



Wealth Preservation Concepts

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1 INTRODUCTION

Asset Protection (also known as Wealth Preservation) is a concept that has spawned a new sub-specialty within the estate planning community. Asset Protection involves the creation of one or more legal entities to prevent, limit or hinder a creditor's attempt to seize and sell a debtor's assets in satisfaction of a debt owed by the debtor to the creditor. Usually, the creditor is seeking payment arising from an award of damages obtained in a lawsuit, but asset protection will protect against most creditor's claims, regardless of origin.

Asset Protection works by changing the character of an asset held by the debtor from those that can be easily seized and sold, to assets that the creditor cannot legally seize and sell. By transferring assets into certain types of trusts or limited liability entities (corporations, limited partnerships and limited liability companies) in which the debtor owns a portion of the interest in the entity and not the asset, such as a beneficiary of a trust, stock, partnership interest or membership interest in an LLC, the creditor is restricted to the debtor's interest in the entity.

As discussed below, the debtor's interest in an entity is often worthless to a creditor, especially when the creditor is not entitled to voting or management rights with respect to the entity. Thus, by creating entities with certain restrictions, a legal barrier is imposed between a creditor's right to seize and sell a debtor's assets in satisfaction of a legal judgment or other claim, and the assets themselves. In some cases, these entities will be formed in foreign jurisdictions that claim to have favorable debtor laws.

There are two general types of asset protection:

“Formation of a domestic LLC to operate an ongoing business or real estate portfolio may avoid the application of fraudulent transfer laws, at least as to the constructive fraudulent interest portion of the statute.”

Generally, there is a four-year statute of limitations for "constructive" fraudulent transfers. For "actual intent" fraudulent transfers, legal action can be brought at any time before the later of (1) four years after the transfer was made; or (2) within seven years of when the transfer was made, as long as the action is brought within one year after the transfer or obligation could reasonably have been discovered by the claimant. (Civil Code Sec. 3439.09).

4.2 Fraudulent Transfers and Domestic Asset Protection

Formation of a domestic LLC to operate an ongoing business or real estate portfolio may avoid the application of fraudulent transfer laws, at least as to the constructive fraudulent interest portion of the statute. First, a transfer to an LLC does not render the client insolvent, since it is a tax-free exchange in which assets are transferred to an entity in exchange for an interest in the entity which is equal in value to the assets transferred. Second, the creditor has the remedy of a charging order, as mandated under state law, so there is no interference with the creditor's rights to satisfy a claim under state law and the debtor is not rendered judgment-proof.

By using the LLC structure, the rights of a creditor are altered and, depending on how the LLC is structured, a charging order may be considered by the creditor as an inadequate remedy.

By having independent business reasons for forming an LLC, such as limited liability for the members, stable management organization and facilitating estate and gift planning, the transfer should avoid the "actual intent to hinder, delay or defraud any creditor" portion of the statute. In the typical case, the actual intent portion arises when a debtor transfers title to a residence or automobile to a relative after a creditor begins to enforce collection actions.