Asset Protection: Protecting your assets from creditors and predators

Introduction

- Who do you trust more to care for your family – yourself or the state?
- …Your choice
- David R. Brewer, Attorney at Law, PLLC

Topics of Discussion

- How Assets Are Transferred at Death
- Gift and Estate Tax
- Trusts
- Family Limited Partnerships
- Installment Sales
- Insurance & Annuities

How Assets Are Transferred at Death

Probate

- Court process to:
  - approve Will
  - distribute probate assets in absence of Will
- Probate Property
  - land
  - autos
  - cash
  - personal property

Non-Probate

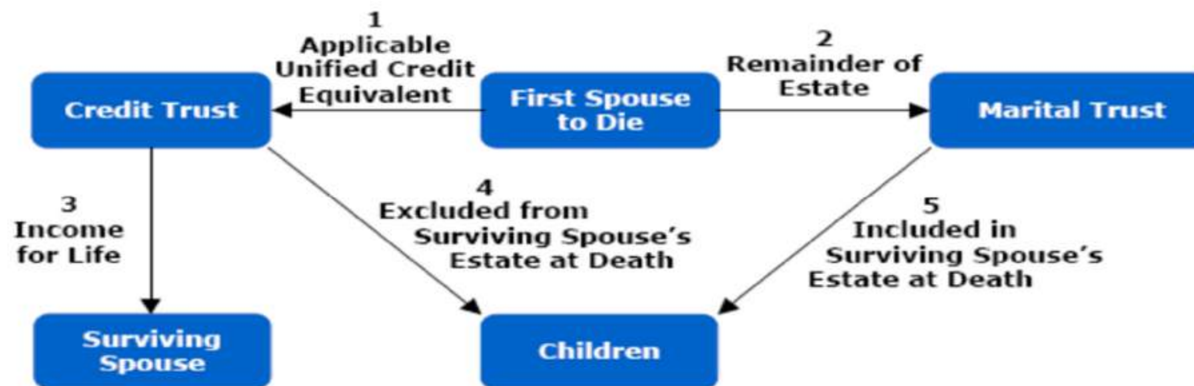
- Property passing outside of probate
- Property passing by contract or beneficiary designation (other than to the estate)
  - Life Insurance
  - Annuities
  - Qualified Plans & IRAs
- Property owned jointly with *"Rights of Survivorship"*

Year	Applicable Exclusion Amount	Unified Tax Credit	Top Estate Tax Rate
2002	1,000,000	345,800	50%
2003	1,000,000	345,800	49%
2004	1,500,000	555,800	48%
2005	1,500,000	555,800	47%
2006	2,000,000	780,800	46%
2007	2,000,000	780,800	45%
2008	2,000,000	780,800	45%
2009	3,500,000	1,455,800	45%
2010	N/A	N/A	0%
2011	5,000,000	1,730,800	35%
2012	5,120,000	1,772,800	35%

In 2013, the estate and gift tax law will be as follows:

- The federal gift, estate and generation-skipping transfer tax exemption amounts remain at $5 million, adjusted annually for inflation (predicted to be $5,250,000 for 2013).
- The gift, estate and generation-skipping transfer tax rate for transfers above the exemption is 40% (an increase from 35%).
- The gift tax annual exclusion increases from $13,000 per year, per donee, to $14,000 per year, per donee.
- The capital gains tax basis of assets acquired from a decedent will be the fair market value of the property at the date of the decedent’s death.
- Estate tax exemption “portability” continues to be an option for surviving spouses. A surviving spouse can elect to take advantage of any unused portion of the estate exclusion of his or her predeceased spouse, allowing married couples to effectively shield up to $10 million, adjusted for inflation, from estate tax.

THE TWO-TRUST PLAN IN ACTION



1. At the first spouse's death, an amount equal to the unified credit equivalent is placed in a credit trust, also known as a credit bypass, family, nonmarital or "B" trust, where it escapes federal estate taxation through use of the unified credit.

2. The remainder of the deceased spouse's estate is transferred to a marital trust, which is structured to qualify for the unlimited marital deduction, meaning that no federal estate tax is due on this portion of the deceased spouse's estate. Alternatively, the remainder of the estate could be transferred outright to the surviving spouse free of federal estate tax through use of the unlimited marital deduction.

