WEALTH PROTECTION PLANNING: AN IMPORTANT PLANNING TOOL.

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As estate and financial advisors, we are accustomed to the application of traditional planning using estate and wealth transfer planning vehicles, such as the variety of revocable and irrevocable trusts together with life insurance trusts, to mitigate client concerns and accomplish as many of the end-of-life planning objectives as possible. However, while we focus on satisfying these end-of-life objectives as we should, no planning is done to protect accumulated wealth during life from an uninsured accident or a liability generating event which might create exposure to significant damages capable of depriving a client of that accumulated estate and wealth. While some may have acquired or accumulated more than others, every client will insist that, to them, their wealth is enough to consider protection from each identifiable threat. While many threats to wealth will cause concern, one such threat to that wealth is at, or very near to, the top of the list: the catastrophic loss resulting from a significant lawsuit.

Lawsuits can be filed almost instantaneously and sometimes for the most absurd and frivolous of reasons. One study estimated that 80 million lawsuits are filed in the United States each year - an average of 152 each minute the courthouses are open.[1] Another study completed at the end of 1999 revealed that filing a lawsuit is viewed as the second fastest way to strike it

[1] Lawyers Weekly

rich today, second only to winning the lottery and way ahead of receiving an inheritance.[2] It seems that almost each and every activity, transaction, confrontation, dissolution of relationship or interaction carries with it an ever increasing chance that litigation may result. Considering those realities, it is not surprising that our clients often express concern about the effects of litigation in both their personal and professional lives.

We know that wealth transfer planning is the process of analyzing assets accumulated during life and formulating a plan of distribution so that at death heirs and beneficiaries, not the tax man, will get the largest portion of accumulated wealth. Obviously, wealth transfer planning is very important to make sure that the transfer of wealth is accomplished while being adequately protected from taxes and the many other claims and attachments which can rapidly dissipate an estate after death when it may be well beyond the ability to control. The consequence of poor, or no, wealth transfer planning could result in the failure to maximize the estate for the benefit of heirs and beneficiaries after death.

However, one glaring problem with traditional wealth transfer planning is that it requires a death, usually the estate owner, before the extensive and protective planning put in place really kicks in. Another problem with wealth transfer planning is that it is geared to protect assets at death for the benefit of others: the heirs, beneficiaries, and the "objects of the estate owner's bounty." While that is a valuable and honorable goal to be accomplished, very little current an real benefit is derived from all the wealth transfer planning done other than the nebulous piece of mind that provision is made for heirs and beneficiaries. But by far the greatest shortcoming with wealth transfer planning is that it does absolutely nothing whatsoever to protect currently owned

[2] U.S. Bancorp

assets from the risks which surround the activities; vocational, occupational, or entertainment in which the owner or perhaps his family engages. This is where inclusion of a wealth protection plan will become vitally important.

According to the American Bar Association, only 240 of the 800,000, or so, attorneys in the United States concentrated their practice in the developing area of wealth protection planning in 2000. As a result, it will come as no surprise that, until very recently, only a very few attorneys, and the clients who have engaged them, have heard of wealth protection planning and what it will mean for them. Frankly, most attorneys and clients have heard so little that unfamiliarity fosters the tendency to avoid this very important area of financial and wealth protection. Additionally, the small number of active practitioners may result in difficult or no access to the requisite expertise required in this highly specialized area of practice. While wealth protection planning may not fit in every planning scenario, certainly every client deserves the right to learn about it and to decide for themselves. This article will define what it is, discuss why this planning is important, expose methods of protecting accumulated wealth which fall short, what it can protect against, and briefly describe how it can be achieved for the benefit of our clients.

