



An educational guide for  
individuals and business owners

 Guardian®

# Protecting and preserving your wealth

**Asset protection strategies that can help**

# Because you've worked so hard for everything you've achieved, protecting your valuable assets is important.

Asset protection can help you and your family implement an efficient wealth preservation strategy. You can accomplish this in many ways, but it is important to ensure that your asset protection strategy fits in with your overall financial and estate planning goals for the next generation.

Asset protection strategies can ultimately help you to prevent or reduce the risk associated with any potential litigation and shield your assets from would-be creditors.

We've designed this guide to help you learn about four common asset protection strategies that you can implement through the use of:

- 1** Liability insurance
- 2** Protected assets
- 3** Planning techniques
- 4** Business entity structure

# Is asset protection right for you?

How you answer these questions can help you decide:

- Are there areas in your life where you feel your assets are at risk — and if so, what steps have you taken to address that concern?
- Do you have personal liability coverage, and if so, when was the last time you reviewed it?
- Do you have children for whom you'd like to leave a legacy, but have concerns about that — perhaps due to their inability to manage money, or because they may need protection from a creditor, or to protect those assets from a spouse or former spouse?
- If you are a professional, does your malpractice insurance fully cover your assets?
- If you own a business, do you have business liability coverage, and if so, when was the last time you reviewed it?



## Why asset protection can be so important

Your assets can be vulnerable in many ways. For example, you can suffer financial losses due to:

- **Professional liability:** Malpractice lawsuits, breach of contract claims, faulty products, work-related accidents, debt, etc.
- **Personal liability:** Auto accidents, divorce, debt, foreclosure, etc.

The time for you to start planning is **before** any issues, bankruptcies, or judgments arise. Planning in advance can help you to stem losses and protect your wealth.



## Asset protection strategy #1

# Liability insurance<sup>1</sup>

Certain types of insurance coverage can help to protect you against some types of risk. The premium is a small price to pay for the valuable protection you'll receive from the coverage you purchase:

- **Personal liability coverage:** A simple and inexpensive way to protect property against certain judgments or loss is to have maximum homeowners and/or automobile insurance coverage, with an excess liability ("umbrella") policy that provides additional protection. You may also wish to review the exclusions in your policies to determine if additional protection is needed.
- **Business, employment, and fiduciary insurance:** If you're a business owner, you may wish to consider purchasing liability coverage to protect your company against employee claims for discrimination or wrongful termination. If you serve as the trustee of your company's qualified plan, you may want to purchase insurance to protect against claims regarding violation of a trustee's fiduciary responsibility.



## Asset protection strategy #2

# Protected assets

Depending on state law, certain types of personal property may be exempt from claims of general creditors, even if owned by the debtor. The most common types of assets are cash value life insurance, non-qualified tax-deferred annuities, and a personal residence in states that have a homestead exemption.<sup>2</sup>

Keep in mind that the law varies greatly from one state to another, so you should consult with your tax and legal advisors in your local jurisdiction.

## Life insurance and annuities

**Life insurance death benefits**<sup>3</sup> are generally protected from creditors in most states, depending upon the identity of the policy owner and beneficiary.

**Life insurance cash value protection** varies from state to state. In some states, the cash value is protected; in other states, there is no protection, or an amount up to a certain limit is protected. Protections may vary under state law in the context of a bankruptcy. If the insured resides in a state that protects cash value:

- If he or she takes out a loan or surrenders cash value, most likely any protection related to the cash value will be lost.<sup>4</sup>
- The protection most likely applies only when the insurance policy is issued on the life of the debtor.

The level of protection for **non-qualified annuities** generally varies by state — from total protection in some states, to limited protection in others, to no protection at all in others.



### How the death benefit may be protected

Bob is a hypothetical business owner who has personally defaulted on \$1 million of loans. Bob's creditor has a judgment against him for \$1 million. Bob also owns \$1 million of life insurance on his life with his spouse as beneficiary.

Upon Bob's death, the life insurance proceeds can be paid to his spouse free of his creditors' claims. But these proceeds are not protected from creditors of the policy beneficiary. Therefore, if the spouse co-signed on the loans, the death benefit would be available to satisfy her creditors.<sup>5</sup>

## Retirement and college savings plans

**Qualified plans** are governed by ERISA and are generally protected from personal creditors. Exceptions include:

- QDROs (Qualified Domestic Relations Orders)
- Funds owed to the IRS
- One-person retirement plans

**IRAs** are governed by state law, and most states generally protect them from personal creditors — with the same exceptions regarding the IRS and spouses or children owed money from a QDRO.

**529 plans** are generally exempted for contributions made two years prior to bankruptcy at a federal level. Some states also have special asset protection laws for 529 plans. “Excess contributions” to 529 plans do not qualify for exemption.



### **Don't overlook this planning opportunity**

If you're a successful business owner, are you contributing the maximum amount to your qualified plan, which is a protected asset?

Check to make sure that your plan design has been updated — and to see if your business is taking advantage of creative strategies designed to maximize contributions for owners and key employees.

Leveraging the asset protection tools available to your business is one way to help accumulate wealth that is protected from most creditors.

## Homestead exemptions

Most states provide **homestead** protection that exempts the residence from creditor claims (except for the bank lien for the mortgage on the property). But keep in mind:

- Usually, the owner of the home must be a full-time resident of the state.
- Homestead protection can be *lost* if the home is not personally owned.
- If the home is sold, the homestead protection is lost.
- In some states, it may be impossible for a creditor of one spouse to attach property owned as a joint tenant with rights of survivorship with another spouse.

