

# *The* **Estate Analyst**<sup>®</sup>

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## **Nevada-nizing Asset Protection**

### ***H.R. 436 Retains Estate Tax***

*By Robert L. Moshman, Esq.*

What if you could set up a trust for yourself? It would be oh, so simple: No middlemen, no third parties, no worries! Although most states have a problem with self-settled asset protection trusts, there are a few jurisdictions where statutory authority exists, albeit with some limits and practical considerations.

**I'm gonna sit right down  
and write myself a letter.  
And make believe it came from you.  
I'm gonna write words oh so sweet  
They're gonna knock me off my feet  
A lotta kisses on the bottom  
I'll be glad I got 'em. <sup>1</sup>**

Let us travel now to the great state of Nevada to examine a fascinating option. The Nevada Asset Protection Trust (NAPT) has unique advantages and who better to consult than attorney Steven J. Oshins<sup>2</sup> who has worked closely with Nevada's legislature on estate planning issues.

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***Presented With Our Compliments***

## ***Nevada Asset Protection Trusts***

Nevada is a large desert area that achieved statehood in 1864. It has been known for gambling (which was legalized in 1931) and as a destination for marriages (and divorces). In fact, 5.5% of American weddings take place in Las Vegas. For an extra \$150, an Elvis impersonator can perform the wedding.

But in recent years, estate planners have had good reason to think seriously about Nevada-izing assets. Aside from not having a state income tax, Nevada laws now protect assets with superior legislation...thanks in part to the efforts of Steve Oshins on Nevada's 365-year perpetuity law, charging order statute, and self-settled trusts.

A Nevada Asset Protection Trust (NAPT) is an irrevocable trust set up under Nevada's special law that allows a settlor to set up a trust for his or her own benefit and which can generally protect assets from the settlor's creditors two years after transfers of assets to the trust. *Note:* In order to use Nevada's law, there must be at least one Nevada trustee, whether an individual, a trust company or a bank. We were fortunate enough to track down Steve Oshins for an interview on how these trusts work.

### **Q-1. What's special about Nevada as an asset protection jurisdiction? Why use a NAPT?**

**A-1.** Only a minority of states permit self-settled trusts. Because of its two-year statute of limitations, Nevada has a competitive advantage over the other states that have similar self-settled asset protection laws. With respect to non-pre-existing creditors, Nevada law protects the transferred assets two years from the date of transfer. With respect to pre-existing creditors, Nevada law protects the transferred assets two years from the date of transfer or six months after the creditor discovers the transfer or reasonably should have discovered the transfer. Under Nevada law, a creditor is deemed to have discovered the transfer at the time of a public record such as the recording of a deed or assignment.

The other states that have similar laws all have a four-year statute of limitations except for Utah, which has a three-year statute of limitations. Certainly, it would be disappointing to have set up one of these trusts under a different state's law and then gotten sued during the third or fourth year only to then discover that it could have been set up under Nevada law in the first place, which would have protected the trust assets.

### **Q-2. What is the most likely profile of a person who will most clearly benefit from a NAPT?**

**A-2.** As a general rule, I suggest the NAPT to people who are worth at least a million dollars. However, I have done plenty of them for young doctors and other people in risky professions who are worth only a few hundred thousand dollars. In other words, the level of risk faced by a person factors into whether the person should be more likely to form a NAPT. The ideal candidate is someone who has sufficient net worth such that the legal fees and costs are relatively small in comparison to the assets being protected.

### **Q-3. Can a person put out-of-state real estate in a NAPT and get protection from a creditor?**

**A-3.** It is not certain which state law would apply in this situation. The majority of asset protection planners believe that the trust assets will be protected under this set of facts. However, when deciding which assets to protect within this structure and which assets to protect using a different technique, I try to leave out-of-state real estate out of the NAPT structure for this reason.

It definitely helps the choice of law argument to transfer the real estate to a Nevada limited liability company ("LLC") which helps "Nevada-nize" the asset in order to increase the probability of obtaining the desired protection. It is also very valuable that Nevada law makes the charging order the sole remedy of a judgment creditor.

