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Developments

IN ASSET PROTECTION AND WEALTH PRESERVATION

The last two years have seen significant changes in asset protection planning. Last year brought the new bankruptcy act which significantly affected homesteaded property and ER-ISA plans, as well as driving what should be the final nail into the concept of the self-settled asset protection trust. This year has so far brought several obscure but potentially very significant cases that may signal how the courts will treat planning that is specifically meant to lessen the rights of unknown future creditors, i.e., asset protection.

Congress and the IRS have recently signaled they are going to make offshore planning unpleasant, if for no other reason than to deter rich people from using it to hide assets and income. Prosecutions are up of offshore promoters and their clients who are caught with unreported offshore entities and accounts, and the IRS is starting to pursue one of the most abusive offshore tax strategies ever – Private Placement Life Insurance tied to the ownership of closely-held business interests and intellectual property rights. I predict that offshore planning will in the future be used in only exceptional circumstances, such as for true multinational families and international estate planning. For the ordinary Dr. Joe, offshore planning is about to become too painful to pursue if it hasn't been such already. Certainly, night has fallen on the heyday of offshore planning, meaning that quality domestic planning will be more important than ever. -- Jay

UPCOMING EVENTS

October 12 – Jay Adkisson will present "Asset Protection: 10 Things You Must Know" at a luncheon of the **Tax Section of the Orange County (California) Bar Association** beginning 12:00 noon at the Double Tree Club. More information at <http://www.ocbar.org/> and seating is limited.

October 19-21 – Jay Adkisson will make two presentations, "Asset Protection: 10 Things You Must Know" and "Understanding Charging Order Protection and Drafting Considerations" at the **Southern California Tax & Estate Planning Forum** at the Manchester Grand Hyatt in San Diego. More information below, and at <http://www.clenet.com>

November 11 – Jay Adkisson will participate in a panel on "Judgment Collection Issues in Federal Court," along with federal bankruptcy judge, Hon. Alan Ahart, hosted by the **Orange County Bankruptcy Forum**, at Chapman Law School in Orange, California, from 9:00a to 12:00a. More information at <http://www.ocbf.org>

November 21 – Jay Adkisson will present "Asset Protection: 10 Things You Must Know" at a luncheon of the **Tulsa County Bar Association**. More information at <http://www.tulsabar.com>

January 8-12, 2007 – Jay Adkisson, Alexander Bove and Gideon Rothschild will present "Ethics of Asset Protection" at the University of Miami's **Heckerling Institute** for Estate Planning in Orlando. More information at <http://www.law.miami.edu/heckerling/>

TWO NEW BOOKS

Equity-Indexed Annuities: The Smart Consumer's Guide, by Jay Adkisson describes and gives the advantages and disadvantages of

an advanced form of annuity that pays the greater of a minimum guaranteed interest rate return or a percentage return that is calculated against a major stock market index. Available at <http://www.amazon.com> (search "equity index").

LostEye: Coping with Monocular Vision, based on letters, messages, and e-mails that Jay Adkisson received, after creating the website <http://losteye.com> after losing his eye to cancer in 2000, and which has since become the leading support resource for those facing or having just experience the loss of an eye. Available at <http://www.amazon.com> (search "lost eye").

ASSET PROTECTION FOR AVIATORS AND AIRCRAFT OWNERS

by Jay D. Adkisson

Merrill C. Meigs Field was a charming little airport next to downtown Chicago. A few years ago, the field was closed and turned into a park, much to the dismay of pilots nationwide, particularly those in the Chicago area. However, before it closed, Meigs Field was an unwitting participant in an aviation accident and subsequent lawsuit that should cause deep concern to every pilot and airplane owner.

On the slightly hazy afternoon on July 19, 1997, the owner-pilot of a small single-engine Bonanza was preparing to land at Meigs Field. An experienced controller employed by Midwest Air Traffic Control, Inc. ("Midwest"), a private contractor to the Federal Aviation Administration ("FAA"), was on duty. As the Bonanza was cleared for landing, the pilot noticed that his landing gear lights did not display the proper gear-down-and-locked indication.

At this moment, the controller advised the Bonanza to make a low fly-by over the runway so that the controller could make a visual inspection of the Bonanza's landing gear. As the Bonanza passed by, the controller advised the Bonanza that the landing gear appeared to be up. The Bonanza pilot then asked to be routed over Lake Michigan so that he could attempt to hand-crank the Bonanza's gear down.

The Bonanza pilot manually cranked down the landing gear, and told the controller that the gear appeared to be down. The controller then agreed to make a second visual inspection of the Bonanza. On this fly-by it appeared to the controller that the Bonanza's gear was down. The Bonanza pilot successfully landed at Meigs Field. He parked the Bonanza, believing that the day had concluded without incident for him.

Meanwhile, a few miles away, while the Bonanza pilot had been dealing with his landing gear problems, the pilots and passengers of two other small planes were sightseeing along the Lake Michigan shoreline near Meigs Field. The pilots of both planes were commercially-rated and had hundreds of hours of flying experience. Conditions were such that visual flight rules ("VFR") were in effect, although it was hazy on this mid-July day.

The FAA rule in visual conditions is "See and Avoid", which means that every pilot is primarily liable for looking out for traffic himself, and that the air traffic controllers will only give advisories regarding other aircraft nearby when workloads allow. Nonetheless, both of these small planes were on the same radio frequency, which was the Meigs Field frequency, and could hear the controller giving instructions to the pilots of each of the two planes as well as to the pilot of the Bonanza with the gear problems.

Nonetheless, the pilots of the two planes (the only other planes in Meigs Field's airspace) failed to look out for one another and collided, killing both the pilots and five other passengers. Mid-air collisions of small airplanes at small and loosely-controlled airports occur a few times a year, with hundreds of near-misses. Collisions are not ordinary

or routine, but they do happen when pilots fail to look out for one another.

This crash had all the hallmarks of a high-wing/low-wing accident, which occurs when the high-wing plane is climbing (with its blind spot above) and the low-wing plane is descending (with its blind below). The witness statements contained in the investigation by the National Transportation Safety Board (NTSB) bear this out.

There were many witnesses who observed the two airplanes collide. One witness, a military pilot, said he "...noticed [a] Cessna 172 at 300-feet less than a mile off [the] beach." He said it "Looked straight and level... moving south bound." He said a Learjet type aircraft was at 800-feet above the lake's surface heading north. This airplane was in "...full landing configuration..." in a 300 to 400-foot per minute descent toward the airport. He said it looked as though the Cessna 172's left wing hit the right side of the inbound airplane.

A second witness, a civilian pilot, said he "...observed a single-engine, low wing, aircraft that appeared to be heading north collide with what appeared to be a single engine high wing aircraft that appeared to be heading south." He continued by saying, "It did not appear to me that any of the two aircraft took any evasive action, although I only viewed the two aircraft shortly before the collision occurred. Both aircraft appeared to be flying normally, with no control problems. I would estimate the collision occurred at an altitude of between 500 and 1,000- feet AGL."

Whenever there is an air crash of any type, a lawsuit is almost sure to follow. In this case, everyone in sight was sued, including the FAA, Midwest and the controller. None of this is surprising, and most of these parties settled with the estates of the victims to avoid a trial.

Remarkably, the estates of the victims also sued the pilot of the Bonanza – the plane with the landing gear problems, which was miles away from the collision – claiming that the Bonanza pilot's gear-up incident distracted the controller such that she was not able to warn the other two small planes not to run into each other. The pilot of the Bonanza quite understandably refused to settle.

At trial, the controller testified that she was not unusually distracted by the Bonanza's situation, that she did not feel that the Bonanza pilot was monopolizing her communications to the detriment of other pilots, and that she warned the two pilots who crashed to look out for each other.

The plaintiff's attorney, however, put an alleged aviation "expert" on the stand who testified that, based on his review of the FAA's transcript of the controller's communications with all the airplanes, the controller was distracted by the Bonanza's gear-up incident, whether she thought so or not. Because of this distraction, the expert claimed, the controller did not give the other two airplanes sufficient instructions so that they could avoid each other.

The jury apparently believed the aviation expert, and awarded damages against the pilot who had the landing gear incident in the amount of \$2,195,416. *Walker v. Segal*, Cook Cty. Cir. Ct. No.2002-L-2169.

So much for "proximate cause" as an element of negligence liability, eh?

To editorialize for a moment, this is a ridiculous verdict. The case should have been thrown out at the Motion to Dismiss stage, but now enters the Hall of Crazy Verdicts with the hot coffee from McDonalds and similar instances of legal absurdity that bring the whole legal system into disrepute.

However, my editorializing doesn't help the poor Bonanza pilot who likely had only \$1 million in general liability coverage (if that) and may now have the portion of the judgment that is unpaid by insurance collected from his personal assets – including probably his Bonanza. Not that he may care, since this incident is likely to cause him to want to give up flying permanently!

Having been an attorney for over 17 years, I have seen a lot of wacky cases and not just a few strange verdicts. But as a pilot myself, and having many pilots as clients and friends, I find the result in this case particularly disturbing because the Bonanza pilot simply did nothing wrong and could not have imagined that his gear-up incident would cause – in either a practical or a legal sense – the mid-air collision of two other aircraft miles away.

Solutions

Pilots are good about dealing with problems, and this is just another problem to be solved. There are no easy solutions, however. Aviation insurance is difficult enough to obtain as it is. It may be expensive to increase the coverage limits of your general liability policy, even if the insurer will allow an increase. Plus, how much insurance is enough?

Umbrella insurance, which I have strongly advocated for years, is of little help for such situations, because nearly all policies exclude aviation-related liabilities.

Put simply, pilots and aircraft owners must protect all of their assets, from their home to their aircraft to their business to personal assets, so that if they are sued they can work out a more favorable settlement on the basis that it may difficult for a plaintiff to collect.

In our book, websites, and presentations, Chris and I have talked at length about protecting various assets such as homes, businesses, and financial assets. There is no way that I can repeat all of that advice and commentary here. What we haven't discussed is how to protect an aircraft from judgments against the owner.

In many ways, an aircraft is like any other moveable physical asset such as an expensive car. The ownership of the asset is evidenced not just by possession, but also by title. Protecting the title of the asset is very important, and this is typically accomplished by placing title to the aircraft in a limited partnership or LLC that offers so-called "charging order protection."

If the entity and its ownership is properly structured, with properly drafted documentation, the individual owner's creditors will not be able to reach the aircraft itself. Instead, creditors will be stuck with some form of a non-controlling, non-voting interest in the entity that owns the aircraft only (and perhaps only a lien on that interest, depending on the state).

Avoid Single-Member LLCs

Some manufacturers and brokers of aircraft recommend to the owners that their aircraft be owned by a "single member LLC", i.e., an LLC which has only one owner. They claim that the LLC provides asset protection and a way for the new owner to avoid local sales taxes.

A single member LLC can provide the owner with protection against liabilities arising from the conduct of the LLC. In other words, if the LLC does something wrong, the owner is not necessarily responsible. To reach the owner's personal assets, a plaintiff would have to "pierce the veil" of the entity by showing that it was undercapitalized for its intended purposes, formalities were not followed, the owner used the LLC mostly for personal purposes and it did not serve a *bona fide* commercial purpose, etc.

However, a single member LLC likely will not protect the assets of the LLC from judgments against the owner. Because charging order protection is based on protecting the innocent non-debtor owners of an LLC or partnership, there is no rational basis for charging order protection for the owner of a single-member LLC, regardless of the fact that the LLC statutes call for such protection. This sort of

legal reasoning has been followed in a few such cases recently, and there is no reason to expect the trend to change. So, if there likely is no charging order protection for single member LLCs, as there is for multi-member LLCs, a plaintiff has a good chance of acquiring either the full controlling ownership of the LLC or the assets in it.

Single member LLCs are great tools as subsidiary asset holding entities owned by a charging order protected holding entity. This sort of structure provides charging order protection at the holding entity level, and liability segregation at the level of the subsidiaries. However, as the sole barrier between an individual owner and assets the owner seeks to protect from his own individual liabilities unrelated to the LLC, single-member LLCs should be avoided. The good news is that it is not terribly difficult to avoid single-member status. Trusts or other entities can be owners of LLCs. This avoids single-member status, and likely provides opportunities for estate and tax planning.

With respect to sales tax avoidance, some aircraft owners who live in states with substantial sales taxes, such as California, may set up an LLC in a state with no sales tax to purchase the airplane. While there are some legitimate means of avoiding sales taxes, they involve a lot more than simply forming an LLC in a no-tax state. Furthermore, in addition to violating state tax laws, unlawfully evading state sales taxes might be considered felony mail and wire fraud under federal law.

Is it worth risking a possible federal indictment to avoid a few thousand dollars in state sales taxes? Sounds like a bad bet. While such crimes are rarely prosecuted, they can result in investigations where the state complains.

Aircraft as a Hot Asset

An aircraft is a "hot asset". It is not just that they look really cool, go really fast, and are hands-down the most fun toy on Earth, but they can also crash into things and generate liabilities. Because of this, aircraft should not be owned by trusts or entities with other valuable assets. The reason is simple: If the aircraft generates a liability to the trust or entity, then every other asset held by the trust or entity will be exposed to satisfy a judgment. Like any other hot asset, an aircraft should be segregated into its own entity, with relatively few other assets in that entity.

Very Light Jets (VLJs)

Concern about the liabilities arising from aircraft operation come at a time when several new so-called "Very Light Jets" have recently obtained FAA certification and are now being manufactured and sold. These are jets with typically

six seats, including two for the pilots. With most prices under \$2 million and fuel consumption relatively low, these jets give business owners the mobility they need without waiting around for hours at the airport.

New aircraft include the:

- Eclipse Aviation 500 – This is a new design by a new manufacturer that is made of composite materials instead of aluminum, with a cost of only \$1.2 million.
- Cessna Mustang – This is a scaled-down version of Cessna's popular and dependable Citation jet for \$2.8 million.
- Adam Aircraft A700 – This new manufacturer's new design is another composite aircraft, and is backed by corporate financing from Goldman Sachs.
- Diamond Aircraft D-Jet – A manufacturer known for quality, low-cost designs presents a 5-seat jet for a cool million. Probably more of a jet for those who already have a pilot's license than for those who will hire a pilot.

Not surprisingly, many buyers have signed up to purchase these aircraft by paying deposits and obtaining delivery positions. Getting the jet will not be the problem, but finding somebody to fly it might be. With airlines reporting record travel seasons, the demand for commercial-rated pilots is higher than ever meaning that the airlines are going to snatch up all the best pilots.

If you are a pilot, owning one of these planes will be like being a kid in a candy store. For everyone else, finding qualified pilots may be a difficulty. You will be much more likely to get the 23-year old kid with 600 hours mostly in a Cessna 172 than the seasoned pilot with 7,500 hours in a 737. Plus, while all of these jets will be certified for flying with one pilot only, having only one pilot creates the risk of a bad accident in the case of "pilot incapacitation", i.e., an unforeseen heart attack, stroke, etc. This will increase the potential for liability arising out of the operation of these new jets.

As with all other aircraft, it will be very important to create a solid asset protection structure to own title to the VLJs and to conduct flight operations. Just make sure that the technology of your asset protection plan matches the technology of your new jet.

PLAN NOW FOR YEAR-END TAXES

The end of the year will be here faster than you think. If you want to develop a quality – and not "last minute" – plan for your business to deal with taxes, the time to do that is now and not on December 31.

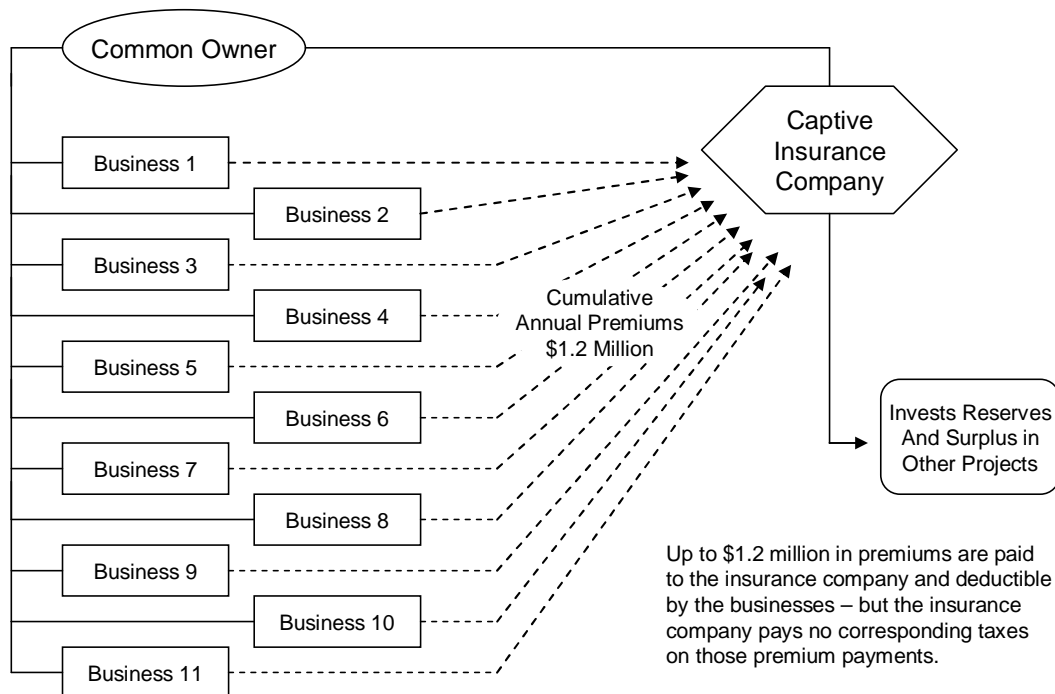
831(b) CAPTIVE INSURANCE COMPANIES

A captive insurance company is one that primarily underwrites the insurance risks of other companies owned by the same owner as the insurance company. A captive often underwrites certain risks for which ordinary commercial insurance cannot be obtained cheaply or at all. For instance, captive insurance companies are used to underwrite environmental risks as well as earthquake and flood risks.

