CAMARDA INVESTOR EDUCATION SERIES

Advanced Asset Protection For Successful Families

Camarda Wealth
ADVISORY GROUP

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INTRODUCTION

What is Asset Protection?

Let's begin by noting that asset protection (like estate planning and so much other legal strategy) varies by state. This material is written specifically for Florida, and while there are important similarities between states, it is best to make sure a proposed plan will be effective in your state.

At its core, asset protection is the art of making it harder to chase your assets than they're worth. The objective is to structure matters so that it costs so much time and money to get and collect a judgment that an adversary will give up or settle for pennies. We do this by setting up hoops, splits, levels and layers—instead of a pile of cash on the table, it's positioned in different places, and secured by safes within safes within safes, figuratively speaking.

The million-dollar-bill is cut in many pieces, and the pieces are hidden separately. For most people, effective planning can be very simple, but still have this effect. It is important to note that this planning is usually fairly inexpensive to create, but extremely expensive to defeat. That's great leverage.

One final, extremely important point: to work well, such planning needs to be done before you think anyone's got a reason to come after you. Do it then, and it's sound planning. Do it after you know about a threat, and it's a "fraudulent conveyance" (and likely to be undone by a judge, and maybe get you in trouble).

While there are techniques for those already entangled, they are more complicated and uncertain. Be smart, do your planning before any threat appears. Since most techniques go hand in hand with estate planning, it is usually much more effective to combine asset protection planning with an estate planning review.

The First Line of Defense—Liability Insurance

Liability insurance—the kind that pays if you become responsible for damage to someone else—is the essential foundation for asset protection. Unless you engage in high-risk activities, the coverage is usually pretty cheap. It is important to have adequate insurance levels (liability limits) and make sure that all potential exposures are covered (real estate, vehicles, boats, planes and rocket ships). You will want at least several hundred thousand in coverage for each risk (a half million is even better) with a high limit payable per individual, not only per incident. "100/300," for instance, means the policy will pay a maximum of $100K per individual and $300K per incident, meaning the most any person could collect would be $100K—not nearly enough to keep them from coming after your assets if they have a good case. "300/300" means a single person could collect up to $300K (so long as no one else was hurt in the incident).

Also, bear in mind that if ten people are damaged by you—in a car wreck, say, or because there was a fire at a rental property—that $300K would be spread awfully thin, and risk to your assets goes way up. Again, you will want at least several hundred thousand in coverage for each risk but should note that multimillion dollar awards are routine, so you should consider your limits accordingly. Usually, the maximum available on your home and auto policies is $500,000 (sometimes less).

The same rationale is true for business: make sure each liability exposure is covered, and the limits are adequate. A good property and casualty agent can be indispensable in this process, but select carefully as there is wide variation in quality, as with any profession, and a careless agent can leave you thinking you're well protected when you are not. If you ask, we can tell you who we trust with our insurance portfolio.

A big concern with this type of insurance is avoiding gaps in coverage, such as where you think your liability coverages are overarching, but some exposures are not covered, leaving a direct and clear path to your assets. Again, a skilled agent can point out concerns like this should they be present.

Umbrellas are policies that sit on top of your basic policies, and extend liability coverage to 1, 3, 10 million, or more. Different umbrellas are required for personal versus business interests. The proper underlying coverage needs to be in place for the umbrellas to actually work, if needed.

Finally, as in all markets, different companies pursue different markets, and have products more approximate for them. Companies like Chubb, Fireman's Fund, Chartis, Zurich, ACE and others cater to the high-net-worth market. If desired, we can suggest brokers we have confidence in to access these higher end insurance companies (who tend to not sell out of corner stores!).

Titling

"Titling" refers to in whose "name" legal ownership is recorded. In Florida, couples who title assets in joint names should use "tenancy by the entirety" ("TBE") instead of "joint tenants with right of survivorship" ("JTWROS") since this form makes it much harder to enforce judgments against the bank account, rental property, brokerage account, etc. For JTWROS, only one spouse has to be successfully sued to take the property; for TBE, both do, which is much less likely.