Homestead protection can vary widely by state:

- New Jersey and Pennsylvania have **no** homestead protection.
- In Texas, homeowners can protect up to 200 acres; in Florida, the limit is 160 acres.
- Home improvements are exempt in many states. In Massachusetts, automatic protection is granted for up to \$125K in improvements, but if a simple state-specific homestead exemption form is filed, up to \$500K worth of improvement protection is available.

**And a final note:** If you transfer your home fraudulently, it will **invalidate** a homestead exemption. Fraudulent transfers will be covered in more detail later in this document.



## Asset protection strategy #3

# Planning techniques

The use of various types of trusts can provide a good deal of protection to both individuals and business owners. And how assets are titled can also make a difference in the level of protection.

## Trusts

### Spendthrift trusts

Spendthrift trusts protect their assets from being attached by the creditors of the beneficiaries, including judgments from lawsuits. But it's important to keep these stipulations in mind:

- Spendthrift trusts are not valid in all states.
- The protection is only for the property in the trust; once distributed to the beneficiaries, it becomes subject to attachment by creditors.
- Creditors can also reach the assets of a spendthrift trust if the conditions necessary for the trust to terminate have already occurred, but the trust has not been terminated.
- A trust often will not be treated as a spendthrift trust unless the trust agreement contains language showing that the creator intended the trust to qualify as spendthrift.

### Irrevocable Life Insurance Trusts (ILITs)

While life insurance offers some statutory protection for both cash value and death benefit in most states, most ILITs include a spendthrift provision that fully protects the death benefit and cash value for the trust beneficiary in the event that he or she is sued and a judgment creditor attempts to attach the beneficiary's interest in the trust.

### Titling of assets

How assets are titled can provide certain protections, depending on the state. Generally speaking:

- A spouse's separate property isn't liable for the debts of the other spouse.
- A spouse's creditor can reach the separate property of the debtor-spouse, both halves of sole-management community property of the debtor-spouse, and all jointly managed community property.
- Debts incurred by either spouse are presumed to be community debts.
- States allow couples to "partition" community assets to create separate property.



## Asset protection strategy #4

# Business entity structure

Whenever possible, it's important for you to keep your personal assets separate and distinct from your business assets. That's because if there are financial problems with your business, your personal assets may remain protected.

The level of protection that you'll have will depend on how your business is structured — and certain types of business structures provide more protection than others:

- **Sole proprietorships and general partners** in a partnership are the most vulnerable to creditors, as owners of both are personally liable for all of the debts of the business, with general partners also held liable for the limited partners' actions.
- **Limited partners** have little input into the running of the partnership, so they are generally not held liable for any issues the management of a partnership might create.

**Corporations and Limited Liability Corporations** are generally only liable for business debts. But keep in mind:

- Creditors could seize the stock of a debtor, and use that to shut the company down if the debtor is a major stockholder.
- Personal asset protection is also important to avoid the business being impacted if stock is seized by levy.

# Special considerations

## The law against fraudulent transfers

The Uniform Fraudulent Transfer Act (UFTA) stipulates that transfers with intent to defraud are void and can be undone.

Each state has its own UFTA. The law deals with transfers that can be deemed to be “badges” of fraud, including:

- Secrecy
- Transfers to related parties
- Secret reservation of interests
- Continued enjoyment of property
- Insolvency

How is a transfer considered an actual fraud or a “badge” of fraud? The burden of proof is on the judgment creditor. With respect to insolvency, a court would look at whether or not the transfer of assets put the individual in an impoverished state.

Insolvency is an important factor when it comes to the UFTA. The definition of “insolvency” can be defined in more ways than one: Is the individual’s balance sheet defining the insolvency, or is it the individual’s inability to pay? For example:

- Can you pay your premiums or children’s education bills?
- Can you establish a qualified retirement plan or contribute to one?
- Can you create a buy-sell plan, or a deferred compensation plan?

Fair market value versus “forced sale” value is also taken into consideration. For example, did you receive equivalent value in return when a transfer was made?

When it comes to fraudulent transactions, the statute of limitations varies from state to state. In many states, there’s a look-back period of four years from when the transfer was made. Some states also have a separate “one year when you find out about it” statute in cases where transfers were hidden. You typically have one year from the time of discovery of the transfer in certain cases in some states.

## Some final words of caution

- The basis of the law is that individuals and businesses should pay their debts.
- Asset protection strategies should never be used as a substitute for liability insurance.
- Laws vary from state to state; laws are not necessarily “black and white.”
- Avoid making a fraudulent transfer.
- Be aware of the length of time a judgment can be enforced.
- Rules may change in bankruptcy.
- Neither Guardian nor any of its financial professionals are in the business of giving asset protection advice, so be sure to have your own legal advisor guide you through the process.

**Make sure to consult your legal advisor if there are any questions or concerns about the possibility of a fraudulent transfer.**

# Could asset protection be right for you?

Only you and your legal advisor can answer that question. But once you've decided this is an approach you want to pursue, a Guardian Financial Professional will work with you and your trusted tax and legal advisors to help implement the strategies you've chosen.

**Contact a Guardian Financial Professional to learn more about the advantages of asset protection.**

- <sup>1</sup> Neither Guardian nor its subsidiaries offer this type of protection.
- <sup>2</sup> Some whole life policies do not have cash values in the first two years of the policy and don't pay a dividend until the policy's third year. Talk to your financial professional and refer to your individual whole life policy illustration for more information.
- <sup>3</sup> State creditor protection for life insurance policies varies by state. Contact your state's insurance department or consult your legal advisor regarding your individual situation.
- <sup>4</sup> Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal may also be subject to a 10% federal tax penalty.
- <sup>5</sup> All scenarios and names mentioned herein are purely fictional and have been created solely for educational purposes. Any resemblance to existing situations, persons or fictional characters is coincidental. The information presented should not be used as the basis for any specific investment advice.

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