A definition of wealth protection planning would sound something like this: Wealth protection planning is the process of organizing wealth, assets and affairs in such a manner, utilizing the most favorable entities, agreements and system of laws, so as to protect and shelter that wealth and those assets from lifetime risks to which they would otherwise be subject. Regardless of the definition used, the concept of lifetime protection of wealth and assets from risks associated with professional practice, vocation and occupational hazards, any activity with a higher than average degree of risk or, frankly, the unfortunate accidents which occur in daily life, should be an attractive concept worthy of inclusion and exploration in every wealth transfer and financial planning discussion. Going one step further, this author feels it to be professional malpractice for an advisor to not introduce the concept of wealth protection planning in every wealth transfer or financial planning discussion with a full review of its applicability to the planning assignments before us. Our clients rely upon our knowledge and experience to provide, or at least be able to offer, the scope of planning required to include the greatest protection available.

The need for wealth protection planning developed as a direct response to the inability of the legal profession to offer and establish reasonable limits to legal damages. The fundamental concept of wealth protection planning is to place assets out of harms way and in a structure that, if required, would protect them from creditor attack. In practice, the prospect of chasing assets literally around the world can cause a potential creditor to think far more deliberately about pursuing collection through otherwise traditional litigation measures in the U.S. and which are often filed in a knee jerk fashion. Wealth protection planning is also intended, in practice, to effect an environment in which the parties heated for battle might cool and retreat from the nose to nose, belly to belly confrontations which, if left unchecked, most often will inevitably lead to litigation and to facilitate meaningful settlement discussions.

The litigation and unchecked confrontations which ensue from any activity, professional or not, could result in a large, potentially devastating judgment. Unfortunately, judgments are entered daily as a result of, and with all due respect, sometimes poorly considered decisions by judges or juries. These results can escape all logic and reason and are without a sound foundation in the law, an ever increasing occurrence in today's court settings. But the tragic result is the same: a judgment fully enforceable by the judgment creditor in each state of the union and collectable by attachment against any and all assets owned by the defendant within the reach of the governing magistrate. While an appeal might correct the effect of a large judgment wrongfully lodged, the damages caused by the seizure of wealth pursuant to collection efforts of the judgment creditor during the appeal process may totally dissipate and frustrate any hope of preserving assets which might otherwise have been protected. And the additional costs required to pursue the appeal process, particularly when assets are frozen or seized, could render that prospect financially prohibitive and completely out of reach. Even if the efforts to defend any frivolous suit are successful, the costs of that defense can be equally as devastating. As an example, Oprah Winfrey was successful in her defense of the suit filed against her by the Texas meat processing industry several years ago, but her defense cost $5 million to "win" the case.

Furthermore, the law has established, and experience has shown, that the United States is comparatively a very creditor friendly environment. For example, the full faith and credit clause of the U.S. Constitution allows seizure of Florida assets in satisfaction of an Illinois judgement, and *vis versa*. Attorneys are readily available for fees contingent on recovery and the administrative fees required to file suit are minuscule. Additionally, Statutes of Limitations are designed to give the creditor longer periods of time within which to file suit.

Well, what about that protection? What can be done to protect accumulated wealth to insure no judgment creditor will be in a position to take it away or the enjoyment if it while the owner is still alive? What can be done to accomplish current wealth and asset protection? Can those assets and wealth be protected today from the risks, occupational or otherwise, during life so the assets can be enjoyed without the threat of a creditor seizing those assets and wealth in satisfaction of a hastily entered judgment resulting from some predatory litigant? The answer is a resounding yes, and this is where careful wealth and asset protection planning can help.

The process begins with identification and measurement of the exposure to risk and the tolerance of it. For example, professional risks are rather easily defined and identifiable resulting from professional activities which put others at physical or financial risk. Practice in the medical and legal professions commonly present these readily apparent risks. Ownership of real estate, operation of manufacturing plants and retail establishments each carry their respective type of risk to be quantified.