Beware advisors who tell you that there is a presumption of TBE just because you're married; if the account reads JTWROS, that's what it is, and you should change it to be safer. Some banks and brokerages refuse to title as TBE in order to limit their liability, at the expense of yours! Find another institution (we can suggest several) or use one of the other more advanced approaches discussed below. Note that Florida is one of only a few states that permit TBE.

Since TBE is a fairly basic strategy and the more advanced ones (like personal holding companies) discussed below are both stronger and applicable to more states, this should not trouble you if you are not a Floridian. (Though if you are not but spend substantial time here, you should deeply consider the significant tax benefits of Florida residency).

A final point on titling: title vehicles in the names of the most frequent drivers. If you hit someone in your car, they can just sue you; if you hit someone while driving your spouse's car, you (and all your separate and joint assets) both are fair game. And, God forbid, think twice about titling children's cars in your name without massive and bulletproof liability insurance.

Per an internet search, the following states are said to have TBE, but check with local counsel to be sure!

Alaska
Arkansas
Delaware
District of Columbia
Florida
Hawaii
Maryland
Massachusetts
Mississippi
Missouri
New Jersey
Oklahoma
Pennsylvania
Rhode Island
Tennessee
Vermont
Virginia
Wyoming

No Place like Homestead

I'm referring to the asset protection exemption, not the city flattened by Hurricane Andrew in 1992. Remember, this is why OJ came to Florida—one's home is nearly impossible to seize in Florida, regardless of how much value is piled up in it. Many consider the homestead to be the ultimate Florida tax shelter, and the protection can even be "rolled-over" from one home to the next. Sadly, the exemption does not apply to loans taken with the home as collateral, so if you stiff the bank on the mortgage, they can still foreclose to get their money.

All of your equity in your homestead qualifies for the protection, which can be an argument for no mortgage and locking up as much wealth as possible in your home. If you are within city limits the homestead exemption applies on up to one-half acre. Live outside the city limits the exemption applies on up to 160 acres. Practically speaking, however, you are likely to get far better returns on other investments, especially since you get all home appreciation

whether you're mortgaged or not, so mortgages still make sense for most people. This is especially true with low interest rate, and the ability to invest using protected vehicles such as personal holding companies. As with all things, life is a compromise!

Life Insurance & Annuities

In Florida, life insurance and annuity cash values enjoy very strong, constitutional protection, but possibly only so long as the cash stays in the contract and is not withdrawn for other use; do that - and this is true for virtually every protected structure - and the cash may be on the table to be attached by judgment creditors, if they can find it. This protection must be weighed against the commissions and ongoing costs in these insurance products, and they can frequently be very high, indeed, making them poor choices from an investment standpoint because of these high costs.

Low cost "no-load" life insurance and annuity products have emerged but tend to not be pushed by salespeople since they won't make much off them, so they are off most consumers' radars. If you have such an insurance product, note that most can be "rolled over" to similar products, continuing the protection but enabling you to shop for low-cost alternatives if you have someone familiar with these and willing to do so for you.

Note that there are typically three parties to an insurance or annuity contract, besides the insurance company: the insured (annuitant), the owner, and the beneficiary, and that these need to be properly named for the strongest protection.

IRAs and Qualified Plans

IRAs, 401ks, and other types of retirement plans offer excellent asset protection, especially in Florida. Remember, like-life insurance and other types of assets, these accounts pass by beneficiary, and the asset protection status becomes somewhat murky once a payment is made at death. Also, like most other asset protection shelters, one should assume the protection only applies so long as value remains in shelter—once removed for consumption, investment, or other purpose, the risk of it being seized goes up considerably.

While IRA and pension accounts usually offer much more flexibility in investment choices than life insurance and annuities, and typically many more low-cost options are available than for insurance products, investment options are still much more limited, in most cases, than is generally true for taxable investments.

Finally, most of these plans are tax-qualified, meaning that any withdrawals trigger income tax, and maybe penalties, in addition to possibly exposing the value to creditor attack. That said, the next concept, where it fits, can be a much more elegant, flexible solution.

The Amazing LLC

LLCs (Limited Liability Companies) are probably still among the most misunderstood vehicles around. I, myself, did not get a very good grasp until a few years ago when I became interested in learning about asset protection, despite pretty much continuously studying financial planning and wealth management since I began with the CFP® way back in 1990. Most folks have at least a rudimentary understanding of corporations, partnerships, and even limited partnerships, but LLCs remain a mystery to many.

