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Chapter 1

WHAT IS INTEGRATED ESTATE PLANNING AND ASSET PROTECTION PLANNING?

¶101 Overview—What Is Integrated Estate Planning and Asset Protection Planning?

In the mid-1980s, when asset protection planning was a new concept that was not well understood, many attorneys viewed it with uncertainty. Some even questioned whether it was ethical. Today, however, the tables have turned. Asset protection planning has become a well-recognized area of practice. Many articles, magazines, and treatises have been written on the subject. The Real Property, Probate and Trust Section of the American Bar Association has formed an Asset Protection Subcommittee. Within the last 15 years, over 20 countries and several states have passed some form of asset protection trust legislation. Today, many estate planning attorneys and other wealth planners who have at least a working knowledge of the concepts involved in asset protection planning are of the view that it is a necessary component of wealth planning. Many planners feel that the failure to advise a client about asset protection planning options may be grounds for a claim of malpractice.

Safeguarding assets from the many risks to which they may be subject is not a new idea or a new planning goal. However, the prominence of Integrated Estate Planning (IEP) in the wealth planning arena has grown due to client demand, and client demand has grown due to a number of factors. These factors include concerns over expanding theories of liability and over what some perceive as judges and juries being result-oriented from time to time. There are concerns as well with traditional forms of protection such as the corporate form and liability insurance. And, while contingency fees serve purposes such as making legal services more widely available, few question that the contingency fee system results in an increased number of claims being brought, many of which involve dubious claims whose only merit is their "settlement value." For these and other reasons, the asset protection component of IEP continues to become more important by the day.

In past years, asset protection planning was often done in isolation without regard to the client's overall estate plan. At the same time, many estate planners focused solely on death-time tax mitigation, avoidance of probate, the smooth transition of property at death, and making sure the deceased's dispositive wishes were followed. As planning principles and concepts have evolved, the wealth planning community has merged these two disciplines into one inte-

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grated estate planning process—integrated estate planning. In this text it is assumed that the reader has a basic understanding of the estate planning component of IEP. Therefore, the author's focus is on the asset protection component of IEP.

.01 Definition of Asset Protection Planning

Asset protection planning is the process of organizing one's assets and affairs in advance so as to safeguard against risks to which the assets would otherwise be subject. The phrase "in advance" warrants strong emphasis. One who is planning to protect assets must be cautious and avoid the negative implications that may follow if there are creditors who are entitled to remedies under applicable fraudulent transfer and similar laws. Asset protection planning principles can be applied to protect any type of asset, including an operating business or a professional practice (see ¶115).

.02 Why Asset Protection Planning?

Safeguarding assets from the many risks to which they may be exposed is not a new idea or a new planning goal. Asset protection today is more in the forefront of planning because of expanding theories of liability. New liability theories are sometimes coupled with results-oriented judges and juries who make decisions based more upon a desired outcome than upon the law. An ever-present concern includes some of the high-dollar jury awards we hear about today. Asset protection must be addressed in today's legal arena because of concerns with the adequacy of traditional forms of protection. Although there are arguments for and against the contingency fee system, it is undeniable that our current legal system, coupled with contingency fees, has helped contribute to the litigation explosion. For this reason, asset protection planning is increasingly important (see ¶125).

.03 Goals of Asset Protection Planning

The goals of the asset protection component of IEP are varied but all must be addressed to create a high-quality plan. The plans must be user-friendly or they may be doomed from the beginning. Because simply being named a defendant in a lawsuit is often a loss in the client's mind, plans must be drafted to deter litigation. The plan must provide an incentive for an early and cheaper settlement if it fails to deter the litigation at the outset. Leveling the litigation playing field is another important goal. This leveling enhances the client's bargaining position. Any plan must be flexible enough to provide options to the client and to the planning structure over time. The main goal of any plan is for the client to ultimately "land more softly" than the client otherwise would. Once goals are discussed with the client, the planner should incorporate them into both the asset protection and estate planning components of the IEP (see ¶135).

.04 The Foundations of Integrated Estate Planning

There are two principal foundations underlying the concepts embedded in IEP and its asset protection component. These are: (1) that property is either more vulnerable or less vulnerable to a judgment creditor or the judicial process in

general, depending on how it is held or titled, and (2) a judgment creditor can only access what one owns and not what one used to own (see ¶ 145).

.05 Engel Ladder of Asset Protection Planning Tools

There is no one asset protection planning tool or technique that universally protects all of a client's assets, so a plan needs to involve a mix of the various tools and techniques available to the planner. The Engel Ladder of Asset Protection Vehicles identifies the various tools available to the asset protection planner and arranges them in ascending order of efficacy. At the bottom of the ladder is gifting, midway up the ladder is the family limited partnership, and close to the top of the ladder is the foreign integrated estate planning trust (IEPT) (see ¶ 155).

.06 The Engel Maxims of Asset Protection Planning

Although there is no one right way to design an asset protection plan, there are many wrong ways to design one. The planner must be familiar with all of the asset protection planning vehicles at his or her disposal. In order to effectively use the different types of asset protection tools, the planner must be familiar with the strengths and weaknesses of each of them (see ¶ 165).

