The Asset Protection Planning Continuum:

Practical Steps for Estate Planning Lawyers and Other Professionals

By: Martin M. Shenkman, Esq.
and Alan S. Gassman, Esq.

A KEY ESTATE PLANNING GUIDE

Law Easy

2

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3

The Asset Protection Planning Continuum

What is Asset Protection Planning?

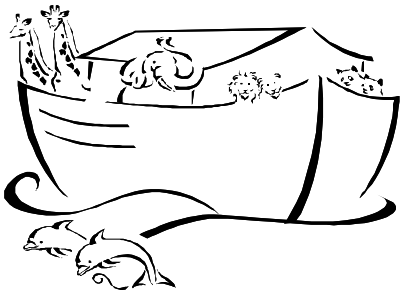
4

What is Asset Protection Planning

- Asset protection is simply planning steps to minimize the risks to client's assets and financial health that a range of risks might pose. These risks might include the costs of a lawsuit, malpractice claim for clients who are professionals, the financial impact of divorce, suits relating to a client serving on a charitable board.
- Asset protection is not limited to costly trusts set up in foreign jurisdictions ("FAPTs").
- While FAPTs might be part of the asset protection tool-kit it is not the focus of asset protection for most clients.

5

"It wasn't raining when Noah built the ark."



6

Primary Causes of Liability

Catastrophes in the Making

1. Debt: General creditors, medical creditors, guarantees, provider agreements, etc.

2. Tort Liability (civil breaches of contract, rather than criminal):

   a. Auto owners and drivers (boats and other vehicles)

   b. Errors and omissions - professional malpractice.

   c. Aiding and abetting others who commit wrongdoings.

   d. Premises liability- building owners. Think of that child on the tricycle going up the wheelchair ramp and flipping down the stairs. Also consider the following:

      (i) Hazardous waste.

      (ii) Asbestos and other harmful building materials.

      (iii) People hurt by construction defects.

      (iv) People tripping and hurting themselves in the parking lot.

      (v) Tenants with rowdy customers who shoot people.

      (vi) Inappropriate acts by lease management.

      (vii) Children eating lead paint.

7

Primary Causes of Liability

3. Relationship Liability:

a. Joint and several liability.

b. Partnerships.

c. Co-signors or co-guarantors on notes.

d. Joint tort feasors (those who commit civil faults) can be jointly and severally liable for economic damages.

e. Co-conspirators.

f. Vicarious liability: An employer is generally liable for the activities of employees in the scope of the business. What if the receptionist runs over a child while running an errand?

g. Spoiled romances and accusations by a forlorn ex-girlfriend or boyfriend, especially if you employed him or her.

4. Tax Liabilities:

a. Income taxes.

b. Trust fund - employee withholding – money stolen that should have gone to the government – paying employees as independent contractors.

c. Penalties, interest, and criminal implications.

8

Primary Causes of Liability

5. Others:

a. Divorce: Alimony and property settlement.

b. Child support.

c. Hazardous waste liability and related issues.

d. Student loans.

e. Business participation: Sexual discrimination, etc.

f. Involvement as trustee with relationship to pension plans.

g. Medicare and other payors.

h. Real estate liability:

(i) Hazardous waste.

(ii) Lead paint.

(iii) Asbestos.

(iv) Tort liability.

(v) Vicarious liability for building activities.

(vi) Civil rights or other violations.

9

Primary Causes of Liability

6. Medicare, Medicaid, and private pay refund liabilities: Carriers have been suing doctors not following referral laws for significant refunds.

Liabilities generally not cancelable in bankruptcy include the following:		Liabilities generally not covered by insurance include the following:	
(i)	Government student loans	(i)	Civil rights violations committed by employees or others
(ii)	Trust fund tax liability	(ii)	Environmental liabilities, including sick building syndrome and lead paint issues
(iii)	Hazardous waste liability	(iii)	Criminal acts
(iv)	Breach of fiduciary duty liabilities	(iv)	Charitable and religious board activities
(v)	Child support and alimony	(v)	Jet skis normally cannot be insured for over $250,000 per occurrence
		(vi)	Acts of terrorism: Most casualty insurance clauses exempt acts of terrorism. The industry has been paying claims on goodwill up until now

10

Creditor Protection: Introductory Concepts

1. Debtor - a party who owes money.
2. Creditor - a party who is owed money by the debtor.
3. Judgment - a court order establishing that a debtor owes money to a creditor. The existence of a judgment is almost always necessary before a creditor can seize a debtor's property.
4. Plaintiff - a party suing to get a judgment against a defendant.
5. Defendant - a party being sued by a plaintiff.
6. Exempt Assets - assets that are protected from seizure under the creditor laws. A debtor will generally be able to keep these assets notwithstanding that a creditor may have a judgment against the debtor.
7. Non-exempt Assets - assets of a debtor that are subject to creditor claims.
8. Fraudulent Transfer - the name given to a transfer of assets from a creditor available status to a creditor non-available status if a primary purpose was to avoid known creditors. Under federal and state law, such transfers may be set aside if the assets are within the jurisdiction of an applicable court making such a finding. Outside of Bankruptcy Court, Florida has a statute of limitations on the ability of a creditor to set aside a fraudulent transfer, which in many cases runs 4 years after the applicable transfer. This does not apply in a transfer of assets to homestead. Under bankruptcy law, however, a discharge can be denied if there has been a fraudulent transfer made within 1 year of the bankruptcy filing. Also, the homestead exemption may be limited to $136,875 if there has been a "fraudulent transfer" to homestead within 10 years of filing bankruptcy. There is also a 10 year set aside rule for "fraudulent transfers to asset protection trusts and similar arrangements" under the 2005 Bankruptcy Act.
9. Preferential Transfer - A transfer that may be set aside under state or bankruptcy law, such as a transfer made to any party within 90 days of filing a bankruptcy, or a transfer made to an "insider" within one year of filing the bankruptcy. See also Florida Statute §726 (providing a two year look back on transfers).
10. Bankruptcy - a federal process whereby every debtor has the right to file in the bankruptcy court, generally under Chapter 7, Chapter 11, or Chapter 13.

11

Creditor Protection: Introductory Concepts

11. Chapter 7 Bankruptcy - generally the debtor will sacrifice all non-exempt assets which will be divided among creditors. After the date the bankruptcy is filed, the creditors will not be entitled to anything other than a share of the non-exempt assets that exist at the date of the bankruptcy filing. A Trustee is appointed to administer the non-exempt assets among the creditors. The debtor will receive a discharge, meaning that the debts formerly owed by the debtor are "discharged".
12. Chapter 11 and 13 Bankruptcies - under these the debtor may establish a plan to pay creditors in part or in full over time (a reorganization).
    1. Debtor in Possession. The person or entity filing a bankruptcy who remains in control of the assets and activities subject to court supervision.
    2. Dirt for Debt. The concept whereby a lender holding a mortgage on property worth as much as is owed may be required to accept the property in full satisfaction of the indebtedness notwithstanding personal guarantees or other monetary obligations that would otherwise apply.
    3. Lien Stripping. The concept whereby a debtor in bankruptcy holding an asset worth less than what is owed may have the mortgage lien of the lender reduced to that value, leaving the mortgage lender as an unsecured creditor for much of the amounts owed. A mortgage lender hoping to eventually recover more value than what a low appraisal reveals might be very unhappy as the result of a lien stripping action.
13. Joint and Several Liability - the concept that individuals who participate in a negligent or improper act will be totally liable for all damages imposed to the extent that the other "co-defendants" do not pay their fair share. There are limitations on joint and several liability pursuant to Florida Statute Section 768.81.
14. Vicarious Liability - the concept that an employer is generally responsible for liabilities incurred by an employee acting within the scope of the employee's duties.
15. Secured Interest - the concept whereby a creditor can record a mortgage or lien on assets whereby that creditor would be entitled to repossess the assets and sell them at auction to satisfy a debt owed to the creditor. Real estate is liened by the recording of a proper mortgage and personal property can be liened by recording a UCC-1 Financing Statement.
16. Marshaling of Assets - whereby a party having a lien against assets may be forced to sacrifice their position if there are plenty of other assets that it has access to, to satisfy the obligation of the debtor. Over secured creditor issues may also arise.

12

Creditor Protection: Introductory Concepts

17. Charging Order - a creditor owed money by a limited partner or LLC member cannot take assets from the entity, but instead is to receive any distributions that will be paid if and when paid. The court may also order limited access to borrowing or use of entity assets.
18. Firewall Protection - the concept that the shareholder of a corporation or limited partner in a limited partnership will not be liable for liabilities incurred by the entity–which is why many companies put the more hazardous activities under a separate subsidiary.
19. Limited Liability Partnerships, Limited Partnerships, Limited Liability Limited Partnerships, Limited Liability Companies, Professional Limited Liability Companies, and Partnerships of the above Entities - the names given to various legal entities which have different effects as to firewall, tax, and charging order versus asset seizure protection – be very careful on which entity you choose because they don't all offer the same protections.
20. Asset Protection Trust - a trust arrangement whereby creditors of the grantor may not have access – which is contrary to Florida and basic common law that if the grantor could receive any benefit whatsoever, then creditors may receive all assets.
21. Bad Faith - the malpractice insurance carrier has an obligation to settle any claim within the limits of coverage of the physician, if reasonably possible. The failure of an insurance carrier to settle within policy limits can result in the carrier being responsible for an "excess verdict." When this occurs, the plaintiff's lawyer will often settle with the defendant by receiving an assignment of the defendant's right to pursue the insurance carrier for the excess amount.

    If the malpractice carrier believes it has a 90% chance winning at trial and a 10% chance of losing with a verdict well over policy limits, then it makes sense for the carrier to take the chance, but not from the point of view of the physician. If the carrier takes the chance then if it has acted in bad faith it will be responsible for any excess verdict. Private legal counsel is commonly hired to encourage the carrier to settle within policy limits, and a physician should almost never encourage a carrier not to settle or be without private representation when the carrier or its lawyer recommends private representation! Fortunately, most verdicts exceeding coverage limits result in the physician assigning their bad faith claim to the plaintiff in exchange for a total release, particularly where the physician is otherwise judgment proof.
22. Automobile Liability - per Florida Statute Section 324.02(9)(b)3, the owner of a motor vehicle in Florida is liable for operation up to $300,000 per incident, which can be covered by insurance or up to $500,000 per incident if the permitted user does not have liability insurance. Therefore, a wife can safely own an automobile driven by the husband if there is appropriate liability insurance. On the other hand, Florida Statutes are not absolutely clear as to whether the liability limitation will apply where an automobile is owned jointly, so often it is recommended that the non-physician spouse own the automobile and allow the physician spouse to drive it. This limitation does not apply to non-individuals (like corporations) that own automobiles. Many businesses therefore have their automobiles owned by the individual drivers or in subsidiary companies.

