

20 Things You Need to Know About Asset Protection

Asset protection is the murky underbelly of personal finance. Most personal finance blogs never talk about it and most people really don't spend much time worrying about it at all. Doctors, however, worry about it a lot. In fact, a ridiculous percentage of continuing medical education credit is extended each year for what really boils down to risk management techniques rather than actual patient care or practice improvement. How many times have you heard in a lecture about how and why you should document a visit in a particular way? Exactly. Is that really helping the patient in any way? No, it's just CYA medicine.



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There is no concrete definition of [asset protection](#), but you will see its practitioners, primarily attorneys, use the broadest possible definition, including [tax saving](#), [estate planning](#), and even [investment strategies](#). You will also see a great deal of fear-mongering going on. Just like with tax preparation, financial planning, investment management, and insurance, their products (primarily [trusts](#), [limited liability companies](#), and partnerships) must be sold. The key to selling these products well is to first create a sense of need. Stoking fear of losing everything to a malpractice suit will

certainly do that. With all the marketing going on, it is VERY difficult to separate fact from marketing here.

Today we're going to go over what you need to know about asset protection. Once you have a grasp of the basics, you can decide if you wish to spend tens of thousands on the services of an asset protection attorney doing a deep dive.

1 You Probably Won't Lose Money to a Patient

Doctors have three big fears when it comes to [malpractice lawsuits](#).

- They'll have to spend all the time, lost earnings, and lost sleep that they have seen in their colleagues. It's even worse when the attorneys tell them not to talk to anyone about the case (just in case someone asks in a deposition or court if they've talked to anyone about it) because it introduces isolation, burnout, depression, and even suicide.
- They worry that people will think they're a bad doctor, even though the main risk factor for a malpractice suit is simply exposure—the more patients you see, the more likely you are to be sued.
- The fear of that they will have a multi-million dollar judgment and lose everything they've worked so hard for.

I even have a former partner who stopped his career early in part because he was risking more than he would ever make practicing medicine. But the truth is that above policy limit judgments that are not reduced on appeal are exceedingly rare.

I calculate out my own risk, now practicing part-time in a relatively doctor-friendly state, at less than 1/20,000 per year. Yours may be higher or even lower than that, but it's far lower than the risk of [being disabled](#), dying early, or

being in a car wreck. Combined.

That doesn't mean you shouldn't do what you can to reduce the risk. It's not zero. But it's also not something you should lose much sleep over. While I won't say asset protection attorneys "prey on the anxious", you and I know that anxiety may be one of the most expensive medical conditions there is!



2 Nothing is 100% Protective

When it comes to protection, we all like 100%. We like to know we're "protected" from anything bad happening to us. However, when you talk to its practitioners, none of them will ever promise that any given technique is 100% effective. It's all about risk reduction, making you less attractive to a potential plaintiff, and trying to stay out of court where a jury or judge may produce an unexpected result. To make matters worse, nobody really knows what will work until it actually goes to court.

3 There is No Step By Step Instruction

It is also frustrating to doctors looking for an easy solution that there is no step by step instruction to follow. You can't

just “Do this, this, and then this and you’ll be fine.” It comes down to your own unique risks and exposures, your state of residence, your wealth level, and your own risk tolerance. This makes it very hard to give specific advice.

4 A Lot of Benefit is Psychological

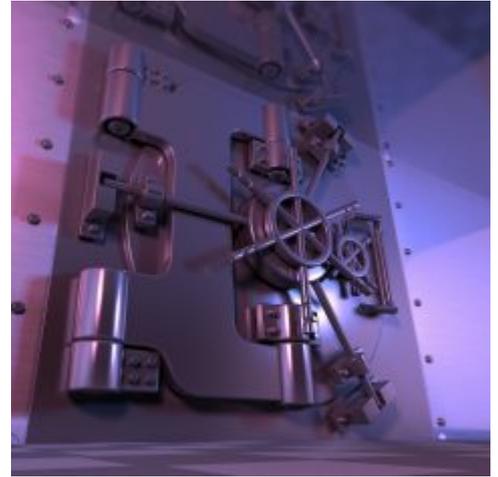
There are three main benefits of asset protection.

- The first is in the event that things really go downhill and there is a huge judgment against you. The asset protection planning limits what the creditor can collect from you.
- The second is prior to the judgment occurring. Good asset protection planning can make it less likely for you to have a large judgment against you in the first place.
- Finally, there is a psychological benefit. You get to feel protected. You get to feel like you did what you could to minimize this. Perhaps this decreases your anxiety a bit.