Another significant non-tax benefit of a captive is that policy terms may be carefully tailored to meet specific needs. Many captive insurance policies are drafted as "litigation expense only" policies that pay only to fund attorney fees and litigation costs, but do not provide a fund for the plaintiff to tap if the claim is successful. This effectively creates a war chest to fight litigation, without creating additional assets to later be pursued.

The 831(b) provision allows an insurance company to take in up to \$1.2 million in premium income every year without the company being taxed on that income. Taking into account IRS requirements under Rev.Ruling 2005-40 and otherwise, this means that an 831(b) captive has the potential to transfer up to \$1.2 million in premiums out of the operating companies (giving it a deduction for the premiums paid) and into the insurance company without any corresponding tax being paid.

Multiple subsidiary arrangement for 831(b) insurance company



Caution that the tax treatment of insurance companies is very complicated, and captive insurance companies are particularly so. Along this line, one must especially beware of the risk spreading and risk shifting requirements discussed in Rev.Ruling 2005-40 and other IRS notices. To become an 831(b) company requires that an election be affirmatively made by the company, much like making an S-corporation election. No election; no 831(b) treatment.

Another benefit of captive insurance is that the premium payments effectively deplete the assets of the business being underwritten. In other words, every dollar of premiums paid to the captive is a dollar that has been moved out of the business and thus away from creditors. A good captive arrangement can keep other businesses appearing as only a "break even" enterprise on paper, because the profits have been effectively shifted to the captive. Because the premium payments are "for value", it would

be very difficult for a creditor to claim that such payments are fraudulent transfers.

A lot of insurance and tax planners have tried to move into selling 831(b) companies the last couple of years, by claiming experience in setting up and managing captives that they do not have. Some of these planners will take the fact that they have associated with an insurance manager who actually has, say, 10 years of experience and then claim to their clients that they themselves have 10 years of experience when they don't have any or little experience with captives. You may be one of their first cases, which is a dangerous thing.

Between us, Chris and I have formed many dozens of captives over the last decade. The captive professionals we work with have formed many dozens more. Yet, it never ceases to amaze any of us that so many "bad" captives are being formed and badly run by others. Captives are a great tool when formed and managed correctly, but doing that is the catch. Offshore providers especially do not seem to understand what it takes for a captive to properly qualify as such under the tax code.

Forming an 831(b) insurance company and getting it licensed is the easiest part. The real difficulty is in running the insurance company and internally managing taxes on the investment income, while also creating a game plan for later winding the insurance company down on a tax efficient basis if that need arises because of unforeseen economic problems, sale of the operating business, death of the owner, or changes in the Internal Revenue Code.

Because of this, it is most important to have a sound game plan before the first steps are taken by having an actuarial analysis completed, having an agreement between the insurance professionals and the tax professionals on how the company will be run, and having a good CPA firm available to conduct the required annual audits.

Once upon a time, most captives were formed in the offshore tax havens such as Bermuda, the Caymans and the British Virgin Islands. Today, most states have passed captive enabling legislation such that there really is no compelling reason to form a captive offshore. To the contrary, with the IRS's war against pretty much anything offshore and with onerous reporting requirements for even properly formed and run captives, it is easy to understand why most captive formations are now done at home.

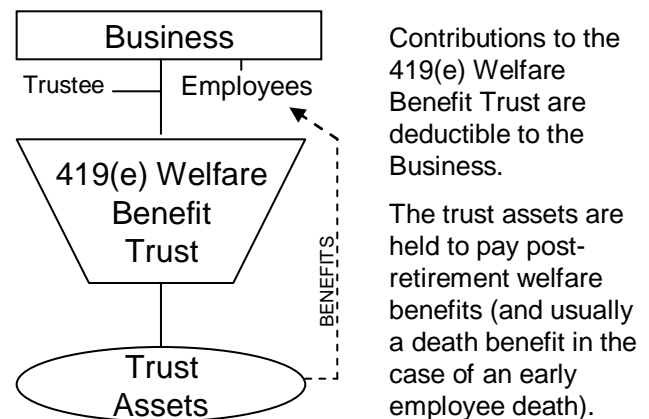
As a captive insurance company typically takes 60 to 90 days to get up and running, it is not a last-minute strategy where you can make a decision on December 31 and get a deduction for premiums paid. Typically, the steps to form a captive need to begin no later than October 15 for the company to be formed and licensed in time for premium payments to be made to it before year's end.

419(e) WELFARE BENEFIT PLANS

The term "419(e) plan" refers to a plan that qualifies under paragraph (e) of Internal Revenue Code Section 419, which provides for the treatment of funded welfare benefit plans.

A 419(e) plan is an employee benefit program that is sponsored by the employer and which provides welfare benefits to its participants. It is a "single employer" welfare benefit plan, meaning that all of the employee benefits are paid for by the same company. There is no pooling of benefits among the employees of various companies. Since Welfare Benefit Plans are for the benefit of employees and the business owners, the assets in the plan should not normally be available to creditors of the business.

The plan typically involves an independent trustee that holds the trust assets and a third-party administrator that arranges actuarial certification of funding and benefits, and approves plan administration.



Cash contributions are made irrevocably to the trust without the possibility of reversion. They are determined actuarially based on an annual census using projected retirement ages of all employees and projected medical costs from retirement through actuarial death. The sponsoring employer may choose a target contribution or a target benefit. Contributions on behalf of key employees are kept separate from contributions for rank-and-file.

This type of plan allows a company a suite of benefits to its employees – including the owners of the business – ranging from death benefits during their working years to medical and long term care benefits in retirement. Essentially, the goal of a 419(e) plan is to allow the company to pre-fund certain retirement benefits in advance; thus, larger contributions may be made to the plan in the early years.

The employer is allowed to decide which benefits to provide to employees. New benefits may be coordinated with

existing employee benefits, and new benefits that supplement the existing benefits may be offered.

One of the more popular benefits of 419(e) plans is post-retirement medical benefits. These benefits provide funding for health expenses incurred during retirement. Employees do not vest in the benefits, but instead become eligible when they reach a retirement age set by the employer.

The welfare benefits provided by a 419(e) plan are meant to enhance the financial security of employees and can include:

- Supplemental Disability Benefits
- Severance Benefits
- Post-Retirement Medical Benefits
- Long Term Care Benefits
- Death Benefits

If you will need certain welfare benefits through retirement anyhow, a 419(e) plan allows you to essentially pay for those benefits in advance and obtain a substantial current-year tax deduction. Some 419(e) plans additionally pay death benefits on behalf of current employees and add substantial medical benefits for retirees. The medical benefits can include reimbursement for amounts paid for medical, dental, and psychological care, prescription and over-the-counter drugs, long term care services, nursing home care, home care, premiums for medical, dental, Medicare and long term care coverage and more.

The investment growth inside section 419(e) plans is taxable to the employer. Because of this, many plans choose to invest in life insurance since life insurance grows on a tax-deferred basis. **This creates the potential double-benefit that if an employee dies early, then death benefits are paid to beneficiaries, but if the employee lives too long then the tax-deferred build-up of the life insurance policy is available to fund benefits.**

Typically, the medical benefit is funded with one or more insurance policies owned by the trust on the life of one or more owners, using cash values and accrued death benefits to cover medical expenses. This takes advantage of the tax-free buildup within the life insurance policy. On the other hand the death benefit is funded with an insurance policy on the life of each participant, payable to the trust but then passed entirely to the participant's beneficiaries. Non-discriminatory rules apply except employees do not vest until actual retirement at a defined retirement age. Contributions to plans compliant with section 419 are deductible

by the employer to the extent permitted by law. Distributions in the form of medical expense reimbursements are not taxable income.

The downsides of 419(e) plans include that, depending on the benefits provided, the contributions to the plan might not be fully deductible (such as where death benefits are provided) and discrimination among employees might not be allowed (such as where medical benefits are provided). Also, these plans are somewhat complex and require the services of an actuary who is experienced in these plans to correctly implement them.

Nonetheless, 419(e) plans are good for businesses that desire to tailor an employee benefit plan to their specific needs or which need flexible funding options. The plans may also be structured to provide valuable incentives to employees to remain with the company.

The benefits of Welfare Benefit Plans include:

- The employees benefit: the employee has the comfort of knowing that his family is protected in case of untimely death while covered and has the comfort of knowing that much of his medical needs in retirement — and the needs of his spouse and dependents — are met, including long-term care.
- The owner-employees benefit: like all employees the owner-employee has the comfort of knowing there is a death benefit and medical benefit awaiting the owner and the owner's family as a before-tax expense of the company.
- The company benefits: the company can offer valuable benefits to reward valued employees at affordable costs; benefits formerly offered only by large employers which are now available to small and mid-size companies; it can use these benefits as "golden handcuffs" to stem turnover of expensively trained and valuable employees; its contributions are deductible so long as the rules of §419 and §419A are met, in other words contributions are more affordable with before-tax dollars to the extent deductible; and, the assets within the insurance policies grow tax deferred.
- A company that wants to offer supplemental benefits: Companies looking to reward their most important employees — the owners and executives — are often limited in the amount that can be contributed to plans for their benefit, particularly retirement plans. A Welfare Benefit Plan can offer additional benefits for these employees, such as family protection and retiree medical bene-

fits, without limitations as long as actuarially reasonable.

- Post-retirement medical accounts are not vested and only become available for use by an employee when retirement age is reached while still an employee. Amounts forfeited due to termination of employment are retained by the plan.

In summary, 419(e) welfare benefit plans offer significant advantages to farsighted business owners and their employees, with a substantial portion of the offered benefits being currently deductible to the business. When correctly structured, they allow the business to pre-fund valuable post-retirement and other welfare benefits for employees.

U.S. v. TOWNLEY

Slip Copy, 2006 WL 1345248 (9th Cir. No. 04-35767, May 17, 2006), case below (E.D.Wash. No. CV-02-00384-RHW, July 29, 2004).

Summary: A couple made transfers of property to a trust created ostensibly for the benefit of their children. At the time they created and funded the trust, they had no current creditors. But they admittedly created and funded the trust for the stated purpose of protecting their assets against the claims of *future unknown* creditors. The couple, after the creation of the trust, incurred a sizeable federal income tax liability. This court held that the fact that they had engaged in asset protection planning to defeat the claims of future unknown creditors was sufficient evidence to satisfy the "actual intent" element of the Washington fraudulent transfer laws as to the IRS.

The court also held that since the couple made no rent payments to the trust while continuing to live in the home that had been transferred, and the affairs of the trust and the couple were so intertwined as to be indistinguishable, the trust to which the couple transferred their assets was in fact their nominee and alter ego.

The 9th Circuit affirmed that the couple transferred their real property into the trust in violation of the Washington Uniform Fraudulent Transfers Act.

FACTS

The Townleys had owned their personal residence since 1977. In 1990, the couple borrowed against the equity in their personal residence to purchase an interest in investment property.

In 1995, the Townleys created the Beaver Valley Trust and conveyed both their personal residence and their interest in

the investment property into this new trust. Although the Beaver Valley Trust has an independent trustee and their children were the beneficiaries, the Townleys were named the "Trust Managers" for an indefinite period and given the power to handle all trust affairs. The Townleys continued to live in their personal residence, but did not pay any rent to the trust or even make the utility payments.

By 2000, the Townleys had gotten themselves into tax trouble and had been assessed nearly \$175,000 in unpaid taxes, interest and penalties.

In 2001, the Townleys filed for bankruptcy to attempt to avoid their personal federal tax liability.

Although the Townleys' objection to the IRS's claim was denied, the Townleys were given a discharge and the bankruptcy trustee reported that there was no unsecured property available for distribution.

The IRS then filed suit in U.S. District Court to reduce the federal tax assessments to judgment, set aside the transfers to the Beaver Valley Trust as fraudulent, and to foreclose on the federal tax liens.

The Townleys claimed that they did not make the transfers to defraud the IRS, since the IRS was not even their creditor at the time they created and funded the trust. They argued that they created and transferred property into the Beaver Valley trust to protect their assets from unknown future creditors.

Townley testified that he was concerned about potential "*lawsuits from the exposure we had from liability from troubled boys in the State of Washington.*"

The District Court held that since the Townleys transferred their property to the Beaver Valley Trust before the IRS became a creditor, the IRS would be considered a future creditor of the Townleys under Washington law.

But, far from exculpating the Townleys from a fraudulent transfer, the District Court held that their admission that they made the transfers to protect against unknown future creditors was a veritable confession of their actual intent to hinder, delay or defraud all creditors, including the IRS.

According to the Court:

"[The Townleys] assert that no 'hypothetical future judgment creditor' exists, nor did one ever exist. * * * [The Townleys fail] to realize that the IRS is such a creditor. Under [the Townleys'] reasoning, the Washington Uniform Fraudulent Transfer Act would never protect future creditors. A close

reading of ' 19.40.041, however, demonstrates that this section provides protections to both present and future creditors."

"Section 19.40.041 states:

"(a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation: (1) With actual intent to hinder, delay, or defraud any creditor of the debtor."

"If this statute is read by inserting the players in this case, it would read as follows: A transfer made or obligation incurred by the Townleys (debtor) is fraudulent as to the United States (a creditor), if the Townleys made the transfer or incurred the obligation with actual intent to hinder, delay, or defraud any potential plaintiffs who may have a cause of action (any creditor) against the Townleys (debtor). Mr. Townley's statement that he wanted to protect his assets from any potential 'lawsuits from the exposure we had liability from troubled boys in the State of Washington' represents direct evidence of his intent to defraud one of his potential future creditors, which is prohibited by ' 19.40.041(a)."

The District Court then noted that, in addition to satisfying the actual intent test, the Badges of Fraud that constructively prove the Townleys' intent to defraud creditors were also satisfied by their admissions:

"Here, [the Townleys] have not filed any affidavits in which they denounce any intent to defraud. Nor have they filed any affidavit testimony of other witnesses that would support that they did not intend to protect their assets from any future creditors. * * * On the contrary, [the Townleys] were very open and honest about their intent to defraud potential or future creditors."

The District Court further held that a trust may be considered an "insider" for purposes of a Badges of Fraud analysis, and additionally a trust may be considered an "insider" where it for the benefit of the debtors' children, since children would be considered an insider as well.

The court found other factors that indicated that the transfers were fraudulent. The Townleys

- retained possession and control of their personal residence by continuing to live in it after the ostensible transfer.
- did not make any rent payments.

- did not pay the utilities.
- transferred substantially all of their assets to the trusts (so they had no means of paying their tax (or other) bills as they came due).
- received no consideration for the transfer of their properties when they gifted them to the trusts.

The District Court also adopted an alternate theory: The trust amounted to the nominees of the Townleys, and thus its assets were available to satisfy their creditors under a nominee or alter ego theory:

"Here, [the Townleys] have retained control over the property of Beaver Valley Trust. [The Townleys] have the beneficial use of the property owned by the Trust, and they do not compensate the Trust for this use. There is a fluid financial arrangement between [the Townleys] and the Trust. Sometimes Defendants are paid for working for the Trust, sometimes they are not. Sometimes [the Townleys] pay the utility bill, sometimes the Trust pays the bill. The office of the Trust is located in [the Townleys'] residence. The ownership of the property changed hands without any consideration. The Townleys created and controlled Beaver Valley Trust, with the intent to protect their assets from potential creditors.

For all intents and purposes, Beaver Valley Trust is the Townleys and the Townleys are Beaver Valley Trust and the interests of Beaver Valley Trust are inseparable from the interests of the Townleys. As such, Beaver Valley Trust is a nominee or 'alter ego' of the Townleys. As nominee or 'alter ego,' it holds the Residential and Investment properties for their benefit. Thus, even if the transfers of the Residential and Investment Proper! ties to Beaver Valley Trust by the Townleys were not fraudulent and could not be avoided, the Residential and Investment Properties owned by Beaver Valley Trust are available to satisfy the Townleys' tax liabilities."

Based on all the foregoing, the District Court entered an order granting the IRS summary judgment and allowing the Service to directly foreclose upon those assets. In a short memorandum opinion, the Ninth Circuit affirmed:

"The district court did not err in holding that the Townleys transferred their real property into the Beaver Valley Trust in violation of the Washington Uniform Fraudulent Transfers Act. The Townleys' repeated admissions that they transferred property to the Trust in order to avoid potential future creditors provide direct evidence of fraud. Further, by demonstrating that the property

transfer was characterized by multiple badges of fraud, the government also showed compelling circumstantial evidence of fraud. Therefore, the government provided the requisite 'clear and satisfactory proof' that the Townleys possessed! an 'actual intent to hinder, delay or defraud a creditor' under the UFTA."

