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Asset Protection: Reducing Risk, Promoting Peace of Mind

Every American adult shares a dubious characteristic - each is a walking litigation target. Part of your birthright is that you may be sued at any time, for any reason, and for any amount.

Civil actions range from the serious to the frivolous. Did you offend someone today with something you said? Did you cause someone to suffer whiplash syndrome in the parking lot? Are you a professional facing a disgruntled client or patient? Do you own a company employing someone who did something irresponsible on company time?

Did you err on the side of caution - or throw caution to the wind?

Each choice you make might be construed as "actionable." That is, someone might spin a good case - or at least a good story - about how you crossed a line in some way, and why you should now pay dearly for your failure.

Sadly enough, the more money you have the more tempting a litigation target you are. The "discovery" phase of litigation will put an end to your uncivil habit of protecting personal information.

WHAT CAN BE DONE?

Well, you could hope for a sudden triumph of common sense in the land. You could hope that plaintiffs with ridiculous claims will suddenly feel shame and go skulking into obscurity. You could hope Congress will start returning cash donations from trial attorneys and embark on a frenzy of tort reform. Or you can seize the opportunity to control the part of the equation within your control, and build a protective barrier around your family and business assets.

There are proven strategies that will ethically preserve your wealth and keep the vultures at bay. Your most powerful weapons in this fight will be a variety of estate planning tools, including the Children's Trust, the Irrevocable Life Insurance Trust and the Family Limited Liability Limited Partnership.

THE CHILDREN'S TRUST

One way to place assets beyond the reach of potential plaintiffs is to transfer property to your children. Like most parents, you've probably been building an estate, not only for your benefit during life, but also to help your children and grandchildren. The IRS will allow you to give up to \$14,000 per person per year absolutely free of gift tax. If both spouses join in the gift, you can give up to \$28,000 a year, gift tax free. (As indexed for inflation).

By giving property to a Children's Trust each year, you can shift the income from your high tax bracket to the lower tax bracket of your children or grandchildren who are older than age 14. Unfortunately, children under age 14 must pay most of their taxes at the same rate as their parents.

Once the Children's Trust is sufficiently funded, it can pay the cost of a child's education. In this manner, the expenses are paid with discounted tax dollars; however, remember that parents or grandparents can pay tuition costs directly as a tax free gift.

If you own a business, you can gift its equipment and furniture to the Children's Trust and have the Trust lease it back to the business. Under this plan, the business gets a legitimate tax deduction, and the rental income is earned by the trust at lower tax rates. Plus, the benefit of the depreciation is given to the trust.

Having a Children's Trust also promotes family investment values. The children now have an identifiable stake in the family's financial success. It goes a long way toward helping them understand the value of money and wise investments.

The Children's Trust protects all assets transferred to the trust since those assets are no longer in your name or owned by you. The transferred assets are would be outside the reach of plaintiffs or creditors, whether yours or your children's. However, you can't transfer assets when you have pending claims or lawsuits against you. Transfers at that time will violate the fraudulent transfer laws. Transfers in violation of fraud laws will allow the courts to ignore the gifts to the Trust and permit your creditors to seize them.

The Children's Trust also has probate avoidance and estate tax reduction benefits. All assets transferred to the Trust are no longer a part of your estate. That means when you die, those assets will not go through probate and will not be subject to federal estate tax.

For example: if you and your spouse had three children and gave each of them \$20,000 in trust per year for ten years, that would amount to \$600,000 of tax-free gifts to their trust. At your death, none of that \$600,000 would be subject to federal estate tax.

Before creating a Children's Trust as part of an asset protection program, ask yourself whether you can permanently do without the benefits of the property. Once title is transferred into the Trust, there is no going back. This Trust can't be revoked or amended, so only transfer the assets that won't be needed to meet your personal expenses.

THE IRREVOCABLE LIFE INSURANCE TRUST

You are probably familiar with several reasons why life insurance is important. Young families may need it to replace part of a breadwinner's income. Mature Americans find it provides their heirs with a source of funds to pay estate expenses.

Life insurance can do all this and shield assets from litigation at the same time. How? By use of the Irrevocable Life Insurance Trust (ILIT). An ILIT is a good idea even if you don't worry about suits or creditors, because it allows the full value of your life insurance to pass tax-free to heirs. Without an ILIT, the government will count the face value of an insurance policy in calculating your taxable estate. Anything over the estate tax exemption is subject to "death tax" rates of 40 percent.

