

Keeping Wealth In The Family - By [Gideon Rothschild](#) - 11/5/2009

Editor's Note: The following article is a summary of a presentation Rothschild will give at the 44th Annual Heckerling Institute of Estate Planning conference in Orlando, Fla., on January 27.

Many clients consider today's social and economic environment more litigious and more hazardous to the preservation of wealth than in years past. This view is supported when one observes the ever-expanding theories of liability, the rise in jury awards, the increasingly result-oriented courts and the high incidence of divorce. By reason of these problems, traditional forms of protection may be inadequate. Moreover, certain classes of beneficiaries may have greater exposure to risk than others. These include, but are not necessarily limited to, professionals subject to malpractice exposure, directors and officers of publicly held companies, investment advisors and owners of real estate.

I've frequently exhorted that it is a primary obligation of estate planning advisors to consider their clients' potential need for timely asset protection planning. In fact, some commentators have suggested that there may be significant malpractice exposure for professionals who neglect this important aspect of financial planning. Although, obviously, not every client's circumstances will require asset protection planning, every estate planning professional should be prepared to advise clients whose circumstances warrant such consultation.

Due Diligence

The first step in advising a client with respect to asset protection is to ensure that the client will not be engaging in a fraudulent transfer. Asset protection planning must be sensitive to avoiding circumstances where the transfer of property appears to have been made with the intent to hinder, delay or defraud creditors. Certainly, no transfers can be made which would have the effect, after consideration is given to any pending or threatened litigation, of rendering the transferor insolvent. Under all other circumstances, the issue boils down to how close in time the transfer was to the subsequent creditor claim. It is, therefore, imperative that asset protection planning be undertaken as far in advance of a potential creditor claim as possible.

The attorney must carefully assess the client's situation by obtaining a net worth statement and identifying any contingent liabilities or claims that the client may be subject to in the foreseeable future. Furthermore, appropriate independent due diligence should be undertaken by searching the Web and services such as LexisNexis and Accurint to confirm the client's representations. The engagement letter should clearly set forth that the client is not contemplating bankruptcy and understands that the attorney will not assist with any fraudulent transfers. The attorney who undertakes such planning without the recommended due diligence may find him or herself involved in civil or criminal litigation as well as a possible disciplinary proceeding.

Exempt Assets

Once the client intake has been cleared, the next step is to identify assets that are inherently exempt under state law and assess the possibility of converting non-exempt assets into exempt assets. For example, maximizing retirement plan contributions and purchasing life insurance and annuities, where such assets are exempt from creditors, may provide significant asset protection at minimum cost. Additionally, where the client is married and residing in a state that provides protection to tenancy by the entirety property, consideration should be given thereto.

Transfers To Others

One of the most basic techniques used in asset protection planning is the simple expedient of transferring assets to one's spouse or to (or in trust for) one's children or other family members. Although generally protective, such transfers involve surrendering all rights to control the transferred assets, and any

certainty that the transferor can continue to enjoy the benefits of the transferred assets. Such transfers also subject the owner to loss in the event of divorce. Additionally, transferring assets to one's spouse (for less-than-adequate consideration) has sometimes been held to be subject to attachment by the transferor's creditors where the transferor earned most or all of the family's income. Using a legal fiction known as a "constructive trust," the courts have sometimes held that the transferee spouse is merely holding the property as a trustee for the benefit of the transferor spouse. Finally, to the extent that the transfer is later deemed a "fraudulent conveyance," the courts will unwind the transfer and the transferred property will be paid over to the transferor's creditors.

Each of these techniques, however, is limited in its protectiveness; the details of which are beyond the scope of this article.

LPs And LLCs

Another fairly common asset protection technique is the transfer of assets to a limited partnership or limited liability company. Under this technique, the owner of the property contributes it to a limited partnership in which he or she is the general partner, wherein other family members (including the transferor) are named as limited partners. As the general partner, the transferor retains control over the assets in a fiduciary capacity for the benefit of all of the partners. At the same time, the assets are generally secure from the claims of the creditors of any individual partner since the assets are owned by the entity, rather than by the individual partner. Under what is known as the "charging order" protection, a creditor of a limited partner is generally only entitled to attach the interest of the limited partner in the partnership and thereby receives distributions only if and when distributions are made. (Some states, however, provide that the charging order is the sole and exclusive remedy. Where such is not the exclusive remedy, the creditor can seek to foreclose against the debtor's interest).

