The 13 Secrets of the Rich or Informed™

Business, Estate, & Asset Protection Plans
Secrets of Insurance, Financial & Pension Products
Secrets to Asset Protection Even When Being Sued!

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Entity, Trusts, Insurance, Pensions, Exemptions

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Foreword: After working on numerous high profile or celebrity files as a celebrity business manager, certain themes of success repeat in wealth building and protection; especially for clients who can afford the best. This article started as an internal cheat-sheet to assist the author in his understanding of such clients, and over the years has grown into this article. As a lesson of such experience and knowledge, this article is now an annual summary and update of the 13 most commonly used devices in estate, business and asset protection planning (basic asset and risk protection). When discussing these planning matters the following devices and alternatives should be discussed with your attorney, wealth building and protection team. This list is a non-exhaustive list and only given as a tool to afford easier discussions with your professional team. Your first step in the right direction is to put together a team, which should include an estate, business and asset protection attorney, CPA, insurance agent (re life, disability, buy-sell, long term care, business interruption or income replacement, etc.), CFP (Certified Financial Planner), money manager or investment advisor and a brokerage. This article is not intended as legal, tax, accounting, financial, money management or insurance advice, and as such you may not rely upon same for that purpose. It is recommended that you hire an attorney experienced in this area to plan your business, estate and protection matters.

13 Most Common Business and Estate Protection Planning Tools or Devices!

1. Revocable Living Trust (or Living Trust). The public knows this device as a Living Trust. The Living Trust is most often used to avoid Probate, its costs and delays. In tax circles it is called the Section 671 Trust or disregarded tax entity trust. It is generally a tax-neutral device. However, you may use this trust to invoke maximum estate tax exclusions for the husband and wife. In larger estates, it is often advisable to put certain assets in various other devices (e.g. LLC, Children's Trusts, Life Insurance Trust, C or S Corporations, Private Retirement Trust, Pensions, etc.) for asset and risk protection, as well as for tax reduction reasons. Interests assigned into certain other devices may be assigned to the Living Trust.

Contrary to myth, generally it is not intended as an asset protection safeguard, at least during life (while it is revocable). Assets held in your living trust are not protected from the reach of creditors. (Ca. Prob. Code, Sections 18200, 15304 (a), 15304 (b)). However, you can achieve some measure of property "characterization" protection (as separate, community, etc.) if the husband and wife maintain separate living trusts with property agreements.

With proper business and estate protection planning, the living trust is commonly used to hold 'select' property and all of your (personal) property "interests". Such interests are usually derived from your ownership of property or real estate (rental units) held or owned in one or more of the entity devices mentioned hereinbelow (or other devices not mentioned herein). Also, the Living Trust can hold such interests in investment accounts or money management accounts. Such investments may be held personally, in the Living Trust, or in an LLC (with its interests held by the Living Trust).

You should have a money manager or investment advisor retained for what we call asset appreciation, growth and liquidity planning. You need to plan your retirement by considering your insurance (life, disability, long term care, etc.) and cash management needs (from investments, and cash equivalents) in the event of disability or death. You must project your liquid or cash equivalent assets necessary to meet your potential taxes upon disability or death, and needs of your beneficiaries. Most persons commonly use the living trust in business and estate protection planning as a central planning device or quarterback. It is part of most business and estate protection plans, as it can avoid probate and act as the directing authority for all or most of your property disposition plans, including certain investments. Although certain investment accounts are considered "POD" accounts may avoid probate (or "payable on demand" accounts), you should coordinate PODs consistently with your estate, business and retirement plans, which includes your Living Trust. For some estates, this device alone is not sufficient as a business, estate and asset protection planning solution. To have maximum effectiveness, it should be used with one or more of the other devices or techniques mentioned hereinbelow.

2. Pour-Over Wills. This device is used in conjunction with your Living Trust. It directs property disposition to the Living Trust to avoid probate. It is intended to be a "catch-all" over property left out of your Living Trust for one reason or another. Each client will generally use one Pour-Over Will.