3. The credit trust generally provides that the surviving spouse receives all income from the trust for life.

4. At the surviving spouse's death, the assets in the credit trust then pass to the children free of federal estate tax.

5. At the surviving spouse's death, the assets in the marital trust are included in his or her estate, but the unified credit is available to reduce or eliminate any federal estate tax due.

NOTE: The 2010 Tax Relief Act provides for "portability" of the maximum estate tax unified credit between spouses, which produces the same outcome as a two-trust marital deduction plan, but without the need to establish trusts. The Act, however, "sunsets" at the end of 2012, meaning that without future Congressional action, portability between spouses will not be available beginning in 2013. As a result, the continued need for marital deduction two-trust planning should be considered.

Potential Results of a Forced Liquidation

DO YOU KNOW WHAT A FORCED LIQUIDATION CAN DO TO THE VALUE OF YOUR BUSINESS?

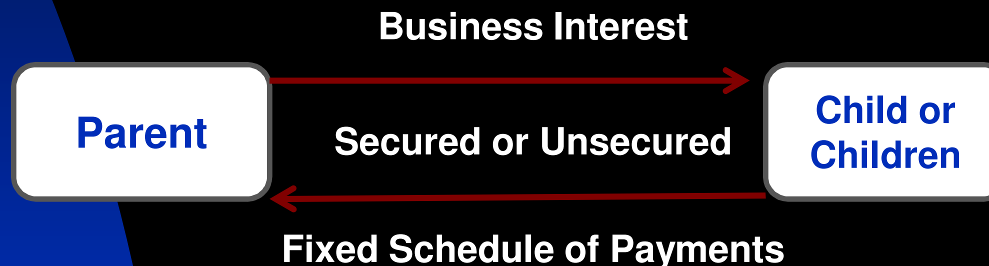
- Sale of business assets at greatly reduced prices.
- Elimination of the disabled business owner's or surviving family's primary source of income.
- Sacrifice of any goodwill value that might have facilitated sale of the business as a going concern.
- Difficulty in collecting accounts receivable.
- Immediate demand by creditors for settlement of their claims.
- Possible liquidation of other estate assets to pay business debts.

The Liquidation value of a business is unpredictable and will certainly be substantially less than the value of the business as a going concern.

What Is An Installment Sale

The installment sale can be an effective device for transferring a business interest and its future appreciation from the current generation to the next generation, while allowing the seller to spread the taxable gain from the sale over a number of years.

In a typical installment sale, a parent transfers all or part of a business interest to a child or children, who then promise to make a fixed schedule of payments to the parent. The child's promise to the parent may be secured, if desired.



Each installment payment consists of gain and interest, both of which are taxable to the seller, as well as a recovery of basis in the business, which is not taxable to the seller. The buyer can deduct the interest portion of each payment. If the seller dies before receiving al of the payments, the remaining payments are made to the seller's estate, where they are included for estate tax purposes.

When there is an installment sale between related parties, such as parents and children, a resale of the business interest within two years may accelerate the reporting of the seller's taxable gain, unless the resale occurs after the death of either party.

Family Limited Partnerships

Summary:

The Family Limited Partnership (FLP) is an attractive vehicle for the orderly management of family businesses and other assets such as real estate or stock portfolios. Since each FLP is custom-made, it can be tailored to meet particular family objectives. FLPs differ from other limited partnerships in that only family members, a family trust or a wholly-owned corporation are partners.

As a result of changes in federal and state law, an FLP can reduce a family's estate tax burden significantly, while limiting the rights of creditors to the limited partnership interests. The FLP allows the general partners (usually the parents) to exercise control of the partnership assets. The limited partners have no say in the management of the partnership and their liability is limited to their interest in it.

For estate planning purposes, a Family Limited Partnership is more flexible than an Irrevocable Life Insurance Trust. It allows individuals to change their minds and plans in light of changing facts and circumstances, making it an excellent planning technique.

ADVANTAGES:

- General partners retain control.
- Gift taxes reduced through discounting.
- Forming partnership is simple.
- Partnership agreement is flexible and amendable.
- Income shifting possible.
- Assets protected from creditors.

