Asset Protection Strategies for Organizations and Individuals

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Asset Protection involves a variety of legal techniques (based on both statutory and common law) dealing with protecting assets of individuals and businesses from civil money judgments.[1] "Asset protection" has developed a bad reputation in part due to questionable offshore planning techniques. Some offshore "tax haven" schemes have been marketed to investors who have ultimately ended up in deep trouble with the IRS and other federal agencies. Many asset protection strategies, however, are ethical and highly advisable. Basically, asset protection planning simply makes use of laws that were passed to enable organizations and individuals to protect their assets. An analogy can be drawn to tax planning. Some schemes that are called "tax planning" are nothing more than illegal and fraudulent evasions of taxes. Legitimate tax planning, however, is essential for both businesses and individuals. Similarly, legitimate asset protection planning is important for both businesses and individuals.

Asset protection planning is receiving ever increasing attention because of the great number of lawsuits filed in the United States[2] and the sometimes surprising results of those lawsuits—not to mention the amounts of some verdicts.[3] While fear of lawsuits can be exaggerated, taking steps that may avoid litigation is generally cost-effective in the long-run. Taking reasonable and appropriate steps to protect assets against a large judgment can be both proper and highly advisable. In fact, it would seem that a company's officers and directors have a duty to protect the organization's assets by employing usual and customary risk management strategies.

Current economic conditions, recent high profile business failures, the recent increased wave of foreclosures and the rising number bankruptcy filings all illustrate the need to pay greater attention to reasonable asset protection strategies. Most businesses and individuals focus great efforts on increasing their financial resources and very little attention to **protecting** their assets.

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[1] "Asset Protection." Wikipedia, http://en.wikipedia.org/wiki/Asset_protection (May 2, 2008).

[2] Rachel Emma Silverman, "Litigation Boom Spurs Efforts to Shield Assets," Wall Street Journal, Oct. 14, 2003. by

[3] For example, in the 1980s a Texas jury found Texaco liable to Pennzoil for tortiously interfering with a contract between Getty Oil and Pennzoil. The jury verdict was for $7.52 billion; and the jury added another $3 billion in punitive damages. *Texaco Inc. v. Pennzoil Co*. (1987), 729 S.W. 2d 768 (Tex. Ct. App.). Texaco of course appealed (all the way to the United States Supreme Court), but the ultimate resolution of the case involved Texaco paying $3 billion and filing bankruptcy. Texaco at the time was one of the largest corporations in the United States. This is a classic reminder that a single jury verdict can have an enormous impact on a company – even a very large company.

Asset protection planning strategies can also be used effectively for clients who are simply concerned about privacy and confidentiality. For example, we have used so-called "blind trusts" to provide privacy for certain clients (including lottery winners) who are concerned about the general public's ability to view their assets.

ASSET PROTECTION STRATEGIES FOR YOUR BUSINESS

There are a number of relatively simple strategies an organization can use to provide significant protection for its assets.

1. Separate Entities. Consider creating a separate entity (possibly a limited liability company) to hold real estate, machinery, or assets relating to a new line of business. If there were a future judgment against the corporation, the assets held in the separate entity or entities would likely not be subject to that judgment as long as appropriate formalities were followed. Tax issues can arise in connection with the transfer of assets, and these should be considered prior to any transfers. For example, the transfer of real estate out of a C corporation into a limited liability company could trigger a significant amount of tax, and thus make the transfer impractical. But if additional real estate or a significant piece of machinery or equipment is being acquired, having a new limited liability company purchase it (and then lease it to the corporation) could have significant advantages.

A holding company arrangement is often useful for purposes of better business organization and asset protection. For example, one or more individuals can own shares or units of a holding company, with the holding company in turn owning shares or units of various operating entities. This separates various business activities and also separates the risk associated with each activity. A separate entity is particularly advisable in the case of a high risk business segment. Separating that operation from other business segments can be perfectly reasonable, as it avoids exposing other assets in the event of some catastrophic event.

Using an entity to hold real estate separately from the operating business provides not only asset protection, but also potential tax advantages. For example, the operating entity will pay rent (possibly at the high end range) to the entity holding the real estate. Distributions to the owner of the real estate entity will not be subject to payroll taxes.

Having separate entities for various functions of an organization is also important for non-profit corporations. For example, we have assisted several non-profit clients with formation of separate foundations, which are not part of the parent organization's operating entity. This was done in each case for very legitimate business, administrative and organizational reasons. A valuable by-product of such a separation, however, is significant added protection for the organization's assets. For example, if a large judgment were obtained against the operating entity, assets held in the separate foundation would not likely be impacted. The operating entity should still carry usual and customary insurance at usual and customary limits; but a separate foundation can provide very valuable protection.