So let's spend a little more time talking about what these are. LLC, again, stands for Limited Liability Company. Two key words: limited liability, which is precisely what we are after in asset protection. We want to limit our liability to little or nothing. This is the major advantage of this company form. The LLC is basically a partnership that has the limited liability of a corporation. Owners are called "members," unlike partners for a partnership or shareholders for a corporation. Because of the partnership element, the entity enjoys *charging order* protection. This basically means that if you own the right kind of LLC (more in a moment) and an adversary succeeds in getting a judgment against you, they might get the bank accounts titled just in your name or as JTWROS but can't force assets out of an LLC to pay it. Moreover, unlike a corporation (business owners take note!), if you are sued, it is very difficult to take your membership interest away.

To clarify, if you own shares in IBM or in your own business, these can easily be lost in a lawsuit. LLC membership interests, again owing to the partnership roots, are very difficult to take in satisfaction of a lawsuit. So, we are protected from the "outside"—losing the asset protection structure. As important, the "contents" of the LLC—the bank and brokerage accounts you have transferred to it, perhaps, or the tractors you use in your business—are protected from being ripped out in satisfaction of a charging order to pay a judgment. So long as the asset stays in the LLC, it is very well sheltered. Take a distribution from the LLC, of course, and the money's in your pocket and on the table. However, a little common-sense creativity can be utilized to work around this.

It is important to stress that the LLC can be utterly your creature—you own, can put assets in or take them out without restriction, and is pretty much invisible when it comes to taxes. It is a very easy creature to live with.

For asset protection, it is absolutely essential that you have "multiple members"—more than one owner. This is so due to the partnership aspect of the entity (much as you may wish, you can't be a partner just with yourself!). Someone else (a spouse, child, or sibling perhaps) needs to own at least a very small interest in the LLC to get the protection. And the rights of this minority member can be virtually nil, but we need multiple members to keep the wealth safe.

It is also vital to have the right "operating agreement." This is like a corporation's bylaws or a partnership agreement, and basically defines how the LLC is structured and what the members' rights and duties are. I cannot stress enough that this needs to be drawn by an attorney quite familiar with asset protection if it is going to work! Please, no online forms, or Office Depot kits. Getting the work done right should be very inexpensive (call if you need help or want a referral) and is absolutely critical if your asset protection plan is going to work if and when a threat darkens your financial door.

LLCs, of course, have broad applications as business structures, and while a treatment of business applications is well beyond the scope of this whitepaper, we will touch on a few of the more important business aspects below.

Virtually all readers, business owners and not, should consider using LLCs as personal holding companies for liquid assets like bank, brokerage, and mutual fund accounts. Follow the points regarding ownership, operating agreement, and so on above. And do NOT mix these assets in the same LLC with those (like operating businesses or real estate) that might incur liabilities that could be satisfied with your liquid accounts.

Keep them separate, and safe! Put your riskier assets in their own LLCs; typically, each business should be encapsulated in its own LLC. Some real estate investors put each property in its own LLC, others group bunches of properties in separate LLCs—commercial in one, residential in another and so on, and deal with the property risk primarily with liability insurance. Having a lot of LLCs can become a chore to keep up with, so this becomes a balancing act between protection and practicality. And note that if properties are mortgaged, any attachment in judgment is subject to any mortgage, making (perhaps depending on equity) these assets less attractive to satisfy a judgment.

A Few LLC Notes for Business Owners

As mentioned above, it is much harder to take membership interests in the right LLCs than it is stock in an S or C corporation. This is a major advantage that is not used by far too many business owners! If you are one, please take note.

To summarize, both LLCs and corporations protect your personal assets from attacks on the business. But only proper LLCs protect the loss of your business from attacks on you; if you are liable in an auto accident for which an award exceeds your insurance, assets held in your name (including your incorporated business) could be lost to satisfy it. LLCs are much, much harder to crack, and this is the reason you have seen so many of them in the past few decades. Now you know why.

Again, the company—Inc. or LLC—is still liable for *its* liabilities, so make sure you are well-insured.