HOW TO IMPLEMENT:

- Create a Family Limited Partnership.
- Transfer assets to Partnership.
- Gift minority interests to family members.

TAX CONSIDERATIONS:

- Family Limited Partnership is taxed as a partnership.
- Gifts of minority interests may qualify for the annual exclusion.
- General partnership interest is included in estates of general partners.

What This Means

- No responsible parent / business owner should EVER put off executing a professionally drafted estate plan that includes asset protection
- Most business owners should also consider business succession planning
- Congressional impasse should not create personal impasse

Next Steps

- Research rates – shop around and price compare
- Find a lawyer you trust and set an appointment now, before you move on to other things

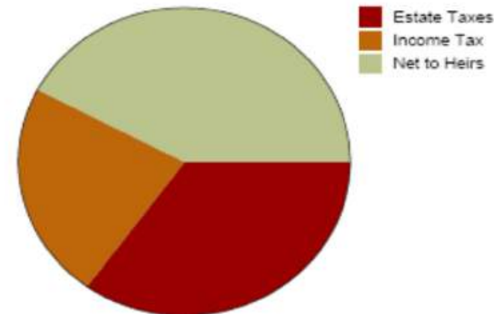
THE IMPACT OF TAXES

For: example Chevron
Age: 62

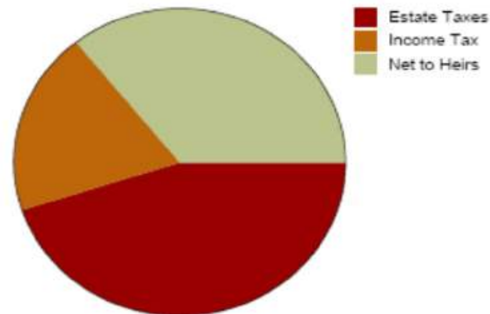
For: Mrs. Chevron
Age: 60

End of Year 2012

End of Year Asset Value	$682,500
Cost Basis	$0
Taxable Gain	$682,500
Estate Taxes*	$238,875
Income Taxes**	$155,269
Total Taxes**	$394,144
Net to Beneficiary	$288,356
% Lost to Taxes	57.75%



End of Year 2035



End of Year Asset Value	$2,096,315
Cost Basis	$0
Taxable Gain	$2,096,315
Estate Taxes*	$943,342
Income Taxes**	$403,541
Total Taxes**	$1,346,882
Net to Beneficiary	$749,433
% Lost to Taxes	64.25%

Hypothetical example; not indicative of any product or performance.

* Estate taxes based on adding annuity, with a hypothetical growth rate of 5.00% to taxable estate currently valued at $6,000,000 and growing at 3.00%. The estate tax amount includes federal and state taxes. This does not include specific residence state tax obligations. A certificate issued by Lincoln under a group policy can be used just as effectively as a Lincoln individual life insurance policy.

** The taxable part of annuity is taxed at beneficiary's assumed Federal Income Tax Rate of 35.00%.

Please verify with the Home Office that the current rate scale is illustrated. SPIA rates and factors are subject to change without notice.

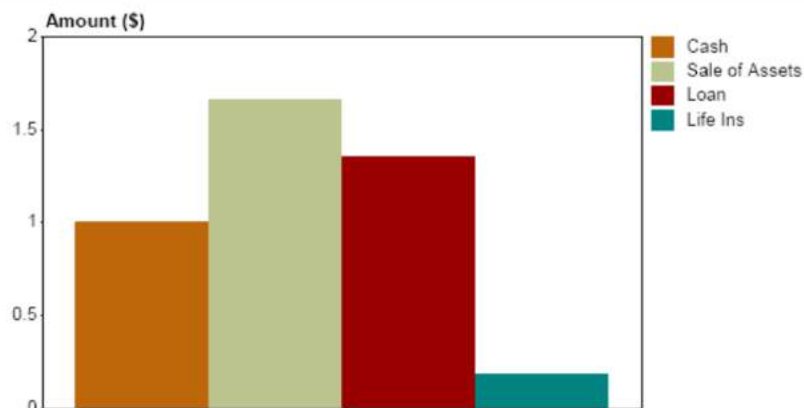
Four Ways To Pay Estate Taxes

Assumptions

Adjusted Gross Estate:	$9,000,000
Estate Growth Rate:	0%
Adjusted Gross Estate (at age 82):	$9,000,000
Estate Tax(less Exemption Credit):	$2,475,000