3. California Advanced Health Care Directive (Durable Power of Attorney). This document is used primarily to direct your attorney-in-fact on how you wish to be cared for in the event of certain illnesses, incapacity, or disability. It is similar to the so-called Living Will. Different states have varying rules on such device(s). For example, California has a statutory durable power of attorney for health care in the form of a Directive called the California Advanced Health Care Directive. Adults and spouses should have an ‘Anti-Schiavo’ health care directive covering medical decisions, pain and pull the plug issues and final wishes. These matters should also be addressed on behalf of minor children, so medical care providers and the court will have clear evidence of the intent of the parents or guardians in the event they are unavailable. Your children deserve to have all of the same questions asked and answered in the formulation of an estate plan, as you and your spouse do. You should be confident that your nominated guardian will execute or interpret his or her “discretion” consistent with your intent and directions when it comes to key decisions concerning the life, disability and death of your children. You should leave nothing to chance. The author refers to this as a Kid’s Legal

Protection Kit™ that could be included in the Living Trusts / Wills and estate plans. This is a major expansion of the typical protections offered in standard living trust/will formats.

4. Durable Power of Attorney for Asset Management. This document is used primarily to direct your attorney-in-fact on how to manage, run, control or dispose of your assets (or certain assets) in the event of certain illnesses, incapacity, or disability. In the event of disability, this document is critical. It will allow you to direct the person(s) of your choice in making business decisions over certain real or personal property (and businesses). It can be very effective for small and family businesses, and landlords (rental properties). For example, per your direction, it could allow for the refinance or sale of real estate.

5. Family Limited Partnership (FLP). This is a very popular business and estate planning instrument (especially before the LLC) used for many purposes, some of which include asset protection, favorable pass-thru taxation, ability to control transferred property (as managing member or per the LLC), reducing estate or income taxes, life insurance ownership, and fractional gifting with use of beneficial "discounts" (e.g. a tax free gift of $20,000 may be worth conservatively (approximately) $30,000 thereby reducing income tax on its appreciation or growth, and eventually, estate taxes). This device is a limited partnership, which requires a general partner and at least one limited partner. But be aware that, by definition the general partner has "control", and also unlimited liability. The "limited's" have no management powers (and cannot, by definition "manage') and are therefore are afforded limited liability.

Charging Order - The family limited partnership will protect its assets from partner creditors. It has the power of the favorable asset protection charging order laws. (Ca.Corp.C 15522, 15673; Fla. Stat. 620.22; Ariz.Rev.Stat.Ann. 29-341; Nev. Rev. Stat. 88.535; NY Partnership Law 111 McKinney; Tex, Code Ann art. 6132a-1 7.03, etc.). However, be aware, in California, effective January 1, 2003 the law changed to allow "foreclosure" of interests. This is a dangerous change and a blow to the asset protection feature of the charging order. Normally a charging order is the exclusive remedy and will only allow the creditor to obtain certain distributions from the entity, if any, and not the assets. However, in such cases, generally the creditor would receive a taxable event (RevRule 77-137) upon the issuance of a charging order (as constructive income), even if he/she receives no cash or property. This could be a powerful settlement device. It appears that one should consider opening an FLP (or LLC) in a state that does not allow "foreclosure", like Wyoming or Nevada, and then qualify to do business in their own state. For example, in California a foreign entity to qualify to do business is about a $100 filing fee. In this example, that would invoke the California Corporations Code respecting the application of laws of the situs concerning the integrity or governance of such entity (or the charging order).

By tax definition the limited partners are "passive investors" with passive income or loss. To obtain limited liability for all members, see the Limited Liability Company (LLC) below. To allow passive investors some voice in management without fear of losing limited liability, see the LLC. To make passive investors active without loss of limited liability status, see the LLC. To obtain family limited liability protections including the charging order, and favorable pass-thru taxation, or favorable single-member ownership taxation, see the LLC below.

