WEALTH COUNCIL INSIGHTS EDUCATION SERIES: ASSET PROTECTION AND INSURANCE

PART 3 – ASSET PROTECTION STRATEGIES

In the first two articles of our four-part series focused on Asset Protection and Insurance Planning for Wealth Preservation, we explored the basics of insurance and highlighted traditional insurance types. Traditional insurance planning is the foundation of a comprehensive asset protection strategy because insurance policies protect financial assets from loss when costly and unforeseen events occur. However, traditional insurance planning is only one component of asset protection. This article focuses on additional asset protection strategies that go beyond traditional insurance options.

ASSET TITLING

Asset titling concerns how an asset is legally owned. Certain assets, such as real property, automobiles, bank accounts and investment accounts are owned subject to titling. There are numerous ways that individuals, businesses or trusts can own an asset, and the titling of the asset plays an important role in protecting the asset from creditors or lawsuits. Conversely, certain asset titling can also subject an asset to unanticipated and unforeseen risk.

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As it relates to non-entity ownership, an asset can be owned individually by one person or jointly with others. The potential for asset protection benefits and, inversely, the potential for unintended risks generally arise from jointly-owned property. When owned by two or more individuals, an asset can generally be titled in three primary ways: as Tenants-in-Common, as Joint Tenants with Rights of Survivorship or as Tenants by the Entirety. Each ownership type comes with important legal distinctions and nuances that impact each joint owners' rights and liabilities associated with the asset.

Tenants-In-Common Ownership and Joint Tenants with Rights of Survivorship Ownership

Tenants-in-Common is the default type of ownership between non-married persons in most jurisdictions. Under this type of ownership, each owner has a divided one-half interest in the asset and may sell, transfer, devise, encumber or pledge his or her respective share irrespective of the other joint owner. Joint Tenancy with Rights of Survivorship has a couple of primary differences. Under this type of ownership, each owner owns an undivided interest in the entire property and the asset passes to the remaining joint owner(s) automatically upon the death of another joint owner regardless of how the deceased owner may have attempted to devise the asset. **For asset protection purposes, both of these types of joint ownership allow creditors to attach the assets of one joint owner.** This places the entire asset at risk for the actions and liabilities of only one of the joint owners.

To illustrate how jointly owned property can subject an asset, and thereby a joint owner, to unanticipated risk and unforeseen consequence, consider the following hypothetical scenario:

I. Bryce and his sister, Mackenzie, jointly purchased a rental property and took ownership equally as Tenants-in-Common. Each sibling contributed $50,000 toward the purchase of the rental property. Shortly after purchasing the rental property, Mackenzie caused a serious car accident that resulted in the injured party suing Mackenzie and obtaining a judgment against her.

II. Mackenzie did not have other assets or insurance available to pay the judgment. Therefore, the injured party attached to Mackenzie's one-half tenant-in-common ownership interest in the rental property and forced the sale of the rental property to satisfy the judgment. Unfortunately, because the residential housing market had declined since the siblings purchased the rental property, each sibling's ownership interest was now worth only $40,000.

III. For Bryce, the forced sale resulted in Bryce receiving $40,000 for his one-half tenant-in-common ownership interest (a $10,000 loss), losing the rental property and its future income stream and wasting time and effort to find, purchase, renovate and lease the property. This negative result for Bryce was caused through no fault of his own and entirely by the unrelated actions of Mackenzie (the joint owner).

