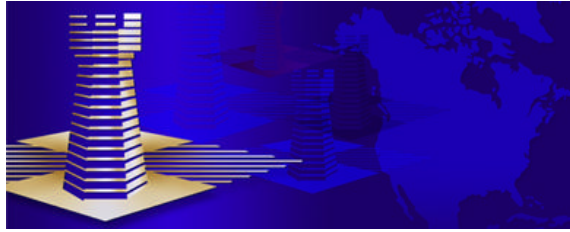


The Asset Protection Strategist or



Learning to Become a Grand Master

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The year was 2024 and lawyers in ever larger numbers ravaged the cities. No longer content to prey on high net worth individuals, the 40 percenters (as they became known²) had by 2020 formed their own political party in order to enact appropriate tort and other laws to more easily redistribute wealth. But banding together against this onslaught on property was a small group called Master Strategists led by their yet more accomplished brethren, the Grand Masters, the ultimate practitioners of the art of protecting wealth.

Whereas much has been written about the legal rules of asset protection and how legal entities are constructed, to the author's knowledge few, if any of these materials try to teach planning and strategy. It is the purpose of this article to delve into the thought process of asset protection "Grand Masters". How do they think? How do they develop a strategy? Why do they choose one legal tool or technique rather than another? How do they integrate several legal tools into a plan? Herein the author outlines the thought process the layman must learn to become a Master Strategist as the author has gleaned it from the esoteric work, *Strategica*.³

In this discussion the thoughts of a Grand Master will take you on a journey to a whole different level of asset protection understanding. On this level, you will no longer spend your entire time utilizing isolated protection tools and reacting to perceived threats; instead you will become proactive. You will learn to think through a client's concerns, set a goal, and methodically put into place the required strategy.

The goal of this discussion is simple: to make you think about asset protection in a different way. In order to understand the strategies that have been gleaned from *Strategica*, you should already be familiar with the laws

concerning fraudulent transfers, understand how to create a financial affidavit,⁴ and know the basic asset protection tools.⁵ To succeed you must become clever. Technical knowledge of the legal tools alone is not enough. You must think. And you must train yourself to think in a different way.

Grand Master Sir Harold St. Martin⁶ is fond of telling the story of one of his early clients for whom he created a well-constructed corporation and learned that cleverness as well as technical knowledge must be mastered. Concerned that he was entering into a high-risk business, Adam Smith consulted the Grand Master (then but a journeyman). The Grand Master being a cautious man called Adam's accountant and together they reviewed the client's business cycle cash needs and then formed and appropriately capitalized a corporation. Years later as a result of a dispute, Adam's corporation was sued as was Adam individually as the corporation's president, for acting outside the scope of his authority. The corporation, it turned out, was properly formed and properly operated, and in spite of several ingenious attacks attempting to pierce its veil, the corporate protection prevailed. Unfortunately Adam, as an individual, was not so successful and all of his assets, including his 100% ownership in his well-designed corporation, are now owned by the plaintiff.

From this lesson the Grand Master learned that it is not enough to create a corporation. When considering using a corporation, the clever practitioner must protect both the assets in the corporation as well as the holders of the corporation's stock.⁷ The clever practitioner must strategize as to:

- (i) From where will the attack (lawsuit) come? Will the corporation be sued?⁸ Will the corporate veil be attacked?⁹ What assets should be placed into a corporation?¹⁰ How valuable should the corporation be allowed to become?¹¹
- (ii) Who will be the corporation's officers, directors, and shareholders?¹²
- (iii) How will the corporate stock be held?¹³

The Grand Master also learned that in a society where few take responsibility for their actions,¹⁴ an incorrectly formulated plan is the practitioner's responsibility alone. No one else's. The practitioner can have no excuses for his blunders. The practitioner and the practitioner only must assume responsibility for his or her asset protection strategy.