13

The Asset Protection Planning Continuum

Who Should or Should Not Pursue Asset Protection Planning?

14

Who Should Pursue Asset Protection Planning

- For every client, better asset protection is almost always an advisable goal.
- Asset protection should not be reserved only for wealthy entrepreneurs and surgeons.
- Every client does and should undertake asset protection planning. The issue is only to what extent planning should be done.

15

Who Should Not Undertake Asset Protection Planning

- Any client where the transfers or other actions could be a fraudulent conveyance, render the client insolvent, etc, unless specialty legal is involved, and state and federal law clearly do not prevent steps being taken.
- While planners should not be involved with inappropriate actions, clients have the right to know what their legal rights are, and may be better served by having more aggressive counsel, if all actions and activities are within the law and sound practices.

See article on Florida Creditor Protection Planning by Alan S. Gassman and Michael Markham – Available upon request.

16

The Asset Protection Planning Continuum

How Might Practitioners Protect Themselves

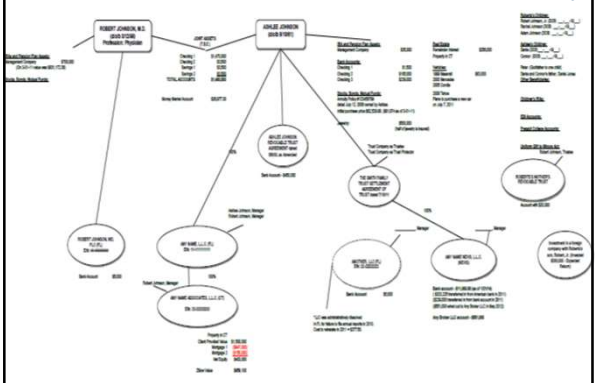
17

Before Proceeding…

- Set a firm policy to perform some due diligence on every client, e.g., google and other searches.
- Obtain a balance sheet for every client and have the client sign it confirming that all planning depends on the accuracy of that data.
- Consider a policy for LexisNexis or other searches.
- Obtain a solvency affidavit before consummating transfers? – Pros and Cons
- Have the client's financial adviser/wealth manager complete financial forecasts corroborating that the contemplated transfers will leave the client with sufficient resources and cash flow to meet anticipated expenses.
- Consider whether hiring a forensic accountant or other expert to perform investigative analysis is appropriate.

Johnson Planning Schematic

18



Dane Samuels Planning Schematic

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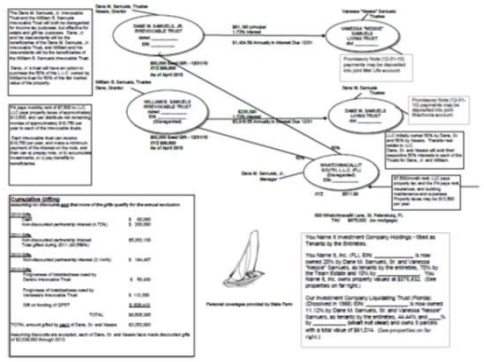

Dane Samuels Planning Schematic (Cont'd)

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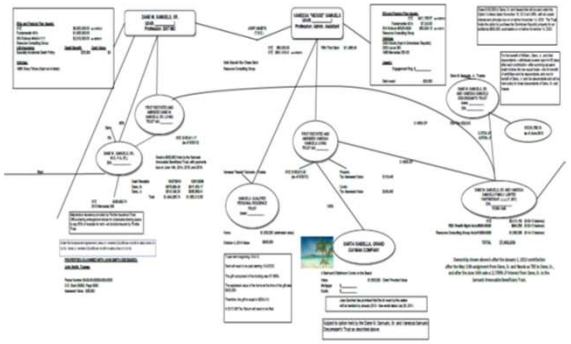

Dane Samuels Planning Schematic (Cont'd)

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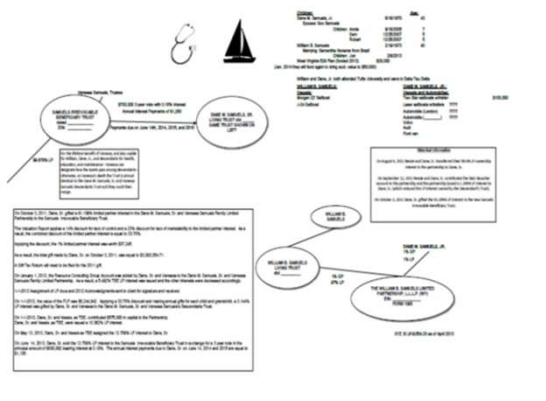

22

The Asset Protection Planning Continuum

Asset Protection Planning Continuum

23

Asset Protection Planning Continuum

- Viewing asset protection as a planning continuum will help advisers who have not specialized in this area become more comfortable making it a part of their regular planning repertoire.
- It will also help clients who may not view themselves as needing significant or costly protections better understand how and why they should undertake some asset protection steps.

24

Asset Protection Planning Continuum

- How far each client will move on the asset protection continuum will depend on the:
  - Client's perception of risk exposure.
  - The costs and complexity of planning.
  - Client's perception of the costs/benefit trade off of each additional step up the planning continuum.
- For estate planners, CPAs, attorneys, wealth advisers, insurance consultants, etc. understanding the asset planning continuum, and how to use it to build awareness and advise every client as to appropriate asset protection planning steps, should be a vital part of the estate and financial planning process.

25

Asset Protection Planning Continuum

- **Low End**:
  - For many clients, relatively simple and low cost steps might suffice to enhance their asset protection.
  - Buying an adequate homeowners and auto insurance policy is asset protection. Determining the size of the deductible and the maximum level of coverage (e.g., whether an excess liability policy is purchased) is asset protection planning at the simplest level.
  - Convert an IRA to a Roth IRA.
  - Change title to assets.

26

Asset Protection Planning Continuum

- **Mid-Range**:
  - Moving forward up the asset protection might involve creating an irrevocable life insurance trust ("ILIT") to protect the cash value of the life insurance (assuming it is not protected under state law) and the death proceeds.
  - Setting up a limited liability company ("LLC") to own a rental property or a home based business.
  - These are generally common planning tools that most advisers are quite familiar with but which clients often neglect absent professional guidance (or if they have addressed these items often in a woefully inadequate an unprofessional manner).

27

Asset Protection Planning Continuum

- **Higher End**:
  - Higher on the asset protection continuum might include the creation of more sophisticated irrevocable trusts such as non-reciprocal spousal lifetime access trusts ("SLATs"). As clients move up the asset protection continuum the irrevocable trusts on the higher end may be formed in a trust friendly jurisdiction (e.g., Alaska, Delaware, Nevada or South Dakota) in contrast to trusts lower on the spectrum that may be formed in the client's home state with a family member trustee.
  - QPRTs.
  - While lower on the planning spectrum a client may have formed an LLC to own a real estate rental property as the planning moves up the spectrum those LLCs might be formed in a jurisdiction with better creditor protection laws and more likely with be fractionalized between various owners including irrevocable trusts.

28

Asset Protection Planning Continuum

- **Highest End**:
  - On the highest end of the asset protection continuum clients might create an asset protection trusts ("APTs") either domestically, domestic asset protection trusts ("DAPTs") or foreign asset protection trusts ("FAPTs") funded with a tier of entities planned, structured and operated to provide further layers of protection.

29

Asset Protection Planning Continuum

- The sequence of the asset planning continuum is not rigid. Depending on the nuances of a particular application of an irrevocable trust it may appropriately be much lower, or higher, on the spectrum.
- Focusing more attention on these alternative asset protection planning techniques will enable practitioners to offer a wider variety of more cost effective asset protection techniques to a wider array of clients. This will provide benefit to clients and help practitioners expand their practices by creating a new driver.

30

Asset Protection Planning Continuum

- A spousal lifetime access trust ("SLAT") in which one spouse creates a trust for the benefit of the other, can vary significantly in how protective it is depending on a number of factors such as: what state it is formed in, what distribution provisions are provided for, whether an independent institutional trustee is named or the beneficiary spouse, and so on.
- Nonetheless, the continuum will provide a useful analogy to guide many clients to pursue more asset protection planning. It will hopefully provide practitioners who do not specialize a useful model to gain more comfort with asset protection planning.
- As practitioners proceed up the planning continuum if they reach a level of planning that is appropriate for a particular client but beyond their skill set they can partner with other advisers to provide that level of planning.

31

The Asset Protection Planning Continuum

Insurance Coverage

32

Insurance Review

The first step on the asset protection continuum is a review of the client's insurance coverage:

- Property and casualty coverage is an essential first line of defense from storms, theft, and other risks. Asset protection should be viewed in a broad context. It is not uncommon to find a physician terrified of malpractice claims pursuing a complex self-settled trust while his or her basic homeowners or schedule property is inadequate.
- Liability coverage to the extent feasible is also a key protective step. This is something all clients should undertake.

33

Insurance Review

- Liability coverage includes liability on appropriate business and professional policies, homeowners and auto and, if appropriate both personal and professional umbrella or excess liability insurance.
- Is insurance coverage in place for each significant asset?
- Is insurance coverage in place for each activity or risk that could cause liability.
- Few practitioners will have the expertise to determine specifically which coverage level, but most practitioners will have the ability to spot some issues and direct clients to retain insurance consultants to review details. It is surprising how many clients, even those with significant wealth, have inadequate or no personal excess liability coverage.

34

Common Insurance Oversights

- No or inadequate personal excess liability (umbrella) policy. Many clients have never had their liability coverage reviewed. A surprising number of clients simply are lacking this type of coverage which could expose most or all of their assets to claims. In some instances, e.g., when the client has different insurance companies providing underlying homeowners and the umbrella policy, there are gaps between underlying coverage and the umbrella.
- Insurance for a rental or family use property is sometimes inappropriate underwritten as a primary residence coverage.

