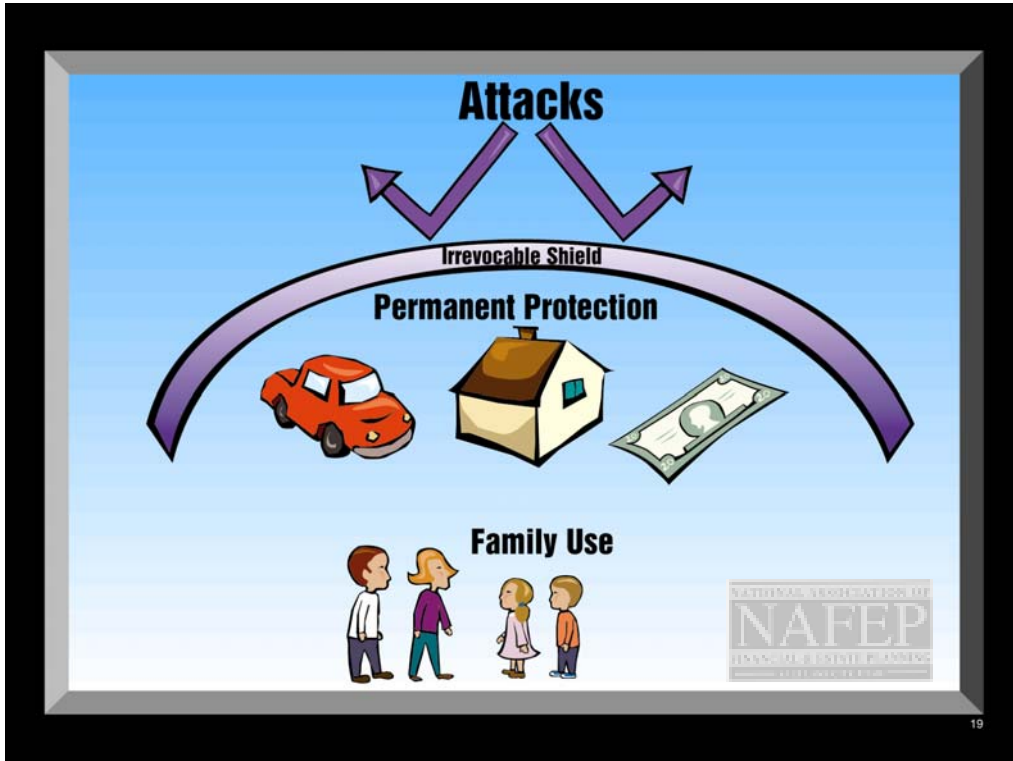


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# Estate Planning with Asset Protection<sup>©</sup>



**The National Association of Financial and Estate Planning**

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**NOTE:** This publication is designed to provide accurate and authoritative information in regard to estate planning, but it is not intended to be legal or accounting advice. NAFEP is not engaged in the business of rendering legal or accounting services. If legal advice or other expert assistance is required, the services of a competent professional person should be sought.

## ESTATE PLANNING WITH ASSET PROTECTION

### Premier II Life Estate Trust

**Disclaimer.** One of the important benefits of a Premier II Life Estate Trust is its ability to provide protection from lawsuits and liens. However, neither NAFEP, NAFEP Associates nor anyone else can guarantee that your Premier II Life Estate Trust will never be compromised by a legal action. No one can predict with certainty that you will setup and use your trust correctly or how a judge may rule in a given case. The best that we can be safe in saying is that, if you are sued, the use of such a trust should allow you to fare significantly better than you would have fared without the trust.

The Premier II Life Estate Trust provides all the standard estate planning benefits which we summarized for the Premier I Living Trust in the previous Chapter. But the Premier II Trust goes far beyond the living trust to provide these extra benefits:

- **Asset Protection.** Protecting one's property from creditors, lawsuits, divorces, liens and judgments.
- **Protection From Rip Offs.** Protecting the assets of elderly or other vulnerable estate owners from con artists and unscrupulous relatives.
- **Financial Privacy.** With this protection the Premier II can shield financial activities and property ownership from most private and bureaucratic snooping.
- **Limited Liability.** This feature means that the grantor can reduce or eliminate personal liability for damages, judgments and claims that may result from the ownership of property which has the potential of leading to an accident.

