

Company owners can take steps to protect assets

There are various strategies to consider in protecting your business and other assets from the claims of potential creditors.

Potential creditors can include business creditors, investors and lenders, tort plaintiffs and even former spouses. This article is directed at owners of closely held businesses, including operating companies and active and passive real estate investments.

- **Isolate your assets from potential sources of liability.**

Operational business entities can be held by a limited liability company (LLC) separately from the entity that owns the underlying asset, such as the facility out of which the business is operated. That way, in the event an adverse judgment is obtained against the operating business, the underlying facility, because it is not an asset of the judgment debtor, would generally be protected.

- **Choose a jurisdiction for forming your ownership entity.**

Business entity organizational laws are not all the same; some are more favorable to asset protection than others. A common misperception by the business public is that, under Washington law, an LLC membership interest cannot be foreclosed upon by a judgment creditor, and is subject only to a "changing order" against distributions.

However, Washington law provides that an LLC membership interest can be foreclosed upon, while both Alaska and Delaware provide that a membership interest in an LLC may not be foreclosed upon. For this reason, owners of closely held businesses often select either Alaska or Delaware, rather than Washington, to form their business operation entity.

- **Decide whether to own the LLC membership interest in an asset protection trust.**

Washington law does not permit a trustor to establish a trust, retain an income interest and protect trust assets from the claims of the trustor's creditors. However, in 1997, Alaska and Delaware revised their trust laws to permit an individual to convey assets into an "asset protection trust," or APT, and retain a discretion-

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ary income interest as a trust beneficiary, while still protecting the assets from the claims of the trustor's creditors (assuming the conveyance into trust was not fraudulent).

A good strategy is often to hold investment real estate in an LLC, while holding the membership interest in an asset protection trust. The trustor of the

asset protection trust can also be the manager of the LLC, permitting him or her to retain day-to-day supervision over the property.

Both Alaska and Delaware's APT statutes require the following:

- 1) The transfer into trust must be irrevocable. An APT can be terminated only under very limited circumstances.

- 2) The trustor cannot be a trustee. The trustor cannot retain control over the disposition of APT assets and, therefore, cannot serve as trustee. If the trustor served as trustee, the trustor's creditors could obtain an order requiring the trustee/debtor to exercise his or her powers in their favor.

- 3) Certain trustee powers must be performed by an Alaska or Delaware-based trustee. An APT's trust powers are generally divided among several trustees. A local Alaska or Delaware trustee is required by statute to keep the books and records of the trust, to manage some trust assets in the jurisdictional state and to be responsible for the preparation of any trust tax return. Other trustee functions, such as investment and distribution decisions, can be performed by another trustee who need not be a resident of the jurisdictional state.

- 4) The transfer into trust must not be fraudulent. In order for assets placed into an APT to be protected, the transfer into trust must not be fraudulent under the laws of the trust's jurisdiction. In Washington, a transfer can be deemed fraudulent, and may be set aside by any creditor, if the conveyance into trust was

intended to defraud a present or future creditor. In both Alaska and Delaware, the specific asset conveyance into trust must have been intended to defraud the specific creditor seeking to challenge the transfer before it can be set aside, and creditors can reach only those specific assets shown to have been fraudulently conveyed into the APT.

The following situations are often well served by the use of an Asset Protection Trust:

- **Protect assets from future claims.** Creation of an APT can protect a portion of an individual's assets from potential future creditor claims.

- **Protect gifts and inheritances.** APTs can shield gifts or inheritances.

- **Protect young adults' assets.** Parents might want to encourage children to put assets that they receive at majority into APTs; the children may receive benefits from the trust, without the ability to dissipate trust assets.

- **Protect officers and directors.** The activities of corporate officers and directors now receive increased scrutiny; an APT can serve to insulate a portion of an individual's assets.

- **Protect assets from future ventures.** The seller of a business might use an APT to protect the sale proceeds from claims that could arise from his or her future ventures.

- **Protect vulnerable people.** APTs might be used to protect the assets of clients who are mentally, physically or financially vulnerable.

- **Provide premarital planning.** Trusts established in Alaska and Delaware are immune from spousal claims in most circumstances, so long as the conveyance into trust was not "fraudulent" as to the spouse.

- **Protect personal injury awards.** An APT could be considered for these court-created trusts that hold personal injury awards or settlements.

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