6. Irrevocable Life Insurance Trust (ILIT). Contrary to common myth, life insurance is generally taxable at your death (as it is included in your estate valuation). However, life insurance originated or placed into an irrevocable life insurance trust, is generally not taxable to the deceased estate. The irrevocable life insurance trust is generally non-amendable and often used to hold and receive life insurance which removes the value of it from the settlors estate for estate tax purposes. There are strict rules of compliance and exceptions. For example, settlors or owner of the policy may be the trustee or retain unfettered control over the trust or incidents of ownership over the policy may have potential estate liability for those policies, and life policies transferred within 3 years of death may not avoid estate taxation. However, the ILIT is one of the most effective methods to avoid taxation of life insurance proceeds, reduce the value of your estate, and reduce estate taxes. The use of insurance has been key to the financial health of the upper middle class and the rich. Life insurance is often used for tax-cost-wealth-replacement, and as a wealth creator for surviving spouses, heirs, and future generations.

California law supplies protection of life insurance from creditors as follows:

> **CCP 704**.100. (a) Unmatured life insurance policies (including endowment and annuity policies), but not the loan value of such policies, are exempt without making a claim.
>
> (b) The aggregate loan value of unmatured life insurance policies (including endowment and annuity policies) is subject to the enforcement of a money judgment but is exempt in the amount of nine thousand seven hundred dollars ($9,700). If the judgment debtor is married, each spouse is entitled to a separate exemption under this subdivision, and the exemptions of the spouses may be combined, regardless of whether the policies belong to either or both spouses and regardless of whether the spouse of the judgment debtor is also a judgment debtor under the judgment. The exemption provided by this subdivision shall be first applied to policies other than the policy before the court and then, if the exemption is not exhausted, to the policy before the court.
>
> (c) Benefits from matured life insurance policies (including endowment and annuity policies) are exempt to the extent reasonably necessary for the support of the judgment debtor and the spouse and dependents of the judgment debtor.

Also, disability, business interruption, or income replacement insurance are often used as a means to income stability. Life insurance is also critical for effective business planning. For example, life insurance is critical for key-man, buy-sell and certain joint venture business agreements. You should seek the advice of a professional insurance agent, as all insurance is not created equally.

7. Children's Trust . Although a creature of many forms, usually it is couched in IRC 2503 (b) or (c). Generally it is an irrevocable trust used to hold property for the benefit of your children. Parents may gift or sell assets to the children's trust and lease or loan certain assets back. This device does carry a high measure of estate and asset protection from creditors. It can also reduce estate and income taxes.

8. Charitable Remainder Trust (CRT). This irrevocable trust is usually used to receive and hold property for the purpose of making charitable gifts, supplying income from such assets for life, achieving current charitable donations, or reducing capital gains tax. It requires the making of a "complete" charitable gift. It may also be used in conjunction with your estate plan including a family Foundation (which are no longer recommended), or "your" own charity. In the most basic sense, your property is transferred to the trust, and the trust sells the property, deferring certain taxes. The trust then invests the sale proceeds, and you receive an income and/or principal payout therefrom (depending upon the device, and factors including the term of the trust and your life expectancy). The trust monies (or res) are protected from most outside liability attacks.

Life insurance must also be seriously considered for wealth replacement and also as a wealth creator. Life insurance is effectively used in a CRT to replace any so-called "gift", and often times results in an increase in wealth for your heirs. See you attorney, and life insurance specialists before acting upon such a plan. Also consider a CLT (Charitable Lead Trust).

9. Limited Liability Company (LLC). An LLC is a creature of state statute. It varies from state to state. It most often takes the form of a limited partnership for purposes of liability, accounting and taxation. Certain LLC's can elect to be taxed as corporations. Most clients will desire the form of a "limited partnership" (not a "corporation"), especially if residential or commercial rental properties or other capital assets are to be held or owned by the LLC. See Articles and the Landlord's Asset & Insurance Protections Kit™ on www.LandlordsClub.Com.

