

# Estate planning primer

by

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# INTRODUCTION

A long time ago estate planning concerned only the passing of your assets to your heirs when you die. In those days wills were good enough, the governments didn't much care (spelled T-A-X) when you died and probate court costs were nominal. Then everyone got into the act. Governments started to treat your assets as theirs, which they would let you use until you died, then, after taking 30% or so of your cash flow during life, they would take 55% of whatever was left. Estate planning became tax planning, probate avoidance planning, planning for the management of your assets long after your death, and planning for the physical care of your children. That was forty years ago when I came into the business.

Things have changed even more since then. Certainly, all of those original concerns are still important, but added to them have come lifetime situations that we now attempt to cope with in the estate and asset planning process: hospitals that won't listen to your family without a document, and physicians who cannot afford to take certain actions without written consent from you.

One of the most challenging areas of estate and asset planning is the protection of your assets from predators. Predators are part of what is usually referred to as the "litigation explosion." It seems that everyone is after what little you have been able to accumulate. Insurance is often no help at all. Protecting your assets from confiscation by court action, by one of the forces that sees you as a target, then, has become part of the process, also.

As you read, remember: you may not need to use all the tools in the toolbox. Our goal is to build a flexible plan that covers the greatest breadth of possible circumstances. To some of you the information will seem very elementary; to others the offshore planning information may be interesting, but not very useful.

As usual, I have to tell you not to rely on this information alone in your planning decisions. Your particular, unique fact situation may introduce very specific needs that will require the help of an experienced estate planning and asset structuring attorney. If you have questions, please call me and we can discuss the information in the context of your particular circumstances.

Most of all, my best to you in your planning endeavors.

# CHAPTER 1

## SUPPOSE YOU DIE WITHOUT AN ESTATE PLAN

WHAT HAPPENS if you die without any kind of estate planning? The simple answer is that the state makes one for you. The more complicated answer includes some facts you may not like.

**HISTORY:** Up until the fifteenth century, the British royal family considered all assets in the hands of “the people” to be the property of the royal family, to be used by the populace and then repatriated to the royals when a user died. One of the most far reaching effects of the "revolution" during that century was that the King was forced to recognize private property rights and allow property to be owned and passed to heirs. The inherent, inalienable personal rights cited by the forward thinking writers of the day were “Life, Liberty and Property.” Thus began the accumulation of the great non-royal fortunes of that country. But the King did not give up that easily.

If the King was to allow a person to pass assets to his heirs, the King decreed that such passage must be accomplished in a very specific way. If you messed up the process, the King still got your assets. And so the Statute of Wills was created which requires you to say things a will in a certain way and sign the will in a very specific manner and have witnesses watch you do so. If you missed any small detail, the King got to confiscate your goods.

**TODAY:** The King, in the form of your State Government, is still in that act. Whether you die with or without a will, the state still controls asset distribution by means of the probate laws. Under the representation that the Court must supervise the disposition of your assets to “guarantee” that the assets go where the law says they must go, your relatives are forced into court, at great expense.

Once in court, if you have no estate plan of any kind, state law will decree who will get your assets. Some of those laying claim to your assets may be real heirs; some may not. They only have to prove to a disinterested judge, by a preponderance of the evidence, that they fit into a category that the law allows to share in the distribution. Even if none of those people show up, the first people to be paid out of your assets are the court and its officers: a probate court fee, a probate attorney's fee and a probate administrator's fee. If appraisals are required for any reason (including federal taxes), add the appraiser's fees.

Then state law tells your relatives how the balance of your assets will be disbursed. If you are married and the property is community property, your surviving spouse gets everything, to keep or to share with her new husband who may have just

noticed that you, thank you very much, just left the new apple of his affection wealthy.

If you are either not married or part of your assets are separate property, things get very, very complicated and state law tells your administrator who to give your assets to. In either case, if assets are to go to a minor, state law mandates the appointment of a very expensive guardian for the assets (estate) of your child(ren) and then the fight among your relatives begins in earnest because they all “love” your children with great fervor, as long as there is money to share.

While the court will tell your relatives that the battle is being conducted in order to see who is the “best” person to take care of your child’s assets, the interest in being the “best” person always rises as the value of insurance money (or other assets) rises. You have nothing to say about the matter because a judge who does not know any of the people involved will make the decision and you didn’t care enough to do anything about the situation before your death. It is open season on your assets.

Even worse, if you have no estate plan at all, the decision about who will take care of the physical needs of your children, (a guardian of the person), will be decided in the same way that the guardian of the estate was decided: who put on the best show in order to get the assets, usually insurance money.

This all presumes that there are cash assets to pay the probate and attorney costs and that there will be something left over to actually pass to your heirs. If there is no cash, the court will order your non-cash assets (house, cars, summer home, boat, etc.) to be sold and the cash paid to the court officers (clerk, judge, attorneys) who are administering the probate process.

The next problem you face is taxes. If you have no plan and own assets with a net value over \$2 mil (in 2008), your heirs face possible confiscation of part of your assets. If there are federal Estate Taxes due, they must be paid nine months after your death and must be paid in cash, not assets. Without a plan to take advantage of the tax laws, you have just guaranteed your heirs maximum losses to taxes.

So, what can you do? At the very least, please find an attorney to **draw you a “simple” will** that names the guardians for your children. That will not save you any money on probate fees, taxes or payments to guardians, but it will control who the children end up with and who gets to use your money, hopefully, for the benefit of the children. Beyond or in place of that, you have almost unlimited flexibility in planning the disposition of your affairs.

Now, let’s look at the actual costs of dying.