**Threats From Lawsuits.** What could cause a lawsuit against either a trust or the grantors?

1. One of the biggest threats is from vehicular accidents. Vehicular accidents can literally cause millions of dollars in legal damages. If you cannot obtain or afford enough liability insurance, the rest of your property is at tremendous risk.
2. One common problem is joint tenancy forms of ownership on either real estate or financial assets. A lawsuit against either tenant exposes the whole property to a judgment. For example, often a parent will name an adult child as a joint tenant on some asset. Later, the child may get into a lawsuit, tax problems or divorce. Then the IRS or the divorcing spouse of the child takes part or all the property in a legal action or divorce settlement.
3. Another litigation source is problems with your creditors, possibly due to your inability to pay promptly, or perhaps just a dispute. However, we must caution you that trusts cannot be legally setup specifically to avoid existing creditors.
4. Any real estate, especially rental property, or equipment you own has the potential for some kind of accident and expensive litigation.
5. Although this technically is not a lawsuit, a widespread problem for elderly and vulnerable estate owners is rip-offs by con artists and unscrupulous relatives. Quite often these vulnerable persons end up as paupers, though they led financially comfortable lives before the rip-off.
6. Business owners are especially wide open targets for lawsuits. Lawsuits against businesses can come from employees, customers, creditors, subcontractors, competitors, and regulatory government agencies.
7. One concern that many single adults have is protecting their estate from a possible divorce suit after they become married. Married individuals with separately owned property often have these same concerns.

Actually the list of threats from lawsuits is longer than this. For a more detailed list see the Footnote at the end of this chapter.

**Structure & Contents.** The Premier Plan II Life Estate Trust is a program developed by NAFEP to provide special protection for the family estate. It

actually consists of three trusts, which we refer to as the Primary and two Holding Trusts (see Figure 13). The Primary Trust performs all the usual estate planning functions that we discussed in Chapter 2 for the Premier Plan I Living Trust. For example, the Primary Trust identifies all the heirs and provides for the transfer of the estate to the heirs after the grantors' deaths. The Holding Trusts are passive entities, and do nothing but hold assets. They are satellites of and slaves to the Primary Trust.

The Primary Trust is used to hold financial assets such as savings and investment accounts, insurance policies, annuities, etc. In addition the Primary Trust is the controlling entity of the Holding Trusts. One of the Holding Trusts is intended to hold the family home and the other is intended for family vehicles. These three types of assets - home, vehicles, and financial property - comprise the total estate of most families. Therefore these three trusts will hold and protect all the assets of most families. If the family has other real estate, or owns a business, additional Holding Trusts and/or a business entity may be added. If the an estate is smaller the Holding Trusts may be eliminated altogether.

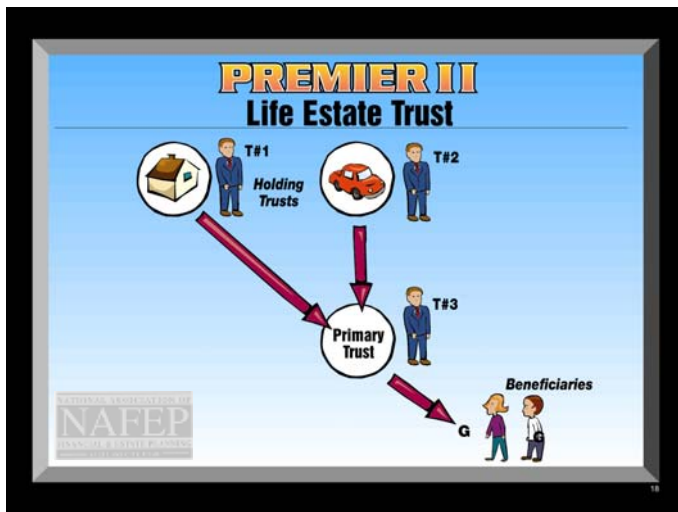


Figure 13

The grantors retain a life estate in and full control of all their property. They are therefore the primary or current beneficiaries. The grantors name their heirs as secondary beneficiaries, who take over the property after the grantors are deceased.

