Letter to a client explaining the concept of asset protection

PREVIEW

1. The following letter may be sent to a client to explain the concept of asset protection. It covers many topics that are included in the decision to form a family limited partnership. The letter covers the following important topics:

a. The definition of asset protection,

b. The sources of financial disaster,

c What assets should be protected,

d. How to own property and the pitfalls of each type of ownership,

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e. Pitfalls and traps in asset protection such as the Fraudulent Transfers to Creditors Act,

f. Types of insurance the client should obtain,

g. What property is exempt from collection by general creditors under the Texas and Federal exemptions,

h. What the client should know about bankruptcy,

i. What the client should know about probate, dying in Texas without a will and important information about trusts, including Living Trusts,

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j. Why the family limited partnership should be considered, and

k. Problems in keeping the protection of a corporation’s status.

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Form: Letter to a client explaining the concept of asset protection

PREVIEW

[Date]

ATTORNEY-CLIENT COMMUNICATION: THIS DOCUMENT AND ITS CONTENTS CONSTITUTE LEGALLY PRIVILEGED INFORMATION

[Client's name]
[Client's address]

Dear [Client's salutation]:

Thank you for meeting with me and discussing your estate plan and protecting your family's assets. The purpose of this letter is to explain, in detail the process of asset protection and how a family limited partnership may help protect your estate.

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ASSET PROTECTION DEFINED

"Asset protection" is an advanced form of estate planning. The purpose of asset protection and estate planning is to:

1. protect the assets and property that you have accumulated, and

2. shelter your assets and income from contingent liabilities.

Your assets and their proceeds can be protected to provide for your spouse and family, to provide for your children's college education, reduce income and estate tax burdens, provide sufficient moneys for retirement, and to plan for, and minimize, the hardships in the event of severe illness or disability.

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SOURCES OF FINANCIAL DISASTERS

You may not realize the fact that your assets and property are subject to many contingencies which could cause you to suffer a loss of part or all of your property. Some of the more common financial disasters include the following:

1. Lawsuits,

2. Taxes,

3. Inflation,

4. Overspending,

5. Improper use of borrowing;

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6. Liabilities from other people, such as son-in-laws, children, business partners,

7. Failure to plan,

8. Failure to keep proper records, and

9. Failure to properly supervise investments.

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GOOD INTENTIONS ALONE
ARE NOT SUFFICIENT TO PRESERVE YOU ESTATE

In order to protect your hard earned assets, you must plan ahead for possible contingencies. Failure to create an estate plan could be subject you or your estate to significant losses or taxes. Good intentions alone cannot substitute for professional estate planning.

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The law allows you to protect your family and assets pursuant to a properly adopted estate plan. You must however execute the proper documents before the occurrence of a financial derailment otherwise your actions could be considered by a court to be a fraudulent transfer.

Additionally, the investments and decisions made in asset and estate planning must be shown to have a viable, worthwhile purchase.

For instance, if you are sued tomorrow (before enacting an estate plan) and then took all of your cash assets and paid off your home in order to take advantage of the homestead exemption, a creditor could easily argue that you have violated the Fraudulent Transfers Act and defrauded your creditors.

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Paying off your home is a legitimate asset and estate planning protection tool. It is supported most frequently on the reason that the motives for paying off the homestead were to take care of a spouse and family, and to reduce living expenses, and payment of interest. This must be done before, not after the occurrence of a contingency.

Placing money into trust is also a particularly worthwhile and legitimate endeavor. These include irrevocable trusts with a spendthrift provision. A spendthrift clause protects the trust fund from its owner’s creditors and the child's creditors. These trusts can be long-term trusts designed to own insurance on a parent's life, and to provide liquidity upon a parent's death, if ever needed. For legal references applicable to the spendthrift provision, see Texas Property Code Sections 112.035 and 112.035(b).

THANK YOU

SOME COMMON PITFALLS

If you or your spouse has not filed income tax returns, or has income tax levies, then the other spouse (including one from a new marriage) is now liable for the tax deficiency. Your community property is at risk in that situation.