.07 What Asset Protection Planning Is Not

As important as it is to know what is the asset protection planning component of integrated estate planning, it is equally important to know what it is not. Asset protection planning will not aid a client in evading the payment of taxes. Asset protection planning is not based on secrecy or on hiding assets. Asset protection is not a means or excuse to make fraudulent transfers (see ¶ 175).

.08 Does Asset Protection Work?

Some of the reported cases have involved poorly designed and poorly conceived asset protection plans and this has led some practitioners to question whether asset protection planning really works. In most situations, if a threat to assets develops, a properly-structured asset protection plan that is integrated with an overall estate plan will result in a post-threat outcome that is a large improvement over the outcome that would have otherwise resulted. The specific result will usually depend upon several variables, as discussed in ¶ 185 below.

¶ 115 Definition of Asset Protection Planning

Asset protection planning may be viewed as the lifetime side of estate planning, and may be defined as the process of organizing one's assets and affairs in advance in order to guard against risks to which the assets would otherwise be subject.

In order to guard against such risks, in most situations, assets will be transferred from an unprotected form of ownership (e.g., direct individual ownership) to a different type of ownership or asset using an asset protection vehicle (see ¶ 155). Sometimes this transfer may involve moving assets from a nonexempt form to an exempt form. An in-depth discussion of using exemptions as a planning tool is discussed beginning at ¶ 501. Other times, such a transfer may be to a family limited partnership. Using family limited partnerships in asset

protection planning is discussed beginning at ¶801. In many cases, the family limited partnership will be combined with a foreign integrated estate planning trust (IEPT) to maximize both the asset protection and the estate planning goals of the client. Integrated estate planning trusts are discussed and analyzed throughout this book.

> **Planning Note:** The client should understand exactly what is and is not included as part of the client's asset protection plan. A good place to document this information is in the fee agreement. The fee agreement should give a detailed description of what is and is not included in the fee charged by the planner. After the client has had time to review the agreement and discuss its provisions with the planner, the agreement should be signed by the planner and by the client. For a sample fee agreement, see Practice Tool ¶10,460.

The concept of asset protection planning done *in advance* of a claim or even a threat cannot be stressed enough. Since asset protection planning generally involves the transfer of assets from a less protected to a more protected form, everyone involved in the plan (including the planner) must endeavor to avoid establishing a protection plan after the client's assets have been "attacked." Protecting assets after there are claims or threats could expose the client and planner to criminal and/or civil liability. All involved in the asset protection plan, including the planner, must be cautious and avoid the negative implications that may follow from failing to plan to protect assets in advance of when there are creditors who are entitled to remedies under applicable fraudulent transfer and similar laws. For more on fraud and fraudulent transfer issues, see the discussion beginning at ¶201.

Asset protection planning concepts may be applied to protect every type of asset, whether cash, stocks, bonds, business interests, insurance proceeds, jewelry, art, antiques, real property, and so on. Although asset protection planning is typically applied in the context of protecting individually accumulated wealth, a number of applications exist for the operating business or professional practice (referred to as Level II Planning—see the discussion beginning at ¶1901).

¶125 Why Asset Protection Planning?

The idea of safeguarding assets from the many risks to which assets are subject is certainly not a new concept. For Americans and, increasingly, for persons in other countries, this is particularly the case with regard to protection from the potential of a future legal liability. Indeed, today a client whose attorney fails to advise him or her to incorporate a business or form a limited liability company to protect the client against the personal risks of owning and operating a business would no doubt wish that his or her own asset protection planning was in place. The importance of this question and the reasons for asking can more easily be illustrated through the following example.

> **Example:** Anne Fasbee was a senior tax partner in the Los Angeles office of a nationwide accounting firm. She was a professional who was thorough and ethical in her work. She was also extremely hard working and

successful. By the time she was in her early forties, she was earning a high salary and had managed to accumulate a sizable net worth.

Fasbee was as diligent with her personal affairs as she was with her clients' affairs. Her estate and her spouse's estate were as well planned as they could be (or so they thought). They had pour-over wills, revocable living trusts, durable springing powers of attorney, living wills, a recently funded irrevocable insurance trust, a trust for each of their three children, burial instructions, and a charitable remainder unitrust. The Fasbee financial plan was also finely tuned with net after-tax returns for the previous several years reaching well beyond the upper reaches of expected norms. Unfortunately, as well planned as the Fasbees' estates were, one very important form of planning soon became quite conspicuous by its absence—asset protection planning.

The first of a series of lawsuits was served upon Fasbee's accounting firm in the latter part of the 1980s, shortly after the Fasbee family returned from three weeks in Spain and Italy. This suit was a class-action suit alleging, among other things, that fraudulent and misleading financial statements were prepared by the firm's Houston office in connection with a public offering of subordinated debentures. The next two suits involved allegedly faulty tax opinion letters rendered by the firm through its offices in Denver and Chicago. Several other suits followed as well. After failing to have two adverse judgments reversed on appeal and following the tremendous drains on the firm's cash and other resources due to the strains and expenses of "fighting the battles," the partners voted to seek federal bankruptcy protection for the firm. Consequently, many of the firm's partners had no choice but to do the same. This included Fasbee and, because she and her family resided in a particular community property state, her spouse as well. Therefore, the community assets were available to satisfy the separate debts of either spouse.

