



Asset Protection Planning

Asset protection planning is commonly thought of as something that only the wealthy need to do. The goal of this type of planning is to protect assets from being adversely effected by events such as a lawsuit, divorce, illness and death, business failure or even a change in taxation or other government action. When you really think about it though, it's not only the wealthy that face such threats. Anyone who drives a car or owns real estate needs to think about asset protection planning. This article will discuss some of the relatively simple and often overlooked strategies that can be employed, as well as some of the more complex strategies that in most instances are more suitable for those with substantial wealth.

One of the most basic steps you can take towards protecting your assets is to practice "risk management" in the form of risk-shifting. We are all familiar with the role of insurance companies – but have you ever thought of them as being bearers of your risk? That is, after all, what they are in business to do. When you pay an insurance premium, you are doing so in order to shift the risk of a certain (or uncertain) event from you to the insurance company.

The first step towards asset protection should be to make certain that you carry adequate liability insurance. Look at the limits on the liability components of your

automobile and homeowner's policies. When purchasing such insurance, most people just take whatever is quoted to them without considering what it is that they are actually buying. When you buy a homeowner's policy with a \$100,000 liability limit, you are protecting \$100,000 worth of your assets. What if you own more than that? If a judgment is entered against you for \$150,000, you may be exposing \$50,000 of your assets when a simple increase in the liability limit could have saved you that risk.

The first step, then, that everyone can and should take is to review the liability limits on their automobile and homeowner's policies in light of the assets that you own. If you own assets in excess of the limits, then an increase in the limits might be in

Simple (and some NOT so simple) steps that everyone can and should take to safeguard their hard-earned assets.

order. It might also make sense to purchase an "umbrella policy" if additional coverage is needed. This type of policy increases the

liability components of your automobile and homeowner's insurance. They are typically sold in increments of \$1,000,000 and are surprisingly inexpensive for the amount of protection that they offer.

The next step is to take a look at how your assets are titled, especially if you are
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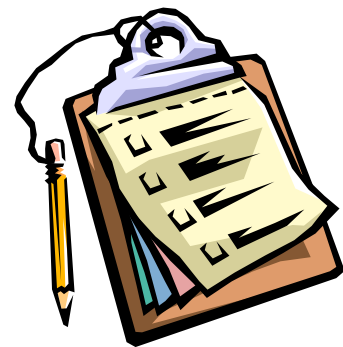
married. The concept of “title” refers to who owns an asset. If you are married, you may own assets just in your name, as may your spouse, or you may own assets jointly – such as when an account or piece of real estate carries both of your names. Pennsylvania law usually treats those assets owned jointly with a spouse as “tenants by the entireties” property, which refers to a way of titling joint property only available to married couples. In most instances, Pennsylvania law protects tenants by the entireties property from the creditors of either individual spouse. That is, if your spouse injures someone and a judgment is entered against him or her in excess of any liability insurance that there might be, any assets that the two of you own as tenants by the entireties cannot be seized to satisfy that judgment. For this reason, in most instances it makes sense for spouses to own assets this way.

As with any “rule” however, there are always exceptions. In the case of joint ownership with your spouse, the exception is for assets that were acquired as part of an inheritance. Now you need to shift gears and think about another type of asset protection – protection from divorce. In Pennsylvania, the process couples go through to “divvy up” assets during divorce is called “equitable distribution.”

For the most part, all assets acquired by either spouse during the marriage are subject to the equitable distribution. One exception, however, is for assets that were inherited by either spouse, *but only if that spouse kept those assets in his or her individual name*. For that reason it may make sense to keep inherited assets in your individual name, as long as you have adequate liability insurance in place, as discussed above.

A recent development worthy of mention with respect to the spousal joint ownership rule casts doubt on the ability to avoid Federal income taxes owed by one spouse with tenants by the entireties property. Should you be faced with that situation, spousal joint ownership may not protect your assets.

Next, have you ever considered your medical insurance in terms of asset protection? Many people do not realize that their medical insurance may have lifetime limits on coverage. What happens when you reach that limit?



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About the firm

Goldblum, Sablowsky and Zemel, LLC is a law firm with a focus on all aspects of business and commercial law, as well as litigation and tax disputes. We also offer individualized estate, tax, asset protection and succession planning for individuals, professionals and business owners. We serve as general counsel to small and mid-size companies in all market segments. Our clients view us as strategic partners, providing a wealth of financial, tax and business planning guidance and advice.

