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Steve Leimberg's Asset Protection Planning
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Subject: Steve Oshins on the Life Insurance Industry’s Biggest Problem Now That There Are Fewer Life Insurance Trusts - The Creditor Tsunami

“You just finished defending a lawsuit that was brought against you. The plaintiff hates you and you hate the plaintiff! In fact, there is nobody you and the plaintiff hate more on this planet than each other!

Unfortunately, the judge ruled against you and the plaintiff is now collecting on his or her judgment. You live in a state where a life insurance policy isn’t protected from your creditors.

The plaintiff takes your $1 million insurance policy from you. And now you can’t sleep knowing that this person who hates you stands to benefit by $1 million when you die. You purchase the best house alarm money can buy. You set up a video surveillance system at home, you put bars on your windows and you buy the most vicious guard dog you can find. But you still can’t sleep.”

Steve Oshins reports on an issue that has quietly become a huge problem for the life insurance industry. Members should take note of Steve’s upcoming **LISI** webinar: “The Life Insurance Industry’s Biggest Problem Now That There Are Fewer Life Insurance Trusts: The Creditor Tsunami” on October 19, 2018 from 3:00 PM EDT - 4:30 PM ET where he will expand on the topic of this newsletter, especially with respect to the asset protection planning options which he will explain in detail.

Frequent **LISI** contributor **Steve Oshins, Esq., AEP (Distinguished)** authors three different annual state rankings charts and one state income tax chart:

Steven J. Oshins, Esq., AEP (Distinguished) is a member of the Law Offices of Oshins & Associates, LLC in Las Vegas, Nevada. He was inducted into the NAEPC Estate Planning Hall of Fame® in 2011. He was named one of the 24 "Elite Estate Planning Attorneys" and the "Top Estate Planning Attorney of 2018" by *The Wealth Advisor*. Steve was also named one of the Top 100 Attorneys in *Worth* and is listed in *The Best Lawyers in America®* which also named him Las Vegas Trusts and Estates Lawyer of the Year in 2012, 2015 and 2018 and Tax Law Lawyer of the Year in 2016. He can be reached at 702-341-6000, ext. 2 or soshins@oshins.com. His law firm's website is www.oshins.com.

LISI would like to congratulate Steve for recently being named "Top Estate Planning Attorney of 2018" by *The Wealth Advisor.*

Now, here is Steve's commentary:

EXECUTIVE SUMMARY:

In the mid-1990s, the federal estate tax exemption was a mere $600,000 per person. It seemed that nearly everybody who purchased a life insurance policy would do so by first setting up an Irrevocable Life Insurance Trust ("ILIT") to be both the owner and the beneficiary of the policy. The exemption climbed very slowly in the latter part of the 1990s by a mere $25,000 per year. Therefore, the proliferation of ILITs continued.

Then came the 2001 Tax Act in which the estate tax exemption rose to $1 million per person and was scheduled to continue to rise over a ten-year period until the so-called Fiscal Cliff would drop it back down. Nearly everyone anticipated the exemption to be reduced and fall off of this Fiscal Cliff. But to the surprise of most people, that didn't happen.

Fast forward to 2018 (and leaving out the details that brought us to this point), each person now has an $11.18 million estate tax exemption and married couples have a $22.36 million estate tax exemption. This leaves roughly 99.9% of the United States residents without a federal estate tax were they to die today.

Therefore, very few people need to form an ILIT to keep the insurance death benefit out of their taxable estate under today's estate tax regime. This has affected planning because most insureds are now simply purchasing their policies in their own name or in the name of their revocable trust.

COMMENT:

I. Are Life Insurance Policies Subject to Creditor Attacks?

In order to determine whether the insurance policy is protected from creditors, you must check the state statute that is in effect in the state where the insured resides.

Be sure to read the statute slowly and multiple times because many of the statutes can be tricky and deceiving at first glance. Some states protect the cash value, while other states don't. Some states protect the death benefit, while other states don't. Some states protect neither the cash value nor the death benefit. And other states have certain limitations based on dollar values and/or recipients.