Of course, if the general partner of the limited partnership is a family member, he or she is unlikely to make any such distributions until after the debtor partner has successfully settled the creditor's claim, which itself provides the debtor partner with the necessary leverage to do so.

In addition to the asset protection benefits that a limited partnership can provide, it can also prove beneficial for more traditional estate planning purposes, such as saving estate and gift taxes. For example, if a parent is the general partner and transfers a limited partner's interest in a limited partnership to his or her children, the value of the transferred interest will likely be entitled to a discount from the value of the underlying assets of the entity since the transferred interest is non-controlling, and has no public market. Moreover, since the parent, as general partner, retains total management control over the assets held within the entity (albeit in a fiduciary capacity for the benefit of all of the partners), the oft-cited fear of a child getting access to substantial sums of money immediately upon attaining majority (as would be the case with a Uniform Gifts to Minors Account or a Uniform Transfers to Minors Account) is not an issue.

The 'Asset Protection Trust'

Where the liability risk warrants additional protection, consideration should be given to utilizing an asset protection, or "self-settled," trust.

The law of most of the United States provides that where a person establishes a trust, and is also a beneficiary of that trust, the trust fund is available to that person's creditors to the full extent of his or her beneficial interest. This principle of domestic trust law holds true even if the trust was established at a time when no creditors existed and even if the future potential for such creditors was wholly unforeseeable at that time.

A distinction is often made between the circumstance where one establishes a spendthrift trust for the benefit of another, and where one attempts to establish a spendthrift trust for his or her own benefit (even if only as a member of a class). Upon public policy grounds, such a "self-settled" spendthrift trust

is, in most jurisdictions, deemed invalid as against the settlor's own creditors. This is true even where the settlor's only beneficial trust interest is the possibility of receiving distributions within the discretion of a third-party trustee. Moreover, in such majority rule jurisdictions, it is also deemed to be immaterial whether the settlor's creditors are present or future, reasonably anticipated or impossible to foresee, as intent to defraud creditors is not required for the application of this rule.

Notably, however, the settlor of a trust may designate the law of any jurisdiction as governing the trust's administration, not just that of his own domicile, and hence may designate a jurisdiction that recognizes self-settled spendthrift trusts as valid even though the jurisdiction of the settlor's domicile does not. Thus a settlor domiciled in one state may create an inter vivos trust by conveying property to a trust company of another state as trustee and delivering the property to it to be administered in that state. In that case the law of that state will, presumably, be applicable as to the rights of creditors to reach the beneficiary's interest. This permits a person who is domiciled in a state in which restraints on alienation are not permitted, to create an inter vivos trust in another state where they are permitted and thereby take advantage of the law of the latter state.

Therefore, although only a minority of jurisdictions, both onshore and offshore, permits the establishment of effective self-settled spendthrift trusts, such trusts are available to all persons regardless of domicile. Care must be taken, however, in order to achieve all of the desired benefits of an effective self-settled spendthrift trust.

The primary consideration in establishing an effective self-settled spendthrift trust is the law under which the trust is established. In this regard the practitioner has the choice of a fair (and constantly expanding) number of offshore jurisdictions as well as, to date, 11 states.

Additional myriad considerations of somewhat lesser (but by no means inconsequential) significance must also be considered in choosing the law that will be designated as governing the trust. Some of those considerations include (i) the effect of the local tax regime upon the trust; (ii) the availability of professional trust services (ideally through a trustee with which an effective working relationship has previously been established); (iii) the political and economic stability of the jurisdiction; (iv) whether there exists language, cultural or other barriers which make administration of the trust in that jurisdiction inconvenient; (v) the situs of the property; and (vi) other practical and psychological hurdles for a creditor attempting to enforce a claim against a trust sited in that jurisdiction.

The law surrounding spendthrift trust protections is, however, an iceberg, and this article exposes merely the tip. Therefore, the diligent estate planner will dig further to discover the myriad creative ways that exist to protect his clients' interests through the use of spendthrift trusts.

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