## CHAPTER 2

# WHAT IT COSTS TO DIE WITHOUT AN ESTATE PLAN

Well, it doesn't really cost YOU anything to die. But it sure costs someone when you die. Here is an outline of what you should expect to put away so that your death isn't a terrible burden on your family:

**ACTUAL EXPENSES OF DYING:** Cash requirements begin with the cost of dying. Most people allot \$5,000 to \$20,000 for this purpose. The average costs, depending on the size of the estate, will be somewhat as follows:

Funeral:	The average funeral costs are usually around \$8,500. However, the costs here could be as little as \$1,500 or as much as \$35,000 or more.
Medical Costs:	This will depend on the amount of health insurance already in force. To be safe, a reasonable figure to keep in cash would probably be around \$20,000.
Taxes:	Federal Estate Tax.
Fees:	Probate Attorney's fee, court fees, Executor's Fees, and tax appraiser's fee.
Debts:	These will include any charge accounts, oil company charge accounts, or other outstanding debts and consumer loans in existence at the time of death.

**EMERGENCY FUND:** In addition to money for death costs, a sum should be set aside for emergencies, like your death!. Insurance companies recommend buying enough insurance to provide a fund equal to six months' income, but this seems excessive. In most cases, an emergency fund of two to four months' income should take care of such immediate crises as repairs or insured illness. (Uninsured illness today can cost, literally, millions).

**MORTGAGE ON HOME:** Most insurance companies recommend providing for a fund to pay off the mortgage if the family intends to stay in the same house. From the point

of view of cost alone, it makes little difference whether the mortgage is paid off immediately or is covered by additional income provided for the survivors. It seems to be more reassuring, however, to leave the house clear of debt. Only if the widow has an exceptionally high income would there be a tax advantage in keeping the mortgage.

**PROBATE COSTS:** In most states, but especially in California, these costs look like a percentage of the probated assets. It never stops there. There are filing fees, special appearance fees, fees to hire accountants to make the accounting, fees to file tax returns and fees to authorize sale of property so you can pay all those fees.

**LIQUID ASSETS:** Liquid assets are items like checking accounts, cash, stocks, bonds, savings accounts, or other holdings that can be converted to cash within a few days time. This is where you store your cash assets, hopefully making enough interest to keep up with inflation.

**INCOME REQUIRED FOR WIDOW:** With the husband gone, a family's expenses will be reduced. All his spending on clothes, transportation, food and life insurance, will disappear, taxes will be less, and if he has provided a special fund to pay off the mortgage, monthly housing costs will be reduced by the amount of the mortgage payments. Family expenses may drop by as much as 50%, but to be on the safe side, perhaps a widow with children will need two-thirds of the family's former gross income and one half if there are no children.

**SOCIAL SECURITY:** The first step in determining Social Security available if a husband should die is to write the local Social Security Office to get a statement of the family breadwinner's contributions and a booklet explaining the benefits. The formuli are now so complex that only their computer can figure it out. And they do make mistakes, so ask lots of questions.

**DEATH TAXES:** If your total NET estate is over two million dollars (four million if you are married), the Federal government wants a piece of every dollar over that amount. And it's about 45 cents of every dollar. They want it nine months after the death and they want it in cash. If there is no cash to pay the taxes with, you might get to pay it over a period of years, but don't count on it. If they won't let you do that, you get to sell something and give the money to the Feds.

So, let's see what we can do about this situation.

## CHAPTER 3

# SOME SPECIAL COMPONENTS OF AN ESTATE PLAN

A mechanical draftsman uses a special computer with a very large screen and CAD software linked with a very large plotter to accomplish his work. An accountant may use the same basic computer, but with different printing hardware and specialized accounting software to do his job. Estate and Asset Planning is much the same way. The planning and execution is the art. That art is enhanced by being able to do the work quickly, thoroughly and effectively.

In this work there are various “bricks” which are molded together by the artist building the plan. These bricks build “buildings” that then form a compound plan. While the bricks may not change a lot, the way they are put together differs greatly and, certainly, the buildings and compounds end up not even resembling each other, except that they may all contain some common devices or “bricks.” The art in estate planning comes in the construction, not of the brick, but of the buildings and the compounds.

While there are many components to an estate plan, consider some that are very useful and that give your planners great flexibility:

**Trusts:** Depending on the value of your assets, including the death benefit of any death insurance, you can create a trust, or set of different kinds of trusts, that will do everything from simply providing a continuation of assets to your spouse and children to a very complicated arrangement that twists its way through the maze of tax laws to save your heirs as much tax as possible. These trusts can be created in your will (a testamentary trust) which means that everything goes through probate first, or during your life (an inter vivos trust), which means that your assets avoid probate. In any event, whatever assets are contained in the trust do not go through the very public, very expensive and very time consuming probate process.

If you choose to create the trust(s) during your life, the probate process is completely eliminated because the trust is considered to be the owner of the assets (you are its manager) and, since it doesn't die, there are no death costs.

There are even some **special tax provisions** that allow you absolute control of your assets after you die and also allow you to avoid a lot of the taxes you would normally face. There is even one version for foreign nationals who live in the U.S.

**"Durable" Power(s) of Attorney:** A power of attorney gives someone else the

ability to manage your affairs when you may not be able to do so yourself. The usual situation involves you getting so sick that you are in the hospital and the hospital administration demanding that a court turn over control of your assets (and public assistance medical payments like Medi-Cal, Medi-Care and Social Security) to the hospital. These powers of attorney can prevent that from happening by giving the decision making power for your care and for the management of your assets to those whom you trust. California now uses an Advance Health Care Directive for medical decision-making and a durable power of attorney.

**Partnerships:** In this very litigious (law suit happy) society, family partnerships, especially limited partnerships, are often used very effectively in your estate plan to protect assets from those who think your assets should become theirs through the action of the courts.