### **Q-4. Let me take advantage of the fact that you authored Nevada's charging order law to go off on a tangent—how exactly do charging orders coordinate with asset protection?**

**A-4.** A charging order is a lien. A creditor with a charging order, or lien, against an LLC membership interest cannot obtain control of the LLC or force a distribution from the LLC. In fact, the combination of a Nevada LLC and a NAPT puts up two walls that on the surface seem insurmountable.

This is especially important for non-residents since their level of protection obtained using a self-settled domestic asset protection trust has not yet been decided by a court of law. Presumably, this is because plaintiffs are settling rather than trying to pierce

through the structure. The perception of the double protection encourages settlement.

**Q-5. I understand that you use a special structure where you combine a NAPT with two Nevada LLCs. Why use double LLCs?**

**A-5.** Interestingly, the NAPT-plus-two-LLC structure came to me while I was in the middle of giving a seminar about four years ago. I have probably used this identical structure for more than a hundred of my clients. Not only does it work well for a Nevada settlor, but it is even more valuable for a resident of another jurisdiction because of the additional importance in adding a second wall of defense.

By using Nevada LLCs, where the charging order is the exclusive remedy of a judgment creditor, if the person is sued and the plaintiff gets a judgment, the plaintiff can only get a charging order, or lien, against the LLC membership interest, subject to certain judicially created exceptions, such as for a single member LLC or in a bankruptcy. Since the client can be the operating manager of the LLCs, this gives the client full investment control over the LLC assets.

Let me explain the specific structure.

LLC #1 is owned 1% voting by the client's revocable trust and 99% non-voting by the NAPT. The client is the operating manager. This LLC acts as a rainy day fund since the client's revocable trust receives only 1% of distributions made and the NAPT receives 99%. The distribution trustee of the NAPT can make distributions to or for the benefit of the client if necessary, such as if the client is sued and loses access to all of his other assets.

LLC #2 is owned 1% voting and 98% non-voting by the client's revocable trust and 1% non-voting by LLC #1. The client will be the operating manager. This will be the fund that the client can live out of since his revocable trust will receive 99% of distributions made.

**Q-6). How does this combination of the NAPT with two Nevada LLCs play out if the client is sued and a judgment is entered against him?**

**A-6).** So long as nobody sues the client, he can live freely out of LLC #2 by distributing 99% of the distributions to his revocable trust which, of course, he controls. If he is sued and the creditor gets a charging order over that 99% interest, he would immediately "turn the spigot off" and stop making distributions

from LLC #2, since 99% of any distributions would have to be paid to the creditor.

He would instead start living out of LLC #1 by distributing 99% to the NAPT and then living out of that trust like a "trust fund baby" assuming the protection holds up (i.e., he has gotten past the statute of limitations period, there are no fraudulent conveyance issues, there are no choice-of-law issues between states, etc.). This combination of two Nevada LLCs with the NAPT should result in a favorable settlement for the client after the plaintiff's attorney realizes how this should play out.

Because of the need to live out of LLC #2 until and unless there is a creditor attack, there must be sufficient assets in LLC #2 for the client to use for living expenses. There should also be sufficient assets in LLC #1 such that the client can threaten to live out of LLC #1 if the debtor refuses to settle a dispute.

**Q-7). Is there a danger of persons throwing assets into a NAPT and then declaring bankruptcy? At what point will the law pierce the firewalls of NAPT's to limit such transfers?**

**A-7).** Yes, there are limits. Section 548(e) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 provides that transfers to a self-settled asset protection trust within 10 years of the filing of a bankruptcy do not protect the assets if the transfer was made with the actual intent to hinder, delay or defraud a creditor.

It is unclear whether this level of actual intent can be easily proven. However, a person with an old-and-cold NAPT should not test the reach of this provision and should instead avoid bankruptcy altogether. The person should use the NAPT as a tool to negotiate with the creditors by showing them that they are unlikely to be able to collect much even if they spend the time and money to obtain a judgment.