How much benefit there is from each of these three categories is hard to measure and likely varies by the individual. When pressed about providing a favorable cost:value ratio given the rarity of lawsuits and judgments, a lot of asset protection will also cite better investing, tax strategizing, and estate planning and using that to justify their costs, which further obscures the financial wisdom of engaging their firm.

5 Insurance is Your First Line of Defense

Some might argue that asset protection, at least as much as it decreases the likelihood of you paying for damage you actually caused, is immoral. Well, one aspect of asset protection that makes it easier to pay for damage you caused is to [have insurance](#).



Insurance not only pays for any judgments or settlements, at least up to policy limits, but it also pays for a robust defense, which can easily reach six figures by itself in many lawsuits. This includes both professional (malpractice) liability insurance as well as personal (auto, homeowners, renters, umbrella) liability insurance.

Good luck getting an attorney to give any sort of guidelines for how much of each you should carry, but widely used rules of thumb suggest that most doctors carry the same amount of malpractice insurance as other doctors in their specialty and geographic area and \$1-5 Million in personal liability (umbrella) coverage.

6 Avoid Fraudulent Transfers

Asset protection works best if set up before any damage occurs, much less a lawsuit is filed. Otherwise, any asset protection maneuvers you do can be considered a “fraudulent transfer.” If you move money from a non-exempt asset to an exempt asset at that point you should expect a judge to reverse it.

7 Best to Have a Business or

Estate Planning Reason

Many asset protection techniques, such as forming a business entity such as a corporation, Limited Liability Company (LLC), Family Limited Partnership (FLP) or trust are done for business purposes or estate planning purposes. It is less likely that the judge will “pierce” the structure if you have a good reason for forming it besides trying to hide your assets.

8 Don't Mix Business and Pleasure

Speaking of piercing corporations or LLCs, a frequent argument that is made by prosecuting attorneys is that there is no significant difference between you as a person and you as a business. This is an easy argument to make if you don't keep the finances of the two strictly separate. Do not spend business money on personal expenses and do not spend personal money on the business. Do not use business assets for personal reasons.

9 Asset Protection Law Varies Highly By State

It is really important to understand your state laws with regard to asset protection. These laws are HIGHLY variable and while you can't necessarily run and hide in another state, protections available in one state may not be available in another. These variations include all of the following:

1. Homestead exemption



2.

IRA exemption

3. Non-qualified retirement plan exemption
4. Life insurance cash value exemption
5. Annuity cash value exemption
6. 529 Plan/Educational Savings Account (ESA) exemption
7. HSA exemption
8. LLC charging orders
9. Burden of proof for malpractice
10. Damage limits on pain and suffering

Know your state laws and act accordingly.

10 Jurisdiction Matters

Jurisdiction refers to which court system a plaintiff has to try to prove his case. The ideal jurisdiction is something like the Cook Islands, where they feel no need to reciprocate with any US state or federal court and they have a short statute of limitations. Naturally, the further away (geographically and politically) the jurisdiction where your entity (corporation, LLC, partnership, trust, etc) is set up, the more it is going to cost and the less access you're going to have. There is a reason so many companies seem to be formed in Delaware, Nevada, and Wyoming though.

11 Beware the Supercreditors

There are creditors and then there are creditors. While your Cook Islands trust may be great for keeping Joe down the street from getting your assets, when the IRS or the SEC comes to call you might not just want to tell them to pound sand. They might just have you sit in jail until you repatriate those assets to the US.

12 Titling Matters

If you are married, in many states you can title a real estate property and perhaps even bank and brokerage accounts as "[Tenants by the Entirety](#)." The idea here is that each spouse owns the entire property or account so a judgment against just one of them cannot take any of it. While it is more gray than it at first appears (see # 2 above), I see little reason not to use tenants by the entirety titling if it is available to you.

Nothing is bombproof, but if you combine a nice homestead exemption with tenants by the entirety titling and maybe even equity stripping (see below), perhaps you'll get to keep some of your house in a crazy huge judgment scenario.



13 ERISA Plans Are Great; IRAs Not as Great

Retirement plans in general and in most states are completely exempt from creditors in a bankruptcy proceeding. ERISA plans such as [401\(k\)s](#), 403(b)s, and [Cash Balance/Defined Benefit Plans](#) are protected under federal exemptions.

Non-ERISA plans like IRAs, [Roth IRAs](#), [individual 401\(k\)s](#) (yes, I know that's unfair), and the fancy California non-qualified retirement plans are governed by state law.