From a tax perspective, LLCs are pretty invisible, and you can choose—by checking a box on the IRS form—to be taxed as a partnership, S-Corp, or C-corp. Just don't choose sole proprietorship, because that would mean a single member LLC and the asset protection would be lost.

For those business owners who consider converting corporations or partnerships to LLCs (and all should consider this), make sure you run it by your tax advisor to make sure this would not trigger capital gains recognition, which might be bad. Even where this is the case, you may have other options to improve asset protection, such as having the corporation be acquired by a new LLC you set up.

The Plot Thickens...Layering, Equity Splitting, and Other Diversions

Remember, the essence of asset protection is diversion. More hoops to jump through discourage potential attackers. For those with a lot of liability (or a lot to protect) a bit more complexity can take fortification to the next level. One idea is the Delaware-style serial LLC (more states have adopted this but so far Florida has not to my knowledge),

which is basically a holding company with subsidiaries (one each to hold a rental property, for instance) whose intent is to minimize filing fees and red tape hassle.
Another way to apply this concept is equity splitting, where one splits a company into pieces to protect value. In this scenario, a school bus company would be split into a holding company which itself owned 1) an LLC which owns the buses 2) an operating company which employs the drivers and c) a management company that collects the money from the school district and contracts for service from the bus and driver divisions; if a driver goes whacko, the buses and the contracts with school districts are insulated.

Added protection can be afforded by using a holding company in an asset-protection-progressive jurisdiction, such as Nevada. This is also a great way to get anonymity, if important a casual adversary may try to check things out in Tallahassee but is unlikely to go digging in Carson City. You can even have holding companies owned by other holding companies. The more hoops, the better protected.

Another technique is using mortgages and promissory notes, as discussed in the section below. In the previous example, if the buses are encumbered by debt that you own in another entity, even if a judgment attaches to the bus subsidiary, for a creditor to get the buses, they will first have to pay off the debt - which means giving cash to you!
A final technique is using an LLC variation of the old family limited partnership technique, which is very useful for estate freezing to avoid estate taxes. And, by the way, the best time to do asset protection planning is at the same time as estate planning—results tend to be cheaper, better coordinated with other wealth goals, and more effective.

That discussion is beyond the scope of this paper but ask me for a copy of my ***Advanced Estate Planning for Successful Families***. But limited "partnership" LLC units can be real poison pills in asset protection planning. If a creditor accepts such a unit, they get no real assets, and no income, but may have to pay tax on undistributed income! As you can imagine, this can be very effective at keeping the bad guys at bay.

A Few Notes on Promissory Notes

If you find a reason to use this technique, it is important to follow the form to actually have a legitimate and defensible note. While I'm no lawyer (so please don't construe any of this report as legal advice), I strongly suggest you follow the UCC (Uniform Commercial Code) format in terms of setting up the notes. It is important to execute, and properly record, such notes, but Florida imposes a tax on this activity. Commerce being what it is, a cottage industry has sprung up to service such needs as these in south Georgia, and many who need to do this find themselves slipping north of the boarder to execute their notes, in places like Kingsland/St. Mary's, GA (conveniently located off I-95, a mile or so into the Peach State), or on their way to a cultural event in Savannah or Atlanta.

This will work because debt is a higher obligation than equity. If you own the bus, but owe against it, a predator can't take the bus unless they pay the note off first. Ditto for real estate, just make sure such debt is evidenced by a recorded mortgage (hard to beat the recording tax on this one). So the basic technique is to lend money from one, low risk entity (a personal holding company, say) to another entity which pledges assets (real estate, buses, cranes, whatever of value) as security for the loan. Make sure to follow the form of legitimate debt, including reasonable interest (this is tax neutral in most cases since you are just taking money from one pocket to another). If the crane crashes into a bridge, the company that owns it can be sued, but the crane itself can't be taken unless the note is paid off first. Again, too much trouble, not enough to get, the attackers are encouraged to settle for pennies or go away entirely.

Trust Protectors, Estate Planning, and a Glimpse of Where They Keep the Wild Things

As mentioned above, estate planning and asset protection planning (as well as income tax control, business planning, and all the other trappings of *wealth management*, while we are at it) are best addressed together. While we deal with smart estate planning and the other elements of wealth management in other reports, a few mentions of estate planning aspects are appropriate here.