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If you are named on a corporation's Board of Directors, or serve as an Officer of a corporation, you may find yourself liable for the corporation's unpaid withholding 941 tax deposits.

PREVIEW

Transfers of business property or stock can backfire if not done properly. An owner of a well-established business, for estate planning purposes, transferred stock in his business to his children. Unfortunately, one of the children subsequently became divorced, and all of the stock was awarded to the other party in the divorce. That interest in the business is now owned by strangers.

FRAUDULENT TRANSFERS

The Texas Uniform Transfers Act is designed to protect creditors from fraudulent transfers when debtors seek to hide their assets, hinder, or defraud a creditor.

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The Act prevents hindering, delaying or transferring properties if a court determines that the purpose of a transfer was to defraud a creditor. The Act has a four-year's statute of limitations time period from when the transfer was made, or one-year's statute of limitations time period after a transfer was, or could have been, recently discovered.

The Act protects creditors whose claims arise within a reasonable time before, or after, the transfer was made. Unfortunately, the language of the Act makes it very difficult to ascertain what transfers will be considered a violation of the law, and which ones will not be.

It may be up to a jury to have each individual transaction determined. In determining the intent of whether a person intended to defraud creditors, the following evidence may be considered:

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1. If the transfer was made to an insider, such as another member of the family,

2. If the debtor retained possession or control of the property transferred, even after the transfer was made,

3. If the transfer was concealed or removed from the jurisdiction of the Texas courts,

4. If the transfer was made after the debtor was sued or threatened with a lawsuit, and if the transfer was substantially all of the debtor's assets, and

5. If the debtor is now insolvent as a result of the transfer.

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The Texas Fraudulent Transfers Act does not look at the solvency of the financial condition of the transferor, but rather looks at the intent of the person making the transfer at the time the transfer was made as the basis for determining whether or not the conveyance was fraudulent.

The statute provides that a transfer is deemed fraudulent if a debtor makes a transfer without receiving a reasonably equivalent value for the exchange, and the debtor was:

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1. engaged in, or was about to be engaged in, a business or transaction for which his remaining assets were unreasonably small; or

PREVIEW

2. intended to incur or believed to have incurred debts beyond his ability to pay the same.

A transfer is also fraudulent if a creditor has a pre-existing claim and the debtor transfers property without receiving a reasonably equivalent consideration for the transfer, and the debtor was insolvent at the time, or became insolvent because of the transfer.

In addition to the Texas Fraudulent Transfers Act, Section 528 of the United States Bankruptcy Code prohibits fraudulent transfers. Transfers made by a debtor within 1 year before the date of filing a bankruptcy petition may be overturned if the transfers are made with actual intent to hinder, delay or defraud any creditor, or made for less than fair market value.

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Based on the above, you should let us advise you before you make transfers of your property.

PROTECTING YOUR RETIREMENT PLANS AND INSURANCE POLICIES

You should protect your retirement and insurance benefits. These two types of property are often the most valuable assets in your estate. Accordingly creditors have sought to obtain the cash value of those assets and courts have ruled on this matter as follows:

The court ruled In Re: Dyke, 943 F. 2d. 1435 (5th Cir. 1991) that the Employee Retirement Income Security Act (ERISA) does not pre-empt provisions of the Texas Property Code which exempt qualified retirement plans and IRA's from the claims of creditors.

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The Supreme Court in Patterson v. Shumate, 11 S. Ct. 2242, 1992, ruled that a debtor's interest in an ERISA qualified retirement plan is not property of a bankruptcy estate, and is therefore, exempt from claims of creditors.

The Texas legislature provides classes of property that are exempt from seizure by creditors and that may be considered exempt and kept by debtors when filing bankruptcy, if the debtor elects to choose the Texas exemptions.

Texas Property Code Section 42.0021 exempts qualified retirement plan benefits and insurance benefits from seizure by creditors.