When you set up your ILIT, you name a trustee other than yourself, most likely one of your children. The trustee purchases a life insurance contract on your life with funds you provide. If you have an existing policy, you can assign ownership of it to the ILIT, but there are conditions imposed on these transactions that should be carefully considered before you do so. For instance, if you die within three years of the transfer, the life insurance contract will be included in your estate.

As we saw in the case of the Children's Trust, a taxpayer may give up to \$14,000 annually to another person free of gift taxes. Other than the per-person rule, there's no limit on the total amount you can give away. For example, if you have five children and eight grandchildren, you and your spouse could give each one \$28,000, for a total of \$364,000 annually, gift tax-free. That can buy a lot of life insurance.

By carefully following the IRS rules, you can employ this gift tax exemption to make the policy's premium payments.

Reducing your estate tax liability is a powerful incentive for considering the ILIT. But that's just the beginning of the long list of benefits it provides.

The ILIT gives you control over how proceeds from your life insurance policy are spent. You control who receives the proceeds and how they receive them. Whatever distribution strategy makes most sense for you and your loved ones, the ILIT gives you the opportunity to put it in effect.

And, of course, there's its important asset protection benefit. Over the years, your premiums and interest earnings can accumulate to considerable sums, making cash value policies a tantalizing target for creditors. When the policy is owned by the ILIT, however, it is out of the reach of creditors.

FAMILY LIMITED LIABILITY LIMITED PARTNERSHIP

A Family Limited Liability Limited Partnership (FLLLP) is one of the most popular estate tax and asset protection planning devices. An FLLLP is simply a limited partnership, similar to the real estate or business operating limited partnerships with which many are familiar, with additional statutory protections.

When you transfer your business and investment assets into an FLLLP, you receive in return:

General Partnership Interest: Generally, you receive 2% of the total partnership interests in the form of general partnership interests. That means that you control all of the decision-making for the FLLLP's activities.

Limited Partnership Interest: You receive the remaining 98% of the FLLLP in the form of limited partnership interests. Limited partnership interests give the limited partner very limited rights in partnership income and activities. While general partners may not treat a limited partner unfairly, a limited partner essentially has no meaningful control or rights.

You are now the proud owner of your very own FLLLP. You are the 2% general partner and control the partnership. Now what happens? You will give your children some of your limited partnership interest. That means that the partnership has partners other than just you.

As a general partner, you have complete control and access to the assets and income of the FLLLP in accordance with terms you designed. If you have given your children 10% of the FLLLP, they are entitled to 10% of any distributions that you decide to make, but they cannot force you to make any distributions.

HOW DOES THE ASSET PROTECTION BENEFIT WORK?

If you are successfully sued, all the plaintiff is able to receive is a "charging order." That's a judgment against the partner that tells the partnership that any distributions of profit that would otherwise be made to the debtor partner must instead be paid to the plaintiff/creditor. But the plaintiff has no power to interfere in partnership matters.

The charging order is a very hollow victory. Because the general partners decide if profit is to be distributed to the partners, the general partners can withhold distributions for partnership purposes and the creditor receives nothing.



For over forty years, the attorneys at Morris Hall, PLLC (MH) have provided quality estate planning documents for our clients. Helping our clients protect their assets for those they love has been our goal from the very beginning. We are recognized throughout the Southwest for our expertise in educating individuals about the importance of proper estate planning. We do this through various speaking engagements and seminars; and further, we keep our clients up-to-date through frequent communication, complimentary reviews and phone calls, and more advanced seminars.

At Morris Hall, we focus on protecting families from the expense and delay of probate and minimizing tax consequences. We also implement basic and advanced estate planning strategies for clients, and assist in the administration of our clients' estates upon death or disability. Since we practice estate planning exclusively, we are able to answer the complex questions and concerns consumers have about estate planning.

MH is staffed with experienced attorneys and paralegals who are trained in the complex areas of probate, trust, elder law and tax law. Our firm's aim is to help you, our client, understand the basic principles of estate planning and why each individual needs a plan. We have helped thousands of individuals secure their assets. We are confident that our experience will help ease your mind and the minds of the family you leave behind. By taking advantage of the services that Morris Hall has to offer, you can be assured that your legacy and your family will be protected.

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