The combination of continual study, reasoning and critical thinking alone allow the Journeyman to become a Grand Master. Technical proficiency by itself is not sufficient. It is critical thinking that allows one to process the information that gives the technical information its value. Critical thinking occurs in every asset protection plan, even those composed by weak planners. The weak planner's eyes may gleam as he or she sets up a corporation which the planner causes to be owned by a family partnership which in turn is owned by a living trust.¹⁵ The planner may believe he or she is clever. But wait a moment. His opponent has pierced the corporation's veil and obtained all of the FLP's assets. How did this happen? What should the planner have done instead? What should he do next? Critical thinking has occurred. Why when put to the test does one person's asset protection planning succeed and another's almost always fail? Why? Because one practitioner has a secret weapon. Strategy.

This article will discuss¹⁶ what strategy is and how to create and harness specific strategies¹⁷ for your own use. The points that will be covered are:

- A. the visual planning philosophy—"red to green";¹⁸
- B. shields or other liability-absorbing tools;¹⁹
- C. the Accumulation Theory;²⁰
- D. screens;²¹ and
- E. funding.²²

A. THE VISUAL PLANNING PHILOSOPHY: RED TO GREEN

First we need to create a context to work in. The Grand Master has just returned from a long client interview, which has revealed the client's litigation concerns and planning needs.²³ The client is in the high-risk trucking business and is fearful that one accident could exceed his insurance and wipe out his company and a lifetime of savings. The Grand Master pulls out several pieces of colored paper and sits down to commence his planning. Seeing the author's surprise that such a sophisticated person is working like a child with colored drawing paper, he explains:

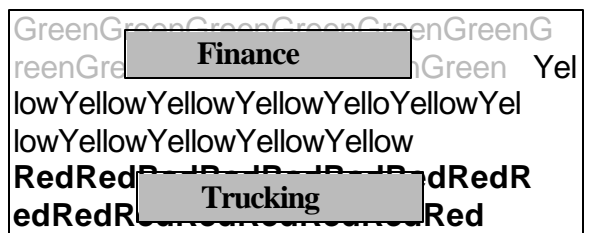
Exhibit 1
Green, Yellow, Red Technique



“I am a very visual person. I use the green to red technique as a method of planning my strategy. I will create entities (represented by boxes on my diagram) which will be designed to be quite profitable, they will be placed in the green area of my plan. Entities placed into the yellow areas engage in more hazardous activities than entities placed into the green, and could attract liability. When I create entities which will be involved in hazardous activities, I place them into the red area. Green area entities tend to be structured to become asset heavy, red entities are asset light. Green entities are well protected on my chess board, red entities are sort of like disposable diapers.”

The Grand Master began to construct his strategy. On the bottom of the paper (deep in the red) he placed a box labeled Trucking. This is the entity which would actually perform the trucking function. At the top of the page (in the green) he placed a second entity-Finance. This entity would operate as the finance arm for the enterprise.²⁴

Exhibit 2
Two Entity Risk Minimization Technique



“The Trucking entity being involved in a highly dangerous activity should not become asset or cash heavy. Therefore I will have Finance loan Trucking 80% of the money needed to buy the trucks. To secure its loan Finance will place a UCC-1 lien

on the trucks. The trucks will depreciate in value and if Trucking is sued its equity in the trucks will be minimal.”

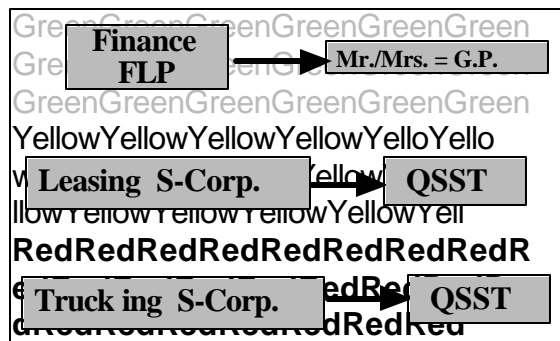
Is that it? Is that all there is to it?

