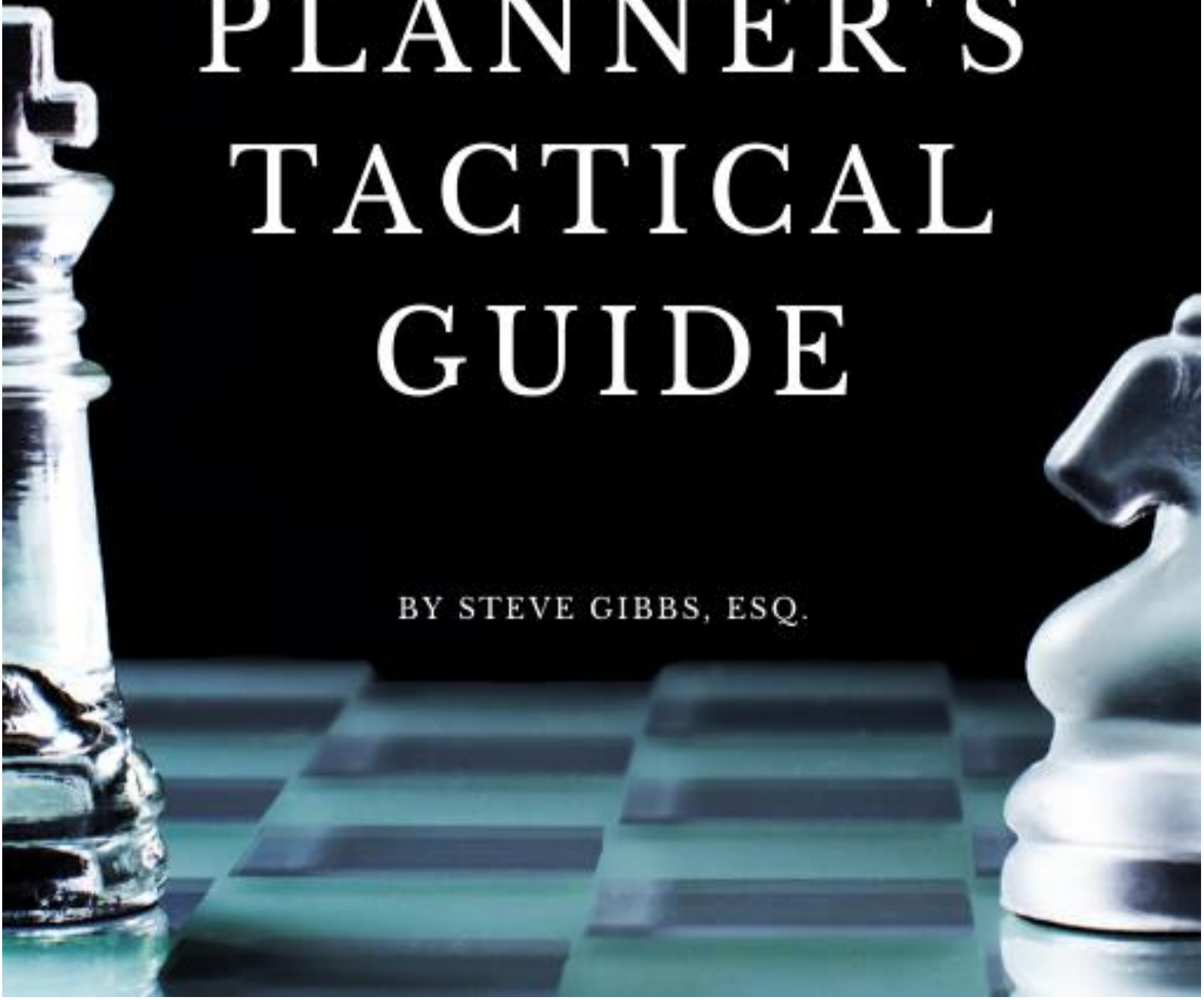
ESSENTIAL LEGAL PROTECTION
FOR ACHIEVERS

THE ESTATE PLANNER'S TACTICAL GUIDE



BY STEVE GIBBS, ESQ.

Table of Contents

Second Edition

Published and distributed in the United States by Gibbs Law Office, PLLC, a Florida Professional Limited Liability Company.

IMPORTANT DISCLAIMER:

The author of this book does NOT intend to dispense financial or legal advice or recommend the use of any financial or legal strategy or approach without the advice of an experienced professional attorney licensed in the area of expertise and jurisdiction of concern. The intent of the author is only to offer information of a general nature to help you in your quest to understand and manage your related concerns from an educated and empowered standpoint. In the event that you use any of the information in this book for yourself, the author and publisher assume no responsibility for your actions.

ABOUT THE AUTHOR

Steven Gibbs is the co-founder and CEO of insuranceandestates.com, a collaboration of experts who are committed to wealth building life insurance strategies and estate planning education.

“Invincibility lies in the defense; the possibility of victory in the attack.”

Sun Tzu

INTRODUCTION: Offense *without* Defense

"Defense to me is the key to playing baseball."

Willie Mays

The Achiever's Risky Mindset

Perhaps you're an entrepreneur, a highly paid professional, an investor OR any combination thereof. I applaud you because you've chosen to get out there and make a difference for yourself and your loved ones. Perhaps you've found a level of success in your own business, in which case I salute you for entering the riskiest of arenas.

If you're an entrepreneur, you've probably got the defensive instincts of a pit bull getting into a fight (*the dog, not the pop star*). What I mean is that you may be mostly geared for offense and are prepared to bear the risk of negative fallout if it ensues.

Perhaps I'm generalizing a bit, but I can say this with some certainty based upon my extensive 20-year history in coaching and hanging out with all kinds of high achievers and entrepreneurial types. Entrepreneurs are mostly a rough and ready bunch that are willing to take big risks to accomplish big goals. I respect this very much. However, it lacks a certain amount of, shall we say…caution.

You may be able to manage the blows in the event of a catastrophe, but how about your loved ones?

So, this book will be a "coming of age" test of sorts. My challenge to you to ask whether you're willing to take some steps to manage your risk? This is not for your own benefit, but for the benefit and safekeeping of those you love and value the most?

HOW TO USE THIS BOOK

The following pages are an overview of the defensive landscape for protecting your business, your investments, your legacy and your loved ones. It doesn't really matter what business or profession you're in. Although, admittedly some businesses are riskier than others and we will touch on this fact. For the most part, the strategies are the same and they evolve as your business and wealth matures.

By the time you've walked through this book, my hope is that the perpetual instinct, found in most achievers, to ignore your defenseless underbelly will have changed. My first goal for you is simply to offer some legal insight as you consider your outstanding risks whether you're a business owner or retiree. This insight may give you pause to consider what protective measures you currently have implemented. Second, I intend to give you a repertoire of tools, or defensive tactics, if you will, to aid in formulating your own lifetime asset protection plan. These defensive tactics extend from your contracts, to business entities, to estate planning and asset protection.

I'll tie this all together with some primers on using insurance properly for protection, wealth accumulation, retirement and tax planning because these are two areas that many business owners tend to "step in it" and do a "face plant". After all, the IRS is a "super creditor" that can threaten your entrepreneurial life in a number of painful ways.

My goal is to give you the wake-up call, followed up with the tips and tools to formulate your own lifetime strategy for estate planning, protection and wealth accumulation. This strategic effort will grant you the ability to ask the right questions, conduct the right additional research, and ultimately, to confidently locate and guide your chosen experts and advisors to implement your strategy. This book was written to help you do all of the above because, simply, I want you to become bulletproof and succeed.

Steve Gibbs, Esq.

Chapter 1. Risk in a Litigious Society

"The risk I took was calculated, but man am I bad at math."

Unknown

Tactical Overview

At the risk of being dramatic, when you begin to "succeed" and acquire some assets, and then decide to get in your car in the morning, you just painted a target on your chest called "financial and legal risk". If you're a business owner or investor, this fact is heightened because, regardless of your attained level of success, the general public (including many lawyers) now views you as a target. Your risks are very real and lurk in a variety of places. This first chapter will thus involve a bit of surveillance to help you spot the risks in the shadows and fine print.

If you aren't yet aware that we live in a litigious society, you'd better dial in and focus. The USA is a hotbed for lawsuits of all spaces and sizes. In fact, as a nation, we love a good fight and NOWHERE does it get more dramatic then inside a courtroom.

Some of our most notable corporations have been subject to bone grinding, blood gushing civil lawsuits and other "regulatory" attacks by assorted special interest groups and government entities. For background information just google "lawsuits involving McDonalds," "Starbucks" and "Chipotle", or any other number of American Corporations. You may be justifiably shocked at your findings.

This is why much of the publicity generated by the media regarding lawsuits faced by our leaders is somewhat laughable because ALL top business leaders endure lawsuits in the same way you might grimace **over** someone cutting you off in traffic.

As a result of random unstoppable litigation, which is supported by our laws (thanks to the trial lawyers lobby) on a grand scale, American companies are rightly paranoid. You only need to notice the litany of disclaimers plastered on everything from your coffee cups to your garden tools. Everything from our playgrounds to our food purchasing is fraught with cautionary warnings. It's no wonder people today live with more stress than ever before, despite all of our modern comforts and conveniences.

Are there some "upsides" to our litigation heavy system?

Admittedly yes when it comes to product safety and protecting the little guy from runaway corporate greed.

However, the difference between these large companies (and perhaps YOU) is that they have the resources to either fend off or pay off these attackers. You, as a smaller operator, could be wiped out by one such legal snafu.

So, it is important to get a feel for the landscape, as one might survey and map the scene of a battlefield. If you think I'm waxing dramatic, talk with someone whose been unwillingly hauled into court.
So, the first part of our tactical overview is to acknowledge that the threat is real.
You won't be facing a howitzer cannon. However, the swift delivery of a civil summons and complaint at your place of business can be almost as unsettling.

Why Civil Litigation Should be Avoided

There are a number of reasons why getting involved in a lawsuit simply sucks. I've helpfully identified the most common discomforts of this process as follows:

1. It's expensive
2. It's complicated
3. It's a reputation thrasher
4. It's time consuming
5. It's scary

Our legal system makes it super easy to sue somebody and super hard to defend against a lawsuit. Cool huh? Not if you've got a life and are spending your time working toward achieving your goals.

Civil litigation is expensive to defend because civil defense attorneys almost always charge a retainer deposit toward the fees. Retainer deposits range from around $3000 to $10,000 or more depending upon how complicated the lawsuit looks to be. Total fees can easily extend into hundreds of thousands of dollars. Plaintiff's attorneys, however, typically work on a contingency fee basis, meaning they get a slice of whatever they manage to collect from you. Usually there are no up-front costs for that bastard who decided to sue you.

As you may be discovering, civil litigation is complicated. Nothing like being catapulted into a dangerous scenario where you do not speak the lingo and must therefore pay for interpretation at every turn. Everything from the papers served to the various motions and orders are extremely cryptic to the non-lawyer business person. This fact, of course, can lead to a fair amount of stress due to the confusion and uncertainty involved.
Being sued tends to have an impact on your business reputation, regardless of the merits of the lawsuit or even the outcome. In business, you might be presumed guilty regardless of your innocence. Frankly, this fact is a serious downer, as you are striving daily to establish a trustworthy business reputation and some idiot has thrown a wrench into that process.

A civil lawsuit may well take up a lot of your time before it is resolved. In fact, complicated lawsuits can take years to resolve. All of the time spent is, of course, time NOT spent building or improving your business. Hours spent providing requested information, appearing in depositions, or making mandatory court appearances is simply not time well spent.

Even for the most battle-hardened soul, a civil lawsuit can be very scary because you often have no idea how things will turn out. But the good news is that if you're well prepared by reading and applying the techniques laid out in this tactical guide (as deemed appropriate for your situation), things can be a lot less scary.

What to Expect in a Civil Lawsuit

There are a number of steps in the process of a civil lawsuit that add to its "suckiness" and add to the reasons why this exposure should be avoided at all costs.

First, you may receive some kind of nasty demand letter requesting payment for any number of alleged grievances. Usually this letter will have a time frame on it, implying that the world will implode upon expiration of the deadline.

Next, it becomes official when you receive a formal summons and complaint from a process server, sheriff or other official person. This fateful delivery will start the lawsuit and the timeclock that will require you to response with a formal answer or motion of some kind within 20-30 days.

