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Asset protection is for everyone

When many people hear the words "asset protection," they think of billionaires with Swiss bank accounts and offshore tax havens. But in reality, asset protection is for everyone. It's simply a series of basic techniques you can use to help ensure that the wealth you've accumulated stays with you and your heirs, and not someone else.

Hard-earned wealth can quickly disappear as a result of a lawsuit, a business going under, or a similar event. Asset protection techniques exist to protect you from these possibilities. You can also use them to help protect your children or other heirs from the consequences of a divorce, lawsuit, business failure, and so on.

It's actually more important for people of moderate wealth to engage in asset protection than it is for billionaires. After all, billionaires can afford to lose a lot of money, whereas the rest of us cannot.

In fact, now that the federal estate tax affects far fewer people than it used to – the tax doesn't even kick in unless an estate is worth over $5 million, or over $10 million for a married couple – the focus of estate planning is increasingly shifting from protecting assets from taxes to protecting assets from creditors.

So what sorts of things can you do to protect yourself?

One of the more basic forms of asset protection is insurance. If you have an auto or homeowner's insurance policy, you're already engaging in asset protection. The policies will protect you in many cases if a lawsuit is filed against you.

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A good first step is to thoroughly review your insurance coverage every few years, and make sure you have enough. You might want to buy an umbrella liability insurance policy, which kicks in after your other policies' coverage limits are reached. The goal should be to have enough insurance (and protect your other assets well enough) that a person who brings a lawsuit against you will simply settle with your insurance company under your policy limits, and not try to go after your home or other assets.

Life insurance can be another way to protect your heirs, because in many states a creditor cannot claim either the proceeds or the cash value of a life insurance policy. In some states, the same is true if you're the beneficiary of a fixed annuity.

Retirement plans are another type of asset protection. Assets in a retirement plan are often exempt from creditors. However, you should be aware that the rules can vary a great deal depending on the type of plan, the type of creditor, and the state where you live.

A federal law called ERISA says that 401(k) plans are generally exempt from creditors, although there are some exceptions, such as claims for child support.

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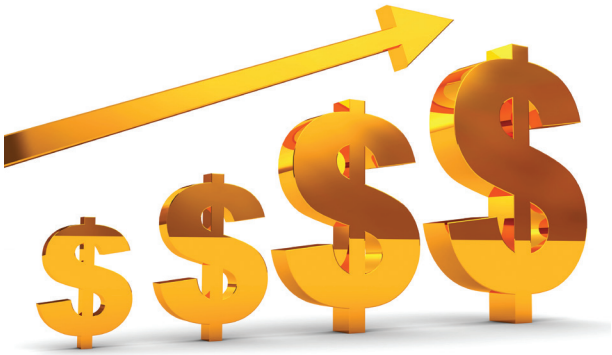
IRS tax crackdown might actually end up helping

IRS officials have been indicating for a few months now that they're about to start cracking down on certain estate planning techniques that have been popular in recent years. But ironically, this might actually help a number of clients to *save* on their taxes.

The issue involves family limited partnerships and LLCs. A technique that many wealthy people have used in the past is to create a family business structure of this type, and then give away partial interests in the business to family members. The idea is that the value of these partial interests can be significantly reduced for purposes of estate and gift taxes.



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The IRS's plan to limit estate tax breaks involving family limited partnerships might result in reducing capital gains taxes for many more people.

Here's an example: Suppose Anne creates a family limited partnership to hold $2 million in assets. She then gives her son Roger a 10% interest in the partnership. You might think that this would result in a taxable gift of $200,000.

But in fact, Anne could claim on her gift tax return that this 10% share was worth much less than $200,000. That's because, if Roger tried to sell it to a third party, it's unlikely anyone would actually pay $200,000 for it. The fact that the third party would be a minority shareholder, with no ability to cash out the investment and no ability to control the business, would reduce its value significantly.

As a result, Anne could "give" $200,000 to Roger and have the gift be treated as something far less valuable for transfer tax purposes.

It's not surprising that the IRS has been upset about this technique. In fact, it has tried on numerous occasions to get Congress to change the law, but to no avail. So now it appears that the IRS is going to issue new regulations to limit the use of family business discounts.

However, for many clients, this might not be a bad thing.

It's expected that in 2016, the federal estate tax will not apply at all to estates of less than $5.45 million (or $10.9 million for married couples), As a result, unless a family is very wealthy, the federal estate and gift taxes are no longer a chief concern, and the IRS regulations won't be a problem.

What *is* a concern, though, are capital gains taxes, since the federal capital gains rates have gone up quite a bit recently (and many state rates have gone up as well).

Now, when a person dies, any assets in the person's estate that have appreciated in value receive a "step-up" in their capital gains tax basis. The new basis is not what the person originally paid for the assets, but their value at the date of death. This reduces the amount of capital gains tax that heirs must pay when they eventually decide to sell them.

So … if an heir receives a minority interest in a family business when someone dies, he or she may actually want a *higher* valuation for that interest, so as to reduce future capital gains taxes.

And if the new IRS regulations limit discounts for family business interests for estate and gift taxes, that should help – because the IRS presumably can't then turn around and argue that the same interests should be *discounted* for the purpose of capital gains taxes.

The bottom line is that the new rules might be a net loss for very wealthy families with partnerships and LLCs, but good news for everyone else.

Preparing now for the possibility of Alzheimer's disease

Did you know that 47% of people over age 85 are affected by Alzheimer's disease? The numbers are high enough that any older person planning for their estate should consider the possibility that they may become intellectually incapacitated at some point.