“No”, the Grand Master replied, “we haven’t even begun”. What type of entities shall we use?²⁵ Who shall own them or how shall they be owned?²⁶ Who shall control them?²⁷ Are we satisfied we have analyzed and protected against all avenues of attack on our client’s assets?”²⁸

Before we proceed further to minimize risk by segregating functions into various entities we need to be aware of the principals enunciated in cases such as *Riddle v. Leuschner*,²⁹ *Talbot v. Fresno Pacific Corp.*,³⁰ and their progeny. With these cases in mind risk segregation should be undertaken along appropriate functional lines and each entities, officers, directors, and owners should be clearly differentiated.³¹

Because the Drivers’ trucking operation was large,³² and the Clients were concerned with their personal assets, the Grand Master refined his initial thoughts (as illustrated in Exhibit 2) by adding a Leasing entity to further reduce risk (see Exhibit 3).³³ Contracts between Finance, Leasing, and Trucking were also drafted so as to clearly set forth the functions of each entity as well as the relationship of each to the other.³⁴ By stipulating both the interest rate Finance would charge Leasing and the lease rate Leasing would charge Trucking, profit in Trucking was minimized, in Leasing decreased and in Finance maximized.³⁵

Exhibit 3 Three Entity Risk Minimization Technique



Trucking as a high-risk (red) activity could be owned by a shield,³⁶ and be structured utilizing the principal of the Accumulation Theory.³⁷ Always cognizant of *Leuschner*, and *Talbot* (see above), we will want Trucking's and Leasing's activities carried on by S corporations each with its own shareholder and as few common officers and directors as feasible.

One advantage of using S corporations is that they each can be held for the benefit of family members by a Qualified Subchapter S Trust (QSST)³⁸ which can act as a shield.³⁹ The major tactical advantage of using a QSST is that it can have only one income beneficiary.⁴⁰ Therefore, it is reasonable that if the clients are planning their estate and own several S corporations, and have several children, a separate QSST must be set up for each estate plan income beneficiary, and a valid legal reason can be used to combat a *Leuschner*, or *Talbot* type attack.⁴¹

The other assets held in the QSSTs (especially the QSST which owns Trucking) will be a minimal amount of cash. The S corporations will hold at a minimum appropriate liability insurance and enough cash to cover its operational needs. We are structuring the entities' relationship with each other so that Trucking will never be a valuable asset and Leasing will only be minimally valuable. Therefore, our client has divested himself of liability without divesting himself of the most valuable part of his business, and has saved a considerable amount of tax dollars.

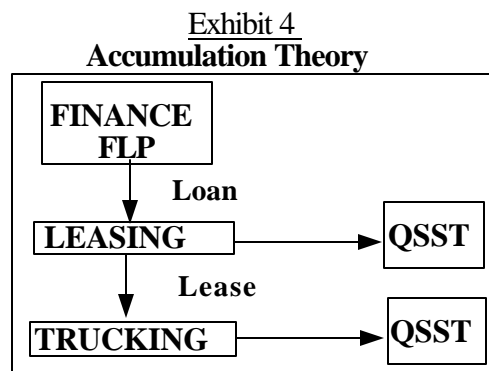
In this three-entity risk minimization technique (as shown in Exhibit 4), Finance FLP will make an 80% loan to Leasing in exchange for a promissory note and lien to secure the note on the trucks Leasing purchases.⁴² Leasing will purchase trucks for twenty percent down and use Finance's loan to pay the balance. Leasing will then lease the truck to Trucking. If Trucking is involved in a lawsuit, it owns only leased trucks. If its veil is pierced, the QSST loses its minimal cash holdings and our client is not legally responsible. If, in addition to Trucking, for some reason a jury holds Leasing (or its shareholders) liable, Leasing has only a 20% equity interest (less depreciation) in the trucks and its QSST owner only a minimal amount of assets. Whether Leasing should be owned by a QSST or whether our client can own it directly is dictated by their concerns as to whether a second level piercing is a reality.⁴³

B. SHIELDS OR

LIABILITY ABSORBING TOOLS

A shield is used to isolate the ownership of a high-risk enterprise from the client. The shield (not the client) owns the high liability entity.⁴⁴ The shield entity need not be overly concerned that either it will be sued directly or that the high risk enterprise's veil (if that entity is a corporation) will be pierced because the shield has few other assets. For an example of the use of a shield please refer to the discussion surrounding Exhibit 3.