**Life Estate and Control of Assets.** A major feature of the Premier II is that it is a "life estate" trust. The term "life estate" is a legal term which means that a property owner has passed the legal title of certain

property to someone else (the heirs), while retaining the life time use of that property. A life estate gives all income, benefit and usage of the assets to the life estate holder (the grantors). Life estates can be created with or without a trust. A well known estate planning practice is for a parent to deed real estate to his or her child, while retaining a life estate in the property. In this usage the life estate is created through the property deed itself and does not require a trust, though a trust can create a much better life estate. The reason for using a life estate trust is that this technique leaves the control and usage of the property with the grantors while protecting the property from lawsuits.

Figure 14 illustrates what happens to the control, ownership and use of the assets that are placed in a Premier II Life Estate Trust. Throughout the grantors' lifetime they have full control and benefit of the property itself. No one but the grantors, not even the trustee, can change or affect this control and usage. The legal title, however, is held by the trustee, in trust for the heirs. During the grantors' lifetime the trustee's role is mostly passive, his major function is to hold the legal title. Upon the death of the last of the grantors, the control and benefit of the property, along with the legal title, are merged together when the trustee passes everything out to the heirs.

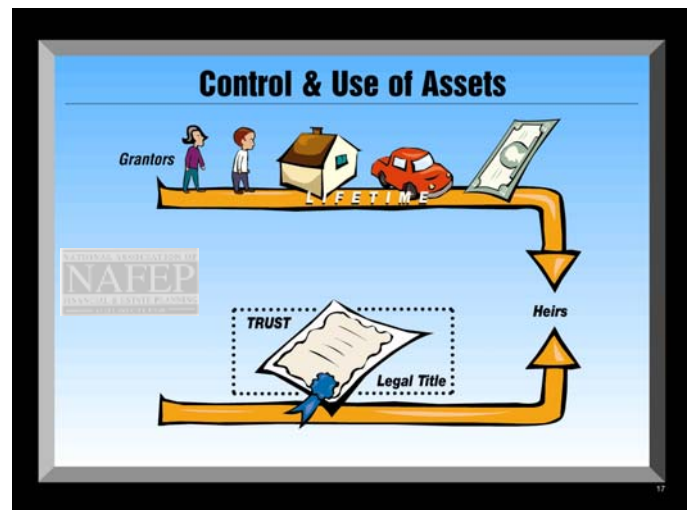


Figure 14

**Asset Protection.** Each of the three trusts in the Premier II is treated as an independent entity in the U.S. legal system. This is because they are each irrevocable, they each have a different trustee, and none of the trustees are the grantors. That makes each one a separate owner, so the assets in each trust are owned separately from the assets in the other trusts. The family

automobile has a different owner than the family home does. If something causes one trust to be sued, such as an auto accident, the plaintiff has no cause of action against the other two trusts. The other two are independent of and unrelated to the automobile trust. In that example the plaintiffs could only get the automobile and any related insurance settlement. They could not reach the house or the financial assets in the Primary Trust.

If someone sues the grantor directly and obtains a judgment against him, that judgment cannot be applied to assets of any of the trusts. Remember that the legal title is held irrevocably by a separate trustee. Legally speaking the grantor's heirs own the property in the trusts (though the Grantor owns lifetime control). That is an important part of the protection which keeps a claimant against the grantor from attaching trust assets.

Another major factor in asset protection is the privacy involved. The property in the trusts is titled in the trusts' name. Routine snooping by outsiders will not reveal any property ownership by the grantors. It will be very expensive for outsiders to ever find out what the grantors do own (which legally is nothing!). The sheer cost and complexity of finding this out will discourage a large number of legal attacks from getting off the ground.

For detailed legal information on this subject, written by independent legal researchers, with appropriate legal citations, ask a NAFEP Associate member for a copy of the NAFEP "Asset Protection Legal and Reference Package".