But many other occupations, activities and ventures will also carry a large degree of risk as well. Daily activities outside of professional or vocational pursuits also give rise to risk in a variety of situations which may not be associated with monetary gain. Any activity which carries a heightened level of risk or could result in harm to others, and ourselves as well, has the ability to turn into an ugly and litigious situation which could have potentially devastating financial results. Driving a car or owning a particular asset capable of causing harm to others will expose the owner to a higher degree of liability. Motorcycle riding, auto racing, flying airplanes, and others each of which carries a greater level of risk to the participants, spectators and passengers which in turn results in a greater opportunity for suit against the operator, owners, their families or anyone associated those vehicles or activities. Additionally, the risk of increased and misplaced liability can arise in other settings such as divorce or bankruptcy which can place assets and wealth in jeopardy. Identification, insulation and protection of assets from these risks using every available tool is the goal of wealth protection planning.

The formation and use of a traditional corporation to hold title to various assets will fail to adequately protect. If assets are owned by a small or one shareholder corporation, which they typically are in a personal setting, in an effort to protect them from a liability and creditor of a shareholder, the creditor will not be hindered from seizing the stock of the corporation in satisfaction of a judgment against the individual owner of the corporation, presumably the same individual who purchased the assets and/or formed the corporation to hold title to them. While the creditor in this circumstance can not take the assets directly, seizure of the corporate stock owned by the individual debtor, stockholder will then grant control, and ownership by imputation, of the assets by the creditor as the new stockholder of the corporation. In either case the result is the same: *i.e.* the creditor seizes ownership of the assets or the creditor seizes the stock of the corporation holding title to them - the owner is deprived of ownership and enjoyment.

Insurance is not the complete answer either. For example, insurance policies have limits based upon the coverage purchased. Furthermore, policies are drafted with specific exclusions from coverage. And finally, the larger the policy, the greater the target.

Plaintiff's lawyers seek the largest money judgment or settlement they can obtain. The more they can recover for their client, the larger the contingency fee becomes. If one of several defendants has a large, juicy insurance policy, it is in the plaintiff's (and his lawyer's) best interest to work harder at tackling that defendant to get at that insurance policy; the proverbial deep pocket. Consequently, reliance upon this method to fully protect assets can prove not only insufficient but concentrate the plaintiff's litigation efforts toward that insurance pot of gold.

No one should be without some level of insurance coverage, nor would I recommend canceling a policy which can offer coverage at prescribed levels. Insurance has value, but it also has limitations which must be recognized. And furthermore, when foresight can never be good enough to indicate how much is enough, perhaps an alternative method of protecting wealth and assets is necessary given the particular circumstances. There is no sense in handing over all the marbles when sound wealth protection can be designed and implemented for virtually every such risk.

How is comprehensive asset protection accomplished? The underlying principal of asset protection planning is the separation of asset ownership from control without deprivation of enjoyment. Several entities can be used to accomplish this separation. If an asset is owned directly, it appears on the judgment creditor's radar screen and can be taken to satisfy the judgment. However, the ownership of personal assets can be structured in such a way that future creditors, any future creditor, will have a very, very difficult time attaching and applying those assets in satisfaction of a judgment.

Once the risks are identified and quantified, design and construction of a simple wealth and asset protection structure begins with the formation of a domestic entity: either a family limited partnership or limited liability company. These entity forms are preferred since there are safeguards against creditors included in the enabling statutes and which can be drafted into the supporting agreements. The assets to be protected are transferred into the entity of choice by the owner in exchange for a corresponding interest in the entity. This entity would be designed to include all the protections and creditor disincentives afforded and permitted by state law against the seizure of assets by unfriendly third parties or potential creditors.

Without going into detail beyond the scope of this article, the selection of which state jurisdiction to use in the formation of the domestic entity becomes a very important analysis as well. Consider it sufficient to state that just as there are 50 states in the union, each has a slightly different slant on the creditor safeguards permitted. Most allow multiple remedies while some, coined single remedy states, will only allow the judgment creditor one bite at the remedy apple against properly formed limited partnerships or limited liability companies.