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This includes but is not limited to, the cash value of the insurance policy, as well as the death benefit awards or proceeds from the insurance. Therefore, insurance enjoys the same protection that the homestead has enjoyed.

Accordingly, permanent life insurance cash values, death benefits and annuity values are protected and may be used as asset protection vehicles. Section 541 of the Bankruptcy Code defines property of the bankruptcy estate to include all legal and equitable interests of the debtor in property as of the date that the bankruptcy is filed.

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This is subject to the exemptions which may be claimed by the debtor. This is also subject to a restriction on the transfer of the interest that a debtor had in a trust.

Therefore, based on current law, under Section 541, a debtor's interest in a valid, spendthrift trust is not property of the bankruptcy estate, and creditors may not seize the debtor's interest in a trust with a valid spendthrift provision.

In Re: Goff, 706 F. 2d. 574, 1983, the Fifth Circuit ruled that ERISA pre-empted the Texas Property Code, which previously exempted qualified retirement plan benefits from creditor claims. In response to the Goff decision, the Texas legislature enacted Texas Property Code Section 42.0021, which generally exempted benefits of qualified retirement plans and IRA's from creditors.

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It was not until the In Re: Dyke decision and then the Patterson decision that this Property Code decision became stable and reliable. Creditors still may be able to attach pension or insurance proceeds if a debtor has violated the Texas Uniform Fraudulent Transfers Act.

The retirement plan at its creation must receive a determination letter from the Internal Revenue Service indicating that the plan is qualified. Unless the plan is audited by the IRS, it will continue to be a qualified plan even though it may have been used for activities that might result in disqualification.

WHAT TYPES OF INSURANCE SHOULD I HAVE IN ORDER TO PROTECT ME AGAINST LAWSUITS?

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You should consider four types of insurance:

1. Homeowners Insurance:

Your homeowner's policy is absolutely essential to protect the value of your home, and to provide liability coverage for contingencies that may happen at your homestead.

We recommend that you talk to your insurance broker and consider getting the largest liability protection amount that is available. Generally, the cost is quite reasonable.

2. Automobile Insurance :

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Although Texas law requires drivers to have auto insurance, many people do not have insurance or only have the lowest limits of liability.

You should consider discussing your coverage with your agent, and consider purchasing the maximum coverage that is allowed. You should obtain the highest limits that are available for the following types of coverage:

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1. personal injury protection,

2. uninsured coverage, and

PREVIEW

3. underinsured coverage.

The cost is quite reasonable in exchange for the protection that the above coverage offers.

3. Umbrella insurance:

This is an important insurance product that you should have since your homeowner's, automobile and boat or recreational vehicle policies have limits in the event that you are liable for a judgment that is larger than the policy limits, you would be liable to pay the difference.

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Umbrella insurance covers that liability. It expands the total amount of liability coverage and dollar amount for usually a relatively small premium. It may also increase liability coverage to other areas that are not covered by traditional home, auto or boat policies. For example, liable and slander may be covered.

4. Negligence/Malpractice/Errors and Omissions Insurance:

Most professional business people are aware of this type of insurance and have had the same for quite some time.

This type of insurance has become increasingly expensive in recent years, and due to the large amount of verdicts that have been assessed against professionals, one can not continue to rely on malpractice insurance to protect them from all of the contingencies that may arise in their business.

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One big mistake that people make is relying too heavily on insurance, not realizing that the company may not cover you in a given situation, or the company may go out of business.

TYPES OF PROPERTY THAT IS EXEMPT FROM SEIZURE BY GENERAL CREDITORS AND THE TEXAS HOMESTEAD EXEMPTION

Definitions of property categories. For the purpose of this discussion, property is categorized as follows:

1. Personal Property and Real Property.

THANK YOU

2. Exempt and Non-exempt Property.

3. Real property consists of land, buildings, real estate, oil & gas interests, easements and non personal property.

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4. Personal property consists of property that is not real property. Examples include: furniture, money, tools and various other property rights including, but not limited to, intellectual property rights, patents, copy rights and other rights.