At last report, Fasbee was a single parent and solo practitioner sharing office space with a number of other professionals. Because of this most unfortunate personal experience, Fasbee learned that all of her sophisticated estate and financial planning was of little value to an estate that was itself of little value.

Planning Note: Had the Fasbees taken an integrated estate planning approach to their overall planning, the ultimate outcome of their misfortunes would likely have been much more favorable. It certainly would not have been any worse.

A number of factors evolved in the 1980s and into the 1990s that made persons with wealth not only more aware of the need to engage in some form of protective planning, but which in fact leave those who fail to plan more exposed than ever before. These factors are not strangers to the first several years of the new millennium.

.01 Expanding Theories of Liability

A legal system whose court decisions are based on legal precedent will often be subject to expansion of its theories of liability. Each decision in the chain will set the stage for the next step of expansion. This, coupled with the apparent and increasing willingness of some judges and juries to expand a theory of liability, leaves a tremendous amount of uncertainty and exposure for the person who has relied on traditional liability principles.

Twenty years ago, the idea that a smoker who developed lung disease would sue a tobacco company seemed ludicrous, but today we have become familiar with this commonplace theory of legal liability. Is it possible that in 10 years we will become familiar with a situation in which people with a more carnivorous persuasion develop heart disease and sue the grocery store where they had purchased their red meat over the years? Even as of just the first writing of this text in 2000, who would have thought that the McDonald's Corporation would be targeted in obesity lawsuits?

.02 Concerns Over High Jury Awards

The popular press headlines are frequently filled with cases that resulted in high jury awards to the plaintiffs. These types of articles are often what motivate someone to proceed with asset protection planning. This is easily understood when a planner considers articles similar to the one covering the $38 million jury award to the 26-year-old couple who did not like the way that a Mississippi bank treated them when the bank repossessed their car.[1] Lest we forget, there is the famous McDonald's hot-coffee-in-the-lap case.[2]

.03 Concerns with Traditional Forms of Protection

The corporate veil seems to be pierced far more than ever before. Concerns with insurance coverage exist as well, whether it is with the solvency of the carrier, its continued willingness to write coverage, the existence of policy exclusions (e.g., punitive damages or damages that result from acts of gross negligence), or the like. For more on how insurance works in asset protection planning, see the discussion beginning at ¶701.

.04 Jury of One's Peers

People of wealth who have ever needed to consider the right to a trial by jury have frequently felt that, if sued, they would never have a jury of their peers. Few litigators can claim to have ever tried a case before a jury comprised of individuals whose average net worth even approached that of the wealthy defendant.

.05 Deep-Pocket Syndrome

Frequently, trial lawyers will base part of their case analysis on whether the potential opposing parties could pay a judgment against them. A party with

[1] Martha Brannigan, "Why a Mississippi Jury Found a Small Dispute Worth $38 Million," *Wall St. Journal*, Apr. 12, 1995, at A1.

[2] Milo Geyelin, "Just Imagine: What Might Have Happened to Noted Plaintiffs Under Legal Overhaul," *Wall St. Journal*, Mar. 28, 1995, at B1.

sizeable assets and an ability to pay is considered a deep-pocket defendant. An example of this is an advertising campaign from a few years ago by an asset search firm showing two lawyers huddled over a table with one of the lawyers commenting to the other that "the defendant has assets, so let's proceed." The converse to this would be that "the defendant does not have much, so let's not bother."

Many good arguments may be advanced on behalf of the contingency fee system. However, at least as many good arguments may be advanced against the contingency fee system. These arguments include the manner in which the system fuels litigation and otherwise often results in groundless or frivolous suits being brought by a plaintiff's counsel whose hope is to reach a favorable settlement with the client rather than to proceed to a trial on the merits.

.06 Once You've Been Sued, You've Lost

Defendants experience a broad range of powerful emotions. These emotions run the gamut of fear, anger, and self-doubt. Once sued, defendants often feel that no matter what may happen, they have already lost.

The psychology affecting the players in the drama of a lawsuit actually can have a greater effect on the ultimate outcome of the lawsuit than the actual facts. Defendants are at a considerable psychological disadvantage. Experienced plaintiff's attorneys know this and know how to exploit this to the benefit of the plaintiff. In contrast, the defendant may feel as if he or she is carrying the full weight of the U.S. legal system on his or her back.

Often, being sued is a major life event that the defendant wants to bring to an end at the earliest possible moment. Many are willing to pay "too much" to do so. Imagine a scenario wherein a defendant is found *not* liable five years after the initial complaint was filed and after spending hundreds of thousands of dollars in legal fees. In the interim, the defendant has had many sleepless nights and has suffered tremendously both in terms of anxiety and inconvenience. The defendant's business and marriage likely will have suffered from absences and distractions. But, . . . the defendant won!! Perhaps it would have been preferable either to have discouraged the suit in the first place or to have been in a position to encourage an early and less expensive settlement.

It is unfortunate that efforts at tort reform have done little to curb the ever-increasing spiral of lawsuits.[3] The nature of the U.S. system where, generally, each party bears its own costs and expenses has the effect of shifting much of the financial burden of litigation to the defendant. Surprisingly to some, the U.S. rule is the exception. Much of the rest of the world follows the "loser-pays" rule.