The first are trust protectors. These are something that seem to make perfect sense to most parents when asked, but we rarely find in new clients' existing estate planning. Protectors basically protect the kids (or other trust beneficiaries or trustees) from being forced to write a check against their interests, such as to satisfy a judgment, or divide assets in a divorce. In many cases, the child's inheritance is given in a trust of which the child is trustee, but a protector - their brother, maybe - takes over if a threat appears. Giving the child their inheritance in their own special trust helps to prevent it from becoming marital property and hence at divorce risk, as in “of course I love you honey and would love to put your name on the account, but Daddy set it up in a trust fund and that's how he wants it . . ." without restricting their access to the funds since they are the trustee (unless a threat appears, and they automatically lose trustee powers to the protector until the threat passes).

Similar measures can be used to protect kids' inheritance, say if one spouse dies and the other remarries, from the clutches of a future step parent. For this and many other very important reasons, living trusts (the kind that exist now, and you would know because your bank and brokerage statements should be in the name of "The Ma & Pa Joint Living Trust dated x/x of 2012) are much preferred over testamentary trusts (the kind that are written into your very thick will but don't actually come into being until you die). Ditto for life insurance, which should be owned (or at least made payable to depending on your estate tax situation) by its own special kind of trust, which should include asset protection aspects.

As a quick sampling of more advanced techniques, consider these. Asset protection trusts (APT's, domestic or offshore) are irrevocable and transfer control to outside parties as trustees, with protectors as control. SLATs (spousal lifetime access trusts) have more limited asset protection power (but this can and should be shored up using personal holding companies and the other techniques discussed above) but allow the couple complete control and access to income, while still getting the property out of the taxable estate—and eliminating estate and gift tax entirely if done right in the right fact pattern. Finally, the so-called dynasty trust can eliminate all gift and estate taxes for the family for many generations, or forever, if this is desired, while still availing the family and descendants of the full benefit of the family assets, which can compound mightily over time in the absence of transfer taxes.

They work by granting rights in trust assets to the family which approach, but technically don't equal, actual ownership (which would trigger estate, gift and generation skipping transfer tax for families with sufficient wealth). Often these techniques, like the family limited partnership concept discussed above, serve multiple purposes—to reduce the size of the taxable estate using long-accepted discount opportunities, to protect assets against predatory attack, and to set up the structure to provide for family on down the line.

CONCLUSION

We have covered a lot of ground in this report. While some of the concepts may seem complicated—and asset protection, as an aspect of the broader discipline of wealth management should be meticulous to work properly—a good plan is actually quite simple for clients to set up and live with, provided they get good advice (sadly this is frequently not the case, and a good reason to get a second opinion, which of course we offer as a way to introduce ourselves, without cost or obligation).

The important thing is to take the time to get your plan in order, or reviewed if you have one. For the great majority of families, this is simple, quick, cheap and easy—if action is taken before a problem appears. If not, and fortune's winds blow the wrong way, the result could be complicated, unending, extremely expensive, and hard—not to mention painful.

Be smart. Get your fortress built now, while the sun is shining. Get started today, while it is fresh on your mind. Good luck, and good fortune!

We regularly confer with successful families and business owners, and it's amazing how important asset protection—protecting wealth from loss from lawsuit, liability, divorce, and other attack—has become to them. This is really on the radar and should be. Unfortunately, if asset protection is even done at all, the planning is usually not very effective. Here are common errors we see nearly every week, and thoughts on how to correct them.

THE 11 BIGGEST ASSET PROTECTION PLANNING MISTAKES

1. **Using the spouse** as the asset protection "plan." We see this a lot, particularly with doctors concerned about malpractice exposure. While this does offer some protection, it ignores the risk of losing the assets if the "safe" spouse dies first or is themselves sued for some reason—like getting in a car wreck. The "technique" also introduces both perceived and real asset control issues that may prove unpalatable—like if loving spouse refuse to write a check out of the "protected" account or argues in divorce proceedings that the assets transferred were a bona fide gift, and hence no longer marital property.

