

Protect Yourself with the Ultimate Asset Protection Tool **by Carlo J. Sparacino**

Many successful business owners and entrepreneurs spend many years, or perhaps a life-time accumulating assets, properties etc.

Unfortunately, in our egregious society, much of this wealth can be consumed by litigation (oftentimes, one lawsuit can wipe out an entire estate).

The best liability insurance anybody could have is to be completely poverty stricken and destitute. So, how does one go from having substantial wealth to being destitute without becoming the victim of lengthy and costly litigation?

The answer is both simple and complex. This strategy can be likened to creating an independent part of your estate plan that functions as the lending arm, or “family bank” to the rest of your estate. The following discussion includes how to be a senior lien holder (encumbering strategy) against your own estate assets.

When correctly implemented, your entire estate can be made lawsuit proof. What if you could limit your liability from lawsuits by judgment-proofing your assets and significantly reduce or even eliminate state income taxes? This strategy takes advantage of two powerful features of corporations:

1. Corporations are considered independent legal entities, separate from their owners.
2. Corporations can be based in any state regardless of where their owners live.

By taking advantage of these two features, it is possible to make yourself lawsuit-proof and/or legally eliminate state income taxes. Here are the steps you would take to implement this strategy.

1. Incorporate the home state business you currently derive income from. For purposes of this example, we are going to call your home state corporation “Red, Inc.” That’s because your home state operation will have a lot of red ink. It will try to make a profit, but when it ends up with red ink (losing money); there will be no state income taxes to pay. Consider making it an S-corporation and elect a tax year ending December 31.
2. Set up another corporation in a state that has no state income tax, such as Nevada. For purposes of this example, we will call this corporation “Warbucks, Inc.” and elect a fiscal year ending June 30th for it.

Operating in your home state, Red, Inc. decided it would be a fine idea to purchase some products and/or services from Warbucks, Inc. Remember, Red, Inc. and Warbucks, Inc. are separate corporations and therefore separate persons (a corporation is “an artificial person created by law”).

Therefore, if Red, Inc. writes a check to Warbucks, Inc., money is spent by Red, Inc. (your home-state-based person) and money is received by Warbucks, Inc. (your tax-free-state based person). There is an expense in your home state to Red, Inc. and there is income to Warbucks, Inc. If Red, Inc. spends all its profits, it makes no money for your home state to tax- plus you have an excellent lawsuit proofing tool which we'll explain later.

What products and services can Warbucks, Inc. sell to Red, Inc. from the tax-free state and still not be liable for state taxes in your home state? What we suggest as the most solid and workable option is that Warbucks, Inc. simply loan money to Red, Inc., which would simply be buying the use of money from Warbucks, Inc. When you borrow money, you generally pay interest. Red, Inc. is no exception. You put money into Warbucks, Inc., which uses the money that has been invested in it to make money. It does this by loaning money to Red, Inc. (and preferably others as well).

The condition of the loan to Red, Inc. is that the money owed is due and payable whenever Warbucks, Inc. asks for it ("calls the note"). This type of note is called a "demand promissory note."

Also, as any good business does Warbucks, Inc. charges Red, Inc. (your home state operation) interest on the money it has loaned.

Be sure to check the usury laws in whatever state Warbucks, Inc is located. For this example, we'll say the rate is 18%. The interest may be due monthly or annually and it may even be compounded monthly. This will get Red, Inc. even further in debt to Warbucks, Inc., which can be very beneficial as you'll see later.

To summarize so far, Red, Inc. borrows money from Warbucks, Inc. with the principal balance due upon demand (when Warbucks, Inc. calls the note). The money owed to Warbucks, Inc. is evidenced by a promissory note written by Red, Inc. (the debtor) at the offices of Warbucks, Inc. This note shows that the money borrowed in Warbucks' home state and, if worded correctly, that it is governed by the laws of that state. How much does Red, Inc. borrow from Warbucks, Inc.? Well at 18 % simple interest, if Red, Inc. borrowed \$100,000, this would mean a business interest expense to Red, Inc. in your home state of \$18,000 in one year. It could be more if the interest compounded monthly.

Depending upon the amount of money borrowed and the interest rate - the two companies (which you own) agree upon, the interest expense to Red, Inc. - it could be higher or lower.

This strategy works just as well if you sell products and/or services to Red, Inc. instead of lending it money. Warbucks, Inc. sells the products and services to Red Inc. and takes back a promissory note. Interest on the note is due monthly or yearly. The interest is still an expense to Red, Inc. and the result is the same; no profit for Red, Inc. in your home state. The principal amount of the note may also be deductible to Red, Inc.

Lawsuit Proof

The stage is now set. All that remains are a few simple steps to make your business operation lawsuit-proof.

Warbucks, Inc. is based outside of your home state and it maintains a low profile. Its main client is Red, Inc. which you own. The chances of Warbucks, Inc. getting sued are slim to none.