So while pretty much all states offer at least some protection to non-ERISA plans, in some states it is significantly less protection than for ERISA plans. Nevertheless, from an asset protection standpoint, one of the best things you can do is max out your retirement plans, especially ERISA plans, and sometimes do Roth conversions (as in effect a conversion moves money into a retirement plan, at least on an after-tax basis.) In some states, an IRA rollover may actually decrease your asset protection.

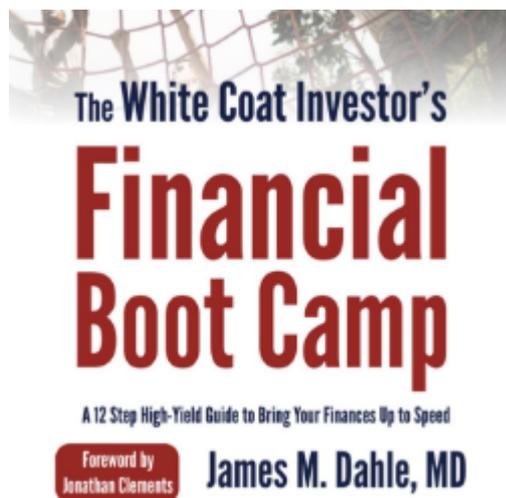
14 Whole Life Insurance and Annuities May Increase Asset Protection

In many states, [cash value life insurance](#) and annuities receive at least some protection. They are 100% protected in some states. So while it's hard to recommend whole life insurance as good insurance or a good investment, in some states it can be a great asset protection move. If you care more about asset protection than your return AND your state offers significant protection to life insurance AND you're insurable, then you may want to consider a policy. In general, annuities offer less protection than life insurance.

15 Don't Expect Much From 529s and HSAs

For quite a while, nobody was quite sure what kind of protection 529s and HSAs would get. The argument an asset protection attorney would use to try to protect your 529 was that the money was designated for someone else to use. The problem is that it is technically still your money as the owner of the 529. If you want, you can pull the money out, pay any taxes and penalties due, and buy a sailboat...or pay a creditor. Case law seems to be going against 529s really getting much protection, but admittedly there aren't very many cases. Same issue with HSAs, so don't expect to keep those in bankruptcy either.

[Update prior to publication: I've been able to find lists of states that do provide some protection for [529s](#) (for residents and non-residents) and [HSAs](#) (for residents.) It's still not the majority, but it's worth [taking a look at this](#).]



16 Giving Away Money Still Works

One of the best asset protections you can have is to simply give assets away. If you don't own it, nobody can take it from you. Obviously, you have to avoid fraudulent transfers (and

sometimes they can reach back a year or two before the injury). You should also be careful “titling everything in my spouses’s name” because the risk of divorce is actually dramatically higher than the risk of losing assets in an above policy limits judgment.

You can give away up to \$15,000 per year to anyone you want without filing tax paperwork. Above and beyond that, you will need to fill out gift tax forms. That doesn’t mean you’ll actually owe any taxes, but it will reduce your federal estate tax exemption by the amount of the gift less \$15,000.

Not a big deal for most of us who will never have an estate anywhere near the current exemption of \$11.4M (\$22.8M married). If you don’t actually want your heir to get anything yet, then consider an [irrevocable trust](#). Funding it is just like giving the money away for estate tax purposes, but you can put in provisions that delay and/or put conditions on when the heirs receive it. Remember that a revocable trust has little if any asset protection benefit, because it can be revoked at any time and paid to your creditors. The purpose of a [revocable trust](#) is simply to avoid probate when you die.

17 Asset Protection/Spendthrift Trusts Cost a Lot

One of the stronger asset protection moves is a spendthrift trust. These grantor trusts have you as both the grantor (person who funds the trust) and the beneficiary. They are available in 15 states in some form or other:

- Alaska
- Delaware
- Hawaii
- Mississippi
- Missouri
- Nevada

- New Hampshire
- Ohio
- Rhode Island
- South Dakota



Tennessee

- Utah
- Virginia
- West Virginia, and
- Wyoming.

In addition to these “Domestic Asset Protection Trusts”, there are also Overseas Trusts such as those in the Cook Islands. It costs thousands to set up a Domestic Asset Protection Trust and tens of thousands to set up an Overseas Trust. That doesn’t include the annual maintenance costs or the costs to revise it when your life or laws change.

