

Structuring Your Wealth For Maximum Protection and Benefit

or

A Leak Is No Way To Run A Ship

by: Attorney Jay W. Henderson

I. 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.

II. 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.

III. 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.

IV. The Approach: A Complex, Integrated, Domestic & Global Structure

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.

V. 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.

VI. 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 judgement 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 judgement. That case settled, after judgement, 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 judgement enforcement laws are very poor.

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

VII. 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 judgement 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 judgement 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 judgement 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 judgement 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. judgement 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.

VIII. 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.

IX. Conclusion

By combining a good business structure, multi-state if possible, good insurance coverage, a well drawn estate plan, a finely crafted domestic structure and a well designed global structure, you can be secure in your asset management. Ask me and I'll tell you a lot more.

Thanks for your time.