

BRINGING BUSINESS & PERSONAL PLANNING TOGETHER

by Lee R. Phillips



Bringing Personal and Business Planning Together

By Lee Phillips, JD
US Supreme Court Counselor
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A solid financial life should start with a rock solid legal foundation. The law touches everything you do. If you know the law and have a solid legal foundation, you can make more money without working harder, sleep better at night, pass more money to your heirs, and actually give your customers better care.

You don't have to be an attorney or be a student of the law, but you do need to know enough that you can direct your personal and business financial affairs. You can't blindly walk in off the street and say, "Hi, here I am Mr. Attorney. Set me up." If you ask your attorney to "set you up" he will do exactly that.

This ebook will explore how to bring your business and personal financial life together. Your taxes, estate planning, asset protection, business operation, and financial security all need to be integrated. I'll detail the four basic documents needed to establish a solid legal foundation; specifics of business structure and operation; personal protection from business liabilities and business protection from personal liabilities; ownership options for equipment and office facilities; protection of your home; and retirement plans (qualified and non qualified) including maximizing contribution amounts, employee participation and asset protection.

Business structuring, asset protection, tax planning, and estate planning are all controlled by the laws. Each one of the parts of your business and personal financial life melts together with the other parts to form the total individual you are. Like it or not, the laws our society establishes shape what you are and what your future will be. How much money you spend, save, and retire with is dependent on your knowledge of the law.

The Major Threat to Your Financial Success

The IRS is your major impediment to financial success in your business life and your personal life. Thousands of professionals and business people have asked me how they can get an extra percent or two return on their investments. My answer is always the same. A higher return on an investment would be nice, but the real issue is; "What's the tax?" Most people don't understand the significance of taxes, and they don't realize how many taxes there are. There are income taxes, property taxes, sales taxes, transfer taxes, estate taxes, and the list goes on.



This illustration will show you how much taxes actually cost you. Take a dollar and double it twenty times. For example; one dollar becomes two; two becomes four; four becomes eight; eight becomes sixteen; sixteen becomes thirty two; and so on. After twenty doublings, you'll end up with \$1,048,576. Note that there wasn't any tax taken out each time it doubled. But, you get taxed on everything. Your real estate is taxed. Your mutual funds are taxed. Everything is taxed.

Take the same dollar and double it twenty times, but take out a 40% tax each time you double and "realize your profit." The 40% is reasonable if you consider federal and state income taxes. One dollar doubles to two, but the dollar in "profit" is taxed at 40%. Therefore you don't end up with two dollars. You end up with \$1.60. Double the \$1.60 to get \$3.20, but the additional \$1.60 has to be taxed, so you actually end up with \$2.56. Do you understand what is happening? At the end of the doubling with no tax you have over a million dollars. When you take out the 40% tax, you don't end up with a 40% loss, i.e., \$600,000. You end up with a grand total of only \$12,089.26 – twelve thou-

sand dollars verses one million, just because of the tax. The question always has to be – “What’s the tax?”

There are three primary ways that you can control taxes. In this, I explore each of them in more detail. You can defer the tax – 401(k)s and IRAs defer taxes. You can shift the tax to someone else – move income to your parents or kids so they pay the tax at their rate. You can change the nature of the tax – hold the investment long enough to get capital gains treatment. Too many people try to control their taxes by making funny investments that are supposed to cut their taxes. If the investment doesn’t stand on its return, it shouldn’t stand on the “tax advantages.” Today the only “tax shelter” investments are in insurance, real estate, and energy. Yes, life insurance is a tax shelter. (Don’t worry. I’m not going to sell you life insurance.)

Income taxes are a daily battle, but there is another tax that substantially disrupts your family wealth – estate taxes. Your estate includes all the real estate; investments; retirement accounts; your business, which you have never placed a value on; and all of your life insurance. It’s all there. The estate tax kicks in at 45%. It’s ugly.

Estate taxes are called the voluntary tax. If you plan for them you don’t have to pay them. The rich don’t lose all their family wealth when dad dies. Why should your family lose a dime? Estate planning has three main goals. 1. Move your property smoothly to your family. 2. Minimize estate taxes. 3. Avoid probate where appropriate.

Estate tax planning and income tax planning go hand in hand. How you structure your business will have a huge effect on your income tax and your estate tax bills. You can minimize those taxes or just ignore them and pay more. Many business people are “too busy” to sweat the little legal details, but it is those “little details” that will make over a million dollars difference in spendable income over the average business person’s life. We’re going to go through the little details right here. Your attorney isn’t going to “handle” it for you. Most attorneys, when you ask for legal help with your business, simply throw a structure together and never explore the asset protection and tax aspects of what they do.



Asset Protection – It’s a Big Deal

Asset protection is a major issue in today’s society. Threats come in the form of lawsuits, identity theft, divorces, accidents, illnesses, and a dozen other forms. How you own assets makes all the difference when you are under attack. Attorneys only have so many tools to use. Trusts, corporations, Limited Liability Companies (LLCs), partnerships, and limited partnerships are the main tools. Retirement plans, benefit plans, and life insurance are also valuable tools, but not for the reasons that just came to your mind. They are tax tools and asset protection tools, not just money pots for retirement or death planning.

This ebook will give you insights into the legal tools and financial tools that your attorneys, accountants and financial planners can use for asset protection. Taxes are a day-to-day threat, and the legal and financial attacks are ever present too. Today it is possible that you could do absolutely nothing wrong and lose everything you’ve worked your whole life for, because your spouse, your kid, one of your employees, or one of your customers does something wrong. You can’t say, “I’m really careful,” and assume that you won’t have any asset protection worries.

You lock your windows and doors, put security lights around your house and office, and do everything you can to protect your assets from a common thief. Yet, you probably haven’t done anything to protect your assets from some sort of a financial or legal attack.

Today you have a better chance of losing money in a legal or financial attack than you do to a common thief. You’ve got to learn to put up legal shields to protect yourself from attacks that will come from your business. Your employees are actually your biggest threat, followed by your customers. How do you protect yourself personally from the attacks that come from your business activities? Lawyers use corporations and LLCs to protect your personal assets from business attacks.

