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ASSET PROTECTION PLANNING: BE CAREFUL!

Summary: Remember the famous admonition from Hill Street Blues? "Let's be careful out there. ... You understand what I'm saying to you?" The world remains a dangerous place and anyone that has accumulated any wealth should take precautions to protect that wealth. That process is called "asset protection planning." 2017 has seen a bunch of cases that have undermined some traditional steps that people take to protect their assets. Caution is in order. And don't dismiss these unfavorable cases as just bad people getting caught. Even bad fact cases can forewarn of issues everyone should be wary of. No one can predict how a future court will interpret cases that may have been decided based on egregious facts.

■ Bottom Line: The take home lesson is not to avoid planning, but to plan carefully, plan with multiple layers and techniques using professionals for guidance, administer your plan with care, and don't count on any plan being fully bulletproof. Nothing is.

■ LLC: The court noted that ordinarily a corporation is considered a separate legal entity, distinct from its stockholders, officers and directors, with separate and distinct liabilities and obligations. The same is true of a limited liability company (LLC) and its members and managers. That distinction can be disregarded by the courts if the entity is used to perpetrate a fraud, circumvent a statute, or accomplish some other wrongful or inequitable purpose. The distinction can also be disregarded under an alter-ego doctrine when the actions of the entity are deemed to be those of the equitable owner. The court in Curci allowed the claimant to pierce a limited liability company (LLC) owned by the debtors and use LLC assets to satisfy claims against the owner. Generally, a charging order is viewed as the sole remedy a claimant can get. That basically means that the claimant can lien your interest in an LLC (or partnership) and receive a distribution you would have been entitled to. The debtor in Curci behaved badly, and he clearly controlled the LLC that was pierced. There were major mistakes in ignoring the entity formalities, and seemingly little purpose for the entity other than to shield assets from the creditor. Curci Investments, LLC v. Baldwin, Court of Appeal, Fourth Dist., Div. 3, CA G052764 Aug. 10, 2017.

■ Trust: In Leathers, the court held that a taxpayer fraudulently transferred assets to a trust to avoid tax debt. The IRS had consistently maintained that the transfer of mineral interests to a trust was fraudulent. Under Kansas law, a transfer by a debtor is fraudulent as to a creditor if the debtor makes the transfer with actual intent to hinder, delay or defraud the creditor. The direct testimony from the individual and the trustee indicated that the purpose of the trust was to protect the transferor's mineral interests from the IRS. The IRS tax liens took priority over any interest the trust might claim. M.R. Leathers, CA-10, 2017-1 USTC ¶50,212, May 4, 2017.

■ LLC: The debtor asserted that the only remedy against an LLC was a charging order, but the creditors argued that the entities were shams, and endeavored to pierce the LLC to reach underlying assets. The creditor similarly asserted the right to pierce a trust and the debtor claimed that such an action against a trust was inappropriate. If entities of any type, or even trusts, are used to defraud creditors, courts may well craft a means to disregard or pierce them. Further, optics can be important in creditor cases. When the debtor lives a lavish lifestyle while claiming no access to assets, the result will more likely be less favorable to the debtor. While Transfirst is another bad-fact case, it should nonetheless serve as a reminder that clients with complex structures must meet regularly, not less frequently than annually, to review the maintenance and operation of those structures with their entire advisor team and assure they are operated with

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CHECKLIST: 2ND MARRIAGE

Summary: Planning for second and later marriages is complicated and each situation is unique. Further, as the relationship evolves (or doesn't) your initial plan should be reviewed and updated. Take a broad approach, and don't focus on the technical to the exclusion of the practical.

√ Nah, you don't need to plan and pay lawyers. Consider the stats. 50% percent of first marriages, 67% of second, and 74% of third marriages end in divorce. Get real dude!

√ Make sure it is YOUR plan. Too often couples in second and later marriages, or their advisers, opt for "standard" planning that has worked for other second marriages (e.g. each keeps his/her property separate and bequeaths to his/her children). That works for some, but not for others. Every situation is unique so start with your facts and goals and make sure the planning fits. If the prenuptial agreement your lawyer hands you says "Brady Bunch" on top, be suspicious.