¶135 Goals of Asset Protection Planning

Having defined the asset protection planning component of integrated estate planning (see ¶115) and having analyzed the reasons that this form of planning

[3] David McIntosh, "Without Malpractice Reform, Forget Health-Care Reform," *Wall St. Journal*, Sept. 22, 1993, at A19.

has become increasingly popular (see ¶125), the next inquiry is what goals do planners and their clients seek to accomplish. The planner must consider making a user-friendly plan or the client will never use it. The plan should naturally deter any litigation, but once that is initiated, the plan should try to steer the outcome to a favorable settlement. This is accomplished by leveling the playing field in the litigation arena by improved bargaining positions that are flexible enough to change while the litigation runs its course, with the intent being to win the game for the client.

.01 Create a User-Friendly Plan

Planners sometimes too easily forget that most clients are laypersons who must live within the confines of the plan designed for them and deal with it on a sometimes daily basis. Asset protection plans that consist of myriad of entities designed to obfuscate and confuse third parties may also serve to confuse and frustrate the client. A properly designed structure that works because it is sound in legal theory and operation, rather than because it is complex, is not only better for the client but ultimately more protective as well.

.02 Deter Litigation

Avoiding the deep-pocket syndrome (see ¶125.05) by reducing the size of the target may itself accomplish much in the asset protection context. Wealth is, of course, a target or a magnet for lawsuits in the United States. Those with wealth are often involved in many activities that increase exposure to litigation. Liability insurance, although designed to solve the problem, may simply become a substituted target, and may in fact encourage or attract litigation.

.03 Provide Incentive for an Early and Cheap Settlement

Economics drive the legal system. Personal experience proves that much can be achieved by knocking the "profit" out of the pursuit and by being able to demonstrate to a claimant that being paid is not the given that it was expected to be. Any seasoned litigator would confirm that it is one thing to win a judgment but another thing to collect a judgment.

.04 Level the Litigation Playing Field

A defendant who has no asset protection planning in place will have fewer strategies and defensive maneuvers available at critical points during the course of litigation. A properly designed asset protection plan will, by its nature, create numerous issues with which some future adversary will have to contend. In fact, it may even be possible to tilt the playing field back in favor of the client and thereby overcome the "once you have been sued you have lost" psychology.

.05 Enhance One's Bargaining Position

Throughout the course of litigation, one who has a well-designed plan in place will have the benefit of a vastly improved negotiating position as a result of the mere fact that the planning was properly conceived and implemented. Well-positioned clients may even have the privilege of playing hardball with the other side.

.06 Provide Options as the Game Is Played

A well-tailored plan will not tie the client's hands or lock the client into a course of action that must be followed regardless of what happens. Rather, it will provide a series of options to the client that would not otherwise exist.

.07 Win the Game

Proper planning will create a series of hurdles that the opponent must clear. With the realization that a deep-pocket, driven, emotional plaintiff may have the stamina and strength to clear the hurdles, the planning must ultimately work because it is legally sound. Therefore, a proper plan will construct a brick wall on the other side of the last hurdle. A plan that merely attempts to stay one step ahead of the pursuit may end up being no plan at all. "Flight" clauses (see ¶1065.03) and "hop-scotching" jurisdictions may be incorporated as a part of the overall plan, but should not be relied upon to win at the end of the day.

It also is important to note that the plan should be designed to ultimately protect against *any* potential adversary. Life is more random and less lineal than we would like to think. For example, a client may have some sort of free-floating anxiety over the possibility of a professional malpractice claim being filed at some point in the future. However, a problem of a completely different nature (e.g., a dispute resulting from a future business transaction or a slip-and-fall action) could certainly develop. Subject to the goals of the client, the proper plan should protect against future perils regardless of source or nature.

¶145 Foundations of Asset Protection Planning

There are two principles that are so key to the asset protection component of integrated estate planning that they can be said to be the foundations of asset protection. First, property will either be more vulnerable or less vulnerable to a judgment creditor, depending on how it is owned. In other words, a client who owns a million dollar managed account outright and in her own name will learn just how vulnerable that account is, if and when she suffers a large judgment. If that same account was simply held in the form of a family limited partnership with her spouse, or as tenants by entirety with her spouse, then she would see how much the level of vulnerability has been reduced. Similarly, if the account was contributed to a domestic trust or a foreign trust. Thus, part of asset protection planning may simply involve the planner taking an inventory of what property is owned by the client and how it is owned by the client, and then changing the manner and form of ownership so that it is held then and thereafter in a less vulnerable manner.

The second foundation of asset protection is that a judgment creditor can only access what one owns, not what one used to own. This principle may best be illustrated by an example.

> **Example:** In a sudden, year-end burst of generosity, a client makes a one million dollar cash donation to the local office of the Red Cross. One year later a cause of action accrues against the client, and three years later a large judgment is entered against the client. The judgment creditor would

prefer to go after the cash donation rather than the illiquid assets the client/judgment debtor then owns. Absent the judgment creditor prevailing on a claim that the gift to the Red Cross was in fact a fraudulent transfer (extremely doubtful under the facts), the judgment creditor will not be successful in getting the Red Cross to "hand the money over." This is because the client divested himself of the asset well before the cause of action accrued against him, and because in general a judgment creditor can only access what one owns and not what one used to own.