Most businesses use corporations and LLCs to protect their owners. However, many profession-

als don't operate as a corporation or LLC, because those entities often won't protect a professional from their own "malpractice." (It depends upon what the professional does for a living. All of the medical professionals, lawyers, accountants, architects, engineers and many others can't use the "corporate shield" to protect themselves from their own malpractice.) Therefore, the attitude of many professionals is; "why use a corporation or LLC?" They simply do business as a sole proprietor or partnership. In my mind, no business, professional or otherwise, should ever be conducted without the asset protection shield of a corporation or LLC.



Professionals can't hide behind the shield for malpractice claims, but it can save their skin in many other situations. For example, when the office manager is on the way to the bank to deposit the checks and the manager hits someone in a crosswalk, that's a business problem. The business owner will be the one that is named in the lawsuit, because the accident is the direct result of business activities. If your business is being run as a sole proprietorship or partnership, all of your personal assets are suddenly in grave peril. If the business is being run as a corporation or LLC, then only the business assets would be at risk. Your personal assets should be protected, if the attack comes from the business side of your protection shield and you have formed and maintained the corporation or LLC properly.

Whether you are a "professional" or not, if you are running any type of business activity, you had better have some sort of "limited liability shield" between you and the business activities.

Lawyers seldom discuss a "reverse" attack. What happens if the attack comes from the personal side of your "corporate shield"? How do you protect your business from a "personal" lawsuit? You get divorced. You hit a pedestrian while you're out joy riding. The neighbor kid breaks his neck on your trampoline. These are all personal attacks.

In most cases, all of the assets in your business are wide open to the reverse attack. That should

be obvious if your business is a sole proprietorship or a partnership. But, what happens if your business is being run as an LLC or corporation. If your business is being operated as a corporation, the judgment will simply award the stock in your corporation to your creditor. Once the creditor owns the stock, they own all the assets of your business – equipment, receivables, building, everything. You've probably never had your attorney discuss the reverse attack. Attorneys just don't address that issue. For detailed information on how you can protect yourself both ways, study my ebook, *How to Double Your LLC Asset Protection* to learn what to do to protect against the "reverse attack."

All of the legal planning, estate planning, tax planning, financial planning, and asset protection planning will come together in a big picture as we go through this. I'll bet you don't have a single advisor that will bring everything together into a big picture. You'll have to do it yourself.

Four Tools of Financial Foundation

The standard business person's life is easily profiled: graduate from school, kiss the books goodbye, and start turning the crank. Make Money!! It sounds a little crass, but lots of business people basically follow that path, and more often than not the empire they build turns out to be a house of cards. When the winds of financial and legal trouble blow, it all collapses.



Let's take a second and build a foundation that will support the empire you create. Just like a house, you can't build a financial fortune from the roof down. You need to build a foundation first. There are two layers to your foundation. The base layer is your personal legal and financial structure, and the top layer is your business structure. They interlock, but should float independent of each other as much as possible.

Have you ever noticed that some business people seem to have wealth flow to them? There are a number of factors that make the difference. Pro-

essional skill is one factor. Marketing is a second factor. (You're in a sales business, whether you like it or not.) A third factor is how the business is structured to take advantage of certain asset protection and tax laws. Without working any harder, if you can squeeze even an extra 10% – 20% more out of your business to take home, that makes a huge difference over the years. A fourth factor is an ordered personal life. If your personal financial and legal dealings are in order and you're not worried about them, you can actually be a better business person. You can focus on your business rather than looking over your shoulder to see if the bad real estate deal is going to give you a substantial hit below the belt.



In order to lay a good foundation, you'll need a working understanding of the legal strategies associated with wealth accumulation. You get the foundation at the legal office. It can be expensive. Actually, the cost isn't always a predictor of the quality you get. Unfortunately, many people are "taken to the cleaners" by ignorant financial planners and insurance dudes or by less-than-competent lawyers who fail to do the work properly or simply fail to educate their clients.

Good legal help is cheaper than bad legal help. The trick isn't just digging deeper into your pocket. The trick is knowing enough about what has to be done that you can see for yourself whether it is being done properly. You don't have to know how to do the work yourself, but you do have to know enough to know whether or not you are being lead down the primrose path or not.

The basic foundation of wealth consists of four legal tools. If you understand the tools and know how to use them, your chances for a secure financial future are much higher. If you and/or your parents don't have the four tools already, it is time to get moving. If you're lucky enough to still have your parents living, you need to pay attention to their legal structure as well as your own. For many baby boomers, handling their parent's estate will be the largest financial transaction they even handle. Little mistakes can mean the loss of hundreds of thousands of dollars in an upper middle class estate – in your estate. Here's a basic overview of the four tools:



Testamentary Will

Everyone needs a will. Even if you have a revocable trust, you need a will. The will names the personal representative (the executor or executrix). A family member, who is geographically near the bulk of your estate, has good business sense, and can be fair with your heirs, is the person you are looking for to serve as personal representative. It is basically malpractice for the attorney to name himself or herself as the personal representative, so don't let that happen. If you have a living trust in conjunction with your will, the personal representative won't really have much to do, so don't

stew over your choices forever.

The will names the guardian for your minor children. If you have minor children or grandchildren, you had better see to it immediately that a guardian is named in the parent's will. The will should put restrictions on the guardians. Most wills simply state, "John and Mary guardians to my minor children." You can do better than that. Coach the judge in your will. It should read, "John and Mary; provided they raise the children in our family home where the children are living at the time of my death." "John and Mary; provided they are still happily married and harmoniously living together." "Grandma and grandpa; provided they have the health to take care of the kids." "Grandma and Grandpa; provide they don't sell the kids." You get the picture.

If you already have a will, when you get a living trust, you'll have to get a new will which goes along with your living trust. It is called a "pour over will," because after your death it "pours" all of your property, not already in the trust, into the trust for ultimate distribution.

