

ASSET PROTECTION: MYTH VERSUS REALITY

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About the author



Engaged in the practice of law since 1995, Judge Calabrese has extensive experience counseling individuals, families, and businesses. His areas of practice include estate planning; wills; trusts; planning for incapacity; probate; asset protection; commercial transactions; general counsel for small and large businesses; contracts; software licensing agreements; and business entity formation and administration.

He has been a Connecticut probate judge since 2003. He is currently judge of the Region 22 Probate District in Southbury and is the Administrative Judge in the Waterbury Regional Children's Court, where he was a founding judge. The Region 22 Probate District serves over 72,000 residents in seven towns and is one of the highest-volume probate courts in Connecticut.

Judge Calabrese has overseen thousands of probate matters, including decedents' estates, trusts, guardianships, conservatorships, and children's matters.

He also was general counsel for Gemini Healthcare, LLC, for ten years beginning in 2005. His responsibilities there included drafting and negotiating contracts and agreements, and managing commercial transactions and intellectual property.

Education

University of Connecticut School of Law, Hartford, Connecticut *Juris Doctor*

University of New Haven, West Haven, Connecticut *Master of Business Administration*

University of Connecticut, Storrs, Connecticut *Bachelor of Science, Allied Health*

Professional Association Memberships

- Connecticut Probate Assembly
 - Member, Executive Committee
 - Member, Education Committee
 - Member, Court Security Committee
- National College of Probate Judges
- Connecticut Bar Association
 - Member, Estates and Probate Section
 - Member, Business Section
- American Bar Association
 - Member, Real Property and Probate Section
 - Member, Business Section
- Waterbury Bar Association

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Who Needs Asset Protection?

MYTH: ASSET PROTECTION IS ONLY FOR THE VERY WEALTHY

Reality: Asset protection focuses on planning to protect what you've worked hard to accumulate. While very the wealthy may use asset protection strategies, the reality is that those of more modest means have an even more compelling reason to create effective asset protection plans. The simple truth is that it's far more likely for middle class individuals and families to be significantly impacted by a lack of asset protection planning.

Let's look at an example. Jennifer and Mary, both 60 years old, were each involved in different motor vehicle accidents for which they were not at fault. Regardless of that fact, each of them was successfully sued in court. The respective juries returned verdicts in favor of the plaintiffs for \$500,000. This means that Jennifer had to pay \$500,000 and Mary also had to pay \$500,000. They each had identical automobile insurance policies with liability limits of \$100,000, well in excess of the minimal \$20,000 coverage required by Connecticut law.

Unfortunately, because the limits of the insurance coverage were well short of the \$500,000 judgments, Jennifer and Mary are now each individually responsible to pay \$400,000 out of their own pockets. This represents the difference between their insurance policy limit - \$100,000 – and the \$500,000 judgments.

Jennifer has a net worth of \$2.7 million. While she won't be happy about paying the remaining \$400,000 of the judgment against her out of her own pocket, it represents only about 20% of her net worth.

Mary's net worth of \$550,000 is much less than Jennifer's. After paying her share of the \$500,000 judgment, Mary will be left with only about 30% of her pre-judgment assets - \$150,000. With retirement age close at hand, Mary will be in a very difficult position, and, depending on a number of factors too numerous to cover here, she may be unable to retire at all as a result of paying the judgment against her.

In this example, because Mary was far less wealthy than Jennifer, an effective asset protection plan would have had a more dramatic and favorable effect on Mary for the impact of an adverse judgment. It could have prevented the judgment creditor from collecting any of the \$400,000 deficiency judgment, or at

the very least, allowed Mary to negotiate a settlement with the judgment creditor for pennies on the dollar.

MYTH: IF YOU ARE NOT A BUSINESS OWNER, ASSET PROTECTION PLANNING IS UNNECESSARY.