This case illustrates at least five very important points for planners:

(1) The fact that that your clients have no creditors now when you are doing the planning does NOT mean that their planning cannot be challenged as a fraudulent transfer by a later- appearing creditor.

(2) If the stated purpose of your clients' planning is asset protection, i.e., to protect assets against future unknown creditors, that by itself may be enough to establish actual intent to engage in a fraudulent transfer.

(3) If your clients are living in a house that is owned by a trust of which they are not beneficiaries, and they are not paying rent to the trust, the arrangement is in danger of being set aside as a fraudulent transfer.

(4) If your clients' relationship with their trust is such that there is little separation between their financial identities, the trust may be considered your clients' alter ego and its assets will be available to satisfy their creditors.

(5) If you are making transfers to trusts where asset protection is an issue, make "for-value" transfers instead of gifts.

NO EXISTING CREDITORS DOES NOT ENSURE SAFETY

A myth has persisted in the asset protection world that as long as you do planning when there are no creditors around, it will ipso facto be safe. That ignores that the UFTA has an entire section 4 that relates to "*Transfers Fraudulent as to Present and Future Creditors*," and which applies "*whether the creditor's claim arose before or after the transfer was made or the obligation was incurred . . .*"

There is what amounts to a "*transferred actual intent*" in fraudulent transfer law. If you make a transfer that is meant to defeat the rights of one creditor, that may be sufficient for a completely different creditor who comes along later to say that the planning was done with actual intent to defraud it too.

This transferred actual intent also applies on what amounts to an undefined group of unknown future creditors. If you do planning with the intent to defeat the rights of any fu-

ture creditors who may later appear, regardless of who they are, then that intent will be applied to set aside the transfer as to any particular creditor who does in fact appear later.

[Query: But what is "asset protection" if not planning that has as its very intention the desire to defeat the rights of creditors, whether appearing now or in the future?]

This also means that the UFTA does NOT, repeat NOT, provide anything like a safe harbor simply because the planning was done when no creditors were present IF the planning was done with the intent to defeat any creditors, including future unknown creditors.

Do not also delude yourself into thinking that because you had your clients execute an Affidavit of Solvency that such gives you a free pass to thereafter to do asset protection planning willy-nilly for your clients, because it doesn't. In fact, the value of such affidavits is somewhere between speculative and dubious, though some planners swear by them.

My gut feeling is that these affidavits accomplish little more than creating a list of assets for creditors to start investigating where stuff disappeared to.

PLANNING MUST BE DONE FOR NON-ASSET PROTECTION REASONS

Except for recognized homestead and statutory exemption planning, and some business entity planning and spend-thrift trust planning, you should not conduct asset protection in its own name.

As this case shows, the very fact that the clients engaged in transfers to protect assets from unforeseen future creditors had the practical effect of a sworn confession that they had the intent to fraudulently transfer assets as to all creditors who came later. You cannot allow your clients to make this confession, which means that you cannot allow them to admit that they engaged in planning for the purpose of defeating ANY creditors of any kind.

This has significant practice implications:

- You should not have an engagement letter that says that a purpose for your planning is asset protection.
- You should not give your clients a memorandum that discusses the asset protective effects of what they are about to do.
- And you can't let your clients give affidavits or testify at depositions that the reason that they engaged in their

planning was because of concerns of unknown future creditors. That doesn't work.

If your clients so testify or the creditors gets possession of any documents that talks about asset protection, that will be evidence of actual intent to hinder, delay or defraud creditors under UFTA, even if the creditor who does appear later was totally unforeseen.

There is little in the law that authorizes asset protection planning generally.

However, there is plenty that prevents it, including primarily the fraudulent transfer laws of each state. By and large, the legislatures and the courts want to see creditors get paid on their judgments and they have not given unconditional approval to planning that has as its stated purpose the shielding of assets from creditors.

If a client can't stand up and give a straight-faced reason why the planning was done for legitimate purposes (other than to lessen the rights of creditors), that planning will be in grave danger until the UFTA statute of limitations has run.

TRUSTS WITH PERSONAL RESIDENCES SHOULD CHARGE RENT TO BE RESPECTED

The District Court repeatedly focused on the fact that the Townleys had transferred their home to the trust, but had continued to live in it while paying no rent or even the utility payments. This fact was important in determining that the trust was really just a nominee of the Townleys or their alter ego.

The upshot of this is obvious: If you expect to put a personal residence into a trust of which your clients are not beneficiaries and have the arrangement respected for creditor-debtor law purposes, it is critically important that a normal landlord-tenant relationship exist between the clients and the trust, with rent, utilities, renter's insurance, etc. paid by the clients.

Also note that the tax law usually does not matter in determining state creditor-debtor issues. There is a Grand Canyon-sized disconnect between tax law and creditor-debtor law.

What often makes the difference in both tax law and creditor-debtor issues is the existence - or non existence - of a truly independent entity or an arms-length relationship.

TRUST AND INDIVIDUAL AFFAIRS MUST BE SEPARATELY IDENTIFIABLE

Alter ego law is once again being expanded to set aside an obvious asset protection scheme, where the debtors claimed that they transferred assets but continued to enjoy and control them.

You simply can't have it all ways: If you expect the trust to be treated as a legally independent entity, then you must treat it as a legally independent entity. That means an arm's length relationship between your clients and the trust must exist at all times.

We recently saw in the Ehmann case in relation to a family LLC that you cannot treat a business entity like the family piggy bank and think that it will still be respected for creditor-debtor purposes. Ditto for trusts.

Merely because you *may* be able to do some things from a tax standpoint and have them survive scrutiny does not mean that they will survive the civil court's scrutiny under nominee and alter ego theories. It may very well be in many cases that a much higher standard of separation and independence is required to survive a judgment collection challenge than would be required to meet a tax treatment standard.

ASSET PROTECTION'S FOUR-LETTER WORD: G I F T

The fraudulent transfer laws are primarily aimed at transactions that are without "reasonably equivalent value". The quite logical reason for this is simple: If the debtor doesn't get back something of value from the transferee, there is nothing available for the creditor to satisfy the judgment.

Gifts are inherently without "reasonably equivalent value" since by definition, there is no consideration for a gift.

Because of this (and although I know that gifts are a bread-and-butter technique for estate and charitable planning), if asset protection is an issue then gifts should be avoided because they are easy for creditors to set aside.

THE BOTTOM LINE

Asset protection is a very difficult planning area. This case illustrates that there is no "safe harbor" simply because the planning was done at a peaceful time when there were no creditors on the horizon. That is a myth and one that is now exploded.

You cannot do asset protection planning in its own name and expect it to survive scrutiny. Either the asset protection

will be explainable for legitimate, non-creditor reasons, or in many situations it will probably fail.

And, as with business entities, you must respect trusts as separate stand-alone legal entities. This includes paying rent when a home is in the trust.

Finally, you must avoid making gifts where asset protection is a concern, because gifts are inherently weak forms of transfers for creditor-debtor purposes.

Arguably, the real art of asset protection planning is creating a fundamentally sound plan to accomplish legitimate client objectives that, as an incidental and collateral consequence, has a solid asset-protective effect.

CAUTION A POSSIBLE STATE-BY-STATE VARIANCE

Note that some states have rejected the notion of transferring and intent to defeat the rights of an "intended but unidentified future creditor", contrary to the plain text of the Uniform Fraudulent Transfer Act. Thus, there may be some states where the *Townley* result would not necessarily occur based on existing case law.

The problem is that the concept of "asset protection", i.e., specifically planning to defeat the rights of unknown future creditors, is relatively new and nobody really knows how the courts will treat this type of planning. Until this area of law is better settled, the smart planners and clients will presume the worst.

My feeling is that the arguments now being raised as to why the fraudulent transfer will not defeat asset protection planning done in its own name has the same ring as the arguments pitched in the 1990s as to why so-called foreign asset protection trusts would be respected by the U.S. courts and the contempt remedy would not be used – and we all know now what a disastrously wrong analysis that turned out to be.

The courts want to see their judgments enforced, and planning that is specifically meant to defeat such enforcement will always and quite understandably be viewed with the greatest skepticism by the courts.

MOVITZ V. FIESTA INVS., LLC (In re Ehmann)

319 B.R. 200, 206 (Bkprt. D. Ariz. 2005); Order Granting Trustee's Motion for Summary Judgment, etc., of December 7, 2005; Order Withdrawing Court's Opinion and Order Dated December 7, 2005, dated January 25, 2006; Case No. 2-00-05708-RJH; Adversary No. 04-00956.

An opinion unfavorable to debtors gets even worse, but then there is a surprise ending!

Summary: A federal bankruptcy court in Arizona granted the motion of a bankruptcy trustee to take possession and control of an LLC of which the bankrupt debtor was a member, and to make distributions or dissolve and liquidate the LLC as necessary to satisfy creditors. If followed, the decision has the potential to circumvent charging order protection in bankruptcy for purely passive membership interests in limited partnerships and LLCs, especially where the entity is used primarily to administer family assets without any significant business purpose.

EHMANN I

On February 9 of 2005, Chris Riser and I related what happened in the federal bankruptcy case of *Movitz v. Fiesta Investments, LLC (In re Ehmann)*, 319 B.R. 200, 206 (Bankr. D. Ariz. 2005) (a/k/a "Ehmann" or sometimes "Fiesta Investments"). The bankruptcy judge had at that time just held that the debtor's non-managing membership interest in an LLC, including the debtor's non-economic rights, may be the property of the debtor's bankruptcy estate. This holding was despite Arizona law restricting the involuntary transfer of a member's LLC interest, which was deemed inapplicable under the Bankruptcy Code.

The central issue of the earlier Order was whether federal bankruptcy law applied, or the restrictive Arizona LLC law applied. This turned on whether the articles of organization and operating agreement defining the membership interest was an "executory contract" requiring the application of Arizona law under section 365 of the Bankruptcy Code. The flip side was whether the membership interest was a "non-executory contract", and thus simply a property interest under section 541 of the bankruptcy code such that federal bankruptcy law would apply, rather than Arizona law.

[As a refresher, executory means that there are duties that must be performed in order to receive benefits; non-executory means that the benefits will be received even if nothing further is done.]

After a very detailed analysis, the court concluded that a membership interest which does not include any management rights or responsibilities and does not require the non-managing member to do anything of substance should not

be considered an executory contract. Such a membership interest should be considered part of a non-executory contract, and the membership interest would be subject to section 541 of the Bankruptcy Code, rather than Arizona law.

The Court noted that the membership interest might have been considered an executory contract if the member had substantial obligations to perform, and the non-performance of which would have amounted to breach of contract. But the debtor simply had no such obligations under the LLC's operating agreement.

The effect of the court's ruling is that the restrictive language of an operating agreement does not control the creditors' rights in bankruptcy if the debtor's interest was non-executory. In other words, the bankruptcy trustee becomes a full member of the LLC even if the operating agreement provides otherwise.

The *Ehmann* ruling caused much consternation in asset protection circles, since it had the potential to defuse the charging order protection in bankruptcy for most limited partnerships and limited liability companies for partners or members who had purely passive roles and no substantial duties to the entity. Planners had to find some duties for the partner or member to perform, but not duties that they might find a creditor someday doing. This isn't always easy to do. And as difficult for planners as this decision was, it was about to get much worse . . .

EHMANN II

Having established that federal bankruptcy law, and not Arizona law, applied to the debtor's membership interest in the LLC, the bankruptcy trustee attempted a bolder move to get around the charging order protection. The bankruptcy trustee moved for summary judgment to establish that the bankruptcy estate was a full member of the LLC, and appoint a receiver to take charge of the LLC so that proper distributions could be made and creditors satisfied.

The Court agreed, granted the Trustee's motion for summary judgment, and ordered the appointment of a receiver with the admonition that the receiver could, if necessary, cause the dissolution and liquidation of the LLC in order to satisfy creditors of the member debtor.

The debtor, other members, and even non-members had taken loans from the LLC. Although the loans were fully repaid with interest, the Court noted that these loans were all violations of the LLC's operating agreement. Although the loans did not harm the LLC, at the same time little or no distributions were made to members (including the debtor member, which distributions would of course have

gone to satisfy creditors). The Court rejected suggestions that it was limited to an injunction to prevent further loans from being made, since:

"The conduct of Fiesta and its manager since the Trustee's appointment demonstrates an unequivocal intent to operate Fiesta as if it were a revocable living spendthrift trust. * * * Utilizing a legitimate business structure for the sole purpose of shielding assets from creditors borders on a fraud on creditors"

Section 365 of the bankruptcy code gives the trustee power to accept or reject executory contracts. However, subsection 365(c)(1)(B) says that the trustee cannot assume or assign contractual rights if the other party to the contract does not agree. It is against this provision that operating agreements are often drafted to prevent a bankruptcy trustee from taking over the debtor's interest. However, the *Ehmann* court went out of its way in Footnote 17 to warn practitioners against relying on § 365(c) for passive membership interests:

"[E]state planners' reliance on § 365(c) to prevent creditor access to assets is probably misplaced, at least where an operating agreement imposes no affirmative obligations on the members. In this arcane and overly technical area of law, it is worthwhile to remember the fundamental reason why special treatment is accorded executory contracts as compared with other assets and liabilities of an estate -- to permit trustees to realize on contracts that have a net asset value to the estate, while also permitting them to avoid the administrative liability that would accompany contracts that lack such a net value."

COMMENTARY

There are many painful lessons to learn from the *Ehmann* opinion. These lessons go to how business entities are used for asset protection purposes. Planners must realize that trusts are the vehicle for holding personal assets, and that business entities are for fulfilling *bona fide* economic ventures. Trouble often results when this dichotomy is forgotten or ignored.

Planners should take this sentence from the *Ehmann* opinion and have it tattooed on their forearm: "Utilizing a legitimate business structure for the sole purpose of shielding assets from creditors borders on a fraud on creditors". Yet, that is precisely what many planners are doing when they stuff purely personal assets into a family limited partner-

ship or LLC having no real purpose but to hold title to the assets.

Another lesson of *Ehmann* (and a lesson that is endlessly repeated in case after case without being heeded), is that no matter how well a business entity is originally structured, it cannot be expected to stand up to creditors if it is used as the family piggy bank. The *Ehmann* court expressed great interest in the fact that at one time more than 70% of the LLC's assets were loaned out to either family members or projects owned by family members. Even though the loans were all paid back with interest, these loans clearly violated the LLC's operating agreement and indicated to the court that the members' real intention was to operate the entity as a living trust disguised as a business entity.

Client must be warned that they cannot misuse a business entity as the family loan vehicle to the exclusion of the rights of creditors and then later hope that the entity will stand up to prolonged creditor attack. Such misuse is an open invitation to the courts to search for unusual theories for relief, such as the *Ehmann* court's prior executory/non-executory analysis, to make the assets of the entity available for creditors.

Planners must further realize that most creditors' attorneys are not stupid, but often are just as creative in developing theories to get at assets as planners are at protecting them. Bankruptcy trustees, who daily watch the debtor's game of creditor dodge ball, can be even more creative in addition to being patient and tenacious. Any judge who has sat on the bench for any appreciable period of time has seen his or her share of debtor tricks.

When a business entity is making myriad loans to members and other insiders but not making distributions to benefit the creditors of a member, one can expect the creditors, the bankruptcy trustee, and the judge to all be looking for a theory that will allow the invasion of the entity to avoid the injustice of a debtor protecting assets within such an entity as if it were a spendthrift trust. (The *Ehmann* court made precisely this point by referring to Arizona's spendthrift trust statute in footnote 18 of the opinion.)

Another lesson of *Ehmann* is that not only must a planner create business entities only for *bona fide* business purposes, but even after the entity is formed the planner probably must assist clients in seeing that the entity continues to be used as intended and is not misused for either personal purposes or in violation of its own operating agreement. Clients should also be expressly educated and warned against using business entities for personal purposes, and the dangers of repeated insider loans. Simply

creating an entity and waiving goodbye to the client when the check clears is doing poor service to the client.

The *Ehmann* decision is a troubling outcome for those who have family limited partnerships and LLC and have used their entity as a family funding vehicle. And that is exactly why the decision was later withdrawn!

THE SURPRISE ENDING

The *Ehmann* decision was so unfavorable to family limited partnerships and LLCs that Fiesta Investments LLC (the LLC at issue) paid \$85,000 to settle all creditor's claims against the LLC and all administrative costs in full, which was conditioned on the court's withdrawal of its December 7 opinion in the case. The grounds were obvious enough:

"Here, it is essentially conceded that the general manager of Defendant Fiesta Investments is particularly interested in eliminating any precedential effect this Court's December 7th Opinion might have, because his principal occupation is as a tax lawyer who frequently advises clients in the use of limited liability companies for estate planning purposes."

Weighing the equities between "the 'buy and bury' strategy that the Ninth Circuit has criticized" and "the interests of unsecured creditors in this case who are understandably much more interested in getting their debts paid than in the law of executory contracts as applied to family planning LLCs," the *Ehmann* ultimately court agreed to withdraw its December 7, 2005 opinion.

CONCLUSION

Does this mean that the *Ehmann* opinion and all the foregoing discussion was all for naught? Of course not. For although the *Ehmann* opinion was withdrawn, I predict that future courts will continue to look to its reasoning for guidance even if the withdrawn opinion cannot be relied upon as precedent. Planners simply must take the executory/non-executory issue into account, and they must strenuously avoid using business entities for personal or family purposes. Even the judge in the *Ehmann* case seemed to predict this with his final comment that "regardless of what the Court does here, it cannot disagree with [the] observation that 'History cannot be rewritten.'"

