

Returning to Asset Protection Planning . . .

F. Bentley Mooney, Jr.

Medi-Cal eligibility planning stories have dominated the last couple of issues. So, since many of you are more interested in asset protection of another kind, here are some current events.

How about a couple of horror stories, one arising from a bull-in-the-china-shop approach, and the other from mindless legal advice.

In the first case, the non-client was a grumpy and mean man, hated by his neighbors. Inclined to self-help in all things, he was busted for setting an automobile on fire while his offending neighbor was in it, asleep. While in jail awaiting his preliminary hearing, he instructed his wife to remove a valuable art collection from the house and store it out of state. Following that, he asked her to track me down to engage me to protect his substantial remaining assets. As I was listening to the facts and circumstances, the sleeping neighbor filed a lawsuit and applied for a temporary restraining order freezing the non-client's assets. The application was based in part on the likelihood of winning the lawsuit and on observing the wife carrying the art collection out the back door. My response? I cannot appear to oppose the application without implying that no fraudulent transfer was intended, then immediately put in place an asset protection plan without putting my license in jeopardy for misleading the court. I passed and had to leave the odious non-client hanging on his self-made hook in the bowels of hell.

In the second case, the client was a spec builder of luxury homes, usually with five or six projects pending at any one point in time.

In selling one of his homes to a sweet, lovely, elderly couple, he relented and broke one of his cardinal rules, allowing them to move in several days before escrow closed. The couple immediately morphed into raging, screaming, maniacal animals, demanding immediate satisfaction of the punch list (minor items to be cleaned up at the end or new construction) but at the same time refusing to permit the client entry to do it. This was followed by a lawsuit in which the buyers sued for construction defects amounting to the full purchase price.

The client had an insured defense, he thought, but a few months into the lawsuit the carrier became insolvent and cut off his funding. He began funding the defense from his own resources, and went to see an attorney holding himself out as an "asset protection specialist." For a \$45,000 fee, the specialist provided some estate planning advice that included a revocable living trust, a gift trust, a family limited partnership to protect assets and facilitate discounted gifts, multiple limited liability companies to hold various properties in development and an irrevocable discretionary foreign trust. As to the last, he (incorrectly) advised the client that ". . . the foreign trust is not subject to U.S. taxes." He specifically advised the client to establish seven limited liability companies and convey each of the seven uninvolved properties to one of those entities. The idea was

that the fictitious names of each entity would make it difficult for an investigator to connect them with the client, enabling him to complete and sell the projects in time to see the litigation to a conclusion.

The couple, however, were sophisticated litigants. They had already completed the asset investigation, and were monitoring title to each property in anticipation of this action. Pointing to this apparent fraudulent transfer, they immediately secured temporary and preliminary injunctions freezing any further asset transfers pending the outcome of the lawsuit. The client quickly ran out of funds, and unable to complete and sell the other projects, was forced to hand over all his properties to the plaintiffs in settlement of their claims.

The client in the second case came to me with nothing left but his skills and business know-how. His initial concern was whether he had a case for legal malpractice against the asset protection specialist. I pointed out the attorney's duty to act competently, listed and discussed the advice given, original attorney liability for negligent referral, applicable statutes of limitation, I advised him of a more prudent plan of action as follows:

The attorney should have anticipated this result and taken action (or counsel non-action) so as to prevent the consequences. Admittedly, the available choices were narrower *after* the carrier insolvency than *before*, but among the options remaining available were the following:

- *Do nothing.* With no record activity evidencing an intent to secrete the properties, there would be no basis for the asset freeze. That would have left the client free to borrow on the properties or sell them to *bona fide* buyers without impairment of the proceeds.

- *Sell everything.* If all but the property subject to the litigation was sold to *bona fide* purchasers for value, the client could have supported the defense costs, and established a valuable loss carryforward for himself. He could also have redeployed the uncommitted cash to the purchase of exempt assets, the nature and scope of which are beyond the scope of this discussion.

- *Exchange the properties for assets beyond the court's jurisdiction.* Although the asset protection specialist might not be expected to know how to accomplish it, a transaction could have been structured in which the properties are exchanged for one or more private annuities with a payor located in a jurisdiction outside the United States. The end result would be to remove the properties from the gross estate of client for federal estate tax purposes, without paying a gift tax, avoiding generation-skipping transfer tax even though the trust remains in effect for the benefit of succeeding generations. The properties are exchanged for an income stream providing the client lifetime economic security, free from the claims of creditors and bankruptcy trustees alike. Any capital gains involved are reported ratably over his life expectancy (more than 30 years) as an allocated portion of the annuity payments.

The advice memo ran 14 pages, so it is too much to include here. But suffice it to say, being a “specialist” and having sufficient experience to deploy the legal advice effectively may be two entirely different things.