2. Limited Liability Companies. A limited liability company ("LLC") is a hybrid type of legal entity that has some characteristics of a corporation and some characteristics of a partnership. Owners of an LLC are called members; they can elect to receive pass through tax treatment like a partnership or an S corporation, or to have the LLC taxed like a C corporation; they have limited liability like in a corporation; and they have a great deal of flexibility in management structure. Thus, many business owners now prefer to form an LLC instead of a corporation when the need for an additional entity arises.

LLCs provide significant asset protection advantages. A creditor of an owner of a corporation (that is, a creditor of a stockholder) often can gain control of a corporation by getting control of the owner's stock. Shares of stock in a corporation are assets that can be "attached" or otherwise taken by a creditor to satisfy a judgment against the owner of the shares. Once the creditor has control of the shares, it can generally vote the shares and possibly gain control of the business entity. Thus, if you own all the stock of ABC Corporation and one of your creditors is able to take that stock, the creditor will control (and own) ABC Corporation. A membership interest in an LLC, however, is treated differently. A creditor of the owner of an LLC, however, generally cannot gain control of the member's interest, because LLCs have what is called "charging order protection". If and when the LLC makes a distribution to you, the creditor can take it. However, the creditor generally cannot force a distribution or gain voting control of the LLC. The bottom line is that a creditor of the owner of an LLC membership interest has much less leverage than a creditor of an owner of stock in a corporation. Ohio Revised Code Section 1705.19 specifically provides that a creditor of a member has no right to obtain possession of the property of the LLC.

The concept behind a limited liability company has been around for more than a hundred years in both Europe and Latin America. The LLC, however, is relatively new in the United States. Wyoming was the first state to pass an LLC Act in 1977. For many years, the federal tax treatment of LLCs remained uncertain and it was not until 1996 that every state in the United States finally had an LLC Act. Various legal issues surrounding LLCs therefore continue to develop. It is now well established, however, that a creditor of an LLC member will likely have a much more difficult time than a creditor of a corporate shareholder in getting control of the entity.

3. Insurance. Review all of your business insurance with both your attorney and your insurance agent. Since your attorney is not selling any insurance products, he or she can often provide an objective review of the types and amount of your business insurance. Having adequate insurance is one of the most important (and generally one of the most cost effective) ways to provide protection for your business. The use of holding companies and

separate LLCs and other business entities should never cause you to lose sight of the fact that adequate insurance is still a key ingredient of any asset protection/risk management plan.

Many larger companies now essentially "self-insure" through so-called captive insurance companies, many of which are formed outside the United States. These captive insurance arrangements offer a number of advantages over more traditional insurance arrangements. Not surprisingly, the costs of such an arrangement make it a reasonable option only for larger organizations. All businesses, however, whether large or small, should periodically review their insurance coverage. An organizations that reaches a certain size should at some point consider self-insurance alternatives.

4. Update Corporate Records and Follow Required Formalities. Many closely held businesses do not keep their corporate record books up to date. In the event of a lawsuit against the company, a plaintiff's attorney can attempt to "pierce to corporate veil". This means the corporation will essentially be ignored and the owners (shareholders) will be personally liable for the corporate debts. Following basic corporate formalities (including holding an annual shareholders meeting; holding regular meetings of the Board of Directors; avoiding any mixing of personal and corporate assets; and keeping corporate records up to date); will all help to insure that the assets of the owner(s) of the business are insulated from any judgment against the business.

One of the many advantages of an LLC over a corporation is that LLCs require fewer formalities in both their organization and operation. However, piercing of the LLC veil is also possible under various circumstances, including inadequate capitalization or failure to maintain a separate indentify (for example, failing to have a separate bank account for the LLC). Courts will be less likely to pierce the "LLC veil" than to pierce the "corporate veil" because fewer formalities are required with respect to LLC's. To date, two reported Ohio court decisions have considered the issue, and both courts held there was insufficient evidence to hold the LLC members personally liable.[4] However, both Ohio courts clearly indicated that the LLC veil could be pierced under limited circumstances. One of the courts basically applied the test for piercing the corporate veil that was established by the Ohio Supreme Court in Belvedere Condominium Unit Owners' Association v. R.R. Roark Cos., Inc., 67 Ohio St. 3d 274 (1993). In general, however, courts across the country seem somewhat less likely to pierce the LLC veil than the corporate veil. Having said that, it is still critical to observe certain formalities with an LLC to be sure that individual members are protected against debts of the LLC.