Methods of Payment		Cost per Dollar of Estate
Cash		
Assets Needed	2,475,000	
Total Transfer Cost	2,475,000	**$1.00**
Liquidation/Redemption - Section 303 (60% of Market Value)		
Assets Needed - Forced Sale[a]	4,125,000	
Total Transfer Cost	4,125,000	**$1.67**
Loan [b]		
Annual Loan Payment	336,273	
Loan Rate	6.00%	
Loan Period (Years)	10	
Total Cash Outlay	3,362,732	**$1.36**
Life Insurance		
Total Cash Outlay (Planned Premiums)	446,345	
Initial Death Benefit	2,450,000	**$0.18**

Cost per Dollar of Estate Tax



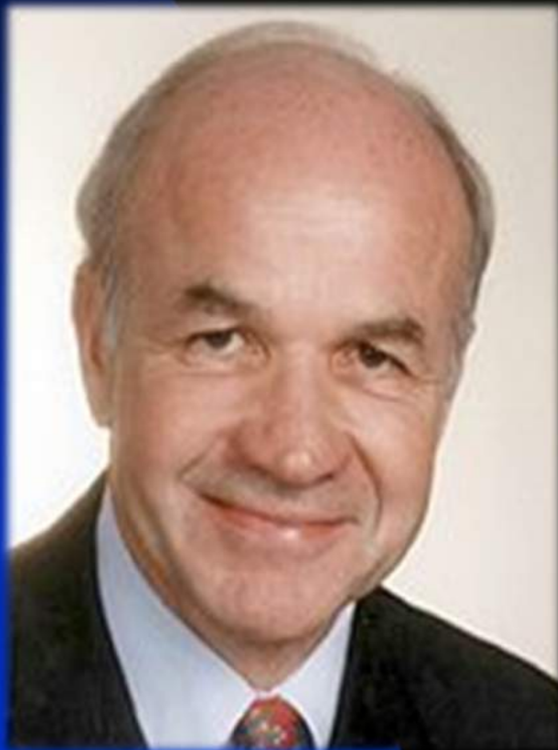
(a) Assumes sale does not affect estate taxes due
(b) This estate does not qualify for Section 6166 benefits.

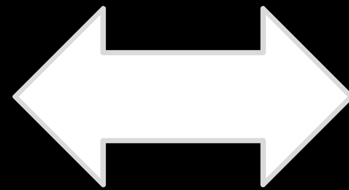
Snapshot of 2013 Federal Capital Gain Tax Rates

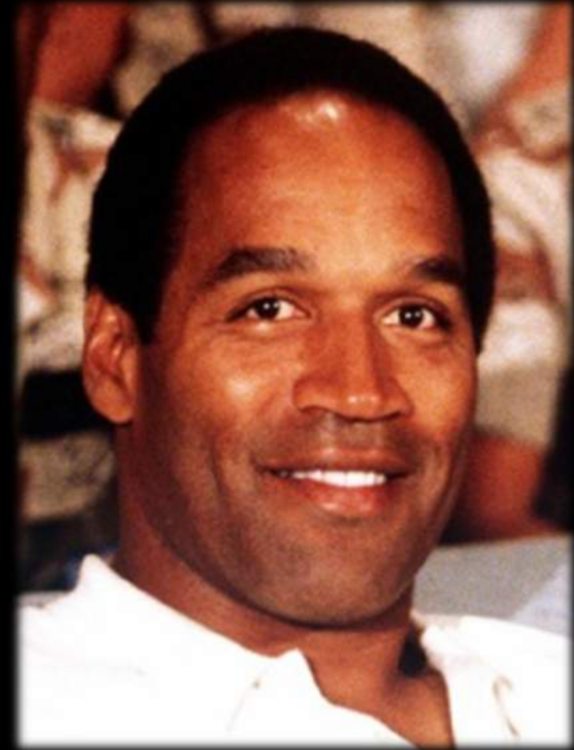
Single Taxpayer	Married Filing Jointly	Capital Gain Tax Rate	Section 1411 Medicare Surtax	Combined Tax Rate
$0 - $36,250	$0 - $72,500	0%	0%	0%
$36,250 - $200,000	$72,500 - $250,000	15%	0%	15%
$200,000 - $400,000	$250,000 - $450,000	15%	3.8%	18.8%
$400,001 +	$450,001 +	20%	3.8%	23.8%

*The 3.8% Medicare surtax only applies to "net investments income" as defined in IRC §1411.