**Foundations:** A private foundation, organized to accomplish your worthy charitable goals, can often be used to meet your desires to provide for a charitable or educational opportunities and save you taxes by doing so.

**Corporations, professional and otherwise:** Since a corporation is a separate individual under the law and does not die, if an asset consists of something that has a life of its own, is hard to appraise or might be very difficult to liquidate, like an ongoing business, a corporation, whose stock will be the only asset in your estate, is a good choice.

**Limited Liability Companies:** These are newer entities that have most of the attributes of a Corporation but are taxed like partnerships. They are ideal for developed real estate. They also have all of the asset protection features of a Limited Partnership without a general partner.

**Global Wealth Preservation planning:** Europeans and others, avoiding trouble at home in whatever country, made Switzerland the banker to the world. In certain very special circumstances, assets held outside the U.S. in trust(s), LLC(s) or corporation(s) can do much toward protecting your assets.

All of these estate planning tools will cost you money to create. Some of them will cost money to maintain and continue in force. But that expense gets you a voice in the financial affairs of your family at a time when they really need your insight and wisdom most.

# CHAPTER 4

## TRUSTS

### Section 1. THE ADVANTAGES OF USING A REVOCABLE LIVING TRUST IN YOUR ESTATE PLAN

Since you may not be familiar with the revocable "living" trust, I would like to discuss some of the advantages of using this device in your estate plan.

Though these trusts have been popular among estate planners for more than 50 years, revocable living trusts became an important element in most estate plans and conversation in 1967 when "How To Avoid Probate" was number one on the best-seller lists, and such trusts were number one on that author's list of devices for avoiding probate. As the tax laws get more draconian and expensive, more and more attention is now being given to the revocable living trust as a tax-saving, probate avoiding, cost cutting and otherwise useful device for building and managing an estate.

While trusts of this type may take different forms and have many variations, the concept involves a trust created right now, before you need it, which will give you the benefits you desire for your lifetime, be subject to your complete control so that it can be changed or completely revoked by you at any time before your death, and will dispose of the trust assets to beneficiaries named by you.

Here are the key advantages of a Revocable Living Trust:

**1. Management of Assets.** If you choose to use a professional Trustee, such as a Trust Company or bank, the burden of managing investments, keeping records, etc. is borne by the company, but borne for a price, usually ½ to 1% of the gross estate (trust) value yearly. You can have this management available to you while you are alive, though its use is more prevalent as a substitute for your own management after you die.

**2. Protection During Illness or Incompetency.** The Trust continues to function even if you should become ill or unable to attend to your affairs because of heavy demands on your time. If you become ill or decide to travel for long periods of time for instance, you can do so, secure in the knowledge that your interests will be fully protected and that your affairs will be conducted as you have instructed.

**3. Continuity.** If you die, the Trust continues to function as planned, with no break or delay for the probate process as in the case of a Will. If the Trust provides that the

income is to be paid to your spouse, for example, your spouse can expect to receive the income according to your plan, from day one. This is especially important for emotional reasons at such a time.

**4. Avoidance of Probate.** In a continuing Trust, the assets need not go through the probate process. This may save some of the fees and expenses that would otherwise be incurred. Taking your property through probate may result in losses as high as 10% of the value of the property, just on probate costs and fees. But it is even more important when you consider that, during the probate process, your spouse will be allowed to use only so much of the estate as the court deems advisable, after the court sets aside enough cash to pay the bills (including the probate fees and costs) and taxes that may become due. That often leaves precious little in liquidity to support your family.

**5. Avoidance of Estate Taxes.** One of the most important objectives when using a Living Trust in an estate where the net assets exceed whatever floor Congress has imposed this year, is to avoid giving the government the majority of your liquid assets as taxes after you or your spouse, or both, die. This is done with a number of sophisticated devices which your estate planning attorney will explain to you, but the most important one deals with the Marital Deduction which allows your Trustee to separate your assets after you die into two or three portions, each of which is available for the use of your spouse, but which, legally, protects the assets of the first one of you to die from taxation on the death of the second to die. While there are many twists and special features, this kind of provision works beautifully to disinherit the IRS.

**6. Privacy.** A corollary advantage is the privacy that exists in the Trust as opposed to the publicity that may be accorded a Will when it becomes a matter of public record in the probate court proceeding.

**7. Choice of Law.** In creating the Trust, you choose the law under which it operates. You may do so in a state other than the one in which you're domiciled, or even in a foreign country. Your home state may have undesirable laws regarding investments, accounting, and other matters. Furthermore, you may want to name a trustee who might not qualify as such under the law of your home state. You may do so simply by naming the law of a jurisdiction that allows such action.

**8. Income Tax Deductions Allowed.** You can take most of the costs of creating a Revocable Trust (the amount allocated to tax and asset preservation planning) as an income tax deduction in the year you pay your attorney for his work. Contrast this with the fact that IRS will not allow the costs of planning and preparation of a will to be deducted. While the Trust is in operation, all administration expenses, except to the extent attributable to any tax-exempt income, are deductible.

**9. Less Easily Challenged Than A Will.** Disappointed relatives and some non-relatives may try to upset a will on grounds of undue influence or mental incompetence.

However, this is extremely difficult to do when the estate is in a Trust which has been in existence for some time during the creator's life, was operating under his observation, and subject to his power to revoke. A properly drafted trust will also have provisions making it very unprofitable for anyone to attack the trust.

**10. Coordinated Estate Plan.** The Revocable Living Trust used in conjunction with the properly drafted Will that catches any assets not already in the Trust and puts them there and properly designated life insurance, pension and profit-sharing plan beneficiary forms will effect the "pouring over" of all assets into the Trust for centralized control and distribution. Without the Trust, the estate plan may well be distributed piecemeal and at different times, so as to cause delays and inequities that were not intended.