The most confusing statutes (to this author) are those that seem at first glance to protect the cash value, but when you read the statute much more closely the statute often only protects the death benefit. This is why it is imperative that the planner read the applicable statute very closely.

II. The Two Primary Reasons to Form an ILIT

If you ask most planners why to form an ILIT, the answer will generally be that it's to keep the life insurance death benefit outside of the insured's taxable estate for estate tax purposes. Period. End of response.

In this author's opinion, that is the wrong answer. There are two very important reasons to form ILITs. The first is to save estate taxes.

However, the second reason, and the one that nearly every planner and every client fails to consider, is to protect the life insurance policy from creditors.

III. Insurable Interest Rules

The laws don't allow you to simply buy an insurance policy on anybody's life. Imagine an uncivilized society where you might buy a policy on a person's life and then murder that person to collect the death benefit.

For this reason states have enacted insurable interest rules that require the purchaser of the insurance to have an insurable interest in the proposed insured. The principle of insurable interest is that a person or organization can obtain an insurance policy on the life of another person if the person or organization obtaining the insurance values the life of the insured more than the amount of the policy.

However, the Insurable Interest rules do not apply to a subsequent owner of the policy such as a creditor of the owner of the policy who gets a judgment or settlement and takes ownership of the policy.

IV. The Last Person You Would Want to Own Insurance on your Life

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Unfortunately, putting the obvious over-dramatization of this example aside, this should be a legitimate concern. And a mere $1 million policy was used in this example in order make it clear that this issue exists even for owners of life insurance policies that are relatively small.

V. This Could Have Been Avoided: Yes, Via Asset Protection!!!

This all could have been avoided had the insurance policy been adequately protected in some form of asset protection vehicle.

Although an ILIT is one such vehicle, it is likely not the proper vehicle if estate taxes aren't an issue which is the case for the roughly 99.9% who would owe no federal estate tax were they to die today. But other options exist. Following is a very short description of some options:

1. Incomplete Gift Hybrid Domestic Asset Protection Trust ("DAPT): This is the state-of-the art asset protection vehicle. The insured transfers the policy into an irrevocable trust for the benefit of the insured's spouse and descendants. Transfers to the trust are incomplete for gift tax purposes. The insured can be the investment trustee. A co-trustee in a top-tier DAPT jurisdiction is generally the distribution trustee. A Trust Protector can be added at a later date and has the power to add and remove beneficiaries, including adding the insured. It is extremely unlikely that the insured will ever have to be added though. The Hybrid DAPT is superior to regular DAPTs and to Foreign Asset Protection Trusts because there is almost no risk that the local court will find any legitimate argument that the creditor can bust through the trust.

2. Charging Order Protected Entity: A Charging Order Protected Entity is a business entity in which the creditors of an owner generally only obtain a charging order against the ownership interest. A "charging order" is a lien. Creditors generally don't want to obtain a lien. They want to be able to access the underlying assets. Charging Order Protected Entities generally include Limited Liability Companies and Limited Partnerships, although Nevada is the only state having Charging Order Protected Corporations as well. Using a Charging Order Protected Entity is much, much better than doing nothing, but still pales in comparison to the Hybrid DAPT option since the Hybrid DAPT option allows access through the insured's spouse, along with other clever back-door ways to access its assets, whereas the Charging Order Protected Entity generally protects its underlying assets, but without any way to access those assets since a distribution must be paid to the court-appointed receiver who then turns them over to the judgment or settlement creditor.

Summary

The lack of ILITs being done in our current estate tax regime is causing a huge problem for many of our clients. Advisors must be proactive with their clients. This is a problem that needs to be addressed by attorneys, accountants, life insurance agents, financial advisors and trust officers.

The industry as a whole must take a good look at their clients' estate plans and make sure that their life insurance policies are protected. The better attorneys, accountants, life insurance agents, financial advisors and trust officers make sure to discuss asset protection, especially with respect to life insurance policies for the reasons described herein.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Steve Oshins

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