35

UNDERSTANDING YOUR LIABILITY INSURANCE COVERAGE

The vast majority of carriers will only issue a $250,000 policy on your home, a $250,000 policy on your driving, and a $250,000 policy on your vacation home.
A separate "umbrella carrier" or "carriers" will then issue separate policies for above $250,000, as shown in the example below. Sometimes one carrier will write two or more of the below described policies, but often there will be 3 or more carriers involved and coordination can be a challenge:

<table>
<tr><td>$5,000,000

$251,000</td><td colspan="2">Umbrella Policy #1

Covers claims for home at $300,000 and for cars at $250,000.

Must be "drop-down" umbrella if home policy is issued by Citizens or a comparable state agency that does not cover liabilities from pools, pets, or other notable exceptions.</td><td>$5,000,000

$301,000</td><td colspan="2">Umbrella Policy #2

May need a separate umbrella for out-of-state vacation home, large boats or other items.</td></tr>
<tr><td>$250,000

$0</td><td>Policy #1 – Homeowners</td><td>Policy #2 – Vacation Home</td><td>$300,000

$0</td><td>Policy #3 – Car Driver and Owner Policy</td><td>Policy #4 - Big Boat at Vacation Home</td></tr>
</table>

36

Common Insurance Oversights

- **Example**: Mom and dad ow a condominium in the city which daughter lives in. When they purchased the condominium it was erroneously insured as their residence. It may be more appropriate to have the parents own a landlord policy and their daughter a renter's policy to assure proper coverage.
- Old coverage. It is not uncommon to find that clients have old property, casualty or liability coverage that was simply never updated.
  - They may have had a home business and when they closed it the rider for it was never cancelled.
  - More dangerously, the client started a home based business and never discussed with their insurance agent what coverage might be necessary to insure the additional risks that provides.
  - Values of coverage may be very out of date.
  - When it the last time the client had collectibles appraised to assure that there is sufficient coverage?

37

Common Insurance Oversights

- Does the client have home health aides? Are they covered with appropriate workers' compensation coverage? Employment practices coverage?
- If the client is a professional have they acquire reasonable/sufficient policy limits? What about other coverage? Business interruption insurance? Business excess liability?
- What about disability and long term care coverage? While these are not considered part of asset protection planning they should be since asset protection planning should encompass all risks. If a client is disabled and has to draw down assets for living expenses because of not having disability insurance that will jeopardize the value of those assets no different then a claim.
- For every client, confirming that they have had a recent review of all property, casualty and liability coverage should be a part of every asset protection plan.

38

Advantages and Disadvantages of Lowering Malpractice Insurance Limits

I. **ADVANTAGES:**

1. Reduction of premiums.

2. In a horrendous situation, a carrier is going to be more likely to simply give up policy limits than to defend a complicated case.

3. In a small number of instances where the liability may be great, but negligence is hard to prove, some plaintiff firms may not pursue a suit if there are fewer dollars available at the end of the rainbow. The better firms may reject such claims, and the "second or third tier plaintiff firms" will more likely settle for less or lose the suit.

4. As a matter of principle, this will leave less money for plaintiffs' lawyers and people who sue doctors to help stop feeding the industry.

5. From a public records and future evaluation standpoint, the prospect of being able to settle any claim at $250,000 instead of at a higher limit means that catastrophic claims will be characterized as having been $250,000 matters as opposed to $1,000,000 matters.

II. **DISADVANTAGES:**

1. If there is a serious claim, personal and practice assets will be exposed so that damages can exceed policy limits. IF A CLAIM VALUE EXCEEDS LIMITS OF LIABILITY, PERSONAL AND PRACTICE ASSETS MAY BE LOST, although this is generally unlikely if proper planning has been effectuated.

39

Advantages and Disadvantages of Lowering Malpractice Insurance Limits

2. Having to go through defending a claim with the risk of losing personal or practice assets results in significantly higher emotional distress for the physician, their partners, and loved ones.

3. Maintaining high limits going forward means that the carrier would have to defend claims for future acts at the same high limits. Reducing limits now means that claims made in the past will only be subject to the now lower limits.

4. Potential employed physicians, banks, and managed care plans may be reluctant to work with a practice having lower limits.

5. In case of an actual error & an injured patient, having more coverage might be the right thing.

III. **THE MIDDLE GROUND:**

1. Many physicians have chosen small out-of-state or offshore carriers or "self-insurance" programs in lieu of traditional malpractice insurance.

2. These programs usually cost much less than traditional malpractice insurance, and offer the doctors "more control" over the claims process.

3. These carriers are not registered with Florida, and upon becoming insolvent the doctor has no protection at all.

4. These carriers are much more likely to become insolvent than Florida carriers.

5. In some cases, these carriers do not satisfy the definitional requirements of "malpractice insurance", so the doctor is actually "*bare*", but may not know to follow the going bare rules. A patient with a judgment against such a doctor may have the ability to cause the doctor to lose his or her discharge in bankruptcy and medical license!

40

- Other than malpractice insurance, there are several other important insurances that are easy (and affordable) to maintain:
  - disability insurance;
  - overhead insurance;
  - liability insurance (for non-malpractice obligations)
  - worker's compensation insurance
  - unowned automobile liability insurance
  - individual automobile liability policies
    - 3M – 5M in umbrella coverage recommended
  - Uninsured Motorist Coverage - if the person who hits you in an automobile accident doesn't have enough insurance, your own carrier can pay for your injuries and damages if you have sufficient uninsured motorist coverage

41

The Asset Protection Planning Continuum

Title to and Nature of Assets

42

Nature and Type of Assets

- The nature and ownership (title) to assets can have important asset protection ramifications.
- Keep assets in the name of the spouse who does not have significant creditor liability. This is often referred to as the "poor person's asset protection plan." It often incurs no cost, but the protection provided may prove inadequate. The tales of the supposed non-risk spouse being sued for an automobile accident and losing the family wealth are legion. So while this might provide some protection, it should rarely be relied on.

43

Title Assets in Non-Risk Spouse's Name

- If the non-risk spouse dies and his or her will does not assure that the assets pass into an appropriately protective trust for the surviving at risk spouse, any protection may be lost.
- In most states, assets acquired from earnings and growth in value during the marriage will be shared equally upon divorce, even when those assets have been kept in the name of one spouse or the other.
- A prenuptial or postnuptial agreement can be entered into to assure the spouse without assets that the spouse with assets will divide these equally in the event of a divorce, and leave them for the benefit of the surviving spouse in the event of death.

44

Retitle to Low Risk Spouse

- **Example**: Where one spouse is a neurosurgeon and the other is a school teacher, it superficially has appeal to put the bulk of otherwise unprotected assets under the school teacher's name, or under a revocable trust that will not protect from creditors but will protect the assets from guardianship and probate if the school teacher dies or becomes incapacitated. But if the school teacher dies without appropriate trust planning the assets will pass back to the neurosurgeon unprotected. If the simplistic approach is used the school teacher spouse's will or revocable trust should include appropriately protective trusts to be funded on his or her death to protect the surviving neurosurgeon spouse. Liability insurance should be reviewed to assure that the school teacher is sufficient protected in the event of possible claims. But in all events, this should be viewed as the minimum of a plan and perhaps at most a temporary first step on the planning spectrum.

45

Tenants by the Entirety

- Tenancy by the entireties property ownership, depending on state law, may provide a meaningful measure of protection. While a relatively few states provide that the creditor of one spouse cannot reach tenancy by the entireties property, which is a special form of ownership that only exists between married couples, the bankruptcy law will recognize tenancy by the entireties with respect to jointly owned real estate that is located in a tenancy by the entireties state, such as Michigan, Florida and Delaware.

46

TBE Revocable Trust

Carefully drafted Trust provides that all beneficial interests are owned as tenants by the entireties, and solely owned by surviving spouse after first death -

Then acts as a simple Revocable Trust for the surviving spouse.

Surviving spouse must have total control over the Trust after the first death to qualify under tenancy by the entireties.

? Question ?

Why not have Credit Shelter/QTIP Trust provisions that would be activated to the extent that the surviving spouse disclaims TBE Trust assets? - To be a true TBE Trust, the beneficial interest disclaimed would need to flow through the probate estate of the first dying spouse.

47

Definition Of Tenancy by the Entireties

Joint tenancy with right of survivorship is not enough because the law requires that "the 6 unities" exist. The 6 unities may be summarized as follows:

1. Unity of possession - Both spouses have joint ownership and control - it may be acceptable that a deposit agreement allows either spouse to withdraw independently of the other on the theory that the power to withdraw is an expression of an authority of agency given by each spouse to the other.
2. Unity of interest - Each spouse has the same interest in the account - it is not a problem if one spouse deposits all or most of the funds into the account as long as each spouse has the same interest immediately after the deposit.
3. Unity of time - The interests of both spouses in the asset must originate simultaneously in the same instrument, such as on the signature card. **Do not try to convert an individual account into a tenancy by the entireties account. Instead, transfer assets from the individual account to a new tenancy by the entireties account.**

48

Definition of Tenancy by the Entireties

4. Unity of title - Both spouses must have ownership under the same title.
5. Survivorship - On the death of one spouse, the other spouse becomes the sole owner of the entireties property. A general power of appointment given to one spouse over joint assets may vitiate tenancy by the entireties status.
6. Unity of marriage - Of course, the owners must be legally married under Florida law.

Non-residents who own property in Florida can also claim the tenancy by the entireties immunity. In Re Cauley, 374 B.R. 311, 316 (Bankr. M.D. Fla. 2007).

49

Special Tenancy by the Entireties Issues

- Joint Accounts. Not with USAA, Strong Mutual funds and many others. You must read the account agreement to be sure. Better to set up a TBE LLC to own accounts.
- Stock Certificates and Shareholder Agreements.
- Tax Reporting and Tax Refunds.
- Tangible Personal Property.
- Automobiles and Other Registered Vehicles.
- Real Estate Owned Outside of Florida.

50

Foreign Accounts and Entities

- It is difficult for a creditor to reach foreign assets because many jurisdictions do not recognize U.S. judgments, and would require a completely new jury trial in the jurisdiction itself before a judgment would be given that would enable a creditor to attach an account in that jurisdiction. The same can apply with respect to stock owned in a foreign company where the stock certificate is also held in that foreign jurisdiction.
- Foreign planning can be fraught with a significant number of traps for the unwary, which could include having a judge put a debtor into jail on contempt of court charges if the judge has the authority to order the debtor to bring the assets back to the jurisdiction where the court is sitting, or the debtor has transferred the assets at the last minute in a "fraudulent transfer."