2. **Overreliance on tenancy by entirety** Florida is nearly unique in allowing spouses (only) to jointly title assets as "tenants by the entirety." While hugely better than the common "joint tenants with right of survivorship" — because "T-by-E" assets can't be taken if a judgment is rendered against one spouse—it offers little protection if both spouses are successfully sued, like when husband hits someone while driving wife's car: husband is liable as operator, and wife as owner. Plus, if the safe spouse dies, the crapshoot begins.

3. **Inadequate divorce protection** not properly segregating non-marital assets—inheritances, wealth acquired before marriage, etc.—can put into play assets that would have been impervious to the divorce axe. This applies as much to your kids as to you, and not using the right kinds of trusts, with protectors, can lay your treasure bare to the attacks of your children's' soon-to-be-ex spouses, who you always knew to be barbarians anyway. The right trusts can often also function as very elegant pre- and post-nup devices, without souring the romance the way traditional pre-nups can.

4. **Titling errors** risk assets—cars, boats, planes, non-homestead real estate, etc. should be titled to an encapsulating entity like an LLC, or at least in the name of the principal operator: his car in his name, and so on. Joint titling or other mistakes can engender needless and expensive liability.

5. **P&C gaps** in any asset protection plan, liability insurance is the very first line of defense. Not having adequate insurance for vehicles, toys, business and real estate exposures, as well as proper levels of business and personal umbrellas, is a problem we see all the time. While this area is complicated and exposing gaps takes some work, the insurance is usually cheap and well worth exploring. It's the first line because marauding plaintiffs' attorneys can be often be placated (get a nice percentage fee without much work) instead of going after your real assets . . and in today's hyper-Google world, it won't take them long to find out where your treasure's buried.

6. **Underutilized qualified plan opportunities** business owners particularly leave a lot on the table here. Not only do they often fail to maximize the tax shelter offered by the right kind of tax-deductible plan, but fail to appreciate the extremely strong asset protection properties for them in such plans, particularly in Florida.

7. **Overreliance on life insurance** products. Like qualified plans, life insurance products, which include annuities, enjoy very strong protection from judgment attachment under Florida law. Unfortunately, these products are often extremely expensive versus investment alternatives, and can have extremely expensive income tax ramifications. Where there is a legitimate need they surely have their place, but are not the panacea some salespeople would like them to be.

8. **Personally-held business stock** if you own an incorporated business, know that the stock (your business) is on the table if you are successfully sued. You may need to hand it over in a judgment. Having it just in your name (or with a piece to you and a piece to your spouse) is needlessly risky; T-by-E (see #2) is better, but a multi-member LLC is, by far, superior.

9. **Not using an LLC (or LLP, or LLLP).** Limited Liability Companies (and their cousins, the Limited Liability Partnership, and the Limited Liability Limited Partnership). These have been around for a long while, but are still poorly understood. Let's face it, you want limited liability, don't you? You wouldn't be reading this otherwise. What an LLC does is protect your personal assets from claims against your business or real estate (yes, I know a corporation does that, too) AND protects you from losing your business if claims are successfully pressed against you (which a corp can never do—get a judgment, hand over the stock). An LLC seals both ends—and that's a very big deal.

10. **Single member LLC.** For the LLC technique discussed in #9 to work, there needs to be more than one owner (LLC owners are called "members"). So make sure your wife or daughter or girlfriend or grandson has a small stake (that has no control or rights to compel income). And remember, this separate interest must be in their name alone, not joint with you.

11. **Waiting until you're fired upon.** Too many people with lots to lose don't get serious about asset protection planning until they smell a lawsuit or have already been filed on. All of this stuff works really great if you take the time to plan your defenses in the happy sunshine, before the hordes gather for a dawn attack. Once potential liability appears, all the planning in the world may be deemed a "fraudulent conveyance" sham, and much less effective, or entirely so. So be smart—build that brick house, while the wolf is still at the other pigs' place.

These are the sort of routine opportunities we uncover for people on a very regular basis. Chances are very good that your business or family could benefit from many of these improvements as well. Of course, there are many other asset protection planning pitfalls we catch that often ensnare successful families, but hopefully these "Big 11" will motivate you to get a comprehensive liability risk checkup.

IMPORTANT DISCLOSURE INFORMATION

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