**Operating Under Irrevocability.** Premier II trusts are termed "irrevocable", but there is nothing about irrevocability that is threatening or hazardous to the grantors. Trusts are irrevocable in a similar manner that corporations are irrevocable. That is, neither a minority shareholder nor some outsider can, under normal circumstances, force a corporation to be revoked or to dissolve. But a majority of shareholders (all of whom are insiders) can dissolve a corporation. With an irrevocable trust the family can revoke the trust should they ever decide to (ask a NAFEP Associate member for a copy of NAFEP's attorney letter and other legal reference material on this subject).

And like a family corporation or partnership, the grantors remain in control of their assets. Property can be bought, sold, leased, etc. The grantors own any income that is produced. They have a life time usage of their property backed up by the U.S. legal system. Even

though the family can revoke the trust it is unlikely they would want that. This is because anything can be done with the property inside the trust that can be done outside it. Since the grantors remain in control of the trust property there is no advantage in or reason for revoking the trust.

Something few people realize is that most living trusts include provisions which create one or more irrevocable trusts upon the death of the first spouse. This arrangement is the "B" or "Bypass" trust described in the previous chapter of this publication. The irrevocable bypass trust normally has a trustee who is someone other than the surviving spouse. The bypass trust is a life estate trust for the surviving spouse. Interestingly, the bypass trust also provides asset protection, financial privacy, and most of the benefits of the Premier II program, while the property left in the surviving spouse's "A" trust does not have those benefits. Even though the bypass trust is irrevocable the surviving spouse and the rest of the family continue to use the bypass trust property without the slightest problem from this irrevocability. Living trust attorneys must be completely comfortable putting their clients into this type trust. They must know that irrevocable, life estate trusts work well for families in actual usage.

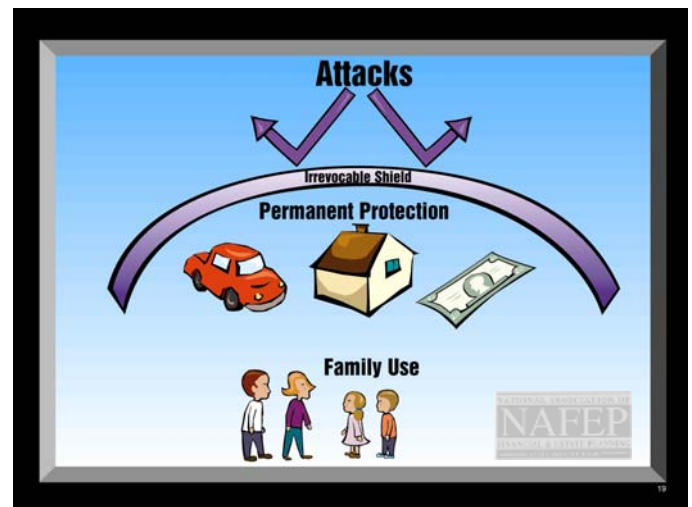


Figure 15

Irrevocability in a trust is therefore a benefit, not a hindrance. Irrevocability simply means that the family has provided a shield of protection from outside attackers for their property. The hindrance of irrevocability is not a problem for the family, it is a problem for outsiders. Since outsiders cannot revoke the trust they cannot get at the property that is in it. The shield of irrevocability protects the property throughout

the family's use of it, much like a corporate shield protects a corporation's officers and shareholders. It is in the family's best interests to use that shield for as long as possible.

**Trustee Distinctions.** It is important to understand that each trust in a Premier II program must have a different trustee (see Figure 16), and the trustee cannot be a grantor. If a grantor is the trustee he is deemed to have so much control over the trust that a court could force him to make trust assets available to satisfy a judgment. Also, if all three trusts have the same trustee and same beneficiaries, there is no legal distinction between them. The plaintiff's attorney could get a judge to merge the three trusts together into a single entity or defendant in a lawsuit. The reason we create three different trusts in the first place is to prevent a lawsuit against one trust from spilling over to the others. The separate trustee arrangement is the key to providing the necessary separation which makes this work.