5. Business Succession Plan. Many business owners lose sleep worrying about lawsuits and other potential legal claims. While these concerns are often justified, more businesses collapse from lack of a business succession plan than from a lawsuit bought by a

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[4] Silman's Printing, Inc. v. Velo International, Ohio App. 5th District (2005); and Siva v. 1138 LLC, Ohio App. 10th District (2007).

party unrelated to the business. Lack of such a plan can lead to fights among family members, including litigation, which can be disastrous at both a business and a personal level. Paying attention in advance to at least some form of succession plan can save an enormous amount of trouble later. Life insurance should be considered as one part of the business succession arrangement. Good business succession planning is also a form of asset protection planning.

6. General Overall Legal Review of Business Operations. Is your business in compliance with applicable employment laws and other regulatory requirements? Has your employee manual been reviewed recently? One lawsuit will likely cost far more than a basic legal compliance review. A legal "check up" is like a medical check up: identifying one or more serious problems and taking care of them now can avoid a much greater problem later.

7. Disaster Preparedness. Most large organizations have some sort of disaster preparedness plan. The majority of small businesses do not. While this is an item that will not generally require consultation with an attorney, it nevertheless deserves consideration as an "asset protection" strategy.

A disaster to your organization can come in many different forms, including fire, weather, terrorism, computer problems and a variety of other causes. Having some sort of contingency plan in place in the event of a disaster is highly advisable. Setting up such a plan can be done at minimal cost. Simple steps like backing up computer data and storing the information at an offsite location can be a critical to an organization's survival in the event of a catastrophe. Many resources are available to help you set up a disaster preparedness plan for your business. [5]

ASSET PROTECTION STRATEGIES FOR INDIVIDUAL OWNERS, DIRECTORS AND OFFICERS

Business owners, officers and directors (as well as physicians and other professionals) have a particular need for personal asset protection planning. The managers and owners of a corporation will not normally face liability for debts of the corporation, limited liability company or other entity. There are limited instances, however, in which individuals may be the target of a lawsuit. For example, plaintiff's counsel can attempt to "pierce the corporate veil." Another example is a lawsuit against directors and/or majority owners for alleged violations of fiduciary duty. The cost of litigation can itself present a crushing burden, even if a party ultimately

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[5] For example, the United States Small Business Administration has tips for business owners at www.sba.gov/disaster_recov/prepared/getready.html. Small business owners should also consider obtaining business interruption insurance. This may cover lost income in the event of certain disasters. It should be noted, however, that insurance may exclude certain catastrophes such as floods, earthquakes or terrorism. Thus, being prepared for simply getting back to business with minimum disruptions is, in this day and age, particularly important.

prevails in the litigation.[6] Business owners and managers should therefore take reasonable steps to protect their personal assets to the greatest extent possible. There are a wide variety of standard asset protection strategies that can be utilized (most of which make sense anyway for general economic/tax reasons):

1. Maximize Contributions to IRAs and Qualified Plans. Assets in IRAs and qualified employee benefit plans are generally afforded special protection from creditors. It has been well settled for some time that retirement assets in qualified plans (401(k)'s, Keoghs, etc.) are protected from creditors. They are also protected in bankruptcy because they are not part of the bankruptcy estate. Until recently, however, it was not certain whether IRA's were protected. In 2005, the Supreme Court specifically confirmed that assets in IRA's are protected assets.[7] The Bankruptcy Abuse and Protection Act of 2005 limits the IRA exemption in bankruptcy to $1 million adjusted for inflation.

   One of the best asset protection strategies for most individuals is to maximize contributions to IRA's and/or qualified retirement plans. This is of course also a good strategy for personal planning and tax reasons.

2. Trusts. Not all trusts provide asset protection; but some do.

   a. Domestic Asset Protection Trusts. At least ten states have enacted asset protection trust legislation.[8] The trust legislation in Alaska, Delaware and Nevada has received the most national attention. The applicable state statutes generally require that a trustee be maintained in the state and the trustee have discretion in making payments to the person who established the trust. Most of this legislation has not yet been tested in the courts, and parties should therefore exercise great caution in using many of these trusts.

      Moreover, the Federal Bankruptcy Act of 2005 limited the usefulness (in a bankruptcy situation) of many of the trust provisions that had been authorized

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[6] Almost all large organizations will provide so-called directors and officers liability insurance for members of the organization's Board of Directors (or Board of Trustees), and for certain executive officers. This is often referred to as D & O coverage. Due to cost considerations, many small organizations do not have D & O liability insurance. Prior to serving on a board of directors (or on a non-profit organization's board of trustees), careful consideration should be given to whether the organization has this kind of insurance. The insurance will pay many of the costs of defending a lawsuit against the directors, which could otherwise be a huge burden to individual defendants. D & O insurance does not cover all actions of directors and officers, but it can be a significant help in the event of litigation. Directors and officers should also take reasonable steps to protect their personal assets, and not simply rely on D & O insurance coverage.