Additional information about the Ehmann case, including copies of these orders and the original Complaint, is available at http://www.assetprotectionbook.com/AZ_Ehmann_2005.htm

IN RE BALDWIN

2006 WL 2034217

(10th Cir. BAP, Okla., July 11, 2006)

Summary: In an unpublished opinion, the 10th Circuit has held that a bankrupt debtor's limited partnership interest is property of the bankruptcy estate, but that a bankruptcy trustee's ability to force a partnership distribution or dissolution is determined by the partnership agreement and state law (Oklahoma, in this case).

FACTS

In 1994, Parents created a limited partnership with their daughter owning a 99% limited partner interest, and the parent's trust owning a 1% general partner interest. The partnership agreement gave exclusive management and control to the general partner, and expressly provided that "[t]he Limited Partner shall not take any part in or interfere in any manner with the conduct or control of the business of the Partnership or have any right or authority to act for or on behalf of the Partnership."

The partnership held 200 acres of undeveloped land used for grazing cattle and a ranch house in which daughter and her husband resided. The property was estimated to be worth \$400,000. During their tenancy, daughter and her husband paid the mortgage, taxes, and utilities.

In 2004, daughter and her husband filed a Chapter 7 bankruptcy petition. Upon the bankruptcy trustee's filing of an adversary action and a trial, the bankruptcy court declared the daughter's limited partnership interest to be the property of the bankruptcy estate and available to creditors, and ordered the partnership to be dissolved.

Both the daughter and the parent's trust appealed, claiming that the bankruptcy trustee should be treated as an assignee of the daughter's limited partnership interest. As an assignee, the bankruptcy trustee's rights with respect to the interest would be limited to partnership distributions, with no voting or other rights (such as the right to vote for a dissolution).

In deciding that the limited partnership interest was property of the bankruptcy estate, the 10th Circuit court brushed aside any possibility that the limited partnership agreement could be an executory contract (and rightly so – the daughter had no real obligations of any sort to the partnership).

Thus, because the debtor's limited partnership interest became part of the bankruptcy estate upon the filing of the bankruptcy petition, the court held that, "the trustee in bankruptcy steps into the shoes of the debtor with respect to partnership interests and may assert whatever rights the

debtor has as a partner under the partnership agreement and state law, including the right to seek dissolution."

The court noted that under the partnership agreement and Oklahoma law, the daughter's rights were very limited and did not include the right to seek dissolution of the partnership. Thus, if the bankruptcy trustee were bound by the partnership agreement then the trustee would not have the right to seek dissolution.

The 10th Circuit did hint in a footnote that, because the daughter had a right to withdraw from the partnership, and apparently, to take her share of the partnership assets with her, the trustee might be able to enforce that provision on her behalf. However, the court refused to rule on that issue because the trustee had not raised it.

Oklahoma law allows a court to dissolve a partnership when it is "not reasonably practical" to carry on the business of the partnership according to the partnership agreement, which allowed the leasing of real property and any other business activity allowable under Oklahoma law.

The debtor's father, who set up the partnership in 1994, testified that he did so for the specific purpose of removing assets from his estate, while still maintaining control of the assets by way of controlling the 1% general partnership interest. The father also testified that the "primary and continuing purpose" of the partnership was estate planning, which was still ongoing.

The business of the partnership included an investment in a mutual fund which made a small profit, the sale of lumber, and the potential future subdivision of the ranch property into residential lots.

Based on this evidence, the 10th Circuit held that the bankruptcy court was wrong in finding that the partnership no longer served an estate planning purpose, finding that:

"the limited partnership was set up to allow [father] to retain complete control of the partnership assets during his lifetime, while at the same time removing them from his estate for tax purposes. This purpose is still being served and will continue to be served even if the partnership were to become totally inactive."

Moreover, the 10th Circuit held that the partnership was still serving a valid commercial purpose because:

"the general partner has made, or attempted to make, profits for the partnership that were then reinvested in the property. Such profit-seeking efforts, such as the possible sale or subdivision of the real property,

are expected to continue as circumstances allow, and serve the partnership purpose of preserving and maintaining assets for the benefit of [father]'s heirs. Given that the partnership was set up, among other things, to hold, improve, and sell real property, along with any other valid business purpose, we can only conclude that the partnership is still operated within the parameters of its stated purposes."

Further noting that the partnership agreement did not require the general partner to recognize or deal with an assignee, such as the bankruptcy trustee, the 10th Circuit held that the bankruptcy court should have taken additional testimony to determine the character of the interest held by the bankruptcy trustee under the partnership agreement and the rights of the bankruptcy trustee and the general partner in relation to the partnership.

The court concluded:

"Since the trustee holds [daughter]'s rights with respect to the partnership, and since [daughter] has neither management power under the partnership agreement, nor any present right to dissolve or liquidate the partnership, then the trustee doesn't either. [Daughter], and therefore the trustee, does have a right under state law to require the general partner to exercise his partnership duties as a fiduciary... In addition, the trustee has succeeded to any rights [daughter] could exercise under the Limited Partnership Agreement However, since the partnership is operating as allowed under the partnership agreement and Oklahoma law, we are constrained to say that the trustee has no present right to force either dissolution of the partnership or liquidation of its assets."

Thus, the 10th Circuit affirmed the bankruptcy court's finding that the bankruptcy trustee owns the 99% limited partnership interest, but reversed the order dissolving the partnership and remanded the case back to the bankruptcy court to determine what rights the general partner has to conduct the business of the partnership without regard to the demands of the bankruptcy trustee.

In other words, the bankruptcy trustee gets the 99% limited partnership interest, but cannot force a liquidation of a partnership. The bankruptcy judge now must decide just how much the general partner can ignore the bankruptcy trustee while conducting the business of the partnership.

ANALYSIS

A line of partnership and LLC cases over the last decade or so, most notably, *In re Ehmann*, indicate that, if a limited

partner or non-managing LLC member wants to keep her non-economic rights (such as the right under the partnership agreement or state law to dissolve the partnership or LLC) out of the reach of a bankruptcy trustee, the partnership agreement or LLC operating agreement should be drafted so that it would be held to be an executory contract under bankruptcy law, so that the bankruptcy trustee's interest would be limited to that of an assignee.¹

Generally, to do so, the limited partner or non-managing LLC member had to have some active duties to be fulfilled. If the partnership agreement or LLC operating agreement was determined to be a non-executory contract, the bankruptcy trustee would have all of the rights associated with the partnership or LLC interest, including, potentially (if the right existed under the agreement or under state law), the right to vote to dissolve and liquidate the partnership or LLC, which if successful, would result in the bankruptcy trustee owning the debtor's share of the net assets of the dissolved and liquidated partnership or LLC.

The trick for planners drafting partnership and LLC agreements is not to include duties that one would not want a creditor performing if the agreement nonetheless was found to be non-executory (such as management duties relating to partnership or LLC assets that could put assets in the hands of the creditor), and/or to include duties that may be to the economic disadvantage of the creditor (such as mandatory capital call provisions).

DON'T COUNT ON STATE LAW COMPLETELY

Some planners are laboring under the false assumption that if they form a limited partnership or LLC in a state that restricts a creditor's remedy to a charging order, then they need not worry about whether a creditor can force a dissolution or otherwise reach partnership or LLC assets. However, to the extent that a debtor is driven or forced into bankruptcy, the protections of state law may wither.

Note that the ruling in the *Ehmann* case, certainly considered a creditor-friendly ruling, arose under the law of Arizona, a state which arguably has the strongest of all pro-

¹ For cases holding that certain LLC operating agreements were executory contracts, see *Matter of Daugherty Construction, Inc.*, 188 B.R. 607, 612 (Bankr. D. Neb. 1995); *Milford Power Co., LLC v. PDC Milford Power, LLC*, 866 A.2d 738, 750 and n.29 (Del. Super. 2004); and *Sumlin Construction Co., L.L.C. v. Taylor*, 850 So. 2d 303, 311 (Ala. 2002). For cases holding that certain LLC operating agreements or partnership agreements were not executory contracts, see *Movitz v. Fiesta Investments, LLC (In re Ehmann)*, 319 B.R. 200 (Bankr. D. Ariz. 2005); *In re Garrison-Ashburn, L.C.*, 253 B.R. 700 (Bankr. E.D. Va. 2000); *Samson v. Prokopf (In re Smith)*, 185 B.R. 285 (Bankr. S.D. Ill. 1995).

debtor charging order protection since the Arizona legislature specifically limited a creditor's remedy to a charging order. The ruling in the *Baldwin* case, also creditor-friendly, arose under the law of Oklahoma which also is considered to have pro-debtor partnership law.

The *Baldwin* case reminds us that:

- (1) State law determines the nature of a bankrupt debtor's partnership interest; but
- (2) Federal law determines the extent to which that partnership interest becomes a part of the bankruptcy estate.

Both *Baldwin* and *Ehmann* reinforce these principles. In other words, absent substantial duties to the partnership or LLC, expect a debtor's entire partnership interest or LLC interest – including the right to participate in management and the right to vote for or otherwise seek dissolution – to be part of the bankruptcy estate.

Once federal bankruptcy law has been applied to determine the general extent of the bankruptcy trustee's interest in the partnership or LLC (i.e., whether the trustee steps into the shoes of the debtor or is merely treated as an assignee), state law and the partnership agreement or LLC operating agreement determine what rights the bankruptcy trustee has.

In order to avoid giving a bankruptcy trustee the right to force distributions or to dissolve and liquidate a partnership or LLC, one must choose state law wisely and carefully draft partnership agreements and LLC operating agreements. Planners should consider the rights of assignees, executory contract issues, and the possibility that, despite best efforts, a bankruptcy trustee or receiver may take control of a partnership or LLC interest. Standard forms will not suffice where asset protection is a primary concern.

DELECTUS PERSONAE

It is worth remembering that partnerships and LLCs are entities *delectus personae*, meaning that at their core they are relationships of trust between the partners or members. Because the partners or members have to work with each other and trust each other in the operations of the entity, it follows that they should not be involuntarily forced into a relationship with a third-party (such as a creditor). Thus, charging order protection exists to prevent an involuntary forced partnership.

The problems arise when a limited partnership or non-managing member is involved, since their interests are passive in nature. These interests are much closer akin to that of a common shareholder than somebody's partner. There

really is no reason why a creditor should not take this type of interest outright, since such a taking should not interfere with the business of the partnership or the relationship between the active partners. But how best to tell the difference between an active interest and a purely passive interest?

The *Ehmann* court struggled with this issue, and adopted the executory/non-executory approach that we have previously written about. If the interest was executory, this meant that the debtor partner owed duties to the partnership such that the court could presume that a relationship with the other active partners might be interfered with. However, if the interest was non-executory and there were no meaningful duties for the debtor partner to perform, there was no possibility of interference with the other partners and therefore the bankruptcy trustee would be allowed to take the interest and all rights in it under section 541 of the bankruptcy code.

By contrast, the *Baldwin* court spent little time agonizing over the executory/non-executory issue, finding simply that the instant partnership interest was non-executory in nature and thus allowing the trustee to take the interest in fee simple absolute under section 541. One wonders what might have happened had the daughter in *Baldwin* had some substantial active duties in regards to the FLP, such as to manage the cattle grazing operation, etc.

A NEWLY DEVELOPING STANDARD?

Another warning by the *Baldwin* court, hidden in footnote 19 of the opinion, is that "absent its 'for profit' business purposes, the limited partnership might not be a lawful partnership under Oklahoma law." An entity that lacks a business purpose might be disregarded, making the assets purportedly owned by the entity owned instead by the purported owners of the entity. This would make assets directly available to creditors of a debtor-owner.

Oklahoma partnership law requires a for-profit business purpose for a valid partnership (including a limited partnership).² Some states specifically have eliminated the for-profit business purpose requirement in their limited partnership statutes, and even more specifically have eliminated the for-profit business purpose requirement for LLCs, allowing instead for "any lawful activity."

Nonetheless, "business purpose" is a theme that has recently appeared in other cases involving business entities. It seems like the law is slowly developing a "business purpose test" that will sort out entities that are being operated

² Okla. Stat. § 54-144 and § 54-1-202.

as businesses as opposed to those that are just shells for asset protection purposes. This trend and the fact that Oklahoma law requires a for-profit business purpose case put the facts in *Baldwin* on the borderline, and it is apparent that the court struggled with these facts.

The lease of the partnership's land for grazing and the long-term property development plan seems to have made a difference. However, if the sole asset of the partnership were a single piece of real estate in a residential neighborhood with no commercial activity, for example, the business purpose issue may have changed the character of the case entirely.

AND DON'T FORGET REVERSE PIERCING....

This developing "commercial purpose test" standard dovetails into another line of cases where creditors were able to make successful end-runs around the charging order protection by asserting other veil piercing theories, i.e., the entire entity was just a sham to defraud creditors.

In *Litchfield Asset Management Corp. v. Howell*,³ a 97% owner of a Connecticut LLC who owed a large debt contributed about \$150,000 to an LLC after he had been sued. The other owners, including the debtor's children, contributed \$10 each. The owner used LLC funds to pay personal expenses and otherwise commingled business and personal affairs and funds. The court held that, although the creditor had the remedy of a charging order available, it would "disregard the fiction of a separate legal entity to pierce the shield of immunity afforded by the corporate structure in a situation in which the corporate entity has been so controlled and dominated that justice requires liability to be imposed...."

A similar example of "reverse veil piercing" occurred in *C.F. Trust, Inc. v. First Flight Ltd. Partnership*,⁴ the debtor, who owed two creditors over \$7 million, owned a 98% limited partnership interest in a Virginia limited partnership that operated a commercial rental property. The debtor's son owned the \$2 general partnership interest. The son owed two creditors over \$7 million. After the two creditors obtained judgments and charging orders, the limited partnership made transfers to a wholly-owned corporation that, in turn, made distributions to the debtor for his living expenses. The debtor also transferred a 49% interest to his son, making his son the majority owner, and the partnership agreement was amended to give the son the sole control over partnership distributions. The son made non pro

rata distributions to himself, and used those funds to pay his father's expenses to the extent of \$4.3 million.

The 4th Circuit court, in certifying the issue to the Virginia Supreme Court, noted that while the charging order is ordinarily the sole remedy of a creditor of a partner, a showing of abuse may warrant reverse veil piercing, even in a case where there are non-debtor owners, if those owners are complicit in the abusive scheme. The Virginia Supreme Court agreed and so held.

MUCH ADO ABOUT SOMETHING

So where does all this leave planners? Many are justifiably confused and a bit worried. Because the final judgment in *Ehmann* was withdrawn pursuant to a settlement agreement, *Ehmann* does not have formal precedential value, although it appears that courts will look to it anyway.

The 10th Circuit made clear that the opinion in *Baldwin* should not be considered binding precedent; in other words, the court may yet change its mind as the law in this area continues to develop. Thus, even in the 10th Circuit this issue is still up in the air. Although, like *Ehmann*, the *Baldwin* opinion is technically non-precedential, look for the 10th Circuit's rationale in the case to be of interest to courts that confront these issues in the future. Perhaps the *Baldwin* opinion was sent up as a trial balloon by the 10th Circuit?

In the meantime, smart planners will conduct themselves as if *Ehmann* and *Baldwin* are established precedent. Planners who do not carefully consider the issues of partners and LLC members in bankruptcy in the 10th Circuit and elsewhere do so at great risk to their clients.

Asset protection is not a game, and not something to take lightly. To the contrary, it is a highly complex and technical practice area where multiple overlapping bodies of law (here, partnership law and bankruptcy law) create both opportunities and traps for planners. Because the courts naturally favor the enforcement of judgments, there are far more traps than opportunities.

The courts are only now starting to address asset protection planning directly, and with a slowing economy and a collapsing real estate market in some areas of the country, we can expect to see a more opinions which address issues such as these. Stay tuned.

³ 70 Conn. App. 133, 799 A.2d 298 (2002).

⁴ 306 F. 3d 126 (4th Cir. 2002), opinion on certified question, 266 Va. 3, 580 S.E.2d 806 (2003).

IS YOUR CORPORATION REALLY PROTECTING YOUR ASSETS?

by Joseph Petrucelli, LL.M.

Flyer after flyer and seminar after seminar and “asset protection planner” after “asset protection planner” tout the use of corporations, especially Nevada corporations, for asset protection. The typical claim is that by putting your business and, in some cases, personal assets into a corporation, creditors will not be able to get at those assets if you are ever sued. You then plunk down anywhere from \$99 to several thousand dollars to have someone with minimal or no legal training pull a form off the internet or out of a book and send it to you in a three-ring binder with the corporation’s name embossed on it and the person’s solemn oath that in fact you are “creditor protected.”

What planners at seminars, websites and flyers often fail to consider is that there are two types of liability that need to be considered. The first is corporate liability and how it could affect the shareholder’s personal property. The second is shareholder liability and how it could affect the property of the corporation.

Corporate Liability

It is generally true that a corporation is a limited liability entity. The basic idea of a corporation is that someone suing the corporation should not be able to get at the shareholder’s personal assets unless there is a reason to “pierce the corporate veil.” So, operating a business through a corporation may make excellent sense as long as you provide no reason to pierce the corporate veil and as long as you are not the only employee of the corporation.