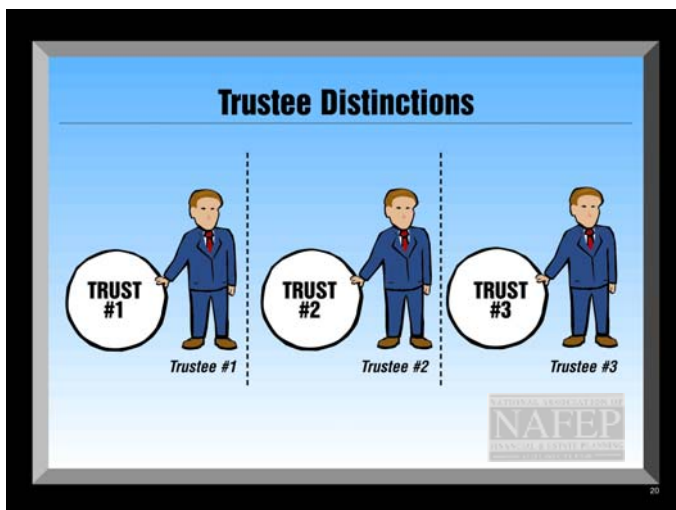


Figure 16

**Trustee Arrangements.** Figure 17 illustrates the possible trustee choices and arrangements.

- First, each trust could have a different corporate trustee.
- A second choice is for each trust to have a different corporate trustee along with one individual serving as co-trustee. This can be the same individual for all the trusts in your particular Premier II program.
- The third choice is for each trust to have a different person acting as trustee. Again, one

other person could serve as co-trustee, and the co-trustee could be the same person on all the trusts in your personal Premier II program.

In any case where human trustees are chosen, they can be adult beneficiaries of your trust, the children of the grantors.

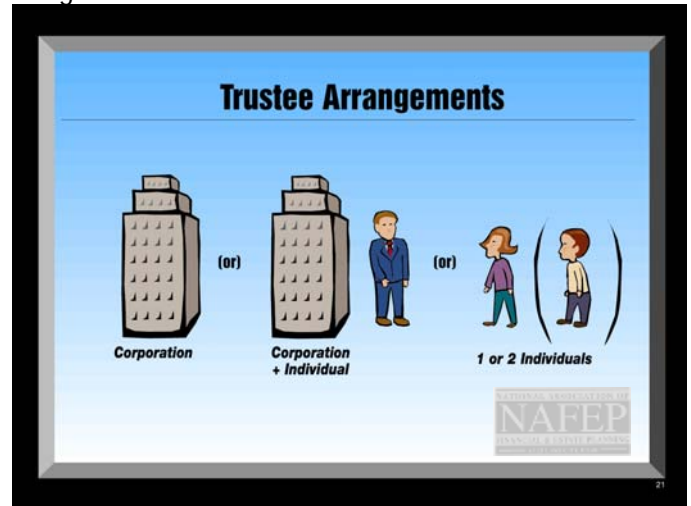


Figure 17

Let's illustrate the trustee arrangements with a typical Premier II structure; three different trusts. In the example in Figure 18 there are corporate trustees, using three different corporations as trustee of the three different trusts. We have the option of using one person as co-trustee with any one, or all three of the trusts. In this example we are using Joe, the grantors' oldest son, as the optional co-trustee with each trust.

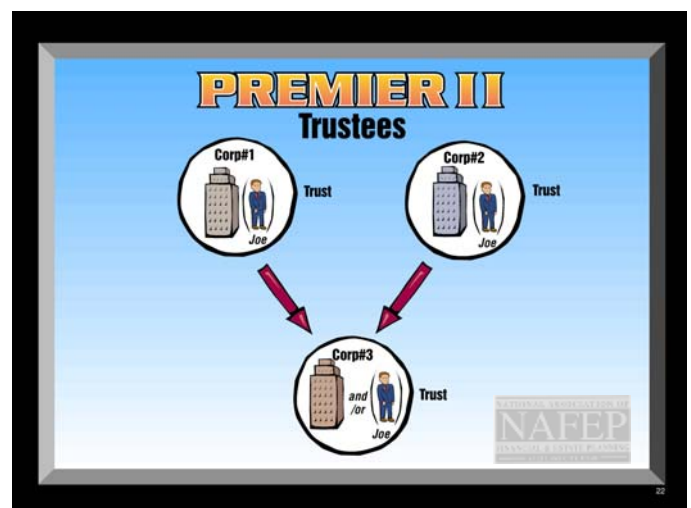


Figure 18

One of the problems that many families have in setting up a Premier II program is they do not have enough adult children, whom they depend on, to provide a different trustee for each trust. That is one of the reasons to choose corporate trustees.

