



PROTECTING

Yourself Through

Asset Protection

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There are many sinkholes out there that can get between you and your hard earned wealth. The foremost of these being ex-spouses, creditors, and anyone who feels they can leverage or sue you to obtain money. This is true for everyone with hard-earned and carefully saved wealth. Whether you have a little or a lot, there is always an event or person motivated to wage war on your assets. Therefore, it is important to be aware of the protection strategies that can offer you greater financial security.

(1) Business Entities: Protecting Your Personal Wealth from Your Business Creditors

This is asset protection 101. If you have a business, the first thing you need to do is make sure that the proper legal documents are drawn up formally recognizing it as a business. Most owners realize this and do so accordingly.

Business entities are crucial because they protect your personal assets from the debts, liabilities, and creditors of your business. By properly forming a business, anyone seeking to settle a claim against the business is limited to the assets of that business. Personal assets, generally your assets unassociated with the business, are insulated from creditors' reach with few exceptions. Such asset protection prevents the business creditors from seizing your personal assets, and you will not be forced, due to such protection, to personally file for bankruptcy.

In today's legal and business world, most entrepreneurs understand the need to form a business entity. However, there are blind spots such as when owners view their business activities through the prism of a self-employed individual rather than as a cohesive running business operation, and thus fail to take the steps necessary to form a business. This is obviously dangerous. Even further under the radar is the leasing of residential real estate, a common pastime for those with any wealth. Often times, individuals and families will purchase real estate in their own individual names, and then lease the property for income. It does not occur to the owners that personal liability suffered by occupants, visitors, or even trespassers on the property can put the owners' personal assets at risk. Placing the rentals into a business will eliminate this unnecessary threat.

(2) Limited Liability Companies: Protecting Your Business from Your Personal Creditors

The type of protection mentioned in the previous section is known in the industry as "inside-out" protection. It protects creditors operating within your business from accessing your assets outside of your business to satisfy debts and obligations. It is also possible to achieve "outside-in" protection, that is, protection which shields your business from your outside, personal creditors.

If you are ever sued personally (and not in the name of your business), the creditor suing you in certain situations may be able to levy and execute on a portion of your business or its assets if that creditor is successful in getting a judgment. This obviously complicates things, and will almost assuredly doom the business. A buy-sell can help here (see our other e-book for why you absolutely need one) but it is not a cure-all when it comes to creditor claims, and it only protects your partners, not you.



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You can protect yourself from such a scenario by picking the right state and the right entity for your business formation. The right state is South Dakota, Nevada, Wyoming, and a few others; the right entity is a limited liability company, or “LLC.” This double-faceted “right combination” is very important, and you need both to maximize and protect assets. Here’s why. In these “right” states, a personal creditor (someone you owe as an individual, not as a business) has very limited rights and options to satisfy debts by going after your business. Using South Dakota as the prime example, a creditor can only obtain a “charging order” against an owner’s LLC if money is owed. A charging order merely permits a creditor to receive distributions the LLC might make to the LLC member, and nothing more. It cannot force those distributions; it cannot interfere with running the business; it cannot seize the LLC assets. Furthermore, in South Dakota, this is true whether the business is a single-member LLC or a multiple-member LLC (a distinction that occasionally matters in other states). A charging order, with exceptions, is worth about as much as the paper it is printed on, maybe even less.

The consequence of this very limited remedy is it discourages your personal creditors from going after the business or its assets since it is not worth the time or expense. Your business remains as an ongoing concern, and you can continue to manage it and work for it.

(3) Trusts: Protecting Your Family from Their Creditors

The rule of thumb for Trusts is you cannot make a Trust for yourself and expect it to be safe from your creditors, business or otherwise. If you make a Trust for yourself—meaning you both create the Trust and get the benefit from it—then your creditors will be able to seize those assets. On the other hand, Trusts you create to benefit someone else are very well protected against that individual’s creditors. And usually that someone else is your family.

Your family has its own pool of potential creditors. Any of their assets are fair game for any of their creditors, and this includes any property you may give them outright. For many, the big potential creditor is an ex-spouse. Any inheritance passing to your family is exposed during a divorce. Assets like retirement accounts and farmland may be jeopardized. By placing such assets in a Trust, however, you can effectively protect the assets from the grasp of your family’s creditors. By legal operation, a Trust will benefit your family but is never technically owned by them. As a result, such assets are not subject to creditor claims. Trusts are great tools for protecting wealth you desire to pass on to your family.

Another important consideration is that almost 60% of inheritances are lost in the second generation, and often times are spent within years of being received. Money burns holes in pockets. In a very real sense, sometimes the person you need to protect your child’s inheritance from is your child. Left unchecked, some children will even spend their inheritance before they have even been cut a check. Rarely are the children better off for their spending either, having wasted they money on impulsive, extravagant purchases rather than investing it in their own financial security. A Trust can combat this by measuring out distributions over time and preventing a child from receiving all of his or her property at once. By using a Trust to protect your children’s inheritance, you can ensure that it will remain a stable and reliable resource for them as they grow older. They will be the ones to benefit from it and not some opportunist.



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(4) Domestic Asset Protection Trusts: Protecting Your Everything from Everyone

The rule of thumb mentioned above that you can't create a Trust for yourself and expect it to be immune to creditors...forget it, it's not entirely true, at least not as long as you go to the "right" places. Again, South Dakota and Nevada would be two of those "right" places. Both states, as do some others, allow an individual to form a Domestic Asset Protection Trust. Also known as a "DAPT," this type of Trust provides support to the person who made the Trust but is nonetheless outside the reach of creditors. It has a "have-your-cake-and-eat-it-too" sort of quality. You can make use of the assets without your creditor doing the same.

A cautious aside should be offered. There is not a perfect asset protection strategy out there that can protect all of your assets, 100%. It is simply impossible to know how a court will decide on any one issue. Creditors should have great difficulty piercing the Trust, but it is not impossible for them to do so. This, however, is not the real benefit of a DAPT. The real benefit is that a DAPT encourages creditors to settle claims. A creditor does not want to go through the time and expense to wage war over a lawsuit they have little confidence they will necessarily win. As a result, creditors are almost universally willing to settle claims on far more favorable terms.

One does not need to have several millions of dollars in order to make use of a DAPT. Such a tool is even useful for people with modest wealth. The point is not to put all your assets into the DAPT. Rather, a DAPT is just one part of a larger asset protection strategy. It is designed to create a stable pool of resources that remain accessible and secure in the event that your other assets are compromised.

As a final note, a DAPT will protect your assets, but to be clear, it cannot be used to commit fraud. If you are using it to defraud someone, it will not hold up under any pressure or scrutiny. A DAPT is also generally ineffective if it is created after a claim has been brought against you. To be most effective, a DAPT needs to be established sooner rather than later.

Asset protection needs to be a part of everyone's thinking, no matter how wealthy, as we are all vulnerable to lawsuits. However, it does no good to wait until financial disaster hits home. If you want to protect yourself and your family, planning needs to happen today before it is too late.



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