[7] Rousey v. Jacoway, 544 U.S. 320, 125 S. Ct. 1561 (2005)

[8] These states include Alaska, Delaware, Missouri, Nevada, Oklahoma, Rhode Island, South Dakota, Tennessee, Utah and Wyoming.

by some of this legislation. The 2005 bankruptcy statute established a ten-year period in which to attack a so-called domestic asset protection trust. That is, if you set up such a trust and file for bankruptcy within ten years, the trustee in bankruptcy may be able to reach the trust assets if it is determined that the trust was established to hinder or delay creditor claims. Proponents of the Nevada, Delaware and Alaska asset protection trust will argue that the recent bankruptcy limitations are not all that important because if you plan properly, there is no reason you should end up in bankruptcy. However, the fact that these statutes have not yet been tested in the courts continues to make many planners wary of using them at this time. While certain domestic asset protection trusts may be worth considering under certain circumstances, the bottom line is that there is no magic state trust statute that will definitively protect your assets.

b. Irrevocable Life Insurance Trusts. Irrevocable life insurance trusts (ILITs) can be a great estate planning tool under the right circumstances. ILITs have the added benefit of providing significant asset protection.

Life insurance owned by an ILIT is not generally part of the insured's estate (for both federal and Ohio estate tax purposes). An ILIT will be most effective if it is formed prior to acquisition of the life insurance policy. The ILIT directly purchases the insurance policy or policies. If the ILIT is formed properly creditors of both the settlor and the beneficiaries should have no rights in either the cash value or the death benefits of the insurance.

Assets of an ILIT should also generally be immune from claims in a divorce or dissolution of marriage. An ILIT (unlike certain other trusts such as so-called marital declaration trusts, credit shelter trust event and/or QTIP trusts) may also provide for termination of a spouse's interest in the event of remarriage.

Whether or not an ILIT is suitable depends on the particular facts and circumstances. Moreover, the insured has to effectively give up control of the assets held in this type of trust; and the fees and expenses to set up such a trust also have to be considered. In some circumstances, however, an ILIT can be a valuable estate planning tool, and also provide significant asset protection opportunities.

c. Dynasty Trusts. So-called "dynasty" trusts are designed to maintain assets in a trust through a number of generations. The term "dynasty trust" is frequently associated with planning for very affluent individuals. Such a trust, however, may be appropriate for certain persons who do not have enormous net worth. There must simply be a sufficient amount of assets to justify administrative costs (including trustee fees) of the trust.

In simple terms, a dynasty trust provides that assets will continue to be held in trust through successive generations, rather than being distributed directly to beneficiaries upon the death of certain persons. Normally, trust assets are distributed to a beneficiary when he or she reaches a certain age. In a dynasty trust, the assets continue to be held in a trust, usually indefinitely. The beneficiaries can use the assets, but they do not own the assets. There are pros and cons to this arrangement. One of the advantages, however, is that the assets in the trust are generally beyond the reach of creditors of the beneficiaries in the event of divorce, court judgments and other financial difficulties.

d. Spendthrift clauses. Many other types of trusts include so called "spendthrift" clauses which limit the rights of creditors to reach the assets of trust beneficiaries. Ohio Revised Code Section 5805.03 prevents creditors of a beneficiary of a completely discretionary trust from reaching the beneficiary's interest (even if the trust does not specifically include a spendthrift clause). Spendthrift provisions can provide a good deal of protection. Spendthrift clauses do not, however, protect trust assets from claims of creditors of the settlor of the trust. The "settlor" is the person who initially establishes the trust. For example, Section 5805.06(A)(2) of the Ohio Revised Code provides that creditors of the settlor of an irrevocable trust may reach the maximum amount that can be distributed for the settlor's benefit.

e. Updating Current Wills and Trusts. Your current will, trust and related estate planning documents should be reviewed periodically with a specific view toward asset protection considerations. For example, your will or trust may provide for distributions to children and/or other family members at an early age. Once distributed, these funds will of course be subject to the claims of those beneficiaries' creditors. They could also be reached in the event of a beneficiary's divorce. It might be preferable to hold the assets in trust for a longer period of time to protect them from such claims.

3. Personal Residence. A debtor's personal residence is a natural target of his or her creditors. Some states (Florida, in particular) provide special protection for your home against claims of creditors. Currently, Florida's protection is so strong that some debtors have re-located to Florida solely to take advantage of this protection. Texas also provides a very strong homestead exemption. Ohio, however, currently provides almost no statutory protection. The current homestead exemption in Ohio is $5,000.[9] It is one of the lowest in

[9] Ohio Revised Code Section 2329.66

the country. Furthermore, Ohio law does not permit residents of Ohio to utilize the federal bankruptcy exemption.[10] Even in bankruptcy, therefore, Ohio residents have only a $5,000 homestead exemption. There are huge variations in state homestead exemptions. Texas and Florida are essentially unlimited; Nevada is currently $550,000.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 has significantly curtailed the previous ability to move from state to state to take advantage of a better homestead exemption. Essentially, the federal law provides that the state homestead exemption is limited to $125,000 if the debtor moved within 3 years and 4 months of the bankruptcy and in certain other limited circumstances. Note that this limitation applies only in bankruptcy, and not to a creditor's action outside of bankruptcy.