51

Excerpt from Leimberg LISI Newsletter # 287, thanks to Steve Leimberg. Full copy available upon request.

The *Barber* of Seville Replaces No Time for *Sargeant*
by Travis Arango and Alan Gassman

It is shocking that the difference between a Limited Liability Company's membership interest and stock in a corporation could cause such a different result. In *Sargeant v. Al-Saleh*, the stock in a foreign corporation could not be reached by the court while *Well Fargo Bank v. Barber* sent the creditor offshore to get a foreign court to allow seizure. In *Barber*, sole ownership of a Nevis LLC was considered to be like any other intangible personal property that a Florida judgment could be applied against.

Fans of *Gomer Pyle, U.S.M.C.* might remember Andy Griffith's movie *No Time for Sergeants*, where he starred as Private Will Stockdale. The *Sargeant* case caught the attention of a great many planners last year when the Fourth District Court of Appeal determined that stock held in a foreign country could only be seized by a creditor when permitted by a court sitting in that foreign country.

One would think that ownership in a limited liability company would be equivalent to owning stock in a foreign corporation, and that may be the case (not to be confused with a case of beer, which is what many planners are going to drink this weekend as they think about this case) because Judge Paul G. Byron, who sits at the United States District Court for the Middle District of Florida, determined that because an LLC membership interest is not "certificated," it is "intangible personal property" that attaches to the debtor.

52

In *No Time for Sergeants*, the character played by Andy Griffith could never get his arms around the situation. Wells Fargo (which has been around since 1852, long before anyone had heard of Andy Griffith,) thought they were going to get their arms around stock but failed. *The Barber of Seville* was an opera that was written by Gioachino Rossini and Cesare Sterbini and first performed in 1861 at the Teatro Argentina in Rome, Italy. When someone gets a cut out of Will Stockdale, it is a heir-cut as opposed to a judicial haircut, which is what Ms. Barber got from Wells Fargo, when she expected that her Nevis LLC interest would not be seizeable[17] without getting a judgment in Nevis. Nevis does not recognize foreign judgments, let alone question the judgment of foreign countries.

The issue of this case will definitely be appealed by Ms. Barber or some subsequent debtor or creditor as this issue is litigated in the future.

Lawyers who have encouraged clients to use out-of-state and/or offshore limited partnerships, LLCs, or other entities need to realize that judges have the ability to apply Florida law in these situations under the Conflict of Law Rules, and that charging order protection will not be available for many Florida based situations where the debtor is the 100% owner of a foreign LLC, thus calling into question whether planners need to get back to clients and suggest additional members.

Another question is whether LLCs should be certificated (required to have stock certificates issued) and whether that would have changed the result for Ms. Barber, who will now have to trade her Rolls Royce in for a Cadillac Seville.

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[1]2015 WL 470589
[2] *Id.*
[3] *Barber*, 2015 WL 470589.
[4] *Id.*
[5] *Id.*
[6] *Id.*
[7] 137 So.3d432 (Fla. Dist. Ct. App.2014).
[8] *Id.* At 433.
[9] *Barber*, 2015 WL 470589.
[10] *Id.*
[11] *Barber*, 2015 WL 470589.
[12] *Barber*, 2015 WL 470589.
[13] *Id.*
[14] *Id.*
[15] *Id.*
[16] *Id.*
[17] "Seizeable" is not a word, but what the heck?

53

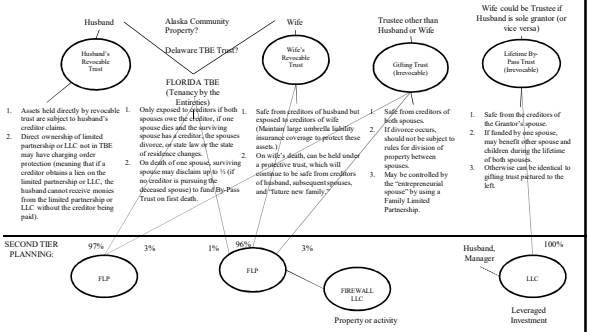
Florida Residents – Learning How to Protect Your Assets in Two Minutes

CREDITOR EXEMPT ASSETS	ASSETS THAT ARE DIFFICULT FOR A CREDITOR TO OBTAIN	ASSETS EXPOSED TO CREDITORS
Homestead *-Up to half acre if within city limits.* *-May be immune from fraudulent transfer statute.*	Limited partnership and similar entity interests.	Individual money and brokerage accounts.
IRA *-Includes ROTH, Rollover, and Voluntary IRAs, but possibly not inherited IRAs.*	Foreign trusts and companies.	Joint assets where both spouses owe money.
401(k) *-Maximize these!*	Foreign bank accounts.	One-half of any joint assets not TBE where one spouse owes money.
Permanent Life Insurance *-Must be owned by insured.*	Note – foreign entities are very rarely recommended and must be reported to IRS -	Personal physical assets, including car, except for $4,000 exemption ($1,000 if homestead exemption is claimed in bankruptcy).
Annuity Contracts Wages of Head-of-Household Wage Accounts (for six months only) Tenancy by the Entireties (joint where only one spouse is obligated) *- Must be properly and specially titled – joint with right of survivorship may not qualify.* 529 College Savings Plans	**Vocabulary:** **EXEMPT ASSET** – An asset that a creditor cannot reach by reason of Florida law – protects Florida residents. **CHARGING ORDER PROTECTION** – The creditor of a partner in a limited partnership, limited liability limited partnership, or properly drafted LLC can only receive distributions as and when they would be paid to the partner. **FRAUDULENT TRANSFER** - Defined as a transfer made for the purpose of avoiding a creditor. Florida has a 4 year reach back statute on fraudulent transfers. A fraudulent transfer into the homestead may not be set aside unless the debtor is in bankruptcy. It takes 3 creditors of a debtor who has 12 or more creditors to force a bankruptcy. Upon filing a Chapter 7 Bankruptcy, an individual debtor may be able to cancel all debts owed and keep exempt assets, subject to certain exemptions. Annuities and life insurance policies are not always good investments, and can be subject to sales charges and administrative fees. There is a lot more to know- but this chart may be a good first step.	

54

Determining Best How To Allocate Assets As Between A Married Couple

Subsidiary Entity Techniques:
-Limited partnerships and LLCs can be used to facilitate discounts, for estate tax purposes, and for charging order protection.
-Limited partnerships and LLCs can also be used to provide "firewall protection" from activities or properties owned.



A COMMON SOLUTION - to use a limited partnership or similar mechanisms and have no assets directly in the "high risk" spouse's trust, half to two-thirds of the assets held as tenants by the entireties, and half to two-thirds of the assets directly in the "low risk" spouse's trust.

55

Marital Asset Preservation System (MAPS)

SPOUSE 2

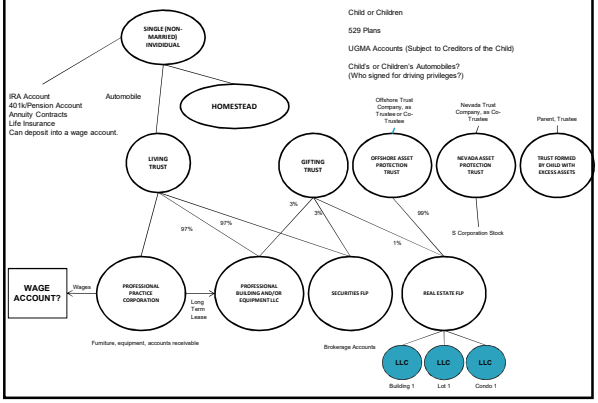
A required contribution to an asset protection trust by Spouse 2 after death of Spouse 1 is not for the primary purpose of avoiding creditors of Spouse 2.

ASSET PROTECTION TRUST
(In Asset Protection Jurisdiction)

Spouse 1 dies. Spouse 2 is required by written agreement to establish asset protection trust in asset protection jurisdiction with all unprotected assets, and contractual obligation to preserve these for common descendants. A standby unsigned, but trust company approved, Trust Agreement can be approved by both spouses during lifetime of Spouse 1 and/or nominally funded.

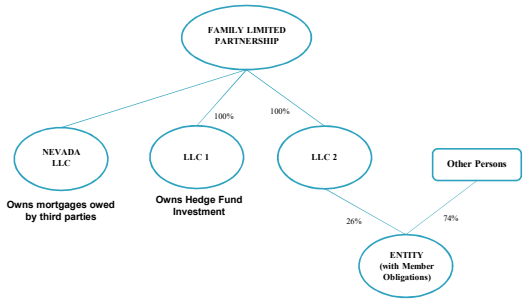
56

ESTATE AND ASSET PROTECTION PLANNING FOR THE SINGLE PROFESSIONAL



57

Using Intermediary Entities to Protect Family Limited Partnership From Potential Liability



58

Separate Community Property to Avoid all Assets Being Subject to the Claims of the Creditors of Either Spouse

(If you live in a Community Property State)

59

Community Property Trust

* May offer creditor protection in asset protection state.
* Step-up basis is more well assured than with JEST - see Zaritsky/Blattmachr articles.
* Deduct your next trip to Alaska to discuss this with Doug Blattmachr.

** See "Tax Planning with Consensual Community Property: Alaska's New Community Property Law (written by Zaritsky/Blattmachr/Ascher) at:

http://www.jstor.org/stable/20782170?seq=1#page_scan_tab_contents

60

Community Property States

- Arizona
- California
- Idaho
- Louisiana
- Nevada
- New Mexico
- Texas
- Washington
- Wisconsin

NOTE: Alaska and Tennessee are opt-in community property states that give both parties the option to make their property community property under a trust that can protect from creditors and enable all assets to receive a new fair market value date of death income tax basis if one spouse dies.

61

The Asset Protection Planning Continuum

Roth IRA Conversion

62

Roth IRA Conversion

- Converting an IRA to a Roth IRA and paying the income tax triggered from unprotected assets may be a useful and easy to implement asset protection step.
- If state law protects both the IRA and the post-conversion Roth IRA the conversion will use up liquid assets held outside the protection of the IRAs, e.g., funds in a brokerage account, to pay the income tax triggered on the conversion. The result will be full post tax dollars protected by the Roth IRA rather than merely pre-tax dollars protected in the regular IRA.
- Roth IRAs have no mandatory distribution rules for the plan holder so dollars will not have to be removed from that protective structure as they eventually will from a regular IRA.