Then, discovery will commence that may include any number of unsavory experiences such as being forced to answer questions, admit or deny allegations and submit to taped "deposition" testimony, all of which is designed to uncover your assets and punch holes in you like that howitzer I mentioned.

Throw in a few settlement conferences and at least one enjoyable pre-trial meeting with the judge, and you're getting an idea of the process.

There are a number of ways to win or lose prior to trial and these are called motions. There are also jury and bench trials with the former being more expensive than the latter. Of course, verdicts at trial can be appealed to higher courts, thereby extending the process for years on end.

If a civil judgment is ever entered against you, it can generally be enforced against your assets for around 20 years, and the amount will accrue at a statutory rate of interest. If a certified copy of the judgment is filed, it usually can be enforced against your various assets situated in that local county.

Have I instilled a certain amount of distaste for this process and why it should be avoided at all costs? If not, you might be a sadist and I can't help you.
Next, let's look at the areas of exposure for you and your business. In other words, what actions in your personal and business life are most likely to expose you to civil lawsuits.

Mapping Legal Minefields

While civil litigation can be a bit unpredictable (just ask McDonalds) there are some areas that impose a higher level of risk. These are the minefields that we'll seek to map out so

you can take some precautions. Areas that tend to cultivate some liability (or risk) for the well-intentioned achiever are:

1. Contract disputes
2. Real property injuries
3. Products injuries
4. Accidents or malpractice
5. Trademark and copyright
6. Debt collection and foreclosures
7. Partnership disputes
8. Bankruptcy
9. Tax disputes
10. Divorce

The above list is certainly NOT exhaustive, yet a brief overview and some common sense should tell you that these are the hot zones for civil litigation. Chapter 2 is devoted to helping you discover and implement strategies to add protection for each of these hot zones.

The Risk of Death

One major area of risk that is, perhaps, in a category all its own is the risk of death. This area of risk will be addressed in Ch. 3 which deals with estate planning. Certainly, the ramifications of an untimely demise may pose greater problems for businesses and loved ones than all others combined.

The Art of Anticipation

There is no magic bullet to protect you and your assets from all types of litigation. In fact, asset protection is NOT full proof and can only go so far as to anticipate the most likely areas of risk and implement legal strategies to make you a less appealing target. Note, everything we talk about in this book is perfectly legal. Asset protection is NOT about evading your legal obligations or hiding assets in any manner than is permitted under the laws of whatever jurisdictions apply. Follow me?

That said, there are lots of legal strategies that anticipate a "sue happy" jerk's favorite moves and are intended to deliver a preemptive strike.

Another "reality check" to consider is that asset protection strategies are all about anticipation because they DO NOT work if you're already being targeted in a lawsuit. Unfortunately, the plaintiffs and their lawyers got worried about people retitling or

transferring assets to various trusts and entities and pushed through legislation a spoiler called the “fraudulent transfer laws”. These laws allow someone with a judgement to unravel your cozy asset protection plan if it is deemed to have been inspired for the sole purpose of denying an active pursuer.

So, while anticipating the blow and planning accordingly is cool, being clueless and trying to block the blow after the arm is in motion…NOT cool.

Starting with Baby Steps

You’re about to be introduced to an array of asset protection concepts, complete with an assortment of legal jargon that could confound and confuse even the most astute reader. I suggest that you not worry about this and begin with baby steps. Hopefully, my simple use of terminology and caring guidance well help you make sense of this relatively quickly. But if not, rest assured that concepts will be repeated enough to allow this to click over time.

It also may help you to know that there are strategies discussed in Chapter 2 that should be embraced by ALL achievers. Other strategies may only be appropriate for those with unique circumstances or higher asset values. I will try to point out when certain strategies might be advisable and leave the rest to your discretion and discussion with your own legal and tax advisors.

With that in mind, let’s launch into Chapter 2.

…you might want to do some stretching first.

Chapter 2. Tactics for Protecting Assets

"Our brains are either our greatest assets or our greatest liabilities."

Robert Kiyosaki

PRELUDE - Using Contracts that Don't Play Nice

In Chapter 1, we flagged contract disputes as the first of a number of civil litigation hot zones to consider.

Applying our self-defense vernacular, we are talking about viewing the other party to your contract as a potential opponent, which they often certainly are "potentially". Sure, things might be all cozy and peppy now, but what happens if that person's alter ego surfaces. When money is involved, this can happen faster than you might realize.

So, treat your contracts seriously. I'm not saying that there isn't a modicum of compromise and mutual trust in any contract, because there usually is and this can lead to good agreements. However, too often people get excited about a business deal and give away the store. Professionals DO NOT do this however.

In any event, the contract is generally negotiated and both sides must give a little to get. Just make sure you're NOT giving in the wrong areas. There are serious aspects to any contract that must be carefully considered as follows:

1. Are the terms clear.
2. Is there a clear and valid legal purpose.
3. Are there any potential catastrophes.
4. Are there clear remedies for default.
5. Is the contract signed properly.

Having clear contract terms may sound obvious. Yet this is where many contracts implode and civil litigation is the result. So, getting clear about clear terms, we are talking about the essential aspects of the business deal such as:

1. Identifying the parties.
2. Specifying a price.
3. Establishing a timeline for performance.
4. Specifying the purpose and subject matter.
5. Identifying and preconditions to performance.

In addition to managing your contracts, you need to maximize your legal asset protection planning.

DEFINING ASSET PROTECTION

Asset protection is about protecting the "stuff" that you have worked so hard to accumulate, and yet this concept means different things to different people. For some, asset protection is as simple as keeping funds in the bank and using a safe deposit box. Others visualize offshore trust accounts and hiding assets in obscure foreign corporations.

Before addressing specific methods of asset protection, it is important to get clearer about what constitutes an asset. I define an asset as everything you may own that has value. I also differentiate between "income producing" and "non-income producing" assets and this is simply a question of whether the asset is creating income for the owner. An important distinction is if something is not appreciating in value or creating income then perhaps it should not be considered an asset. It is your task to determine what constitutes an asset and thus what warrants asset protection for you.

An income-producing asset may be your ownership in a business or rental property. An asset can also be (non-income producing) personal property such as a stamp collection or an antique car. Other assets may include funds in a bank account or investment account. You get the idea. This is the stuff that generates income and builds your net worth.

Why is asset protection important?

The “somewhat obvious” answer is simply that we live in a society with a legal environment that tends to favor creditors. Who are creditors? A creditor in today’s legal environment can be someone “off the street” who decides to sue you for whatever reason. For a business owner, a creditor may be anyone who enters your place of business.

McDonald’s Restaurants found this out years ago with the infamous “hot coffee lawsuit,” Liebeck v. McDonald’s Restaurants, in which an elderly customer won a large judgment by jury (2.8 million) after asserting that the coffee she spilled on herself was unreasonably hot. Although the judge in that case ultimately reduced the verdict and the case was settled, the “hot coffee” fact pattern was repeated recently when a police offer filed a similar lawsuit against Starbucks Corporation.

A “slip and fall” can easily result in a prolonged, expensive lawsuit and the real problem is that plaintiffs’ lawyers are on the hunt for clients, and they often do not charge any upfront fees to take a case.

Plaintiffs’ lawyers operate on a contingency basis where they collect a portion of the verdict or settlement as their fee and this fee usually ranges between 25% and 45% of the total award of damages to the client. The bottom line is that you are easy to sue, and these lawsuits are tough to defend, often requiring a $5,000 retainer to the defense lawyer just to get started. Worse yet, all too often a plaintiff’s lawyer will take a case to try to leverage a quick settlement rather than attempt to litigate it. However, to you, the plaintiff’s ultimate goal is inconsequential because they can still file a complaint against you and you’ll still be required to hire a lawyer to file a legal defense to a lawsuit that may be entirely frivolous.

As discussed in Chapter 1 and Chapter 9, if you fail to act and/or are not successful in defending a lawsuit, you may well end up with a large judgment (filed of record against you) that may be enforced for 20 years in many jurisdictions.

A creditor may also be a bank, business partner or individual who loaned you money or entered into another kind of business deal with you. Promissory notes and mortgages are usually drafted heavily in favor of the lender creditor, and any kind of legal dispute

will be extremely expensive. I have observed many clients in deep legal "doo doo" as a result of going through financial straits or other business deals gone bad.
There are two creditors that warrant a special category that I define as "super-creditors." The super-creditors earn this definition because they pack an extra punch due to their unique position to get your assets under the current laws. The super-creditors are a spouse in a divorce and the IRS. The latter, IRS, is somewhat self-explanatory because, as a federal entity, the ability of the IRS to pursue assets is somewhat unlimited when compared to your "non-super" creditors, including the ability to place liens upon homestead property. Spouses in a divorce are also super creditors because divorce actions require full disclosure of all assets and the spouse generally is entitled to ½ of all the marital assets depending on the local laws.

When any type of creditor obtains a judgment, they record it in your county of local residence and can then seek to "attach" the judgment to your assets in the jurisdiction. Further, this judgment can then be filed in other jurisdictions where other assets are located, and this can lead to liens being attached to assets and forced sales to pay the judgments. Judgments can also lead to wage garnishments and other unpleasant circumstances.

It is important to understand that asset protection law is not about "hiding assets" from the IRS or anyone else or about being sneaky in defrauding creditors. On the contrary, asset protection is about identifying the strategies available under applicable laws that allow for the maximum protection of your assets in the event a plaintiff or other party brings a legal action against you.

So, considering what judgment creditors can do to try to get your assets, and remember that assets are defined as our stuff that is either income-producing or appreciating, the next question becomes how to utilize the most effective strategies available in order to protect these assets.

That is the **goal** of this chapter—to give you a working definition of asset protection and the strategies available, so you can become empowered to consider and implement the available strategies that may be appropriate for your specific circumstances.

By the time we're through here, you'll also be informed of your options and will also understand why it may be too late to protect your assets from certain active creditors due to what is called "fraudulent transfer laws." With this new empowerment, you can avoid this common asset protection error as demonstrated by this brief, true-to-life excerpt.

Oops, I'd better meet with an attorney…

Client Bob: Hello, I was wondering if I might schedule a time with you to discuss asset protection.

Attorney: We do advise folks about asset protection strategies, Bob. Can I ask if you're in the middle of any active legal disputes?

Client Bob: Well, uh, there may be a situation, so I should do something.

Attorney: (Red Flag #1) Bob, this conversation is protected by attorney-client confidentiality, so what kind of situation?

Client Bob: I had a business partner and … well, uh, he's alleging that I did not comply with our contract.

Attorney: (Red Flag #2) What kind of contract, Bob?

Client Bob: I was selling him some business equipment, and he's alleging I didn't provide what I said I would.

Attorney: Okay, has he filed a lawsuit?

Client Bob: I believe so…

Attorney: So there is an active lawsuit?

Client Bob: Yes.

Attorney: Bob, let's talk about the contract and your other assets? Did you sign the contract in your own name or as a business entity such as an LLC or corporation?

Client Bob: I signed it personally.

Attorney: (Red Flag #3). So how about your assets? Are they in other LLCs or Corporations … perhaps protected accounts?

Client Bob: Um … that's why I called… They are mostly in my own name…

Attorney: Welcome to the perfect storm, Bob. Now is the time to manage that lawsuit. You'll need to locate your "unprotected" checkbook and have it handy when you come over.

> The dialogue above is an example of a scenario that I've experienced on numerous occasions and one that you will want to avoid at all costs. To avoid this situation, you need to create an asset protection strategy while things are good and the sun is shining. In a best-case scenario, being proactive is about

taking protective measures before entering into any business contracts, loan agreements, real estate transactions or landlord-tenant agreements, or any other liability producing ventures.

Types of Lawsuits

1. Plaintiffs' lawsuits
2. Divorce lawsuits
3. IRS Tax actions
4. Business lawsuits
5. Real estate/landlord tenant lawsuits
6. Creditor/loan repayment lawsuits

Rather than addressing these 6 liability types individually, the strategies to be discussed should cover them all with some additional recommendations concerning our super-creditors, the IRS and the aggrieved spouse in a divorce action.