Generally all of the favorable attributes of the (family) limited partnership discussed above apply to the LLC, including but not limited to: asset protection, favorable pass-thru taxation (Subchapter K partnership taxation), the ability to control transferred property (as a managing member or per the LLC), ability to reduce estate or income taxes, life insurance ownership, fractional gifting with the use of beneficial "discounts", ability to allow passive investors a voice in management without fear of losing the limited liability status, the ability to make passive investors active without loss of limited liability status, favorable asset protection charging order laws (Ca.Corp.C 15522, 15673; Fla. Stat. 620.22; Ariz.Rev.Stat.Ann. 29-341; Nev. Rev. Stat. 88.535; NY Partnership Law 111 McKinney; Tex, Code Ann art. 6132a-1 7.03, etc.), and the favorable single-member ownership taxation (TR 301.7701 et seq) which does not require a separate entity tax return or Federal ID number. However, be aware that some states, for example, in California, effective January 1, 2003, changed the law to allow "foreclosure". Also note that certain cases have allowed single-owned LLCs to be pierced. These are dangerous changes and a blow to the asset protection feature of the charging order and the single-member LLC. Normally a charging order is the exclusive remedy and will only allow the creditor to obtain certain distributions from the entity, if any; but not the assets. In such cases, generally the creditor would receive a taxable event (RevRule 77-137) upon the issuance of a charging order (as constructive income), even if he/she receives nothing.

10. Will. – Two words: Warning, PROBATE! The old-faithful estate planning tool, the Will, is often times not the appropriate estate planning choice in modern times. With modern business or estate planning, the Revocable Living Trust (with a Pour-Over-Will) is often the best choice. The historical Will is possibly the simplest document to implement, however, it does not avoid Court Probate. The Will may cost your family great Probate expense (2-10% of the gross value), delay and court battles (with Will challenges and lawsuits). However, the marital deduction provisions often used in Revocable Living Trust may also be used in the Will, but probate, its delay and costs will not be avoided by doing so. For an article on the losses incurred by using Wills, see: Celebrity Wills And Trusts!™ Legal & Financial Health Check-Up on http://clublegal.com/html/goto.html .

11A. The Corporation: "C" Corporation. The "C" corporation is often the best entity for front line business operations that can afford maximum tax write-offs (however, the Sub-Chapter S (“S”) is getting closer, year after year). Corporations are often used to operate a business with limited liability, and to divide up your business activities for creditor and lawsuit protection reasons. It is often beneficial to segment your "risky" business activity (or assets) from your "safer" activity (or assets), or to have certain corporation(s) act as partner(s) to other devices. The "C" or "S" corporation may be used to as your front line business entity, which in this day and age, is expected to be sued.

The "C" corporation is often used to "conduct" business with minimum asset ownership. Certain capitalization rules must be satisfied with legal contributions, insurance and credit. The "C" corporation is often used to maximize corporate and "fringe benefit" deductions. However, if "C" deductions and fringe benefits are not used, the "C" corporation will be vulnerable to "double taxation" (taxation once at the corporate tax return level and again at the personal "wage" level). The corporation may have superior payroll tax opportunities. (See Sole Proprietorship vs. Corporations - Lower Corporate Tax Rates vs. Double Taxation - A Payroll Tax Comparison).

11B. "S" Corporation . Like the "C", the "S" is often used to achieve the same level of limited liability protection, but with less fringe benefit tax deductions. However, the "S" comes with pass-through taxation, which is often advantageous to many clients who expect (some) losses in the first years of operation, or use the "S" with other devices named herein, etcetera. The tax attributes of income, deduction, credit and loss are passed-through to the shareholder’s personal tax return. The "S" corporation does have several limitations that you must be aware of, including but not limited to (a) limited loss deductions when debt is in excess of basis, (b) the lack of increase in basis due to entity level debt (whereas the LLC and FLP (LP) does not have such limitations), etc. For example, for basis reasons, an S owner should consider getting a loan personally (not the

S itself) as opposed to the LLC (or FLP) which can have the entity itself get the loan and benefit from that increase in basis adjustment.

