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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. Unfortunately, in our current times, 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?

Each of your daily decisions might be construed as "actionable." That is, someone might spin a good case - or at least a good story - about your crossing a line in some way that merits a payout.

Sadly, the more resources you have the more tempting a litigation target you may be.

What Can Be Done?

There are a variety of ethical strategies geared toward protecting assets from numerous forms of liability. Many of these liability and wealth shields can be incorporated into an existing estate plan. The key to any asset protection strategy is timing; setting up a solid plan before there is an attack, is crucial. The Children's Trust, the Irrevocable Life Insurance Trust, and the Family Limited Liability Limited Partnership are three good estate planning tools frequently employed for asset protection.

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 (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 any number of expenses, for instance: 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. In addition, the benefit of the depreciation is given to the trust.

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 outside the reach of plaintiffs or creditors, whether yours or your children's. It should be noted that asset transfers performed in anticipation of litigation or pending claims are considered fraudulent transfers. Transfers in violation of fraud laws will allow the courts to ignore the gifts to the Trust and permit 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. This means that when you die, the Children's Trust 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, you would pass $600,000 in 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, meaning only assets that won't be needed to meet your personal expenses should be transferred to the Trust.

THE IRREVOCABLE LIFE INSURANCE TRUST

Life insurance can be an important part of an estate plan. It can be used as an income replacement tool or as a source of funds for estate expenses. It can also be used as part of an asset protection plan.

An Irrevocable Life Insurance Trust (ILIT) is a tool. 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, however, when the policy is owned by the ILIT, 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 fifty 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 public seminars. We also strive to keep our clients up-to-date through frequent communication like e-newsletters, 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 trust administration, probate and tax law. Our firm's aim is to help you understand the basic principles of estate planning and why each individual needs a plan. We have helped thousands of individuals secure their assets. 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.

To see our current calendar of events in your area, visit www.morristrust.com/seminars or to schedule a free consultation with an attorney, call us toll free 888.222.1328.

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The American Academy of Estate Planning Attorneys is a member organization serving the needs of attorneys committed to providing their clients with the best in estate planning. Through the Academy's comprehensive training and educational programs, it fosters excellence in estate planning among its members and helps them deliver the highest possible service to their clients.