Of course, a critical step in planning for incapacity is having a durable power of attorney document in place that allows someone to handle your financial affairs if you're no longer able to do so.

It's also critical to have a health care power of attorney or proxy form, so that someone you trust can manage your health care if you're no longer able to provide informed consent. These two forms are essential components of a good estate plan.

But beyond the forms, as you get older it's also wise to arrange your affairs so that someone else can easily step in if it becomes necessary. This might include consolidating and simplifying accounts, organizing your records, making lists of your assets and obligations, and generally having a conversation with children or other agents so they have some idea what to do if the need arises.

It's understandable that many people are reluctant to plan for incapacity, but it will be much better for both you and your loved ones if they have a handle in advance on what needs to be done.

Asset protection planning is for everyone

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However, ERISA doesn't apply to IRAs, SEP plans, SIMPLE plans, Keogh plans, or government plans. For these plans, the level of asset protection typically depends on state law.

Many states have broad protection from creditors, but not all. Sometimes the rules are highly complex. (In Massachusetts, for instance, IRA contributions generally are not protected from a court judgment to the extent that they exceed 7% of the person's total income during the five years before the judgment occurred.)

Further, there are completely different rules if a person has a business setback and files for bankruptcy. For instance, rollover IRAs are generally protected in bankruptcy, but traditional and Roth IRAs are protected only up to about $1 million. And an IRA that you inherited from someone else might not be protected at all.

What this means, among other things, is that you should never just casually consolidate different types of retirement accounts. While this might make things easier in terms of recordkeeping, it could destroy or weaken your protection from creditors.

If you're concerned about your heirs, a good way to protect them is to put assets into a trust for their benefit, rather than giving money to them directly or leaving assets to them in your will.

Many people use trusts to make sure a beneficiary who is young or financially inexperienced won't make mistakes and quickly exhaust an inheritance. But such trusts can actually make sense for other types of heirs as well. That's because assets in a trust might be kept out of reach of a business or lawsuit creditor or a divorcing spouse.

Can you put your assets into a trust for your *own* benefit, and keep them away from creditors?

That's a good question. Some 15 states now allow trusts of this type, and people who live in other states can take advantage of them by setting up trusts in one of the 15 states. However, these states' laws are new, and it's still very unclear how well they will actually work to protect assets (especially for people who live outside the 15 states).

Still, while it's not clear that these trusts will ultimately succeed, they're one more hurdle that might discourage a creditor from going after you.

If you really want to protect your assets in this way, you might consider setting up a trust in a foreign country that offers this type of protection. Doing so is complicated and can involve a lot of regulations and paperwork, but it might be a safer bet.

Speaking of going offshore, some foreign companies offer life insurance policies with greater asset protection rules than are available in some U.S. states.

If you're concerned about protecting your wealth, it's a good idea to talk with a lawyer to review your potential exposure and your options. And it's wise to do it sooner rather than later, because asset protection planning only works against *future* problems. In general, once a claim against you has arisen, it's already too late to protect your assets against it.

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Having two trustees may be better than one

A trustee has two important duties – managing the assets in the trust, and distributing them to the beneficiaries according to the donor's wishes. But it can be hard to find one person who can do both things well. An aunt or uncle might be the perfect person to know how to distribute assets to family members, but might not have a lot of financial acumen. An investment advisor might be very skilled at growing the assets, but not have a deep understanding of the donor's values and preferences.

So you might want to have two trustees and divide the duties – put one in charge of investments and another in charge of distributions.

Some 35 states now have "directed trust" laws, which have an added benefit. These laws say that if the investment trustee makes a mistake or does something wrong, the distribution trustee can't be sued by the beneficiaries.

Here's a good example of why this is important. Suppose a trust is set up that contains a lot of stock in a family company. The understanding is that the trust will hold onto the stock over time. After a while, though, things go badly for the company, and the heirs are upset because the value of their trust has declined significantly.

The heirs might want to sue the advisor for not diversifying the trust's holdings, or for voting the family stock in a way that hurt the company. Traditionally, both trustees could potentially be liable for these types of losses. But under a directed trust law, the distribution trustee might be legally off the hook if he or she didn't participate in the financial decisions.

Without such a law, some friends or family members might be very reluctant to take on the role of a distribution trustee at all.

If you're thinking of setting up a trust with divided roles, this is definitely something to discuss with your attorney.

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Audrey Hepburn's sons battle over keepsakes for 23 years

When actress Audrey Hepburn died in January 1993, she owned a storage locker containing memorabilia of her career – costumes, photos, awards, scripts, posters and the like. In her will, she directed that the contents be divided equally between her two sons.

But some 23 years later, the two sons (who had different fathers) still can't agree on how to divide the goods. The older son, who is now in his mid-fifties, has filed a lawsuit and asked a judge to split the possessions.

wikipedia commons

This is an extreme case, but it goes to show the importance of specifying in your estate plan what will happen not only to your financial assets but also to your personal possessions, especially if they have significant monetary or sentimental value.

In many states, you can write a "tangible personal property memorandum" that covers how personal items will be distributed. It's separate from your will, and a big advantage is that you can change it yourself whenever you like without having to revise your entire will.

But however you handle such matters, don't just assume that family members will agree on who gets the piano or the jewelry or the beloved photo albums. Making your preferences clear can prevent a lot of awkwardness and hard feelings later.