63

The Asset Protection Planning Continuum

State Exemptions

64

State Exemptions

- Most planners are aware that each state has certain creditor "exemptions" that will provide protection for "exempt assets" that are purchased before a creditor problem arises, or with the proceeds from other exempt assets. Every advisor should be familiar with the exemption laws of his or her state if those are material. Some states, like Florida, have exemption rules that are extremely favorable to debtors, and can include protection of an unlimited or high homestead value, the cash value of life insurance policies, annuity contracts, IRAs, pension accounts, tenancy by the entireties assets owned by a married couple, 529 College Savings Plan accounts, Health Savings Account, and other categories of assets.

65

State Exemptions

- **Example**: Move to Florida and buy a big home. Florida is one of the few states to have an unlimited homestead exemption, and the Florida Constitution's homestead protection trumps its fraudulent transfer law, meaning that a debtor with a judgment against him could move to Florida and buy a big house and not be pushed out of the house even if this was an intentional "fraudulent transfer" of previously owned non-exempt assets. It is noteworthy that the 2005 Bankruptcy Act provides that home equity that is attributable to a fraudulent transfer made within ten years before the filing of a bankruptcy can be lost if the debtor ends up in bankruptcy, but it normally takes three creditors to require a debtor to be in bankruptcy if the debtor has at least twelve legitimate creditors.

66

State Exemptions

- Other states, like Nevada, have very limited creditor protection exemptions, and in some situations the only exemptions that can be relied upon are those provided under Section 522 of the Bankruptcy Code, which are somewhat limited but include certain real and personal property, retirement funds and homestead.
- If the client's state has meaningful exemptions this might be a relatively simple and inexpensive planning step to retitle or purchase additional protected assets to provide incremental protection.

67

The Asset Protection Planning Continuum

Simpler Irrevocable Trusts

68

Simple Irrevocable Trust Basics

- The use of irrevocable trusts is the foundation for many asset protection plans. Protective trusts should be used at each phase of planning.
- A typical irrevocable life insurance trust ("ILIT") or trust for children or other heirs, can provide asset protection benefits.
- Parents should bequeath assets into long term trust for heirs rather than make outright bequests. If benefactors for the client make all gift or testamentary transfers into protective long term trusts for the client the client may be able to have access too, and meaningful control over, those assets, without exposing them to his or her creditors, divorce or other predators. Some commentators refer to these protective yet flexible trusts as beneficiary controlled trusts.

69

Simple Irrevocable Trust Basics

- Spouses and partners should gift and bequeath assets to each other only in protective long-term trusts. Caution should be exercised when spouses (and even other family members) plan to address the reciprocal trust doctrine. While this is a tax doctrine that may enable the IRS to unravel planning, it may also permit a creditor to challenge contributions made by one spouse as having been made by the other spouse when both spouses are funding similar trusts for one another within a relatively short period of time. Many practical steps can be taken to lessen this type of challenge by forming the trusts in different jurisdictions, naming different beneficiaries, using different trustees, varying the terms, not signing the trusts at the same time, funding the trusts with different assets, and so forth.
- Single individuals may have few options other than funding a trust that they themselves are a beneficiary. See discussion of self-settled domestic asset protection trusts ("DAPTs") below.

70

Structure Irrevocable Trusts Better

- One of the common issues with trusts is that the distribution provisions are structured in a manner that characterizes them as "support trusts." This gives the trustee the power to pay trust income to provide for the health education maintenance and support ("HEMS") of the beneficiary. A support trust is somewhat protective of beneficiary's interests because the beneficiary is only entitled to distributions for his or her support. A spendthrift provision should be included.
- A support trust is not as protective as may be desired because the distributions to maintain support may be reached, and depending on state law put the trust at risk in the event of the beneficiary's divorce.

71

Structure Irrevocable Trusts Better

- A preferable approach is to structure trust distribution provisions as a discretionary trust. Distributions are made only in the discretion of trustee. The creditors of a beneficiary of a discretionary trust should not be able to compel the trustee to pay. The interest of the beneficiary does not qualify as a property right so even preferred creditors like spouses may be prevented access. However, it may not provide protection in some jurisdictions from what might be characterized as "super creditors."
- Ideally, an independent trustee other than the beneficiary should be named.
- Traditional trusts often distributed assets at specified ages and ended at some specified age, e.g. one-third at age 25, one-half of what remains at 30 and the balance at 35. These mandated distributions and terminations undermine the protection of these trusts from an asset protection perspective.

72

Fix Existing Trust that is Not Optimal for Asset Protection

If a trust is identified that is less than optimal from an asset protection perspective, there may be options to modify the trust to enhance the asset protection benefits of the trust:

- Modify the trust by actions of a trustee or trust protector if permitted under the governing instrument.
- Decanting the trust into a new trust that has better administrative and distribution provisions.
- Merge the existing trust into a new trust that has better administrative and distribution provisions.
- Effect a non-judicial modification pursuant to state statute if the settlor is alive and all beneficiaries are of age or can be represented virtually.

73

The Asset Protection Planning Continuum

Qualified Personal Residence Trusts (QPRTs)

74

QPRTs

- A Qualified Personal Residence Trust ("QPRT") is a technique whereby a taxpayer gifts his or her home to a special trust reserving the right to live in the home rent-free for a fixed number of years (the "QPRT term"). Upon the expiration of the QPRT term, the children (or a trust for their benefit, often a grantor trust) will own the home. The parent may continue to live in the residence after the QPRT term pursuant to a fair market lease arrangement.
- The estate planning advantage of a QPRT, assuming a taxable estate, is that the technique can be used to leverage the gift of a taxpayer's personal residence out of his or her taxable estate. The leverage is in part due to the fact that the parent/donor retains the right to live in the house rent-free for a fixed number of years.

75

QPRTs

- That retained right delays the beneficiary's receipt of the residence and reduces the value of the gift of the home on a present value basis. Often QPRTs represented an acceptable form of gift because clients could retain their liquid assets intact to cover living expenses. For most moderate wealth clients, there may be no tax benefit from QPRTS with a $5 million inflation adjusted exemptions.
- Why give up the basis step-up at death if the client's estate won't be taxable? A QPRT, however, might provide some measure of asset protection planning benefits since it transforms an outright equity interest in the home into a mere term of years' interest that should not be particularly valuable to a creditor.

76

Alternatives to QPRTs

- If the client is married and lives in a state that provides for tenants by the entirety protection for a home, e.g. New Jersey, practitioners must weigh the possible benefits and limitations of that protection versus the benefits, restrictions and income tax consequences of a QPRT.
- If the state provides a valuable homestead exemption, e.g., Florida, using a QPRT might reduce protection.
- If the client is single a QPRT may be useful, simpler and perhaps safer than transferring the house to a limited liability company which would be held in whole or part by a self-settled DAPT.

77

QPRT Implementation

- Husband and wife jointly own a personal residence. The deed is re-titled to tenants in common so that each spouse owns a one-half interest in the home.
- Create a separate QPRT trust for each of husband and wife.
- The home is appraised with consideration to possible fractional interest discounts.
- Each of husband and wife gift their one-half interest in the home to their respective QPRT.
- If either spouse outlives the term of their QPRT the 50% interest in the home is transferred to a remainder trust for the children. By using a grantor trust at the "back end" if the parents wish to continue living in the home the rent they pay to the trust would be disregarded for income tax.

78

The Asset Protection Planning Continuum

Spousal Lifetime Access Trust (SLAT)

79

SLAT

- Spousal lifetime access trusts (SLATs) can provide a valuable asset protection benefit for married couples.
- With SLATs each spouse creates a trust for the benefit of the other spouse that may include other sprinkle beneficiaries. The couple can effectively move significant assets into trusts yet continue to access all of those assets. The risks of SLATs include premature death which can be insured against, and the possibility of divorce. How might divorce impact a SLAT plan if one of the premises of the plan is that each spouse might indirectly benefit from the assets of the trust they create through the distributions to their spouse. Divorce would undermine that access.

80

SLAT

- SLATs are almost always structured as grantor trusts so that the income is taxed to the settlor. This will result in the clients paying income tax on income earned in the SLAT thereby reducing their estate and accelerating the growth of assets inside the SLATs. This is also a valuable asset protection benefit as the protections will be enhanced each time the clients/grantors make income tax payments to cover SLAT income. The power of this grantor trust tax burn on the clients' estates can be powerful. Even a moderate gift by a married couple both age 65 to two non-reciprocal spousal lifetime access trusts ("SLATs") can shift over the duration of the couple's life a substantial portion of their wealth outside their taxable and creditor-reachable estate.

81

SLAT/ILIT

- Non-reciprocal SLATs are a common planning technique. These trusts are more robust versions of more traditional irrevocable life insurance trusts ("ILITs"). In fact, properly structured (e.g., with a separate insurance trustee and appropriate insurance provisions) SLATs can hold life insurance and in many instances may be used in that context to eliminate old ILITs simplifying and improving the client's planning.

82

Dynasty Wealth Protection Trust

Trustee

DYNASTY WEALTH PROTECTION TRUST

Assets gifted to trust and growth thereon.

Note: Nevada gets a gold star for having a law that says there cannot be an assumed or an oral agreement between the Grantor and the Trustee of a dynasty trust; because of this, the IRS has a weaker argument that the grantor retains "secret" control.

1. Grantor can replace the Trustee at any time and for any reason.
2. Protected from creditors of Grantor and family members.
3. Can benefit spouse and descendants as needed for health, education and maintenance.
4. Per Private Letter Ruling 200944002 the Grantor may be a discretionary beneficiary of the trust and not have it subject to estate tax in his or her estate. But be very careful on this! The Trust would need to be formed in an asset protection jurisdiction and there is no Revenue Procedure on this.
5. Should be grandfathered from future legislative restrictions.
6. May loan money to Grantor.
7. May own limited partnership or LLC interests that are managed at arm's-length by the Grantor.
8. May be subject to income tax at its own bracket, or the Grantor may be subject to income tax on the income of the trust, allowing it to grow income-tax free unless or until desired otherwise. If the Grantor is a beneficiary it must remain a disregarded Grantor Trust.