What happens if you want to remove a trustee? The grantors and the surviving beneficiaries have the power to fire and replace the trustees at any time.

Where can you get corporate trustees? That is one of the services that NAFEP provides, a service available to you at a very nominal annual cost. Other reasons that corporate trustees make a lot of sense are:

- ✓ Your children may not have enough business, financial or legal skills to act in this capacity.
- ✓ If an individual trustee dies, or is unavailable for any reason, it can be expensive and time consuming to have trust business handled. The corporate trustees are represented by trust officers. If anything happens to the officer, another one can be appointed immediately by NAFEP.
- ✓ Individual trustees can be subjected to more hassles and pressures from other family members, especially upon the death of the grantors. The corporate trustees will be much more immune to and capable of handling these difficulties.
- ✓ Individual trustees have more personal exposure to liabilities in the trust. The corporate trust officer has limited liability protection provided by the corporation.

**Trust Management and Operation.** The actual management of this trust structure is simple and uncomplicated. All of the required activities are the same ones that have to be handled with or without a trust. The Holding Trusts generally have no daily activities at all since their only function is to hold legal title to their property. Payments and expenses for trust property can be paid from the grantors' personal account. There are no new payments or check writing required for those activities. In daily operation the Primary and Holding Trusts can be thought of as just one entity, as a silent partner who does little more than hold the legal title to your property for safekeeping. The fact that there are a number of trusts involved is irrelevant in the normal routine.

Under the Premier Plan II the grantors run and manage the trust property and activities just as they did before. They receive any income there is, and they have full use of their personal assets. They are in control of their life estate. If a grantor or any party to the trust dies or becomes ill all functions will continue without interruption from probate or from custodial or other legal proceedings. After the deaths of the grantors their heirs take over the management where the grantors left off, or they have the property distributed to themselves, depending on the trust instructions.

**Tax Status.** The Premier II Life Estate Trust is termed a "grantor" trust by federal tax law. Grantor trusts do not pay any income or capital gains taxes which may be incurred by property inside the trust. That is because grantor trusts are tax neutral to the IRS. The IRS views all the assets as if the grantor still owns them.

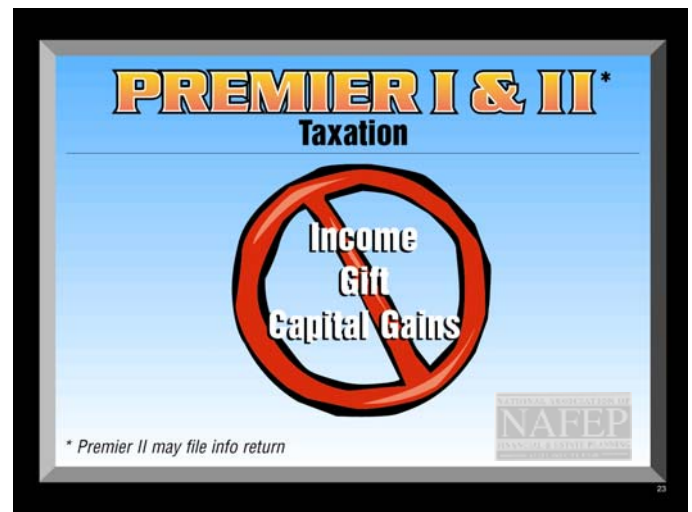


Figure 19

Since the trust assets are treated by the IRS as if the grantor still owns them, several other tax principles apply:

1. There are no gift taxes from putting assets into one of these trusts.
2. All property will continue to be included in the taxable estate of the grantors.
3. Property will receive the step up in basis allocations on the death of the grantors.
4. The grantors can still use their \$250,000/500,000 capital gains exemption on the sale of their personal residence.