Tenants by the Entirety Ownership

Tenants by the Entirety ownership is a type of ownership available to married couples in 25 states (available in Florida, Illinois, Indiana and Michigan; not available in Georgia, Minnesota or Ohio). Available only to married couples, Tenants by the Entirety ownership operates similarly to Joint Tenants with Rights of Survivorship in terms of complete undivided ownership in the entire property and automatic transfer to the surviving spouse upon the first spouse's death. **For asset protection, however, there is a major difference from other types of joint ownership – an asset owned as Tenants by the Entirety is protected from the separate creditors of either spouse.**

To illustrate how an asset owned as Tenants by the Entirety receives a certain level of asset protection from the separate creditors of one spouse, consider the following hypothetical scenario:

I. Bryce and his wife, Katy, purchased their home as Tenants by the Entirety. Bryce subsequently opened an unsecured line of credit with a local bank in his name only and, unfortunately, defaulted on that line of credit. The bank received a judgment against Bryce for the balance of the loan outstanding. The bank will not be able to attach to Bryce and Katy's home or use the equity in the home to satisfy the judgment because Bryce and Katy took ownership as Tenants by the Entirety.

Trust and Entity Ownership

Assets may also be owned in an entity or trust structure for a variety of reasons, including asset protection purposes. When assets are transferred to an entity, the individual members no longer own the transferred assets; rather, the individual members own membership interests (oftentimes called "shares") of the entity. Additionally, many asset protection and estate planning strategies involve the transfer of those membership interests to trust structures. This results in the trust owning the membership interests in the entity that ultimately owns the assets.

LIMITED LIABILITY COMPANIES (LLCs)

A Limited Liability Company (LLC) is a formal business entity that combines the advantageous limited liability characteristics of a corporation with the flexible administrative and tax elements of a sole proprietorship or general partnership. LLCs are considered to be effective business vehicles to protect assets and limit potential liability. When structured and administered properly, an individual member's personal assets are not at risk for the actions or debts of the LLC or the individual actions or debts of other LLC members.

To illustrate how an LLC structure can provide asset protection, consider the following hypothetical scenario:

I. Before purchasing the rental property described in the first hypothetical scenario, Bryce and Mackenzie formed an LLC to own the rental property with each sibling taking a 50% membership interest in the LLC. Because the LLC owns the rental property, Mackenzie's individual creditor resulting from the car accident has no ability to attach to the rental property or force the sale of the property to satisfy its judgment against Mackenzie.

To maintain limited liability, and thereby achieve asset protection, the members of the LLC must operate the LLC as an independent entity and follow all corporate formalities. Failure to abide by the required corporate formalities can result in the LLC being disregarded for asset protection purposes.

DOMESTIC ASSET PROTECTION TRUST (DAPT)

A Domestic Asset Protection Trust (DAPT) is a type of trust that allows the Settlor (the creator of the trust) the ability to irrevocably transfer assets to a trust and remain a beneficiary of the trust *while receiving asset protection from the Settlor's creditors*. This results in the Settlor removing assets from the reach of potential creditors by transferring them to a DAPT while retaining access to those assets. Because DAPTs significantly favor debtors and limit creditors' potential remedies, only certain states allow them. However, one does not need to reside in a state that permits DAPTs to establish a DAPT. DAPTs are often utilized by those working in professions with higher liability risk, such as medical professionals, but can be used by anyone who wishes to shield assets from potential creditors.

While the specific legal requirements and protections vary by state, two common DAPT factors are:

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I. **Limitation (Look-Back) Period:** This refers to the time required to elapse between the transfer of assets to the DAPT and the time when those transferred assets are shielded from creditors. Timing varies by jurisdiction with two to four years being common for most types of creditors.

II. **Exception Creditors:** There are certain types of creditors that are never barred from pursuing DAPT assets, such as creditors related to a divorce (claims for child support and alimony). In addition, many states allow preexisting creditors to attach to DAPT assets.

In all cases, a DAPT will fail if it is proven that the Settlor transferred assets with the intent to hinder, defraud or delay an existing creditor. As such, a DAPT is best used as a preemptive strategy before any known creditors exist.

CONCLUSION

Advanced asset protection strategies play a key role in a comprehensive estate and financial plan. Your Oxford Team partners with you and trusted specialists to select and implement tailored asset protection strategies that are in line with your overall estate and financial plan.

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