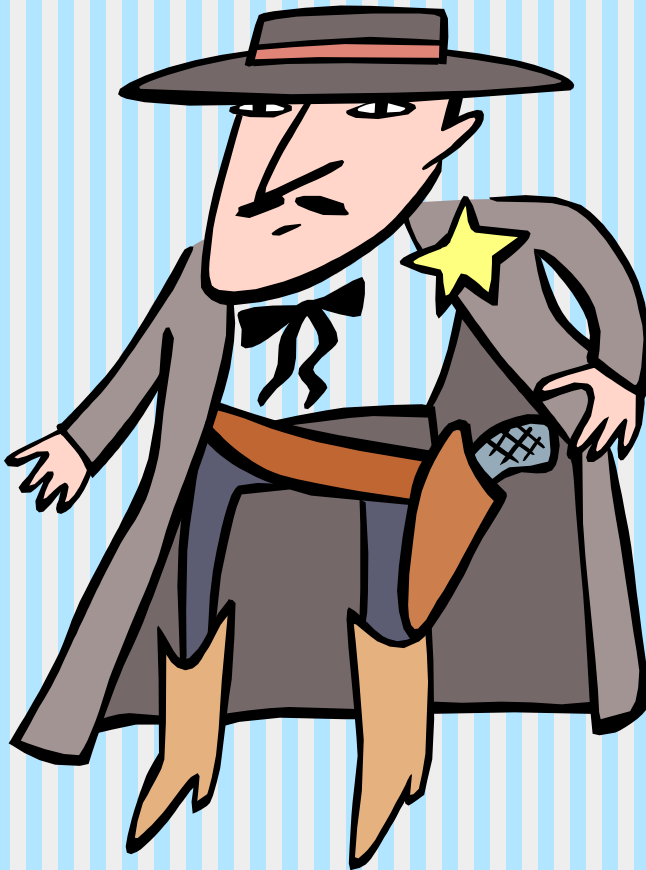
- U.S Judgments not Respected = New LawsUIT by Creditor
- Short Statute of Limitations
- High Proof Standard
- Creditor Expense & Psychological Barriers
- Trust can be “Self Settled”
 - Client = Beneficiary

Cook Islands & Nevis have Strongest Laws

Offshore Trust Structure



Role of Protector



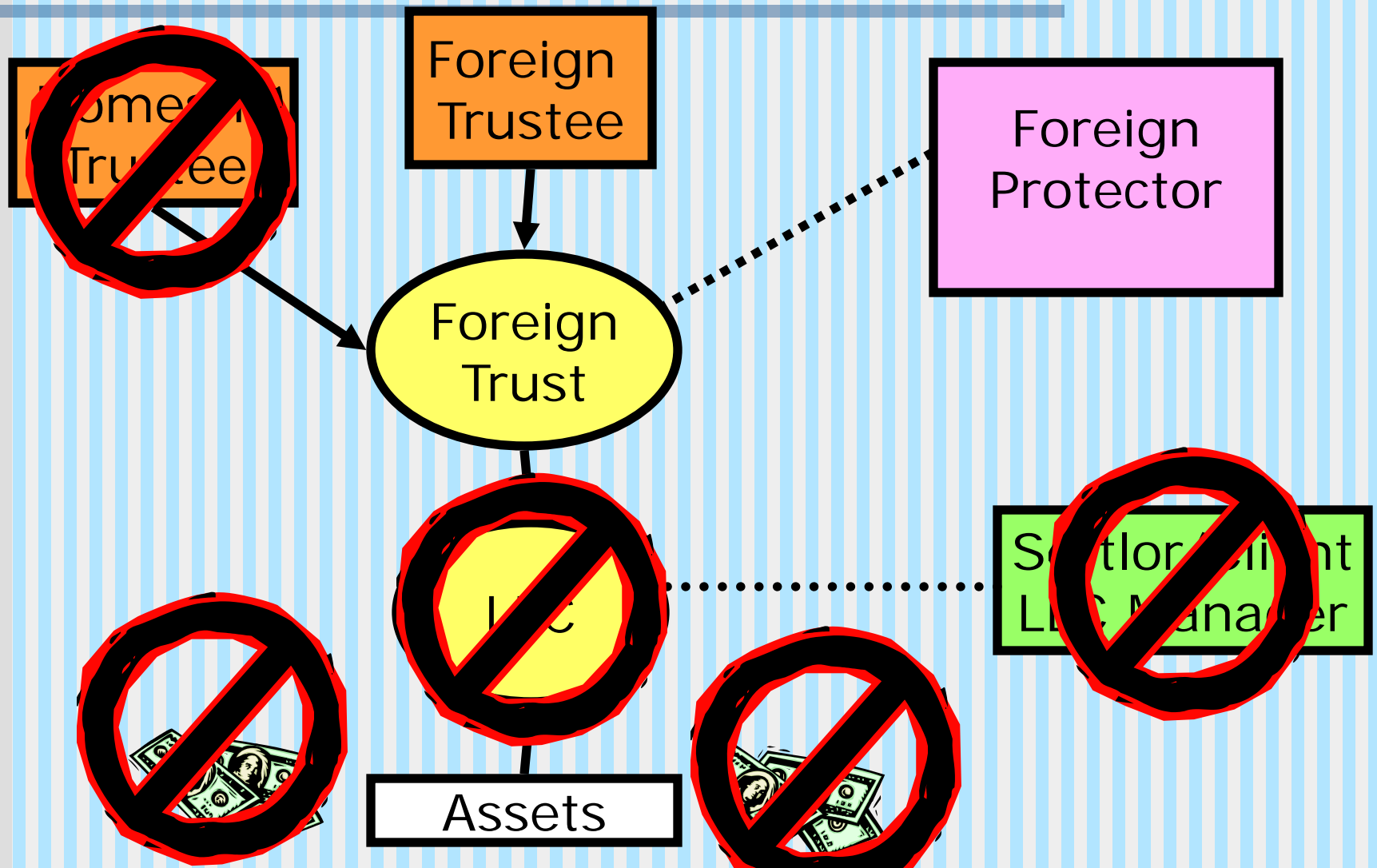
- Keeps Trustee in Check
- Veto Power
 - Distributions
 - Removal of Trustee
- Foreign Protector
- U.S. Protector
 - Cousin, Aunt
 - Accountant
 - Independent Party

