

COMPLETE GUIDE TO ASSET PROTECTION

If you're a homeowner, there are many tax loop holes that can help your home make money for you:

If you've lived in your home for two years, you can take a tax-free gain of \$250K for a single filer and \$500K for married (filing jointly). You just have to have used the property as your principal residence for two of the past five years. You can even rent your house out for most that period and still qualify for the full gain!

If you've lived in your home for less than two years, you can still take a "reduced exclusion amount" (pro-rated from the full amount according to how long you've lived there) if you're "forced" to move because of "unforeseen circumstances" – which can simply mean that you've started (or ended) a home –based business.

If you've lived in your home for more than two years, you can always re-finance it to remove the value. If the current market interest rates are higher than your existing loan, for instance, get a home equity loan instead. Once your gain approaches \$250K if you're single and (\$500 if married), it's time to move.

If you decide to rent out a room in your house, you've created a home business from which you can deduct relevant expenses against the rental income, as well as the depreciation of the space. And when you sell the house, you can exclude the gain on the pro-rated portion.

If your income grows so high that you begin to lose itemized deductions, you can always move the mortgage interest deduction off Schedule by using the home office deduction, which allows you to deduct a pro-rated portion of the mortgage interest and property tax on a separate schedule.

If you wish to take out a home equity loan that's fully deductible, simply demonstrate that the additional debt above the amount allowable was used for business or investment purposes-such as buying in to an apartment building.

THE DANGERS OF JOINT OWNERSHIP

Joint tenancy is the most frequent form of ownership of stocks, bonds, real estate and bank accounts in the U.S. Many financial advisors recommend joint tenancy because it avoids probate.

There are times when joint ownership may be appropriate. For instance, an adult child may hold joint ownership of an aging parent's checking account to assist him or her in paying bills. But joint ownership also presents more potential trouble than any other legal status in estate planning. Most people don't realize that joint ownership almost always supersedes the stipulations of a will.

Improper use of joint ownership can result in the following:

- Make the jointly held assets vulnerable to suits and judgments against any one of the joint owners.

- Make it much easier for anyone of the joint owners to take all the jointly held assets without permission of the other joint owner.

Make a will legally ineffective.

Increase estate taxes at the death of the surviving joint owner.

Review all the assets you currently hold in joint tenancy. If you sense that any of them may present a potential problem, consider changing joint tenancy to another form of ownership, such as individual ownership, trust or, limited partnership.

PROTECT YOUR PROPERTY THROUGH LIVING TRUSTS

There are many different kinds of trusts, but they all have these characteristics in common:

It contains a property.

It owns the property, but the principal and/ or income may be disbursed to others.

The person who holds legal title to the property is called the trustee.

The person who receives the benefit of the property is called the beneficiary.

The person who creates the trust is the trustor.

and The person who places the property inside the trust is called the settler (the trustor and settler are almost always the same person).

A properly drafted trust will specify the benefits the beneficiary is to receive and the procedures that the trustee must follow.

Although there are three titles associated with a trust (trustee, beneficiary, and trustor/settler) one person can have two or even all three titles, though a trust may lose many of its income tax and lawsuit protection advantages when the same person is both trustee and beneficiary.

Generally speaking, living trusts won't protect your assets from lawsuits or liens. People usually establish living trust for the following reason:

Probate can be avoided on the assets held in the trust.

Bypass and marital trust tax provisions ensure that assets held in the trust for a spouse or child will eventually pass to other heirs, saving estate taxes.

It's revocable, meaning it can be changed anytime.

It can appoint competent people to manage your affairs during your life or after our death.

It can afford some liability protections to its assets.

Irrevocable trusts can avoid probate and provide income and estate tax advantages. Unlike a will, it's a private document and can't be inspected by the public. It goes in to effect immediately, unlike testamentary trusts, which are only activated after death.

Property can be added or subtracted anytime.

It's not under the supervision of any court, unlike testamentary trusts.

Living trusts can also protect a spouse's assets from seizure – unless fraud is proved.

Both spouses must convey their assets directly to the trust of the spouse who's less vulnerable to lawsuits. Preferably, the spouse less vulnerable to lawsuits is the trustee.

The right to alter the trust should belong solely to the less vulnerable spouse.

The trust must file its own income tax return with its own ID number.

If both spouses are equally vulnerable to lawsuits, however, it's unlikely that a living trust will provide any protection.

If you wish to protect your children, you can create a Spendthrift Trust, which can prevent creditor from seizing the trust's assets.

If the trustor retains the power to change the trust, however, that may be sufficient for a court to allow the trustor's creditors to seize its assets.

An Irrevocable Trust can't be changed or revoked by anyone, including the trustor. It's usually not reachable by creditors as long as the trustor is independent of the trust, and proper income and disbursement records are maintained.

Another way to avoid or delay creditors is to create a foreign trust. That way, creditors have to sue in a foreign court for access.

Finally, give the trustee the right to extend the trust's term to prevent creditors from seizing a beneficiary's interest.

PROTECT YOUR HOME FROM LAWSUITS

A common strategy to avoid probate costs is to hold property in joint ownership – however, creditors can often seize such property if either owner owes them money.

Another drawback is that joint ownership supersedes the provisions of any will, so loved ones might get accidentally disinherited.

Here are some alternatives to joint ownership that offer some protection against creditors:

Place the property in a spouse's name – this can only work, however, if it's demonstrated the spouse isn't fraudulently protecting assets. Also, if the spouse dies unexpectedly, the property will end up in his or her probate estate.

Place the property in a spouse's revocable living trust – once again, however, it must be demonstrated that the conveyance isn't fraudulent.