The options/strategies that are available for protection of various types of assets are:

1. Homestead or personal residence protection
2. Annuities and life insurance
3. Qualified accounts (IRAs, 401ks, and 403bs) and wage accounts
4. Domestic business entities (LLCs, corporations and limited partnerships)
5. Marital agreements (pre-nuptial and post-nuptial)
6. Domestic trusts (revocable (living), DAPTs, land trusts, other irrevocable trusts)
7. Offshore trusts and offshore business entities

So, for YOUR strategic asset protection plan, options 1 – 7 from the strategies above move from the most common options for average folks at number 1 to the most expensive and least common approach at number 7. While the above are protected classes of assets, there are some classes of assets that offer little or no protection, which are:

1. Checking accounts, savings accounts and CDs
2. Non-qualified investment accounts (mutual funds or trading accounts)
3. Real property held in an individual's name (not a personal residence)
4. Business owned as sole proprietorship or general partnership
5. Personal property held in individual's name

Personal Residence Protection

Whether a protection of one's family residence is available depends on the state's laws and the amount of protection that is allowed. It is important not to confuse the homestead tax exemption from the exemption that is applicable for asset protection

purposes both under the state laws as well as the federal bankruptcy laws in that state. For example, on the "max protection" end of the spectrum, the state of Florida offers 100% protection against the forced sale of a home. The homestead protection is guaranteed under Article X, Section IV of the Florida Constitution and it covers 100% of the real property value of up to 160 contiguous acres in any county in Florida or up to ½ acre in a municipality. The state of Texas offers even greater protection of 10 urban acres and 200 rural acres, and this protection is strictly enforced by the state courts. On the "minimal protection" end of the spectrum, the state of Virginia only allows real property owners to exempt $5000 of the value plus $500 for each dependent or a maximum of $10,000 per married couple.

Many states offering an "in between level" of protection allow approximately $70 - $170,000 of homestead real property value to be claimed as exempt from creditors in a state action or bankruptcy proceeding.

So, the effectiveness of this strategy will be largely based upon your local state's laws, or you might consider relocating your residence to Texas or Florida. Another important point is that there are exceptions to homestead protection that generally include actions concerning the default of your mortgage because the mortgage may be enforced by a security interest in the home, as well as homeowners' association actions for the community in which the homestead is located. Other exceptions may include IRS tax liens and, of course, divorce actions by a spouse (our super-creditors), both of which may be imposed on a homestead.

Annuities and Life Insurance

An annuity is a financial product created by the insurance industry that provides a rate of income at a contractually agreed rate. Annuities can be either immediate or deferred, and the cash value is protected under most state statutes with the amount of protection varying based upon the state laws. Annuities and Life Insurance are opposite sides of the same coin. Whereas an annuity provides a benefit during the policyholder's lifetime, typically life insurance is purchased primarily for the death benefit to be available for the policy holder's beneficiaries. So, if somebody dies, the insurance company pays out on life insurance but saves on the annuity and vice versa and in this way the insurance company is hedging.

So, the state asset protection laws are in place to offer some protection to the policyholder and the beneficiaries from creditor actions, most likely because, to allow creditors to access insurance products would be bad policy, no pun intended.
There are limits to the protections offered for life insurance in the same way that homestead protection may be limited. Life insurance protection may also vary depending on whether the policy is "mature" or "unmatured". Here again, the strictest protection for annuities and life insurance is found in Texas, which essentially offers total protection for these policies. In Florida and a number of other states, the protection is available if the proceeds are for the benefit of another and not used for the insured. In California, only up to $9,700 for an individual or $19,400 for a married couple is exempt for "unmatured policies" or for a "matured policy" whatever amount is needed to support the judgment debtor, spouse and dependents."

Once again, the effectiveness of this kind of planning depends on the state laws, giving the nod to Texas. It is also important to consider whether your policy is matured and for the benefit of only you or primarily for your beneficiaries.

Qualified Accounts

In many states, investment accounts that receive special income treatment by the IRS also receive asset protection under the state laws. These accounts generally are for retirement purposes and tax deferred and are thus called qualified plans or qualified retirement plans or qualified accounts. Qualified accounts that are exempt under state laws from creditor attachment include IRAs, Roth IRAs, and Keogh plans (tax deferred pension plan geared to self-employed individuals). There are varying rules that apply to the exemption of these accounts similar to the varying state laws pertaining to homestead protection. These accounts are generally protected because the IRS is interested in preserving these accounts for future taxation and the protection often applies in both the bankruptcy court (federal) as well as the state's courts. Some states only protect qualified accounts that are not for the benefit of the debtor, whereas other states do not impose this condition.

Domestic Business Entities

Whereas the rules concerning homestead protection and qualified accounts are somewhat "cut and dry" it gets a bit more interesting in the following sections because contractual language may be used to "enhance" your asset protection.

When we're talking about "domestic business entities", for our purposes here, we're talking about entities that are based in the United States versus another asset protection jurisdiction like the Cayman Islands or Nevis. I make this distinction because states often refer to a "foreign" entity as an entity filed in another state. So, keeping it simple, a foreign entity is from out of the U.S.A. for purposes of this discussion. When we're talking about "entities", we're talking about business formation, which is a document filed with a particular state's secretary of state that creates a new "legal person" or "entity" that is separate from you.

Common types of business entities are limited liability companies, corporations, and limited partnerships and sometimes the various entities are multi-layered or combined. The last section of this chapter will address foreign entities as well as foreign trusts, but these are reserved because, in my opinion, they may only be appropriate for the largest of estates due to the expense and relative cost-benefit. Domestic entities and domestic asset protection trusts (DAPTs), to be discussed in the next section, may be considered a more mainstream level of protection than offshore trusts.

Limited Liability Companies

A limited liability company (LLC) is perhaps the most flexible and accessible way to provide asset protection for "non-qualified" assets or assets not covered by one of the above strategies. Every state offers the ability to create an LLC in that state, and the process is essentially the same in every state, and that is to file articles of organization with the secretary of that state. The articles will specify some variation of who the initial "members" and "managers" are and who the "registered agent" is. The short primer on LLCs is that the members are similar to the shareholders of a corporation, and the managers are similar to the officers.

Generally, when operating an LLC, one should not confuse the terminology with that of a corporation, to be discussed, although some jurisdictions allow the appointment of a president and secretary of an LLC. An LLC can typically be "member managed" or "manager managed" and this choice depends on whether a "non-member manager" is a possibility. Many family LLCs are member managed because only members will be managers and often everyone gets a vote.

Although most people think of LLCs as used for operating a business or investment real estate, LLCs can also be used for holding other assets like art, antiques, boats, stocks, and bonds. Therefore, many states have endeavored to create a body of asset protection laws that favor LLC protection, and thus serve to protect the LLC membership owners. This concept means that the assets that are owned by the LLC would also be protected from creditors.

At present, some of the best states to have LLCs (just as a guide for your own research) are Wyoming, South Dakota, Delaware, and Alaska. These four states have various strong points and there are other favorable jurisdictions, so this could be the subject of debate among asset protection attorneys.

More important than the ever-evolving options available in asset protection states are the general reasons why these states are favorable. I do not recommend a particular jurisdiction because doing so involves a complex set of considerations and a full understanding the unique circumstances of the individual. However, if you understand why some states may be more favorable, you can do your own "empowered" research.

Charging Order Protection

So, what makes Wyoming, for example, a good LLC asset protection jurisdiction? Understanding this concept also brings the need to understand some basic LLC terminology.

First, there is a difference between what I define as "inside liability" and "outside liability". So, if someone has a grievance with your business, they will be legally compelled to take action against your corporation and not you personally. When someone associated with your business sues your business, I call this **inside** liability. When a personal creditor who is unrelated to your business sues your business in order to levy upon your business assets, I call this **outside** liability. LLCs are advantageous for both "inside liability" and "outside liability" due to what we call "charging order protection".

Charging order protection for LLCs is embodied in a state's laws. Charging order protection is like garnishment order protection for businesses. Garnishment is when a creditor wants to take a portion of your wages to satisfy a judgment, and most states

limit how much they can take. Charging order protection means that if a creditor obtains a judgment against you personally, they cannot place a lien on your LLC membership interest, but rather, they must be satisfied with a charging order.
The Charging order simply states that the creditor is allowed to receive income being paid from the LLC to the member. However, a meeting of the members can result in a decision that no income will be paid to that member, and the creditor is essentially out of luck at that point.

Most states offer charging order protection for LLCs and yet the key is the state's history of backing up the protection. In a state like Wyoming, there is a long history if enforcing the sanctity of the LLC and upholding the charging order protection against creditors even if the LLC only has one member (single member LLCs). In weaker jurisdictions, the courts may have allowed single member LLCs to be invaded by creditors, as in Florida, so this reduces confidence in the asset protection favorability of that state.
In addition to charging order protection, an effective LLC should also have an operating agreement because this document can say whether a creditor is intended to have any rights at all.

<u>The Danger of DIY LLCs</u>
Most folks who file a DIY ("do it yourself") LLC on line do not understand the importance of the **Operating Agreement**, and this is where an asset protection attorney earns his big bucks. The operating agreement is also like a partnership agreement in that it determines the obligations of the various members, and I highly recommend that any partnership includes an LLC with a well-prepared operating agreement, having personally observed a fair amount of partnership fallout during my legal tenure.
LLCs have been touted in recent years as a great option for business asset protection due to the ease of setup and the flexibility they offer. LLCs are much more flexible than corporations because the relationship between the members can all be determined by contract just like a partnership and yet the liability protection of the members is much higher than in a partnership.

<u>General Partnership Alert</u>
You need to know that a general partnership will make you 100% liable for the actions of your partner and expose your personal assets to the creditors of your partnership even if you partner acts without your authorization. LLCs address this problem because

your liability for your partner's business decisions only extends to your assets held by the LLC in most cases. LLCs are also very flexible for income tax filing purposes because they can be treated either as a sole proprietorship, partnership or S Corporation. All of the above is to say that there is an array of advantages to using a properly formed LLC, which includes a solid operating agreement, for asset protection and business protection purposes.

I would be remiss if I did not add that you need to follow all business formalities if you're operating your own LLC or you need to pay someone to help you do it. Formalities include filing initial organizational meeting minutes and thereafter filing annual meeting minutes every year. You should keep an LLC book and document business changes, especially significant changes such as the addition of a new member. Good LLC planning also relates back to our discussion at the end of Chapter 2 on business succession planning, because you need to decide what will happen to the LLC upon the disability or death of a member.

Corporations

A corporation may be described as a "more established" and "more formal" older brother to the LLC. A corporation is filed similarly to an LLC. Articles of incorporation are filed with the secretary of state in the state of incorporation in order to form a legal "person" or entity. Every state provides for the filing of corporations as it is an important incentive for local businesses as well as an important revenue stream.

For more traditional or larger organizations, a corporation offers the most advantages due to the tax laws and the ability to sell securities, go public, etc. The downside is that, in many jurisdictions, the corporation is also easier for creditors to attack because corporate stock has traditionally been subject to judgment liens and creditors have historically been able to force the sale of corporate stock in order to satisfy judgments. However, in some states, like Florida, the state legislature has undertaken efforts to update corporate laws in order to provide more asset protection for corporations akin to the charging order protection discussed above for LLCs.

Adding "charging order type protection" for corporations in order to make corporations more like LLCs from an asset protection standpoint appears to be a trend in state law changes. Even if your state laws have not updated the asset protection benefits

available to corporations, there is still asset protection for corporations because it is a separate legal entity, and not the individual shareholder, who is engaging in the business of the corporation.

Referring to our earlier definition of "inside liability" versus "outside liability", asset protection for corporations is solid for inside liability and perhaps "not so solid" for outside liability protection in many jurisdictions. LLCs have traditionally been more effective for outside liability protection due to the charging order protection discussed earlier in this chapter, and thus, if a 3rd party who is unrelated to the business sues an LLC, they cannot place a lien upon and force a sale of the membership interest. That same 3rd party may be able to place a lien and force a sale on corporate stock due to the lack of charging order protection for corporations. It is important to check your state's laws to determine if your corporate laws have been updated to provide this protection from 3rd party lawsuits.

In any event, it is important to consider your business objectives as well as the asset protection benefits when deciding what entity will best serve your business or will best protect your investment assets.