There is also a hybrid trust available, sometimes called a “Bridge Trust” or a “[Portable Offshore Trust](#),” where it basically starts with the lower costs and increased convenience of a domestic trust but in the event of a judgment can be converted into the more expensive, less convenient, but much harder to pierce foreign trust.

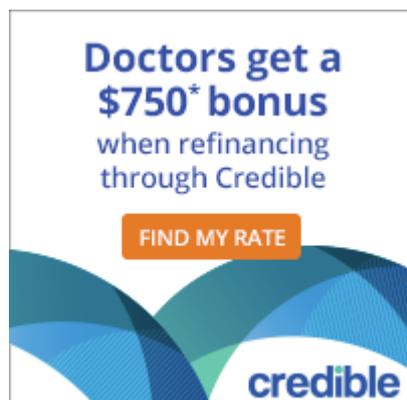
It’s hard to recommend a trust for the typical doc. Not only are their risks not that high, but most of their assets are often protected simply by the exemptions in their state. Plus,

even if they have a taxable account, it's probably at most only a six-figure or low seven-figure amount, where the costs of an asset protection trust are not insignificant. Perhaps if their anxiety is particularly high they would still be interested. But for a particularly successful doc who still practices in a high-risk specialty, has some businesses or risky investments on the side, and millions of dollars in unprotected assets, it isn't that hard to make a case for one of these.

Unfortunately, case law is not going well for the Domestic trusts. They're apparently not quite as strong as many clients may have been led to believe.

18 LLCs May Offer Cheap Protection

Limited Liability Companies are designed to be cheaper and easier to manage than corporations while offering similar protections, i.e. the entity is separate from its owners. This provides both external (personal judgments like malpractice can't get your assets in the LLC) and internal (judgments from the LLC can't get your personal assets) protection. LLCs, like corporations, are at risk of a judgment "piercing the corporate veil" so keep them strictly separate from your personal assets.



Also, be careful how much you put into a given LLC. If your

rental property causes a large judgment, you could lose any other properties that were placed into the same LLC. A “serial LLC” may decrease this risk while keeping costs low. When it comes to external liability, your creditors are generally limited to a “charging order.” In many states, a charging order only allows a creditor to collect your assets when they are distributed from the LLC. Of course, there is no rule that you must distribute any assets from an LLC if you don’t want to. But you are required to pay taxes on the income from the LLC. So theoretically, you could force a creditor to pay taxes on income they never actually receive! The idea here is to force them to settle for pennies on the dollar so they don’t get an unwanted tax bill. Bear in mind that an LLC with a single member, or even two members if they are married, may not have the same protection as a multi-member LLC.

19 Family Limited Partnerships May Be Better Than an LLC

Many asset protection attorneys like a [Family Limited Partnership \(FLP\)](#) better than an LLC, but whether that is due to their higher cost to set-up and maintain or a real asset protection benefit is a little hard to tell.

The real purpose behind an FLP is estate planning and business management, but it has pretty significant asset protection benefits as well. As an LLC, it is a separate entity from its owners, providing internal and external liability protection. An FLP also allows for “discounts” for the limited partners, which can really help lower estate taxes, however, the FLP may provide less asset protection than an LLC since only the limited partners have limited liability to internal liabilities. The general partners, usually the ones who need the asset protection, don’t get any at all.

However, there are a few benefits to an FLP over an LLC when it comes to asset protection. The FLP requires unanimous consent for dissolution, whereas an LLC only requires majority

consent. There is no right to a distribution in an FLP either, even if a majority of members want one. And an FLP can distribute income, gain, loss, etc in any manner it wishes.

So maybe the asset protection attorneys are right and all those benefits outweigh the decreased internal liability. Some attorneys think combining an FLP with an asset protection trust as the limited partner is the ultimate in asset protection.

20 Equity Stripping Can Help Protect More Assets



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The idea behind equity stripping is to “strip” the equity from a non-exempt asset (such as your home in a state with a lousy homestead exemption) and place it into an exempt asset such as a retirement account or whole life insurance policy. You do this by borrowing against the non-exempt asset. Obviously this costs interest so you’ll have to weigh that against the additional asset protection.

Asset protection techniques can be tricky, can be expensive, and may not work all that well. Be sure to do the basics well – [buy insurance](#), title property correctly, [max out retirement accounts](#) and know your state laws. Then you may have some difficult decisions to make before engaging in “advanced” asset protection techniques.

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What do you think? What do asset protection strategies do you follow? Comment below!