Since the grantors still own the trust assets for tax purposes, any income and capital gains taxes, along with depreciation from the property, will continue to be reported on the grantors' personal tax return. This will result in no change in the amount of the grantors' tax payments or how their tax returns are prepared.

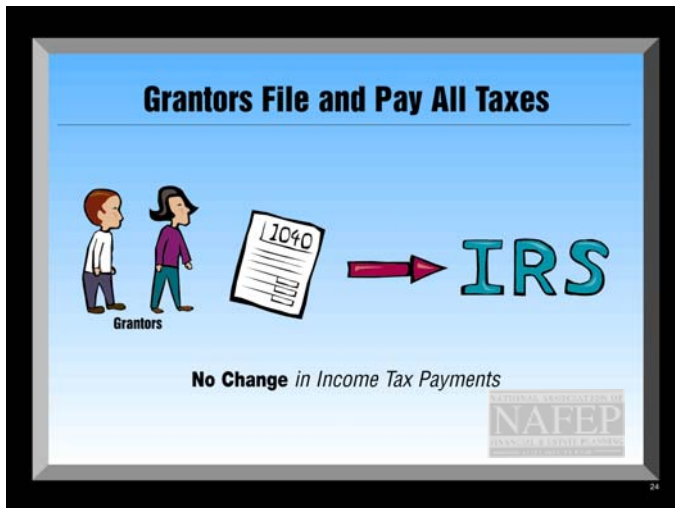


Figure 20

**Fraudulent Conveyance.** The asset protection safeguards only apply to assets you place in trusts before there are problems. Once a damage, debt, or liability has occurred, even if no lawsuit has been filed, setting up the trust will not "legally" protect your assets from that specific liability. On the other hand each state does have a statute of limitations that prevents a litigant from suing after a few years (usually four or five years). After that any property in the trust is generally home free, even for pre-existing problems. Figure 21 is a time line illustration of this principle.

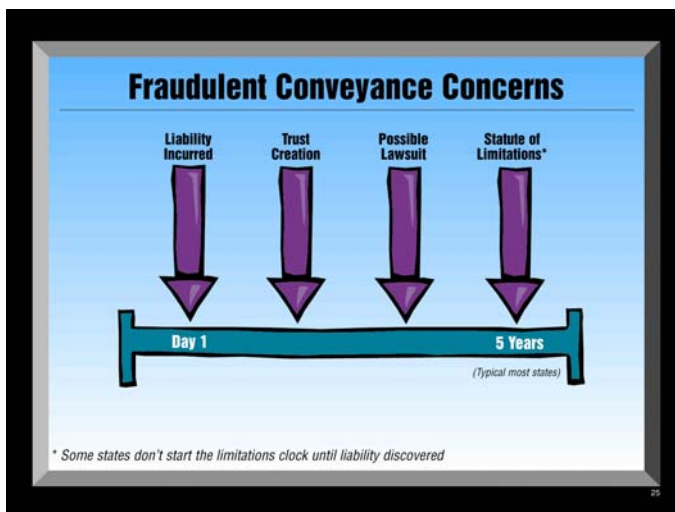


Figure 21

Setting up a trust after a liability has occurred could be ruled as a fraudulent act by a judge hearing a lawsuit against you. A fraudulent conveyance will not send you to prison though, fraudulent conveyance is not a felony. Fraudulent conveyance laws are primarily designed to give a litigant a remedy to place a claim on assets that were transferred by their owner after a liability occurred. Fraudulent conveyance is very difficult and expensive for a litigant to prove, by the way. So even if a transfer is technically illegal, often you have everything to gain and nothing to lose by setting up asset protection with existing liabilities. This subject is somewhat complex though, so be sure to consult with a NAFEP Associate if you have questions.