In part, then, asset protection planning involves working with clients to divest themselves of assets so that if they are sued someday for something, they are not the owner of the subject assets. How a client can divest himself or herself of assets and still retain a degree of control over the property and/or benefit under the property is, of course, a goal that is discussed throughout this book.

¶155 Engel Ladder of Asset Protection Planning Tools

There is no single asset protection planning tool or technique that universally protects all of a client's assets or that is an ideal match for all clients. Asset protection plans will almost always involve a mix of the various tools and techniques available to the planner.

In determining what tools to use in the mix, the asset protection planner must analyze and take into consideration a number of factors. These will include, but are not limited to, the goals of the client, the concerns and sensitivities of the client, the nature of the assets to be protected, the location of the assets involved, and the net worth of the client.

The Engel Ladder of Asset Protection Vehicles identifies the various tools available to the asset protection planner and arranges them in good-better-best fashion, in ascending order of efficacy. Next appears a list of each rung of the Engel Ladder of Asset Protection Vehicles beginning with the least effective form of asset protection and ascending to the most effective form:

- Gifting (see the discussion beginning at ¶301);
- Joint ownership (see the discussion beginning at ¶401);
- Exemption planning (see the discussion beginning at ¶501);
- Foreign life insurance and annuities (see the discussion beginning at ¶601);
- Insurance (see the discussion beginning at ¶701);
- Family limited partnership (see the discussion beginning at ¶801);
- Domestic trust (see the discussion beginning at ¶901);
- Foreign trust (see the discussion beginning at ¶1001);
- Stiftung or civil foundation (see the discussion beginning at ¶1345); and
- Expatriation (see the discussion beginning at ¶1401).

See the Practice Tool at ¶10,020.

Creditor exempt retirement plans and like plans are conspicously absent from the Engel Ladder. The reason is that while such plans offer the subject assets varying degrees of asset protection, they are not the type of vehicle that one can create and then fund with the bulk of his or her estate. To the extent exemption type protection is afforded, the reader is directed to Chapter 15.

Also conspicuously absent from the Engel Ladder are bearer share corporations. The reason is that to the extent such entities are used for asset protection, they are often used as part of an approach that involves secrecy. Secrecy-based planning is not recommended by the author. See ¶175.02.

Foreign (offshore) corporations are also absent by design from the ladder. The reason is that the formation of a corporation (whether domestic or foreign) merely entails the substitution of one asset for another (e.g., cash in, stock back), and that which is received back is not really much less attractive to a future potential creditor. There is no "charging order" or like protection that goes with what is received in exchange for the contribution, as there is when a contribution is made to a limited partnership or like vehicle. See ¶815 for more on the charging order concept.

¶165 The Engel Maxims of Asset Protection Planning

To effectively understand the Engel Ladder of Asset Protection Planning (see ¶155), the planner must clearly identify the goals of asset protection planning. There are several helpful, basic maxims to observe when performing asset protection planning services for a client.

.01 Better to Look Ahead and Plan Than to Look Behind and Regret

Many options that a client will want available must be planned for and created in advance of a legal challenge. After the storm clouds have gathered, and even as they are brewing on the horizon, the range of planning possibilities will certainly have narrowed. Some planning options may even be eliminated altogether.

.02 Asset Protection Planning Should Be a Way of Life, Not a Reaction to a Problem

People in business usually learn the wisdom of avoiding unnecessary risks. If there is a relatively straightforward and cost-efficient method by which one can implement a plan in advance, then such a plan should at least receive thorough consideration. Ensuring that the client consistently follows through with the adopted plan by virtue of the client's subsequent actions is equally important to the overall plan.

.03 Asset Protection Planning Is a Vaccine, Not a Cure

Asset protection planning is most effective when done *before* the client has a problem. It is a vaccine for the prevention of creditors and is not a cure for "ailments" already contracted.

.04 Don't Sweat the Last Three Percent

This maxim of life management has broad application in the asset protection arena. A cost-benefit analysis run on protecting "the last three percent" (as a figure of speech) may just not pan out, whether from a financial point of view or from the client's personal point of view.

.05 Hope the Asset Protection Plan Will Prove to Be a Waste of Time and Money

The author's hope for his clients is that they will someday view the entire exercise as a waste of time and money. Why? Because with 20/20 hindsight the client will see that the "need" for the plan never came to pass—there was never a suit, claim, or threat made against the client. In this regard, asset protection planning is very much like a fire insurance policy on one's home. The policy is taken out, the premiums are paid, and the insured hopes he or she never has to make a claim under the policy, and that the premiums are a waste of money. Of course, if there is a fire . . .

.06 There Is No Such Thing as the Perfect Offshore Financial Center

Depending on how one classifies, there are more than 60 offshore financial centers (OFCs). Each has different attributes and characteristics, and none can be said to be the "perfect" jurisdiction. In the course of designing the asset protection plan with foreign or offshore elements, the planner is well advised to take advantage of the best of what each OFC has to offer. For example, it would not be unusual to design and implement a structure that utilizes a Cook Islands trust with an Isle of Man limited liability company that holds a managed account in Switzerland.