WHAT DO WE HAVE IN COMMON?







WHAT DO YOU KNOW ABOUT… ASSET PROTECTION?

Asset Protection Strategies Protect Your Assets From Creditors and Predators

…Your Choice

AN ASSET PROTECTION PLAN IS…

- A plan *not* intended to hide assets from courts or creditors
- A *well thought out arrangement* of your assets that will protect you in case someone brings a lawsuit
- The plan has to be put in place *before the liability is incurred* or any alleged tort is committed
- The longer the plan is in effect before the liability occurs, the better your chances are that the plan will stand up
- Done so without fraudulent intent

A sound asset protection plan is one that is straightforward; you should be able to understand it

A FEW THINGS TO REMEMBER….

INSURANCE:
Insurance policies have limits on coverage that may increase your chances of being sued and do not cover things like lawsuits for environmental damages, discrimination claims, gross negligence, punitive damages, palimony awards, acts (including paternity suits) committed by your minor children, breaches of contract, or just plain insolvency.

ADVISOR RECOMMENDATIONS:
Placing assets in foreign trusts or corporations in places that have secrecy laws and even allow secret ownership – beware - a court may be inclined to consider secret accounts or ownership a "badge of fraud".

KEEP IT SIMPLE:
To avoid any criminal complications and/or costly legal battles, a good asset protection plan should be transparent; you should never have to hide any of the transactions that are part of the plan

TEXAS LAW:
Stipulates that the proceeds of annuity contracts "are fully exempt from creditors and from all demands in any bankruptcy and from execution, attachment, garnishment, or other legal process unless a statutory exemption, such as fraud, is applicable."

WHAT OJ SIMPSON CAN TEACH US ABOUT ASSET PROTECTION…

OJ Simpson made mistakes in a lot of areas. Having a great asset protection plan in place was not one of those areas. In fact, OJ played the asset protection aspect of his life to near perfection, without the use of offshore trusts, and we can all learn a little something from an analysis of the mechanisms that OJ used (perhaps unwittingly in the two instances discussed below) to protect his assets. Please keep in mind throughout this discussion that with the help of an asset protection attorney, many additional layers of protection can be achieved.

In 1969, after winning the Heisman Trophy, OJ Simpson began playing for the Buffalo Bills. As part of his compensation for playing in the NFL, OJ received a defined benefit retirement plan. Fast forward thirty years to 1999. By 1999 OJ had been acquitted of double homicide. That was the “good news” for him. The bad news was that in 1997 he had lost a civil case brought by the Brown and Goldman families who had obtained a $33.5 million dollar judgment against Simpson.

See Rufo v. Simpson, 103 Cal. Rptr. 2d 492, 497 (Cal. Ct. App. 2001). The judge presiding over the civil case ruled that Simpson’s defined benefit retirement plan could not be used as a source of proceeds to satisfy the

WHAT WE CAN LEARN FROM KEN LAY'S "NEST EGG"…

Thousands of former Enron employees saw their retirement funds disappear when the energy giant collapsed -- but Kenneth Lay had millions socked away in lawsuit-proof investments.

In January of 2002, the wife of the late and former Enron chairman Kenneth Lay tearfully told a national television audience that she and her husband were struggling to avoid personal bankruptcy following the collapse of the Houston energy-trading company. What Linda Lay failed to tell viewers of NBC's Today show, however, was that she and her husband had shifted millions in personal assets to investments that are beyond the reach of creditors or legal judgments'.

In her Today show appearance, Linda Lay said that she and her husband were "fighting for liquidity," adding: "It's gone. There's nothing left. Everything we had mostly was in Enron stock."

Once the annuities reached maturity in February 2007, Linda Lay will be guaranteed monthly payments of $43,023 and $32,643, respectively, for life.