In several states, debtors may benefit from re-titling their residence as "tenants by the entities." Ohio, however, does not currently recognize this form of home ownership.

In light of the fact that Ohio provides no meaningful form of statutory homestead exemption, we look at alternative means of protection for our Ohio clients. We can sometimes gain some protection for clients through certain trusts. We frequently advise re-titling the house in the name of the spouse who is least likely to face future litigation.

Not all trusts provide creditor protection. Certain trusts, however, may provide some protection for a residence. A so-called qualified personal residence trust (QPRT) is one such trust; but this arrangement only makes sense in a limited number of situations. A person setting up a QPRT irrevocably contributes his or her house to a trust, but retains the right to live in the house. The trust can be structured so that the rights of beneficiaries are beyond the reach of their creditors. The interest of the settlor is subject to claims of his or her creditors, but this interest is illiquid. A creditor could file a particular action or take other steps to reach the settlor's interest, but this would be difficult and expensive. As a practical matter, therefore, a QPRT provides significant asset protection. However, because the trust settlor is basically irrevocably transferring his or her interest in the residence, this planning technique is only useful in certain situations.

Spendthrift clauses and other provisions of credit shelter trusts or so-called special needs trusts may also provide protection against creditors of the beneficiaries of these trusts.

4. <u>Divide Assets Between Spouses</u>. Simply dividing assets between spouses may offer some protection, and can also be important in some situations for estate planning reasons.

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[10] Ohio Revised Code Section 2329.662

It is generally not advisable to have all assets titled in the name of one spouse. Most of us are not paying constant attention to how our assets are titled. Various changes in our lives, such as receipt of an inheritance, can sometimes cause a disproportionate amount of a married couple's assets to be titled in the name of one spouse. A periodic review of how assets are titled is highly advisable.

5. Life Insurance. In many states life insurance death benefits and/or cash values are exempt in whole or in part from claims of creditors of the insured. In Ohio, for example, insurance death proceeds are exempt by statute if paid to the spouse, children, and certain other designated beneficiaries.[11]

SPECIFIC ASSET PROTECTION NEEDS OF CERTAIN PROFESSIONALS

Asset protection for physicians, architects, engineers and other professionals may require attention to particular insurance or other planning considerations. Real estate developers also tend to have specific asset protection needs. Certain individuals who are affluent (especially those with significant liquid assets) and persons contemplating marriage (especially second marriages) can also benefit from asset protection planning.

For example, despite all the fears of physicians about crippling malpractice verdicts, most medical malpractice verdicts do not in fact exceed the insurance limits. So do physicians need asset protection planning? Absolutely yes. The planning should focus, however, on a number of items that physicians often do not view as potential problems including a business succession plan for their practices (for private practice physicians) and general estate planning needs. And since a malpractice verdict could of course exceed insurance limits, physicians in private practice should consider having real estate, equipment and accounts receivables in separate limited liability companies.

Physicians, architects, engineers, closely held business owners, public company directors and officers and other professionals all have somewhat different asset protection needs. This is precisely why one product (for example one type of trust) is not good for all situations. The attorney assisting with asset protection planning should not be trying to market a particular type of trust or other product. He or she should conduct a thorough analysis of the particular needs of the client and then recommend strategies tailored for that individual client.

OFFSHORE ASSET PROTECTION OPTIONS

If justified by particular circumstances, there are a variety of more involved asset protection strategies that could be worth considering. For example, if your U.S. business entity is doing business overseas (which is increasingly common, even among smaller U.S. businesses), formation of one or more non-US entities may be appropriate and advisable for a whole host of

[11] Ohio Revised Code Section 3911.10.

business reasons. In some instances, these offshore companies could also provide asset protection. Almost all large U.S. corporations now have non-U.S. affiliates.

