

What Does “Asset Protection”

Really Mean?

Part II

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This is the second part of an article *What Does “Asset Protection” Really Mean?* In the first installment, the topics of Protecting Assets from Probate, Protecting Assets from Nursing Home Costs, Protecting Assets from Divorce, and Protecting Assets for Problem Beneficiaries were addressed.

Protecting Assets from Lawsuits

Many people think “asset protection” means that if they get sued, the person suing them can’t reach the assets that have been “protected.”

For starters, it’s important to understand that those simple trusts that most people create when they visit their estate planning attorney don’t do anything to protect assets from these types of creditors. Assets held in the standard revocable trust are just as subject to recovery by a person with a lawsuit judgment as those assets would be if no trust existed.

However, there are other planning tools that may protect assets from lawsuits and other judgment creditors. These include (1) so-called “self-settled asset protection trusts,” (2) business entities, like corporations and partnerships, and (3) liability insurance coverage.

In Michigan, a trust in which you place your assets and in which you reserve the right to have those assets distributed back to you, or used to pay your expenses, can be reached by your creditors. But that is not true everywhere. Some states and some foreign nations (most notable, certain island nations) have laws that are different from Michigan in that they allow for self-settled asset protection trusts.

Michigan residents may choose to create trusts in jurisdictions where self-settled asset protection trusts are allowed in order to obtain the benefits of these protective trusts. To do so, your trust investments are typically held in that other jurisdiction (state or foreign nation) and the person in charge of the trust (the “trustee”) is likewise in that state or foreign nation. This loss of control is often a barrier to people using self-settled asset protection trusts. Another concern is that although the self-settled asset protection trusts may be subject to the laws of the foreign state or nation, if you are sued in Michigan, Michigan laws will control the lawsuit and may control the rights of the judgment creditor to collect against your assets.

A more common and reliable form of asset protection, typically used by business people, is to create protective entities like corporations and partnerships. Done right, these business entities allow a business owner to separate business assets from personal assets, and to prevent a creditor of the business (including someone who successfully sues the business), from reaching the personal assets of the businessperson.

Finally, the first line of defense for most people who get sued is their liability insurance coverage. Concerns about exposing one's assets to lawsuits can often be resolved by simply maintaining sufficient types and amounts of liability insurance coverage.

Protecting Assets from the "Death Tax"

Another common concern for clients is that their estate plan "protects" their assets from the so-called "death tax" (more accurately called the federal estate and gift tax).

In a rather incredible turn of events, at the time this article is written, there is no death tax. The tax was repealed December 31, 2009, and has not been reinstated. While there is talk that the tax will be reinstated shortly, if congress fails to act at all, the death tax will return January 1, 2011 with a "unified credit amount" (the amount each person can pass at death free of the tax) of \$1,000,000 per person. (Prior to December 31, 2010 the individual unified creditor amount was \$3,500,000.)

One reality is that many people who worry about avoiding the "death tax" are worrying unnecessarily. Their estates are simply not that large. For those who face the prospect of the death tax, there are many well-established planning tools that can help. These include:

1. Trusts for married persons that allow the "unified credit amount" for both the husband and wife to be exercised. This planning technique takes advantage of the fact that for married couples, each has their own unified credit. Such plans divide the marital assets when the first spouse dies, typically putting part of the assets in a trust that continues and is available to support the surviving spouse, while the rest of the marital assets are left to the surviving spouse without restriction.
2. Annual gifting plans, including gifts into trust. By taking

advantage of the annual gift tax exclusion amount, people with estates subject to the death tax can give away a limited amount of assets each year in a manner that will allow them to preserve their full unified credit amount. These gifts can be made directly to children and/or other beneficiaries, or can be made in trust for the children and/or other beneficiaries.

3. Life insurance and life insurance trusts. Purchasing life insurance is often one way of planning for a taxable estate. By purchasing life insurance and transferring ownership of the life insurance policy to an "irrevocable life insurance trust," funds can be available to pay the death tax so that the assets in the estate do not have to be liquidated at death.

Conclusion

As is hopefully clear from the information in this article, "asset protection" is more complicated than simply putting your assets in a living trust. In fact, putting assets in a simple living trust has no meaningful asset protection benefit. Rather, for people who have legitimate concerns about creditors, taxes and lawsuits, there are a variety of legal tools that are available, and which can be used to successfully protect assets.

DOUGLAS G. CHALGIAN is one of the few attorneys in Michigan who is certified in Elder Law by the National Elder Law Foundation. Mr. Chalgian is incoming Chair of the Probate and Estate Planning Section and former Chair of the Elder Law and Disability Rights Section of the Michigan State Bar. Mr. Chalgian is the author of the *Michigan Medicaid Planning Handbook* published by the Institute of Continuing Legal Education and has authored articles in the *Michigan State Bar Journal*, the *Michigan Probate and Estate Section Journal*, the *Elder Law Advocate* and *Michigan Lawyers Weekly*. Mr. Chalgian is a regular speaker on elder law issues. He is involved in various community activities, including the State Council of the Alzheimer's Association, the Board of Directors of Thomas M. Cooley Law School Sixty Plus Clinic and the Board of Directors of Hospice of Lansing and Ionia. He has been selected as one of the top 100 attorneys in the state of Michigan by *Super Lawyers Magazine* for both 2008 and 2009, and is also named in the 2007, 2008, and 2009 editions of the magazine.