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5. Exempt property is property that a general creditor cannot seize or take in order to satisfy a judgment (unless that property has a valid lien placed on it to secure a debt typically a purchase money debt).

6. Non-exempt property is property which a creditor may seize to satisfy a judgment or a debt.

EXEMPT REAL PROPERTY IN TEXAS:
THE TEXAS HOMESTEAD EXEMPTION

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The following types of property are included under the term "exempt property" in Texas:

1. A homestead:

a. An urban homestead consists of one or more lots that do not exceed more than 10 contiguous acres of land together with any improvements on the land regardless of whether it is a family homestead or a single adult.

b. A rural homestead consists of, for a family, not more than 200 acres which may be in one or more parcel with improvements thereon and 100 acres for a single adult.

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c. A homestead and one or more lots used for the place burial of the dead are exempt of seizure for the claims of creditors except for encumbrances or liens properly fixed on the homestead property.

EXEMPT PERSONAL PROPERTY IN TEXAS

Personal properties of various categories are considered exempt up to a total fair market value of $60,000 per family or $30,000 per single adult who is not part of a family. (See chapter 42 of the Texas Property Code).

The following personal property is exempt from garnishment, attachment, execution or other seizure as follows:

THANK YOU

1. $ 60,000 (or $ 30,000 for a single person) exclusive of the amount of any liens, security interests or other charges encumbering the property.

2. If the personal property exceeds the statutory exemption amount, the head of the family or the person entitled to the exemption may designate which property they desire to have the exempt status and which property should be non-exempt.

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The property that is exempt includes the following:

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1. Current wages for personal services & court ordered child support payments,

2. Professional prescribed health aids of a debtor or a dependent of a debtor,

This section does not prevent seizure by a secured creditor with a contractual landlord's lien for the security and the property to be seized,

3. Unpaid commissions for personal services, not exceed %25 of the aggregate limitations described above,

4. Home furnishings, family heirlooms, provisions for consumption,

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5. Farming or ranching vehicles and implements,

6. Tools & miscellaneous equipment,

7. Books,

8. Apparatus including boats and motor vehicles used in a trade or profession,

9. Wearing apparel & jewelry not to exceed 25% of the aggregate limitations (the $60,000, $30,000 amounts),

10. Two firearms,

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11. Athletic and sporting equipment including bicycles, a two wheeled, three wheeled or four wheeled motor vehicle for each member of a family or single adult who have a drivers license or does not hold a drivers license but relies on another person to operate the vehicle for the benefit of the non licensed person,

12. The following animals and foliage on hand for their consumption:

    a. two horses, mules, donkeys and a saddle, blanket and saddle for each,

    b. 12 head of cattle,

    c. 60 head of other types of livestock,

    d. 120 cows,

    e. household pets,

THANK YOU

13. The present value of any life insurance policy to the extent that a member of the family of the insured or dependent, a single insured adult claiming the exemption as a beneficiary of the policy.

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RETIREMENT PLANS:

In addition to the exemptions described above, a person's right to the assets held or to receive payment, whether vested or not, under any:

1. stock, bonus, pension, profit sharing or similar plan,

2. retirement plans for self employed individuals or any annuity or similar contract purchased with assets distributed from that type of plan and under any retirement annuity or account described by Section 403 (of the Internal Revenue Code 1986) and under any individual retirement account or any individual retirement annuity including a simplified employee pension plan is also exempt from attachment from any execution and seizure for the satisfaction of debts unless the plan, contract or account does not qualify under the applicable provisions of the Internal Revenue Code.

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LIENS ON THE HOMESTEAD

Encumbrances or liens may be attached on homestead property for the purchase of the property (purchase money), taxes on the property or work and material used in constructing improvements on the property (materialmen & mechanic's liens).