All wills that are "used" after the testator dies have to be probated. Probate is a legal tool. Unfortunately, lawyers often take advantage of the probate process. They can easily put in a lot of time (Billable Hours in attorney language). Some of the hours are justified and some aren't. Probate is the legal process for wrapping up a dead person's earthly affairs. It takes a lot of time and

frustration, in addition to a lot of money. You've probably heard horror stories about probate, and your financial planner said you needed to avoid probate at all costs. In most cases you should avoid probate. However, there are times when you should use probate as an asset protection device.

A practicing professional's estate should probably be probated, because it will wipe out any malpractice claims that might vex the estate later. The estate of someone who has a lot of debt should probably be probated. Once the probate gavel falls, the estate is gone forever. Unless the malpractice claim is filed or the creditors come forth before the probate is completed, the claims will essentially be wiped out.

When you're using probate as a protection tool, you should control the probate process. For example, the cost and frustration of probate is directly related to the size of the probatable estate. If most of the estate is held in a living trust, then only a limited number of assets need to be probated. The cost will be a lot less. If proper planning is done, you can control what assets are probated. If you are probating an asset that you don't care whether or not it is tied up for three years, your frustration level will be a lot lower. Most of, if not all of, the estate should be held in a living revocable trust. The living trust is the next part of the foundation.

Living Revocable Trust

The living trust allows an estate to avoid probate, get twice the estate tax exclusion, and provide for a smooth transfer of property. It is definitely worth having for most families. Yes, there is a big argument in the legal profession between the standard will guys, probate guys and the attorneys that pitch living trusts to everybody. I come down in favor of the living trust, but I think it is your decision.

Frank Sinatra was called the "Chairman of the Board," and he knew how to handle money. His living trust provided his estate with total privacy, much to the media's chagrin. Michael Jackson's death had the press drooling over his juicy half billion dollar estate. Once it was determined he had a living trust, you never heard another word

about the size or management of his estate. For these celebrities privacy was the issue. The estate tax savings they got out of their living trusts were a spit in the bucket. If you have a great business, the trust could mean almost \$2 million extra in your family's pocket. That's not a spit in my bucket.

The vast majority of living trusts don't avoid probate and don't deliver the extra dollars they could. The problem isn't with a well designed trust, but the lawyer and user of the trust. The trust has to be maintained. For example, it has to "own" all of your real estate, your bank accounts, your business, and other assets. The trust isn't hard to manage, but the lawyer never takes the time to teach you how to do the management and you can't afford to pay the lawyer to do it for you. As a result, a majority of people who get a living trust don't get the benefits they could from the trust. My book, *Protecting Your Financial Future*, will walk you through step by step how to use a living trust. The living trust will "overlap" with a durable power of attorney, which is the third tool.



Durable Power of Attorney

Durable powers of attorney allow an individual to control the property of a person who is unable to control their own property. As you know, people of all ages, not just old people, fall victim and are rendered unable to control their business life. A well drafted living trust will have a provision that automatically lets a successor trustee manage your trust if you become incompetent. The durable power of attorney lets the person of your choice manage all of your other business affairs when you can't do it. In a well drafted *durable* power of attorney, power doesn't transfer from you until the criteria outlined in the power of attorney are met. Then there is an automatic transfer of power. This prevents the messy and expensive court proceedings that are required to name a guardian/conservator for an incompetent individual.

The emotional and financial drain of a court proceeding, when a family member has an accident or gets sick, is the last thing the family needs at that time. The durable power of attorney prevents a lot of legal problems at a time of crisis in the family, when a family member becomes incompetent.

Many powers of attorney include a section which addresses an individual's instructions and desires for their health care. This is a durable power of attorney for health care, which appoints an 'agent' and grants them power to interface with the medical industry. It will be very frustrating for your spouse or children if you suddenly become unable to direct your own medical care. Actually, your business may fail if someone can't immediately step in and "take care of matters" if you can't act anymore.

You also need a HIPAA statement, so the family can talk to your doctors. The durable power of attorney for health care can be part of the document entitled durable power of attorney, or it can be a separate document. It deals only with the medical treatment, not the right to die, which is addressed in a living will.

Living Will

A living will is the fourth and simplest of the four documents that make up your personal foundation. It directs the doctors to keep you alive or pull the plug. You need one and so does the rest of your family. The best place to get one is at your hospital. Hospitals give them away free, and the hospitals like to see their own document rather than the 30 page beautiful, very expensive document you get from your lawyer.

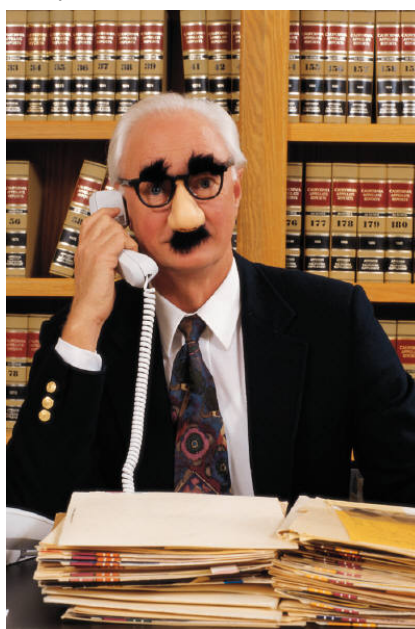
I have practiced law for a long time and observed that the rich always have these four legal tools as part of their basic foundation. The foundation is always there in some form. Yes, there is lots of other structure, but the basic four legal documents are always there. They are what I call the "basic tools of wealth." Use them, and you will be able to build a lot stronger financial fortune. From a financial standpoint, it will be worth every effort you make and every dime you spend. Almost more important, I'll guarantee that it will be worth it just for your piece of mind.

Your Living Trust – Does It Work?

Your living revocable trust is basically the "centerpiece" of your personal legal foundation.