Limited Partnerships

The limited partnership (LP) is well known in real estate investor circles because it allows one person to control the partnership (the general partner) and other partners to contribute funds and participate in profits (the limited partners). Traditionally, this structure has also placed all of the liability of the general partner for decisions made and actions taken on behalf of the partnership.

A limited partnership is filed in the state of organization, similar to LLCs and corporations, by filing a certificate of limited partnership. The partnership may be governed by a limited partnership agreement in the same way that an operating agreement is utilized for an LLC. (The LP was very popular in the 1980s when tax sheltered investments were extremely popular, but all of this changed when President Reagan ushered in changes to the U.S. tax code.)

The current trend is to use LLCs instead of limited partnerships because (1) a controlling partner doesn't need to assume unlimited liability and (2) all of the other purposes of a

limited partnership may be accomplished with an LLC by allocating different "classes" of membership interest in the LLC. In addition, LLCs are often much less expensive to file than a limited partnership.

Marital Agreements (Pre and Post Nuptial)

Marital agreements are an important asset protection strategy that is not often considered and yet is critical because an aggrieved spouse is one of the two "super-creditors" mentioned above. A marital agreement is an asset protection strategy because, as in the case of all other strategies discussed, it is a way to allocate the risk of marital fallout before any issues arise. Ideally, any marital agreement should be implemented at the inception of a marriage or shortly thereafter. You've heard the terms, but it should be explained that a pre-nuptial agreement is signed prior to the marriage whereas a post-nuptial is signed after the marriage.

In my humble opinion and my experience as a lawyer, for any marital agreement to be enforceable, a few general facts must exist, which are:

1. Full disclosure of all assets by both spouses and a full financial statement attached to the agreement.
2. Independent review by two attorneys (from different firms) who represent each of the spouses respectively.
3. No evidence that the agreement was obtained by duress.

Don't let this happen to you…

Tammy: (at the altar in front of the priest, husband to be, Tom, rushing up to join her) "Where were you! You're late, and everyone was worried!"

Tom: "I had to make a stop at my attorney's office."

Tammy: "Is that stack of paper in your hands related?"

Tom: "Um, yes actually… I thought we could just sign these deal quick… Shirley, over there is a notary" (she catches his eye and waves back from aisle 3).

Tammy: "What the … expletive … Tom! It would have been nice to know about this ahead of time."

Tom: "Yeah, I know, uh, can you just sign them?"

Tammy: "No way, Buster. Have you lost your mind? All of our guests are here … everything's paid for! You're crazy!"

Tom: "Well, I just can't get married until they're signed. You understand, right?"

This exchange would be an example of duress, and of course it doesn't work from a legal standpoint. The idea is that both parties must have a chance to deliberate, seek the advice of counsel and confirm the consequences of signing any marital agreement. The requirements of full disclosure and observance of legal formalities surrounding marital agreements are for a good reason.

Once signed, these agreements do not have a shelf life and would arguably impact a divorce after a 30-year marriage. The other thing to know is that a spouse who signs a nuptial agreement may be waiving substantial financial rights such as ½ the marital home if owned prior to marriage or rights to investment accounts, alimony, etc. For the above reasons, a marital agreement can be a highly effective and important asset protection strategy, especially, where family fortunes and short-term marriages are involved.

Asset Protection Trusts

In Ch. 3 of this guide, we will discuss revocable living trusts (AKA inter vivos trusts) in detail and will consider the ramifications that living trusts are not "asset protected" for the trustmaker/s by virtue of the fact that they are revocable.

It is important to remember that, although there is no asset protection from creditors for the trustmakers of a revocable living trust, the revocable living trusts can and often do provide protection for **beneficiaries** upon the death of the last surviving trustmaker because the revocable living trust becomes "vested" and irrevocable upon the death of the trustmaker(s).

There is another genre of trusts that are "irrevocable" when they are established, and thus they offer asset protection (from creditors) for the trustmaker during his/her lifetime.

Types of Irrevocable Trusts

1. Domestic asset protection trusts
2. Foreign or offshore asset protection trusts
3. Wealth replacement trusts or irrevocable life insurance trusts (ILITs)
4. Grantor retained interest trusts (GRATs and GRUTS)
5. Charitable trusts (CRTs and CLTs)
6. Land trusts

The thing to know about the irrevocable trusts in the above list is that they are all intended for different purposes. This is advanced planning that requires the assistance of an experienced attorney and expert in this area, so I will cover highlights and distinctions between them so that you will be empowered to guide your hired expert in your decision making.

Domestic Asset Protection Trusts

So, diving right in, domestic asset protection trusts are a product of a state's laws that are offered in certain favorable jurisdictions. Delaware and Alaska are two states that make it a priority to maintain favorable asset protection laws as are South Dakota, Nevada, Wyoming and some other jurisdictions.

Domestic Asset Protection Trusts are set up for the express purpose of asset protection. The idea behind this type of trust is that if a creditor obtains a judgment against the trustmaker, the assets in the trust are not reachable due to the trust protection and duty of the trustee to protect the trust assets. An irrevocable trust is a separate legal entity, with a separate tax ID number, and thus it is designed to be beyond the reach of creditors. Unlike a revocable living trust, the trustmaker of a domestic asset protection trust cannot amend or revoke this trust, absent very specific circumstances, and this lack of control is the primary disadvantage of this type of trust.

It is important to know that, although these trusts are, by definition, irrevocable, and cannot be amended or terminated, the trustmaker generally keeps a certain amount of permissible control such as the ability to remove and replace the trustee, or to appoint a trust protector who can amend the trust. There is always a great amount of debate (among lawyers…they like to do that) about whether the use of a domestic asset protection trust is a solid strategy.

You need to know that these types of trusts are still within the jurisdiction of all U.S. Courts and, under the "full faith and credit clause" of the U.S. Constitution, the states are bound to essentially cooperate. You can also be held in contempt of court for refusal to release assets in the face of a court order. So, essentially, it's always up to the Judge and whether he or she is willing to apply the laws of that asset protection state (let's say Delaware) to the dispute at hand which may be occurring in Florida or Ohio.

Foreign or "Offshore" Trusts

A Foreign or "Offshore" Trust is similar to a domestic asset protection trust, with the distinction that it is administered in another country; usually one with laws protecting the secrecy and autonomy of trusts and not beholden to the U.S. government. Examples of offshore trust jurisdictions are Nevis, the Bahamas, Grand Cayman, and Lichtenstein … to name a few.

The economics of asset protection trusts (domestic and foreign) are such that you need some serious liquidity (lots of money) to make it worthwhile. A domestic asset protection trust is expensive because you need to fund the trust and pay a local trustee. So, figure about a million dollars "liquid" to justify this strategy. Foreign asset protection trusts are much more expensive to set up and maintain. If you're in this group, you already know it without me elaborating further. I hear the weather is nice in Nevis.

One key to remember is that, even if your assets are in an offshore asset protection trust, you can be held in contempt of court in the USA upon refusal to surrender assets even if the foreign government refuses to do so. For this reason, offshore asset protection trusts are not effective for the purpose of hiding assets or evading taxes but can be highly effective in building a wall of protection against the attack of other creditors.

Other Types of Irrevocable Trusts

Wealth replacement trusts a/k/a irrevocable life insurance trusts (ILITs), GRATs, GRUTs, and Charitable Trusts are irrevocable trusts that are often utilized more for tax planning than simple asset protection; however, these types of trusts are irrevocable and thus offer asset protection benefits.

Land Trusts

Land trusts actually may be revocable or irrevocable (depending upon goals and preference) are a unique asset protection strategy that, as of this writing and to the best of this author's knowledge, are available in Illinois, Florida, Texas, Arizona, Virginia, Ohio, Indiana, North Dakota and (possibly) California.

Land trusts essentially convert "real property interest" into a "personal property interest" by virtue of a contract between the land trustee and the trust beneficiary. The

beneficiary of a land trust may be an individual or an entity such as an LLC. The idea behind a land trust is that the creditor may, once again, not reach an asset because it is in the hands of the trustee and the beneficiary has no immediate interest to record a lien upon or otherwise attach. According to Florida law, this land trust contract creates an "executory contract" in favor of the land trust beneficiary that serves as a protective barrier against predatory creditors.

After this broad overview, my hope is that you understand the key concepts necessary to explore your own asset protection needs and formulate a plan that makes sense. I encourage you to seek professional legal counsel for this endeavor due to the complexity and importance of this area.

Asset Protection Chapter Summary

Don't enter into a contract that plays nice because this creates unnecessary liability.

Assets are defined as anything you own that hopefully is appreciating and may be defined as income producing and non-income producing.

Types of liability we are trying to protect against are plaintiffs' lawsuits, divorce lawsuits, IRS tax actions, business lawsuits, real estate/landlord-tenant lawsuits, and lender/loan repayment lawsuits.

There are various options/strategies that offer protection of various types of assets. Homestead protection or "protection of your family home" varies from state to state but usually, some portion of the home is protected.

Annuities and life insurance are generally at least partially protected, and the amount of protection varies widely from state to state.

Qualified accounts (IRAs, 401ks, and 403bs) and wage accounts offer asset protection. Domestic business entities (LLCs, corporations and limited partnerships) can create a shield against personal liability from "inside creditors" and can also shield business assets from the third party "outside creditors".

Marital agreements (pre-nuptial and post-nuptial) are an important asset protection consideration that must be executed with the proper formalities.

Domestic asset protection trusts can offer asset protection benefits that must be weighed against the loss of control over assets and the expense of establishment and maintenance.

Offshore trusts and offshore business entities can be effective in protecting assets with certain limitations, such as contempt of court, and the benefits should be weighed against the expense and risk of operating in foreign jurisdictions.

Other types of tax strategies such as ILITs, GRATs, GRUTS, ILITS and charitable trusts may offer asset protection while providing certain tax advantages.

Land trusts may be revocable or irrevocable and offer significant asset protection benefits but only operate in certain jurisdictions.

Chapter 3. Estate Planning Essentials

"Now read me the part again where I disinherit everybody."

New Yorker Cartoon by Peter Amo (1940)

Remember that "**risk of death**" thing that we mentioned in Ch. 1 of this guide? Well, estate planning is all about taking steps to plan for that risk, in the best interest of your loved ones, your business and your legacy. This is also about planning for disability and care during your elderly years.

The Estate Planning Conundrum

Somewhere between 50% and 80% of people (which varies depending upon demographics) do not have a simple will, and a whopping estimated 92% of persons under age 35 do not have this simple document. Yet we do know that everybody dies at some point. Sorry to break the news.

Denial of important life decisions often leads families down a perilous road and I've observed the impact on families firsthand. Those experiences inspired me to teach regularly on estate planning. Thus, the goal of this chapter is to offer the basic principles that you need to know in order to manage your estate planning.

I am told that among the top reasons for neglecting to prepare a simple will is the belief that it is not necessary (mostly men) or it costs too much (mostly women). Other reasons include that it is too time-consuming or believe that the surviving spouse will receive all the assets anyway and these beliefs are generally false.

Let's face it; most people would rather work on their taxes or get a root canal than work on their estate planning. I would add that this national "hang up" also has a lot to do with grappling with one's mortality. The burgeoning knowledge of the need for estate planning coupled with the lack of motivation to take this seriously has allowed huge "on

line form" websites to succeed in peddling inadequate documents as quick and easy solutions. If you've started down that road, I encourage you to **read the disclaimer** on these websites because the loved ones are always left to pick up the pieces of a disorganized or incomplete DIY estate plan.

What do you need to know in order to make better than average decisions? In the pages that follow, you'll receive an overview of the basic "life events" related to estate planning as well as the big 3 standard estate planning documents and how they work together. You will also learn enough to navigate the basics as well as what questions are important to ask.

After the basics, we'll explore the area of trust planning, starting with the general concepts and moving more specifically into what you need to know. Whether you've heard the buzz about living trusts or revocable trusts, I will describe this document's purpose, how it works, and the pros and cons.

With all of this established, we'll wade cautiously, putting our toes in the water of some more advanced planning issues just to offer a basic understanding and road map. I will also touch on the concept of business succession planning for those of you with business ventures and this includes real estate investment companies. Don't worry; my goal is not to offer you yet another attorney's treatise on these areas. Remember this is just us chatting about concepts and estate planning truths enough to allow you to begin to navigate these more advanced areas with some ideas and direction.

