

Asset Protection and Personal Business Planning

Helping clients protect what they've built requires a clear understanding of both asset protection strategies and the personal planning issues that arise in business contexts. This course examines shielding assets from creditors and liabilities, structuring ownership to reduce exposure, and addressing the personal financial planning considerations that business owners often overlook. If you work with entrepreneurs, self-employed individuals, or closely held business owners, the strategies covered here will strengthen the advice you're able to offer.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course Objectives

- Identify strategies for protecting assets.
- Recall the purposes of the various partnership formations.

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Publication Date: March 2026

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Chapter 1: ASSET PROTECTION STRATEGIES

Chapter Objective

After completing this chapter, you should be able to:

- Identify strategies for protecting assets.

One of the most significant threats to your wealth management plan is a potential legal judgment. Many lawsuits are unfounded but nevertheless result in settlements as less expensive alternatives to a trial. Almost by definition, if you are reading this course, your income and/or net worth places you in the top 10 percent of wealthy individuals in this country. However, a jury may be composed of people who are not wealthy and may not sympathize with a defendant who is. Remember, too, that plaintiffs (the people who sue you) have nothing at risk except their time. Their attorneys typically take their cases on a contingency basis, which means that the attorneys receive no compensation if their clients do not win. Thus, the attorneys are in effect spending their own money prosecuting the case. This can cost anywhere from a few thousand dollars to several hundred thousand dollars of expenses as well as attorneys' time. Talk about an incentive to win a case! You may assume that attorneys review potential cases based on the merits of the facts. Unfortunately, that's not always true. Some attorneys consider the probability of winning or losing a case with little regard for right or wrong. This use of our system of justice has resulted in a litigation crisis in America. It is your responsibility to make sure that you and your family are protected as much as possible from such problems. In this chapter, we discuss the various strategies you can use to protect your assets from potential creditors. Some of them have already been discussed briefly earlier in the course; we will now review them in more detail.

THE CONCEPT OF FRAUDULENT TRANSFERS

Many people don't think about protecting their assets until there is the threat of a lawsuit. Then they rush around shifting assets to family members, trusts, partnerships, and foreign bank accounts. Most states have adopted either the Uniform Fraudulent Transfer Act (UFTA) or its modern successor, the Uniform Voidable Transactions Act (UVTA). In the remaining states, older fraudulent-conveyance statutes and long-standing common-law principles are used to reach essentially the same result. In essence, this law says that any property transferred for the purpose of avoiding known creditors represents a fraudulent transfer and can be set aside. For example, you learn that you are about to be sued, so you transfer your bank accounts and real estate temporarily to your sister, leaving you without assets. The lawsuit goes forward, and a substantial judgment is entered against you. You assume that because you now have no assets, you're judgment-proof. However, the

law of fraudulent transfers will set aside the transfer to your sister, forcing her to transfer the assets back to you and thus making them fully available to your creditors. You should prepare now for the possibility that you may be sued later. If you implement strategies of asset protection when you have no knowledge of possible litigation, then you can avoid the fraudulent transfer laws.

State Exemptions

Each state has enacted laws that exempt certain property from the claims of creditors. For example, in some states your personal residence is totally exempt from creditor claims no matter how much it is worth (although in certain bankruptcy proceedings a portion of the equity can be available to the bankruptcy trustee after a forced sale). Other states exempt various amounts of cash, cash value of life insurance, or personal property.

Insurance

One obvious answer to a lawsuit is to have insurance that will reimburse you for legal fees and any judgments entered against you. Two primary forms of this type of insurance include *personal liability insurance* and *business liability insurance*. Personal liability insurance is typically included in your auto and homeowners insurance policy. If, for example, you are at fault in an accident and injure someone, which results in a lawsuit and judgment against you, your auto insurance coverage will pay both your legal fees and claims up to your policy limits. If someone falls down the steps at your home, is injured, sues, and receives a judgment, your homeowner's policy will pay your legal costs and claims up to the policy limits. However, if the judgment exceeds the policy limits, the excess will come from your personal assets. One way to avoid this problem is through the purchase of a *personal liability umbrella policy*, which requires that your underlying auto and homeowners policies' liability limits be raised to a certain level (usually \$300,000 to \$500,000). The umbrella policy then adds an additional \$1 million to \$5 million or more of liability protection. Such policies are usually purchased through your auto or homeowners agent and are relatively inexpensive. For example, a \$1 million umbrella policy may cost as little as a few hundred dollars per year. Note that these policies cover only personal liability issues, not liability arising from business issues.