OFFSHORE TRUSTS AND OFFSHORE INSURANCE

A number of offshore jurisdictions have enacted trust laws that provide significant protection for debtors. An example is St. Vincent in the West Indies. Its trust laws have a number of separate provisions that make assets held in a St. Vincent trust very difficult for a U.S. creditor to reach. One such provision is that St. Vincent simply does not recognize foreign judgments with respect to trusts. If a U.S. creditor has a judgment against a debtor in the United States, the creditor cannot collect assets of that debtor held in a St. Vincent trust without filing a new action in St. Vincent. That new action will be subject to numerous requirements that put obstacles in the creditor's path. Jurisdictions such as St. Vincent also provide very short statues of limitations for fraudulent transfers. Such an offshore trust is not without risks; it will be expensive; and may not provide absolute protection; but the assets in such a trust will be far more difficult for creditors to reach than if they were held in the United States.

In practice, the formation of trusts or entities in certain locations can sometimes do more harm than good. Judges are naturally skeptical of entities formed in places that most Americans have never heard of. There are various other risks involved with offshore entities formed in places like St. Vincent. On the other hand, formation of an entity say in Great Britain (especially by U.S. corporation that does some business in Europe) may not raise any concern. There may be perfectly legitimate business reasons for forming such an entity. The U.K. Partnership Act of 2000 created a new form of legal entity in the United Kingdom called the limited liability partnership. It is similar to a U.S. LLC. Having such an entity as part of the U.S. company's business organization may be appropriate, and should not raise any abnormal concerns with a U.S. judge. Creditors, however, could have a much harder time reaching the assets of the U.K. entity than the assets of a U.S. entity.

Again, there are various risks associated with offshore trusts and other offshore entities. Forming the entity in say Great Britain can minimize many of these risks. Trusts and/or business entities can also be formed in other economically and politically stable countries, particularly British Commonwealth countries. Assets can be held by a Swiss custodian, so they are not actually in the situs of the trust. Assets of offshore trusts and offshore business entities can even sometimes be held in the United States, although this often makes them much easier for the U.S. creditors to reach. Another alternative (to avoid currency fluctuation) is to hold assets in a foreign account denominated in U.S. dollars.

High net worth individuals may be able to utilize offshore variable life insurance in combination with offshore trusts as part of an asset protection plan. Certain offshore life insurance products can provide more flexible investment opportunities and other advantages in addition to asset protection.

OFFSHORE BUSINESS ENTITIES

In our global economy, many U.S. businesses (even small and medium sized companies) have affiliated entities outside the United States. In some instances, the assets of these non U.S. entities can be much more difficult for U.S. creditors to reach. For example, The New York Times recently had a front page article explaining that foreign courts are far less likely than U.S. courts to enforce punitive damage awards.[12]

One lawsuit discussed in the New York Times article involved a fifteen year-old killed in a motorcycle accident. The buckle of his helmet failed, and he died when his bare head hit the pavement. His mother sued the Italian company that made the helmet. An Alabama court awarded her $1 million but the company simply refused to pay. When the family tried to collect on its judgment in Italy, the Italian courts refused to enforce the judgment. The Italian Supreme Court held that punitive damages were not in accord with Italian notions of justice. Only compensatory awards would be enforced. Courts in many other foreign countries will also likely refuse to enforce punitive damage awards.

An American company would not likely move to Italy or some other country for this reason alone. The point, however, is that assets held outside the United States can simply be much more difficult for a creditor to reach than if those assets were held in the United States.[13]

The main point to remember is this: in today's global economy, the use of offshore trusts or business entities could be perfectly reasonable and appropriate under many circumstances.

TAXATION

The United States taxes its citizens on income received anywhere in the world. U.S. tax law specifically requires U.S. citizens to disclose foreign accounts. In fact, offshore trust result in a variety of reporting requirements for U.S. citizens. Neither offshore trusts nor domestic trusts automatically provide tax advantages. In fact, many are tax neutral for both income and estate tax purposes. Certain trust arrangements can, however, be properly used for tax planning purposes. For example, an irrevocable life insurance trust can provide very significant estate tax savings in many instances. It is a big misconception, however, that offshore or domestic trusts automatically provide tax advantages.

ROLE OF THE ATTORNEY

[12] Adam Liptak, "Foreign Courts Wary of U.S. Punitive Damages," N.Y. Times, Mar. 26, 2008, p. 1.
[13] Again, there can also be significant risks in having assets in certain foreign countries.

The medical profession is sometimes criticized for simply treating a patient's problems after they occur (often on an emergency basis), instead of working with patients in advance to **avoid** health problems. This criticism is often unfair with respect to physicians because the physician's principal role is to treat disease. However, health care professionals can in fact provide a great benefit by urging their patients to take steps to avoid or alleviate illnesses.

Likewise, a principal responsibility of an attorney is to handle litigation when there is no reasonable way to avoid it. Attorneys, however, can also perform a great service by working with clients in advance of litigation to either prevent the litigation or strengthen the client's protection in the event there is a lawsuit (or even worse, in case there is a large judgment against the client).