It needs to be discussed in more detail, because, the vast majority of people who get a living trust never get much benefit from it. They spend the big bucks upfront for the trust, and it doesn't do them any good. Or, they get a poorly written trust. Or, they get really taken and end up with a testamentary trust instead of the living trust they thought they were getting.

A testamentary trust is created as part of a will. The trust is actually "created" or put in place after the individual dies. If the heading on your "trust document" says "will" instead of "trust" then you have a testamentary trust, even though the document creates a trust. The problem with a testa-



mentary trust is everything is probated before it goes into the trust, and then the courts control the trust forever after. In crude terms, it's the attorney's retirement plan, not your estate plan. On the other hand, a living trust is "created" during your life and should be an active, "living" part of your life before you die.

Your chance of getting a well written trust isn't good. *Fortune Magazine* reported a number of years ago that only 1% of American lawyers could draft a good living trust. Getting a good trust is only part of the battle. My father-in-law got a well written living trust in 1976. In today's dollars, he spent about \$8,500 for the trust. Even though he got a

good trust, when I looked at it in the early 1980s, I could immediately tell that he had wasted his money. The lawyer hadn't taught him how to use the trust. My father-in-law argued with me, saying that his lawyer had taught him everything about the trust.

The lawyers almost never tell you what you need to know, because if they don't tell you what you need to do, then when you die everything has to be probated, and the family will go back to the same lawyer in about 90% of the cases. He gets the big bucks for setting up the trust and then also gets the probate. It's a great deal!! – for the lawyer.

You will have to make sure you got a well drafted trust and then learn how to use it on your own. It's not hard to use, but it requires a shift in your thinking. When you were single, you got your

checking account in your own name. When you got married the first thing your spouse said is, "Don't you love me sweetheart?" You said "yes," and they said, "Good, let's put my name on the checking account as a joint tenant." Everything you have done since then has been done as a joint tenant with your spouse. You will now have to start wearing a different hat. You'll have to take off your joint tenancy hat and put on your trustee hat. You are going to now operate as a trustee, not a joint tenant or single person.



One of the primary things you have to do in order to make the trust work for you is have everything owned in the name of the trust. The trust's name has to be on the checking account. You don't have to re-print the checks, but you do have to sign a new signature card at the bank. You will write the trust's name and date on the new signature card, check the "trust" box on the card, and sign your name with "trustee" or "co-trustee" after your name. The checks will bounce just as high as they used to. Life won't change, but technically you don't own your checking account any more. This entity called a trust that you created owns your checking account.

The trust has to own your safe deposit box, brokerage account, cars, house, other real estate, and your business entity (corporation or LLC). Everything you sign your name on has to be "owned" by the trust. (With a car, don't change title now, because you'll get hit with a tax if you try to change title to your existing car. Just buy your next car in the name of your trust.)

Your Trust's Name and It Has to Be the Owner

Your trust has a name. Years ago I would just use the clients' names in the trust. For example: The John and Mary Jones Living Trust. Now I use an odd name for privacy purposes. With the internet and ID theft, privacy is a big issue. So I might use the Jory Living Trust, which is a combination of the two first names. Your trust has a "last name." It's actually the date you created the trust. Never forget the date. (The Jory Trust U/A 7/15/2010) You can abbreviate with things like U/A for Under Agreement. Trustee = TTE or TTEE Trust = Tr. When you sign your checks you will just sign your name without the TTE, but the

trustee designation should be on the signature card. When you take title to real estate, the deed will read John Jones and Mary Jones Trustees of the Jory Trust U/A 7/15/2010. Carry a little piece of paper in your wallet with the trust information on it until you memorize the name and date.

When the trust "owns" everything, you'll avoid probate. Avoiding probate is one of the major benefits of a living trust. The probate process is the legal process where the court appoints a person (executor or executrix) to sign the legal documents, such as signature cards and deeds, on behalf of an owner who is dead. If the trust "owns" all of your assets (bank accounts, deeds, etc.) where you have to sign your name to access or transfer them, then when you die the "owner" of the assets doesn't die. The manager of the assets (you as trustee) died. The trust (owner of the assets) didn't die. The law says that you can appoint a new trustee, and instantly upon your death the "successor trustee" has full signature authority over the assets. The trustee can access the bank account the day after you die with no court intervention. You just went right out and around probate.



You've got to get it into your head. You are not a joint tenant or single person any more. You are a trustee of a trust.

Think of this analogy. You are not an individual in your business. You are the "owner." You sign as President. When you have a living trust you are not a joint tenant or single person anymore, you are a trustee. You've got to shift your thinking. Otherwise your trust isn't going to avoid probate. My father-in-law hadn't made the shift until I taught him. Yes, I am belaboring the point, but it can't be overstated, and most people never get it right. But, you can be taught.

Your business is one of your biggest assets. It has to be owned by your living trust, otherwise your family will end up probating the business if you die unexpectedly before you retire and sell the business. The stock in your corporation or the membership interests in your LLC should be held in the name of your trust.

Most business owners I help have never made out stock certificates or membership certificates, and they've never made a stock/membership ledger. If you haven't done those things, I'll bet big bucks your LLC or corporation is worthless when you get sued. When your employee sues the business, you won't be protected. My [LLC Wizard Course](http://www.llcwizard.com) answers those questions and can walk you through how to issue the stock. <http://www.llcwizard.com>

If you have an S corporation or an LLC taxed as an S corporation, you'll have to have a specially designed living revocable trust, or you'll have to probate the business. Only trusts that meet the criteria of a Subchapter S Qualified Trust can hold stock or membership interests in a Subchapter S entity.

When you make it so that your trust owns your business, you do not have to change bank accounts or anything else in the business. The trust owns them by virtue of the fact that it owns the entity. If you've never issued the certificates and made the ledger entries, do it now. It's a necessary part of maintaining your asset protection shield. My course, *LLC Wizard* will walk you through every aspect of your LLC and maintaining it.