While we might stop at this point with some confidence that we have done enough using the available statutory protections which accompany the domestic entity, the real safeguards are afforded by creating a mechanism which removes the assets completely from the reach of creditors or the creditor friendly jurisdictions of the United States. Remember that the goal of wealth protection planning is to protect accumulated wealth applying the most favorable legal system which most effectively frustrates seizure by creditors. Statutory domestic entity safeguards notwithstanding, experience has shown that total reliance upon the U.S. statutory and common law framework may be ill placed. Consequently, to obtain the greatest protection of assets available, the next step should be carefully and fully considered.

Once the domestic entity is in place, a carefully designed asset protection trust should be drafted and funded with a large interest in the domestic entity previously formed plus any assets which by their character are not suited for ownership by the domestic entity. Initial control is retained by the party responsible for managing the domestic entity; the general partner of the limited partnership or the manager of the limited liability company, regardless of percentage ownership or ownership at all.

No physical relocation of assets is necessary at this point in the planning and implementation stage. The assets which are now titled in the name of the domestic entity are still in the local bank or brokerage house, perhaps even where they were located before planning began. The real estate is still located where you built or purchased it, although real estate protection presents its unique set of issues. What has been accomplished is a careful re-titling of assets such that the protective mechanism is in place to spring into effect when, if ever, that might become necessary. The trust just established is no different than the wealth transfer planning trust used in traditional wealth transfer planning contexts, but for the addition of several more bells and whistles and the inclusion of a foreign fiduciary who remains passive until needed.

The trust is designed such that it is a grantor trust and retains the characteristic of a "U.S. person" and is tax neutral for income and wealth transfer tax purposes thereby minimizing the reporting and compliance required of foreign trusts and the corresponding cost. The principal parties are a foreign and domestic trustee, a foreign and domestic protector to monitor the trustees (principally the foreign trustee), and beneficiaries.

Full protection of the assets is accomplished when threatened by the initiation of mechanisms within the trust documentation designed to sever all legal ties with the United States, dissolve the domestic entity, and place the assets in the structure under the control of the foreign trustee. For the duration of the threat, the assets are protected by the offshore trustee from attachment by creditors even if the U.S. court has issued a repatriation order as that court order has no effect against the foreign fiduciaries now in title. And, just as with any trust well designed for the benefit of the beneficiaries, the trustee is directed to continue making necessary distributions for the benefit of those beneficiaries as well. The trustee will pay the electric, gas and mortgage bill; medical and orthodontia bills, if required; and any others which are necessary for the beneficiaries benefit. After the threat subsides or is extinguished, the mechanisms are in place to reestablish the initial structure using the original design including a domestic entity for active domestic management and perhaps by the initial founding party.

Using the laws of a foreign jurisdiction in this context is no different in practical terms than an Illinois company incorporating in Delaware. It is using laws available to it, even though outside its home jurisdiction, to accomplish the goals established for incorporation of the company and for the greatest obtainable benefit of the company. In wealth and asset protection planning, all available laws are considered, even though outside our domestic or home jurisdiction, to accomplish the most effective protection of wealth and assets and for the greatest obtainable benefit of the trust beneficiaries. In this context, we use the laws of the jurisdictions most favorable to accomplish the goal and which will result in the greatest wealth and asset protection available.

These jurisdictions have enacted legislation to support the wealth and asset protection industry. For example, the full faith and credit clause of the U.S. Constitution has no application outside the territory of the United States. Attorneys are not permitted by law in these jurisdictions to accept cases for contingent fees. To file a lawsuit in these jurisdictions, the courts require a bond of sufficient size to insure that if the plaintiff loses, it will pay the attorney's fees and costs of the defendant. The Statutes of Limitations are very short in comparison. And, as a significant additional benefit, by designing the wealth and asset protection structure utilizing these safeguards and enlisting the laws of these favorable jurisdictions, we have chosen the location of the final contest: the courts of that creditor unfriendly jurisdiction.