Philip A. Goldblum, a founding member of the firm, concentrates his practice in tax, business, estate and trust planning matters, as well as asset protection and succession planning matters. He regularly handles commercial, financial and real estate transactions of all varieties and sizes and acts as general counsel to many privately owned companies.

Steven L. Sablowsky, a founding member of the firm, concentrates his practice in the areas of federal and local tax disputes, including related litigation in the U.S. District Court, U.S. Tax Court and Court of Common

Pleas. He also represents business owners and individuals in business succession planning, estate planning and administration, general corporate and real estate matters.

Mitchel Zemel, a member of the firm, focuses his practice on the representation of small and mid-size business, with particular emphasis on litigation, and avoiding litigation. He provides support for all aspects of business representation, from general corporate matters and transactions to employment matters, contracting and real estate.

Theresa A. Malmstrom, a member of the firm, focuses her practice on the representation of individuals in the estate planning and administration areas. She also works with clients to obtain guardianships and establish special needs trusts for incapacitated individuals. She also assists clients with charitable gift planning, including the creation of private foundations and charitable trusts.

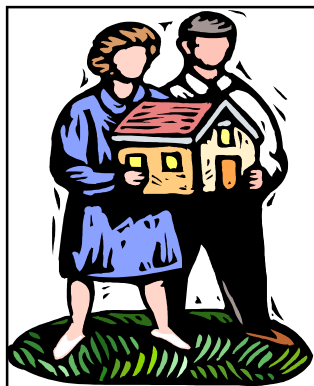
Please feel free to contact any of our attorneys if we can be of assistance to you.

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That's when you start paying your own medical bills if other insurance is unavailable. We don't need to mention how quickly your savings could be depleted if you became a self-pay patient. Unfortunately, though, for most people, there may not be much that you can do to "fix" the problem, especially if you have group coverage which you cannot change. Even though there may not be anything that can be done, you should be aware of the coverage that you do have, and the limits there may be.

And one more for the "I never would have thought of that" category - your Social Security statements. The Social Security Administration has begun sending statements containing earnings record to everyone who has ever paid Social Security taxes. When you receive your statement, look over the reported earnings to make sure that they seem right. You may not recall what you earned 10 or 15 years ago, but if the earnings for a particular year don't make sense - perhaps they were very low, or even zero, then it is worth an inquiry. Your earnings record will determine the Social Security benefits that you may receive. If earnings are not reported, it could result in a decrease in your benefits. A decrease means that you will have to spend more of your own assets - another form of asset erosion that is worth protecting against. If you find a mistake, the form contains instructions on how to "keep your earnings record accurate."

On to the more sophisticated strategies - that is, those dealing with off-shore trusts and other legal entities specifically created to provide asset protection. Generally, the goals of these types of strategies are to deter litigation and provide incentives for early and cost effective settlements by enhancing one's bargaining position. It should be noted that these strategies are not a means to defraud creditors or hide assets. Candidates for asset protection include business owners who wish to shelter personal assets from liability and individuals with substantial investment assets who wish to diversify their investment portfolios into direct overseas investments. Before anyone enters into any of these strategies, they must be compatible with the strictures of asset protection (be able to afford to lock up assets) and be in a financial position that lends itself to asset protection planning.



The first of these strategies, Family Limited Partnerships ("FLP's"), are attractive as an asset protection tool

because of the limited remedies available to creditors when attempting to reach assets transferred to an FLP. When you form an FLP, you transfer ownership of a particular asset or assets to the FLP in return for an ownership interest in the FLP itself. So, instead of owning 100 shares of a stock or a piece of real estate, you own (as a "partner") an interest in an FLP that owns the stock or real estate.