**11. Other Advantages.** There may be other advantages applicable to your particular estate. You need to sit down with an experienced estate planning attorney who knows your situation and decide how one of these trusts can be of benefit to your estate. Please, though, be careful of the estate planning "mill" that is in business to sell you a form trust that may or may not fit your needs. In this field, you get what you pay for. Pay the money and know that your needs are being met.

## **Section 2: A DOZEN NON-TAX USES OF TRUSTS**

More often than not, when you read or hear about a trust device, it is in connection with tax-saving maneuvers - whether the idea is to save income taxes or estate taxes, or both. But there are some important non-tax considerations inherent in the creation of trusts. Here are some other needs and purposes that you can fill through use of a living trust. By using a living trust, you can:

- 1. Provide built-in financial supervision** and management safeguards for the support of your spouse and children. If your spouse or children are inexperienced or immature in financial affairs, they could present serious planning problems if you wish to make sure that your property still yields maximum benefits to them.
- 2. Provide an income to your child** until he attains majority. Few minors have the experience, intelligence, and capacity to wisely handle any sums of money large enough to provide a livable income. Without a trust, the family would have to go through the legal entanglements associated with appointing a legal guardian to manage assets or sign agreements on the child's behalf.
- 3. Provide both income and principal for your spouse and children** with the same property at the same time.

For example, suppose you want to provide for the support of your spouse after your death. But you also wish to combine this objective with the definite assurance that the property will pass to your two children at your spouse's death. You can employ a trust

arrangement in the following pattern:

- a. the trust income to be paid to your spouse for life;
- b. the trust will then be terminated and the property distributed to the two children in equal shares at your spouse's death;
- c. your spouse's new husband or wife takes nothing.

**4.** Provide for the **passage of property** to only your blood relatives. For instance, you might want to exclude sons-in-law or daughters-in-law from taking the property if your own kin should die.

**5.** Provide **specific property for immediate distribution** to a particular beneficiary. Property in a living trust is not generally involved in the administrative problems of an estate, and the beneficiary continues to get the income from the trust when you die.

**6. Tie-up principal** for the benefit of a child for a number of years with periodic payouts at attainment of specified ages. For example, one part at age 30, a further distribution at age 35, and the balance of the principal at age 40.

**7. Control the ultimate disposition** of your property long after your death. For example, you may not want your spouse to have the principal if she or he remarries. There is no reason to set your spouse up as a target for some less than scrupulous suitor. In such event, you can stipulate that the income shall go to her or him for life, with the further provision that in the event of her or his remarriage, the property shall then be held in the trust for the children with no access for the newly remarried widow(er).

**8. Provide restrictions** upon the sale of your assets. You can dictate the terms and conditions under which trust property should be sold by spelling out the details in the trust instrument. In that way you can impress your own objectives and convictions when you're not around to advise.

**9.** Provide a **temporary surrender of your assets** and the income taxes they generate. A short-term trust will permit you to reclaim the property after ten years, at which time you may have need for it.

**10.** Provide the **disposition of life insurance proceeds** to your family other than through lump-sum payments or settlement options of the policy. A trust may be named as beneficiary to reflect your wishes for distribution of the proceeds far better than the usually less flexible options the insurance policy.

**11.** Provide **current management** of securities and other property during the period immediately following your death. Without a trust, the executor must assemble the estate assets, supervise the property, and distribute it to the heirs. He will probably need a court's approval. This can take months or years. Nor can he properly watch securities in a changing market, since he is a court appointed estate administrator, not

an investment person. This hazard is not present when you have a living trust, since experienced managers can already be in full command.

**12. Provide protection** against a will contest through a living trust. You may wish to leave money to someone outside your family but not want to arouse any antagonism and hostility in your family, or at least prevent the family from challenging your wishes. If you make the provision now through a living trust, you can often avoid a post-mortem feud, since no notice of the trust transfer will be given to your family or heirs as in the case of a testamentary transfer and you can make it unprofitable for them to make a challenge.

### **Section 3. OTHER TYPES OF TRUST**

This is an area where alphabet soup seems to have taken over the world of trusts. Each of these trusts have a very special use and fit only very limited circumstances. As such, they are not general estate planning tools, but are very important for each specialized application. We will cover most of the important of these in other places in this piece, but some of the more interesting special trusts are:

**QSST:** a trust used specifically to hold stock in a Sub-chapter S corporation, which normally cannot have a trust as a shareholder. This type of trust is authorized under IRC Section 1361(d)(2). Beware the very limiting requirements of this kind of trust: it must be for the benefit of only one person, the income must be distributed annually and it cannot be a “sprinkling” or discretionary type trust. That means that it cannot have the usual A-B (bypass) provisions because more than one person is involved and cannot be used as an offshore protection trust, since the discretion to withhold distribution is the major feature of this kind of trust. You must also notify the IRS of the existence of this trust and its provisions within two and one half months of its creation.

**2503© TRUST:** is a trust set up for your children, which isolates the gifts to this kind of trust for the benefit of the child, without gift tax, until the child is 21. However, when he or she turns 21, he or she gets the money or asset outright.

**GRIT, GRAT, GRUT** trusts are special trusts wherein the Grantor can retain an interest in property for his or her life and then give it away with beneficial tax consequences. Sometimes, if you want to give away title to your home, but remain in the home until you die, this is a good way to do it.

**LIFE INSURANCE TRUST:** This device is used to isolate the proceeds of the insurance on your life from Estate Tax in your estate. It is virtually the only practical way to do so and works very well if used correctly. There is no reason for your spouse to pay estate taxes on insurance proceeds you never had and, in fact, paid premiums on for all those years.