C. ACCUMULATION THEORY



The Accumulation Theory states that “a game can and should be won by the accumulation of small advantages”.⁴⁵ This theory may be placed into practice by the contractual arrangements⁴⁶ set up between the various entities. For instance:

1. Finance to Leasing Contract. The loan⁴⁷ of 80% to value from Finance to Leasing will, within normal commercial limits, be drafted to be favorable to Finance, thereby drawing profit from the yellow zone to the green zone. Leasing will have only a 20% equity interest in the trucks subject to Finance's 80% lien. Leasing's exposure has been reduced by 80%.
2. Leasing to Trucking Contract. The lease⁴⁸ from Leasing to Trucking will, within normal commercial terms, be favorable to Leasing, thereby drawing profit from the red zone to the yellow zone. Trucking has no equity in the trucks it leases.

3. Finance to Trucking Contracts. To the extent that Finance can provide services directly to Trucking,⁴⁹ appropriate contracts will be entered into.

In addition profits distributed to the QSSTs and to the over 14 years of age children who are beneficiaries is tax efficient.⁵⁰

D. SCREENS

A screen is an intermediate entity used to: (i) screen the real person or entity involved from view, and (ii) prevent corporate piercing from attaching assets.

Exhibit 5 Screens



For instance, suppose your client wishes to utilize a family limited partnership, but does not want to be seen to be the general partner. Most states require the identity and address of the general (but not limited) partner(s) to be stated on Form LP-1 which must be filed with the Secretary of State.⁵¹ In order to obtain anonymity the general partner could be a Nevada corporation. The Nevada corporation would show up on the LP-1, but to find out whom the corporation's shareholders are the opponent would have to make inquiries to the Nevada authorities. Since in Nevada, shareholders of a corporation need not be registered this inquiry would be fruitless.⁵² The shareholder of the corporation could be the client, or if risk of general partner liability was high, or there was concern that the corporate veil of the Nevada corporation could be pierced, the shareholder could be a trust.

E. FUNDING

The funding of the legal entities used in a plan is a whole art in itself, the Grand Master told me with a disapproving look on his face.

“Many years ago as I entered the practice, I encountered clients who, having already paid for asset protection planning, would arrive at my office with 7 family limited partnerships in tow. When I asked how this had come to be, I was told that they had attended a seminar whose nationally known speaker told them that as they wished to protect 7 individual pieces of real estate, in order to isolate the liability that one lawsuit could bring to all their real estate if funded into one partnership, each property should be placed into its own partnership. Whereas, before this process commenced the client was running a successful real estate business, after this process he was quite confused by the separate accounting he was told he had to keep for each partnership and consequently found his business in confusion.

How was I to tell him that all he had really accomplished is assist the establishment of the Attorney’s and Accountant’s Full Employment Act, as well as providing the state with franchise tax on 7 partnerships. How to tell him, not only has he caused himself confusion and incurred unnecessary legal, accounting and franchise tax expenses, but he had potentially hurt his heirs capital gains tax wise?”⁵³

The sophisticated practitioner knows there are different techniques to use in funding legal vehicles.

1. Funding By Real Estate Deed

Exhibit 6 Funding By Deed



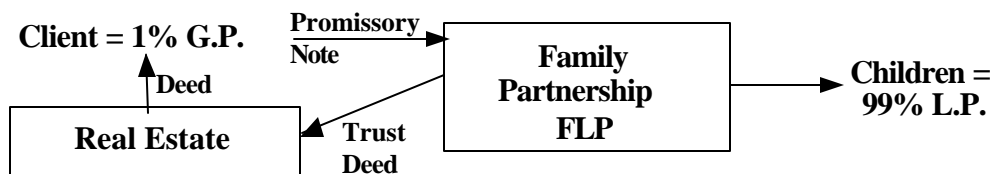
Herein the FLP owns the real estate and stands liable for any injury caused by it.⁵⁴ In California the transfer of the deed to the FLP as well as the transfer of limited partnership interests to the client’s children must be carefully structured so as not to trigger Proposition 13.⁵⁵ In addition the appropriate state, county and city transfer tax statutes need be consulted.⁵⁶