Generally, a judgment creditor may only obtain a "charging order" against distributions received by the debtor partner from the FLP. The creditor is treated as an assignee of the FLP interest. As an assignee of an FLP partnership interest, the creditor may be treated as the owner of the interest for federal income tax purpose, and subject to tax on the pro rata undistributed income of the FLP. Creditors

No discussion of asset protection planning would be complete without making mention of protecting your most valuable asset - you.

don't like reporting income without receiving cash distributions to pay the associated tax. This, therefore, discourages creditors from looking to FLP interests to satisfy a debt. However, it is still possible that creditors in egregious circumstances could argue that fraudulent conveyances should result in remedies other than merely a charging order, such as a sale of the debtor's FLP interest or even liquidation of the FLP. This may be a particular danger if the creation of the FLP lacks any apparent purpose other than asset protection. Often, the client's impetus for the discussion of an FLP is triggered by some event or circumstance that raises liability exposure and the client is hoping that establishing an FLP will provide some defense against an anticipated onslaught of creditors. This is obviously a dangerous perspective, as it immediately raises fraudulent conveyance issues (i.e. transfers made in order to defraud creditors). Clients must be cognizant of the limits of what can and cannot be accomplished in this area, and the compromises a client must be willing to accept to achieve his/her goals and objectives. Transferring assets to an FLP before liability arises will result in a shield, although not an invulnerable shield, to protect assets from creditors.

Where asset protection planning is a paramount concern of the client, the safest structure from an asset protection perspective is to have an offshore trust serve as the

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limited partner of the FLP and to have substantially all the assets of the partnership located outside the jurisdiction of the U.S. Courts. By moving both the limited partner as well as the partnership's assets outside the jurisdiction of the U.S. Courts, the client has forced the potential creditor to physically go to the foreign jurisdiction where the trust has its situs and attempt to persuade a local court that the creation of the trust and the original transfer was fraudulent. Obviously, this structure exponentially increases the complexity and cost of planning, and causes increased filing requirements.

Another asset protection tool that you may not have considered is your estate plan. Your Wills and other estate planning documents should be structured to minimize the death taxes payable by your estate—at both the state and federal levels. Simply put, more death taxes means less of an inheritance to your heirs—just another form of asset erosion.

Death taxes at the state level will vary depending on the state in which you reside at the time of your death, as will the strategies employed to save them. The federal estate tax is imposed on the estate of every U.S. citizen or resident (regardless of citizenship). Every estate is entitled to an “exemption” from the federal estate tax. For decedents dying in years 2006 through 2008, the “exemption” from the federal estate tax is \$2,000,000. Under the current law, the exemption increases to \$3,500,000 in 2009. The federal estate tax is repealed for the estates of decedents dying in 2010, but comes back in 2011 with a \$1,000,000 “exemption.” Those numbers may seem high, however, clients are often surprised by how quickly their estates reach those levels once they add up the death benefit on their life insurances, balances in retirement plans, etc. In 2006, every dollar after the \$2,000,000 “exempt” amount is taxed at 46%. A full discussion of proper estate tax planning is far beyond the scope of this article, but it is enough to say that if your and your spouse's combined estates are in excess of the exempt amount, there are strategies that you should consider to potentially save your heirs significant death tax dollars.

Finally, no discussion of asset protection planning would be complete without making mention of protecting your most valuable asset – you. A 35 year old earning \$50,000 per year has the potential to earn \$1,500,000 before retirement at age 65 – and that's not taking into account raises, etc.! No one would dream of not carrying homeowner's insurance to replace their house in the event of a catastrophe, yet many people fail to properly insure themselves and their family against events such as disability or premature death.

We have all seen the ad for the bicycle helmet that reads something like: “Have a five dollar brain? Wear a five dollar helmet.” The same applies to your life and disability insurances. You need to make certain that you carry adequate coverage of both types, in terms of death and disability benefits, and that you understand the policy coverage. For example, many people rely on group disability insurance provided by their employer without checking the definition of “disability” under the policy. Don't wait until it is too late to find out that your injury or condition does not fit the insurance company's definition of “disabled.” Make certain that you understand, too, the tax consequences of receiving the benefits before you rely on them to “replace” your income.

Unlike other types of insurance, your ability to qualify for and purchase life and disability depends on your health and medical history. For that reason, it is always better to look into acquiring that coverage sooner rather than later, before medical problems arise. Without those types of insurance in place, you or your family could be forced to spend your life's savings if you become disabled or die prematurely – again, another source of asset erosion that can be prevented.

Please call one of our attorneys if you have any questions regarding any of the information in this article. As always, we are available to assist you with all of your estate planning, administration, taxation and business planning needs.

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