Reality: While owning a business is definitely an added source of potential liability, there are many other sources of potential liability that the average person may rarely think about, but for which most people have exposure. Cars, trucks, recreational vehicles, motorcycles, boats, quads, snowmobiles, swimming pools, trampolines, playsets, houses, minor children, and pets are all potential sources of unlimited liability. If you have, own, lease, rent or operate any of these or myriad other sources of liability, you should seriously consider an asset protection plan.

Shortcomings of Insurance

MYTH: ADEQUATE INSURANCE ALONE IS SUFFICIENT TO PROTECT WHAT I OWN.

LIMITS OF COVERAGE

Reality: Insurance is an important element of an asset protection plan. Everyone should have adequate insurance. However, it's insufficient by itself and has many shortcomings. There are several reasons for this. First, as you can see from the example above, all insurance policies have limits of coverage. If a judgment against you is in excess of the coverage, you will be responsible to pay the difference from your own assets.

POLICY EXCLUSIONS

Second, insurance companies lose money when they pay claims. For this reason, insurance companies go to great lengths to avoid paying claims. Usually the first place they look are policy exclusions. Policy exclusions are in every insurance contract, but most insured people fail to understand this. For example, if someone is injured as the result of a fall on the stairway in your home, and the stairs are not compliant with the local building code, your homeowner's insurance policy will exclude coverage. Building code violations are incredibly common, particularly in residential settings. Examples include fences, swimming pools, decks, patios, driveways, trampolines, playsets, stairs, walkways, doorways, electrical systems, and plumbing. The "big box" home remodeling stores nationwide base their success largely on the premise that homeowners can "do it themselves." However, homeowners (and even contractors) can be ignorant of building codes. They often fail to get permits for the work being performed. Even

if you're not a "do it yourselfer", it's likely that the previous owner of your home was, and there could be elements of your home that don't comply with the building code. It will be very difficult to thoroughly assess your home for each and every possible building code violation.

MISREPRESENTATIONS ON APPLICATIONS

Third, insurance companies may also refuse to provide coverage of a claim if, in the application for insurance, there were "misrepresentations" made by the homeowner. I've seen more than a few instances of the insurance agent coyly advising clients to be less than forthcoming on applications in order to be able to issue a policy, or to be price competitive on a policy. However, if this situation results in loss of coverage for a claim, it's the insured who will be at a significant disadvantage.

TENANTS

Fourth, some homeowners lease space in their home or garage to a tenant, but haven't added the appropriate coverage in their insurance policy. If the tenant or guest of the tenant is injured, or if the tenant inadvertently starts a fire, or any of a number of other issues, the insurer may well refuse to pay a claim.

HOME BUSINESSES

Fifth, many people conduct business out of their home, or use their personal vehicles to conduct business. The business could be owned by the owner or tenant of the property, or it could be their employer's business. Unless an insurance policy specifically includes coverage for business activities, any claim arising out of such activities – such as motor vehicle accidents, or injury to clients at the home where business is conducted - will be excluded from coverage, leaving you to pay for your legal defense and any potential judgment out of your own funds.

Defective Asset Protection Strategies

MYTH: ASSET PROTECTION IS BASED ON HIDING ASSETS

Reality: While most asset protection plans may include moving assets into entities outside the control of the owner, an asset protection plan based on hiding assets is seriously deficient.

Debtors are subject to debtor's exams. In a debtor's exam, the creditor questions the debtor under oath. The debtor will be asked to divulge his or her assets, and the debtor will be subject to criminal liability for perjury should he or she lie during the debtor's exam. If the debtor's plan is entirely based on hiding

assets, the plan at this point will be foiled. Conversely, a debtor who has an effective asset protection plan can readily disclose his or her assets without in any way compromising the plan's effectiveness. Indeed, it is at this very stage that a creditor, understanding that there is an effective asset protection plan in place and what it consists of, will walk away with nothing, or, at best, settle his or her claim for pennies on the dollar.

MYTH: ASSET PROTECTION IS ILLEGAL AND UNETHICAL

ASSET PROTECTION IS LEGAL

Reality: While the actions of criminals who engage in asset protection make for compelling headlines, the reality is that everyday, responsible, law abiding, ethical people engage in perfectly legal and ethical asset protection planning.