When the client dies, his 1% general partner ownership will step-up (less the appraisal discount) to its date of death valuation. The subsequent sale of the property will be capital gains costly.⁵⁷

When this method is used, because the partnership will own and be held liable for the real estate, the 7 aforementioned partnerships are needed in order to isolate the liabilities only to the particular parcel of real estate causing the liability.

2. Funding By Real Estate Trust Deed

Exhibit 7 Funding By Trust Deed



Herein the client owns the 7 parcels of real estate and stands liable for any injury caused by them. However since all of the client's assets have been protected, he is judgment proof.⁵⁸ The partnership owns most of the value of the 7 parcels of real estate.⁵⁹ The partnership obtains this value as follows: The client contributes a \$990,000 promissory note to the partnership in exchange for his or her general and limited partnership interests. The partnership places a trust deed (thereby asset protecting the real estate) on the real estate as security in case the note is not paid. In California Proposition 13 does not apply.⁶⁰ In addition, state, county and city transfer tax statutes do not apply as a deed transfer has not taken place. When the client dies, he dies owning 100% of the real estate and his heirs receive a 100% tax step-up. If the real estate is now sold by the heirs, no capital gains tax will be due.⁶¹

CONCLUSION

Technical knowledge of the legal tools alone is not enough. You must think, and you must train yourself to think in a different way. Strategic planning involves more than technical expertise.

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- ¹ Mr. Eber is available for questions or discussions of related matters at: 818-906-0126. Emails are welcomed at: info@assetprotectionlaw.com
- ² Success in litigation brought the lawyer 40% of the judgment in addition to being recompensed for all expenses.
- ³ Written in the year 2015 by Sir Harold St. Martin, the greatest of the Grand Masters.
- ⁴ To protect yourself as a professional against your client's opponent claiming you assisted your client in making a fraudulent transfer.
- ⁵ For example: (a) family law (appropriately titling assets, and marital agreements); (b) family partnerships (c) corporations and LLCs (avoiding piercing of veil); (d) spendthrift and other protective trusts (discretionary and shifting trusts, self-settled vs. non-self-settled trusts); (e) retirement plans, and (f) offshore trusts and techniques, etc.
- ⁶ See footnote 2
- ⁷ This thought process is called "inside/outside protection." To protect owners from business (inside) liabilities, activities are carried on through an appropriate entity (herein a corporation). To protect the entity it must be set up correctly (herein appropriately capitalized and operated with due consideration given to prevent piercing, etc.). To protect the ownership interest in the entity from a "piercing" attack or from an outside creditor of the owner, care must be given as to how the stock is held.
- ⁸ E.g., did the corporation injure someone?
- ⁹ If the veil is successfully attacked whoever owns the stock can be held liable in the action.
- ¹⁰ Will the corporation hold "safe" or "dangerous" lawsuit-producing assets? E.g. if it is involved in trucking activities, trucks are dangerous instrumentalities, if it is involved in marketing of clothing the activity is lower risk.
- ¹¹ As will be seen below if the corporation will be involved in hazardous activities it should not be allowed to own valuable assets. On the other hand if its functions are of a low lawsuit risk it can hold valuable assets.
- ¹² When corporations are sued, many times so are their officers and directors. When a corporate veil is pierced, the shareholders' assets can be reached.
- ¹³ An officer or director of the corporation could own stock directly or (for instance) via an FLP. If the officer or director is sued and loses he or she will lose stock owned directly but not stock held via an FLP. However, if the corporation's veil is pierced, all of the assets in the FLP could be lost.
- ¹⁴ It is always someone else's fault, hence the proliferation of lawsuits.
- ¹⁵ The corporate stock was placed into the FLP to give it "outside" protection, to prevent its loss in a lawsuit against the client. The FLP interests were placed into the living trust to give them the living trust's traditional benefits – no probate, estate tax saving, and disposition over time. What the planner did not consider was protecting the corporate veil; see the discussion in the Article under (i) above as well as footnotes 8, 28 and 29.
- ¹⁶ As the author has gleaned it from the esoteric work *Strategica*, see footnote 2.
- ¹⁷ Chess Grandmaster Larry Evans calls strategy "...a long-range master plan." Hooper and Whyld, in the Oxford Companion to Chess, say that strategy is "...the planning and conduct of the long-term objectives..." Perhaps the late World Champion Max Euwe put it best when he said, "Strategies require thought; tactics require observation."
- ¹⁸ See "A. The Visual Planning Philosophy: Red to Green", below.
- ¹⁹ See "B. Shields or Other Liability Absorbing Tools", below.
- ²⁰ As taught by the chess master Wilhelm Steinitz. In the Accumulation Theory the Grand Master creates a strategy composed of several tools; each one provides a small advantage, but together the accumulative effect is overwhelming. See "C. Accumulation Theory", below.
- ²¹ See "D. Screens", below.
- ²² See "E. Funding", below.
- ²³ For purposes of this article the client, Adam Driver, is married to Jeannie Driver and has three children who are minors but who are over the age of 14. Adam runs a large trucking company wherein he solicits contacts to ship goods in trucks. Adam purchases the trucks and manufactures the truck-trailers.

