

Asset Protection - Lessons from Literature

May 2021

PROTECTING WHAT YOU HAVE BUILT

Those who have accumulated substantial wealth are often concerned about protecting it from future creditors, predators, divorcing spouses, and even their own heirs' financial mismanagement. Perhaps some might recall the lesson from Ozymandias, that old sonnet that a few of us studied in high school literature class:

Ozymandias

*I met a traveller from an antique land
Who said: "Two vast and trunkless legs of stone
Stand in the desert . . . Near them, on the sand,
Half sunk, a shattered visage lies, whose frown,
And wrinkled lip, and sneer of cold command,
Tell that its sculptor well those passions read
Which yet survive, stamped on these lifeless things,
The hand that mocked them, and the heart that fed:
And on the pedestal these words appear:
'My name is Ozymandias, king of kings:
Look on my works, ye Mighty, and despair!
Nothing beside remains. Round the decay
Of that colossal wreck, boundless and bare
The lone and level sands stretch far away."*

— Percy Bysshe Shelley (1792-1822) (Public Domain)



Of course, one might understand that Ozymandias in a somewhat humorous way confronts the harsh reality that not much of what we build in this world lasts forever – particularly where there are people involved. However, whether the concern is for your personal assets or your business, various tools exist to keep your property safe from tax collectors, accident victims, healthcare providers, credit card issuers, business creditors, and others.

No one tool is a panacea. You will have to evaluate each tool in terms of your own situation. You may decide that insurance and a Declaration of Homestead may be sufficient protection for your home because your exposure to a claim is low. For high exposure, you may want to discuss with your legal counsel the merits of a business entity or an offshore trust to shield your assets. As with many areas of financial and estate planning, you may have to adjust your asset protection strategies as your situation, or the laws change.

LIABILITY INSURANCE

Liability insurance is a critical first step for asset protection.

Personal liability coverage means purchasing an umbrella coverage on your homeowner's policy. Umbrella insurance is extra insurance that provides protection beyond existing limits and coverages of other policies. Umbrella insurance can provide coverage for injuries, property damage, certain lawsuits, and personal liability situations. Keep in mind, though that an umbrella policy generally does not provide coverage for your injuries or damage to



your personal property, a criminal or intentional action causing damage to someone else, or liability you assume under a contract.

For business-related liability protection, you can purchase or increase your liability coverage under a business insurance policy. Generally, the cost of the premiums for this type of coverage is minimal compared to what you might be required to pay under a court judgment should you ever be sued.

HOMESTEAD DECLARATION

Generally, a homestead declaration can protect a family residence because it means a creditor cannot auction a home if the owner, his/her spouse, and other family members live in the home. In many states, the homeowner's family inherits the homestead protection while they are living in your home.

State law determines the creditor and judgment protection afforded a residence by way of a declaration of homestead, which varies greatly from state to state. For example, a state may provide a complete exemption for a residence (i.e., its entire value), a limited exemption (e.g., up to \$100,000), or an exemption under certain circumstances (e.g., a judgment for medical bills). In Massachusetts, a \$125,000 homestead exemption is automatically on the homeowner's personal residence. Beyond that, you can protect up to \$500,000 in equity in your home in Massachusetts, but you must file a Declaration of Homestead.

If your home is owned in a trust, then in many states, the holder of a beneficial interest in the trust is considered an "owner," eligible for an estate of homestead. In this case, the trustee executes a declaration of homestead on behalf of the trust's beneficiaries.

The homestead declaration protects a homeowner from unsecured creditors and certain other debts or attachments, however, it will not offer protection from first or second mortgage lenders and/or equity lenders who possess a security interest in a home. If payments are not current on these types of secured credit, a homeowner runs the risk of losing the home to foreclosure proceedings.

DIVIDING ASSETS BETWEEN SPOUSES

On May 14, the Wall Street Journal's real estate section published an short article entitled, "[On Jupiter Island, the Seaside Mansion of Lehman's last CEO Sells for \\$32.5 Million.](#)" The article is full of photos of the beautiful estate (3.3 acres – including 265 feet of ocean frontage, and nearly 15,000 square feet between the main and guest houses!), and opens with a statement:

"On Florida's Jupiter Island, a seaside mansion owned by Richard S. Fuld Jr., the former chairman and chief executive of Lehman Brothers, has sold for \$32.5 million, according to people familiar with the sale. The seller was listed as Mr. Fuld's wife, Kathleen Fuld. The couple jointly purchased the property for \$13.75 million in 2004, but transferred it to Ms. Fuld in 2008, per public sales records."

Note the timing of the transfer of ownership of the home between Mr. and Mrs. Fuld. Certainly not coincidental. There are certain individuals (physicians, attorneys, CEOs) who may work in an occupation or business that exposes them to heightened potential liability. In those cases, it can be a good idea to divide assets between spouses so that one spouse keeps only the income and assets from his/her job, while the other sole ownership of your investments and other valuable assets. Generally, creditors can reach only those assets that are titled in the individuals name.



BUSINESS ENTITY STRUCTURE

Business entities shield personal assets from business creditors and conversely, shield business assets from personal creditors. Broadly speaking, there are four forms of business entity structure:

SOLE PROPRIETORSHIP

A simple form of business owned and run by a single person, where the business does not have a separate legal existence from the owner.

PARTNERSHIP

A business with two or more owners (partners) who contribute to all aspects of the business and share in the profits and losses (including general partnerships and limited partnerships).

