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ASSET PROTECTION – AN OUNCE OF PREVENTION IS WORTH A POUND OF CURE

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Asset protection is not about hiding assets from creditors nor is it about withholding information from authorities. Asset protection is about making sure that your assets are not unnecessarily exposed to loss or forfeiture. When properly done, asset protection is similar to locking your car doors or putting documents in a safety deposit box. You are simply taking reasonable steps to prevent avoidable loss. You are managing risk.

Examples of asset protection are numerous and varied. They range from simple adjustments to complex restructuring. Perhaps some examples will help.

The Family Purpose Doctrine. West Virginia and most states have a legal concept often referred to as the family purpose doctrine. Oversimplified, the doctrine states that if you furnish a motor vehicle to a member of your family then you can be held personally liable for any damages caused by that driver. In light of this, two things are apparent. First of all, make sure that you have an umbrella policy above and beyond the customary automobile coverage. Secondly, if you are going to provide a child with a car, titling the vehicle in his or her name and letting the child apply for and own the policy will go a long way towards shielding you from exposure to the family purpose doctrine.

Title Locked Land. Another form of asset protection relates to inheritance. If a family has real estate holdings when property passes to the next generation you may inadvertently create a situation where the property becomes unmarketable from a practical standpoint. The property becomes “title locked.” Suppose a husband and wife die and leave the property to three children. One of the children then dies and a portion of the property passes to three grandchildren. If any owner wishes to sell, lease or borrow against this property, the unanimous consent of five different people is required. If a minor is involved, court approval is also needed. An expensive and time consuming solution to “title locked” property is a partition lawsuit. To avoid this, real property can be left to younger generations in the form of a limited liability company with an appropriate operating agreement. By doing this, the limited liability company units can be freely inheritable; however, a majority of the unit owners will be able to manage, control, develop or sell the property. Unanimous consent is no longer required. A limited liability company is a pass through entity for tax purposes. The disadvantages of doing this is the need to file an informational return, pay business franchise tax in West Virginia and maintain the limited liability company with the Secretary of State. However, those costs are minuscule when compared to the cost of a partition suit or lost opportunity costs if the property is “title locked.”

Separate Entities. Another form of asset protection relates to the ownership of investment properties and operating businesses. In order to prevent the exposure of one property or business to the liabilities of another, it is always wise to consider owning the assets separately. In other words, rather than placing all of these assets in one company or limited liability company, it is preferable to have them owned in different companies even though one person owns all of the different companies.

“Offshore” Banks. Many people equate asset protection with offshore banking. Simply put, placing assets “offshore” in a foreign jurisdiction protects those assets primarily because the laws of the foreign jurisdiction may not recognize judgments or liens from an American court. On the other hand, when you “go offshore” you need to surrender control and access to the assets to a foreign trustee since if you retain those rights, an American court can order you to exercise them for the benefit of your creditor.

Charitable Stock Bailout. Another form of asset protection relates to the sale of a company to the younger generation where the founders are ready to retire. Customarily, the younger generation or the company itself would purchase back the stock owned by the older generation and the sellers would pay capital gains tax. There is a relatively little known technique sometimes referred to as a “charitable stock bailout” which allows the retiring seller to avoid capital gains tax altogether, receive a charitable income tax deduction and a lifetime annuity. This technique also removes the value of the company and the sale proceeds from taxation in the estate of the seller.

Succession Planning. For a business owner, asset protection includes proper succession planning. There are numerous techniques available to transfer ownership in a planned and controlled manner. These include a customized buy-sell agreement often funded by key man life insurance which addresses repurchase of ownership (stock, units, percentage share) in the event of death, disability or retirement. Corporations can also transfer stock to key employees and create a non-cash income tax deduction by using a Section 83 plan.

Creditor Trusts. Recently, some states have passed legislation creating trusts which are intended to protect assets from creditors. Most of the statutes have yet to be tested in court, and many require that the creator of the trust must be a resident of the state. Furthermore, the ability of state statutes to override the scope of federal bankruptcy laws is also largely unsettled.

Spendthrift Trusts. West Virginia like most states authorizes the use of “spendthrift trusts.” However, you cannot create a spendthrift trust for yourself. A West Virginia spendthrift trust is created for the benefit of another (perhaps a child) and it must provide that the income and principal of the trust may only be used for the health, education, support or maintenance of the beneficiary for the life of the beneficiary or for a fixed term of years. A spendthrift trust in West Virginia cannot merely instruct the trustee to automatically pay all of the net trust income to the beneficiary.

FDIC Insurance. Asset protection also includes making sure that your bank deposits are covered by FDIC insurance. Although the coverage limits have been recently increased, the mistake which most people make is to assume that each account with a bank is insured up to the maximum FDIC limit. That is simply not the case. The FDIC limits are applied on a combined basis meaning that if you have three different accounts with a bank those accounts are considered

one for purpose of the limits of FDIC insurance. Most banks are now offering a program where you can have deposit insurance on accounts substantially in excess of the per-institution FDIC limit by having your funds deposited with other banks but administered through your local institution.

Lockdown Company. There is also a vehicle which can be established in West Virginia which will create, if need be, a “Mexican standoff” with your creditors. A “Mexican standoff” is a situation where neither of two parties can move because they are equally matched. This means that you can create a situation where although you cannot get your hands on the protected property (stocks, bonds, cash, land, etc.), neither can your creditor. In such a situation, most creditors will negotiate a settlement.

Estate Planning. Finally, asset protection includes estate planning. Even though the death tax exemption is now \$3.5 million per person and for most people that more than protects all of their assets from death tax, that exemption and the rates of the estate tax (presently in the 45-55% range) will be changed from time to time by Congress. This means that your will must contain standard provisions to shelter your assets from tax and yet at the same time must not be so “rigid” that upon your death assets are unnecessarily placed into credit shelter or bypass trusts which are not needed. The proper use of disclaimers to ensure that assets are sheltered after your death if that is necessary is preferable to “oversheltered” estate plans. Estate planning also includes creating a trust in the event underage children or grandchildren inherit, making use of POST orders in a medical power of attorney and authorizing tuition and medical expense gifts in a durable power of attorney.

Timing. A final general issue relates to timing. All states including West Virginia have some version of a statute of frauds doctrine. Basically, this is a statute which provides that transfers and transactions can be reversed by a court if it can be shown that the purpose of the transaction was to defraud or hinder creditors. Accordingly, the worst time to address asset protection is after a claim has been made, an accident occurs or a lawsuit is filed. Therefore, it is far wiser to address asset protection before it is needed, not after.

In closing, no one can afford to unnecessarily lose or part with personal or family wealth. Asset protection in all of its different forms may just be the “smoke detectors” that your financial “house” needs. Having a qualified professional confidentially review your personal situation will help you preserve what you have and protect you and your family from avoidable risk. As the old saying goes, “an ounce of prevention is worth a pound of cure.”

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