Adam hires drivers to move the goods over urban and rural streets and highways. Aside from his business, Adam has a home, stocks, bonds and cash.

²⁴ Not only could it extend financing to Trucking to purchase trucks but it could extend financing for whatever reason Trucking or any other of the “group’s” entities required, i.e. real estate, renovations, equipment, inventory, etc. This would keep the assets of Trucking and any other lower tier (red) entity asset poor and in debt.

²⁵ Corporations, LLCs, FLPs, Trusts, Offshore entities?

²⁶ “Outside” protection. See footnote 6. Should they be owned by Adam and Jeannie Driver as community property? By the Drivers as their sole and separate property? By another entity such as a family limited partnership, etc.?

²⁷ If held via a trust should Adam and/or Jeannie Driver be trustees or protectors? If held by a corporation should Adam and/or Jeanne Driver be officers or directors? If held by an FLP should Adam and/or Jeanne Driver be general partners, etc.?

²⁸ E.g., if Finance is a corporation: (i) is the corporation secure from piercing?, (ii) has funding of Finance (safe vs. dangerous assets and functions been considered?), (iii) if the corporation is pierced, who owns the stock? Who has the liability?, (iv) if our clients are sued personally who owns the stock? If the clients lose a personal lawsuit will they lose the stock and hence the corporation?

²⁹ 51 Cal. 2d 574 (1959). In some circumstances courts will ignore the corporate entity and hold the individual shareholders, or the corporate parent of a corporation, liable for the debts and obligations of that corporation by applying a legal theory that is commonly referred to as the *alter ego doctrine*. Under this theory, if a party whose interests have been injured due to the acts of a corporation can prove that the corporate entity is the alter ego of one or more individuals, or another corporation, the court may hold the individuals themselves or with the controlling corporation responsible for the injurious conduct. *It should be noted that formal ownership of stock is not required to hold an individual liable for corporate debts. A debtor will be treated as the owner of stock if the true owner is not real, i.e. is a straw person set up to hold the debtor’s stock.*

Courts that apply the alter ego doctrine frequently state that they are *piercing the corporate veil* or are *disregarding the corporate entity*. Such phrases are metaphors used to describe the legal theory that is aimed at preventing persons from abusing the privilege of carrying on business in a corporate form.