Federal law says that there is no tax consequence when you move an asset into a living trust. The mortgage company can't call the due on sale clause if you transfer a mortgaged piece of property into the trust. You'll file your 1040 tax return just like you always have. Nothing changes, except your family avoids probate and receives a lot more of your estate.

Living trusts are great management tools. If you become incompetent or die, the co-trustee or successor trustee can immediately step in and take over management of the trust's assets. Your trust should have a provision in it which dictates how you will be determined to be incompetent. It will say that you are considered incompetent when one doctor, your spouse, and all of your adult children sign an affidavit saying you've lost it.

The Revocable Living Trust and Asset Protection

Asset protection should be a major part of your estate and business planning. A living trust isn't a good asset protection tool. I often have people describe how they are protected from lawsuits

and creditors, because all of their assets are in a trust. There are certain types of trusts that will protect assets, but you won't use them, because they are irrevocable and you have to "give away" the assets. Suddenly, the assets aren't yours and you usually can't even control them.

The standard trust that everybody gets is a living revocable trust. The trust will have a provision that says that you can amend or revoke the trust. That's actually the trust you want. Because it is revocable AND you are the grantor (guy who puts property into the trust), AND you are the trustee (guy that controls the property), AND you are the



beneficiary (guy who gets the benefits of the trust), your life will go on just as if you didn't have the trust.

The trust I've just described is a "grantor trust." The income tax laws ignore it, the courts ignore it (except for probate issues), and you have full control. IF you don't have a grantor trust, you've probably got a problem.

However, the grantor trust doesn't give you any asset protection. You can revoke the property and get it back at any time. Therefore, the courts can make you revoke it and get it back at any time. No asset protection!

Having said "No Asset Protection," there is an exception. You can get some protection out of the living trust. You can split the assets between you and your spouse. If your spouse is in a low liability situation, then you can "stack assets" under the spouse's ownership. You could do that by simply putting the assets in the spouse's name. However, you should use the trust to avoid probate.

If you want to protect the family residence or large brokerage account, then create a trust where the spouse is the grantor, trustee and beneficiary. It won't protect the assets from the spouse's liabilities, but it will protect them from your lawsuit or your creditors. You want to make sure you use a living trust, so you don't have to probate "your" house if your spouse dies. The "his trust" and "her trust" can be created by two trust separate documents or they could be created by only one document that describes the two separate trusts.

Stacking assets in either his trust or her trust works well, except in the community property states where both spouses are considered one ownership unit. Welcome to Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, Washington and Wisconsin. Be careful not to stack more than the estate tax limit values in either spouse's trust, because that could create estate tax problems if the trust isn't written well.

Living trusts are powerful estate planning and wealth preservation tools. I can't imagine a successful professional or business owner not making good use of the living trust. Yes, it may be true your widowed mother living in your basement may not need one, but that's not you. You need one and you need to learn how to use one. Just having the piece of paper isn't enough.



Squeezing More Money and Asset Protection Out of Your Business

The million dollar question for a business owner is how to structure your business. Should you use a corporation (S or C?), limited liability company, limited partnership, general partnership, or just a sole proprietorship for the single owner? I am sure you have talked to an accountant and gotten one story and then talked to an attorney and gotten another story. In fact, you may have talked to several attorneys and gotten a different story from each one.

There is no right answer, but it is one of the most important decisions you will make. Getting the

answer right really could be worth a million dollars during the average business owner's career. Even if you've been in business for decades, it isn't too late to change. At a minimum, you'd better evaluate what you're doing.

This part of the ebook will give you the pros and cons of each business entity structure you could operate your business with. Once you know the advantages and disadvantages, you can decide what's best for you. The business entity you operate your business through will determine what asset protection you get, how much money you take home, what health benefits you can get, how you sell the business some day, how you share with partners, how easy one of your partners can cheat you, and a dozen other things.

Some of the professionals reading this just dismissed me as a quack, because "everybody" knows that there is no use having a corporation or LLC, because they don't give you any professional liability protection. We talked about that issue in one of the earlier sections of this ebook, but since I work with so many professionals, let's visit it once more.

If you are one of the "professionals," you have to have a "professional corporation" or a "professional LLC." A "professional" entity won't protect the doctor from his own malpractice. I talk to a lot of doctors that end the discussion at this point and say that they will just do business as a partnership or sole proprietorship. Why go to the bother of setting up a company if it doesn't protect you any way?

Operating your business as a "company entity" will give you protection in many ways. Corporations, limited liability companies (LLCs), and limited partnerships are all entities designed to encourage people to take the risks of going into business. They shield the investors and owners against the liabilities incurred in the business. In order to give people even more encouragement to operate businesses, Congress has given special tax breaks to small businesses operating under one of the entity forms. The small business is the engine that drives our economy, and Washington has traditionally tried to encourage small businesses.

If you are a professional, you need to realize that you are practicing a profession, and you are also operating a business. In many respects it is a business just like the neighborhood grocery store, the lawn care guy, the plumber, or any other “shop” you can think of. In the grocery store, the liabilities an entity structure protects against are the “slip and fall” on aisle 6 when the milk gets spilled, a disgruntled employee who wants to hurt the owner, the IRS, bad partners, financial downturns, and lots of other “disasters” that might happen.

It is true that neither the corporation nor the LLC can protect against a professional’s malpractice, but they can protect the business owner’s personal assets from the slip and fall in the clinic or on the icy walks and parking lot, from a disgruntled employee who wants to hurt the owner, from the other “partners” in the business that want to go out and take on huge debts to redo the office, from the acts of the businesses’ employees, and dozens of other financial disasters.

The classic case of a “careful” business owner operating as a sole proprietor and losing everything is the case where the office secretary is on the way to the bank to make the daily deposit. She hits a young father in the crosswalk and kills him. The business owner is personally liable for that accident – as the sole proprietor employer. The business owner loses everything. As a sole proprietor or a general partner you and all of your assets are personally liable for everything your employees do. It’s your employees that get you in trouble.