Business owners may consider using a corporation, limited partnership, or limited liability company (LLC) to operate the business. Such business entities shield the personal assets of the shareholders, limited partners, or LLC members from liabilities that arise from the business. The liability of these owners will be limited to the assets of the business. You should discuss with qualified legal and tax counsel the appropriate entity selection for your situation.

With a ***Sole Proprietorship***, business liabilities and debts are the owner's personal liabilities and debts. If business assets are insufficient to pay creditors, the creditors can go after the owner's personal assets, whether used in the business or not. This obviously puts the owner and the owner's family at financial risk. So, the sole proprietorship offers no asset protection.

In a ***Partnership***, each general partner is liable for the full amount of partnership obligations, not only to the extent of the partnership assets, but also to the full extent of the partner's personal assets.

For example, suppose Don and Mike agree to form a partnership, each contributing \$20,000. They purchase raw material, but when the bill comes due, they are unable to pay it because of cash-flow problems. The supplier sues the partnership and the two partners individually for the amount of the debt—\$25,000. At the time judgment is awarded to the supplier, partnership assets total \$20,000. Don and Mike would have to make up the \$5,000 deficit out of their own pockets. If Don lacked the assets to pay his portion,

In contrast to the unlimited liability of a general partner, the limited partner has no personal liability for partnership debts. The limited partner's loss is limited to the total amount of his/her investment in the partnership.

The ***Corporation*** is a separate legal entity. Debts and liabilities incurred by the corporation are the debts of the corporation, not the debts of the owners (shareholders).

In either a publicly-held or closely-held corporation, an owner's liability is limited to the shareholder's capital contribution. For example, if an individual has invested \$20,000 in a corporation that goes bankrupt, the shareholder's loss would be limited to that \$20,000.

Situations Where Shareholders May Have Additional Personal Liability Over and Above Their Capital Contributions:

There are situations where shareholders may incur additional personal liability over and above their capital contributions. Those situations can arise when the "corporate veil" is pierced by courts in the case of fraud or other inequitable results to shareholders or the public. These cases usually involve small, closely-held corporations. Occasionally, shareholders will voluntarily agree to accept additional liability. In the case of new corporations



or financially unstable corporations, lenders and creditors may be reluctant to do business with the corporation for fear the corporation's financial resources will not cover the debt. In that case, a shareholder may be willing to collateralize the corporation with personal assets in those situations.

A **Limited Liability Company (LLC)** provides its owners with limited liability, and in states that provide for a "charging order," offers an additional level of asset protection for the LLC. A charging order is a court order that allows a creditor to take any distribution the owner will receive from the LLC but does not allow the creditor to attach the shares and take control of the entity (even to the point of forcing a liquidation). Instead, the charging order is like a lien on the interest of the debtor-owner. Currently, only a few states provide charging order protection to single-member LLCs.

ASSET PROTECTION TRUSTS

Asset protection trusts are typically established by individuals in high-risk occupations (i.e., physicians, real estate developers, attorneys) and very wealthy individuals who realize that in the future they could be targets for creditors due to their net worth. The extent to which a beneficiary's creditors can reach trust property depends on how much access the beneficiary has to the trust property. The more access the beneficiary has to the trust property, the more access the beneficiary's creditors will have. To provide asset protection, the trust should be irrevocable and become the owner of your property, and the grantor should not maintain control over the trust property.

Offshore Trusts

Since certain claims can pierce domestic protective trusts (e.g., claims by a spouse or child for support and state or federal claims), legal counsel may recommend that an individual bolster protection by placing the trust in a foreign jurisdiction. Offshore or foreign trusts are established under, or made subject to, the laws of another country (e.g., the Bahamas, the Cayman Islands, Bermuda, etc.) that do not generally honor judgments made in the United States.

It is very important to seek and rely on the advice of legal counsel who are well versed in the area of asset protection planning with trusts – both domestic and offshore. In a Partnership, each general partner is liable for the full amount of partnership obligations, not only to the extent of the partnership assets, but also to the full extent of the partner's personal assets.

A WORD ABOUT FRAUDULENT TRANSFERS

The court will ignore transfers to an asset protection trust if:

- A creditor's claim arose before you made the transfer.
- You made the transfer with the intent to defraud a creditor.
- You incurred debts without a reasonable expectation of paying them.

AND NOW MORE LESSONS FROM LITERATURE

At Pallas, from time to time we have conversations with clients about what they believe is important to protect and pass along to the next generation. Of course, assets and finances are always part of those discussions, but in my experience, those things have never been paramount – rather it is usually about the values, ethics, faith, and beliefs that have shaped the clients into who they are.



Quite different from Ozymandias in almost every way (including length) is Charles Dickens' 1859 historical novel, [A Tale of Two Cities](#) that is set in London and Paris during the French Revolution. From the very end the novel:

I see the lives for which I lay down my life, peaceful, useful, prosperous and happy, in that England which I shall see no more...

I see that I hold a sanctuary in their hearts, and in the hearts of their descendants, generations hence...

It is a far, far better thing that I do, than I have ever done; it is a far, far better rest that I go to than I have ever known.

Well, I think we can agree that there is something that insurance, legal entities, or trusts just cannot provide or even protect – our real legacy.

Please reach out to the team at Pallas Capital Advisors if you have any questions about asset protection plans as it applies to your particular situation.

Sincerely,



James Landry, ChFC
Chief Operating Officer, Director of Planning
Pallas Capital Advisors

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