Typically, an alter ego allegation is made against a corporation and its shareholder(s) when the corporation’s assets or insurance are inadequate to respond to a claim or to pay a debt. A creditor who would otherwise go unpaid by the corporation will seek to hold its shareholder(s) personally liable for the claim based on the theory that:

- The shareholders have not treated the corporation as an entity separate and apart from themselves, so why should the court, and
- Maintaining the corporate veil would be inequitable

It should be noted that the Court also found in *Leuschner* that neither corporation held regular directors meetings, both occupied the same office, both used the same furniture, files, bookkeeper and attorney and the shareholder entered into personal transactions with the corporation.

³⁰ 181 Cal.App.2d 425 (1960) Shareholder *liability may also attach when the business enterprise is divided into artificial segments so that the segment holding the majority of the assets of the enterprise is isolated from the operating segment that is likely to incur the liabilities.*

Example: An individual decided to incorporate her business and, instead of forming one corporation, formed Corporation A and Corporation B. *Corporation A, which was the operating entity, assumed all of the liabilities of the business while Corporation B acquired all of the assets, equipment and the building. Corporation A leased all of its operating assets from Corporation B.* The court held that the individual shareholder was the alter ego of Corporation A and was personally liable for its obligations.

³¹ For instance a manufacturing entity could manufacture the trailers, a leasing entity could lease them to end users, and a trucking company could attach the trailers to leased trucks and haul freight. However, two trucking entities may make little functional sense aside from liability minimization. From a separation (or separateness) point of view, the entities should have their own space, employees, phones,

stationary, officers, directors, owners, etc. See *Leuschner* footnote 28, above. See Spero, *Asset Protection, Legal Planning and Strategies*, Chapter 9 Corporations.

³² Over 500 trucks could be on the road on a given day.

³³ See also “Part “C. Accumulation Theory” below.

³⁴ These contracts were drafted with the *Leuschner* and *Talbot* cases in mind. See footnotes 28-29 above.

³⁵ See “Part “C. Accumulation Theory” below. The contracts need to be structured within commercially reasonable terms. However, within that constraint Finance will be favored over Leasing, and Leasing over Trucking. If the group’s activities were large enough a fourth entity (perhaps called “Services”) could be added to provide legal and accounting services for the group as well as to (perhaps) market and enter into contracts for the trucking services. Services (on favorable terms) could then subcontract with Trucking for Trucking to perform the trucking contracts.

³⁶ See “Part B. Shields or Liability Absorbing Tools”, below.

³⁷ See “Part “C. Accumulation Theory” below.

³⁸ Although Grantor Trusts and Electing Small Business Trusts may also be used to hold S corporation stock, we are using the QSST because of its requirements that there be but one income beneficiary and its requirement that income be distributed.

³⁹ See “Part B. Shields or Liability Absorbing Tools”, below.

⁴⁰ IRC Section 1361(d)(3)(A)(i). Except in the case of the spousal rule Treas.Reg. Section 1.1361-1(j)(2)(i)-whereby the spouses will be treated as one beneficiary for all QSST purposes.

⁴¹ Our clients by tax law must set up three QSSTs for their children. Therefore it is reasonable as part of estate planning that son #1 is the beneficiary of QSST #1 and son #2 is the beneficiary of QSST #2. Trucking is owned by QSST #1 and Leasing by QSST #2. Different shareholders own each corporation, and different shareholders have to own each corporation. In addition as the children are over 14 (see footnote 22) the use of S corporations and QSSTs will prove to be tax efficient by shifting income out of the Drivers’ high tax bracket into their children’s 15% tax bracket.

⁴² This structure involves three entities (Finance, Leasing and Trucking) rather than the two entity (Finance and Trucking) structure described in Exhibit 2). Finance FLP could be part of the Drivers’ personal protection planning and could hold their cash, stocks, bonds and other personal assets. Leasing could lease trucks, trailers and other assets needed by Trucking to Trucking as Trucking may not have the cash available to purchase assets on its own.

⁴³ Client’s personal assets are asset protected in Finance should the court attempt to use a *Leuschner* type argument to impute liability to the client.

⁴⁴ The Client may also own, control, or be a beneficiary of the shield entity, but usually because of *Leuschner* and *Talbot*, this is not advisable.