Yes, I am going to say that there is no way on earth you should be operating your business as a sole proprietor or as a general partner in a partnership. You have got to (no questions asked) operate your business as a corporation, LLC, or possibly a limited partnership. For asset protection reasons and tax reasons, there is no exception in my mind.

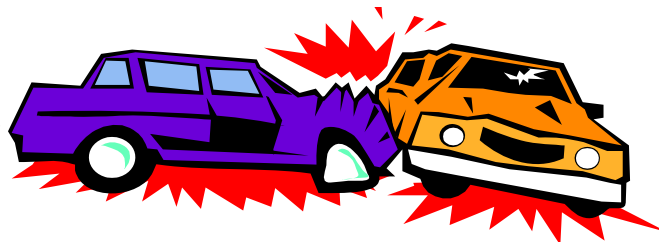
When you choose the entity you want to use, you need to consider three things: (1) the asset protection it will give you, (2) the tax advantages, and (3) the ease of operation. Let’s look at the corporation, LLC, and limited partnership with asset protection and tax issues in mind.

Protecting Your Business

Asset protection is a double swinging door. Your advisors tend to look at asset protection from the business side of the door. If your business gets in trouble, you want to block people from coming through the door after you and your assets. The corporation and LLC can block people from coming from the business side of the door into your personal life. The limited partnership can block the door from opening into the personal life of the limited partners, but not the general partner.

What about the other side of the door? If I were to ask what assets you wanted to protect, your answer would immediately be your house, summer cabin, and retirement nest egg. You just forgot a major asset. Your business is probably your most valuable asset, but most business people don’t look at their business as their prize asset. Thoughts of asset protection go to personal assets not the business. Even though most business

owners do tons of “asset protection” trying to protect their personal assets, lots of businesses are lost when disaster strikes, because the business owners are never advised to consider protecting the business.



You are now confused, because the purpose of the “corporate shield” is to protect personal assets from business problems. By the way, the “corporate shield” applies to an LLC, just like it does to the corporation structure. It’s the same shield. Obviously, if the company has trouble, the company is in danger. The corporate shield doesn’t protect the company from business liabilities. The corporate shield protects you from the business liabilities. How do you protect the company, and what are you protecting it from?

The object is to protect your business from your personal liabilities. If you hit somebody in the crosswalk while you are going to the store or the baseball game, that’s not a company problem. That’s a personal problem. The kid jumping on the trampoline in the back yard breaks his neck, a bad investment in real estate, divorce, a business deal/partnership goes south, and dozens of other “personal” financial and legal challenges are always a threat to you and your business.

The corporate shield doesn’t protect the business from your personal problems. The guy sues you

and gets a judgment; he simply takes over the stock in your little company, and he is now in the driver's seat. He sells the assets of the business, and you're out of business. How do you "block the door" from swinging into your business? Corporations only block the door from swinging into your personal life from the business. LLCs and limited partnerships have another facet to them that corporations don't have. They block the door from swinging into your business from the personal side of your life.

LLCs and limited partnerships have a concept known as a "charging order" associated with them. Charging orders are old English law designed to protect partners from the personal disasters incurred by any one of the partners.

If an individual owns stock in a company and has a personal disaster that "takes away his stock," the corporation simply goes on without any disruption. If you lose your stock in IBM because of a bankruptcy, IBM gets a new stockholder (your creditor) and doesn't even know anything happened. In big corporations, and in theory in all corporations, stockholders elect the officers and directors and then have nothing to do with the management of the company. Note that if it's your small company and you own all of the stock, then when your creditor gets the stock (as one of your assets) you lose the entire company and all of its assets.

Historically, in a partnership, if a partner lost his partnership interest, say in a divorce, the ex-spouse would come in as a full partner who could bind all of the other partners, conduct business on behalf of the partnership, and do whatever he or she wanted to do to the partners and partnership. Remember, the partners are personally liable for whatever one of the other partners does.

In order to prevent the partnership disaster for the existing partners who "hadn't done anything wrong," the English created "charging order" laws. When a partner is attacked personally, their creditor first has to get a judgment against the partner. Once the judgment is received, the creditor has to then ask the court for a charging order against the partner's partnership interest. The creditor can't just come and take the "interest" in the partnership like they can take the stock in a corporation.



The charging order is basically a lien against the partner's "economic interest" in the partnership. Uniform Partnership Acts (acts under USA laws that are intended to establish a uniform basis for all state laws) specifically state that the creditor will not receive any management interest in the partnership. The creditor only gets a lien. That means that the creditor will receive any split of the partnership "profits" that might be distributed to the partners, but the creditor can NOT affect the operation of the partnership. The partner who has the judgment against him can continue to work, receive a wage, and the partnership will go on undisturbed.

Of course, if the partnership is a small company, the managing partner(s) probably won't be issuing many distributions of profit, so a charging order isn't worth a lot to the creditor. Even though the charging order protection in a partnership helps block the door for personal problems coming into your business, you don't want to operate your business as a general partnership, because there is no "corporate shield" protection from the business problems.

A limited partnership will protect the limited partners from both sides of the door, but there is always a general partner in a limited partnership structure. Because you are the manager in your business, you would likely be the general partner. If you are the general partner, you won't have any corporate shield protection. A limited partnership probably isn't a good way to operate your business. It's a good tool, but probably not the best for an active business.

Limited liability companies (it's a limited liability company not a limited liability corporation) have all the aspects of the corporate shield, and they also have all of the aspects of the partnership charging orders. That gives the LLC a distinct advantage over the corporation. The LLC protects from both sides of the door.

Corporations give good asset protection from business liabilities, but no asset protection for the business from personal liabilities. Yet, corporations are still the most common form of business entity. That's because LLCs with their corporate shield plus charging order protection are "relatively" new. Corporations are popular, because they have always been the "standard business entity," and they have historically had tax

advantages over other types of business structures. Even today, there are tax advantages available to corporations that aren't possible in other entity tax structures.

