

CASE STUDY –

**THE USE OF THE TAX DEFECTIVE GRANTOR TRUST TO
FREEZE THE ESTATE AND TRANSFER FUTURE GROWTH**

The following case study will show how the establishment of an appropriate estate plan can safeguard your estate.

Bill and Mary have been married over 35 years and have raised 3 children, all of whom are presently married with children. Bill has owned his own business for many years and has been successful in several outside ventures, including the acquisition of several multi-tenant residential properties. Bill has received an attractive offer to sell his business. He is planning to accept so he can devote more time to his wife, to the personal management of his investments, and to his rental properties. He plans to remain on the board of directors of several firms, one of which is a publicly-traded company. For many years, Mary has been active in the community and serves on several boards of trustees.

Bill and Mary have a revocable living trust and companion wills, a life insurance trust and durable powers of attorney for health care and property. Bill is concerned about the potential exposure to liability suits from the sale of his business, the boards on which he serves, and from the real estate portfolio his living trust owns and which he manages as the trustee.

Bill and Mary have the following balance sheet

o Cash & cash equivalents (stocks, bonds & mutual funds)	\$900,000
o 3 Rental properties (net of mortgages) - 65 unit Apartment, 145 unit Apartment, 250 space mobile home park	\$1,750,000
o Personal Residence (net of mortgages)	\$650,000
o Personal property and effects	\$200,000
o IRA Rollover account	<u>\$2,000,000</u>
**TOTAL ESTATE VALUE	<u>\$5,500,000</u>

Bill and Mary's domestic living trust holds title to the above-described cash equivalents, the three rental properties and their personal residence. This structure exposed their liquid assets to the risk of liability arising from their rental properties. Moreover, should a future lawsuit arise by virtue of Bill's position on the various Boards, or from the sale of his business, the domestic living trust would not shield the assets.

Bill and Mary were given the following advice in connection with the restructuring of their estate plan. In addition to the asset protection planning, we were able to reduce the size of the projected taxable estate by gifting assets from their estate to their children and grandchildren, without the loss of control.

Here is what Bill and Mary did:

1. Bill and Mary's Living Trust formed a **Family Limited Partnership (FLP)** to hold the cash and cash equivalents. Bill and Mary became the general partners of the FLP and once formed, notified the account holders of the change to the FLP.
2. The Living Trust then formed 3 more FLPs, each one to hold title to one of the three rental properties. This time, however, Bill formed a corporation to serve as the general partner to eliminate any possibility that Bill and Mary would be personally liable should a future lawsuit arise. They were equal shareholders of the corporation. Bill and Mary made a gift of 68% of their limited partnership interest in these FLPs to their 3 children. The value of the gift equaled the present unused portion of their unified credit (presently \$1.2 million). All future appreciation will belong to the children and will be out of Bill and Mary's estate at death. All rental income will be controlled by Bill and Mary through the corporate general partner, which they own.
3. Finally, to provide the maximum protection for the cash assets owned by the FLP, Bill and Mary amended and restated their existing living trust creating an **Asset Protection Trust (APT)** in the Cook Islands. The APT incorporated their prior trust's plan for the disposition of their estate at their respective deaths.

In this manner, should an *unforeseen* lawsuit arise whereby a plaintiff's attorney would attempt to reach the liquid assets in the FLP, the funds easily could be transferred to the APT and held in an overseas bank or brokerage firm until the threats were removed. As Protectors of the overseas trust, Bill and Mary each would have the power to veto decisions concerning the trust assets and even to remove the one trustee in favor of another should they desire.



Bill and Mary have achieved several important goals through this planning:

- 1. Protection of assets against lawsuits or attachment from whatever source.**
- 2. Reduction of taxable estate at the death of last spouse by gift of 68% of rental FLPs to children, transferring the appreciation to the children.**
- 3. Maintain management and control of the rental properties and investments.**
- 4. Creation of an estate plan that is not subject to the uncertainties of the US legal system, including a superior vehicle to avoid the expense and problems of a challenge to the trust after their deaths.**

The foregoing discussion encompasses important issues but is by no means a complete discussion of the planning performed for Bill and Mary. There were other estate and gift tax planning strategies employed which are too lengthy for this discussion. You are welcome to contact me for more in-depth discussion.

Careful tax planning is essential and there are numerous traps for the unwary. You are advised to consult with competent tax, accounting and legal professionals.

Please contact Jeffrey M. Verdon Law Group, LLP* at (949) 263-1133 or jeff@jmvlaw.com for further information.

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