



Top 10 Ways to Protect Assets From Creditors

A common concern for many individuals, particularly business owners and professionals, is the fear of losing wealth as a result of creditors and judgments from lawsuits. With proper advance planning, however, the good news is that everyone can protect some or most of their assets, making it difficult for creditors to reach them. Of course, to become “judgment proof” requires independent tax and legal advice and involves direct or indirect costs.

Let’s take a brief look at some of the strategies, both simple and complex, that can be considered.

- 1. Review liability coverage, limits and exclusions.** A simple and inexpensive way to protect property against certain tort claims or loss is to increase premises, errors and omissions liability coverage. For example, if you are a homeowner or automobile owner, you should obtain maximum homeowner’s or automobile insurance coverage and have an excess liability (“umbrella”) policy that provides additional protection beyond the limits of the underlying policy. Given the potential awards in certain tort cases, an umbrella policy of at least several million dollars should be purchased. In addition, you should review exclusions to the liability policies. The classic example of an “exclusion” was the position taken by many casualty insurers who denied claims to homeowners impacted by Hurricane Katrina in 2005, on the basis that their homeowner’s insurance did not cover flooding. It is the responsibility of the policy owner to know what events will be covered, what is excluded from coverage and how the insurance company computes losses.
- 2. Avoid conducting business as a sole proprietor or as a general partner.** A general partner or sole proprietor is personally liable for all of the obligations of the business. If you’re a business owner, conduct business as a LLC (Limited Liability Company) or as a corporation. In general, your personal assets will be protected from the claims of creditors of the business. Keep in mind that you should operate your company as a business and not commingle personal assets and affairs with the business. This includes retaining accurate records, documenting meetings of owners and officers of the company, and titling business property in the name of the business. In addition, business funds should not be used to pay for your personal expenses. If you are a professional, such as a doctor, lawyer, engineer, accountant and other, keep in mind that personal liability from malpractice claims cannot be limited by simply conducting business in a professional corporation or LLC.
- 3. Create multiple businesses.** If possible, create multiple business entities so that the debts or obligations of one line of your business cannot be imputed to another company. Of course, there should be legitimate business reasons to have multiple businesses and each entity should be treated as a distinct company.
- 4. Have business owned employment and fiduciary insurance.** Your business should purchase liability coverage to protect the company against claims by employees for discrimination or wrongful termination of employment. In addition, a business owner is often the trustee of the company’s qualified plan. If you are in that position, you may be able to purchase insurance to protect you and the company against claims made by employees regarding violation of a trustee’s fiduciary responsibility.



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5. **Create wealth in employer sponsored qualified retirement plans.** Under ERISA (Employee Retirement Income Security Act of 1974), the account of a participant of an employer sponsored retirement plan is generally not subject to claims of personal or business creditors. The only exceptions to this rule are the IRS, and a spouse or child owed alimony or child support pursuant to a QDRO (Qualified Domestic Relations Order). Note, however, it is unclear if a retirement plan has ERISA protection if the only participant is the business owner.

6. **Create an IRA or rollover qualified retirement plan money to an IRA.** IRAs (Individual Retirement Accounts) are governed by state law, not ERISA. Most states have enacted statutes that protect IRAs entirely from creditor claims. Others protect up to a certain amount of money. Claims by the IRS, spouses and children owed alimony and child support payments pursuant to a QDRO are typically not protected.

7. **Title assets in the name of a spouse.** In general, a spouse is not liable for the debts and obligations of his or her spouse. Therefore, a simple way to protect wealth is for the spouse with less exposure to liability risk to own all property in his or her own name. Of course, there can be some unforeseen consequences. In the event of a divorce, the spouse owning the property may be legally entitled to keep it. If the spouse possessing the property dies, the property will be distributed by the terms of his or her will or trust, or by the laws of intestate distribution (if there is no will).

In community property states, in order to utilize this technique, it might be best to classify property as the separate property of one spouse.

An individual can also give property to children or to an irrevocable trust that can be protected from creditor claims. However, gifts to an irrevocable trust or other third party are subject to federal and state gift tax laws.

8. **Create a joint tenancy with your spouse.** In some states, property owned jointly with a spouse may be exempt from the general claims of creditors of either spouse, unless both spouses are debtors of the same creditor. The law varies greatly from one state to another, and may only apply to certain types of jointly owned property such as a personal residence.

9. **Create an Asset Protection Trust.** An Asset Protection Trust (APT) is a trust created in a state with favorable laws with respect to protecting trust assets from creditor claims against the person creating the trust (the "grantor"). These trusts are funded primarily with investments. In general, these trusts are designed to give an independent trustee the discretionary power to distribute trust property back to the grantor or to other family members. Since the property can be returned to the grantor, it is not considered a completed gift for gift tax purposes. APTs are complicated and available only in some states so you must seek the advice of an attorney who specializes in this field. Also, one of the trustees may be required to be a resident of the state where the trust is domiciled (i.e., state where the trust is governed which may not be the state of residence of the grantor).

10. **Create wealth in an exempt asset.** Depending on state law, certain types of personal property may be exempt from claims of general creditors even if owned by the debtor. The most common types of assets are cash value life insurance, non-qualified tax deferred annuities and a personal residence in states that have a homestead exemption. Keep in mind that the law varies greatly from one



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state to another, so you must consult with a tax and legal advisor in your local jurisdiction.

Before we end, we must make note of the concept of “fraudulent conveyance” or “fraudulent transfer.” This concept is an integral part of asset protection planning. In general, state law prohibits an individual from either transferring property or converting property into an “exempt” asset if the intent is to defraud creditors. “Exempt” assets are those that are specified by individual state law that may not be attached by creditors (e.g., homestead exemption for your primary residence). While the law may vary from one state to another, the courts will look at the individual’s intent, when the debt arose, the amount of consideration received in the asset transfer (if any), the size of the transaction, and the ability of the creditor to reach other assets of the debtor. If a transfer is considered a fraudulent transfer, it can be reached by a creditor regardless of who owns the property or the type of property owned. As a result, the best way to protect wealth is to plan for the future by implementing the applicable strategies when you are financially solvent and without debt.



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