To protect you against liability when you own a business, you should consider *business liability insurance*. (For health care professionals, this is known as *malpractice insurance*, and for other professionals, it may be referred to as *E and O [errors and omissions] insurance*.) This insurance is often costly: Malpractice insurance for physicians can run into the tens of thousands of dollars each year. Many of these policies also have large deductibles, which represent the amount of money you must pay before your insurance kicks in—\$10,000, \$25,000, \$50,000, or more. Furthermore, the insurance company will require that you use its attorney rather than your own and will likely want to settle your case even if you have done nothing wrong. Unfortunately, from the public's point of view, you will have lost the case and maybe some of your reputation as well. You are not compensated for your time, anguish, or loss of income while fighting the lawsuit. Some observers

have even suggested that you encourage lawsuits by having liability insurance. After all, insurance companies have been easy targets for plaintiff attorneys. Perhaps the best solution is some combination of insurance along with additional asset protection strategies.

Asset Protection for Married Couples

Being married affords you some possibilities for asset protection. We have found that most couples title the bulk of their assets jointly. We have already discussed the many reasons for not doing so; you can now add asset protection to the list. If you are at a significantly greater risk of being sued than your spouse, you should consider transferring assets to his or her name.

Tip

Some states will allow a special form of titling for real estate owned by two people called *tenants-in-common with cross-contingent remainders*. With property titled in this form, one spouse cannot sell the real estate, but both could. A creditor of one spouse will find it difficult, if not impossible, to seize the interest in property titled in this fashion. Check your state to see if this is available.

When we discuss the possibility of shifting assets with a client, there is often an unspoken tension in the air. The potential transferor is thinking it but unwilling to say it: *divorce*. What would happen if a doctor were to transfer all of his assets to his spouse and then she subsequently files for a divorce? The results can be quite negative, but not for the reasons that you might think. First, you need to make a distinction between separate property states and community property states. If you become divorced in a separate property state, the settlement will be based on what is called *equitable principles*, which require the judge to look at a number of factors, including the length of the marriage, the value of separate property brought into the marriage, the value of any inherited property, and the ability of each spouse to earn a living after the marriage. The fact that you transferred your interest in marital property to your spouse will typically have little effect on how property is split upon divorce. Take the case of a doctor who has been married for 25 years and whose husband works as a teacher. Even if the majority of their assets are the result of her income *and* they are all titled in her name, her husband would receive both a substantial property settlement and alimony in the event of a divorce. The issue here is not losing your assets to a divorcing spouse but rather receiving your share of the assets in a divorce. Let us explain. Assume that you have transferred the bulk of your assets to your spouse as an asset protection strategy. Sometime later you are sued, resulting in a \$1 million judgment against you, *and* you get divorced during the same time period. As part of the divorce settlement you receive \$1 million worth of property that can now be attached by your creditors. Transferring assets to your spouse as an asset protection strategy should be used only in stable marriages. Also, using the facts just described, if your spouse died and left you assets, those assets may become available to satisfy creditors as well.

Divorce issues aside, you should know that a transfer of assets to a spouse also legally transfers the “control” of those assets as well.

Community property states present a unique challenge for couples interested in protecting assets through an asset-shifting strategy. In community property states, all property acquired during the marriage is considered to be half owned by each spouse regardless of whose name the property is in. Inherited property and property acquired prior to the marriage is typically considered separate property *so long as it has never been commingled with marital property*. Community property states include Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington, and Wisconsin (Alaska has an opt-in system by agreement of the married couple). If you live in a community property state and get a divorce, you and your spouse each keep your separate property plus, generally, one-half of all community property. This sounds simple and straightforward. However, a creditor can generally attach community property to settle a judgment. If you or your spouse own separate or inherited property, it is imperative that neither of you commingle that property with community property.

It is possible to plan around community-property rules in many states. Spouses may enter into a *transmutation agreement* that changes the character of certain assets—for example, converting community property into separate property or vice versa. Each spouse must consent in writing, and most states require strict formalities (some, like California, require an “express declaration” signed by the affected spouse). If real estate is involved, the deed should also be retitled and recorded to reflect the new ownership, such as “John Doe, 50 percent interest as his sole and separate property; and Jane Doe, 50 percent interest as her sole and separate property.” Care must be taken not to violate the fraudulent-transfer laws, and couples should understand that converting community property to separate property can affect creditor protection and the income-tax basis at death. Because requirements differ by state, transmutation agreements should always be reviewed by an attorney licensed in your jurisdiction.

A WORD ABOUT JOINTLY HELD PROPERTY

A quick refresher course on jointly held property may be in order. Remember that jointly held property is subject to the claims of creditors even if the claim is against only one of the joint owners. These creditors can force the sale of the property and are then entitled to up to one-half of the proceeds. Avoid jointly held property if you have concerns about asset protection.

As an alternative to joint tenancy, some states allow a form of titling called *tenancy by the entirety*. This type of ownership is restricted to married couples. Property that is owned by this method generally cannot be attached by creditors. Let’s say that you and your spouse live in a \$2 million home in a state that allows you to own real estate titled as tenants by the entirety. Your only other asset is your pension income of \$10,000 per month, and you have no liabilities. You are sued and incur a \$1 million judgment against you. Your creditors can get nothing because they cannot attach

your home unless the judgment was against both of you. In this situation, your creditors will receive nothing until there is a divorce, the property is sold, or you die. If you die before your spouse, their claim is forever set aside! Some states offer similar (but different) protections under “tenants in common with cross-contingent remainders”. Check with your legal counsel to see if your state allows this form of titling.