The first question is "Why does all of this matter?" I pose this common question based on many experiences with clients who have told me, "I'll be dead anyway". While I acknowledge the simple truth of this statement, I would also contend that most people do not, at least consciously, want to be remembered by loved ones as disorganized, selfish or reckless.

Common Estate Planning Myths

Myth 1 - Having good estate planning documents will only complicate things. **Answer** - it is already complicated and good documents simplify things.

Myth 2 - Doing my estate planning might cause my death. **Answer** – silly and paranoid thinking.

Myth 3 – Its easier if just put my adult child's names on everything. **Answer** – this is often a reckless and irreversible strategy that could destroy the estate.

Myth 4 - My advisor, accountant, or friends can help me. **Answer** – high risk comparable to having your non-mechanic neighbor repair your Audi.

Myth 5 - Legal form providers will help me figure it out. **Answer** – not recommended because these are "self-help" providers who have no duty or motivation to represent you.

There are other myths of course and those are just some of the most prevalent that I've observed over the years. The point of that exercise is that you cannot make assumptions because they tend to be bad, and you need to educate yourself! We still need to answer the question of why it matters because there is the fateful (no pun intended) "I'll be dead anyway argument".

Why Estate Planning Matters

As a lawyer who has handled many estate matters over the years, I can tell you that it all matters because when a "life event" happens such as the death of a family member, the other family members are often thrown into some level of disarray due to grief and the temporary destabilization of the family unit. During this difficult time, there are many financial decisions that need to be made and the situation often becomes very confusing.

The era of electronic records has made this even more complicated because families may not know how to access the deceased person's records. The legal backdrop of all of this is that people do not have the legal authority to act for one another or receive inherited assets immediately just because they're family. Quite the contrary, the law assumes that each individual has legal authority only over themselves, and assets that are not designated to transfer automatically must go through a court process called probate in order to be passed to the heirs or beneficiaries.

If a last will and testament (hereafter referred to as "last will") has been validly prepared, the court will have some guidance in the process of passing assets to heirs. Remember the statistics? Having no Last Will means no guidance for the court, and this means that the court will fall back on the state probate statutes. The state statutes are essentially the government's predetermined estate plan and usually result in splitting up the estate between some variation of spouse, kids or other blood relatives. However, what many don't know is that the probate fees may be increased due to how "screwed up" the estate is. This issue will be addressed more in the pages that follow. The family members who are to be empowered to make decisions also involves an important decision, and the failure to designate these responsibilities regularly leads to family disputes. Finally, the "all-important" question of "who gets what?" is impossible to answer, at least initially, without a last will.

So we've established that there is a rational basis to do some estate planning and that it is advisable to have a last will. A common assumption that follows is that a last will is all that is needed. Time to dispel some more common myths…

Although a last will is an important document, for all of the reasons mentioned above, its role is limited to how assets are distributed upon death and 2 other estate-planning documents are needed at a minimum to make all of this stuff work. A recent "on line" estate plan that I reviewed for a new client included 2 wills and nothing else, and the estate was over $3,000,000 and this scenario would have spelled disaster for the loved ones and the estate itself.

The Big 3 Estate Planning Documents

For any size estate, the key "big 3" estate planning documents are:

1. Durable Power of Attorney
2. Advance Healthcare Directive
3. Last Will and Testament

The big 3 estate documents are important because they address different situations or "life events". The 3 important life events are:

1. Disability
2. Incapacity
3. Death

Disability and Durable Powers of Attorney

No one likes to think about disability. We all want to be self-sufficient and yet we are also human, and none of us is invulnerable. In my life, I have witnessed people who were "larger than life" brought to a very vulnerable place of dependency due to an accident or illness. At some point, we may find ourselves in a situation where we need help.

Disability may be something as simple as decreased spinal mobility leading to difficulty in continuing to work. Of course, much more serious conditions can occur, and when a life event happens, it is important to have the proper documents in place to protect you and to maintain a sense of order among loved ones. There are also different kinds of disabilities, which are either mental or physical, or there may be a combination thereof. If you become disabled, your financial concerns do not just stop. Your bills still need to be paid, and your business needs to continue to operate if you are a business owner. Your banking will need to be managed, and any other ongoing financial matters will need to continue as efficiently as possible.

A power of attorney is expressly for the purpose of allowing another person to conduct business on your behalf. Remember, your loved ones do not have the authority to step in for you just because they are family. In fact, banks and other financial providers tend to be especially paranoid about family members seeking to meddle with another family member's business affairs.

With that in mind, there are many different kinds of powers of attorney. For example, **special powers of attorney** are used for a specific purpose such as purchasing real property. So, for example, you could give someone this special power to purchase real property in Idaho if you live in New York and cannot be present for certain transactions. Similarly, you might empower a business associate to make certain business decisions for a limited purpose in your absence. What you need to know is that none of these special powers of attorney will be effective if you suddenly become disabled. In the event of disability, all powers of attorney will become ineffective except one distinguished document and that is the **durable power of attorney.** The "durability" of this document causes it to survive disability, and this is fundamental to estate planning. For this reason, regardless of how many powers of attorney you've granted, you need to have a durable power of attorney with specific individuals who are designated to act on your behalf in the event that you become disabled.

Makes sense, doesn't it? This is an extremely important document because you're empowering your most trusted family member or members to step in and take care of your business concerns if you become disabled. This is an essential component to your estate plan and one of the big 3 life events, as we've discussed, and it's worth noting that whomever you designate should be trustworthy and capable of performing these kinds of functions. If you're starting to think about whom you would designate, this section is having the intended impact.

Advance Healthcare Directives and Incapacity

There are a few terms used to describe the advance healthcare directive, two of which are medical directive and advance directive or any combination therewith (i.e. advance medical directive). This is a document often included with other medical documents such as a living will and a designation of healthcare surrogate. Other names for these two documents are a do not resuscitate or medical power of attorney. What you need to know is that you need these two medical documents to make up your advance healthcare directive to cover yourself and your family. I also recommend that folks have a number of HIPAA release documents. HIPAA documents have risen to "front and center" status in the world of medical estate planning documents because they allow family members access to medical records. Hospitals and doctors have become extremely cautious due to the strict privacy laws in force today under HIPAA, and this issue will be discussed in greater detail to follow.

Several years ago, the Terry Shiavo case made national headlines. The gist of the case was that a woman, Theresa Marie Shiavo, was in a coma or a "persistent vegetative state" for many years. An interfamily dispute ensued between Ms. Shiavo's husband (and legal guardian), named Michael Shiavo, and Ms. Shiavo's biological family. The Shiavo family advocated that Ms. Shiavo was responsive and desired to be kept alive by the feeding tube as life support, whereas Michael Shiavo contended that she would not have wanted to remain kept alive in this situation. Ms. Shiavo's diagnosis and the fact that she had no "living will" were key factors in this protracted legal battle that lasted for almost **fifteen years**.

The Shiavo case prompted the involvement of Florida's legislature and even Governor Jeb Bush, and in the end, it was concluded that Ms. Shiavo would have wished to be "allowed to die" in these circumstances. Thereafter, the Florida legislature expanded

the prognosis in which one can designate that life-supporting treatment may be denied to include a "persistent vegetative state," "irreversible end-stage condition" and a "terminal condition." The Shiavo case prompted national action and illustrated how important it is to make these kinds of decisions in advance when we have the ability to do so.

Whereas the Shiavo case example concerns the "living will" component of the advance medical directive, there is also the designation of healthcare surrogate (or healthcare power of attorney). This document is simply to designate the person (or persons) who is empowered to enforce your medical wishes as expressed in your living will. The health care surrogate role functions very much like the durable power of attorney with the distinction that the former is concerned with medical decisions, and the latter is concerned with business and financial decisions. The two different roles specified in these two documents may be filled by the same or different people.

Last Will & Testament and Death

> "I Elvis A. Presley, a resident and citizen of Shelby County Tennessee, being of sound mind and disposing memory, do hereby make, publish and declare this instrument to be my last will and testament, hereby revoking any and all wills and codicils by me at any time heretofore made."

The last will is the stuff of high drama. This is the most formal and most recognized of the "big 3" estate documents because it is the one that usually makes headlines, notwithstanding the Shiavo case. When somebody important dies, the first questions are often did they have a will and what did it say or who got all the money? These are not unreasonable questions because the last will becomes public record as soon as a probate is filed.

The last will is what is called a "testamentary document," which means that it provides for a distribution of assets upon death. Because of this, the **formalities** for the last will are often stricter than other documents. By formalities, I mean the requirements for signing it that make it a valid and enforceable document. The formalities of a last will serve 4 main purposes, which are:

1. Evidence that the document is the testator's last will and testament
2. Ritual alerting the testator that it is important and should be carefully considered
3. Prevention of fraud
4. Influencing the testator to consult an attorney to prepare it due to the possibility of errors

In addition to formalities, the body of the last will must be well drafted so that it clearly identifies who gets which assets and if there are any special distributions, which are often called bequests. The formalities required for attestation of wills are dictated by the state's probate laws or its "Statute of Wills" and tend to be mysterious because to an extent they are woven into the state's particular legal traditions and customs and thus either a more or less formal approach may be adopted by that state's laws.
The provisions of the last will are also important because a well-drafted document will address a few important items such as the process for payment of estate expenses, naming who the executor is and, of course, who is to receive the estate assets.

When talking about the estate, there are a few important terms to know which include a "special bequest," a "general bequest" and the "residuary" or "residual estate." A provision to address the distribution of personal property is also important. Finally, there are specific types of wills to be aware of, which include a "pour over will", holographic will, and a Medicaid will. A will can also include a testamentary trust. I will discuss trust planning later in this chapter so for this section I will just identify what a testamentary trust is as it relates to a last will and how it functions when a will is administered.

Most wills are put through a legal process called a **probate**, which is a court proceeding in the county where the assets are located and is for the purposes of verifying the validity of the will and essentially signing off on the distribution of the assets.
This is why a last will must comply with the formalities so that the probate court will be able to admit it. The last will is like a set of instructions for the probate court judge, and this is why it must be clearly written. There are a few different types of probates as well, which are formal administration, summary administration, and ancillary administration. Confused yet? Well, let's make sense of all of this and discuss the formalities, key provisions, types of wills, and the probate process in more detail below.

The Formalities of Estate Planning Documents

The signing…

Attorney at Law: "Nice to see you, Ms. Smith."
Ms. Smith (name changed for confidentiality): "Likewise, glad we're getting this done."
Attorney at Law: "Before we get started, I need to ask you a few questions in front of the witnesses."

Ms. Smith: "Okay."
Attorney at Law: "Do you understand that you're here today to create a testamentary document that will provide for the distribution of your assets among your family members … your three children in equal shares?"
Ms. Smith: "Yes."
Attorney at Law: "Do you know who the current U.S. president is?"
Ms. Smith: "Well, I know who it is, but that doesn't mean I'm happy about it!"
Attorney at Law: (Concealing a smile and turning to the witnesses) "Are you guys satisfied that Ms. Smith has the capacity to sign her Last Will and other estate planning documents here today?"
(Witnesses smiling and nodding … yes … yes)

A properly executed last will have 3 fundamental parts, which are:

1. Body
2. Signing
3. Attestation

The formalities for our purposes generally concern the signing and attestation sections of the last will, and we're starting with the formalities because this is arguably the most important component. "Why?" you may ask. Because a beautifully drafted last will without the formalities having been observed will be disallowed by the probate judge and thus will not be worth the fine cotton paper that it's printed upon. Depending upon your state of residence, the formalities for signing and attesting the last will may vary. What is fairly consistent is that generally 2 witnesses and a registered notary public are required. You'll need to check your state laws to determine if the notary can and should serve as one of the witnesses.

You need to know that a few states require a formal approach in which all witnesses and the notary are in the same room, and the testator must observe the witnesses sign in the same room.

Other states follow a less formal approach, which is the modern trend called the "conscious presence test." With this approach, the witnesses may sign outside the room if the testator is simply conscious of their presence while they sign the will. There is also a "line of sight" test, which is slightly more stringent than the conscious presence test because the witnesses must sign the will in the testator's line of sight.