# CHAPTER 5

## WILLS

For hundreds of years everyone presumed that their heirs would get their assets, one way or another, and a will was used not so much as an estate distribution device as it was to simply direct the court regarding who and how much to give. It was, after all, the court that was going to distribute the assets.

With the advent of trusts as the major estate planning device, both for tax and probate avoidance reasons, the will has become a catch-all that is used to be absolutely certain that everything, even the items that never quite make it into the trust, goes into the trust, eventually. These are called pour over wills, meaning that they pour over from the probate estate into the trust. However, they do other things as well.

It is only in a will that you can appoint the guardian(s) of your minor children if neither parent is alive. And, even though you might be able to use a letter of direction to do the same thing, it is safest to put directions about specific items of gift to certain people in a will. If you have a favorite rifle or guitar or car or set of china, it is safest to put that information in a will.

Remember that, while a handwritten, dated, signed will on plain white paper may be valid, it probably won't do what you want done. Wills must follow very strict rules about how they are drafted, where and how large the margins are, how the wording flows, where and how they are signed, and in whose presence. Please don't try to do this kind of work from a computer program or a book with tear out forms. It's a lot more complicated than that.

# CHAPTER 6

## THE GLOBAL APPROACH TO ASSET CONTROL STRUCTURES

### Section 1. Introduction

If you are reading this article I presume that you have some wealth, or soon will have. Unfortunately, these days you must face the fact that just having the wealth imposes a responsibility on two levels: (1) protecting it now and (2) planning what to do with it when you make a final exit.

In these considerations, please remember that it is a lot easier to deal with peanuts than it is to walk behind the elephant with a scoop. If you take some fairly simple steps, right now, you can keep some of the wealth. If you don't, someone will waste a lot of your time and money trying to cut themselves in on the fruits of your labor. I call these people financial predators. Protecting yourself from them is what this article is about.

We have traditionally viewed wealth structuring as the part of Estate Planning. It was accomplished, if at all, by financial advisors or a combination of attorneys and accountants, without too much attention to a cohesive overall structure. Years ago, a complex structure really wasn't necessary, except for the very wealthy. But the world has changed. While the traditional type of Estate Planning, which is really death planning, is essential because it assures that your wealth will go where you point it, the kind of wealth structuring I want to discuss with you in this article is for this life, not the next.

It is also important to remember, while we consider the nuances of wealth structuring that you don't measure success in this arena by clean wins. You measure success by where you would have been if you had kept the same structure you started with, or tried to develop a structure one small piece at a time. So, let's discuss the concept of structure.

### Section 2. Structure

I am a great believer in structure. Nothing is more gratifying to me than watching a well oiled machine, mechanical or economic, work the way it was intended to work and even beyond the expectations of its designers. I have proven, through years of experience, that structure does a number of things:

**1. It sets the tone.** The specter of the wealthy young business person who treats wealth in a cavalier manner and then whines at everyone in sight when that

wealth becomes a target for economic predators is foolish and un-becoming, but very typical. If you are serious about your wealth, you will treat it as a serious matter and place it into the structure that will most enhance its natural characteristics. It is part of “maximizing profits.” That serious approach will convince those who deal with you, especially those who decide to be your enemy, that such a course is ill conceived.

**2. It brings discipline.** Successful people know that meeting the needs and requirements of a good structure is one sure way to continue being successful. If the structure was designed well, then following its dictates brings nothing other than the exact results intended in the design. Stretching to meet the demands of the structure so that you can have the intended results of the structure, then, is part of the genius of having a structure. Think of these very simple examples of structure creating the demand that must be met by the participants: baseball would never develop pitchers if there was no strike zone; rallying would be no test of either drivers or cars if there were no time limits; who would care which direction the boats sailed if there were no course markers on the America’s Cup course? You get the idea.

**3. It allows you to take the strategic high ground.** It ensures that the outcome of any accidental or intentional attack can be kept within limits set by you and not by your opponent. You never want to let the enemy choose the battlefield. If you do, he will drag you into his arena where he will keep you on the defensive. If you structure your situation correctly, you can drag him onto your designated ground and make the structure grind him up instead of breaking you. Now, let’s consider some of the dangers that a good structure can protect you from.

### **Section 3. Leakages**

There are two purposes of wealth structuring: (1) To fold your wealth into a pattern in which you can increase the productivity of your wealth, and, while doing so, (2) be sure the structure cuts "leakage" to a minimum. Here are some, but surely not all, of the “leakages” I see all the time:

**1. Out of Control Expenses.** You must decide which economic level you will live at. If expenses are greater than income, like they are with our governments, then there will be nothing left to build wealth with. This form of leakage is your responsibility. But remember, if you look like a target, sooner or later you will become one. Visibly spending a lot of money not only deprives you of the basic tool (money) you need to accomplish your wealth building goals, but it indicates to your neighbors, friends, acquaintances and other watchers that you are a “rich dude.” You can expect to take a hit from an unknown source within about three years of establishing such spending habits.

**2. Taxes.** To paraphrase a Supreme Court justice of many years ago, there is absolutely nothing wrong with structuring your affairs so that the structure pays the least possible legal amount of taxes. Congress created the rules so that its members and

their friends would have methods by which they can cut taxes to a minimum. For you to do less is a foolish waste of precious financial opportunities.

**3. Marital Discord** and other intra family problems. These are by far the most tragic of the leaks. They are completely unnecessary. First of all, if wealth is an issue that could interfere with your domestic relationships, then an agreement about how finances will be handled in the future can be made before you get married. There are also things that can be done to isolate assets in these situations. But by far the worst situation is to see a less than strong child (or his stronger wife) fall into the hands of an unscrupulous attorney who will chase your money until the fees run out. A good structure can give you immense bargaining power in all these situations.