What many planners fail to explain is that a person is always responsible for his own acts. That means if you are working for a corporation, even your own corporation, and do something that results in a lawsuit there could be a judgment against you and you would be responsible to pay the judgment with your personal assets. In such a case, the corporate veil would be of no consequence and the creditor could proceed against your personal assets directly. So, a corporation may be good for avoiding liability for the actions of other employees, but will generally not shield you from personal liability for your own actions in working for the corporation.

The other problem is that there are any of a dozen legal theories for “piercing the corporate veil.” What this means is that in many instances the shareholder’s assets are not safe from creditors. This is true even if the shareholder is

not working for the corporation or the liability is caused by an employee.

One rationale that courts have used to pierce the corporate veil is the failure of the corporation to follow corporate formalities. For instance, the corporation may fail to hold annual shareholders’ meetings, annual directors’ meetings, to have directors approve certain acts, to use a proper corporate signature line, or any of a dozen other things that would constitute a failure to follow corporate formalities. In such a case, the court may rule that because the corporation is not being treated like a corporation, it should be ignored for “asset protection” purposes as well.

Another reason the court could “pierce the corporate veil” is that there has been a co-mingling of the assets of the corporation with the shareholder’s personal assets. This can occur in situations where personal expenses are being paid with corporate funds. It could also occur in instances when the corporation is using personal property of the shareholder such as when the corporation is being run from the shareholder’s home or using a vehicle leased in the shareholder’s name. Corporate co-mingling can also occur when the shareholder is using corporate property for personal purposes like using a corporate computer for personal business or driving a corporate car on off hours. There, the court might hold that the corporation and the person are one and the same.

When a corporation and a person are considered one and the same, the courts apply the alter ego theory. When there is a high concentration of corporate ownership in the hands of one or only a few shareholders, there is the possibility of the court saying that the corporation and the shareholder’s are so indistinguishable that they should be considered one and the same so that the shareholder should be responsible for the debts of the corporation.

In any of these circumstances, the corporation will not act as a limited liability entity. If the corporate veil is pierced for any reason, you run the risk of losing your personal assets.

Personal Liability

On the other side of the coin, a corporation is typically considered a separate legal person from the shareholders. That means that the creditors of the shareholders should not usually be able to get access to the assets of the corporation.

However, there are reasons why corporate assets would in fact be available to creditors of the shareholder either directly or because the creditor could obtain control of the corporation. If a creditor gets control of the stock of the corporation, the creditor gets control of the assets inside the corporation. So, by using a corporation for “asset protection” what you have really done is create a nice little picnic basket where creditors can go grab a sandwich unless you take proper steps to protect the sandwiches.

Without getting too technical, the Uniform Fraudulent Transfer Act (the “UFTA”) as adopted by the various states and the Federal version of the UFTA which is called the Federal Debt Collections Procedures Act of 1990 (the “Federal Act”) essentially say that if property is transferred for the purpose of frustrating, hindering or delaying creditors, that the transfer can be voided by the courts. It also says that the court can order not only the property that was transferred but other property of the person to be attached for the benefit of creditors. So, the idea of putting property into a corporation for the sole purpose of hindering, delaying or frustrating creditors may be a fraudulent transfer and it is possible that the court could in fact reverse the transfer of the property into the corporation.

Even without the transfer of property being considered a fraudulent transfer, there is a possibility that the assets of the corporation could be available to creditors indirectly. Stock of a corporation is personal property. Under the laws of most states, the owner of the stock does not have direct ownership of the property of the corporation. For example, California law says that a shareholder does not own the assets of the corporation and is not entitled to profits of the corporation except in liquidation (after all creditors have been paid) or when the Board of Directors declares a dividend.

However, the stock itself is generally available to creditors to satisfy the debts of the debtor. Being able to obtain the stock of the corporation is therefore valuable to a creditor because the owner of the stock generally has rights that can provide access to corporate assets.

For example, a shareholder has the right to vote to elect the directors of the corporation. If the creditor gets enough stock to obtain control of the Board of Directors of the corporation, the creditor can force the corporation to sell assets, declare dividends, buy back the shares of the creditor, or liquidate the corporation to pay the creditor.

Even if the creditor does not get enough shares to obtain control of the corporation, the laws of many states provide

that the majority shareholder in a privately held company owes a fiduciary duty to the minority shareholder and may be forced to allow the corporation to liquidate sufficient assets to pay the debt. Worse, in many states a minority shareholder can bring a suit for involuntary dissolution of the corporation and force the corporation to liquidate to pay the debts owed by the shareholder. In short, having corporate stock exposed to creditors can result in severely negative consequences.

Does that mean that the corporation is worthless? No, but absent proper planning that is typically not done by “planners” selling corporate identities to reduce taxes and protect assets, you could be facing serious problems that could have been easily avoided if you first get counsel from someone knowledgeable in the field of corporate law. We review corporate structures on an almost daily basis and rarely find one that can’t be improved by simple changes that would have cost very little to have done initially.

It is also important that the business planning be done in conjunction with estate planning so that the two can function seamlessly. By integrating the business and estate planning processes, you are better able to meet all of your objectives and goals. Integrated planning can therefore provide solutions for protecting the corporation from creditor action by providing proper holding structures for the stock.

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THE B.S. BEHIND NEVADA BEARER SHARES

by Randall Edwards, J.D.

Spend about an hour listening to talk radio and you can't miss it – that radio ad touting Nevada corporations as the bulletproof Asset Protection shelter that can keep you from getting sued and losing your fortune to those greedy personal injury lawyers who are laying in wait to put your name on the defendant line of a meritless lawsuit.

There's no question that Asset Protection is a good idea – just as you'd be irresponsible to drive your car without insurance, you'd be crazy not to shield yourself and your money from a lawsuit. But are Nevada corporations the one-size-fits-all answer? As a lawyer who has practiced in Nevada since 1983, I have to tell you that the answer is a resounding “no.”

The marketing of Nevada corporations takes many forms – from Internet sites promising to incorporate you cheap

cheap cheap to a network of sales representatives pushing a Las Vegas-based program. Nonetheless, the legal theory behind the craze is always the same: Because Nevada is the only state that approves "bearer shares" – as negotiable and easy to transfer as cash – no one can really ever know who owns a corporation at any time, because at any time anyone might have the "bearer shares" in their pocket.

The theory appears to go something like this:

Because Nevada's corporate statute differs from the Revised Model Business Corporation Act as developed by the Committee on Corporate Laws of the American Bar Association in that NRS does not require that a stock certificate state the name of the person to whom the stock is issued, somehow the stock certificate can be made out simply to "bearer" and thus, just like cash, whoever happens to be hanging onto the shares at any given time is the "owner" for Asset Protection purposes. Thus, when a creditor hauls the person who has been running the corporation up until the morning of his testimony into court, that person can look the judge in the eye and state truthfully, "Gee, I don't know who owns the corporation, sir, since I just don't know where the 'bearer' shares are right now, or who's got 'em today. And whoever's got 'em is the owner – at least right now."

Accordingly, the judge will shrug his shoulders, throw his hands in the air and confess, "Well, I guess that's the end of that. We just can't figure it out, so ... CASE DISMISSED! Next?"

The debtor then scurries home, where his grandma, or whoever happens to be holding the stock certificates, says, "Welcome home, Sonny ... here are those pesky papers you gave me this morning," after which life goes on unabated, since the debtor now has the stock (and thus ownership of the corporation) back in his hands, with the frustrated creditor stamping his feet in the background, muttering, "Curses! Foiled again by that darned Nevada 'bearer shares' law!"

That's the theory, at least. Unfortunately, this structure appears to be built on a pretty shaky foundation. Here's why:

First, there is no statutory or case authority that stands for the proposition that such a thing as "bearer shares" exists in Nevada - at least not in the form pushed by the "Asset Protection" promoters. There are no Supreme Court opinions dealing with the concept, no Attorney General's opinions, no federal cases and, as far as I've been able to ascertain, no district court opinions upholding such a concept.

In fact, the whole "bearer share" idea stems from this language, in NRS 78.235(1):

"Except as otherwise provided in subsection 4, every stockholder is entitled to have a certificate, signed by officers or agents designated by the corporation for the purpose, certifying the number of shares owned by him in the corporation." That's it. There's not a word in Nevada statute that says "bearer," no indication that the owner of a corporation can scam a creditor by claiming that he doesn't know who owns the corporation, and no provision that entitlement to a certificate equates to entitlement to hide from a valid debt.

In fact, Nevada case law appears to stand for just the opposite conclusion. As far back as 1942, the Nevada Supreme Court held that "a transfer of stock between individuals, in order to receive recognition by the corporation, must be registered upon its books." See *Petition of Simrak*, 61 Nev. 431, 132 P.2d 605. This concept has been upheld as recently as 1986, in the case of *Schwabacher v. Zobrist*, 102 Nev. 55, 714 P.2d 1003, which again confirmed that an ownership interest in a corporation is not valid as to the corporation until that interest is registered with the corporation. In fact, the case went on to say that when a stock transfer isn't registered on the corporate books, the person transferring the stock stands as a trustee for the person receiving the stock. Doesn't sound much like the idea that there somehow exists a provision under Nevada law that authorizes "bearer shares" that can be transferred like cash. To the contrary, it appears that Nevada case law stands for just the opposite proposition.

Second, under Nevada law, the holding of the stock certificate doesn't necessarily mean anything. In 1921, the Nevada Attorney General's Office issued an opinion that the stock certificate does not equate to the stock itself, but is merely a piece of paper evidencing ownership. See AGO 38 (6-7-1921). In all the intervening years, the Attorney General's Office has never modified or rescinded this opinion. In fact, because Nevada does not necessarily require that corporations issue certificates at all, it makes no sense to assume that possession of a stock certificate equals ownership of the shares anyway.

Along that same line, Nevada law provides that stock shares are personal property. NRS 78.240. All rules, regulations and taxes that would otherwise apply to transfers of personal property would also apply to transfers of "bearer shares," if indeed such an animal exists. For example, my car is also my personal property. Handing my buddy the keys until I got back from court wouldn't equate to transferring ownership, nor could I get away with telling a

judge, "Gosh, your honor, I don't know who's driving the jalopy right now, so I couldn't really tell you who owns the old clunker."

Thus, even if such a concept as "bearer shares" did somehow exist under Nevada law, and even if the transfer of ownership of a corporation could somehow be accomplished with such ease, there would still be all sorts of estate, gift and capital gains tax issues. Furthermore, there is also the possibility that the transferee of the bearer shares would also be hit with any judgment that had been levied against the transferor since, as the Schwabacher case stated, when an unregistered transfer of stock has occurred, the transferee of that stock is "responsible for the burdens and liabilities growing out of its ownership," at least as against the transferor of the stock. Presumably, this would carry with it any court order relative to the stock arising from the transferor's liabilities.

Finally, does anyone seriously believe that any judge would fall for this sham? I've been practicing law in Nevada since 1983, and I know or have practiced before an awful lot of the judges on the Nevada bench, including the Nevada Supreme Court. Now, even granting that not everyone who's ever been appointed or elected to the bench (that's right, in Nevada, judges are elected) is the brightest lamp on the casino marquee, I don't believe that even the dimmest of Nevada's legal luminaries would fall for the idea that a corporate ledger book that makes out the owner of stock shares to "Bearer," coupled with a befuddled-looking debtor defendant smugly saying, "Yup, I think I might've had some of them stock certificates, but I don't have any now," would somehow leave the judge without any ability to fashion a legal remedy other than dismissal of a case against a debtor.

I think that the most tame thing that a judge would do under such circumstances would be to declare the debtor to be in constructive, if not actual, ownership of the shares and order the corporation to be liquidated to satisfy a creditor's claim. Most of the judges I know wouldn't sit still for just that, though; somehow, the phrase "contempt of court" keeps springing to mind.

So, when you hear that radio ad that promises untold Asset Protection by merely filing articles of incorporation in Nevada, I have this work of advice: RUN! Actually, a few more words: AS FAST AS YOU CAN. THE OTHER WAY!

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ASSET PROTECTION SHORT SUMMARIES

IRS vs. Spendthrift Trusts

The IRS has taken the position that it can levy against a taxpayer's interest in a trust despite the spendthrift provisions, where the taxpayer has a mandatory right to income of the trust or any right to receive trust principle either now or in the future. C.C.A. 200614006.

This position mostly tracks civil law as it relates to an ordinary creditor's right to attach income or principal distributions from a trust, i.e., whatever the debtor-beneficiary can get, so can the creditor get. The solution is easy: Just make sure that the trust document is drafted so that a beneficiary has a mandatory interest in or right to income or principal of the trust. In other words, distributions should be entirely discretionary with the trustees.

Caution that engaging in asset protection for the specific purpose of defeating the collection of a federal tax debt can be a felony.

Increases in Home Equity Not Protected Within 40 Months of Bankruptcy Filing

An Orlando bankruptcy judge has held that, under the 2006 bankruptcy reforms, an increase in home value within 40 months of filing bankruptcy is not exempt from collection, notwithstanding contrary state law. In other words, if your home has gone up in value in the 40 month period prior to when you filed bankruptcy (whether by payments or appreciation), you can kiss that value goodbye. *In re Sainlar*, Ch. 7 Case No. 6:050-bk-14070 (Bkrpt.M.D.Fla. 2006).

This is another good reason why your home should be in a solid asset protection structure. Quite absurdly, some clients are advised to deliberately leave their personal residence outside of any asset protection structure so that their balance sheets appear to be more liquid if there is a later fraudulent transfer issue. This is really bad advice.

Confusion Regarding Revocable Trusts and Bankruptcy

A Connecticut bankruptcy court has held that the Connecticut homestead exemption is not effective in bankruptcy if the home is held in a revocable trust. *In re Estarella*, 2006 BANKR. LEXIS 318 (Feb. 23, 2006). One Florida bankruptcy court reached this same result last year. *In re Bosonetto*, 271 B.R. 403 (Bkprt. M.D. Fla., 2005)

Meanwhile, another judge in the same district (Orlando) has come to the opposite determination, and held that

homestead property held in a revocable trust would be protected. *In re Alexander*, (Bkrpt.M.D.Fla. July 25, 2006). A Kansas bankruptcy court similarly held (in a decision already affirmed by the 10th Circuit) that as to a Kansas home held in a revocable trust that the homestead exemption was effective. *In re Keifer*, 2006 BANKR. LEXIS 319 (Mar. 13, 2006).

How is this going to shake out? Who knows and, really, who cares. Revocable trusts are a very poor asset protection tool and should not be used if creditor-debtor planning is a serious concern.

Alaska Amends Trust Act, Again

Alaska has once again amended its trust act for the specific purpose of providing greater asset protection. There is now greater protection for assets in the event of a divorce, better administration of claims in a divorce proceeding, shorter statutes of actions for bringing suit against the trust, and the alleged ability to for non-residents to protect their IRAs in an Alaska trust (fat chance of that last one working).

The trouble is: *For any of this to be effective to protect your assets, you probably have to reside in Alaska and have all your property there.* Furthermore, you must also avoid bankruptcy as the federal bankruptcy law will automatically trump any contrary Alaska law by reason of the Supremacy Clause of the U.S. Constitution. None of this will keep the Alaska trust companies, and some misguided lawyers, from trying to peddle Alaska trusts to clients outside of Alaska of course.

A big caution is that it is anything but certain that Alaska law will apply to a creditor-debtor dispute involving a trust formed in Alaska but holding property locally. Some planners blindly assume this will be the case, but there really is nothing that justifies that expectation. You had better assume that a local judge will apply local law to a local controversy where local assets can be collected against. Anything else is more wishful thinking than hard legal reality.

CALIFORNIA FRANCHISE TAX BOARD (FTB) TAXES SEPARATELY EACH SERIES OF A SERIES LLC

Citing the potential for “abusive tax strategies”, the California Franchise Tax Board (FTB) has taken the position that each series in a Delaware Series LLC is considered a separate LLC for California franchise tax purposes, and must file its own Form 568 and pay its own separate LLC

annual tax if it is registered or doing business in California. D. Newcomb, *What is FTB’s Position on Delaware Series LLCs*, California Franchise Tax Board’s Tax News, Mar/Apr 2006, at p. 3.

The California Franchise Tax Board (FTB) has been asked this question: Does a Delaware Series LLC that has qualified or engaged in business in California is required to file the Form 568 Liability Company Return of Income form only once, for the entity itself, or must the Form 568 be filed for each Series?

Section 18-215 of the Delaware LLC Act allows the creation of an LLC with what amounts to “cells” or “subcompartments” known as “Series” that effectively are respected as their own stand-alone entity, though they are part of a sole LLC that has paid only one formation fee. Each Series has separate obligations and duties, as well as unique rights, to the main LLC including profit and loss participation. An individual Series can also be wound up without causing the dissolution of the LLC.

In reviewing the Delaware Series LLC, the FTB commented that:

A Series LLC is essentially a master LLC that has separate divisions, similar to an S corporation with Q-sub. * * * The Treasury Department has not issued direct guidance of the tax treatment of Series LLCs. Review of the tax research services indicates that the Series LLCs are compared to the separate series of a single trust, which have been regarded as separate taxpayers as found in *National Securities Series -- Industrial Stock Series v. Commissioner*, 13 TC 884 and Revenue Ruling 55-416. In addition, the IRS issued various private letter rulings based on those early authorities.