The actual structure used may vary widely with each specific situation and level of wealth protection desired or necessary as each planning opportunity will have a different threshold of risk endurance and degree of wealth protection desired. What may be an acceptable level of risk endurance in light of the profession or activities in which the individual is engaged will be quite different from someone wishing to protect different assets from a specific and unique range of risks. For that reason, the design and installation of a particular wealth protection structure may apply only for one situation and be completely inappropriate for another. It is an individual decision based upon entirely subjective criteria and after careful consultation with an appropriate and qualified professional advisor.

Also, it is an individual decision as to how much of currently owned assets should be sheltered using the methods described. Some seek and desire a complete shelter of all assets to safeguard as many assets and as much of the estate as possible, being careful to preserve the legal solvency of the client. Others will desire more of a nest egg, or rainy day, approach, setting aside only that amount which might be necessary to get through a difficult period. Again, it becomes a subjective decision considering all factors including the type of risk generating activity from which the individual is attempting to protect assets and the quantity of assets to be sheltered. While there are no absolute guarantees of a complete, ironclad and utterly failsafe method of protecting wealth against all creditors, despite the many sales efforts which claim so, the methods outlined here can add a level of protection which cannot be attained through even complex wealth transfer planning or any domestic structures.

A legitimate discussion at this point would include a question regarding the effectiveness of this planning. While there are a number of instances which have not been litigated but which endorse that effectiveness, several cases have worked through the court systems which have shown that, despite the very poor designs put in place, designs which this author has never used, the assets placed in the structures remain outside the jurisdiction of the U.S. Courts. Two cases which have risen to the top of discussions in the wealth and asset protection circles are *FTC v. Affordable Media, L.L.C.*[3] and *In Re Lawrence*[4]. In these cases the protagonists, Mr. & Mrs. Anderson and Stephen Lawrence, respectively, settled wealth protection trusts in jurisdictions with favorable legislation. However, in both cases they retained significantly too much control over the management of the trusts, well beyond the time when it was prudent to do so. Consequently, without going into great detail, both parties were held in contempt and suffered, and are suffering, the consequences. The end result is, however, that the trusts have retained the assets deposited which remain outside the control of the U.S. court system. It becomes a question of proper design with a well qualified designer, familiar with the planning options.

Unlike estate and wealth transfer planning, wealth and asset protection planning falls into the category of planning it is hoped will never be needed. However, those engaging in riskier activities who are unprepared in this environment have a far greater degree of vulnerability and may get hurt, perhaps irreversibly so. For the individual interested in wealth protection planning, the time to accomplish it is as soon as possible and hopefully long before any accident or event occurs which may result in a lawsuit. Attempting to shelter wealth from current or potentially foreseeable creditors is fraudulent and reversible in nature. Certainly, once the accident happens, the lawsuit is filed or results in a judgment, the transaction goes awry, or the

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[3] 179 F 3d 1228 (9th Cir. 1999)

[4] 279 F.3d 1294 (11th Cir. 2002)

relationship sours, may be too late. Just as with insurance, the time to plan and purchase is exactly the same time that there are no needs or conflicts looming or foreseeable. Those who are prepared will weather the storm and carry on with a greater proportion of wealth and assets intact.

In conclusion, the first step of preparation in any planning context is assessment of the concerns, goals and objectives followed closely by education of alternatives and benefits. While some may choose to forgo wealth and asset protection planning when the time comes to consider such things, it is the duty of each advisor, legal or financial, to expose clients to this relatively new concept. Armed with this article, each planner can begin to discuss, in general terms, the structure created and the goals achievable through this specialized aspect of the planning process. Together with a qualified professional, the applicability of wealth protection planning in the overall financial plan can be explored. Realizing what may be at stake and available to offer protection, the better educated can then be more fully prepared to make an informed decision to plan with the assistance of qualified professionals, or to endure the risks and concerns without it.

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