√ What ifs – too many plans for second marriages fail because they are too rigid and do not consider the potential for changes in circumstance that undermine the plan. Example, one spouse becomes disabled at a peak earning age. What happens? Do both working spouses have adequate disability insurance?

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…Asset Protection Planning: Be Careful!

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all appropriate formality. Clients with legitimate business purposes for entity and trust structures should corroborate them.

This case provides yet another reminder that creating entity structures (LLC, corporation, partnership, trust) to protect assets will not succeed if the debtor himself does not respect the integrity of those entities. A trust was held to be a mere nominee for the taxpayer and could be disregarded to satisfy a tax lien. Transfirst Group, Inc. v. Magliarditi, 2017 WL 2294288 (D. Nev., May 25, 2017).

■ Trust: The IRS successfully pierced a trust created by a taxpayer to satisfy a tax lien on the basis that the trust was a mere nominee for the taxpayer and could be disregarded. Here are some facts the court cited in determining if a trust is a mere nominee for the settlor: ■ Did the trust pay adequate consideration for the property. ■ Did the taxpayer transfer property to the name of the nominee in anticipation of a suit. ■ Did the transferor continue to use the property. ■ Did the transferor retain enjoyment of the benefits of the transferred property. ■ Was there is a close relationship between transferor and the nominee. ■ Was the transfer recorded in the case of real estate. Balice, U.S. v. Balice, Case 2:14-cv-03937-KM-JBC, (D.N.J. 8/9/2017).

■ Guardian: Serving as a fiduciary, guardian or otherwise, is not without risk. A New Jersey case evaluated the performance of a court appointed guardian for an incompetent ward. The probate court approved the settlement of the formal accounting of the guardian who managed the ward's substantial estate during her final years, but only after a battle with the remainder beneficiary. The beneficiary also argued that the trial court should have charged the guardian (an attorney) for alleged losses incurred in her efforts to dispose of the ward's real property and should have disallowed legal fees and accounting fees to an outside accountant. In the Matter of J.F., 58-2-2529 (N.J. Super. App. Div.).

■ Precautions: ■ Have a plausible purpose for each trust and entity and be able to explain it. ■ Have the correct person, in the correct capacity, sign each document. If your brother is your trustee, then he not you, should sign trust documents (other than you signing the trust as grantor). ■ Issue Crummey notices (yes, really!) and observe other formalities. ■ Every trust and entity should have its own bank account. ■ Have financial statements prepared before making transfers. ■ Sign solvency affidavits before making significant transfers. ■ Have your wealth adviser do projections demonstrating you can support yourself without having to tap irrevocable trusts or entities. ■ Correctly list trust and entity assets as belonging to the appropriate trust or entity, not as your personal asset. ■ Attach schedules to a prenuptial agreement listing all assets. ■ Don't disregard the formalities of trusts and entities. ■ Have at least an annual review meeting with all your advisers in attendance so that each adviser is aware of the plan and each adviser can help police the proper administration of your plan within her expertise. ■ Corporations should have bylaws, a shareholders' agreement and annual minutes. ■ For LLCs, do not rely on state default rules and instead have an operating agreement. Corroborate meetings with written and signed minutes or consents. ■ The mere fact that the managers and members of the LLC meet with all their advisers may itself help demonstrate that the entity is not a mere alter-ego for the members. ■ Have the correct trust or entity pay its expenses, not the one that you think nets the best tax bennie. ■ Plan upfront, before you need it, not after the stuff hits the fan. ■ Separate different liability risks into different entities. If you have three retail stores or rental properties each should be in its own separate entity, e.g. an LLC. ■ Have your wealth adviser create an investment policy statement for each trust or entity with investment assets. ■ Periodically review the governing documents (e.g. trust instrument, operating agreement) with your attorney to make sure you understand the operational and administration aspects of that agreement. ■ Hire a pro. If you have a substantial trust, name an institutional trustee that professionally administers trusts. Have a CPA do tax returns. Have your insurance consultants review policies periodically. Consult with a property, casualty, and liability consultant as there are more nooks and crannies to insurance coverage than a Thomas' English Muffin. ■ Entities should often have multiple owners, and that your interests, when feasible, are held by irrevocable trusts. Layers of properly crafted and administered entities are critical to your safety. PP

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Reviewer: *Andrew Wolfe, CPA, Esq.*

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...CHECKLIST: 2ND AND LATER MARRIAGES.