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## TECHNICAL REFERENCES

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1. "I'm Gonna Sit Right Down and Write Myself a Letter" was written in 1935 by Fred Ahlert and Joe Young and recorded by Fats Waller. It has been recorded by Bill Haley & the Comets, Frank Sinatra, Bing Crosby, Dean Martin and others.
2. **Steven J. Oshins** is a member of the Law Offices of Oshins & Associates, LLC, in Las Vegas, Nevada. Steve has been recognized as one of the nation's top estate planners and is a prolific author. We last interviewed Steve Oshins for The Estate Analyst in May, 2006 in an article entitled "Dynastic Trusts Today."

## H.R. 436 Retains Estate Tax

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You know that tax that we used to impose on estates? The one that we repealed in 2001 but which we kept imposing for nine years? The same tax that no one really believed would be repealed anyway?

In January, Congressman Earl Pomeroy, a Democrat from North Dakota (the sole representative of that state since 1993), introduced legislation to keep the estate tax. (Act surprised.)

H.R. 436 is now before the House Ways and Means Committee and it, or a bill just like it, will undoubtedly be making its way through the legislative process this year. But as opposed to stating a primary reason for the bill, such as maintaining tax revenues, encouraging philanthropy, or some plain old-fashioned “soak the rich” class warfare, the preamble to the bill identifies a long-feared tax nemesis as the primary objective:

“to repeal the new carryover basis rules in order to prevent tax increases and the imposition of compliance burdens on many more estates than would benefit from repeal.”

### ***Blame The Carryover Basis***

The carryover basis may work in Canada but in the United States it has been the Balrog of tax problems. The last time we tried to switch to a carryover basis in 1976, the transition had to be postponed and revamped and ultimately repealed retroactively.

Implementing a carryover basis embarrassed Congress back then and was poised to do so again. But perhaps H.R. 436 has ingeniously placed it at the forefront as the scapegoat for keeping the estate tax.

Whatever the face-saving motivations, there are certainly ample practical problems with imposing capital gains on property held at death. Estates that would face no transfer tax could have huge taxes on various capital assets and beneficiaries could be forced to sell those assets.

Establishing the cost basis for assets held for many years is incredibly burdensome. Years of estate planning have been based on a stepped-up basis at death, creating unfair burdens on individuals when they can no longer rearrange their estate plans as easily. Even utilizing the home sale exemption for capital gains isn't attractive in light of current residential property values.

### ***His Name Is Earl***

Congressman Pomeroy's proposal points out that only a few estates currently face federal estate tax, but vast numbers of estates would face burdens associated with the carryover basis. So instead of simplifying the taxation of estates, the repeal of the estate tax would increase tax burdens and complexity for more estates than it helped.

It took nine years to notice this? But let's look beyond such subterfuge. The estate tax is the focal point here. As had been long foreseen and awaited, Congress will most likely step back from the estate-taxless abyss of confusion and just keep the tax.

Under H.R. 436, the current \$3.5-million exemption which was phased in for 2009 would simply continue, with 45% as the top tax estate tax bracket. The unified credit would return and graduated rates would phase out for estates exceeding \$10 million.

We have reached the high plateau and it looks like the status quo will continue from here on out.

### ***A Sleeper Provision***

There is a stowaway aboard this repeal of the estate tax repeal. Estate-planning expert Marshall Jones (JD, ChFC, CLU, AEP) of R. Marshall Jones, Inc. in West Palm Beach, Florida, notes that the proposal is a mere six pages and, “as a result of its simplicity, has a high degree of likelihood of passage.” However, he identifies a significant provision that has hitched a ride on H.R. 436.

The extraneous provision has to do with the valuation of minority interests in businesses where, for instance, the minority status is created by establishing a family limited partnership.

Although FLPs are not targeted *per se*, they would be impacted by the legislation which would deny minority valuation discounts where members of the same family unit retain control of the asset.

Because H.R. 436 could be enacted by mid year, there may be only a few months to properly set up a family limited partnership or otherwise make successful transfers of discountable minority interests. Other limitations in H.R. 436 would apply “look-through” rules to address the valuation of transfers of non-business or passive assets.