.07 There Is No One "Right" Way to Design an Asset Protection Plan

If five qualified and experienced planners were locked in separate rooms with an estate planning case, each would likely emerge (at some point) with a different yet competent plan. Until a plan is challenged, who is to say which is the better plan? Of course, a competent plan must be measured in terms of the goals of the particular client and the nature of the client's holdings.

.08 If You Can Reach Your Assets, So Can Your Creditors

Generally speaking, under American law, if "strings" exist between a client and property, then a judgment creditor of the client can take hold of the strings and reel in the property. While this principle is not applicable worldwide, it should be considered when it comes to U.S. clients and/or U.S. property.

.09 Once You've Been Sued, You've Lost

The negative psychology of being sued can be overwhelming unless an effective asset protection plan is in place. The defendant's thought, however remote, that one may lose a significant portion or all of one's assets is a significant advantage for the plaintiff. A good plaintiff's attorney knows this and will use it. It renders the defendant susceptible to settlement pressures in even spurious and unfounded lawsuits. Just the cost and the perceived continued

harassment that is the hallmark of prolonged lawsuits can lead an otherwise forceful and rational defendant to commit weak-kneed mistakes in the absence of asset protection planning. One is far less prone to such lapses in judgment when the fear of loss has been eliminated or at least mitigated through asset protection planning.

.10 The Golden Rule

A well-known variation of the "golden rule" is, "he who has the gold, rules." In the asset protection context, the variation of the golden rule is, "he who has the gold, pays." The sad news is how some courts have adopted a risk-spreading approach to lawsuits. Unless asset protection planning has been put in place, wealth can actually be a magnet for lawsuits that otherwise would not even have crystallized in the mind of the most imaginative plaintiff's attorney.

¶175 What Asset Protection Planning Is Not

As important as it is to know what asset protection planning is, it is equally important to know what it is not. Asset protection planning is not an excuse or vehicle for evading taxes, is not based on hiding assets, and is not an excuse to defraud creditors.

.01 Not an Excuse or Vehicle for Evading Taxes

Some clients and advisors are attracted to asset protection planning by the tax advantages that they hope to find. This is particularly true when the planning involves the use of foreign entities. Relatively few tax maneuvers involving foreign entities exist for the global investor today. A well-designed asset protection plan will have no particular income, gift, or estate tax advantage (or disadvantage), whether under the tax laws of the foreign country or whether under U.S. tax law. However, the familiar estate tax advantages that can be accomplished through tax-oriented approaches ordinarily found in domestic *inter vivos* or testamentary trusts will generally be included.

Most importantly, under most circumstances, a well-designed asset protection plan will have no particular income, gift, excise, or estate tax disadvantages, either domestically or abroad; it will be tax neutral. Both the planner and the client should be aware of this on an ongoing basis. However, both tend to be no more involved than those clients and their planners who tend to be associated with more familiar approaches. Tax neutrality will, therefore, prevail for the proper plan.

.02 Not Based on Hiding Assets

Hiding assets can be dangerous; therefore, an asset protection plan that is based on such an approach is dangerous. The dangers arise from the likelihood that the client will have to make a choice between protecting assets and committing perjury if the client becomes involved in litigation. Whether or not the client ever becomes embroiled in litigation, the client may face some difficult decisions each year when the client's tax return is filed because full disclosure on a tax return is certainly inconsistent with planning based on secreting assets. Further,

depending on the circumstances, hiding assets may carry with it certain criminal implications. Finally, the intricately elaborate and tangled web that often results from such planning is inconsistent with the goal of creating a user-friendly plan.

> **Planning Note:** Although many clients appreciate the confidentiality that can be obtained through an asset protection plan, a properly devised plan will not rely on hiding assets or even obscuring the asset trail to be successful.

.03 Not an Excuse to Defraud Creditors

In the world of asset protection planning, the "clean" case is easy to identify. This is the case that involves an individual with neither an outstanding judgment nor a pending, threatened, or expected claim, but who, nevertheless, wishes to protect against the possibility of the "what if" occurring one day. The "dirty" case is also easy to identify. This is the case that involves an individual who is on the brink of bankruptcy (although prebankruptcy planning—a different type of planning altogether—may offer some hope for this person). In between are the many variations in the world of asset protection.

Fraudulent conveyance law varies by state, as discussed beginning at ¶201. A statutory body of fraudulent conveyance laws applicable to certain situations exists at the federal level as well. Our common law system favors the free alienability of property. As a result, one who is free from current creditor or expected creditor issues is in general absolutely free to dispose of his or her property as he or she sees fit. This person may want to make gifts to charities or to his or her children. Gifts to a spouse, whether outright or in trust, are also well within the realm of the ordinary, as are gifts in trust for the benefit of members of the client's immediate family. Fraudulent conveyance laws tend to focus not on who the transferee is but rather on the intent of the transferor at the time of the transfer. Since they are concerned with such intent, fraudulent conveyance laws generally protect present and subsequent creditors from transfers made by a person who is or foreseeably will become the debtor. The class known as "subsequent creditors" does not, however, include *every* person who becomes a creditor at some point in the future. For the good of the client and the planner, an asset protection plan must be implemented within the bounds of propriety as defined by reference to applicable fraudulent conveyance laws and ethical standards.