Tax Structures of a Business

There are two tax structures for corporations. You can choose which one you want. A corporation can be taxed under Chapter C of the IRS Code or Subchapter S. Note that the corporate structure is identical. The corporate shield is identical, and everything else about the corporations is the same, because it is the same corporation. The only difference in an S corporation and a C corporation is the tax rules applied to it.

S corporations have the tax advantage of being able to distribute profit directly to the owners. Distributions must be made pro rata based upon ownership. Distributions come to the recipient without the self employment, FICA, FUTA, and other "social" taxes associated with "wages." The owner must take a "reasonable salary" for work done and pay all of the social taxes, and then amounts above that can be distributed. That's an immediate tax savings. S corporation taxes were designed to help the "little guy."

C corporations have the advantage of being able to have benefit plans not available to S corporations. For example, an HRA (Health Reimbursement Agreement) can be created under a C corporation and benefits can be given to the owner. C corporations have the disadvantage of requiring that all "profits" be taken out as W2 wages or double taxed as dividends. The decision as to whether or not to become an S corporation or a C corporation is not a legal question. It is an accounting/tax question.

LLCs have the advantage of being able to take on any tax structure you want. You simply tell the IRS which rules you want to be taxed under. You can be taxed as a sole proprietor (if there is only one owner), a partnership, or either corporate entity. In fact, there are a number of accounting rules unique to LLCs. For example, distributions in an LLC don't have to be distributed pro rata based on ownership. Actually, that may be a dis-

advantage if you don't fully trust the other LLC owners. If you don't fully trust your "partners," use an S corporation structure.

In most situations, an LLC taxed as an S corporation will probably give the "average business owner" the best asset protection and tax structure. Of course, there are overriding reasons to pick another form of business structure, but you always have to consider ease of management, asset protection, and tax possibilities.

However you operate your business, remember the actual ownership of the entity has to be "owned" by your living revocable trust, so your family won't have to probate your business (your most valuable asset) when you die.

Let's Make More Money



Now that we've established that your business needs to be run as a business entity (corporation or LLC), let's start to make more money. That sounds a little crass, but that's why you're in business.

There are lots of laws that apply to businesses that don't apply to you as an individual. Those laws are designed to offer asset protection and tax benefits to the person who is willing to take the risk of starting and operating a small business.

Many people have more than one "business." If you have more than one business, the businesses can "play" off of each other to provide even better asset protection and tax results.

Before you throw up your hands and say you can't stand to have another business, just remember you can pay your bookkeeper in the office or your CPA to keep track of the second business. It will be easy and cheap. If a second business will let you have more money to spend in your family, the little extra expense of a second business is easily justified.

Shifting Income

A common "use" of a second business is to "shift income" away from your business to selected family members. You can't just "pay" your family members part of your profits and have it taxed to

them. You have to “shift” the income. There are a number of ways you can shift income. One is by turning your earned income into passive income for your family members.

Let's assume that you have an excavating business that leases its backhoes, frontend loaders, and other equipment. Obviously, you will deduct the rental costs as an expense. Those rental payments come directly off the top of your income. ACE Rents or whoever you rented from has to recognize the rental payments as income, and if it makes a profit, then ACE Rents shareholders get a dividend. If you are sued and “lose everything,” the equipment will go back to ACE Rents. It's protected from anything that happens to you.

Why not set up your own leasing company. This has to be a second company that will interact with your business. Your family members (kids, grandkids, and/or aging parents) will own the leasing company. You can own some of the leasing company, but the majority of the company will be owned by selected members of your family. (If you don't have family and your business is doing really well, I'm up for adoption.)



The lease payments will be paid to the leasing company as a tax deductible expense to your business. The profits from the leasing company will be divided among the “owners” of the company, and they will pay income tax on the money they receive from the leasing company.

The rental payment has been converted tax deductible from your earned income into passive income and shifted to the family member, who will pay tax on it at their tax rate. Assuming the family member is in a lower tax bracket than you are, the family has more money to spend. This is a perfect technique to help aging parents. For children, it works well, but you are limited as to the amount you can shift to the children and not have some ugly IRS rules kick in.

In order to prevent “shifting” from having a big impact in the family, congress passed the “kiddie tax.” It says if a child receives more than \$1,900 from any “passive income source” the income is “stacked on top of daddy's income.” The child will pay at daddy's rate, and because the income is stacked on top of daddy's income, it can actually

throw daddy into a higher tax bracket. It will actually increase daddy's Adjusted Gross Income (AGI) if the child doesn't file his own tax return and Daddy reports the child's income on form 8814.

The current congress has increased the age of a kiddie up to 24 if the child is a student and claimed as your dependent. If the child is not your dependent or a student, then the age is 19.

The bottom line is you can only shift \$1,900 to your children without triggering the kiddie tax – that's assuming they don't have other sources of passive income. So keep your “shifting” down, but if you have three children and you shift some of your income to them, your family could save several thousand dollars more each year.

Of course, the equipment in the leasing company is protected from your business liabilities and business creditors, and if the leasing company is established as an LLC or limited partnership, the equipment will be protected from your personal creditors, under the charging order laws. That's pretty good protection.

As a business owner, you may have a lot of equipment, and it needs to be protected. Should disaster strike, you may lose your business, but you'll still have your equipment. That means you can open up shop down the street after the dust clears, and you are back in business. By the way, the most common disasters that I see today threatening businesses are horrid real estate investments that ultimately force the business owners into personal bankruptcy and then business bankruptcy.

Additionally, the equipment is not part of your estate when you die. When you die, everything you “own” is subject to estate taxes. You own your business. It will be part of your estate for estate tax calculations. Because you don't own the equipment, it will not be included in the value of your business when estate taxes are calculated. Only the value of your interest in the leasing company will be considered as part of your estate.

How do you get property out of your business into the leasing company? After you have fully depreciated the equipment, you can sell it to the leasing company. Technically, the property isn't

worth much, but it may still have a long useful life. You want to sell it cheap, because you don't want to recapture the depreciation deductions. The leasing company won't worry about depreciating the used equipment.