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Many prenups demand life insurance but give inadequate attention to disability coverage.

√ With late-in-life divorce (so called, silver divorce) becoming so common, how will the post-divorce couple, or each ex-spouse on remarriage, get by financially? See the $400,000+ medical figure below. This is a big issue. Half of those over age 85 have some degree of dementia according to some reports. Older couple wants to marry and travel but in 3 years one is ill and the other becomes a caregiver. Has this all been factored into the plan for a late-in-life marriage?

√ What if expenses rise faster than anticipated and the couple cannot afford to do what the original plan was? All plans need flexibility built in and need to address many uncertainties but too often they don't.

√ Be practical. Make sure what you agree to do can actually work. So, if you are going to keep all assets separate who pays the monthly electric bill? Do you alternate? If your assets are supposed to be kept separate, but the income they generate is considered marital, how mechanically will that happen? If you don't set up a plan from inception that is practical, the marital and non-marital assets will get commingled and untangling them later will be a messy hairball.

√ Don't overlook the details. Too many plans neglect to get into the nitty gritty. What are the titles on each bank and brokerage account? Do you have to change a deed? What about beneficiary designations?

√ Powers of attorney. Who will you name as agent? What powers will they be given? So, you have a great relationship with your new partner but she names her eldest son the CPA as agent under her power of attorney. Will he continue to share expenses or cut of funds when your partner is ill and pressure you into negotiating a deal different then what you and your partner agreed to? Perhaps it might be better to name an institutional trustee that won't get involved in the emotional baggage?

√ Trusts can save the day. If you are planning to wed for the 2nd or later time, look at the stats as to divorce rate for 2nd and later marriages. Scary huh! Consider funding irrevocable trusts, even a self-settled trust, prior to the new marriage, to provide another layer of protection behind the prenuptial agreement you'll sign. Even if you want a simpler and less costly approach, consider setting up a revocable trust with its own tax identification number and funding it with assets you and your honey agree will be separate. Use the trust as separate accounting pot to minimize commingling issues.

√ Clean up the loose-ends from your prior marriage before starting a new one. If you have insurance obligations be certain they are in place. Remove your ex and his family and buds from any fiduciary positions. Change beneficiary designations. Don't flip so hard over your new "number one" that you neglect cleaning up the remnants of splitting from your last number one.

√ Consider how you file your income tax returns.

√ Investments count. If you're going into a second or later marriage you've likely been hurt by the financial cost of the prior divorces. Investment planning is critical. Too often, however, folks spend to much time licking those old divorce wounds rather than focusing on rebuilding their wealth. Hug your financial adviser and get your asset allocation back to where it should be based on your new realities. As you enter a second or later marriage coordinate how you and your new spouse invest. You can certainly each keep your own wealth managers if you wish but let them share information so they can coordinate the planning. PP

RECENT DEVELOPMENTS

■ Settlement was taxable. How the complaint and settlement are drafted in a suit for physical injury or sickness is critical to a portion or all of the settlement amount being non-taxable under IRC Sec. 104(a)(2). In a recent case the settlement proceeds were denominated as lost wages. The complaint only referenced discrimination based on disability. Rajcoomar, TC Memo 2017-129.

■ Art Appraisals. When valuing multiple individual items for donation it may be preferable to have a separate appraisal report prepared for each individual item. Be certain to adhere to the specifics of the statute and Regulations, including assuring that the appraiser meets the criteria as a qualified appraiser. Office of Chief Counsel Internal Revenue Service, Memorandum Number: 201711009, Release Date: 3/17/2017.