So it is very important to understand your state's statute of wills and the requirements for the signing and attestation of the last will. Many states now require that a last will either must or should be notarized, and this notary section is called a "self-proving affidavit." The self-proving affidavit will allow the last will to be admitted to the probate court without having to locate the witnesses, and this is important because the last will may be around for a long time and witnesses tend to disappear.

Key Provisions of Estate Planning Documents

There are certain key provisions that are typically found in the body of the last will itself. The document itself may "theoretically" include any provisions that the testator desires provided they are clear and pertain to the distribution of assets in order to be relevant. For our purposes, key provisions are those that would cause the last will to be incomplete and perhaps flawed if they were omitted. A summary of key provisions is as follows:

1. Identification of the testator
2. Identification of document as the last will and testament
3. Appointment of the executor
4. Distribution of personal property
5. Bequests – defined as special or general
6. Payment of estate expenses
7. Distribution of residuary estate

Both 1 and 2 above, Identification of the testator and Identification of document, are illustrated in the example above wherein Elvis is identifying himself as a citizen of Shelby County, TN, and the maker of his last will and testament. In #3 the appointment of executor is where the testator is appointing the individual to be responsible for "administering" the estate upon the testator's death. The executor is responsible for the "business" side of administering the estate and, depending upon the estate and state laws, they may need to hire a probate attorney to handle the probate administration.

Some states require that only attorneys can file probates while others allow limited exceptions to the rule in simple estate cases. An executor is responsible to the estate beneficiaries (heirs) and may be an heir also. A section in the last will for the distribution of personal property is also important, and many last wills simply state that the personal property may be distributed per a separate written memorandum. Actual

distributions of personal property may also be made directly in the last will using language like, “To Tommy, I give my authentic civil war era saber.”

Bequests are any distribution of property in the last will and may be either specific or general bequests depending upon the intent of the testator. If a gift is unique and the testator does not intend to give the value of the gift in the event that the gift disappeared, then a specific bequest would be used. In other words, if I were giving my 1969 Ferrari to my cousin Phil, as a specific bequest, and the car is not in my estate at death, the gift would be extinguished or “**adeemed**”. However, if that gift were a general bequest, the estate would be obligated to pay Phil the approximate value of the Ferrari from the remaining estate assets. Okay, I don’t have a 1969 Ferrari…
The payment of estate expenses is somewhat self-explanatory and concerns the creditors of the deceased testator (decedent).

Generally, when a will is admitted to probate, notice will be published in the local paper and will also be sent to all known creditors, and they have 90 days to file a claim against the estate. Where there are adequate assets, creditor claims may be paid from the estate.

The **residuary estate** is whatever is left over in the estate after all specific bequests, general bequests and personal property distributions, and all other debts have been paid out by the estate. A will should always designate who is to receive the residuary of the estate in some fashion whether that is “to my heirs in equal shares per stirpes” or “to my two children, Tommy, and June.”

Another important point about the last will document is that the state laws will dictate how assets are distributed among a number of beneficiaries if the will doesn’t do so. This is where terms like “per stirpes” and “per capita” or “per capita with representation” become important. These rules are simply ways to divide the estate if there are groups of children, grandchildren and perhaps great-grandchildren.

Per stirpes is the most traditional approach and essentially creates 1 share for each class of beneficiaries (children being one class, grandchildren being a second class and so on down the line). So, under a strict per stirpes approach, if Zeb dies unmarried with 3 children, Zach, Zena and Zoe, each child would receive a 1/3 share, and if Zoe

predeceased Zeb and left 2 children (Zeb's grandchildren), they would receive Zoe's 1/3 share to divide equally.

Using the same example but applying a **per capita approach**, Zach and Zena would each take an equal share in the estate and Zoe's children would be cut out of the estate because only the highest class shares in the distribution of the estate. Applying a per capita with representation approach would yield a similar result and allow Zoe's children to share Zoe's 1/3 share equally.

Where it gets more complicated is if all 3 of Zeb's children were to predecease him, and let's say Zach has 1 child, and Zena has 3 children, and Zoe has 2 children as per the example above. If this occurs, applying a strict per stirpes approach, the grandchildren would only be entitled to the 1/3 that their parents were entitled to and so Zach's child would inherit 1/3 and Zena's 3 children would share 1/3 as would Zoe's 2 children. With a per capita approach, all of the grandchildren would share an equal share in the estate so it would be divided equally into 6 shares. Applying a per capita with representation approach, the distinction is the result would be the same as per stirpes if only grandchildren survived, which would be an equal division of the estate. Applying a per capita with representation approach, if any of Zeb's children survived then that child would receive a 1/3 share, and the balance of the estate would be shared equally among the grandchildren.

A key distinction between a per capita approach and a strict per stirpes approach is that with a per capita approach all of the grandchildren are cut off if one of Zeb's children survives due to a member of a higher class having survived. Another key distinction is that under a strict per stirpes approach, the members of the same class of grandchildren will not be awarded an equal share even if none of the children (higher class) survive because their share will always be based upon that of the higher class (their parents).

Various Types of Wills

To make this all just a tad bit more exciting, there are a number of different types of wills to remember such as pour over wills, holographic wills, Medicaid wills, and a will that includes a testamentary trust. Guardianship provisions are also included in wills for important reasons to be discussed.

All of these “types” are enhancements or upgrades (to use a car analogy) to the standard last will model that we’ve been discussing. So all of the formalities and fundamental terms will apply unless specified otherwise.

Pour over wills are used when there is a revocable trust (hereafter the “trust”), so this should tie together nicely with the discussion to come shortly about revocable living trust planning. Think of this as a pitcher (of water) pouring the estate assets into the trust. So this kind of will, instead of making the distributions to beneficiaries (remember specific and general bequests), will generally make one distribution into the Trust. This type of will requires all of the other key provisions mentioned in this chapter but is unique in its function because it essentially transfers the duty to distribute the estate assets to the trustee of the trust rather than allowing the probate judge to do so via the last will under the charge of the personal representative.

Holographic wills are not allowed in some states but are accepted in others. A holographic will is essentially a “handwritten will”. Generally, the requirements are that it be in the testator’s own handwriting, signed and dated by the testator. Another implied requirement is that it can be identified as a will by some descriptive language such as “This is my last will” or “Upon my death I bequeath my assets to...” If all this can be verified, a holograph can be admitted to the probate court as a valid will. For many reasons, this is not the recommended approach to estate planning, but it may be useful if death is imminent and only a pen and paper are handy.

A last will with a testamentary trust is a last will that creates a trust fund for children or other beneficiaries. This type of will creates a trust that becomes effective upon the death of the testator, and this is distinct from a revocable living trust, which becomes effective during the lifetime of the settlor (the person who sets up the trust). This type if last will is generally longer and more involved than the others because the provisions of the trust, such as the appointment of the trustee and other requirements of the trust, will be included in the last will.

A Medicaid will creates a specific type of testamentary trust and is not a well-known concept among the general public. This type is a strategy for elder and Medicaid planning, which will be discussed in more detail in the Chapter 3. Suffice to say it is a last will that creates a supplemental trust fund in order to allow a spouse who is

receiving Medicaid benefits for long-term medical care to continue eligibility after a spouse passes away. This unique last will accomplishes this goal by allowing the estate assets to be held in a separate supplemental fund to provide for the surviving spouse's incidentals.

The Probate Process

Thus far, we've talked about probate as a court process in which it is necessary to retitle your estate assets into the names of your beneficiaries. We've also discussed that the last will is essentially an instruction sheet for the probate court and must be deemed "admissible" to be allowed to be so. The way that a Last Will is deemed admissible is for the court to confirm that it meets all of the required formalities discussed earlier in this chapter. We also discussed how a well-drafted last will can make the probate process easier.

So a little more about probate. Probate in the United States is best explained by time traveling back to small town America. In the old days, a family member would pass away, and the other family members would go to the butcher, who was also the probate judge, and he would tell them to sell dad's plow and pay the livery stable, sell the tools and pay the general store, and so on and so forth.

Today, the butcher is no longer the probate judge and the creditors are not the livery stable and general store. Today, judges are often overwhelmed with a crammed caseload and the creditors are national and international corporations. This all leads to probate having become an extremely complicated and burdensome process. In many jurisdictions, you must be an attorney to handle a probate and in every jurisdiction, it tends to be expensive. You can figure that the average probate will take 12-18 months to complete and will cost anywhere from 3 to 10% of the gross estate value or even more if there are complications in the estate such as non-ascertainable beneficiaries, creditor issues or family conflicts.

There are different types of probates to be aware of as well, and the type is based upon circumstances surrounding the estate as well as the state laws. Generally, these three types are called something like formal administration, summary administration, and ancillary administration.

A formal administration generally means that there are no shortcuts and that a full petition will be filed complete with a formal "notice to creditors" and full process that

will take some time to allow all assets to be inventoried prior to the final court order.

A summary administration is often for cases with less than a minimum amount of around $75,000 (total assets) in the estate and this option usually takes less time and is less expensive to file. In some states, there is also a summary proceeding in some form that does not require an attorney and is only an administrative process. This kind of proceeding is usually reserved for estates with minimal assets.

An ancillary administration is a probate in another jurisdiction from where the testator resided, so an example would be a resident of Florida who also had real property in Indiana. A probate would need to be filed in both states if the testator had real property in both states, so perhaps a formal administration would be filed in Florida, and an ancillary administration would be filed in Indiana. The cost and time burden of probate, along with the possibility of multiple probates, has necessitated options to allow beneficiaries to avoid this process altogether. One solution, and arguably the best, is the utilization of a revocable living trust.

Planning with Revocable Living Trusts

When a revocable living trust (hereafter "trust" for purposes of this section) is properly in place, and assets are properly titled in the trust, then a probate may not be required. By "titled in the trust" I mean that, instead having an individual name on assets, one can have "Tom Jones, Trustee of the Jones Family Living Trust" on the title to the assets. In this case, a private trust administration could then take the place of the public probate administration process.

A trust administration involves your hand-picked trustee notifying all beneficiaries, conducting an accounting of the assets, and privately distributing assets to the beneficiaries in accordance with the specific terms of the trust. The trustee may be assisted by professionals and may even receive reasonable compensation for serving as trustee.

Trust administration is a private process that may be completed in days or weeks rather than months at a fraction of the cost of probate. Also, creditor issues or disputes that can often occur in probates may be entirely avoided by using a revocable living trust.

A living trust can afford protection for you and your beneficiaries on a number of other

fronts, which may include estate tax protection, disability planning, divorce protection and creditor protection.

For our purposes, a revocable or living trust is the one generally utilized for simple estate planning and probate avoidance as distinguished from an irrevocable trust. There are various types of irrevocable trusts, and these will be covered in the Chapter 4.

Another important point is that there was a trend for many years to create separate revocable trusts for husbands and wives as an estate tax planning strategy. The current trend is to create joint revocable trusts, and I will address why at the end of this chapter.

The other thing you need to know is that there are all kinds of special provisions that can and should be included in your revocable trust if they are applicable to your estate. For example, qualified Subchapter "S" provisions, special needs beneficiary provisions, homestead provisions, HIPAA provisions or other unique provisions may be warranted based upon the circumstances of your particular estate. There are also special kinds of revocable trusts for unique purposes such as IRA trusts and NRA gun trusts. The important thing is that now you have the framework to identify your specific area of concern and make sure that it is addressed in your estate plan.

It is worth noting that another method of avoiding probate is planning through joint titling of assets. While this can be an effective strategy, it is not often recommended due to the issues that can arise and the superiority of using a revocable trust for identical planning purposes.

An especially common approach is to "jointly title" assets with adult children. Putting your adult child's name on your assets may seem like a good estate planning option, yet there are some very serious drawbacks because young adults are likely to be less responsible than their parents, and this exposes the adult's assets to numerous risks.

An adult child is also vulnerable to many life changes that create risk to your assets such as divorce, bankruptcy, IRS problems, problems with the law, injuries and illness. Worse yet, when someone's name is titled (with yours) on an asset, this cannot be easily reversed. The risks with any kind of joint titling strategy are similar to the legal risks discussed in Ch. 1 and 2 of this guide.

1. Divorce

Divorce can financially devastate the participants and generally splits the estate assets in half, so at least ½ of an adult child's assets are in jeopardy including any jointly titled assets with the parents.

2. Bankruptcy
Similar to divorce, a bankruptcy places all the adult child's assets at risk only, this time, the pursuer is an aggressive bankruptcy trustee.