83

The Asset Protection Planning Continuum

Beneficiary Defective Irrevocable Trusts (BDITs)

84

BDITs

- Beneficiary Defective Irrevocable Trusts (" BDITs") may provide valuable asset protection benefits.
- The BDIT is an irrevocable trust that uses the common Crummey power to allow someone other than a third party benefactor (such as a client's parent) who establishes the trust for the client and his or her family to be treated as the owner of the trust property for income tax purposes.
- The client for whom the BDIT was created can be treated as the owner of the trust for income tax purposes only (i.e. the BDIT is a grantor trust as to the client not the actual settlor). \
- The settlor, e.g., the client's parent, establishes the trust and makes a $5,000 gift to the trust. The client as beneficiary has the right to withdraw that cash gift using the Crummey power, lapsing power of withdrawal, but does not do so.

85

BDITs

- As a result of the client holding a right of withdrawal under a Crummey power, Code Section 678 treats the client as the owner of the trust property for income tax purposes. This tax characterization is vital to the planning applications.
- The client never makes any gratuitous transfers to the BDIT. The trust is intentionally designed so that it is not a grantor trust as to the settlor. This will enable the client, as deemed owner of the trust property for income tax purposes, to sell appreciated assets to the BDIT without triggering income tax consequences. Some practitioners believe that because the client is not the settlor of the trust the BDIT is superior to a self-settled DAPT discussed below. Once the BDIT is established the client transfers appreciating assets to the BDIT via a nontaxable note sale similar to the traditional note sale to a defective grantor trust.

86

BDITs

- Why go through these additional machinations to differentiate the BDIT from the DAPT which would permit the same type of sale? Proponents of BDITs argue that a drawback to the DAPT is that the client is the person establishing the trust and making transfers to it. Because the client is the one making the transfers to the DAPT, his or her control over the transferred assets must be substantially limited if the desired estate tax benefits are to be achieved.
- Because the client will not make any gratuitous transfers to the BDIT, the assets inside the BDIT are, according to many practitioners who use the technique, more secure from claimants than the assets held in a DAPT. The BDIT is an approach that enables the client to be in substantial control of the transferred wealth.

87

The Asset Protection Planning Continuum

Entities, Contractual Relationships and Other Steps

88

Entities and Relationships

- Prudent use of limited liability companies ("LLCs") and other limited liability entities (corporations, S Corporations, limited partnerships, limited liability partnerships, etc.).
- Re-characterize relationships, such as by making employees into independent contractors and outsourcing risky activities to third parties.

89

Entities and Relationships

- **Example**: A judgment holder could levy upon all stocks and bonds owned by a debtor. However, before any claim arose the client transferred assets to an LLC. The client/debtor owns 95% of the LLC and the remaining 5% of the membership interests are owned by her parents, or a trust for her children. In most states the creditor cannot reach into the LLC, but generally will only instead receive a charging order which gives the creditor the right to receive 95% of any distributions, but only if and when there would be a distribution. The courts will normally not have any power to require distributions, so creditors typically negotiate favorable settlements when their only avenue is to receive a charging order.

90

Entity Restructure

- Move assets out into a separate leasing or licensing entity that can have an arm's-length relationship with the operating entity, if this will not trigger material taxes. It may be possible for a business entity taxed as an S corporation or a C corporation to avoid taxes being incurred upon separation by entering into what is known as a new Parent F reorganization, whereby a new company will own the existing operating company and a new "brother/sister company" that can receive valuable assets from the operating company without triggering income taxes.

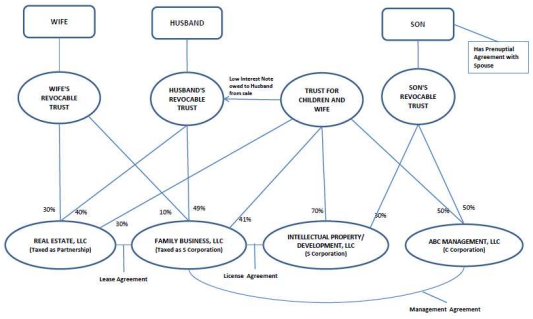
91

Entity Restructure

- Have the company owe shareholders pursuant to loans, or indebtedness to others. A legitimate creditor can be given a lien against entity assets in the same way that a bank normally takes a mortgage lien against a house.
- Liens given against physical assets and also intangible assets like accounts receivable are normally "perfected" by the filing of UCC-1 Financing Statements in the state where the assets are maintained. Consider factoring accounts receivable to an entity owned for the primary benefit of family members in the next generation, to help with estate tax planning, and also pare down the balance sheet.

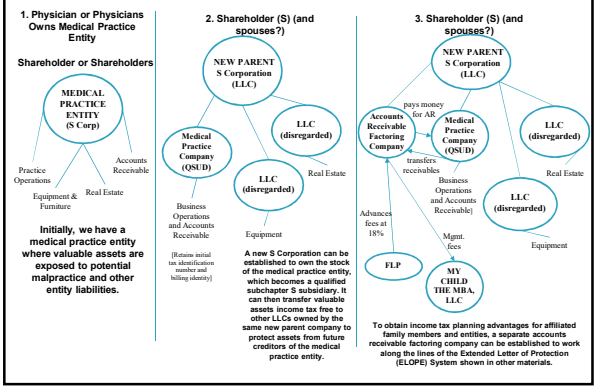
92

Possible Family Logistics for a Successful Business and Estate Planning



93

NEW PARENT F REORGANIZATION
SHOWING ACCOUNTS RECEIVABLE FACTORING ARRANGEMENT



94

Extended Letter of Protection Enhancement (ELOPE System)

To enable a Family Limited Partnership and child-owned management entity to derive reasonable profits for the purchase and administration of letters of protection

95

The Extended Letter of Protection Enhancement (ELOPE) System

***The Extended Letter of Protection Enhancement (ELOPE) System is a term and technique developed by Alan S. Gassman, Esquire © 2007.**

Many orthopedic surgeons, spine surgeons, and podiatrists have significant "personal injury" medical practices. Oftentimes, these doctors accept Letters of Protection for their services.

A Letter of Protection is a promise that the physician will be paid if and when the personal injury claim is settled. The law firm issuing the Letter of Protection basically agrees that the settlement or jury verdict judgment monies that would otherwise go to the plaintiff/patient will be paid to the doctor to the extent of the Letter of Protection.

Typically, the Letter of Protection charges are significantly higher than medical insurance, HMOs, or Medicare pays, which takes into account that the doctor has to wait a long time to be paid, and cannot be certain if or when he or she will be paid.

There is, therefore, a significant "Financial Leverage" occurring, as the doctor finances his practice while waiting to be paid sometimes as long as 2-3 years on average.

Besides the Financial Leverage issue, the value of the total of the Letters of Protection that a busy physician might be holding will often exceed $1,000,000. Those assets are subject to potential creditor claims of the medical practice.

The ELOPE System is designed to allow affiliated family entities, which may be owned by or for children, grandchildren, and other family members in lower tax brackets, to realize reasonable profits that would otherwise be taxed at the highest bracket possible, while also protecting the Letters of Protection from potential creditors of the medical practice and the physician.

It would make sense to immediately transfer Letters of Protection outside of the medical practice to an affiliated entity, but if the medical practice is taxed as a corporation, whether a regular corporation or an S corporation, the transfer of such Letters of Protection out to the doctor or any other entity affiliated with him or her will normally trigger taxable income on the value of the Letter of Protection at such time.

Therefore, the common idea of having a family limited partnership or other affiliated entity factor or purchase the Letters of Protection from the medical practice is typically not a popular one.

96

The Extended Letter of Protection Enhancement (ELOPE) System

The solution under the ELOPE system is to have a factoring company established as a brother/sister company to the medical practice.

It is simple and inexpensive to establish a "New Parent S Corporation" to own 100% of the stock of the medical practice company and 100% of the stock of the factoring company. This new S corporation can be a Limited Liability Company that might be owned by the physician, the physician's spouse, or by the physician and the physician's spouse as Tenants by the Entireties.

The medical practice entity does not need to change its name, its taxpayer identification number, or any other significant aspect of its operations as a result of this "F Reorganization." Under the tax law it will be known as a Qualified Sub-Chapter S subsidiary ("Q-Sub").

One business purpose of this arrangement is to allow the affiliated family entity to be reasonably assured that the Letters of Protection that it finances the purchase of will not be lost to a malpractice claimant of the medical practice.

The purpose accomplished from the point of view of the medical practice company and doctor is that income tax will not be triggered when the Letters of Protection are transferred to the Factoring Company, because transfers between a brother and sister company that are commonly owned by an S corporation parent can be disregarded for income tax purposes.

Note - a subsidiary company can elect to be treated as QSST (Qualified Sub-Chapter S Subsidiary). A new entity may elect to be treated as a Q-Sub or as a disregarded entity L.L.C., but may have a separate tax identification number. Each separate subsidiary should have separate financial statements, bank accounts, and fiscal conduct.

All income and deductions of the subsidiary companies will go onto a single S corporation tax return for the parent company, although it is crucial to have separate books and records for each subsidiary in order to maintain their independence and to avoid having a creditor of the medical practice assert that the Letter of Protection entity is an "alter ego" or "partner" of the medical practice.

In order to allow an affiliated family entity to provide financial assistance to the medical practice and be paid reasonable compensation as a result therefore, the applicable family limited partnership, S corporation, or trust established in whole or in part for the doctors' children, grandchildren, or other family members may have assets that can be pledged or otherwise collateralized in order to provide financing for the Factoring Company. An example would be a family limited partnership with a $1,000,000 investment portfolio which borrows money on margin from the brokerage firm at 6.8% interest and advances this money to the subsidiary Factoring Company. The Factoring Company then uses this money to purchase the pre-existing Letters of Protection that the medical practice owns, which may be valued at $400,000 based upon industry standards. The Letters of Protection may have a face amount of $1,000,000.

97

The Extended Letter of Protection Enhancement (ELOPE) System

The market value of the Letters of Protection may be established by having arm's-length Factoring Companies review and make offers for the purchase or financing thereof. The Factoring Company can agree to pay a fairly high interest rate to the affiliated family company for the use of money. The affiliated family company may be paying its brokerage firm 6.8% interest on the margin loan, and may be receiving 15% interest back from the Factoring Company. Some companies in this industry charge the highest percentage permitted by Florida law, which is 25% when the borrower is a corporation and the loan is in excess of $500,000. Where the loan is under $500,000, the usury rate under Florida Law is 18%. See Florida Statute 687.03.