■ Uniform Voidable Transfers Act. Michigan and Utah enacted variations of the Uniform Voidable Transactions Act (UVTA). They joined California, Georgia, Idaho, Iowa, Kentucky, Minnesota, New Mexico, North Carolina and North Dakota. Note that Michigan has DAPT legislation and still enacted the UVTA. ? UVTA Section 4, Comment 8, provides that a transfer to a self-settled domestic asset protection trust ("DAPT") is voidable if the transferor's home state does not have DAPT legislation. If you have a DAPT and live in a state that does not permit DAPTs (e.g., NY, NJ) call your estate planner and reassess the risks of your plan and whether additional steps are warranted.

■ Death Investigation Costs. The Fifth Circuit affirmed the Tax Court's holding that a taxpayer could not deduct the costs of investigating his father's death because the investigation was not motivated by profit. Bizarrely, the disallowance came under the hobby loss rules. Vest v. Comm., (CA 5 06/02/2017) 119 AFTR 2d ¶2017-813.

■ No Charitable Deduction. Because the donor did not part with dominion and control over the donation of a building no deduction was permitted. George Fakiris v. Commissioner, Docket No. 18292-12, 2017 Tax Ct. Memo. LEXIS 121 (2017).

■ Digital Assets. Proposed New Jersey law establishes default rules concerning third-party access to digital assets. A3433/S2527. PP

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- **The 52nd Annual Heckerling Institute on Estate Planning will be held January 22-26, 2018 at the Orlando World Center Marriott. More information is available at** www.law.miami.edu/Heckerling **or by email:** heckerling@law.miami.edu
- **The 43rd Annual Notre Dame Tax and Estate Planning Institute will take place on October 26 and 27, 2017, at the Century Center on the banks of the St. Joseph River in downtown South Bend, Ind. Registration link:** http://law.nd.edu/alumni/tax-estate

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Planning Potpourri

■ E-Signatures. Florida's governor vetoed bills to permit wills to be signed by e-signatures. What about using e-signatures now on Crummey notices? That would save incredible time and hassle for many taxpayers, and there is no requirement for them to be signed (although many advisers recommend it). Besides it might get hordes of folks to address Crummey powers that get so frustrated they give up. What about annual minutes for an entity or consents for the various fiduciaries of an irrevocable trust? Too often these matters are never documented and if e-signatures confirm important actions that too may be far better than no documentation at all. Consider the challenges to LLCs and trusts above. Perhaps periodic web meetings corroborated with e-signed minutes might be a positive step to deflect challenges for ignoring entity formalities.

■ Health Care Costs. The average 65-year-old healthy couple will spend $400,000+ on health care during their remaining lifetimes. What about a couple where one or both have health issues? At $400,000 the uber wealthy won't have to worry, but for the mere wealthy who are already pushing the envelope on prudent spending, that figure could sink their financial ship.

■ Is it a loan? A creative taxpayer tried to characterize distributions from a closely held business as loans. After all, if he treated the amounts as compensation he'd have to pay tax. The court wasn't impressed and gave a checklist of factors to consider when determining if something is a loan (fish or fowl?). While everyone should know these factors, it seems that so many taxpayers trip over loan characterization that a refresher course is worthwhile: ■ Ability to repay. ■ Existence of a debt instrument. ■ Security for the repayment. ■ Interest being paid. ■ A fixed maturity date. ■ Repayment schedule. ■ Records of the parties confirming the transfer was a loan. ■ Conduct of the parties corroborating loan treatment. ■ Whether the borrower actually made payments on the note. ■ Whether the lender had demanded repayment.

■ Agent confusion. A growing and potentially nettlesome issue is how aging folks appoint people to help them with financial matters. The lack of coordination of how this is addressed could create considerable conflict. Consider each of the positions or appointments: safe deposit box alternate signer, bank account titles, agent under power of attorney, successor trustee on a revocable trust, trusted contact person on a brokerage account under FINRA Rule 4512, Social Security Representative Payee, agent to make funeral arrangements, and more…PP