3. IRS
Young adults often face tax problems, and this triggers the sweeping powers of the IRS and the possibility of tax liens on all assets.

4. Legal Problems
Accidents due to DUIs and civil and criminal judgments could result in judgment liens upon all assets.

5. Health Concerns and Injuries
Young adults may be subject to injuries due to an active lifestyle or may experience medical emergencies such as heart attacks, and medical bills can pose a substantial risk to all assets.

Another strategy called transfers upon death ("TOD") or pay on death ("POD") can be used for accounts of all types and is often used to avoid probate. Although this strategy can be useful, there are still problems with this approach, the foremost of which is that people can forget about TODs and PODs. Also, if the transferee dies, the TOD/POD is no good. If the transferee becomes disabled, they could be disqualified from government benefits by a direct transfer upon death. If the transferee falls out of favor and the testator forgets, the entire estate plan is destroyed.

Why does the revocable trust solve these problems?

Revocable trust planning, thoroughly done, can solve all the above problems. The trust allows you to title the assets in the name of the trust rather than individuals, and numerous trust provisions can then govern how the assets are distributed. An adult child may still be a beneficiary of the trust, and yet there is no risk that the assets will be exposed to any of the beneficiary's creditors. A trust also provides asset protection for

beneficiaries so that your kids can be protected from creditors even after your death. A trust may also be the transferee on a TOD or POD account, and the trust can never die or become disabled so the estate planning purposes will be preserved and managed in a simpler fashion than having multiple POD or TOD accounts or jointly titled assets all over the place. Additionally, the trust can include "special needs" provisions so that no disabled beneficiary would be disqualified due to the trust having received a transfer due to a TOD or POD.

Advanced Estate Planning Concerns

Okay, I promised that we would put our toes in the water of some advanced estate planning. Once again, this book is for the purpose of providing an overview and guidelines and not to encourage you to engage in your own estate tax planning or to incite folks to "self-help" complex legal issues. That would require a much longer book and would probably do more harm than good. Nonetheless, there are some things that you should understand to remain in the driver's seat when working with other professionals concerning complex matters and that is the ultimate goal.

Estate Taxes

To become empowered in the area of estate tax planning, you need to understand first that proper trust planning may be utilized in many ways to limit federal estate taxes. Federal estate taxes are exactly what they sound like, and that is a federal tax levied upon death based upon the amount of the gross estate of an individual. Your home state of residence may also have a state estate tax so check on this as well, but for our purposes, we'll refer to the federal tax.

> Good news! A significant portion of your estate is exempt from federal estate taxes and this exemption amount is called the "unified credit." The unified credit amount bounced around for many years and at the time of this *Second Edition* in late 2019 has leveled off at approximately $11.49 million for individuals and $22.8 million for married couples. The exemption is doubled for married couples because you're allowed to utilize your spouse's exemption in addition to your own exemption. In the old days, in order to use your spouse's exemption amount, you had to create an "A-B" trust, or you could lose the double benefit if the deceased spouse's estate became part of the surviving spouse's estate upon death. For this reason, many married couples used to have 2 separate revocable trusts. Keep in mind that there are varied "legalese" terms used to describe all of

this, the most common of which is an A-B trust.

Portability

The idea behind the A-B trust, for a larger estate, was that, upon the death of one spouse, the estate would be retained in a separate family trust that could be used for the benefit of the surviving spouse, for health, education, maintenance, and support. This family trust was technically not a part of the surviving spouse's estate but was a resource for the surviving spouse. The surviving spouse's assets would remain in a separate marital trust that was totally within that spouse's control. Upon the death of the surviving spouse, both the family trust and marital trust could pass to the heirs and this strategy would allow the estate to be twice as large and avoid the federal estate tax by utilizing the exemption of both spouses.

Recently, the concept of "**portability**" was made permanent and this concept essentially allows a surviving spouse to use the deceased spouse's federal estate tax exemption even if trust planning was not considered in advance. However, this should not be taken as a reason to avoid this kind of complex planning due to the chaos and uncertainty that inevitably ensues when there is no coherent plan. In the world of advanced estate planning, there are all kinds of cool terms such as QTIP Trust, QDOT, GRATs, GRUTs, CRTs, CLTs, of various forms, and these are all specific tax planning tools that, unfortunately, are outside of the scope of this humble legal guide. If you're at the level where large sums of cash are at stake, be advised to locate the most experienced tax guru in your neck of the woods.

Business Succession and Continuity

Another common advanced planning issue that arises is business succession or business continuation planning. If you have a family business, a closely held business or investment company of any kind, it is important to ask who will operate that business in the event that a key person dies or becomes disabled. Usually, if these concerns are a factor, then a buy-sell agreement in some form is used. This may either be drafted as a standalone document or can be included as part of an operating agreement, partnership agreement, or shareholders' agreement. The important thing is to define how the company (or the respective ownership interest of any partner/shareholder/member) will be valued and how buyout transfer would occur if a life event happens. A valuation may be accomplished by designating that a business appraisal by a certified appraiser

will be conducted or a less formal valuation by a business broker may be preferred.

Business Valuation

Another recommended approach is to include a valuation formula that is agreed upon by all the partners. The more specific this formula and overall approach to valuation is, the less likely are disputes down the road. It is also important to identify whether the buy-sell arrangement is for an "entity purchase" or a "cross purchase". The former refers to a buy back of the partner's interest by the company, and the latter refers to a buy back by the other respective partners or a designated partner.

Life Insurance

How to buy out the partners' interest is also a common concern and often a life insurance policy is purchased on the various partners' lives to provide funds for the buyout. As stated above, in an entity purchase, the company would be the beneficiary whereas the partners or a designated partner would be the beneficiary in a cross-purchase arrangement. Of course, business succession planning can occur in conjunction with estate tax planning and often multiple trusts and business entities are utilized in combination with various insurance strategies to address the looming estate tax ramifications. More aspects of life insurance planning will be discussed in Ch. 4 for this guide.

Estate Planning Chapter Summary

The highlights of this chapter to remember are:

Dispel the common estate planning myths and get proactive with estate planning. The big 3 estate planning documents are the durable power of attorney, advance healthcare directive and the last will.

The big 3 estate planning documents in the order stated above serve to accommodate 3 key life events which are disability, incapacity and death.

The formalities of the last will are critical since following them will assure that the last will is admissible in the probate courts.

The key provisions in the body of the last will are important because they make the last will understandable and enforceable and serve to avoid unnecessary conflicts.

Understanding the various types of last wills and their uses will empower you to determine the best type of estate planning for you.
Probate is a lengthy and generally expensive process leading many people to seek out the best ways to avoid it.

The 3 kinds of probate administration are important because your loved ones may be at risk for multiple probates due to assets in different states and some estates qualify for simpler probate proceedings.

Revocable trust planning is the most effective means to avoid probate due to issues that often arise with other methods of avoiding probate such as joint titling of assets and transfers upon death (TOD and POD accounts).

Review the current estate tax exemption amounts and determine whether your estate will be exposed to federal and state estate taxes. Your estate plan should have tax planning provisions even if you don't exceed the limit because the unified credit has historically bounced around and one cannot predict the future.

Implement a sensible business succession plan by clearly designating a course of action in a buy-sell agreement.

A solid buy-sell agreement should reference either a cross purchase or entity purchase and include formula (or other valuation approach) to facilitate a buy-out in the event of a partner's disability or death.

Advance estate planning strategies may incorporate insurance strategies as well as various business entities to minimize the estate tax ramifications.

Chapter 4. The Power of Life Insurance

"Fun is like life insurance; the older you get, the more it costs."

Frank McKinney Hubbard

Much of the financial community today seems content with regulating life insurance to the mantra of "buy term and invest the difference". However, I suggest that this approach is not only seriously short sighted but dangerous and deceptive when it comes to tactical estate planning.

The History of Life Insurance

Back in the late 1800s, America was a young country taking great strides and many of her greatest minds were making unprecedented discoveries (i.e. Franklin, Edison and Graham). During this time, one of the first financial tools of the western world was created and its origins dated back to ancient Rome. This tool would become so ingrained in American culture that making changes to it would become nearly impossible. This asset would save countless families from financial ruin and would become the last place truly protected from greedy investors, untamed government and financial collapse.

Further, this financial fortress would empower some of the greatest entrepreneurs in history such as *Ray Kroc* and *Walt Disney*, both of whom borrowed against their whole life policies to finance their historic ventures. During the Great Depression, the stock market would suffer an astonishing 32-year setback and lose 90% of its value from its peak in September 1929.

While banks, businesses and government sectors were closing their doors, one sector of the economy stood unaffected. You guessed it, mutual life insurance companies. In fact, traditional whole life insurance is so stable that many were paid dividends from profits every single year during the Great Depression.

Bank Owned Life Insurance

Consider why the top players in the "money business", you know those with access to the top financial experts in the U.S., own literally "billions" of dollars of dividend paying, mutual whole life insurance? There is even a name for it...***BOLI*** (bank owned life insurance) or ***COLI*** (corporation owned life insurance).

Temporary vs. Permanent Life Insurance

Permanent life insurance refers to a broad category of life insurance that offers permanent benefits. Life insurance that offers permanent benefits is distinguished from temporary life insurance that offers benefits for a set period of time.

When suggesting that permanent life insurance offers permanent benefits, we are talking about a permanent death benefit once the policy premium is completely paid for (or paid up) AND some level of accumulation of cash value within the policy. Permanence and accumulation of cash value are the two factors that separate permanent life insurance from term life insurance.

Permanent Life vs. Term Life Insurance

Buying vs. Renting a Death Benefit

Temporary life insurance, more commonly known as term life insurance, does NOT offer a permanent death benefit. Term life insurance offers a specified amount of death benefit for a specified term length, ranging from annual renewable term (ART) which renews every year to 5, 10, 15, 20, 25 and 30 years.

A longer term or higher death benefit (as well as the age and health rating of the individual policy applicant) determines the cost of the insurance. There is no cash accrual or other permanent benefit of any kind. This is why we often refer to term life insurance as "*renting a death benefit*" and highly recommend purchasing convertible term life insurance if you choose to go this route.

For the above reasons, term life insurance is inexpensive when compared to any type of permanent life insurance. The comparative low cost of term life insurance is why financial entertainers tout opinions like "buy term and invest the difference". The fact is, term life insurance is NOT "bought" but rather rented for a defined period. This is not me being "cagey" about term life insurance. Rather, it is the simple fact of how term life insurance is packaged.

Different Types of Term Life Insurance

There are different types of term life insurance such as 5, 10 and 20-year level term. These policies offer coverage at a fixed premium for a set period of time. Upon expiration of the term, the premiums for the coverage will typically skyrocket, so that the policy will no longer be practical to maintain and a new term policy may be needed. There is also graduated term insurance which isn't fixed for a set term of more than a year and offers premiums that increase gradually year after year.

Convertible term life insurance allows the temporary term policy to be converted to a permanent life insurance policy if elected within the policy period. We highly recommend this approach because it preserves the option to convert from temporary to permanent life insurance for any number reasons.

> For example, if a person's health declines, he or she may no longer qualify for renewable term and a permanent life insurance may be needed.

Because permanent life insurance can be used for tax advantaged cash value accumulation, it is a good idea to consider convertible term insurance if you're looking at term insurance. Convertible term will allow you to increase your base of permanent life insurance as your needs and budget increase.

It is important, however, to research the conversion details of your intended policy, such as when you may convert and what policies are allowed. Some policies only allow conversion in the middle of the policy period and only to certain policies…not good. You're looking for flexibility in timing AND conversion into a favorable policy type to make it worthwhile.

2 Types of Permanent Life Insurance

There are 2 major types of permanent life insurance that vary based upon how the policy is to be managed AND how cash value returns are calculated.

The broad types of permanent life insurance are:

1. Whole Life Insurance
2. Universal Life Insurance

The 2 types of permanent life insurance are different animals both philosophically and practically. As analogy, if most universal life products can be referred to as a thoroughbred racehorse, most whole life policies may be deemed the

Clydesdale workhorse. The exception may be guaranteed universal life which is similar to whole life in terms of offering conservative cash value growth.