California does not have Series LLC legislation; thus, there is a question as to how a Delaware Series LLC which qualifies to do business in California, or engages in business in California should be taxed as a single entity, as Delaware does, or as a multiple entity. The FTB was clear in its answer:

Tax practitioners propose that only one Form 568 needs to be filed for the entire series. FTB does not agree. Our current position is that each series in a Delaware Series LLC is considered a separate LLC and must file its own Form 568 Liability Company Return of Income and pay its own separate LLC annual tax and fee if it is registered or doing business in California. [Emphasis in original]

The impact of the FTB's ruling on the Series LLC as it relates to California is clear, but this should not be seen as strictly a California issue. Few states have adopted Series LLC legislation, there is great variance between the enabling Acts of even the few states that have adopted such legislation, and the state law tax treatment of the Series LLC in each non-Series state can be a very significant issue.

What the FTB decision highlights, and what is not unique to California at all, is that the taxation of Series LLCs is a vast minefield with potentially even more questions than when the original plain-bread LLCs were first introduced. So what is a Series LLC anyhow, and why do they cause such great problems.

The Most Sophisticated Business Entity Ever?

The Series LLC is the latest and by far most sophisticated form of business entity yet created. The concept is that a single entity may be formed in a state, but separate series (or "cells") may be internally created within the entity. Think of it as a "master entity" with numerous "sub-entities" within each, with each sub-entity acting as if it were a totally separate business entity in and of itself. Or think of it as a class of stock shares that controls a specific portion of a company to the exclusion of the other classes.

Some states, such as Delaware, have enacted legislation that has the potential effect of protecting the assets of one Series from the liabilities of another series. Other states have stopped short of these internal walls, but still given each Series what amounts to a separate business identity having separate rights, power and duties from the other Series, as well as different rights or obligations to participate in profits or losses.

Series LLCs are definitely the advanced planning tool of the future, and offer tremendous advantages in planning for such things as hedge funds, venture capital funds, oil & gas deals, and fractional share arrangements. Otherwise complex business arrangements can sometimes be easily simplified by the use of a Series LLC. This new form of entity is like a Boeing 777 in that its inner workings are nearly impossible for even the experienced practitioner to comprehend, yet a Series LLC in skilled hands can be a highly versatile and efficient machine.

But Don't Use A Ferrari To Cut The Lawn

Although Series LLCs are best suited for advanced cutting-edge business entity planning, they are instead being increasingly mass-marketed and sold to real estate investors

as a po'boy alternative to forming a separate LLCs for each parcel.

For instance, assume that Ms. Business Owner has six distribution centers located in a state that has not yet enable Series LLCs. Instead of putting each distribution center into six LLCs, she could instead form only a one Series LLC, but put each distribution center into separate Series. Thus, if a liability arises within one of the distribution centers, in theory the other five distribution centers would be segregated by the internal "walls" of the Series protection.

There are many problems with this approach. First, while it sounds great in theory, this internal segregation of liabilities has yet to be validated in any significant fashion by the courts. Second, there are numerous unresolved questions of how each Series will be treated for alter ego and similar attempts to pierce the veil of one Series to get at the assets of another. Finally, and most importantly, there is little reason to believe that a court in a non-Series state will respect the internal liability segregation.

The latter may be especially true as it relates to claimants who are not party to the LLC's operating agreement, thus are not contractually bound to recognize these paper walls. Perhaps as between members the Series LLC may govern claims, but there simply is no reason why a third-party creditor should suffer in their recovery efforts in a state whose legislatures have not seen fit to adopt this new form of entity (this is the same primary concern that makes the so-called Domestic Asset Protection Trust valueless outside of a DAPT state).

Shortcutting Through A Minefield

So, going back our distribution centers example, it does not make sense for Ms. Business Owner to gamble on using a Series LLC if she can afford to have each distribution held in a separate LLC. Now, with the FTB's ruling, there is an additional very serious concern to attempting to use the Series LLC as a cheapie shortcut to save a few nickels, which is that in the end they may not even save the nickels in addition to exposing the assets to totally untested and highly suspect protection.

The Series LLC is thus the perfect example of a highly complex entity that is being totally misused to solve problems that should be handled in a more traditional fashion. It is very much like using GRAT for a client who has little assets and is only interested in probate avoidance: Not only is it overkill, but it brings unnecessary risk to the client.

Summary

The Series LLC presents tremendous planning opportunity and may eventually become the sophisticated planner's entity of choice for many situations. However, there are many unresolved tax and civil law issues regarding the Series LLC and its use in non-Series states is at best a dangerous proposition. And while one may desire to use the Series LLC to provide inexpensive asset protection, as the FTB's comments show, it may not be inexpensive after all. If you are going to dabble with these entities in non-Series states, don't be surprised when you hear loud bangs as you stumble through the minefield.

OLD STRATEGY REBORN: THE PRIVATE TRUST COMPANY

Do you have a big family with multiple trusts for each family member? Are you tired of paying trustee fees? Do you have to wrangle with your trustee to make simple asset transfers? Are you tired of being gouged for costs for every small decision? Do you not feel that you are getting enough value for the asset management fees being charged to your trust? Do you not trust your trustee?

If the answer to any of these questions is a "Yes", then a Private Trust Company (PTC) is at least worth exploring.

A Private Trust Company is just that – it is a authorized trust company that is owned by the family (or some of the members of the family) and which provides trustee services for trusts for family members. Since the family owns the PTC, the trustee fees are whatever you decide they need to be. Similarly, because you control the PTC you will never have to worry about "trusting your trustee", the trustee running off to Maui with your money, or having to argue with the trustee to transfer or sale trust assets.

Some states now cater to the Private Trust Company concept, and allow families to create trust companies to serve the families needs. The laws of these states may restrict PTCs to dealing with family members only, i.e., you cannot hang out a shingle and start offering trust services to anybody who walks by. But for a family with many members, a PTC definitely has the potential to save costs and make management of the family assets easier.

Although Private Trust Companies seem like a new phenomena, they have actually been used for years by asset protection planners. Some offshore havens, such as Belize and Nevis, did not restrict ordinary companies from acting as trustees. A common arrangement was to have such a Belize or Nevis company owned by a charitable trust or a

purpose trust, and then the Belize or Nevis company would act as the trustee of a foreign asset protection trust. Because the trust control was truly with the trustee (as it should be), this allowed the smarter planners to strip out much of the "control the trustee" language that the U.S. courts found opprobrious.

Private Trust Companies are a logical and reasonable backlash to the excessive fees, red tape, and inflexibility of ordinary trust companies. For large trusts particularly, trustee fees have gotten out of hand and the large trust companies greedily charge for a percentage of assets in the trust even if they are managed by an outside financial advisor. Even though they are earning hefty fees, most trust companies do not actually want to do anything but sit on assets and it often very difficult to persuade trustees to make even the most mundane transfers of assets or sign off as a passive member of an LLC agreement, etc., at least without incurring thousands of dollars of costs in having the trustee's lawyers review the arrangement and advise the trust, etc.

Fearing liability, ordinary trust companies will often not allow ownership interests in an operating business (such as the family business) to be held in trust. Thus, the family is deprived of placing what is typically its largest asset into a structure that is protected from estate taxes and possibly from creditors. There are no such restrictions on a PTC.

Other factors also favor the formation of PTCs, such as using it to help train younger family members in asset management and more effectively resolving family control issues. The PTC can also choose the investment managers that the family wants, and not just from a list given by an ordinary trust company.

The use of a PTC may help to mitigate certain estate tax problems. Although the IRS has not yet issued any guidance for PTCs, several favorable Private Letter Rulings have in individual cases validated the benefits of PTCs. See PLR 200523003 (6-10-2005), PLR 200546055 (11-18-2005), and PLR 200548035 (12-2-2005). But there may be restrictions, such as the need for at least one non-family member to be a director of the PTC.

What you have to look out for is that PTC are being sold by some estate planners as the flavor-of-the-day planning tool to everybody who thinks they want one, whether they actually need one or not. In fact, some families who have bought PTCs might have been better off just rearranging their existing trust and entity structure to make it more efficient than biting off a PTC. Like anything else, the PTC is a tool that has its uses in particular circumstances but not everywhere. Before the decision is made to implement a

PTC, the family should have an extensive analysis made of its advantages, disadvantages and efficiency as compared to alternative structures.

INTRODUCING THE OCC PLAN: OWNERSHIP CONTINUITY AND CONTROL PLAN

The legal systems of the United States and most other industrialized nations are relatively advanced and competent when it comes to deciding issues of ownership of corporations, such as when a shareholder dies. Not so with emerging nations, such as India, Vietnam, Thailand, China or Mexico, where the legal systems are often a combination of inadequacy or corruption, and the resolution of ownership issues is at best uncertain.

The problem of uncertainty of corporate ownership and of succession creates many problems for the shareholders. Even for a simple business sale or stock sale, the uncertainty of the foreign courts gives little comfort to buyers that their ownership rights will be quickly respected. When a shareholder dies, the business ownership may slide into limbo for many years before the issue of succession is determined.

Problems of uncertain corporation ownership may even permeate investments in the United States, such as where a brokerage firm may decide not to open an investment account or assist in the sale of a business interest to U.S. investors because the corporate ownership situation will be difficult to resolve.

Enter the OCC Plan, which has been developed by Robert Sommers and Jay Adkisson. This plan seeks to consolidate the ownership of a business in an emerging nation into a trust and business entity combination formed either in the United States or an offshore jurisdiction which caters to such activity. This combination thus allows the quick resolution of business sale and business succession issues in a jurisdiction where the laws are well-developed and the issues may be determined with some certainty.

Significant benefits of the OCC Plan include protecting the ownership and free transferability of intellectual property, foreign sales contracts, and facilitating buy-sale arrangements. Other benefits include arranging U.S.-quality financial planning and life insurance consulting to provide benefits that are simply not available in many emerging nations.

The OCC Plan also seeks to utilize recognized U.S. strategies for mitigating taxes to the foreign structure, where it is

practical to make such an application. The OCC Plan could include, for instance, the use of a family-held captive insurance company to underwrite certain risks of the foreign business and thus provide an alternative and legal means of wealth and currency transfer out of the foreign jurisdiction.

The OCC Plan is not a plan for U.S. persons engaged in business in the United States, and does not seek to avoid or defer any U.S. taxes. It is strictly limited to *bona fide* businesses legitimately operating in an emerging nation.

See <http://www.occplan.com> for more details.

WHY CONGRESS IS ABOUT TO DECLARE WAR ON PRETTY MUCH EVERYTHING OFFSHORE

In August, the Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs held hearings on offshore tax evasion. Led by Senator Carl Levin of Michigan, the hearings examined the phenomena of continued offshore tax evasion by Americans even after new rules and regulations and a general crackdown by the IRS and criminal investigators.

According to the report "Tax Haven Abuses: The Enablers, the Tools and the Secrecy":

Offshore tax havens and secrecy jurisdictions today hold trillions of dollars in assets. While these jurisdictions claim to offer clients financial privacy, limited regulation, and low or no taxes, too often these jurisdictions have instead become havens for tax evasion, financial fraud, and money laundering. A sophisticated offshore industry, composed of a cadre of international professionals including tax attorneys, accountants, bankers, brokers, corporate service providers, and trust administrators, aggressively promotes offshore jurisdictions to U.S. citizens as a means to avoid taxes and creditors in their home jurisdictions. These professionals, many of whom are located or do business in the United States, advise and assist U.S. citizens on opening offshore accounts, establishing sham trusts and shell corporations, hiding assets offshore, and making secret use of their offshore assets here at home. Experts estimate that Americans now have more than \$1 trillion in assets offshore and illegally evade between \$40 and \$70 billion in U.S. taxes each year through the use of offshore tax schemes.

Utilizing tax haven secrecy laws and practices that limit corporate, bank, and financial disclosures, financial professionals often use offshore tax haven jurisdictions

as a "black box" to hide assets and transactions from the Internal Revenue Service ("IRS"), other U.S. regulators, and law enforcement. * * * The evidence is overwhelming that inaction in combating offshore abuses has resulted in their growing more widespread and reaching new levels of sophistication.

Terry Neal's Tax Scheme and Theft of Funds

The hearings used several examples of offshore tax evasion and related conduct. Among these was the case of Kurt Greaves, the owner of the largest residential roofing company in Michigan, who was unlucky enough to believe in the advice of Terry Neal (who is discussed in this edition's Report from Quatloosia, below).

According to the report, Mr. Greaves used the services of Neal's Offshore Corporate Services, Inc. (which later became "Lauglin International, Inc." and which amazingly is still doing business from Nevada) and Neal's Nevis American Trust Company (NATCO). Neal assured Greaves that Neal's offshore plan was completely legal and that "There's nothing you can't ask us, we're one-hundred percent legit."

Under Mr. Neal's guidance, Mr. Greaves used a variety of sham transactions to transfer untaxed business income offshore without giving up the ability to use and manage those funds. Mr. Greaves told the Subcommittee that all of the offshore service providers who managed his offshore corporations readily complied with his requests on how to handle his assets, even though he did not technically own any shares in the offshore corporations. He said that the offshore service providers even fabricated documents to support fictitious tax deductions, including a phony mortgage and insurance policy. Like Mr. Holliday, Mr. Greaves established shell corporations in Nevada as an additional layer of separation between him and his offshore assets, and arranged for fictitious bills and loans to move funds between his Nevada and offshore entities.

* * *

Mr. Neal developed several schemes to help Mr. Greaves move his assets offshore. In one scheme that combined asset protection and tax benefits, Mr. Greaves took out a mortgage on his home through an ostensibly independent Canadian corporation that he in fact controlled. No money was actually borrowed, but the mortgage encumbered Mr. Greaves's property and thereby rendered it immune from asset seizure. Each tax-deductible interest payment to the company on the "mortgage" moved money into foreign bank accounts that Mr. Greaves controlled.

Mr. Greaves described another scheme that used a Nevada corporation called Midwest Consultants. Mr. Greaves paid about \$150,000 to the company for "consulting services," which he listed as a tax deduction. Then Midwest Consultants sent the money to a company in Nevis controlled by Mr. Greaves, and Midwest Consultants deducted the expense as well. Mr. Greaves routinely moved money in this way, sending it offshore through a U.S. company he controlled for phony business expenses such as consulting or accounting services.

A third scheme devised by Mr. Neal and utilized by Mr. Greaves involved a phony insurance company. Mr. Greaves wired \$230,000 to a company controlled by Mr. Neal called Sovereign Life & Casualty Limited for "Business Casualty and Fidelity Insurance," which purported to insure against a variety of business losses. The policy was phony, and Sovereign Life & Casualty Limited did not provide any actual insurance coverage. A Nevis company controlled by Mr. Greaves, called McLaren Investment, Inc., entered into an indemnity agreement with Sovereign Life & Casualty Limited and assumed all of its liabilities under the policy. The money that Mr. Greaves wired to the phony insurance company then went into an offshore account that he controlled.

Mr. Greaves later pled guilty to tax evasion. Notably, Mr. Greaves told the committee that there were significant discrepancies in Neal's accounting for his funds, and that in the final days he feared that Neal would steal all of his money when he found out that Greaves was cooperating with criminal investigators. (These fears were probably not unfounded, considering that Neal was accused of cheating investors in a stock deal only a few years previously and paid a huge fine to the SEC).

Sam Congdon and Equity Developers Group (EDG)

The hearings also focused on Equity Development Group of Dallas and its president, Samuel Congdon. The summary of the report relates that:

Over the past six years, EDG utilized the internet to provide about 900 mainly American clients, many of relatively modest wealth, with the type of offshore services previously available primarily to high-net-worth individuals. With few resources, no employees, and only nine months prior experience in the industry, Mr. Congdon was able to quickly create and promote an online offshore facilitation business that provided a one-stop-shop for persons looking to establish an offshore structure. Mr. Congdon rarely met his clients, did not work with their lawyers or accountants, and seldom inquired into their in-

tent. EDG told prospective clients that regardless of the offshore structures established for them, the client would retain full control of their offshore funds. Mr. Congdon told the Subcommittee that, in six years of operation, he could recall only one instance in which an offshore service provider declined to comply with a client instruction, in that case refusing to supply a sworn affidavit attesting to facts for a lawsuit. By connecting his clients with offshore banks and companies that establish and manage offshore trusts and corporations, and by acting as a liaison between his clients and the offshore service providers, Mr. Congdon enabled his clients to move assets offshore, maintain control of them, obscure their ownership, and conceal their existence from family, courts, creditors, the IRS, and other government agencies.

In the most favorable light, the picture painted by the report of EDG is of an unsophisticated, rinky-dink operation. The report noted that:

Mr. Congdon is EDG's sole employee. * * * The EDG website states that the company also maintains an office in Nassau, Bahamas, but Mr. Congdon told the Subcommittee that the Nassau office is just a mailbox, and that he, the company's President and sole employee, has never been to the Nassau office. * * * Mr. Congdon rarely met his clients, did not work with their lawyers or accountants, and seldom inquired into their motives. Yet, he helped design and establish the financial structures that enabled his clients to move assets offshore, maintain control of them, obscure their ownership, and conceal their existence from family, courts, creditors, the IRS, and other government regulators. Mr. Congdon willfully remained ignorant of his clients' motives for moving money offshore, and in so doing, he operated in apparent compliance with current law while facilitating potentially illegal activity.