**Use of Umbrella Insurance in Asset Protection.**

Couldn't an umbrella insurance policy be used to cover the costs of potential litigation? Well maybe, but there are negatives and risks associated with that strategy. One is the on-going cost of the umbrella that has to be paid from now on, whereas the trust is a one time cost. Related to cost considerations is the fact that one may not be able to buy a single policy to cover all properties. Normally there must be a separate policy for each different property. While any one policy may not be that expensive, having to buy a number of them can add up. Another problem is that insurance policies do not cover every possible liability. For example, lead paint in rental property is not covered by insurance, but lead paint poisoning represents a large liability. Another problem is, how big of an umbrella do you need? When is it big enough? Attorneys usually sue for more than the limits of your coverage no matter how big it is. If they win more than your limit, your assets have to be used to pay the difference. Another problem with an increased amount of insurance is that it attracts lawsuits due to the potential payoff. These high umbrella amounts can cause the very problem that you are trying to avoid. Smaller amounts of coverage can actually discourage an opposing attorney from offering to work on a contingency basis, forcing the plaintiff to bear all the risks and costs of litigation.

**Footnote:**

**Lawsuit Threats.** A more complete list of lawsuit sources includes: Divorces, environmental hazards, employees, creditors, business customers, business competitors, business regulatory agencies, rental property accidents, lead paint hazards on home or rental property (which is not covered by most insurance policies), guest accidents at home, joint ownership of real estate (when the other joint tenant gets sued), involvement in partnerships, corporate officer and director positions, advisory board positions, and leadership positions in civic organizations.

## NAFEP ESTATE PLANNING PROGRAMS

**Premier I Living Trust.** This trust is the minimum level in trust planning for probate avoidance, control over the transfer of the estate to the heirs, and estate tax exemption for both spouses. Virtually all other estate planning practitioners and services stop here with their product offering. With NAFEP this is just the beginning.

**Premier II Life Estate Trust.** This is NAFEP's most advanced family trust, providing the same estate planning as a living trust, but it incorporates protection of assets from lawsuits and judgments, protection from con artists and unscrupulous relatives, and financial privacy. This program has been tested under fire and thus far has held up to all legal threats against client assets.

**Premier III Childrens/Gifting Trust.** This trust has several uses including: Gifting programs to heirs free of gift and death taxes, to simply hold assets for the heirs until a predetermined date, as an educational fund or for the special needs of a handicapped beneficiary. Much greater flexibility and client controls than UGMA accounts.

**Premier V Life Insurance Trust.** This trust allows a client to leave a substantial inheritance free of gift and death taxes and/or to furnish liquidity to pay their death taxes.

**Premier VI Private Annuity/Trust.** This is an excellent program to provide long term deferral of capital gains taxes from the sale of appreciated assets. Also very useful for avoidance of gift and estate taxes. In many cases it is the best Medicaid planning strategy.

**Premier VII Family Foundation Trust.** This is an advanced type of charitable family foundation with significantly better tax benefits and flexibility than private foundations.

**FLP Trust.** This trust is treated as a family limited partnership (FLP) under tax laws, but which is an advancement over ordinary FLPs. Its primary use is to allow the discounting of gifts so that a larger amount of an estate may be gifted away without incurring gift taxes.

**Limited Liability Company.** A legal entity that provides advanced limited liability protection. LLCs are formed in the state in which the business owner operates, or a Nevada LLC with its special advantages

can be used. NAFEP provides annual services to support Nevada LLCs.

**C, S and Nevada Corporations.** Corporations will be formed either in the state in which the business owner operates or a Nevada corporation with its special advantages can be used. NAFEP provides annual services to support Nevada corporations.

**Nevada Domiciling Service.** A service to allow trusts and Nevada corporations and LLCs to be physically and legally domiciled in Nevada. This provides a significant enhancement to the asset protection feature of a Premier II Life Estate Trust (or any other trust for that matter), due to the especially protective nature of Nevada's trust laws. In some cases Nevada domiciling will allow trust income to avoid state income taxes. For Nevada corporations and LLCs this type service is mandatory if the entity is to be legal in and protected by Nevada laws.

**Miscellaneous.** Standard wills, pour over wills, QTIP and generation skipping (GST) trusts, bypass (credit shelter trusts), durable power of attorney, medical power of attorney, guardianship appointment for minors, advanced medical directive (living will).

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**Trust Information And Brochures** are available from NAFEP Associates, and trust brochures may be downloaded from NAFEP's web site. Go to [www.nafep.com](http://www.nafep.com), then select "More About NAFEP".



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