Generally, if any element of an asset protection plan is not for a legitimate purpose, it will fail. For example, undertaking actions – such as moving assets, or changing the provisions of an operating agreement - for the sole purpose of hiding assets or thwarting a creditor are, potentially, illegitimate purposes. In those cases, it's likely that the action will fail. It's essential that an asset protection plan be prepared by a knowledgeable attorney with extensive expertise in this area to avoid such an outcome.

THE "LAWSUIT LOTTERY"

There are numerous legal and ethical options for legitimate asset protection planning. There has been a litigation explosion in the United States over the past few decades. Most plaintiffs' attorneys work on a contingency fee basis, so it costs their clients nothing to file a lawsuit. A plaintiff who loses a lawsuit pays very little. However, if the plaintiff wins the trial, any judgment they are able to collect is exempt from federal and state taxes.

In reality, most lawsuits don't result in a trial; instead, the defendant will usually pay the plaintiff something to simply withdraw the lawsuit. This is common even for defendants who may have no actual liability at all, but who want to avoid the stress and cost of prolonged litigation. A good asset protection plan may well result in a potential plaintiff deciding to pursue an easier target.

LOOKING FOR "DEEP POCKETS"

The "deep pockets" approach to civil litigation sometimes results in parties with remote and even questionable connections to events or conditions that result in injuries and property damage to be held liable for the actions of tortfeasors.

In Connecticut, the law requires only \$20,000 in "no fault" insurance to legally operate a motor vehicle. Many states have minimum requirements as low as

\$10,000!¹ This minimum has not changed in years, and, in 2018, is grossly insufficient given the potential magnitude of damage inherent in motor vehicle accidents. An increasing number of vehicles operated on the roadways have no insurance coverage at all.

These facts, among others, create a need among the plaintiff attorneys to find defendants who have assets in order to obtain settlement for their clients. These deep pocket individuals and businesses may have no direct relationship to the events giving rise to a plaintiff's claim. In fact, with the proliferation of reckless motor vehicle operators and criminals who are "judgment proof" – those with no insurance and no assets – the "deep pockets" approach has been used much more frequently in the United States.

Don't Do It Yourself

MYTH: SIMPLY TRANSFERRING YOUR ASSETS TO A TRUSTED FRIEND OR FAMILY MEMBER CAN EFFECTIVELY SHIELD THEM FROM CREDITORS.

Reality: While such an approach may seem simple and "inexpensive", it is inherently risky. It ignores the fact that a creditor of the "new" owner may reach all of the transferred assets. This can happen if the new owner becomes a party to a divorce, is assessed for tax liabilities, is subject to the claim of a judgment creditor, or declares bankruptcy. This kind of transfer may also trigger gift tax liability. In addition, the transferor will inevitably lose control of the transferred assets.

Someone who uses this strategy after they've been made a party to a lawsuit, or after they've engaged in conduct likely to create liability, subjects themselves to civil and criminal penalties under the fraudulent transfer laws.

MYTH: "DO IT YOURSELF" LIMITED LIABILITY COMPANIES PROVIDE EFFECTIVE ASSET PROTECTION.

Reality: Limited liability companies can be effective elements of an asset protection plan. However, simply registering a limited liability company with the secretary of the state (for which an attorney's services are unnecessary), or having an online provider create your limited liability company is insufficient. Strict adherence to day-to-day procedures to preserve the liability protection offered by an LLC is essential. Far too many business owners fail to make an investment in effective legal counsel to help them understand the pitfalls that must be avoided in these situations. An experienced asset protection attorney will advise exactly how to operate the business, create an operating agreement designed to your specific needs, and be available when questions arise.

¹ <https://www.thebalance.com/understanding-minimum-car-insurance-requirements-2645473>. Accessed 7/29/18

MYTH: ALL LIMITED LIABILITY COMPANIES OFFER THE SAME LEVEL OF ASSET PROTECTION.