Notably, the IRS later moved to subpoena from EDG its client list. After a brief squabble, EDG complied with the subpoena and, as EDG's attorney confirmed to us, turned its client list over to the IRS (that is not a client list that you would want to be on).

What These Hearings Presage

The IRS has asked for significant new powers and resources to attack offshore tax evasion, and Congress is more than willing to oblige. Even for those people who have innocent motives and are trying to comply with the law, the use of the debtor-haven jurisdictions and even routine foreign transfers are about to become a nightmare of

more tax forms, higher mandatory fines for both willful and negligent non-compliance, and increased audits for even innocent transactions.

In other words, Congress and the IRS are about to make offshore planning a living hell for even those who are trying to do it right, to discourage offshore planning and encourage those with offshore assets to repatriate them to the U.S. where they can be more closely accounted for. While the Jobs Act was a baby step in this direction, the next wave of regulation will be a giant stride. With soaring deficits and the war to finance, Congress and the IRS are determined to close the so-called "tax gap" of unreported income and assets, and going after everything offshore is their best hope of a windfall.

If you don't really have a need to go offshore, keep everything at home. And if you have something offshore already, maybe it is a good time to talk with your advisors about whether it is time to wind up your offshore structures and get rid of all the reporting of foreign entities and accounts.

A full copy of this report is available for free at http://www.assetprotectionbook.com/tax_haven_abuses.pdf

And speaking of offshore tax evasion . . .

PRIVATE PLACEMENT LIFE INSURANCE DEAL IMPLODES

We have warned for some time that the IRS is chasing abusive arrangements involving private placement life insurance (PPLI). The Service has now issued a (rare) Field Attorney Advice that blasts one such arrangement. The Service's action amounts to a declaration of Jihad against offshore PPLI.

For those of you who don't know, private placement life insurance is a variable universal life (VUL) life insurance policy that is purchased on either an individual or limited-edition basis, and which gives much greater flexibility to the policyholder to choose investments. Some attorneys have used these arrangements to commit tax evasion, such as: (1) selling interests in the client's operating business to the policy, usually by way of an intermediate step involving a private annuity or similar arrangement to avoid taxes on the sale of the business interests; (2) shifting intellectual property and royalty streams to the PPLI; (3) using the PPLI policy to hold interests in a bogus offshore insurance company so that premiums paid to the company are later upstreamed to the PPLI policy.

The benefit in each of these cases is that an otherwise taxable income stream is magically converted into higher cash values in the insurance policy that the business owner/policyholder can then borrow against. This is an extremely abusive transaction, and are clearly prohibited by the "step transaction" and other rules, especially since there is no economic substance to these transactions whatsoever. Yet, a few unscrupulous tax planners have been using such policies to illegally reduce their clients' tax burden. The tax evasive policies are purchased offshore, since there is a lower likelihood that the policyholder will get caught.

Note that not all PPLI policies, and not even all offshore PPLI policies, are abusive. If the policyholder is merely using the PPLI policy as a way to "dial down" the loads and expenses that are being paid, and to have greater investment flexibility, there is absolutely nothing wrong with that. It is where the PPLI policy is used to avoid taxes from a business or from intellectual property or royalty rights that PPLI crosses the line from proper to evasive.

FAA 20062701F

Field Attorney Advice 20062701F (original release date July 7, 2006; actual release date August 4, 2006) dealt with a very abusive plan intended to commit tax evasion. The client formed an offshore trust and the trust was funded with an offshore PPLI policy. The client then entered into a complex offshore deferred compensation arrangement, which allowed the client to take a deduction and the profits were upstreamed to the PPLI policy. The client then entered into a complex private annuity transaction to get the stock of his business into the PPLI policy also.

The IRS, correctly identifying the entire arrangement as a sham, denied all the benefits and directed that substantial penalties be assessed. These penalties included: (1) failure to report direct or indirect transfers of money or property to a foreign trust, for a 35% penalty of the value of the transferred property; (2) failure of the trust to provide a full accounting, for 5% of the gross value of all the trust assets; and (3) failure to furnish information about a controlled foreign corporation, for \$10,000 per accounting period. Ouch!

The next that we may hear about this case may be murder - as the client kills the planner that got him into this mess! It probably would be justifiable homicide.

The Swiss Annuity

A variation of PPLI, and which actually existed before PPLI, is the so-called "Swiss Annuity". The Swiss Annuity

is very similar to PPLI, except that instead of life insurance a variable annuity product is used. Frankly, because of estate tax considerations, Swiss Annuities make no sense. Whereas a PPLI product can be structured to avoid taxes, such as by simply placing it into an irrevocable live insurance trust, the proceeds of a Swiss Annuity will stay in the policyholder's estate at death. Moreover, it is much easier to unwittingly terminate the tax deferral of an annuity by, for instance, putting it into a corporation or partnership.

Form TD90.22-1

Contrary to what the promoters might say, an offshore PPLI or Swiss Annuity is subject to the annual filing of the Form TD90.22-1. This is the form by which a foreign financial account is reported, and there are still penalties for failure to file this form.

Remediation

If you have been suckered into one of these deals, you need to immediately contact competent and reputable tax counsel (and not whoever got you into this deal) and immediately to inquire about getting out of it and making full disclosures to the IRS, including amending past returns. This FAA is only one of the first actions by the IRS against abusive PPLI transactions, and we expect to see DOJ-TAX soon make some criminal examples out of both some clients and planners who have set up these arrangements and not properly reported them.

To read more about this, see "FAA 20062701F Bright line Test For Insurance Based Grantor Trust Status," by Howard M. Zaritsky in Steve Leimberg's Estate Planning Email Newsletter - Archive Message #1011, <http://www.leimbergservices.com>

REPORT FROM QUATLOOSIA

by Tony-the-Wonder-Llama

<http://www.quatloos.com>

FEDERAL TRADE COMMISSION SHUTS DOWN ASSET PROTECTION GROUP SCAM

Our story begins with Richard C. Neiswonger a/k/a Rick Neiswonger who ran a business called "Medical Recovery Systems, Inc." (MRS). Neiswonger marketed MRS as a business opportunity to victims who paid \$9,900 by telling them that with only two days of training they could assist small businesses in acquiring capital loans and in reducing their expenses.

To induce victims into buying into MRS, Neiswonger provided the victims who bought into MRS with lots of nice glossy brochures, videotapes, and other stuff to make the victims think they had a real shot at making this a real business. Neiswonger promised the victims that they would make a six-figure income, but almost none even got their \$9,900 back.

A few of the victims apparently caught on to the fact that they had been scammed by Neiswonger and complained to the Federal Trade Commission (FTC), which brought an injunction action to stop Neiswonger from continuing to operate MRS. Later, Neiswonger was indicted for wire fraud and money laundering, and spent 6 months in prison as inmate 25367-044, to be followed by 3 years of supervised release after being let out of prison on June 7, 2000.

When Neiswonger got out of prison, he hooked up with another loser, William S. Reed a/k/a Bill Reed, a former lawyer whose license was suspended by the Colorado Bar Association after he was caught in a series of fraudulent transfers from his law firm to himself to cheat his legitimate creditors. According to the opinion of the Supreme Court of Colorado, Reed:

engaged in misrepresentations and dishonesty by transferring various purported ownership interests to lawyer employees of the firm who were not managers or operating directors, did not receive profits, and did not participate in the ownership of the firm.

Noting that Reed's "dishonest and selfish motive is an aggravating factor for discipline purposes," the Colorado Supreme Court suspended him from practice for one year and a day, which was just long enough so that Reed would be "automatically required to petition for reinstatement and present clear and convincing evidence of rehabilitation and establish fitness to practice law again." In other words, clean up or quit practicing law.

Not being licensed to practice law anymore, Reed reinvented himself as an "asset protection consultant" and started selling a poorly-designed structure that involved a Nevada bearer share corporation and sometimes a Bahamas IBC, also owned with bearer shares. (Never mind that it doesn't even appear that Nevada will recognize bearer shares, and that the Bahamas later abolished bearer shares. Details. Details.)

At some point, Neiswonger and Reed hooked up and decided to merge their schemes. Thereafter, the two formed Asset Protection Group, Inc. (APG), and started offering a bogus business opportunity barely distinguishable from the MRS scheme that sent Neiswonger to prison the first time.

The two would use Reed's name, such as it was (few people knew about the fraudulent transfers or his suspension from law practice) and his asset protection structure, and Neiswonger would package and market what amounted to franchises by which victims would think that they could become the "planners to the stars" and make the big bucks selling Nevada bearer share corporations as an "asset protection consultant" – for only \$9,800 and including a two-day training course taught by Mr. Fraudulent Transfer himself.

Neiswonger took over the marketing, and none of the victims who bought into APG were told or had the sense to investigate Neiswonger's criminal conviction for running the basically the very same scam again. Spending big bucks on advertising, Reed and Neiswonger ran radio and print advertisements nationwide touting the APG opportunity, including sponsoring the Rush Limbaugh show and using the name of celebrity Robert Wagner.

As with MRS, the victims who bought in were told that they could make six-figure incomes, but almost none even got their \$9,800 back. Most just tried it for a few months, set up a website and hounded their friends to engage in this hokey planning, and then gave it up and walked away from their money. But this didn't keep Reed and Neiswonger from selling hundreds of bogus franchise opportunities, and generating gross revenues that the FTC believes has exceeded \$19 million.

APG was successful in scamming victims for several years (and apparently some time while Neiswonger will still on supervised release) before the FTC went back before the same court that had heard the MRS case, and obtained a restraining order against Reed and Neiswonger, which compelled them to turn over APG to a receiver and also identify and turn over any offshore assets. The FTC's motion noted the obvious, that "defendant Neiswonger and . . . Reed are writing new chapters in professional lives already marked by dishonesty, and defrauding consumers with practices prohibited by this Court."

APG's offices in Las Vegas were raided in July by agents of the FTC and the IRS-CI (Criminal Investigations), and a great deal of records and information obtained, including reportedly the names of all of APG's clients. So much for APG's secrecy and privacy, eh?

APG continues to operate under a receiver in providing Nevada registered agent services for the Nevada corporations that have been set up, but APG's lucrative sales of "Asset Protection Consultant" franchises has been totally shut down. Some of the victims of Neiswonger's and

Reed's scams have filed a nationwide class-action suit against them in federal court, and it will be interesting to see whether Neiswonger and Reed had a better asset protection structure than the crappy one they were selling to the APG victims.

The sad thing is that many of the APG "consultant" are still out there trying to pitch asset protection services, even though they basically have no clue as to what they are doing. You wouldn't want to go to a brain surgeon who only had two days of training and got some videotapes on the subject, and you wouldn't want to go to an asset protection planner who had this level of planning either.

As for Neiswonger, the most likely result is that the Graybar Hotel will once again beckon (convicted felons who run the same scam again get much, much, much longer sentences the second time around), and whether the doors will open for Reed too remains to be seen. If the class action suit is successful, it will be interesting to see whether Reed's asset protection is any more successful this time around (remember, last time he got caught in a fraudulent transfer) considering that the level of his advice is so poor. Frankly, one of the more amazing things is that the APG franchisees continue to believe in Reed's asset protection structure, even though it is so simplistic and flawed as to probably make the average first-year law student blush with shame.

But at least APG is no longer producing any of the poorly trained consultants who will get their clients into various messes. If you are somebody who has utilized APG for any services, you would be very smart to consult with an attorney immediately to see whether your structure needs to be scrapped or fixed. If you were victimized by buying into an APG franchise, you should consult with an attorney to see what your options might be.

The attorney bringing the national class action by the APG franchisees against Neiswonger and Reed is attorney Randall Edwards, who may be reached at 801-328-0300.

Patented Legal and Tax Strategies Drawing Heat

In our August/September 2005 Report from Quatloosia, we discussed the phenomena of some promoters attempting to patent certain legal and tax strategies. Our report noted that such patenting is misleading and harmful to consumers because it falsely implies that the strategy works.

Our report helped to stir interest in the phenomena of patenting legal and tax strategies, which culminated in several articles in the mainstream financial press this summer and

hearings on Capitol Hill. For instance, Jeremy Kahn of Fortune wrote on August 30 that:

To tax shelter touts, the patents are a potentially deceptive new marketing tool. After all, if something is patented, it sounds as if it is government-approved. But just because something is patented doesn't mean it's legal. "A patent carries with it no assurance whatsoever that the patented process, transaction or structure will pass IRS muster," IRS Commissioner Mark Everson told a Congressional hearing in July. "We are concerned, however, that taxpayers may be confused about this."

The Subcommittee on Select Revenue Measures of the House Committee on Ways and Means held hearings on July 13 regarding patented legal and tax strategies. We expect Congress to eventually pass new legislation that will prevent such strategies from being patented, hopefully sooner rather than later.

Meanwhile, the latest scam is for an unscrupulous promoter to file a patent application that has little or no chance of being granted, but then claim to the victims and their advisors that there is a "patent pending" on the strategy. Sometimes the scam artists will use the term "provisional patent pending" even though legally that phrase has no meaning.

If you or your clients are approached to get into a strategy that is held out to be patented, patent pending, or "confidential," the best advice is to start running because nothing good is going to happen.

SOLI Hitting Icebergs and Sinking

In our Report from Quatloosia for June/July 2005, we warned about Stranger-Owned Life Insurance (SOLI), whereby you take a large life insurance policy on yourself and then two years later you sell it to somebody else for cash. Known as "free life insurance" (since the investors loan you the money for the life insurance during the first two years), this arrangement has all sorts of problems, including the lack of any insurable interest in you by the investors.

Since our story, the wheels have started to come off SOLI. New York Life and Annuity Corporation has rescinded a \$1 million policy that was involved in such a deal, and the Louisiana insurance commissioner has indicated that SOLI arrangements probably violate several provisions of the Louisiana insurance code. More states, and perhaps even Congress, are about to slam SOLI hard too. When these deals go south, the investors who loaned the money to purchase the policy will sue everybody for securities fraud,

including the insured. So, if you got into one of these deals, avoid the rush and sue your advisors now.

Con-Man Terry Neal Gets Sentenced

Offshore con-man Terry Neal, author of such books as "The Offshore Advantage" and "The Nevada Advantage" was sentenced to five years for his part in various tax scams that evaded an estimated \$22 million in taxes. Notably, when IRS-CI agents raided Neal's Portland, Oregon, business they found thousands of dollars worth of gold bars and valuable coins – as well as a list of clients that Neal had helped to commit tax evasion. Neal also ran Nevis-American Trust Company (NATCO) in Nevis, and preached for years about how totally invulnerable his measures to protect his clients secrecy and confidentiality were. Uh, yeah, like keeping a list of clients and their super-secret offshore affairs in his Portland office.

Laughlin's Aaron Young Gets Sentenced Too

Along with Neal were also sentenced James Fontano, Lee Morgan, and Aaron Young, for shorter sentences ranging from one year to a year and a half. Aaron Young's sentencing is remarkable because of his involvement with Laughlin & Associates, which provides incorporation and other services in Las Vegas. And you don't think that IRS-CI will not be heavily scrutinizing Laughlin's clients next?

While Another Terry Neal Client Goes Down Hard

Illinois insurance salesman Denny R. Patridge bought into Terry Neal's schlock and transferred \$200,000 to St. Kitts, with the assistance of Neal's Offshore Consulting Services and Laughlin, Inc., denying to the IRS that the trust was his while still controlling it. Patridge then used Neal's service to loan the money back to himself as a home mortgage loan, thus placing a bogus lien on his house.

Not content with evading his own taxes, Patridge also helped to sell a bogus trust package from a group called Aegis (which group has itself given rise to many convictions).

The really stupid thing is that Patridge saved relatively little in taxes, at least when you consider that he now has a felony conviction, doubtless lost his insurance license, and permanently screwed up his life. This is a recurring theme in offshore tax evasion cases -- people risking felony convictions to save less than \$100,000 per year in taxes. That is a stupid trade, folks.

It's a stupid trade at any price if you really think about it.

After having written "The Offshore Advantage" and "The Nevada Advantage", perhaps Terry Neal's next book should be "The Lompoc Advantage". (For those of you who don't know, Lompoc is a federal prison facility on the California coast that is popular with white collar criminals because of its moderate weather.)

A Tower to Club Fed

Tower Executive Resources was a group in Denver that helped its members to commit offshore tax evasion. Tower was operated by Paul D. Harris, Lester R. Retherford and Robert N. Bedford, and helped its members to set up bogus corporations in the Turks and Caicos Islands to hide income. Members paid \$50,000 to Tower for this privilege. Harris and Retherford were both convicted of tax evasion, and Bedford has been indicted and faces trial.

Many of the Tower members have been prosecuted for tax fraud. Most recently, Russell J. Brown from Teton County, Wyoming, pled guilty to aiding and assisting in the filing of a false return for Paul D. Bekins, who is the former President and majority shareholder of Bekins Moving and Storage in Seattle (Bekins pled guilty in 2004). Brown set up a series of bogus offshore corporations through which Bekins funneled \$2.5 million from the sale of his records storage business. The money passed through Brown's corporations and into other bogus offshore corporations controlled by Bekins.

If you are a Tower member and have not been arrested yet, maybe this is a good time to flee the country . . .

PILL No More

One of the more prolific offshore scams, Prosper International League Limited (PILL), is officially no more. Representatives of what is left of PILL entered into a consent agreement with the Justice Department to stop marketing its offshore tax evasion strategies. In the final years, PILL was run by Pierre J. Gauthier of Longwood, Florida, and Jean Jay Gauthier a/k/a "Earl L. Savoy" of Orlando, Florida.