RETIREMENT PLANS

Congress enacted the *Employee Retirement Income Security Act of 1974 (ERISA)* to regulate employer-sponsored retirement plans and protect participants. ERISA covers most private-sector qualified plans, including profit-sharing, money-purchase, defined-benefit, and 401(k) plans, as well as certain 403(b), 457(b), and self-employed (Keogh) plans. The law’s anti-alienation rule shields plan benefits from creditors, except for limited cases such as qualified domestic relations orders (QDROs) or federal tax levies. If you get divorced, under a QDRO, the courts can award your departing spouse a portion or all of your retirement plan assets.

When you leave a job or retire, you may roll your plan balance into an IRA to continue tax deferral. However, once rolled over, the funds no longer enjoy ERISA’s federal creditor protection. Instead, IRAs are protected under the Bankruptcy Code (up to \$1,711,975, in 2026, for traditional and Roth IRAs and fully protected for amounts rolled over from ERISA plans) and under state law for non-bankruptcy creditors, which varies by state.

If you want maximum creditor protection, consider keeping assets in (or rolling to) an ERISA-qualified plan that accepts rollovers. For example, assume you have accumulated \$20,000 based on your annual investments into your personal IRA account and you want to make certain it is not subject to the claims of creditors. If your employer’s plan allows, you can roll your \$20,000 into the employer’s qualified retirement plan. It is now protected from creditors by federal law. When rolling from an IRA to a company sponsored plan, only the pre-tax amounts are eligible; after-tax basis typically cannot go into the plan.

What are the disadvantages to maintaining your money in a qualified retirement plan rather than using an IRA? Compared with an IRA, many employer retirement plans offer a smaller, curated investment menu. In an IRA you can typically buy ETFs, mutual funds, individual stocks and bonds, and CDs, giving you broad flexibility. Some employer plans also offer ETFs—either directly or through a self-directed brokerage window—but many do not. Greater flexibility doesn’t automatically mean higher returns; results depend on your asset allocation, costs, and discipline. By contrast, staying in an ERISA plan may provide stronger creditor protection, access to institutional-price funds or stable-value options, potential employer matching, plan loans, and certain early-withdrawal advantages. The trade-off is plan constraints and a narrower core menu.

LIFE INSURANCE

Life insurance has long been considered an important tool for protecting the finances of American families. As such, our government has provided life insurance companies and their policyholders with favorable tax treatment. For example, when an insured person dies, the beneficiary generally owes no income taxes on the proceeds. Also, there is no current taxation on the earnings or growth of the policy's cash values. Many states have carried the concept of protecting life insurance policies and annuities over to the creditor protection arena as well. For example, Alabama state law provides that *cash value* generally cannot be attached by creditors. Other states provide similar protections, whereas some states provide none. Some states also provide creditor protection for the cash values in annuity contracts. When it comes to life insurance death benefits, care should be exercised in choosing your beneficiary to protect the death benefits from would-be creditors. Let's say, for example, that you name your estate the beneficiary of your life insurance. At your death your estate representative is required by law to post a legal notice of your death so that creditors can file a claim against your estate. If you do have creditors, your life insurance proceeds are now available to settle their claims. You could have avoided this by having a named beneficiary. This beneficiary could be a person such as your spouse, or it could be a trust. In our practices, we have a large number of physicians as clients. We are always concerned that at their death, an ex-patient might present a lawsuit as a way of treasure hunting, knowing that the doctor will not be around to defend him- or herself. You should check your state exemption laws to determine what protection they provide for your life insurance policies. We should note that this beneficiary issue is not restricted to life insurance.

When researching a client's case, we often find that they have made their estate the beneficiary of the retirement plan proceeds or their other employee benefits. Or they may have named a person as the primary beneficiary and either named the secondary beneficiary their estate or left the secondary beneficiary blank. If the primary beneficiary predeceases you, in these cases, your estate will automatically become the primary beneficiary. You'll also want to consider annuities that you own. Anything that has a beneficiary designation should be reviewed. If you want your benefits to pass according to your will but also want the benefits of asset protection, consider making your beneficiary an irrevocable trust under your will. This has the same effect as naming your estate but will generally avoid both creditors and probate. Because the trust does not become irrevocable until you die, you retain the right to make changes any time prior to your death.

USING TRUSTS TO PROTECT ASSETS

One way to shield your life insurance from creditors is to place your policies into an *irrevocable life insurance trust*, which is treated as a separate person for tax (and creditor) purposes. Depending on your state's laws, the cash value may already be protected, but a trust can help protect the proceeds for the benefit of your trust beneficiaries. The drawback to building up cash values in an irrevocable