Place the property in an irrevocable living trust – the longer it's there, the better legal protection it provides, just as long as the trustor is not also a trustee.

Place the property in your children's names - once again, however, it must not be fraudulent. One drawback is that the property may become vulnerable to a child's creditors.

Use a corporation – deeding your home to a corporation, with your family as its officers and shareholders, provides substantial legal protection. Its main drawback is tax disadvantages.

Use a limited partnership – this may provide the best property protection, but the complex rules dealing with business purpose and other requirements to set one up will need an expert to correctly implement it.

Tenancy by the entireties – twenty three states allow this form of joint ownership by married couples, which precludes the creditors of one spouse from seizing any assets, since each spouse is presumed to own the entire asset. This plan only provides protection if one spouse is being sued, however.

In order to protect yourself from lawsuits by visitors to your home who suffer some injury, make sure that you've taken all reasonable precautions to address any potential dangers, and always carry home liability insurance.

If you wish to augment your insurance policy, consider adding an "umbrella liability policy," which provides much higher limits to your homeowner and automobile policies than either one provides on its own.

Most states allow a "homestead exemption" to protect at least a portion of your home equity from suits or liquidation in a bankruptcy. If your home equity is higher than the exemption in your state, however, you may be forced to sell your home and you'll only receive the statutory amount allowed. Check your state laws for more information.

PROTECT YOUR HOME FROM DIVORCE

More than half of all marriages end in divorce, yet very few people take the steps necessary to protect their assets from that possibility.

A pre-nuptial agreement is the most basic legal tool to protect assets, but there are also more advanced tools available.

Pre-nuptial agreements may not only define the inheritance right of various heirs, but can also protect the less-wealthy spouse if he or she is giving up a lucrative career for the marriage.

Pre-nuptial agreements can also help maintain control of family businesses, as well as clarify which state laws will apply in the event of divorce.

If no pre-nuptial agreement exists, the marriage assets will be divided according to state law.

There are several ways to protect property apart from a pre-nuptial agreement:

Irrevocable trust – may result in loss of control and flexibility. Also, if you retain any control, your spouse may be entitled to some property because of it.

Revocable trust – usually doesn't protect assets in divorce. Also, if you die, state laws may supersede trust provisions granting no interest.

Limited partnership – after divorce, the spouse who's the general partner remains in control of the assets. If the outcome turns out to be too one-sided, however, courts will often set such schemes aside as unjust.

Gifts – giving away money is a drastic solution, which may fail anyway if done fraudulently.

In order for a pre-nuptial agreement to be binding, the agreement should be not be enforceable.

The agreement must be in writing, but changes made be made orally. Courts will be reluctant to interfere if it's clear that both parties have abided by any changes. The agreement should, however, have a severability clause that makes it clear even if one clause is violated the rest of the agreement remains in force.

The agreement should also make clear that there aren't any agreements between the spouses other than those in the pre – nuptial. That will prevent either spouse from claiming oral promises were made that must be fulfilled.

Don't include provisions that encourage divorce, like allowing a spouse to receive more in divorce than he or she would otherwise receive.

If you've entered in to a pre – nuptial agreement, avoid placing any assets in joint ownership, as this may supersede the provisions of the agreement.

If you give a significant gift to your spouse, it should come with a signed memo explaining its purpose. That will avoid any later confusion over possible asset protection schemes.

If you cohabit, it's best to decide in advance how you plan to split your assets. Otherwise the courts will decide for you.

WHAT IS A STARKER 1031 TAX – DEFERRED EXCHANGE?

Starker 1031 tax – deferred exchanges are the best known and most common tax-deferral tool for real estate: it's an exchange of property and tax deferral under the provisions of IRS Code section 1031.

A 1031 exchange allows the complete and indefinite deferral of capital gains taxes and recapture of depreciation, allowing taxpayers to do the following:

- Trade up to larger investment properties.

- Relocate real estate investments.

- Change the type or character of real estate investments.

- Diversify or consolidate real estate investments to or from multiple properties.

- Trade nonproductive property for real estate investments that produce income.

The 1031 exchanges sprang from a 1979 court decisions that allowed property owners to sell one property and wait up to six months to buy another without losing the right to consider the transaction an exchange for tax deferral purposes.

That case opened up a whole new profession in the real estate industry: the qualified intermediary or accommodator. Their job is to facilitate and document 1031 exchanges by receiving the proceeds of a sale under the terms of an exchange agreement and then applying those funds at the direction of the exchanger for the acquisition of the replacement property.

1031 exchanges usually happen with little effort on the part of the buyer and seller. Instead, the qualified intermediary or accommodator handles the paperwork and then sends it to escrow/title companies or closing agents to the buyer and seller of each property for signatures.

This is how the process goes if you're the seller/exchanger:

- List your property with an agent, making sure he or she knows you plan a 1031 exchange.

- When you get an offer, your agent will include a counteroffer provision that states "buyer agrees to cooperate with seller's 1031 exchange.

- Open escrow, and then choose your accommodator.

- Sign an exchange agreement with your accommodator through escrow along with the other customary escrow paperwork.

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trust At the close of escrow, your proceeds will be transferred to your accommodator's fund on your behalf and held there until you begin the process of buying your replacement property.

Here's how the process goes to purchase the replacement property:

Identify the potential replacement properties following IRS rules.

Negotiate a purchase agreement, including a provision that the seller will cooperate with the 1031 exchange.

Open escrow and have the purchase contract earnest money deposit transferred from the accommodator's trust fund to the escrow or closing agent's account.

Continue the purchase process normally, doing inspections, arranging financing, and so on.

At closing, the accommodator transfers the balance of the exchange funds to the escrow or closing agent, who then closes the transaction.

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