Not only was PILL an offshore tax evasion scheme that involved companies in Belize, Grenada and Panama, but it also was a multi-level marketing scheme where suckers were paid from \$200 to \$800 to bring in other suckers. According to the DOJ's complaint, PILL extensively marketed and used offshore trusts and offshore corporations, as well as so-called "private interest foundations", to help its clients to evade taxes.

PILL also assisted their clients in making extensive use of offshore credit cards, i.e., MasterCard and Visa cards backed by offshore bank accounts. This is one of the ways that PILL clients were told to repatriate their offshore moneys when needed.

Basically, the Gauthiers and PILL helped people to commit blatant offshore tax evasion in about every way that it can be committed. To give you an idea of their *sophistication*, the Gauthiers also marketed many of the tried-and-failed tax protestor strategies, such as that the 16th Amendment was never actually passed. While the Gauthiers acted like sophisticated international businessmen, the truth is that the two of them are dumber than a bag of rocks and their strategies were totally unsophisticated.

Although their website says that no client information has yet to be disclosed to the DOJ, anybody who doesn't think that an extensive criminal investigation of PILL is not ongoing is an idiot. The DOJ will get their client records and other information that will lead to indictments of their clients, if they do not have that information already. You absolutely do not want to be on their client list -- or even having shown up on their phone records or e-mail as having asked them for information -- and if you are then you need to seek the assistance of criminal defense counsel immediately.

If you are a PILL client, then fleeing the country now is probably a good idea. Maybe you can hook up with some of the Tower and Aegis members and start a new club in Cuba, the Sudan, Somalia or whichever country you end up in that doesn't have an extradition treaty with the U.S.

While the Biggest Offshore Tax Evasion Case Ends

Telecommunications Entrepreneur Walter C. Anderson has plead guilty in \$200 million income tax evasion case. Anderson, 52, will spend the next decade in jail if he lives so long, and pay restitution to the United States for all income taxes evaded. According to the DOJ-TAX's press release:

Anderson crafted an elaborate evasion scheme involving offshore corporations and bank accounts to avoid paying taxes on \$450 million he earned from business ventures between 1995 and 1999. In October 1992, Anderson formed Gold & Appel Transfer in the British Virgin Islands (BVI). Anderson directed the issuance of ten shares of Gold & Appel stock to another BVI corporation previously formed by Anderson. The remaining shares were held by Anderson in the form of an exclusive op-

tion. In so structuring the share distribution, Anderson concealed his ownership of Gold & Appel.

Anderson further obscured his ownership of Gold & Appel in September 1993 when he formed Iceberg Transport in the Republic of Panama. Using the alias Mark Roth, Anderson directed a trust company located in Liverpool, England to form Iceberg Transport as a bearer share company. As its name implies, these shares were unregistered. The actual possessor of the share certificates is considered the owner. At Anderson's direction, these shares were mailed from Panama to Liverpool to the Netherlands into one of Anderson's private mail boxes and subsequently seized from his Washington D.C. residence in March 2002 during the execution of a search warrant.

Anderson hired trust companies in the BVI and England to create the appearance that he was not in control of these offshore entities. In reality, these trust companies served as Anderson's nominees. Anderson directed all aspects of Gold & Appel and Iceberg Transport, exercising his true ownership of these corporations.

Between October 1992 and July 1996, Anderson transferred his ownership interests in three telecommunications companies -- Mid-Atlantic Telecom, Esprit Telecom and Telco Communications Group--to Gold & Appel and Iceberg Transport. After these transactions were made, the value of each of these corporations dramatically increased. Between 1995 and 1999, Anderson used the assets of Gold & Appel and Iceberg Transport, which included the profits realized from these three telecommunication corporations, to invest in other business ventures that generated more than \$450 million in earnings. Anderson conducted most of these transactions through bank accounts located in the Channel Islands, a known tax haven jurisdiction.

Anderson failed to disclose to his tax return preparers that he controlled Gold & Appel, Iceberg Transport and foreign bank accounts. As a result, Anderson's U.S. Individual Income Tax Returns for 1998 and 1999 omitted approximately \$126 million and \$239 million of additional income, respectively. Anderson similarly filed a false D.C. Income Tax Return for the tax year 1999 failing to report this income.

"[S]ome people who have benefited the most from taxes believe they are not obligated to pay them, and that they can avoid doing so by hiding their income and assets in offshore accounts and shell companies. They are wrong on both counts," said Eileen J. O'Con-

nor, Assistant Attorney General for the Justice Department's Tax Division. "Today's guilty plea is proof that federal prosecutors and IRS agents can and will do the hard work necessary to unravel even the most extensive tax evasion schemes."

"The defendant is a successful entrepreneur who made a fateful and criminal decision to devote his considerable business talents to an elaborate tax avoidance scheme," stated U.S. Attorney Wainstein. "In the process, he perpetrated the largest personal tax evasion in history, cheating the Federal and District governments out of more than 200 million dollars. From capital gains taxes on huge business profits to luxury use taxes on his expensive wine collection, he ducked all the tax obligations he could, all while amassing an enormous personal fortune. Today's conviction demonstrates that the District and Federal governments will make every effort to ensure that criminals like Mr. Anderson pay a steep price for cheating their fellow citizens."

The first lesson here is that if you get caught in offshore tax evasion, surrounding yourself with the best lawyers that money will buy will not keep you out of prison. The second lesson is that the only wine that Anderson will be drinking for the next 10 years will be Hooch de Toilette.

Contempt Remedy Finally Works After 6½ Years

Martin Armstrong defrauded Japanese investors out of hundreds of millions of dollars in relations to his Princeton Economics International Ltd. The investors sued Armstrong in a civil case, and the judge ordered Armstrong to cough up \$14.9 million in gold bars and rare coins. When Armstrong claimed that he didn't know where those gold bar and rare coins had disappeared to, U.S. District Judge John Keenan ordered him to jail. This was in January 2000.

Finally, on August 17 of this year, Armstrong pled guilty to criminal securities fraud charges and faces possibly another five years in prison. The judge has not yet indicated whether Armstrong's contempt time will count against his sentence for securities fraud.

Armstrong's 6½ years set the record for the longer federal contempt incarceration (there used to be a theory going around that a federal judge could only hold somebody in jail for contempt for 6 months – bah!). Now who is shooting for the record? You guessed it: Former options trader Stephen Jay Lawrence was put in jail in August 2000 when he refused to provide information about an offshore trust that he had created to avoid a debt to securities clearinghouse Bear Stearns on a simple margin call.

Tax Shelter Goes Kapok

Ronald W. Rasmussen, Dan Russell Collins, and John Michael Collins of Greenville, South Carolina won a one year probation and a \$50,000 fine for attempting to evade taxes via the U.S. Virgin Islands' tax credit. According to the U.S. Attorney's press release:

In 1999, the three men participated in a purported tax shelter in the United States Virgin Islands. A legitimate 90% tax credit is available to residents of the Virgin Islands who invest income in the local economy, and the credited taxes are paid to the Virgin Islands taxing authority rather than the IRS. In an attempt to qualify for the 90% tax credit, the men joined Kapok, a partnership in the Virgin Islands that purported to provide management services to businesses in the United States.

Kapok used a method for partners with existing businesses in the United States to run business proceeds through the Virgin Islands so as to claim the USVI tax credit. Kapok partners became "managers" of their existing businesses, and sent business proceeds to Kapok as management fees. Kapok then returned the money, minus an administrative fee, to the partners as partnership income.

Rather than filing returns with the IRS for this income, the men filed tax returns for tax year 2000 with the USVI taxing authority, claiming the 90% tax credit. The IRS later determined the Kapok system to be an illegal tax shelter. The men admitted during guilty pleas last December that their returns should have been filed with the IRS.

Rumor has it that many people are about to get hit for attempting to game the USVI's tax credit.

Even Former U.S. Attorneys Can Get Caught Offshore

Sam Currin, a protégé of former Senator Jesse Helms and previously the U.S. Attorney for the Eastern District of North Carolina, was charged with a variety of counts for helping wealthy Americans evade federal income taxes offshore through offshore trusts and bank accounts. Currin is also charged with giving false and misleading answers to a grand jury investigating the case, and for attempting to persuade another attorney to give false testimony to the grand jury as well.

Currin was caught in an undercover sting wherein he allegedly proposed unlawful methods to help the undercover IRS agents to conceal income and assets offshore. Indicted along with Currin were Howell Way Woltz, Vernice Chai-

tan Woltz, and Ricky Edward Graves. Two defendants have already cut plea deals with the government, being Raleigh lawyer Robert Wellons, who was charged with conspiracy to obstruct justice, and Coyt Murray of South Carolina, who was charged with conspiracy to commit commodities fraud.

Shidler's List

Former attorney Michael Jay Shidler of Denver was sentenced to two months in federal prison and 8 months of home detention after he pled guilty to one count of tax evasion. Shidler also surrendered his license to practice law.

Shidler had a client by the name of Donald Mack who ran a publicly-traded company called Comtec International, Inc., in New Mexico. Mack, who was also indicted on similar tax evasion charges, owed the IRS \$124,000 for back payroll taxes owed by another failed company that Mack had been involved with.

When the IRS started to levy upon Mack's accounts, Shidler helped Mack to liquidate his assets and shift the cash to a series of offshore trusts and companies, and then return the money back to Mack in the U.S. by way of "investments" by the offshore companies in real estate in Parker, Colorado.

There are several lessons here. The first is that Shidler, whose practice was primarily in preparing tax returns and tax planning, was way out of his league when he decided to engage in asset protection planning for Mack. The second is that asset protection against the IRS can be a felony, as this case amply illustrates. The third is that, as an attorney, you can very quickly get into deep doo-doo when you try to help somebody to avoid an existing judgment.

Offshore Planner Required to Give Up Client Lists

Disbarred attorney Bruce Hawkins of Seattle was enjoined on August 11 from promoting fraudulent tax schemes. The government alleged that Hawkins set up limited partnerships in Nevis so that his clients could treat personal expenses as deductible business expenses and thus avoid U.S. tax. The partnerships were bogus, however, and simply agencies of his clients.

The order requires Hawkins to turn over to the Justice Department a list of his clients' names, addresses, e-mail addresses, Social Security numbers, and telephone numbers. This illustrates one of the biggest problems with offshore tax evasion: Somebody knows.

More information at
<http://www.usdoj.gov/tax/txdv06156.htm>

Speaking of an Offshore Planner Who Cooperated for a Lesser Sentence

Former offshore guru Jerome Schneider was released from the Federal Bureau of Prisons on August 18. Schneider got a greatly reduced sentence (only six months) for cooperating with the Feds.

Schneider's many books included such subtle works as "How to Own Your Own Private International Bank: For Profit, Privacy, and Tax Protection" and "The Complete Guide to Offshore Money Havens". Maybe he could co-author a title with Terry Neal, "The Complete Guide to Lompoc".

Again, you may think that offshore secrecy and privacy will protect you, but the bottom line is: Somebody knows.

Florida Lawyer Embezzles Trust to Get Scammed by Nigerians

Florida attorney Knovack Jones, a former prosecutor who had practiced law for 25 years, dipped into her client's trust account to the tune of \$300,000 so that she could participate in a wacky venture that promised her a big percentage of a \$38.6 million payday in Nigeria. Jones has been disbarred and pleaded guilty to stealing the funds. Prosecutors are asking for a 9-year sentence. And you thought that people weren't dumb enough to actually fall for this scam.

Meanwhile in xelan land

The group by the name of xelan that marketed benefits to physicians may no longer exist, but various problems linger. Two of these problems were taken care of with the recent indictments of Robert Suverkrubbe and Wendy Lee Hixson.

Ironically, Suverkrubbe was a former IRS-CI agent who apparently worked at a law firm that provided audit defense services to xelan clients, and Hixson was his assistant. The two allegedly induced former xelan clients to send money and property to them by certain misleading statements that the clients would be receiving distributions from Doctor's Benefit Insurance Corporation.

Through their alleged fraud, Suverkrubbe and Hixson obtained over \$400,000 from the xelan clients. Moreover, the pair obtained the credit card numbers of several hundred xelan clients and made unauthorized charges against those cards. The two were caught when they altered a stolen check which they deposited into an account created by Hixson for "L&T Precision Sheet Metal Co." and then converted the funds to their own use.

No Free Lunch Any Longer

The SEC has finally started cracking down on so-called "free lunch" seminar promoters, who drag in seniors with the promise of a free lunch to sell them crappy financial and insurance products. These seminars have been a plague in Florida. More at <http://ftp.sec.gov/news/press/extra/seniors/freelunchseminars.htm>

Finally: The End of Privacy As We Know It

First, take a spin on <http://www.zabasearch.com> which is a free service by which I was able to locate 9 of 10 old girlfriends in less than 5 minutes – a new Quatloosian record! Then, after you have their new address and telephone number, check out their home and how many cars they have via satellite from Google Earth. <http://earth.google.com/> Both services are free.

OUTSTANDING LINE-UP AT 2007 SOCAL-TEPF

The Southern California Tax & Estate Planning Forum will be held October 19-21, 2006, at the Manchester Grand Hyatt in San Diego. In addition to Jay Adkisson, other speakers will include:

Jonathan G. Blattmachr – Circular 230 Redux: Questions of Validity and Compliance Strategies – Making Spousal Exemptions Transferable – Grantor Retained Annuity Trusts (GRATs) versus Installment Sales to Intentionally Defective Grantor Trusts (IDGTs)

Natalie B. Choate – Making Retirement Benefits Payable to a Trust -- The Tax Pro's Guide to Stretch IRAs – Qualified Personal Residence Trusts: How to Integrate this Useful Planning Device into Your Practice – Plan Beneficiary Designations from A to Z (Including a Review of Recent Developments and What Estate Planners Need to Know about "Roth 401(k)s")

Kevin McGrath – The Private Annuity Trust: An Effective Tax Deferral Strategy in the Disposition of Appreciated Real Estate or a Questionable Tax Strategy from a Tax Perspective?

Mark Merric – Planning for Maximum Creditor Protection for Beneficiaries of Third-Party Settled Trusts

Jeffrey N. Pennell – Recent Estate Planning Developments: An Analysis of the Significant 2006 Regulatory, Legislative and Judicial Tax & Estate Planning Developments

More information is available at <http://clenet.com>

SOME OTHER STUFF

Chris Riser has been appointed a Co-Chairman of the ABA's Asset Protection Planning Committee.

Jay Adkisson has been designated an Honorary Member of the California Association of Judgment Professionals. <http://www.cajp.org>

Jay Adkisson was featured in several recent articles, including "Asset Protection: What To Do, How To Do It" by Marcy Tolkoﬀ in the June edition of Medical Economics magazine, and a July 15, 2006, article of the Wall Street Journal "A Fortress for Your Money" by Rachel Silverman.

TWO NEW BOOKS

Equity-Indexed Annuities: The Smart Consumer's Guide, by Jay Adkisson describes and gives the advantages and disadvantages of an advanced form of annuity that pays the greater of a minimum guaranteed interest rate return or a percentage return that is calculated against a major stock market index. Available at <http://www.amazon.com> (search "equity index").

LostEye: Coping with Monocular Vision, based on letters, messages, and e-mails that Jay Adkisson received, after creating the website <http://losteye.com> after losing his eye to cancer in 2000, and which has since become the leading support resource for those facing or having just experience the loss of an eye. Available at <http://www.amazon.com> (search "lost eye").

UPCOMING EVENTS

October 12 – **Jay Adkisson** will present "Asset Protection: 10 Things You Must Know" at a luncheon of the Tax Section of the **Orange County (California) Bar Association** beginning 12:00 noon at the Double Tree Club. More information at <http://www.ocbar.org/> and seating is limited.

October 19-21 – **Jay Adkisson** will make two presentations, "Asset Protection: 10 Things You Must Know" and "Understanding Charging Order Protection and Drafting Considerations" at the **Southern California Tax & Estate Planning Forum** at the Manchester Grand Hyatt in **San Diego**. More information below, and at <http://www.clenet.com>

November 11 – **Jay Adkisson** will participate in a panel on "Judgment Collection Issues in Federal Court," along with federal bankruptcy judge, Hon. Alan Ahart, hosted by

the **Orange County Bankruptcy Forum**, at Chapman Law School in Orange, California, from 9:00a to 12:00a. More information at <http://www.ocbf.org>

November 21 – Jay Adkisson will present “Asset Protection: 10 Things You Must Know” at a luncheon of the **Tulsa County Bar Association**. More information at <http://www.tulsabar.com>

January 8-12, 2007 – Jay Adkisson, Alexander Bove and Gideon Rothschild will present “Ethics of Asset Protection” at the **University of Miami’s Heckerling Institute for Estate Planning** at the Marriott in Orlando. More information at <http://www.law.miami.edu/heckerling/>

May 7, 2007 – Jay Adkisson will present “Asset Protection for the OB/GYN” at the **American College of Obste-**

tricians and Gynecologists, held at the Manchester Grand Hyatt in **San Diego**. More information at <http://www.acog.org>

MORE BOOKS

Asset Protection: Concepts and Strategies, by Jay Adkisson and Chris Riser

Accounts Receivable Financing for Retirement and Asset Protection, by Ron Adkisson

Both books are available at <http://amazon.com> (search "Adkisson")

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