

# FREQUENTLY ASKED QUESTIONS ABOUT ASSET PROTECTION

**Introduction:** You have worked hard for what you own, and you want to keep it. An asset protection program simply employs legal techniques that deters others from taking, or in some cases, attempting to take your assets. The complexity of any asset protection program depends largely on what types of assets you have, and what type of work you do. Even something as ordinary as a car accident can give rise to a liability. If the liability exceeds your auto insurance policy limits, your assets will be at risk, unless you plan ahead.

## **1. Would standard liability insurance provide me with enough protection for my assets, and those of my company?**

A claim can always exceed your liability coverage. Additionally, most plans do not cover you for punitive damages, or intentional wrongdoing. Proper planning includes both liability coverage and asset protection techniques.

## **2. I have heard a lot about "living trusts". Would a living trust provide protection for my assets if I were sued?**

No. While a properly structured living trust can provide privacy, and avoid the probate process, it provides practically no protection from your creditors. The trust's assets will generally be available to your creditors.

## **3. What type of asset protection "tools" are there?**

A typical asset protection case involves the formation of one or more entities, typically limited liability companies (LLCs), and/or irrevocable trusts. In a typical situation, an LLC is formed, in which you are the manager, and the assets that you want protected are contributed to the LLC. As the manager, you retain control over the assets in the LLC. With an irrevocable trust, you give up the ownership and control of the property transferred to the irrevocable trust and turn it over to the trustee of the irrevocable trust. Both of these techniques can shield the assets from creditors.

## **4. How can a limited liability company provide me with asset protection?**

An LLC provides liability protection from two different directions. First, an LLC protects its members from liabilities generated by property owned by the LLC. For example, if an LLC is formed and a rental property is contributed to the LLC and later someone falls down the steps of the rental property and sues the owner, it is the LLC that gets sued. Any liability belongs to the LLC. Only the assets owned by the LLC, in this case the rental property, are available to the plaintiff if the lawsuit is successful. The other assets owned by the members of the LLC are not available to the plaintiff.

Second, the assets owned by the LLC are protected from any liability of any member. For example, assume that, as in the previous example, two or more people have formed an LLC and it owns a rental property. Now, if one of the members runs a red light and causes an accident, the rental property will be protected. Although the creditor (in this case the "victim" of the auto accident) can sue the member, the "victim" cannot either take the member's interest in the LLC, or force him to sell it. The interest in the LLCs and the rental property are protected.

## **5. Is it really true that the victim cannot take the interest in the LLC?**

A creditor of a member of an LLC cannot take either the interest in the LLC or assets from the LLC. A creditor is only entitled to get what is known as a charging order. This means that if any distributions are made by the LLC to the member, the creditor is entitled to those distributions until the judgment is paid in full. The charging order does not entitle the creditor to become a member of the LLC.

**6. Does a small business (subchapter S) corporation give me the same protection as an LLC?**

Yes and No. Corporations provide limited liability to the officers, directors and stockholders of the company similar to the protection provided to an LLC for its members. This means that in a properly organized, maintained and capitalized corporation, the officers, directors and stockholders have no personal liability for any debts of the corporation. If your corporation loses a lawsuit, and the corporation does not have sufficient assets to satisfy a liability, a creditor cannot seek the personal assets of the officers, directors or stockholders. However, if your corporation loses a lawsuit, all of the corporate assets are available to satisfy the judgment. As a general rule, you do not want the corporation to own any valuable assets (real estate, equipment or surplus cash). This just makes them available to a creditor or future creditor of the corporation. However, the stock of a corporation is not protected from a shareholder's other liabilities. Think of it like this: If you own stock in IBM and you are sued and a judgment is obtained against you, the creditor can take your stock. The same is true for Mom & Pop, Inc. (of which you own some or all of the stock). This is why it is usually better to be organized as an LLC rather than a corporation. Remember, with an LLC, the creditor cannot take the member's interest in the LLC.

**7. I have heard that for tax purposes it is better to be a subchapter S corporation than an LLC. Is this true?**

This may be true. However, you can be organized as an LLC for asset protection purposes and then elect that the LLC to be taxed as a subchapter S corporation. This is like having your cake and eating it too.

**8. Is it possible that I may need more than one LLC?**

Yes. Remember the rental property example. If someone falls down the steps of the rental property owned by the LLC and sues the LLC, the only assets available to them is the property owned by the LLC. If you own multiple rental properties you may want to own them in separate LLCs so that each rental property is protected from the potential liabilities of all the other rental properties.

**9. How can I protect my personal residence as part of an asset protection program?**

In North Carolina property purchased together by a husband and wife is held as what is know as a Tenancy by the Entirety. This type of ownership provides excellent asset protection. If the husband is sued and a judgment is obtained against him, the creditor cannot simply take the house because the creditor cannot break this type of ownership. However, if there is a judgment and the house is later sold, the creditor is entitled to his share of the proceeds from the sale.

**10. How about transferring all of my assets to an "offshore trust"?**

This is typically not a good idea. First, there are reporting requirements to the IRS that must be closely followed or your offshore trust can turn into a tax scam. Second, if you have a judgment entered against you, the judge can order you to bring the assets back into a US jurisdiction, or hold you in contempt (i.e. send you to jail) until you produce the assets.

**11. Can you describe to me what a typical asset protection program would be for someone who owns their own company, has about \$1 million in personal assets in addition to that, plus a family residence valued at over \$500,000?**

The first step is to make sure the company is structured properly, whether that is a corporation, LLC, limited partnership, or some other form of ownership. The structure depends on multiple factors that should be discussed with your attorney. The next step is to shield the personal assets. In most cases this involves the formation of one or more LLCs to hold the assets, or the formation of an irrevocable trust (it depends on the owner's wishes). If the personal residence is owned as Tenancy by the Entirety, typically, nothing else needs to be done to protect the residence.

## **12. What should I be careful of when preparing an asset protection program?**

It is important to realize that not every person will use the same asset protection structure, and designing a plan to fit your needs should take place under the guidance of an attorney who concentrates in these matters. Finally, and most importantly, your asset protection plan must be created **before** any claim or threatened litigation. If you wait until there is a liability, it is probably too late.

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We hope this information helps you. It is important to understand that you need the assistance of professionals who are knowledgeable in the field of asset protection in order to make the decisions that are necessary to implement an asset protection program that is appropriate for your needs and desires. If we can be of further assistance to you, please contact us by phone or email at your convenience to schedule a conference.