Asset protection planning will be most effective if the business owner/manager involves several different professionals in the planning process (including his or her insurance agent, accountant, financial planner, and attorney). Ultimately, however, asset protection planning should only be done with the help of an attorney. Only communications with an attorney will be privileged; and the attorney-client privilege could prove critical in many instances.

An attorney offering advice about asset protection planning should have at least some prior experience in litigation. Ultimately, asset protection involves both pre-litigation planning and post-litigation planning. The attorney should also be familiar with applicable fraudulent transfer laws; different forms of business entities; trusts; IRAs and qualified plans; and at least to some extent, tax and estate planning (since these considerations often overlap with asset protection). If an attorney does not have experience in all of these areas, he or she should at least have other attorneys in the firm who have expertise in each of these areas.

TIMING

While certain asset protection strategies can properly be utilized after a problem arises, not surprisingly it is far better to consider the planning before any claim is made.

Nevertheless, even when a party is specifically aware of an actual claim, planning opportunities may still be available. For instance, the United States Supreme Court has held that when a debtor has sufficient assets to cover a claim, the debtor may be able to arrange assets in such a way as to control which particular assets can be reached by a creditor and which cannot.[14] Various other options may be available. Again, however, it is far better to plan before a problem arises.

FRAUDULENT TRANSFERS

[14] *Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc* (1999)., 527 U.S. 308.

Not surprisingly, there are statutory prohibitions against transferring your assets with the intent of avoiding your legal obligations. Whenever any assets are transferred or re-titled for protection purposes, it is critical to focus on applicable "fraudulent conveyance" laws, which give creditors the ability to void certain asset transfers and thus reach a debtor's assets in order to satisfy a judgment.

Asset protection planners must have a thorough understanding of fraudulent conveyance laws. For example, conveying an asset will be deemed fraudulent if it is transferred to prevent a creditor from reaching it to satisfy a judgment against you. Problems can arise, however, even though you have no real intent to do anything wrong, because fraudulent conveyance statutes are so broad in scope.

The Ohio Uniform Fraudulent Transfer Act (Chapter 1336 of the Ohio Revised Code) is fairly typical of the statutes found in most other states. An examination the statute reveals how broadly a fraudulent conveyance is defined. Whether a conveyance is "fraudulent" as to a creditor requires an analysis of many different factors.

Ohio Revised Code Section 1336.04 provides as follows:

> (A) A transfer made or an obligation incurred by a debtor is fraudulent as to a creditor, whether the claim of the creditor arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation in either of the following ways:
>
> (1) With actual intent to hinder, delay, or defraud any creditor of the debtor;
>
> (2) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and if either of the following applies:
>
> (a) The debtor was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction;
>
> (b) The debtor intended to incur, or believed or reasonably should have believed that he would incur, debts beyond his ability to pay as they became due.
>
> (B) In determining actual intent under division (A)(1) of this section, consideration may be given to all relevant factors, including, but not limited to, the following:
>
> (1) Whether the transfer or obligation was to an insider;
>
> (2) Whether the debtor retained possession or control of the property transferred after the transfer;

(3) Whether the transfer or obligation was disclosed or concealed;

(4) Whether before the transfer was made or the obligation was incurred, the debtor had been sued or threatened with suit;

(5) Whether the transfer was of substantially all of the assets of the debtor;

(6) Whether the debtor absconded;

(7) Whether the debtor removed or concealed assets;

(8) Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;

(9) Whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(10) Whether the transfer occurred shortly before or shortly after a substantial debt was incurred;

(11) Whether the debtor transferred the essential assets of the business to a lien holder who transferred the assets to an insider of the debtor.

Whether or not a transfer is "fraudulent" is often a complicated issue that depends on a wide variety of factors. Other terms in the statute also frequently raise complicated questions. Debtors and creditors frequently argue about whether an asset was "transferred" at all. The term "transfer" is defined very broadly in Ohio Revised Code Section 1336.01(L) to include a direct or indirect, absolute or conditional, voluntary or involuntary method of disposing of an asset or an interest in an asset. The term "transfer" includes the payment of money, a release, a lease, creation of lien or other encumbrance. Exactly when a transfer occurs can be very important and may determine whether or not a creditor can reach a particular asset. [15]

"Insiders" will receive careful scrutiny by a court that is considering whether a transfer was "fraudulent". This term is also defined very broadly. The Uniform Fraudulent Transfer Act (Ohio Revised Code Section 1336.01(G)) defines "insiders" to include relatives, partners, and

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[15] See for example *Comer v. Calim* (1998), Ohio App. 3d 599 (Ohio App. 1 Dist.). In this case, the key issue on appeal was when a transfer occurs for purposes of the Ohio Fraudulent Transfer Act. The Court ruled that a "transfer" did not occur until a Uniform Commercial Code financing statement was filed. The transfer of assets was not deemed complete until it was "perfected" by the filing of a UCC statement. Assets were physically transferred before the creditor's claim arose, but a UCC statement was filed after the claim arose. The transfer was deemed to have occurred (for purposes of the Ohio Fraudulent Transfer Act) after the claim arose, and it was therefore "fraudulent" under the Act. This case highlights the fact that careful attention must be paid to any transfer of assets among related entities.

even relatives of partners. It includes corporations in which the debtor is an officer, director or control person.