The Lays purchased the annuities almost two years before Enron filed for

INSURANCE CODE CHAPTER 1108. BENEFITS EXEMPT FROM SEIZURE

INSURANCE CODE

TITLE 7. LIFE INSURANCE AND ANNUITIES

SUBTITLE A. LIFE INSURANCE IN GENERAL

CHAPTER 1108. BENEFITS EXEMPT FROM SEIZURE

SUBCHAPTER A. GENERAL PROVISIONS

Sec. 1108.001. CONSTRUCTION WITH OTHER LAW.

The exemptions under this chapter are in addition to the exemptions from garnishment, attachment, execution, or other seizure under Chapter 42, Property Code.

Added by Acts 2001, 77th Leg., ch. 1419, Sec. 2, eff. June 1, 2003.

Sec. 1108.002. ANNUITY CONTRACTS. For purposes of regulation under this code, an annuity contract is considered an insurance policy or contract if the annuity contract is issued:

(1) by a life, health, or accident insurance company, including a mutual company or fraternal benefit society; or

(2) under an annuity or benefit plan used by an employer or individual.

Added by Acts 2001, 77th Leg., ch. 1419, Sec. 2, eff. June 1, 2003.

SUBCHAPTER B. EXEMPTIONS FROM SEIZURE

Sec. 1108.051. EXEMPTIONS FOR CERTAIN INSURANCE AND ANNUITY BENEFITS.

(a) Except as provided by Section 1108.053, this section applies to any benefits, including the cash value and proceeds of an insurance policy, to be provided to an insured or beneficiary under:

(1) an insurance policy or annuity contract issued by a life, health, or accident insurance company, including a mutual company or fraternal benefit society; or

(2) an annuity or benefit plan used by an employer or individual.

(b) Notwithstanding any other provision of this code, insurance or annuity benefits described by Subsection (a):

(1) inure exclusively to the benefit of the person for whose use and benefit the insurance or annuity is designated in the policy or contract; and

(2) are fully exempt from:

(A) garnishment, attachment, execution, or other seizure;

(B) seizure, appropriation, or application by any legal or equitable process or by operation of law to pay a debt or other liability of an insured or of a beneficiary, either before or after the benefits are provided; and

(C)a demand in a bankruptcy proceeding of the insured or beneficiary.

Added by Acts 2001, 77th Leg., ch. 1419, Sec. 2, eff. June 1, 2003.

Sec.1108.052. EXEMPTIONS UNAFFECTED BY BENEFICIARY DESIGNATION. The exemptions provided by Section 1108.051 apply regardless of whether:

(1)the power to change the beneficiary is reserved to the insured; or

(2)the insured or the insured 's estate is a contingent beneficiary.

Added by Acts 2001, 77th Leg., ch. 1419, Sec. 2, eff. June 1, 2003.

Sec.1108.053. EXCEPTIONS TO EXEMPTIONS. The exemptions provided by Section 1108.051 do not apply to:

(1) a premium payment made in fraud of a creditor, subject to the applicable statute of limitations for recovering the payment;

(2) a debt of the insured or beneficiary secured by a pledge of the insurance policy or the proceeds of the policy; or

(3) a child support lien or levy under Chapter 157, Family Code.

Added by Acts 2001, 77th Leg., ch. 1419, Sec. 2, eff. June 1, 2003.

Amended by Acts 2003, 78th Leg., ch. 1276, Sec. 10A.301(a), eff. Sept. 1, 2003.

SUBCHAPTER C. ASSIGNMENT OF BENEFITS

Sec.1108.101. ASSIGNMENT GENERALLY. This chapter does not prevent an insured, owner, or annuitant from assigning, in accordance with the terms of the policy or contract:

(1) any benefits to be provided under an insurance policy or annuity contract to which this chapter applies: or

(2) any other rights under the policy or contract.

Sec. 1108.102. CERTAIN ASSIGNMENTS VOID. If an insurance Policy, annuity contract, or annuity or benefit plan described by Section 1108.051 prohibits a beneficiary from assigning or commuting benefits to be provided or other rights under the policy, contract, or plan, an assignment or commutation or attempted assignment Or commutation of the benefits or rights by the beneficiary is void.

Added by Acts 2001, 77th Leg., ch. 1419, Sec. 2, eff. June 1, 2003.