¶185 Does Asset Protection Planning Work?

In a 1993 article, the author predicted that over the course of time, claimants would attack a certain number of offshore asset protection plans and that a certain percentage of these attacks would produce less than favorable results for the planning structures involved.[4] These results would come about because of the way in which the asset protection plan was designed and implemented. This prediction (which was an easy one to make) has proven to be accurate. Because

[4] Barry S. Engel, "Asset Protection and Fear of Flying," 36 *Offshore Investment* 28 (May 1993).

of these attacks, some wealth planners and their clients have become concerned about the effectiveness of asset protection planning. Should they be concerned? At the risk of sounding too vague, the answer is that "it depends" on a number of factors, including (1) the standard applied in determining whether a plan worked, (2) the many variables that existed under a given plan, and (3) the planning vehicle or vehicles used within the asset protection plan.

First, the standard applied in determining whether the asset protection component of the IEP "worked" must be defined by reference to where a client would have ended up financially, had he or she not engaged in the planning. The ultimate goal of integrated estate planning is realized if the client weathers a legal storm at least moderately better than he or she otherwise would have in the absence of any planning.

> **Comment:** In the experience of the author as well as in the experiences of most if not all of the many attorneys and other professionals with whom the author has co-counselled planning cases, this modest and realistic standard can almost always be surpassed provided the planning is undertaken at an appropriate time and provided the plan is designed, implemented, and administered competently. Further, even in those cases where the plan did not completely stop a creditor, in almost all cases the defendant fared better than he or she would have in the absence of any planning.

Second, the many variables that exist under any given IEP prevent, in all fairness, the use of blanket statements such as a particular asset plan "works" or it "does not work." The following variables are generally of key importance in determining how a particular IEP will fare if challenged:

1. The facts peculiar to a given client's situation;
2. The goals of the client;
3. The manner and extent to which the goals are or can be incorporated into the design of the IEPT;
4. The skill with which the IEPT was crafted;
5. The nature of the asset or assets transferred to the IEPT;
6. The skill with which the IEPT is attacked;
7. The skill with which the IEPT is defended;
8. The thoroughness and protectiveness of the IEPT's applicable law;
9. Whether the opposing party is a governmental instrumentality;
10. Whether any criminal sanctions would result from the trustees or others involved exercising certain options that they would otherwise be free to exercise if the litigants were all private parties;
11. The law of the forum court; and
12. Any biases or the bent of the presiding judge.

Third, the asset protection component of an IEP involves implementing one or more asset protection vehicles, such as state or federal exemptions, a family limited partnership, a limited liability company, a domestic trust, or a foreign

asset protection trust. Some of these tools, such as exemptions, protect only certain types of assets (e.g., retirement benefits). Other tools, such as a domestic trust, generally are more effective for asset protection purposes (e.g., when a parent transfers assets in an irrevocable trust to a child). Many plans combine one or more asset protection vehicles—(such as the family limited partnership combined with a foreign IEPT). The asset protection planner's knowledge of whether and when to implement the various asset protection vehicles will strongly affect the degree to which a given asset protection plan will "work."

> **Comment:** To date, the author's firm has designed and implemented well over 1,000 foreign IEPTs and has thereby protected billions of dollars in assets. Approximately eight percent of these plans have come under attack by an adverse party. This is not considered to be a high percentage considering the wealth profile of the typical client. Further, in all cases but one, the clients weathered the storm in substantially better shape than he or she would have in the absence of any planning, thus far surpassing the "moderately better" standard for determining whether a particular plan "worked."

The following examples are summaries of a few of the planning cases designed and implemented by the author's firm that were subsequently challenged. The names used are of course ficticious.

> **Example 1:** Robert and Judy Albert sold the family business for $12 million. Promptly following the sale, they settled their net after-tax proceeds in a foreign IEPT. A few years later, the business that was sold filed for bankruptcy. The bankruptcy trustee filed an action against the Alberts as sellers based upon a reverse fraudulent transfer theory under which the bankruptcy trustee sought to recover the gross sales proceeds received by the Alberts ($12 million). In other words, the bankruptcy trustee was seeking to recover more from the Alberts than they had received after taxes. Generally, a bankruptcy trustee is a particularly problematic creditor due to all of the powers granted to the bankruptcy trustee under the Bankruptcy Code. In this case, however, the bankruptcy trustee learned of the asset protection planning structure that was undertaken several years earlier, and the bankruptcy trustee settled his claim for $175,000 (i.e., about 1.5 cents on the dollar).

> **Example 2:** Bart Bernard was a real estate investor. Knowing the many perils of the real estate market and given his various liquidated and contingent liabilities, he protected as much of his estate as was appropriate at the time by transferring as much of his asset base to a foreign IEPT as he could and still avoid a claim under a fraudulent conveyance theory. Several years later, Bernard suffered a judgment as a co-guarantor. Unfortunately for Bernard, the other guarantors had already been forced into bankruptcy due to other real estate deals with which they were involved. Therefore, Bernard became the sole focus of a collection effort by a very large bank and its Wall Street law firm. This combination would represent a formidable opponent for most asset protection plans. Fortunately, Bernard had utilized a foreign IEPT, and even though the foreign IEPT held one-half of the assets in

Bernard's home state, a fact of which his creditor was fully aware, the judgment against Bernard was settled for less than five cents on the dollar.