The idea is to make Red, Inc. lawsuit-proof by turning it into a turnip that no one can bleed for money. At the same time, you need to make sure it has the money, equipment, fixtures, land, buildings, etc. to conduct your business. Here are the steps:

- First, create a large debt. Red, Inc. borrows money from Warbucks, Inc. every time it gets a chance. It probably even finances part of its interest payments to Warbucks, Inc. because it can't make them all in cash. Therefore, each month the debt keeps increasing. It would not be hard to establish a debt so large to Warbucks, Inc. that it exceeds the value of all the assets of Red, Inc.

Let's say Red, Inc. has assets totaling \$250,000 that you want to protect. Red, Inc. borrows and borrows from Warbucks, Inc. getting deeper and deeper in debt. The debt figure is limited only by the principal amount Warbucks, Inc. and Red, Inc. agree upon and the corresponding interest rate.

"If Red, Inc. spends all of its profits, it makes no money for your home state to tax..."

"Warbucks, Inc. is in first position on all of the assets that Red, Inc. owns and those assets can't be touched until Warbucks, Inc. is paid.

- Next, draw up a "security agreement." Warbucks, Inc. is going to make sure it gets paid. It will want some collateral on the loan to Red, Inc. A security agreement is a common, powerful tool that is used to secure certain assets as collateral on a loan. By this agreement, Warbucks, Inc. and Red, Inc. agree that the assets, receivables, inventory, and everything belonging to Red, Inc. are collateral for the loan. On any equity on real property, Red, Inc. would issue a deed of trust (mortgage) to Warbucks, Inc.

The final and most important step is next:

- File a "UCC-1. " As notice to the world that these assets are collateral for a debt owed to Warbucks, Inc. Warbucks, Inc. will record what is called a "UCC-1" financing statement with the Secretary of State's office and/ or appropriate county Recorder's office in your home state. The UCC-1 form states that these assets are collateral for a note that is owed. It gives notice to the world that these assets are encumbered and no one can touch these assets until the debt owed to Warbucks, Inc. is paid.

Warbucks, Inc. is in first position on all of these assets that Red, Inc. owns and those assets can't be touched until Warbucks, Inc. is paid. UCC-1 filings and the security

agreement, which perfects a security interest in the assets of Red, Inc., come before everything else (except some tax claims). In other words, this is correct unless other creditors have filed liens or perfected their security interest prior to your filing the UCC-1.

What happens if Red, Inc. gets sued? When the lawyer and the person suing Red, Inc. check on the assets owned by Red, Inc., they get a very rude awakening. They search to see what Red, Inc. is worth which includes looking for any real property it owns along with debt against it, and any UCC-1 filing encumbering the assets Red, Inc. may own. They find a BIG debt. They find that all of the assets of Red, Inc. are encumbered and that Red, Inc. is worthless. That's probably the end of the lawsuit against Red, Inc.

However, let's say that the person decides to sue and files the lawsuit. He even gets a judgment against Red, Inc.

Remember, Warbucks, Inc. is owed money by Red, Inc. as evidenced by a promissory note due on demand. Warbucks, Inc. decides it is time to get paid and calls the note. Red, Inc. can't pay such a large debt. Warbucks, Inc. has no recourse except to execute its security interest and/or deed of trust on the assets of Red, Inc. by taking the assets of Red, Inc. to satisfy the debt.

What Happened?

That's the same question that attorney who sued you is asking. He's got a judgment against Red, Inc. but Red, Inc. has nothing to execute that judgment on. In fact, you could even call the attorney and tell him, "I'll give you the whole corporation. Come on down and pick up the keys. "Even though Warbucks, Inc. has taken the assets of Red, Inc., the debt owed to Warbucks, Inc. may be so large that Red, Inc. still owes money to Warbucks, Inc.

In that case, the only thing your opponent would gain is the large debt owed to Warbucks, Inc. – which you own. To reiterate what we've just discussed, here's a summary of the steps to lawsuit-proof Red, Inc.

1. Warbucks, Inc. loans money to Red, Inc.
2. The money Red, Inc. owes Warbucks, Inc. is evidenced by a promissory note due when Warbucks, Inc. says it's due.
3. As security or collateral, Warbucks, Inc. and Red, Inc. agree that the assets of Red, Inc. will be collateral and security for the note.
4. As notice to the world and evidence that these assets are collateral on the loan, a UCC-1 filing is done at Warbucks' home state and in your home state. A trust deed is executed on any real property and filed in the county in which said property is located.
5. Warbucks, Inc. is in first position on the assets of Red, Inc., and no one who may sue Red, Inc. can touch those said assets until the debt to Warbucks, Inc. is paid.
6. You are doing business "lawsuit proof" because even if there is a judgment against Red, Inc., there is nothing to take.

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