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PLANNING MATTERS

Practical Problems in Asset Protection

(Now that I have my asset protection plan, What do I do?)

By James C. Mulder

This article will focus on the day to day practical problems that effective asset protection involves. In other words, now that I have my asset protection plan, what do I do? Effective asset protection involves three aspects, planning, implementation, and maintaining. We have discussed many times the planning and implementation aspects of asset protection planning, but haven't really focused on the maintaining of your asset protection plan. It is not difficult, but involves monitoring and consistency. Some of the common issues that need to be addressed and maintained are discussed below.

Insurance

Insurance covers two aspects, (1) one making sure you have casualty coverage for assets that you used to own personally, but that are now owned by an entity and (2) making sure you do not drop your liability coverage, now that you think you are "bullet proof".

We advise our clients to notify in writing their casualty insurance carriers as to ownership changes on property. In fact, we advise our clients to check with their casualty agents during the planning process so that the client will know of any rate or coverage changes because that rent house is now going to be in an LLC, for instance. Business assets that once were owned by the operating company, but now are going to be owned by a leasing company, need to be covered by the operating company still, but the leasing company needs to be listed as an additional insured on the policy.

Don't drop your liability coverage. Just because you are asset protected doesn't mean that you should not have liability coverage. Liability coverage provides an attorney for you should you be sued and have a defense. Liability coverage provides recompense to an injured party who really deserves it. You may want to consider the liability limits you currently have and see what cost savings you can make by lowering the coverage, but you should still maintain some liability coverage.

Mortgage Companies

In order for you to get the asset protection you desire, you must transfer the asset into your entity (LLC or Limited partnership). If it is a piece of real property, you need to record the transfer in the real property records, otherwise a creditor can ignore the transfer. Mortgage companies generally have a right to demand you pay off your mortgage should you transfer the property on which the mortgage company has a lien. This is often called a "due on sale" clause. It is not limited to a sale though and will apply to a transfer to your LLC, for instance. So, you need to either (1) notify



the mortgage company before transferring and get their consent and be prepared to get other financing should they not give consent, or (2) transfer it and hope they don't object and if they do, be prepared to get alternate financing then.

Accounting and Contracts

Because you are forming new entities that have substance, you must treat them as a separate “business” and consequently account for them separately. Many times these structures won't require a separate income tax return, but they do need to be accounted for separately. What I mean by this is the following:

Suppose you have formed a limited partnership or LLC holding company that acts as your own private “bank” and owns all of your liquid assets as well as your subsidiary LLCs that own pieces of real property that are leased out. The tenants in the properties need to be leasing from the subsidiary LLC, not you and you need to be collecting rents under the name of the subsidiary LLC that actually owns the property or have a contract with another LLC that handles all property management for all LLCs. You should have a set of books for each LLC and account for all expenses and income. The net result is reported for federal income tax purposes on the holding company's partnership return.

This is not as cumbersome as it may seem. Most of this can be kept in Quick Books or simply on a spreadsheet. You should have been accounting for all of this prior to the planning implementation anyway. It really is easy to do, but absolutely needs to be done.

Part of ensuring the business relationship is to have contracts between your entities and your tenants that show the new relationship between landlord and tenant. The tenants need to make their rent checks out to the LLC owner or LLC management company. As stated above, your liability and casualty insurance companies need to show the new owner LLC as the insured.

Transition of Management

As stated previously, it is vital that you treat your new asset protection entities as real businesses. Accordingly, you should make sure that the tenants are aware by an amendment to the lease agreement to make their checks out to the owner LLC or an LLC that you have set up to be the property manager. This is not a real necessity if you only have a few rentals and one LLC owner. However, if you have several LLCs that own several properties, I suggest you have a management LLC to collect all rents and handle all aspects of property management. There should be a property management contract between all the LLC owners and the LLC property management company to do this. In this way, only one bank account needs to be opened to handle all rents and property management transactions. Again, if the property management LLC is only owned by one person or entity, it does not have to file a separate income tax return.

Cumbersome and Increased Annual Cost

What I have presented here might seem cumbersome and it will increase your annual accounting fees to your CPA or tax preparer and may increase your casualty and liability insurance premiums. That is the price for sleeping well at night. It shouldn't cost you significantly more than before the planning and implementation and will ensure that your plan if ever challenged will stand up.



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One of only a few attorneys in the Houston area Board certified in both Estate Planning & Probate Law and in Tax Law, Mr. Mulder concentrates his practice primarily in wealth transfer, tax, and asset protection planning.

The implementation of such planning includes very comprehensive planning and may involve the preparation of very comprehensive wills, trusts, business organizations and family partnerships. Mr. Mulder has prepared over 1,000 asset protection plans. Mr. Mulder is a frequent speaker on estate planning and on asset protection planning.

