

High-Profile: Advice Article

Protecting Your Assets From Future Creditors

by Buz Aaron

You've worked hard to build your net worth. But if you haven't set up adequate protections, your assets could be attacked by frivolous lawsuits or unreasonable creditor claims. So go on the offensive, and implement asset-protection strategies that will defend your assets against potential legal and financial hazards.

A good offense is your best defense

Your best offensive move will depend on your individual circumstances and goals. For example, if you and your spouse live in a state that recognizes the form of ownership known as "tenancy by the entirety," holding a home or other real estate in that form protects the property from claims of your creditors and your spouse's separate creditors. It doesn't protect you, however, from claims of your joint creditors. This protection is due to the fact that in a tenancy by the entirety each spouse effectively owns the whole property and neither can act on the property without the other. Creditors of one spouse cannot enforce claims because the other spouse is also deemed to own the entire property.



Aaron

This type of ownership is a form of joint tenancy with right of survivorship that can apply to personal residences. Available in more than half of all states, it allows you to protect your home for as long as you and your spouse continue to use it as your primary residence. Unfortunately, persistent creditors may eventually succeed to ownership of the property when you sell or upon your or your spouse's death. However, if the debtor spouse dies first, the creditor can not enforce the claim against the property.

If one of you has greater liability exposure (perhaps your spouse is a doctor who is susceptible to malpractice suits) another option is to transfer title to property to the spouse with less exposure. Even if you live in a community property state (of which there are only nine), you may be able to protect your assets by partitioning community property into separate property or having one spouse give property to the other spouse. However if you do this you should be aware that you give up control over the asset.

Other asset-protection strategies include:

Retirement plan. Qualified retirement plans — such as 401(k)s — generally are exempt from creditors' claims. IRAs also offer protection against creditors. Qualified plans offer federal protection, while IRAs are protected under the laws of the state where you live. Also note that retirement assets are not protected against claims by the US government or against qualified domestic relations orders.

Family limited partnerships (FLPs).

You can transfer assets to an FLP in exchange for limited partnership interests for you and your family. In general, a limited partner's creditors can't reach the FLP's assets; they can only obtain rights to receive any distributions made from the FLP to the limited partner. But a word of caution is in order — if you retain both a general partner interest and a limited partner interest, it can have devastating results with respect to your asset protection objectives. Again, careful planning is vital, as is proper drafting, and there must be a valid business purpose for the FLP.

Further, keep in mind that FLPs must be well structured and carefully operated to minimize the risk of failing an IRS challenge.

Trusts. To effectively use a trust as an asset-protection tool, it must be irrevocable and it must own the property. Once given away, these assets are no longer yours and aren't available to satisfy claims against you. To properly establish an asset-protection trust, you must not keep any interest in the trust assets or control over the trust. And, the less access the beneficiary has to the trust property, the less access the beneficiary's creditors will have. So, work with your CPA and attorney. Only an attorney experienced in this area should draft this type of instrument

Finally, know that certain claims can pierce domestic protective trusts, such as claims by a spouse or child for support, and state or federal claims. Two cautionary notes: 1) There were changes to the bankruptcy code in 2005 which created a 10 year lookback period for all assets transferred to asset protection trusts, and 2) Most states statutorily prohibit this type of trust.

You can strengthen your front-line protection by placing the assets in an offshore trust. Offshore trusts can offer significant protection, but they must comply with the laws in the country in which they're established and be structured in accordance with U.S. tax laws and regulations. And, they can be very expensive to set up and maintain.

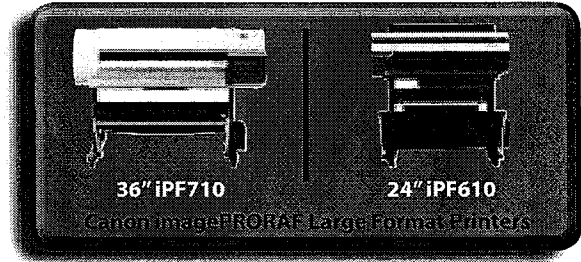
Don't wait. One asset-protection strategy may not meet all of your needs, so you should consider a combination of several as your best line of defense. But get started now. Don't wait until trouble is at your doorstep. Laws against "fraudulent conveyance," or defrauding creditors by transferring your assets to avoid paying your debts, provide that creditors can legally stop transfers that occur after a claim has been made.

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