When you set up the leasing company, you will literally buy the ownership interests (stock or membership interests) in the company. Thus, the company has money it can use to purchase the equipment. It could even purchase new equipment, but if the leasing company is purchasing the new equipment, your business wouldn't get the depreciation on the equipment. These are all issues your CPA can help you with.

Once you have set up the leasing company and have bought the membership interests (assuming it is an LLC), then "gift" the membership interests in the company to your children, parents, or whoever you want to "share the wealth with." Watch the annual amounts that you can "give away" and not trigger a gift tax. The annual exclusion is currently \$13,000.

Instead of "shifting income," you could hire your children directly, if they can do work for you. Paying children directly for "work" will avoid the kiddie tax. Paying kids directly is a good idea, but it is hard to get your four year old to scrub down the office. Try this method. Have professional photos of your children taken and put them on your advertising materials. Pay the children a royalty for their pictures. It works well. Remember, what you pay your children directly is earned income to them and the kiddie tax doesn't apply.

Lowering Your AGI

Of course, the name of the game today is "lower your AGI." Shifting income to your leasing company can lower your AGI. The current laws are focusing on penalizing you if you are making over \$250,000 per year in AGI (for married couples) and \$200,000 for singles. That makes the successful business owner a bull's-eye target, especially if your spouse works. Under the new laws you could easily be paying out 60% or more of your income to one type of tax or another. Remember, the IRS is your major impediment to financial success.



As a small business owner, you have lots of opportunities to lower your AGI that a W2 employee doesn't have. You've got to run as many of your expenses through the company as possible. Keep track of car mileage, buy supplies, take trips, and do everything you can to run money through your company. If you've structured your business as an entity, you have more tax possibilities than you would get if you were just running your business as a sole proprietorship or partnership.

If you are running a business with multiple professionals in the business, have each "partner" contract as an independent LLC entity with the main "business entity" to provide services to the business entity. Pay each professional through their own unique LLC. Now each one of the professionals has a personal "company" or "little business" he or she can work with.

If you own less than 20% of the main business entity, then you can have unique benefit plans in your own LLC, and you don't have to worry about providing benefits for anybody in the main business entity. You can provide yourself lots of benefits with an HSA or HRA. It's all deductible to your little business.

Note that you can "put a lot more money away" with an HRA than you can with an HSA. However, if you are using an HRA, your unique LLC has to be taxed as a C Corporation to let you get the HRA benefits under new law. It may be worth having a C corporation status to get the HRA benefits. You can easily take \$20,000 a year off the top of your AGI, use it to pay for current "health related expenses," and store what's left each year.

Use retirement plans. All your retirement contributions are deductions that come off before your AGI is calculated. The problem with retirement plans is the obligation to provide benefits for your employees. The rules are a lot more complicated for retirement plans than they are benefit plans, so you are going to have to get help from your CPA before you try to set up a retirement plan in your own LLC.

Go to your association conventions and take the family. A lot of the trip can be charged tax de-

ductibly to your own LLC. Buy computers at home for your use in the evening as a business owner. Find all the possible ways you can charge off business expenses to your own LLC, and do it! It isn't how much money you make. It is how well you live and how secure you are.

A Cute Tax Law

There are a number of "off the path" tax laws you can use. For example, Section 280A(g) of the IRS Code. The section was created to help house people in High Point, NC during the furniture show held there each year. 280A(g) says that if you rent a "residence" for no more than 14 days a year, the rental income is not reportable – tax free. A residence is anywhere someone can sleep, including boats and motor homes.

How do you get somebody to rent your house for no more than 14 days a year? Your own LLC or your business entity can rent the house. Have the business retreats at your house. Check and see what it is to rent a meeting facility with kitchen for a day in your community. If you check the local hotels, a conference room with a meal will be \$1000 a day. Hold your board meetings at the house and serve lunch.

If a colleague comes in from out of town, house the colleague at your house. Your company can rent the residence to house and entertain the colleague. If you have a beach house or mountain home, take the other business owners there for a Mastermind. Your company can rent the house. If you have more than one house you will get 14 days rent for each house. Can you see where you can remove thousands of dollars of tax free income out of your little company each year?

You are creating tax deductions for your company and moving tax free income to yourself. No, your CPA has never mentioned this, but he will absolutely verify it. He will caution that you have to use a reasonable rent. P.S. Your CPA doesn't really plan taxes. He just plugs numbers.

Let's say that by using shifting income techniques, benefit plans, retirement

plans (at least fund your IRA), and little laws, like 280A(g), you can move an extra \$25,000 of spendable income to your family. How many extra patients would you have to see or cars would you have to fix to net an extra \$25,000 in after tax spendable income?

There are lots of things we can do to lower your AGI. I took a client two years ago that had to have a Roth IRA. The problem is he made over \$400,000 that year, and in order to establish a Roth IRA, he had to have under \$150,000 in AGI. We got the Roth IRA for him. You can substantially lower your AGI without even pushing the IRS rules to their limits.

The IRS really is your major impediment to financial success. You've got to pay attention to the laws. Business owners routinely go to their "advisors" and tell them they want to be "set up" with tax shelters and asset protection. Unfortunately, they get "set up." You've got to at least learn enough to know when you are getting the set up or getting good help.

The reality is, whether it is taxes or asset protection for your personal or business life, you need to create a rock solid legal foundation. Take the time to implement the four basic documents discussed in this ebook for your personal life and the business strategies and structures outlined to enhance your business life. You need to be able to do this yourself or direct your professional advisor.

Never blindly trust an advisor. The truth is that professionals don't always give you the help you need. I learned this lesson the hard way. At the age of 27, only ninety days after becoming a patent attorney, I was diagnosed with advanced cancer, after having been treated for a year for an infection. Doctors gave me little hope of surviving. I almost lost everything I owned. This didn't need to happen and now I'm a man on a mission to help others avoid such tragedy. So I created the **LLC Wizard**.

Don't learn your lessons the hard way. Get the [LLC Wizard™](#), so you can create a more successful business, get more asset protection, and make more money.■