Fraudulent conveyance statutes do not make asset protection planning impossible. On the contrary they are intended only to prevent improper transfers. However, asset protection planners must pay close attention to fraudulent conveyance limitations and avoid any inadvertent violation of the applicable law.

In addition to the specific provisions of Ohio Revise Code Section 1336.04 (and/or any other applicable statute), debtors must also consider how certain transfers may be perceived by a judge who may try to "do justice" notwithstanding the words of the statute.

CREDITORS' RIGHTS

Asset protection planners must also be familiar with the various remedies available to creditors. Debtors have certain legal rights, but so do creditors. Attorneys who have represented creditors in collection actions often have a good understanding of which lawful actions of debtors make it more difficult to reach a debtor's assets.

Collection attorneys have a wide variety of legal remedies that they can use to seize or gain control of assets to satisfy a judgment. These remedies include garnishing personal wages,[16] execution against property, various forms of injunctive relief and receivership. In limited instances, a creditor may even be able to use pre-judgment attachment remedies (meaning the creditor could obtain control of property of a debtor even before the creditor has a judgment). [17] After obtaining a judgment, a creditor may be able to gain control of an asset that the debtor has transferred by setting aside the transfer as "fraudulent" under an applicable state fraudulent conveyance statute.

Asset protection planners must have a thorough understanding of the rights of creditors.

CONCLUSION

There are many "exotic" asset protection techniques, including offshore trusts, captive insurance companies, and so-called domestic asset protection trusts (in states such as Alaska, Delaware, and Nevada). Some of these are legal and may be appropriate in some circumstances and some are neither legal nor advisable. However, before any consideration is given to more complicated asset protection techniques, simply focusing on the basic planning opportunities

[16] Up to 25% of a debtor's net disposable earnings may be garnished. Federal Consumer Credit Protection Act, 15 U.S.C. §1673; Ohio Revised Code Section 2716.07.

[17] See Botti, James P., Anderson's Ohio Creditors' Rights Manual (Anderson's Ohio Practice Manual Series, Matthew Bender & Company, 2007), Chapter 5, for a detailed discussion of attachment before judgment. This publication contains a detailed presentation of creditors' rights in Ohio.

outlined above will provide a great deal of protection and peace of mind to a closely held business owner. More complicated strategies can be implemented in appropriate situations.

The foregoing is a short (and a necessarily over-simplified) summary of some basic asset protection strategies for individuals and closely held business owners. Needless to say, each of the topics outlined noted above could be discussed in far greater detail. The most important point to keep in mind, however, is that basic asset protection planning for an individual or a closely held business owner will not likely involve offshore trusts, captive insurance companies or other exotic devices. It will involve basic planning techniques that can often be implemented relatively quickly at a reasonable cost. There is no simple "product" or "magic bullet" that can be purchased off the shelf for asset protection. Each situation must be analyzed on an individual basis. Strategies best suited to a particular individual or business owner's needs can then be developed and implemented.

FURTHER READING

One of the leading books on asset protection planning is Asset Protection: Concepts and Strategies for Protecting Your Wealth by Jay D. Adkisson and Christopher M. Riser (currently the chairperson of the American Bar Association Asset Protection Planning Committee). The authors do an excellent job of outlining various asset protection techniques and they provide appropriate warnings about avoiding asset protection scams. They emphasize that each client's case must be analyzed on an individual basis; and that there is no magic plan that uniformly applies in all circumstances.

ABOUT THE AUTHOR

Kenneth J. Laino is licensed to practice law in Florida, New York and Ohio. He is a member of the American Bar Association, Ohio State Bar Association, and the Cleveland Metropolitan Bar Association. Mr. Laino graduated *summa cum laude* from John Carroll University and holds a law degree from the University of Michigan Law School. He started law practice in New York City, specializing in corporate and securities law, and for the past twenty-five years has been practicing law in Cleveland, Ohio. Mr. Laino focuses on business law, real estate and estate planning. He represents closely-held businesses and non-profit entities, and assists clients with general business, employment and commercial litigation matters. He has counseled clients for many years about asset protection planning. Mr. Laino is a member of the Asset Protection Planning Committee of the American Bar Association.