In our example, the Factoring Company would purchase Letters of Protection as they are received by the medical practice. At the end of each calendar month, the Letters of Protection received by the medical practice can be assigned to the Factoring Company, in exchange for which the Factoring Company can give cash to the medical practice.

The monies received by the medical practice for the Letters of Protection may be held by the parent company for long term capital needs under an investment account. Unless or until the monies are paid out from the parent company, there should be no income tax thereon. The income from the Letters of Protection will therefore not have to be recognized until the ultimate payor (the patient or the insurance carrier) pays the Factoring Company for the Letter of Protection.

The Factoring Company may be administered by a separate S corporation that might be owned and run by the doctor's children. In that event, the Factoring Company would pay a reasonable management fee to the management S corporation, then the children might earn sufficient funds to fund their IRAs, and they also receive dividends to the extent that computer systems, policy and procedure manuals, and other physical and intangible assets of the management company cause income to be received.

98

Choices and Factors with Respect to Allocation & Payment of Medical Practice Income for the Solo Practitioner

Owned by Physician or as Tenants by the Entireties

S CORPORATION PRACTICE ENTITY

PAYEE	CREDITOR PROTECTED IN FLORIDA?	TAX/EXPENSE	NOTES AND OBSERVATIONS
Pension Plans	Yes	Costs for staff and to maintain plan – spouse on payroll to justify additional contribution.	
Children on the Payroll	Yes – if goes to Roth IRA in the name of the child.	Child in lower rate (Lowest bracket – 10%) but 15.3% employment taxes apply..	Can do this for parents and in-laws as well!
Wages paid to Doctor	If Head of Household, Florida Statute 222 may apply – deposit directly into protected account.	15.3% employment taxes on first $127,200, and then 2.9% over $127,200 plus .9% tax on wages exceeding $200,000 for single person and $250,000 for married joint filers.	Up to $270,000 countable for pension contribution purposes.
Dividends to owner of entity.	Only if owner is protected – such as tenants by the entireties or a family limited partnership owning the entity.	Not subject to payroll taxes – but could be recharacterized by IRS.	Not creditor protected as wages.
Spouse on payroll.	Yes, if spouse is safe.	15.3% employment taxes on first $127,200, and then 2.9% over $127,200 plus .9% tax on wages exceeding $200,000 for single person and $250,000 for married joint filers.	
Rent	Yes, if renting entity is protected. They protect PA assets if landlord has lien to enforce rent on long-term lease.	7% sales tax – after tax cost is 4.55%. Subject to the 3.8% Medicare tax for single taxpayers with MAGI over $200,000 and MFJ taxpayers with MAGI over $250,000.	May be worth paying full retail rent if owner or part owner of building or equipment are children and/or bypass trust for spouse to facilitate estate tax savings.
Interest owed to related parties.	If related party is protected.	Deductible as interest – receiving party pays interest income.	Why pay a bank 7% with personal guarantees when a family limited partnership or trust for the children might loan the money without guarantees at 14% and take a lien on all practice assets.

99

Optimize Qualified Plan Contributions – Confer with a Good Actuary – Employee Census

Name of Employer:

Provide complete information for all employees employed during the year, even if they have terminated.

Employee Name	Date of Birth	Date of Hire	Date of Termination	Annualized W-2 Compensation	Hours per Week	Ownership %

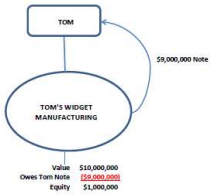
100

Debt Equity Planning

Tom owns a company that has a $10,000,000 book value and no debt.
It makes widgets and may be sued.

Why not have Tom be owed $9,000,000 on a note secured by a pledge of the assets of the company, so that if something bad happens in the company, Tom can foreclose and receive $9,000,000 worth of assets to be in front of the other creditor or creditors.

Typically, this can be done tax-free.



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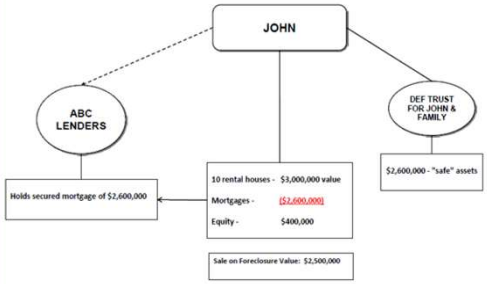


102

The Asset Protection Planning Continuum

Domestic Asset Protection Trusts (DAPTs)

103

DAPT

- Many state courts have held that self-settled trusts are accessible to creditors. There is precedent in New York and New Jersey that a self-settled trust is void as against public policy. But there are no cases analyzing the application of this with respect to a self-settled trust state, like Alaska, Delaware, South Dakota or Nevada. If your client lives in one of the states permitting self-settled trusts, then your client can likely use a DAPT. If your client, however, does not reside in one of those states, then there may be an issue, but how much of an issue remains unclear for several reasons.

104

DAPT

- Courts have remained critical of DAPTs, because judges are generally unfamiliar with how these trusts work, and often have an unfavorable attitude when the law of a jurisdiction outside of the judge's reach and command are used to protect assets that may have significant relationships with the jurisdiction where the judge is located.
- In the 2013 Bankruptcy Court decision of *Huber*, a bankruptcy judge in Washington State held that Washington State law, in lieu of the protective Alaska law, applied where the debtor had established an Alaska LLC and placed Washington State real estate into the LLC, and then transferred the ownership of the LLC to an Alaska Creditor Protection Trust.

105

DAPT

- A key issue for DAPTs is whether protection provided by these trusts will be afforded to settlors not residing in those states? What protection, if any, is available for someone residing in a non-DAPT state that creates a DAPT in a state permitting such trusts?
- The Restatement of Conflicts of Law Section 273 concerning restraints on alienation of trust interests creates a further issue for DAPTs. This provides that the local law of the state in which the settlor has manifested an intention for the trust to be governed should control. But Section 270 of the Restatement provides that an inter-vivos trust is valid under the local law of the state designated, provided that application of its law does not violate a strong public policy of a state which has the most significant interest in the trust. This could imply that the non-DAPT state may successfully maintain that a DAPT created by its resident to escape creditors in its jurisdiction violates a strong public policy of that state.

106

DAPT

- This interpretation could obviate the benefits of a DAPT for a resident of a non-DAPT jurisdiction. The Uniform Voidable Transactions Act raises further concerns. Section 4 comment 2. Might make a DAPT voidable per se for a non-DAPT resident.
- **Example**: A resident of New Jersey (which does not permit self-settled trusts) creates a DAPT in Alaska (the first state to permit self-settled trusts), New Jersey courts may permit creditors to reach that trust as being void per se.

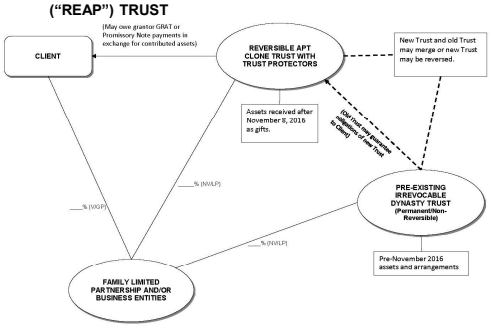
107

Hybrid DAPT Sample Clause

- The Grantor appoints NAME as the Designator. During the Grantor's lifetime, the Designator, shall have the power, exercisable at any time and from time to time in a non-fiduciary capacity, and without the approval or consent of any person in a fiduciary capacity, to add as additional beneficiaries hereunder any person who is a descendant of Grantor's grandparents who is not already designated herein as Beneficiary. Further, the Designator may at any time remove any person so added by written notice to the General Trustee, so that from the date of such written notification that added descendant of Grantor's grandparents shall cease being a beneficiary hereunder. The Grantor directs that this power is not assignable. In the event that NAME dies before the Grantor dies, the successor Designator shall be such individual (other than the Grantor, any person acting as a Trustee under this instrument) whom NAME shall have designated by an instrument in writing.

108

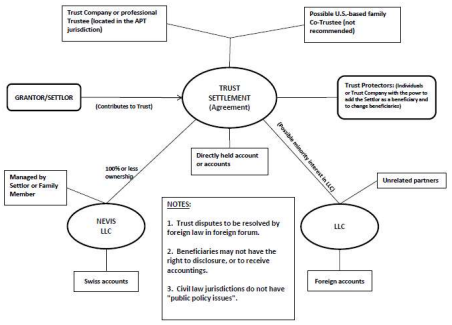
THE REVERSIBLE EXEMPT ASSET PROTECTION ("REAP") TRUST



If large gifts are being made to existing irrevocable trusts based upon what was in progress before the election results, consider using an identical but reversible irrevocable trust to gift to, which can either be merged into the pre-existing trust, held in parallel, or reversed back by Trust Protectors if and when the estate tax is truly and permanently eliminated.

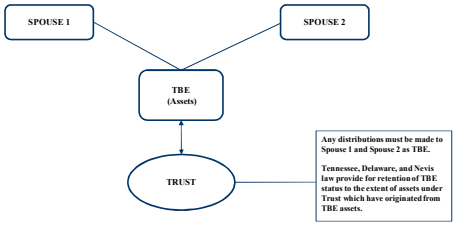
109

The Anatomy of a Typical Offshore or APT State Trust Arrangement



110

Nevis, Tennessee, or Delaware TBE APT Jurisdiction Trust



The jurisdiction law provides that TBE assets transferred to a trust will retain their TBE character, and must be distributed to the spouses only as TBE assets.

111

The Anatomy of an Asset Protection Trust

1. Trustee – The Trustee holds the trust assets for the benefit of the beneficiaries pursuant to the terms of the Trust Agreement.
2. Trust Settlement - This is the Trust Agreement, and should be drafted by competent legal counsel with an understanding of:
   a) The law of the jurisdiction
   b) United States tax law
   c) Trust and creditor protection law in general
3. Scheduled Beneficiaries – These are the initial named beneficiaries that the trust is established for. Reputable offshore trust companies will require passports, utility bills, professional letters of reference, and sometimes affidavits from each beneficiary when the trust is established.
4. Trust Protectors – These are individuals and/or trust companies who have certain powers over the trust:
   a) To change the Trustee or Trustees – commonly any replacement Trustee must be a reputable trust company or a lawyer practicing in an asset protection trust ("APT") jurisdiction.
   b) The power to add beneficiaries who are not "excluded persons."
5. Flee Clause a/k/a Cuba Clause – A provision that requires the Trustee to move the trust and trust assets to another jurisdiction in the event of a governmental change, or if a judicial challenge to the trust makes it possible that the trust assets would be invaded within a short period of time.
6. United States Judgment – A judgment from a United States Court, which means nothing whatsoever in the jurisdiction where the trust is situsd (located). In most reputable APT jurisdictions, the creditor will have to file a brand new lawsuit in the jurisdiction and obtain a new judgment against the debtor before then attempting to set aside the trust by proving that the trust is an alter ego of the settlor or a beneficiary, or that the transfer to the trust was for the primary purpose of avoiding creditors.