**4. Attacks for things you did.** We all make mistakes. We used to live in a world where almost everyone we dealt with was pretty tolerant and expected others to be the same. The philosophy was that you accepted certain risks in life and took your hits and expected others to do the same. No longer. If you do make a mistake, even if you intended no harm, there is a very good chance that the other guy's attorney will claim many times the amount of money he might have traditionally deserved. Since his fee is a percentage of the final recovery, he hopes to get a very large settlement from your insurance company. Isolation of assets and putting most of them out of the reach of creditors is the only way to cope with this kind of attack.

**5. Attacks for things that were done by others** but for which you have liability. You've heard the stories: the parent who loaned her car to her son who let his girlfriend drive it and mom got tagged with a gigantic judgment when the ditz girlfriend killed someone; the grandmother who loaned her grandson money to buy a car and was held liable on the doctrine of "negligent entrustment" when there was an accident; the partner who wasn't even in the state and certainly was not aware that his partner injured a surgery patient; the partner who sold his interest in the business, only to be sued by the new buyers because his old partner had been dumping used motor oil on the property and caused an EPA problem; and many others.

A few years ago, a Federal law went into effect that makes you personally liable (to the extent of three times actual damage) if you ever *sold* a residence that was painted with lead based paint and someone ingests the stuff; whether it was you who painted it or not. We all question the wisdom of parents who let their children chew on the woodwork, but the government (in the form of your idiot Congress) has said that you get to pay, and you may not have a lot to say about it.

If you serve on a Board of Directors or as an officer of a corporation, you are responsible to everyone who owns stock, or does business with the corporation, for the actions and the effects, or supposed effects, of those actions, as perceived by some judge or jury a number of years later. If it is your corporation, it will usually protect you from the business debts, but not from personal liability as an Officer or Director (unless it is formed in one of the very few states where the corporation can indemnify you). If it

isn't a corporation in which you exercise day to day control, it will be someone else's action that have slopped liability over onto you.

Partnerships are even worse. You are personally liable to the extent of your entire personal fortune for anything another partner says or does. If you have any assets at all, it would be wise to not even think of getting involved in a general partnership or as a general partner of a limited partnership.

**6. Political and Monetary Instability.** Those who remember the Nixon price controls, or even the Brazilian devaluations, or, more recently, two serious devaluations in Mexico and can read economic trends know that we could face such situations. If those things do happen, it would be wise to have some of your assets somewhere else.

**7. So, What do you Do?** For all these reasons and many others, you need to build a structure that will allow you to avoid having your hard earned assets stripped away by the current version of legal banditry. If you don't build such a structure, you will probably be sued about five times in your adult life and wasting a year of your time and up to \$100,000 of your precious resources each time someone decides to take a shot at your assets. If you set up the right structure before you need it, you can look forward to chuckling each time someone comes sniffing around your assets: you know (and they will soon find out) that you have armor strong enough to defeat the most well aimed shot.

#### **Section 4. The Approach**

Wealth Structuring is complex and should not be approached from a simplistic mind set. I usually want to keep things as simple as I can, but in the context of wealth structuring, the complexity of the structure is a great advantage. As you throw up your defenses complexity is absolutely necessary if you are to make maximum use of the wealth you are managing. If you are a "simple" freak, just look at widow Kennedy/Onassis' estate. She was just a single mom on the society stage. But her estate was intensely complex. That was for a reason.

If you do not like to cope with complexity yourself, have your professional advisors do it for you and report only the results to you. However, I am sure you have noticed the problems that professional athletes, musicians and others with "professional" management have had with their advisors. So, you will want to see the actual, primary documents each quarter. They, along with the reports generated from them, will tell you exactly what you have and where it is. I can help you wade through them and simplify the understanding process. That way you only get four really bad headaches a year.

On the other hand, my advice to my clients is to always manage your affairs yourself. You and your enlightened self interest will always motivate you to be your own best manager.

## Section 5. General Strategies.

The strategy I usually suggest is based on the legal reality that the courts of this country generally hold that if you have too many connections to an asset you are treated as its owner. If you are the owner, then a court can order someone (a creditor) to step into your shoes and take the asset away from you. Therefore, you need to maintain absolute control of your assets, but put ownership one or two levels away, preferably out of sight. Remember, the President of General Motors controls the entire corporation, but doesn't own more than a few shares of its stock.

There are two possible approaches we can take:

**1. Don't even let them know you have wealth.** This one is called “keep my assets out of view in plain sight” and requires some discipline. It is a little difficult if you like to pose for your neighbors and live a lifestyle indicative of your earnings. However, it is not too hard to cut your visibility and your target exposure (reduce the size of the bulls eye) and still live very well indeed, but just not attract the attention of financial predators. Keep them guessing. Only a fool will file a lawsuit based on a guess.

**2. Make any attack occur on “foreign” ground that you control.** They will be the ones at a terrible disadvantage. This strategy consists of forcing any collection effort into a court where the attack must be made in a foreign jurisdiction where he/she will have to hire local counsel, where contingent fees are not legal, where transportation is difficult and where the courts will insist that he/she transport the witnesses for an all new trial on the merits of the case. You don't send the assets; you just establish the location of the law and the litigation forum and location of professional advisors who will handle some of the aspects of the structure.

**3. Or both.** If you combine these approaches, you have the best of all worlds and can be sure that the creditor is put to the utmost disadvantage. Can they still get something? Maybe. But it sure won't be from the part of your structure that is based in the other jurisdiction.