Reality: Limited liability company law is largely state law (there are exceptions, one of which is federal tax law). Different states offer differing levels of liability protection. For example, in some states, single member limited liability companies provide far weaker charging order protection than in other states. In a few states, such as Nevada, South Dakota and Delaware, it's possible to avoid registering the names of the members of the company with the secretary of the state, and thus, making that information a matter of public record.

The operating agreement is a critical document. Exactly how it's drafted can mean the difference between excellent liability protection and unwanted (and unintended) consequences. Only an experienced asset protection attorney is able to draft such an agreement. In my experience, far too many companies either have no operating agreement, or use a "cookie-cutter" template from an inexperienced attorney or web provider.

Another important practical consideration is how states assess fees and taxes on limited liability companies. There is usually a filing fee for the annual report. In addition to that, however, there may also be "entity taxes." For some states, such as California, this tax can be as much as \$800 per year. Many other states assess entity taxes of several hundred dollars annually. These are in addition to filing fees and annual report fees; some states may assess additional taxes on LLCs.

MYTH: IT'S BETTER AND CHEAPER TO WAIT UNTIL YOU NEED AN ASSET PROTECTION PLAN TO CREATE ONE.

Reality: Waiting until you become a defendant in a lawsuit, incur liability, or are involved in some type of action that can potentially lead to liability before engaging in asset protection planning will severely limit your options. In many cases, doing so may also cause you to violate fraudulent transfer laws. It's far better, easier, less expensive and less stressful to be proactive and create your asset protection plan before you are sued, become a debtor, or the actions leading to potential liability arise.

Objectives of Planning

MYTH: A GOOD ASSET PROTECTION PLAN WILL CAUSE ASSETS TO BE COMPLETELY UNREACHABLE BY CREDITORS.

Reality: It is virtually impossible to make all of one's assets totally unreachable to potential creditors. Effective asset protection plans simply make it more difficult

for judgment creditors to access your assets. In most cases, simply having an effective asset protection plan in place will be sufficient to deter creditors. Many plaintiffs' attorneys will first conduct a search for a prospective defendant's assets. If such a search shows no assets in the prospective defendant's name, or shows only difficult to reach assets, many attorneys will not proceed with a lawsuit. Even for more determined creditors, asset protection plans will place you in a much better position to negotiate a settlement for pennies on the dollar.

MYTH: A GOOD ASSET PROTECTION PLAN WILL EFFECTIVELY PREVENT LAWSUITS.

Reality: While a good asset protection plan may, in some cases, prevent a lawsuit, there is no amount or kind of planning guaranteed to completely preclude a lawsuit.

Where asset protection plans can be particularly effective is in preventing a judgment creditor from being able to collect all or most of their judgment. Collecting on a judgment is different and separate from the judgment itself. Judgment creditors have many tools at their disposal to collect a judgment. A good asset protection plan will take these tools into consideration.

Summary

Most people work hard over a lifetime to achieve important objectives: accumulate savings for retirement; own a home; pay for college tuition; develop an emergency fund; and many other objectives.

Unfortunately, all that honest, hardworking people save can be jeopardized suddenly and without warning. Motor vehicle accidents, injuries on real property, liability as the result of serving on a board of directors, and myriad other sources of liability can destroy what has taken time and effort to achieve. The likelihood of being a defendant in a lawsuit in the United States is 33% over a lifetime - a sobering statistic.

While maintaining adequate liability insurance is important, there are far too many situations where liability insurance will fail to protect you – completely or partially – should you be sued.

An effective asset protection plan should be customized for each person and family. Each person has different assets and levels of assets, tolerance for risk, and objectives. The first step should be to meet with an asset protection attorney – an attorney who devotes a substantial portion of her or his practice to asset protection – to discuss preparing an asset protection plan.

Asset protection involves a number of areas: estate planning, tax planning, family law, business entities, and other areas. A 35 year old business owner with extensive real estate holdings and young children would need a plan that might be very different from a 70 year old whose real estate holdings are limited to their residence but may have significant liquid assets.