The difference between the whole life workhorse and the universal life racehorse is how life insurance assets are invested AND the level of guaranteed growth within the policy. Flexibility of premiums is also an important consideration when differentiating these 2 major types of permanent life insurance.

Differences Between Whole Life and Universal Life

Whole Life Insurance

A whole life insurance policy returns are conservative and based upon the insurance company's pool of extremely conservative investments and thus are guaranteed at rates which have been relatively consistent over the last 200 years. In addition, if the whole life insurance company's pool of investments performs well, then policy holders (*with a mutual participating whole life insurance company*) will receive a higher return, projected as non-guaranteed, which is based upon a return of premiums to policy holders.

Within the arena of whole life insurance, policies mostly differ in terms of the "bells and whistles" attached and what the company chooses to offer policy holders. Some companies, for example, will offer better options for paid up additions riders in order to facilitate cash value accumulation for wealth building strategies.

> For example, some companies offer more flexibility concerning paid up additions then some other competitors because the company requires that additional payments must be made only on a portion of the years that paid up additions are scheduled. Other companies may require full payment of scheduled paid up additions every year.

Whole life policies may also differ in design depending upon the goal sought by the policy applicant. If a permanent death benefit and lower costs is preferred, then the policy will NOT be designed to enhance cash value accumulation AND vice versa if cash accumulation is sought over permanent death benefit.

Universal Life Insurance

Universal life policy growth of the cash value will depend upon the type of product selected and may be either guaranteed, tied to a market index, OR depend upon the success of the financial markets, and investment vehicles such as mutual funds. Policies

often offer a floor, to prevent market losses of greater than zero AND may cap gains at a certain rate depending upon the risk of the given index.

Guaranteed Universal Life Insurance usually ties policy cash value growth to a fixed interest rate of return but little cash value growth is usually realized.

Indexed Universal Life Insurance ties policy growth to a selection of market indexes such as the S&P 500.

Variable Universal Life Insurance ties policy growth to investments in the financial markets such as mutual funds or even hedge funds.

So the key with universal life, is that a policy can be designed to accommodate the level of risk/reward that you're seeking. If you have more of a risk-taking preference, then a variable policy may offer the chance for greater market returns with the greater risk of losses. Thus, the potential opportunity for higher returns due to stock market gains should be weighed against greater stability and predictable returns year after year.

Private Placement Life Insurance

Within the variable life genre of permanent life insurance there is a little-known variation called private placement life insurance. This is a little known and highly customized type of variable life insurance that is suitable for higher net worth individuals. For someone that is interested in maintaining a high degree of investment control AND obtaining the tax advantages of permanent life insurance, this is a strong strategy to consider.

Funding Retirement with Permanent Life Insurance

By nature, term life insurance cannot contribute to funding retirement or providing future capital for investment because it doesn't build cash value. Permanent life insurance can do this by allowing cash value to building inside the policy in a tax advantaged environment.

Tax Advantages of Permanent Life Insurance

When cash value accumulates inside a permanent life insurance policy, tax advantages are allowed under current rules because it is a life insurance policy. Rather than having taxable gain on 100% of the growth of your accounts, your **life insurance cash value can grow tax free**, increasing you overall **financial leverage** AND **return on investment**. This is allowed due the payment of whole life dividends which are basically defined as a

"return of premiums" to the policy holders rather than regular income. This is a potential key benefit to ALL permanent life insurance but especially traditional whole life insurance policies.

Asset Protection and Permanent Life Insurance

As discussed in Ch. 2, permanent life insurance, along with a number of other asset classes, gets special asset protection under state laws. This means that the cash value in your policy NOT ONLY gets special tax treatment, but may also get protection from lawsuits and rogue creditors. This benefit also relates back to retirement planning, and helping you create a secure future.

Review of Permanent Life Insurance Benefits

For all of the above reasons, permanent life insurance offers benefits that temporary term life cannot. So, let's review 5 advantages of permanent life insurance in contrast with its cheaper counterpart of term insurance.

1. Permanent death benefit vs. renting one
2. Peace of mind if health changes
3. Accruing cash value for retirement or investing
4. Tax advantaged growth of investments
5. Asset protection of safe account

Estate Planning with Life Insurance

Death Benefit

The most obvious relationship between life insurance and estate planning concerns the payment of a **death benefit** to the heirs. The death benefit, providing a lump sum to beneficiaries at death, is obviously one of the key incentives for people to buy life insurance, at least initially.

Scrolling back to our review of permanent insurance, the important concern relating to a death benefit is whether to purchase a permanent policy or risk the increasing expense in term insurance that inevitably will occur with age.

Estate Taxes

One reason that a death benefit is often a major priority is because of the need for liquidity created by the **federal estate tax** discussed in Ch. 3 of this guide.

Business Planning with Life Insurance

There are many ways to use life insurance as powerful tool for business planning. All of the following are strategies that may be adopted as part of a comprehensive business succession planning strategy as discussed in Ch. 3 of this guide.

1. Executive Bonus Plans
2. Deferred Compensation Plans
3. Split Dollar Plans
4. Key Person Replacement

The above strategies can each be reviewed in detail on our website at insuranceandestates.com/blog. **Business planning** strategies may be critical to protect a business from the loss of talent, either in the form of "golden handcuffs" or as a death benefit to the business owner to protect against the loss of valuable personnel.

Often term life insurance is used for key person replacement due to its low cost; however, the other strategies noted above require at least a blend of permanent, cash value accruing, insurance as part of the strategy. Often whole life insurance is advantageous because it will pay for itself in the long run even based upon the guaranteed returns which are conservative. Other life insurance products, such IULs and term life, may not offer long term stability due to the possibility of underfunding, or the expiration of the term.

The most important thing to know is that permanent life insurance, and particularly whole life insurance, can reliably build an asset on the business' balance sheet. Don't take my word for it, just google "BOLI and COLI on balance sheet" and check out some of your major banks and corporations.

Permanent Life Insurance and Wealth Accumulation

Cash Value Accrual

Most insurance and estate planning people know that permanent life insurance that accrues cash value may offer access to the cash later. Access to cash in a policy can be accomplished either through cash withdrawals or loans at a future date, depending upon the policy holder's goals.

Simply allowing cash to accrue within a policy is very different from designing a policy to hold and accumulate wealth at accelerated rate. Proponents of concepts such as Leap Systems or Infinite Banking emphasize how a policy can be used to accumulate cash value for a variety of "self-financing" purposes. Generally, accumulating cash value within a permanent life insurance policy is a way to safe-haven for wealth while growing it in a tax favorable and asset protected environment. As stated, the large banks and corporations understand the power of these advantages very well and thus spend heavily on this insurance.

Although beyond the scope of this guide, you can use your permanent policy to create a personal bank for use in family financing and beyond.

Types of Policies for Wealth Accumulation

As discussed above concerning **permanent life insurance**, the type of permanent insurance varies based upon the method of cash accumulation and flexibility of policy premiums. Thus, the distinction between indexed and variable universal life, or traditional whole life, is based upon whether the market gains will determine cash value growth.

> For universal life policies, an indexed product will tie the cash accumulation to a number of market indexes such as the S & P 500. A variable life policy is more flexible, allowing more active investment in the markets. Whereas, a whole life policy offers a lower guaranteed return on cash value with non-guaranteed estimates based upon markets and projected dividends.

Traditionally, **infinite banking practitioners** have emphasized **whole life policies** as the most viable product for this strategy. Paid up additions to the policy are typically used to expedite cash value growth and this growing fund of cash is usually earmarked to recapture debt owed to outside lenders.

> A current trend among insurance agents, however, is to recommend universal life policies for wealth accumulation and self-financing.

On the **pro side**, these products may grow cash value more quickly due to the opportunity to participate in booming market years.

On the **con side**, these products are historically viewed as more unstable, due to (1) the potential for market loss and (2) the potential that they be "underfunded" due to the flexible premium payment structured.

Underfunding a policy isn't really an issue with traditional whole life products due to the **fixed premium structure**; however, these policies are less flexible and generally more expensive offering slower but more predictable (and perhaps reliable) growth of the cash. However, critics contend that because the policies are expensive, they may be vulnerable to forfeiture due to non-payment of premiums.

Tax Advantages of Cash Value Growth in Life Insurance Policies

Permanent life insurance offers tax advantages that can expedite cash value growth. Proponents of life insurance as a wealth accumulator often ask whether you would rather pay taxes on the seed or the harvest? The correct answer is on the seed, where the taxes are considerably less than on the harvest.

Regardless of the type of permanent life insurance, cash value that is left within the policy accumulates free of income taxes. This means that income taxes or capital gains are a non-issue until cash is withdrawn. In addition, traditional whole life insurance purchase with a mutual company (verses a stock company) consistently pays dividends.

The payment of policy dividends in a mutual whole life policy can accelerate cash value growth in a tax-free environment because the IRS treats dividends as a return of premiums. This means that the policy cash value "basis" may be withdrawn without cash penalties.

Policy Loans

A key feature that is essential to the private financing strategy discussed is the ability to take loans that are backed by the policy cash value. I equate this ability to taking out an equity loan against the equity in your home, but in a quicker and more favorable environment.

What I mean is that a home equity loan requires a lengthy approval process that "dings" your credit and results in foreclosure proceedings if you don't pay.

A loan against your insurance cash value is quick, with no approval process and generally doesn't even need to be repaid, although infinite banking practitioners often advise borrowers to do so just like any other business loan in order to reap the maximum value of your policy.

Direct and Non-Direct Recognition

Another key aspect of the infinite banking strategy is the ability to take out loans against the cash value, even up to the maximum amount, while the policy continues to perform. The reality is, particularly with **non-direct recognition companies**, that dividends continue to be paid to policy holders regardless of the outstanding loans. Again, I equate this to earning equity on your home even if it is leveraged heavily. The difference is that a portion of the policy growth is "guaranteed" and even the kind of growth that is usually defined as "non-guaranteed" has historically performed through terrible economic times.

Direct recognition companies may lower the dividend payment if there are outstanding loans, however, top companies usually don't drastically reduce dividends even if there are outstanding policy loans.

The ability to take out policy loans offers the opportunity to create financial leverage and potential positive arbitrage by borrowing at low rates to finance more lucrative investment opportunities. Another aspect of the infinite banking philosophy is the velocity of money, because 100% of your money keeps working regardless of the amounts taken out as policy loans.

Other Areas of Life Insurance Planning

The following are other aspects of using life insurance strategically for estate planning

1. SBA Loan Funding
2. 1035 Exchanges
3. Second to Die Policies

There are in depth articles on the above topics on our blog at insuranceandestates.com/blog.

With that in mind, if you're starting a business, you may not be aware that SBA loan funding requires life insurance and all of the considerations in this chapter apply. A 1035 exchange may also offer you a solid strategy if you're considering "upgrading" your existing life insurance product for another product.

Life Insurance Chapter Summary

History attests to the reliability of life insurance as a financial safeguard.

The largest banks and corporations in the United States maintain massive reserves of life insurance called BOLI and COLI.

Permanent life insurance offers advantages in most cases over temporary (or term) insurance.

The type of permanent life insurance is usually based upon the formula for cash value approval and the flexibility of premium payments.

Permanent life insurance can be used strategically for retirement planning.

Temporary and permanent life insurance can be used strategically for estate tax planning.

Temporary and permanent life insurance can be used strategically for business succession planning.

Business planning may be enhanced through strategic life insurance planning.

Other life insurance planning considerations are SBS loans, second to die policies and 1035 exchanges.

CONCLUSION: Offense *with* Defense

"Offense Sells Tickets, Defense Wins Championships."

Unknown

Given the **tactical knowledge** that you now possess, I submit that if you have NO PLAN, you're all out of excuses.

The *next steps* are yours alone. The challenge is whether you going to take your knowledge and locate the right experts to help you plan for the worst while expecting the best?

This does NOT need to be complicated. Having worked with countless clients for many years in ALL of the areas discussed in this guide, I can tell you that it boils down to a few simple steps which are:

1. Get good estate planning advice.
2. Get solid asset protection advice.
3. Put together a good plan that includes both.
4. Get the right life insurance to support the specific aspects of your plan.
5. Consider the long game and not just the short one.

Remember, we all become more vulnerable as we age, so it is important to make strong moves when we're young, or at least reasonably young, and vibrant. With that, I wish you *Godspeed*.