## Section 6. Levels of Structure

There are four levels of protective structure, or “motes”, I suggest to my clients:

**1. Business structure.** A good, clean structure for your active business operations is the first line of defense. A corporation or a limited liability company is the only secure platform from which to do business. This is your first "mote" around your wealth generating machine. Be careful where you form that entity; it really matters.

**2. Insurance protection.** Whenever you buy liability insurance you are hiring a “reserve” attorney who will be paid from a backup pool of money which will also pay the

judgment if all the legal maneuvering fails. It is like a sink hole full of money that becomes available only if you need it. But not too large a hole; a lot of insurance can itself become a target. Insurance is the second mote around your wealth generating machine.

**3. Domestic structure.** This structure consists of: (1) your estate (death) plan which will provide your loved ones with protection if you should die prematurely, and (2) a domestic structure for your lifetime wealth that is beyond attack by financial predators. These two components overlap and work together. This structure is the third mote around your wealth generating machine.

**4. Global structure.** This is the "Ultimate Mote." By choosing the law under which any attacker will have to make his attack, you force the battle onto your ground in a situation you can control. Once the attacker recognizes what he is up against, he almost always fades or settles. The numbers are impressive: my associates and I have created just over 1000 of these structures. When a potential attacker looms large on the horizon, the structure is made known to the opposition. In only five cases has an actual attack been made. In only one case did the attacker get to a judgment. That case settled, after judgment, for five cents on the dollar.

However, when you are ready to implement your global strategy you must keep in mind that it is in the nature of fire insurance. It is not possible to use this strategy if there is already a serious creditor problem on the table. Remember where we started: it is a lot easier to deal with peanuts than to follow the elephant with a scoop.

Please do not try to implement a global strategy with amateurs or from a lack of knowledge or with the wrong information. You **MUST** not leave yourself either technically or really insolvent by your creation of this structure. You also must not make transfers to your global structure at a time when there is a known or suspected serious claim pending in such a way that you could not pay the claim if it materialized. Only your professional advisors with years of experience in this area of practice can tell you the difference between a future potential creditor and a present pending creditor. The difference makes the difference between a valid fire insurance tactic and fraud.

You must also avoid setting your structure down in a jurisdiction that is inappropriate for the protection you need. There are advisors trying to use a protection structure in the Cayman Islands. While Cayman is a magnificent business venue, the asset protection aspects of its trust and judgment enforcement laws are very poor.

So, please, hire good people (yes, I am available) that understand the maze and can navigate you through it.

## **Section 7. Components**

**1. In your business structure:** If you are in business or even standing close to

one, incorporate. While corporations are not very effective in defending your assets against a government agency (IRS, Franchise Tax Board, EPA, etc.), they are very effective as a first line of defense against general liability claims. The old "wisdom" about double taxation is just not true. Ask me and I'll explain. The one thing to keep in mind is that, while your attackers are chasing your corporation which has no assets (it will take them awhile to discover that fact), you have solidified asset arrangements elsewhere. At the very worst a corporation is a good starting point for an argument over who should be sued and at best provides a good shell that your opponent may not be able to penetrate. His ability to collect is dead at the first attack.

Two corporations, nested if possible, are even better. By placing the liability generating business activity in one corporation and the assets used by it (and leased to it) in another corporation or entity, you can confuse the opposition something terrible.

Another entity we are testing right now is the Limited Liability Company. While some issues are still unsettled, and liability is only one of them, they appear to be very fine vehicles, especially for real estate assets.

If you combine your corporations so that one is a Subchapter S or LLC and the other is a Subchapter C (normal, ordinary) corporation, you can accomplish some very interesting tax planning.

**2. Insurance.** There is no substitute for a good insurance plan as your second level of defense. It is a second mote around your assets. What you are really buying is a very well paid attorney. The one problem is that you don't have a lot to say about who he is. You can be assured, though, that he is experienced, handles your kind of case on a daily basis, and wins. Otherwise, the company would find someone else. Tell him early in any case that the rest of your asset protection plan is in good shape and that he should take a very hard settlement approach if you feel the case is not your fault.

**3. The Domestic Structure,** which consists of at least two and maybe three parts:

**A. The Family Estate Plan.** This is the traditional plan which makes provision for assets to be transferred, at death, to the people you appoint while mitigating taxes. There are usually catch all (pour over) wills, a living trust with marital deduction tax features (A/B marital deduction trust), durable powers of attorney and maybe even a community property agreement. These devices are wonderful structure and very necessary to the accomplishment of your ultimate goal: to get as much of your wealth to the next generation as possible at the lowest cost after providing for you and your spouse; no probate, lowered taxes, no fights. However, they have virtually nothing to do with the structure of your asset management machine during your life and have no protective features whatsoever.

**B. The Children's Trust.** These are special trusts under IRC section

2503C. They provide some real tax based advantages in dealing with assets which will ultimately go to the children. If structured properly, this trust is probably not reachable by creditors.

**C. The Unfunded Irrevocable Life Insurance Trust.** This is also a tax device. It is used to keep the proceeds (and maybe even the “interpolated terminal reserve”) out of your estate. Since it has no funds and only accepts gifts (from undisclosed sources in many instances) to pay premiums each year, there is no reason for a creditor to go after one of these, unless you let a lot of cash value build up inside the trust. Since the trust is not for your benefit, it may not be reachable by a creditor.

**D. The Family Limited Liability Company.** Here is where we overlap the death plan with the life plan in a device intended, at least in large part, to protect assets.

This type of entity has now been around for a few years and was used as a method for turning a good dollar into fifty cents just by signing the papers in some real estate and oil drilling syndicates. That was when they were being used as investment vehicles. During those days, many of the people who bought LLC interests were attacked for all the reasons cited above. We learned from that experience about four very interesting aspects of these structures:

(1) The instant you convey an operating business or financial interest or some kinds of assets to an LLC, of which you or you and your spouse are the managers, the value for tax purposes goes down approximately 30% (or more). This is due to three *discounts* allowed by the IRS because fragmented interests are worth less on the open market than are whole interests.

