ASSET PROTECTION for BUSINESS OWNERS

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Some Scary Stats

- **70,000 lawsuits are filed per day**, many without merit, and we are the most litigious society in the world;
- The average medical malpractice award is $3.9 MM;
- The average legal costs of settling a **frivolous lawsuit** is $91,000 – plus the actual settlement amount itself;
- The average **sexual harassment** suit against a small business produces a verdict of $530,000. Employees are suing more often, winning more often and winning proportionally larger judgments. **They win 75% of the time!**

What is Asset Protection?

- **Risk Management Planning** designed to:
  - Discourage a Potential Lawsuit
  - Promote a favorable settlement
  - Building a **plausible "story"** that can be told to a judge or jury SO THAT YOUR ASSETS ARE PRESERVED
  - Each case must be analyzed, designed, and implemented on a case-by-case basis
  - You cannot "Bullet-Proof" your estate

Who Needs Asset Protection?

- Owners of Established or New Business
- Individual Buying or Selling a Business
- Doctors, Lawyers, CPAs, Architects, Engineers (Professionals)
- Officer/Director of a Business or Non-Profit
- Individual who has made Personal Guarantees

Who Needs Asset Protection?

- Owner of a Boat, Airplane, Race Cars
- Owner of Multiple Apartment Units
- Owner of Factory Premises
- Owner of Land with Toxic Contamination
- Wealthy Substance Abuser
- Celebrities
- Individual Expecting an Inheritance

- Larry, a high-profile celebrity, sold a luxury ocean-front condo in 2008 for $1,000,000.
- **2 years later,** after the value of the property dropped by 50%, the buyer sued for recession based on undisclosed construction defects.
- Although there were no defects, the plaintiff refused to settle; after spending $200,000 on his defense, Larry was acquitted.

Asset Protection Theory

- The EARLIER, the BETTER!
- Does not rely on Secrecy for its effectiveness **(but Attorney-Client Privilege is essential)**
- Must have a **legitimate** Business, Estate Planning, or Tax reason
- Marketing materials touting “Asset Protection” will hurt!
- 75% of Frivolous creditors “give up” when confronted with an asset protection plan; 95% settle on favorable terms

ASSET PROTECTION

- Basic Concepts:
  - – Business liability (Inside Creditors)
    - Contractual disputes
    - Disgruntled Employees
    - Vicarious Liability
  - – Personal Liability (Outside Creditors)
    - Car wrecks, accidents, etc.
    - Divorce
    - Torts
      - – Defamation, Sexual Harassment, Discrimination

Asset Protection Techniques

- Insurance
- **Prenuptial** Agreements
- Transmutation Agreements (**Post**nups)
- Contractual Techniques (Indemnification, liquidated damages, Hold Harmless, choice of law, HR Employee Manual)
- Statutory Exemption Protection
  - Homestead Exemptions ($75k to $175k)
  - ERISA qualified retirement plans (SEP IRA’s and SIMPLE IRA’s do not comply!)
  - Annuities and Life Insurance

Statutory Exemptions, cont'd.

CALIFORNIA PRIVATE <u>RETIREMENT</u> PLANS

- CA Code of Civil Procedure 704.115 – even distributions OUT of the plan are 100% protected

- There is not a limit on how much one can contribute into the plan.
- Other employees do not need to be covered.
- No IRS annual filings
- There are no substantial restrictions on the types of investments in the plan.
- You can put the assets in any financial institution you wish.
- You can manage the investments yourself or use a financial planner

Techniques

- Installment Sales:
  - – Private Annuity
  - – SCIN (Self-Cancelling Installment Note)
- Irrevocable Trusts
  - – Qualified Personal Residence Trust
  - – ILIT (Irrevocable Life Insurance Trust)
  - – Domestic /Offshore **Asset Protection Trusts**
  - – 13 States allow “self-settled” APTs
    - Contempt of Court – Jail Time possible!
- IRA Trusts for Inherited IRAs (Clark Case)

Business Entities

- Corporations
  - Formalities
  - “Piercing the corporate veil”
- Charging Order Protected Entities
  - Limited Partnerships
  - Limited Liability Companies
  - “Outside” Creditors only entitled to distributions made “in respect of debtor’s ownership interest”
  - Foreclosure possible in California

Methodolgy

- Purchase Insurance
- Limit liability exposure with Contracts
- Structure businesses to limit liability
- Maximize Value of Exempt Assets or Change non-Exempt to Exempt Assets
- Transfer Ownership (to individuals or to trusts) as permitted under Fraudulent Conveyance law

Fraudulent Conveyances

- Can be used to set aside an asset protection transfer (Voidable Transfers)
- Applies to transfers made to hinder, delay, or defraud present or **future** creditors
- In California (Civil Code sec. 3439.01):
  - **Actual Intent** to defraud ("Badges of Fraud")
  - Transfers without **reasonable equivalent value** as consideration

Fraudulent Conveyances

- Statute of Limitations:
  - – The later of:
    - 4 years after the transfer, or
    - 1 year after discovery of the transfer
    - but NOT after 7 years in any event!

Really Bad Asset Protection

- Attempting to defeat the collection of taxes
- Rely solely on insurance coverage
- Wait until immediately before trial to engage in blatant asset protection
- Put your home into an LLC or Corporation
- Transfer all of your assets to a FLP
- Rely on a Seminar “DIY” Asset Protection Kit sold by the “Father of Asset Protection”

Captive Insurance Company

- For wealthy clients (over $20 million)
- Form real Insurance Company, with employees and insurance license
- Insurance Company Advantage:
  - Reserves are deductible for corporate income tax purposes
  - Premiums paid are deductible and are sheltered
  - Wealth transfer if children own the Captive Insurance Company

Captive Insurance Company, continued

- Captive Insurance Company issues polices related to:
- Payment of other policy deductibles
- Claims in excess of existing policies
- *Litigation expenses* related to:
    - Regulatory or administrative actions
    - Environmental and hazardous materials
    - Suits based on sexual harassment, age discrimination, ADA infractions, etc.
  - Potential creditors see large “war chest” for litigation expenses

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