112

The Anatomy of an Asset Protection Trust

7. APT Legislation – Special laws passed in a number of offshore jurisdictions which make it extremely difficult, if not impossible, for a creditor to pierce an APT:
8. Contingency Fees Not Permitted – In most asset protection jurisdictions, lawyers must charge their clients by the hour, and not on a contingency fee basis.
   a) Belize has no statute of limitations – unless there is a judgment against the settlor in Belize on the day the trust is formed, Belize law will protect the trust.
   b) Court Registry deposit requirement – Nevis requires a 100,000 Nevis dollars deposit into the Court Registry before a trust can be challenged. A 100,000 Nevis dollars deposit is also required to challenge an LLC. A Nevis trust and LLC challenge will therefore require a 200,000 Nevis dollars deposit.
9. Conflict of Interest Considerations – Typically, there are between two to six dozen practicing lawyers in a popular asset protection trust jurisdiction. Most or all of these lawyers have done work for the more popular trust companies, and would therefore have a conflict of interest in pursuing a trust for a creditor – lawyers from outside of the country must therefore come in as "foreigners before the court" to be admitted to practice law there to challenge the trust.
10. Judicial Bias - The asset protection trust jurisdictions derive significant income and lawyer work, not too mention governmental fees that support the local economy. The last thing an asset protection trust jurisdiction economy needs would be a judicial decision that lets creditors into a well intended asset protection trust that was structured in advance.
11. Having Your Cake and Protecting it, Too - The Trustee of the APT can own a 99% limited partnership interest or the ownership of an LLC, with the entity being managed responsibly and transparently by the general partner or manager, which may be the settlor. If and when a challenge might occur, the settlor may transfer control of the subsidiary entity to the Trustee of the trust.

113

Common Offshore Trust Mistakes

- Not reporting the trust and trust activities on a Form 3520, upon inception, Form 3520A each year thereafter, TD F 90-22.1 (FBAR) forms annually, and compliance with FATCA (Foreign Account Tax Compliance Act) reporting requirements.
- Not reporting trust income or not reporting income that goes into the trust.
- Being dishonest with any potential creditor, the IRS or any taxing authority with respect to the trust or its underlying operations.
- Not reporting the funding of the trust as a completed gift for gift tax purposes if the grantor has not retained a power with respect to the trust that would cause its funding to be an incomplete gift (such as the testamentary power to appoint trust assets) even if the trust will be subject to estate tax by reason of such power.
- Failure to provide that upon death, any marital deduction devise must override any discretionary power of the trustee or trust protectors to deprive the grantor's spouse of sole lifetime beneficiary/QTIP trust or outright payment rights.
- Getting the trust assets stolen by the trustee.
- Being dishonest with any court with respect to the trust or its operations.

114

Consider the Offshore Foundation

- A foundation is a special entity found in a handful of countries that include Nevis, the Bahamas, Panama, Lichtenstein, and Switzerland.
- A foundation is similar to a trust, because it is held for the benefit of one or more individuals and/or charities. It can own assets and can return those assets to any beneficiary who may have contributed them.
- A foundation has a manager, a secretary, and a registered agent. Typically, the secretary and registered agent will be a lawyer or trust company in the foreign jurisdiction. A trusted U.S. individual will typically be the manager.
- Trust reporting requirements may be eased considerably.
- Normally, a foundation will be taxed as a regular C corporation, which can be catastrophic, but it is possible for a foundation to be taxed as a trust or as a partnership, depending upon drafting and operation.
- Tax filings with a foundation will be the same as applies to an offshore trust, but red tape normally required by reputable trust companies under trust arrangements will often not apply with a foundation.
- In civil law jurisdictions, such as Lichtenstein, a judge does not have the power or authority to do anything but follow the exact written law. If the law says that creditors cannot reach a foundation, that is the judge's order, and the case is otherwise dismissed.

115

The Very Best Creditor Protection Technique

(Give Significant Assets to a 501(c)(3) Charitable Foundation)

CHARITY

1. Tax deduction for contribution, which is controlled by the donors, and earmarked for eventual use for charity.
2. Creditors cannot reach it.
3. Family members can receive reasonable compensation for charitable services rendered on behalf of the Foundation.
4. Organization provisions can require that only family members will control the organization for up to 360 years.
5. The organization can be set up as a trust, with the donors as Trustees, to avoid state filings and annual filing costs that would apply for a charitable corporation.
6. The organization can be the beneficiary of a Charitable Lead Annuity Trust, but there will have to be a Chinese wall on management for a separate identical organization, so that the Grantor cannot manage what ends up going to charity from the CLAT.

116

Foreign Charitable Foundation

- No U.S. income tax deduction for funding, but may qualify for gift tax charitable deduction.
- Formed in foreign jurisdiction that does not impose income tax.
- Non-U.S. source income not subject to tax, even though foundation is controlled by U.S. taxpayers.
- Careful and appropriate management and compliance is essential.
- Not subject to estate tax on U.S. taxpayer's death – must be held solely for charity.
- See Jonathan Moore's book – A Practical Guide to International Philanthropy.

117

Conclusion and Additional Information

Conclusion

118

Conclusion

- Although asset protection trusts are a valuable asset protection technique, it is important for clients and practitioners to know that there are other less expensive and less complex mechanisms that can be put into in place to provide valuable creditor protection. In many situations a combination of such methods, which may also include the use of an asset protection trusts may also be considered. The asset protection continuum introduced in this article will hopefully help practitioners guide all clients through a range of asset protection planning that will help each client achieve a level of protection that is appropriate for that client's circumstances and budget.

119

Additional information

- Contact Martin M. Shenkman via email at shenkman@shenkmanlaw.com
- Contact Alan S. Gassman via email at agassman@gassmanpa.com

A KEY ESTATE PLANNING GUIDE

Law Easy

Partnership v. S Corporation- Which is Better to Hold Real Estate?

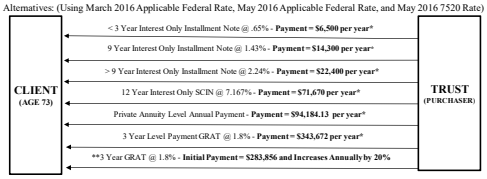
120

PARTNERSHIP	S CORPORATION
Advantages 😊	*and Disadvantages* ☹
Partners receive basis for indebtedness incurred by the partnership 😊	DOI income insolvency exclusion is determined at the corporate level. 😊
On the death of a partner, the partnership's (inside) tax basis of its assets can receive a step-up in income tax basis, if a Section 754 election is in place for the partnership 😊	No similar basis adjustment mechanism applies to S corporations. ☹
When a new partner buys into a partnership corporation, their depreciation write-off and underlying basis in their partnership interest will be based upon the price that they pay. 😊	When a new shareholder buys into an S corporation, their depreciation write-off and underlying basis if and when the real estate is ever sold has to be based upon the historic basis and depreciation taken, versus being based upon the price they pay. ☹
Appreciated real property can generally be distributed from the partnership tax-free to the partners. 😊	Distributions of appreciated real property to the shareholders are treated as if the property was sold at its fair market value to the shareholders. ☹
No restrictions apply as to who can own partnership interests. 😊	S corporations can only be owned by certain individuals and trusts, and cannot be owned non-resident aliens, corporations or partnerships ☹
Partnerships can have more than one class of stock, and income and distribution preferences can be drafted in virtually any manner, so long as they have substantial economic effect 😊	S corporations cannot have a "second class of stock," and income allocation and distribution rights must be pro rata to ownership ☹
DOI income insolvency exclusion is determined at each partner's level. ☹	Shareholders do not receive basis for indebtedness incurred by the corporate, unless the loan is made by such shareholder. ☹

121

$1,000,000 Promissory Note/SCIN/Private Annuity/GRAT Alternatives
Typical 2016 – Client Age 73

Alternatives: (Using March 2016 Applicable Federal Rate, May 2016 Applicable Federal Rate, and May 2016 7520 Rate)



* Notes would have no penalty for prepayment – minimum payments are shown above.
Self-cancelling installment Notes must balloon before life expectancy as measured at time of Note being made. John Smith's life expectancy is 12.33 years under IRS tables.
The SCIN calculations above are based on a 12-year note term.

** This GRAT assumes that each annuity payment will increase by 20% each year.

All GRATs assume a taxable gift of approximately $5,000.00 on funding

Note: May 2016 rates for annual compounding are:
Short-Term – .67%
Mid-Term – 1.43%
Long-Term – 2.24%

Usable through July 30, 2016 for sales or exchanges

122

Asset Protection Ownership Choices

1. In my own name.
2. In my spouse's name.
3. In my mother's name. Is it really hers?
4. Tenancy by the entireties between spouses in a TBE state.
5. In investments that are protected from creditors. (But not the IRS, the FTC, the SEC and future government categories).
6. In LLC's and Family Limited Partnerships.
7. An offshore LLC or Family Limited Partnership.
8. An offshore trust or foundation.
9. In our children's name(s).
   - UTMA?
   - 529 Plans?
   - Prepaid college savings plans?
10. In a trust for our children.
11. In a trust for our children that we can be added to as beneficiaries if it falls apart.
    - The above in a traditional law state.
    - The above in an APT state.
    - The above for estate tax planning purposes.
12. In a foreign bank account or a Delaware bank account.
13. In an LLC owned 95% by an offshore trust.
14. In a company owned for my children or in a trust described above that earns monies for services rendered from my primary company for services offshore that are actually rendered and tax advantaged.
15. In a trust formed by my parents for me that has invested wisely, and limits what I take out to what is needed for health, education and maintenance.
16. In my assets, but subject to debt owed to others that liens or mortgages my assets.
17. In a private charity.