Example 3: Dr. Joe Calvin was an uninsured practicing physician. Within months of Calvin's foreign IEPT being funded, Calvin was unexpectedly named as one of several defendants in a malpractice nuisance suit. The plaintiff's legal counsel was advised that Calvin's assets had been protected with a foreign IEPT, and a token settlement offer was extended. After confirming that Calvin's assets were indeed protected and that Calvin was uninsured, the plaintiff accepted Calvin's settlement offer. Unfortunately for the remaining defendants, the plaintiff continued to pursue the claim against them.

Example 4: Robert Donahue, the owner of vast real estate holdings, was concerned about the potential of a toxic waste problem with one of his holdings. At the time of funding his foreign IEPT, Donahue had no reason to believe that this general concern was a reality and otherwise did not know whether any of his property was in fact contaminated. Several years went by, and, as is the case with many asset protection planning clients, the motivating factor (i.e., toxic waste) for his concern did not materialize. Instead, a different asset protection concern developed as Donahue's wife filed for divorce. As a result of Donahue's asset protection planning, a property settlement was reached as part of the divorce negotiations. As assessed by Donahue's divorce counsel, the settlement was substantially more favorable than would have resulted had Donahue not implemented his planning.

Example 5: Stuart Eckersly was an entrepreneur who had a proclivity for making deals happen and making money. Unfortunately, Eckersly incurred a substantial liability attributable to a general partnership in which he was one of the general partners. Not only did Eckersly lose most of his hard-earned wealth, but he lost his drive and ambition to continue making deals happen, since he felt that his future successes would serve only to satisfy his sole past failure. Although little integrated estate planning may be done to protect existing assets from a present claim, the same is not true for future business opportunities. Future business opportunities may be diverted to a foreign IEPT prior to their ripening into "property interests." Eckersly settled a foreign IEPT and the trustees of the foreign IEPT pursued any future business opportunities that Eckersly came across. The new wealth accumulated in the foreign IEPT was protected.When Eckersly later filed for bankruptcy, he was granted a discharge from his sole past failure, and the assets that developed from the business opportunities that were transferred to the foreign IEPT were not included in his bankruptcy estate.

Example 6: Dr. Juan Martine was besieged with a series of groundless and frivolous malpractice lawsuits immediately following a negative exposé on local television. Prior to the television exposé, Martine had an almost clean slate with regard to any malpractice actions. One of the plaintiff's lawyers thought, at a minimum, that they would be able to settle with

Martine merely by subjecting him to the hazards of litigation and the high costs of defending himself. He was ultimately proven incorrect. Martine's malpractice premiums soared; he was constantly spending time gathering documents, meeting with defense attorneys, and being deposed or going to court; and he ultimately left his practice. After a few years of fighting the legal battles, Martine established a foreign IEPT. Martine's assets were protected to the extent permitted under applicable fraudulent conveyance law under the circumstances. Martine then fired his battery of defense counsel and proceeded to negotiate an end to each of his remaining malpractice suits. Each suit was settled by him for pennies on the dollar.

Example 7: Kevin Mesmer, Chuck Gallant, Gary Holland, and Mike Inez settled and funded foreign IEPTs with personal assets at a time when their business was current on all its obligations and cash rich. At this time, there was no reason to believe that they would be called upon with respect to the personal guarantee on which each of them was personally liable. Therefore, there was not a fraudulent conveyance issue at the time that the trusts were funded. A few years later, the economy sputtered and their business started a slow downward spiral. At this time, the bank called the personal guarantees of Mesmer, Gallant, Holland, and Inez on the business loans. Since most of their personal assets had been transferred to foreign IEPTs, the bank attempted to pursue collection of the debt against the foreign asset protection trusts abroad. This pursuit proved unsuccessful, and the bank ultimately agreed to a global settlement on a substantially discounted basis. No settlement payment was required of or was made by any of the foreign asset protection trusts involved.

Example 8: Jerry and Susan Marconi were referred to the author's firm by their litigation counsel at a time when they were being sued on a promissory note secured by real estate. Since there was a pending claim, due to fraudulent conveyance issues the Marconis would be required to leave outside of any newly created integrated estate planning structure a sufficient amount of assets to satisfy the existing claim. Here, the Marconis wanted the creditor, a large bank, to proceed against the real estate rather than to proceed against the Marconis' substantial liquid assets. The liquid assets had a very low tax basis that would generate a substantial capital gain if they were used to satisfy the amount due on the promissory note. On the other hand, the real estate had a high tax basis that would actually generate a loss on sale. Unfortunately, the bank did not want to be bothered with the details of a foreclosure sale and was unwilling to allow the clients sufficient time to sell the property and remit the proceeds to the bank. The bank wished to proceed directly against the Marconis' liquid assets. In order to force the bank to proceed against the real property that secured the indebtedness, most of the liquid assets were transferred to a foreign asset protection trust. The result was that the bank could not reach these assets and was forced to look to the collateral that secured the loan for payment.