(2) A creditor, even if he can get a judgment through your first two lines of defense, cannot get to the assets held inside the LLC. He can only get a “*charging order*” against the distribution rights you hold. It does him no good at all until the manager (you) decides to distribute something.

(3) The manager (you) can *refuse to make any distributions*. No one (court) can compel him to make a distribution. The LCC, through you, can, however, loan you money and pay you a management salary.

(4) The creditor with a charging order *cannot* become a *Substituted Member* unless you allow him to do so. Since there is no valid business reason for you to do that, you wouldn’t, would you!

(5) However, the Federal tax law is different than the state law on attachments. The tax law says that the creditor with a judgment levied against the LCC is treated (for tax purposes only) like a member, even though he gets nothing. Therefore, he gets to pay taxes at personal income tax levels on income he never sees

and never will see.

So, here are the hurdles a creditor must jump over to get to assets in your Family LLC:

- (1) he must get an original judgment in the face of your determined opposition.
- (2) he must prove from obscure or even non-existent records that you own an interest in that particular LLC.
- (3) he must get to court (expensive) and convince a judge, in the face of your opposition, that he deserves a "charging order."
- (4) he must then get ancillary court orders (expensive) appointing a receiver to receive any distributions that might come from the LLC.
- (5) he must apply to the court (expensive) for a foreclosure order on the LLC interest, something that is prohibited by the LLC laws of every state, but allowed in some very limited circumstances only in California.
- (6) he must pursue a forced sale, in the face of your opposition, of your LLC interest at a foreclosure sale.
- (7) if the creditor is the purchaser, he cannot become a substituted member, he can only obtain rights to the distributions you decide to make. It is permissible for you to decide not to make any distributions at all. If your agreement is drawn properly, the creditor has no right to an accounting.
- (8) he must then accept the K1 form each year and pay taxes on his undistributed share of the income because that same form is sent to the IRS by the LLC.

These attributes have two effects on creditors attempting to attack you: (1) experienced attorneys and knowledgeable clients simply fade when they see this structure. They don't want to waste good money chasing protected money and other assets they will never see. (2) Less experienced attorneys and their clients will carry the matter to judgment only to come face to face with your third mote and whimper for some kind, any kind, of settlement. Attorneys who defend these cases tell me that they almost always can settle for eight cents or less on the dollar. Even the IRS cannot get past this mote, though they usually have other weapons at their disposal to use against you personally.

**4. Global Structure.** We very often have clients use a state other than their home state for incorporations and other purposes. That is done because the law of that

state is more advantageous. Nevada, for instance, allows the corporation to indemnify its directors and officers for all their actions and does not require the identity of shareholders to be made public. Why limit yourself to fifty states when you can choose the law of any one of 130 countries?

By using the law of another country, you obtain a view toward creditors that just does not exist here in the “consumer” (populist) view of economics. In other countries, it is recognized that creditors set their original prices with all risks considered. Those other countries, then, take a harder view about what a creditor must prove in order to deprive you of your property, even by due process.

Many countries also will not allow out-of-country attorneys to practice in their courts, mandating that any pretended creditor hire local counsel. Most of them will not allow contingency fees and, in almost all jurisdictions, consider such fees unethical.

There are also a few countries that have intentionally and with great deliberation enacted a set of trust and company laws that are aimed directly at protecting any organizations using their law from creditors, domestic or foreign. These countries have very short statutes of limitation for creditor actions (some as short as two years), will not recognize foreign judgments or foreign service of process and sometimes even allow essentially “blind” entities to exist. But only in these jurisdictions. Using one of these jurisdictions, you can then go on the offensive and not worry about always fighting from a defensive posture.

In order to do this, a person will usually form an irrevocable trust in the country with laws ideally suited to his or her needs. He or she may even be one of the trustees, if other provisions are drafted very carefully. The Settlor (as the creator of this kind of trust is called) will then transfer the LLC interests (see above), maybe the real estate, and some other assets into that trust. The laws of that country are usually strong enough to protect the assets in all events. But the trust has “flight” provisions which go into effect in case of “duress” which allow the trust to move to another country if it needs to do so. And another. And another.

When your adversary’s attorney realizes that his U.S. judgment is not good in the country where the trust is housed, that he must transport his witnesses and records and other evidence 12,000 miles to an obscure courtroom with an unfamiliar judicial system, hire a local attorney who charges by the hour, and do it all within two years and that he cannot charge a contingency fee on the work accomplished in that country, he remembers how to spell “settlement.”

Where are these countries? To just tell you that would waste 25 years of research and experience. I am, however, available to help you build your global asset protection and estate planning structure.

## CHAPTER 6

### Cost

Does wealth structuring cost money? Sure. So does building your house or buying your car. You wouldn't try to manage a wealth producing machine from a shopping cart under a freeway overpass any more than you would try to gain the benefits of a global structure with minimum outlay. You really do get what you pay for in this business. If someone is quoting you less than the \$35,000 - \$90,000 range to do the entire domestic estate plan and global protection plan, look for the holes and ask about "ups and extras." These costs are why this kind of planning is only suitable for a few, discriminating individuals who understand what it takes to keep what you make.

On the other hand, the experience and dedication of your professional advisors to your goals is of paramount importance to you. Choose them carefully and then understand and be sure you concur with the selection of structure they propose to you. If you don't understand or your advisor is impatient with you or you get the "trust me" line, move to other advisors.

Once you lay the money down, expect the very best service because you have entered an arena where the very best is available and is, in fact, the norm.