Client Surrenders Control?

- Trustee & Protector
 - Client cannot be either...
 - U.S. Persons or Foreign Corporations?
 - Who can Remove?
 - Committee?
 - Foreign Protector?
- More Control/Less Asset Protection
- Less Control/More Asset Protection

Event of *DURESS*

Protective Actions Take by Foreign Trustee

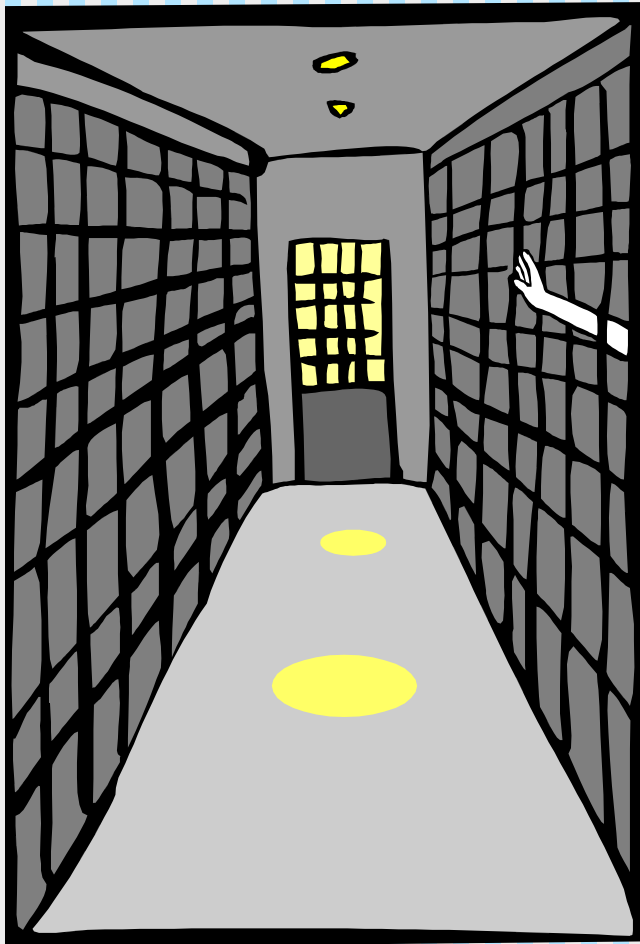


The Anderson Case

- Telemarketing Scam
- Millions Transferred to Cook Islands Offshore Trust
- Poor Planning
 - Clients were co-Trustees
 - Court believed Clients Retained Control
- Clients 6 Months in Jail for Contempt
- Case Settled

Contempt of Court

Does Impossibility Defense Work?



- Is Impossibility Self Created?
- The Lawrence case
 - Grantor in Jail
 - But trust not broken
- Contrary Viewpoints
- How much Time from:
 - Creation Trust
 - Litigation

Verdict on Offshore Trusts



- Highest Form of Asset Protection for Self-Settled Trusts
- Most cases settle
- No U.S. Trustee or Protector?
- Not Inexpensive

THE END!!!



- Free Legal Consultation
 - Asset Protection
 - Estate Planning
- Thank You