⁴⁵ Yasser Seirawan, *Strategies*, Microsoft Press at page 200 quoting Wilhelm Steinitz

⁴⁶ Contracts must be set up to define the relationship and the arrangements between the parties. Lacking this normal, prudent, commercial practice a *Leuschner* and *Talbot*, argument is more easily made.

⁴⁷ Finance must secure its loan by taking and recording a lien. Lacking this normal, prudent, commercial practice a *Leuschner* and *Talbot*, argument is more easily made.

⁴⁸ Which must be drafted with all the normal commercial terms, is required to define the relationship and the arrangements between Leasing and Trucking. Lacking this normal, prudent, commercial practice a *Leuschner* and *Talbot*, argument is more easily made.

⁴⁹ Such as Finance performing accounting, marketing, billing and collection, and other services. The contracts while within normal commercial parameters, will favor Finance thereby drawing profits from the red direct to the green zone.

⁵⁰ When children turn 14 they will enter their own tax bracket, not their parents’. Distributions to them will be taxed in the children’s’ low tax bracket instead of the parents’ higher brackets. A further consequence of this QSST tax saving technique is that the income distributions will be removed from the QSST and thereby be lost to a piercing attack directed at the S corporation and hence the QSST. The fact that significant tax savings can be shown will add further credence to the QSSTs owning the stock.

⁵¹ For example see Section 15621 of the California Corporate Code.

⁵² NRS 78.240 “The shares of stock in every corporation shall be personal property and shall be transferable on the books of the corporation, in such a manner and under such regulations as may be provided in the bylaws, and as provided in Chapter 104 of NRS.”

⁵³ Not only in reference to estate tax step-up in basis issues, hence the capital gains issues as illustrated (in footnotes 56 and 60) below, but also transfer tax, and in California, Proposition 13 issues.

⁵⁴ Hence the need for 7 partnerships if this form of funding is utilized.

⁵⁵ In California if real estate is properly transferred it is not reassessed for property tax purposes (California Revenue & Taxation Code Section 62(a)(2): Change in Ownership does not occur in a transfer in which proportional ownership of the transferors & transferees in each and every piece of real estate transferred remains the same). In transferring FLP interests (California Revenue & Taxation Code Section 64(e)) Change in Ownership does not occur if cumulatively more than 50% of total interests in both capital and profits are not transferred.

⁵⁶ Transfer of real estate may cause state, county and/or city taxation.

⁵⁷ Assume the client's basis in a \$1 million date of death fair market value parcel is \$91,000. When he dies (omitting valuation discounts) a 1% or approximate \$9,000 step-up occurs, as the client owns only 1% of the partnership, which owns the real estate. Total step-up (if he owned the real estate outright would be \$909,000). When the children sell the property they need to pay capital gains tax on a \$909,000 gain.

⁵⁸ His 1% (in the parcel of real estate previously discussed) is worth only \$10,000. \$990,000 is protected by the family limited partnership.

⁵⁹ This technique is sometimes called equity stripping. We have used \$990,000 in order to stay consistent with the examples previously used. In practice, the equity strip should not exceed the amount of loan which client could receive from a lending institution.

⁶⁰ Real estate has been encumbered not transferred.

⁶¹ However, it should be clearly noted that the partnership in this example holds a \$990,000 note. Assuming that 8% is a commercially reasonable rate for such a loan, then the client must pay \$79,200 per year to service the debt.

From a tax point of view the results shall be an interest deduction for the client when he pays the note on the commercial property and interest income when he receives the partnership K-1. The issues here initially involves minor cash flow planning.

However, if the client transfers 99% of his or her partnership interests to his or her children, income tax and cash flow planning becomes more acute. The client owns the real estate pays on the note and gets an income tax deduction. The children receive a K-1 for 99% of the income, and receive 99% of the cash flow.

If this is a problem the astute planner may want to consider transferring the 99% limited partnership interest into a GRAT for a term of years. During the life of the GRAT, the client will receive both the cash flow and the tax liability to offset his or her payment and tax deduction.