12. The Business or Land Trust. The business trust is often used as an alternative to the other business devices to operate a business and add a level of privacy and potential creditor protection; or used to hold rental real estate. The trustee may be a person not owning the beneficial interests therein. Often family members may be effective holders of the generally "private" beneficial interests of the business trust. Warning - the beneficial interests may be attachable by creditors.

13A. Other Devices or Secrets. Other devices used include the Grantor Retained Annuity Trust (GRAT, GRUT, GRIT), Qualified Personal Residence Trust (QPRT), Self Canceling Installment Note (SCIN), Private Retirement Trust (PRT), selling to a Intentionally Defective Irrevocable Trust (IDIT), SOs, Pools, 1031 exchanges, 1031-TICs, Cost Segregation Depreciation on Real Estate, etc.

13B. Converting Non-Exempt Assets to Exempt Assets. In addition to homestead exemptions which have limited but effective value, one of the most powerful asset protection methods is converting the non-exempt assets to exempt status. This can be done is various ways including by trusts, pensions and (marital or separate) property or transmutation agreements. For example:

a. Private Retirement Trust (PRT). The PRT is one of the most powerful devices used to enhance an estate and business plan which protects the wealth, equity or assets transferred into this irrevocable trust for purposes of retirement. The authority of such a trust is a create of local state statute, which varies state to state. For example, in California, under its Code of Civil Procedure Section 704.115(b), all amounts held, controlled, or even distributed by a private retirement plan are exempt. This means that you could even transfer certain assets to a PRT during litigation or after a judgment. The term “private retirement plan” is not defined in the state code however, typically, the retirement plan would be sponsored by an employer (LLC), in writing pursuant to an actuarial calculation based upon numerous retirement factors including age. The California code states in part as follows:

> **704.115**. (a) As used in this section, "private retirement plan" means:
> (1) Private retirement plans, including, but not limited to, union retirement plans.
> (2) Profit-sharing plans designed and used for retirement purposes.
> (3) Self-employed retirement plans and individual retirement annuities or accounts provided for in the Internal Revenue Code of 1986, as amended, including individual retirement accounts qualified under Section 408 or 408A of that code, to the extent the amounts held in the plans, annuities, or accounts do not exceed the maximum amounts exempt from federal income taxation under that code.
> (b) All amounts held, controlled, or in process of distribution by a private retirement plan, for the payment of benefits as an

> annuity, pension, retirement allowance, disability payment, or death benefit from a private retirement plan are exempt.

Other exemption codes in California are found at: California Codes Code Of Civil Procedure Section 704.010-704.210.

b. Individual Retirement Accounts (IRAs). IRAs are <u>not</u> protected under the asset protection laws found in federal ERISA protections. However, some states have enacted special but restrictive protections of IRA plans protecting the funds and distributions only to the extent necessary for the support of the debtor, his/her spouse and dependents. For example, in California California Codes Code Of Civil Procedure Section 705.115 (e) states:

> (e) Notwithstanding subdivisions (b) and (d), except as provided in subdivision (f), the amounts described in paragraph (3) of subdivision (a) are exempt only to the extent necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires. In determining the amount to be exempt under this subdivision, the court shall allow the judgment debtor such additional amount as is necessary to pay any federal and state income taxes payable as a result of the applying of an amount described in paragraph (3) of subdivision (a) to the satisfaction of the money judgment.

c. Qualified ERISA Plans. ERISA (Employee Retirement Income Security Act of 1974) supplies very effective asset protection over pension funds. The federal law overrides state law to the contrary and protects 401k, profit sharing and pension plans that prohibit involuntary assignment of plan benefits to any creditors. Assets may be transferred into such a plan with known creditors, lawsuits or judgments. However, ERISA will not protect such assets from the IRS or subject to court order in divorce court (Qualified Domestic Relations Order). ERISA plans protect employees not owner-only plan participants. If the plan's only participants are the owner and his family (spouse or dependents), then ERISA will not apply to protect the funds.

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