The following must occur before the materialmen & mechanic's lien can be effective:

1. The improvements or work must be contracted for in writing before the material is furnished to the property or the labor performed in constructing or improving the property.

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2. The paper work (the materialmen's & mechanics lien deed of trust, note etc.) must be prepared properly. Both spouses should sign the documents if the homestead claimant is married.

3. The sale of one's homestead (the money received from selling your homestead i.e. home) are not subject to seizure by creditors for 6 months after the date of sale.

IMPORTANT CONSIDERATIONS APPLICABLE TO YOUR HOMESTEAD

The temporary renting of a home does not change its homestead character if the homestead claimant has not acquired another homestead.

THANK YOU

If the homestead claimant is married the homestead cannot be abandoned without the consent of the spouse.

DESIGNATION OF YOUR HOMESTEAD

If a rural homestead is part of 4 or more parcels containing a total of more than 200 acres the head of the family, if married, may voluntarily designate not more than 200 acres of property as the homestead.

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For urban properties, the head of the household may likewise voluntarily designate not more than one acre of the property as the homestead.

To designate the property as a homestead the person must make the designation in an instrument that is signed and acknowledged or approved in a manner required for the recording instruments, i.e. notarized.

A person must file the designation with the county clerk of the county in which all or part of the property is located. The court shall record the designation in the county deed records. The designation must contain a description that identifies the designated property, a statement by the person who executed the instrument that the property is designated as a homestead, the name of the original grantee of the property and for a rural homestead the number of acres and if there is more than one survey, the number of acres in each survey.

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DESIGNATION OF A HOMESTEAD
AFTER A JUDGMENT HAS BEEN OBTAINED

If a judgment has been obtained against you, the creditor may take steps to collect or enforce the judgment. Once a judgment has been obtained, the creditor can file notice of the judgment 30 days after the judgment becomes final. This filing is called an " Abstract of Judgment".

If the creditor has requested an execution of judgment to be issued against you (if you are a judgment debtor) and if you own a homestead you must protect your homestead by filing a Voluntary Designation of your homestead under Section 41.005 of the Texas Property Code.

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If you have not designated your homestead, the judgment creditor may give you, the judgment debtor, notice to vacate your homestead as defined in Section 41.002 of the Texas Property Code.

The notice shall state that if the judgment debtor fails to designate the homestead within the time allowed by Section 41.002 of the Texas Property Code, the court will appoint a commissioner to make the designation at the expense of the judgment debtor.

At any time before 10:00 am on the Monday next after the expiration of 20 days after the date of the service of the notice to designate (the general time period allowed for answering lawsuits), the judgment debtor must designate the homestead as defined in Section 21.002 Texas Property Code by filing a written designation, signed by the debtor in front of the justice or the clerk of the court from which the writ of execution is issued, together with the legal description or area designated as your homestead.

THANK YOU

SALE OF THE EXCESS OF THE HOMESTEAD

A constable or officer may sell the part of your property that exceeds the homestead exemption, (if your property exceeds the statutory allowance). The sale can be conducted pursuant to the holding an execution (sale of your property).

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LIABILITY FOR COMMUNITY DEBTS

Debts, which are incurred during a marriage, are presumed to be on community credit and are presumed to be community obligations unless it is shown that the creditor agreed to look solely to the separate estate of the person who took out the loan. Therefore, the community interest may be subject to satisfaction of the debt.

GARNISHMENT OF BANK ACCOUNT PROCEEDS TO SATISFY A JUDGMENT

Garnishment involves a legal procedure whereby a person who is owed money, typically in the form of a judgment, is entitled to seize and collect assets that are owed to the judgment debtor.

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Garnishment can occur on property owned directly by the debtor or property held by a third person that is owned by the judgment debtor. For instance, if a person, as a defendant in a lawsuit, incurs a judgment for $100,000 and if that judgment debtor has $50,000 in a bank account, a creditor may be able to garnish the $50,000 in the bank account to partially satisfy the judgment debt.

Bank deposits are the most commonly garnished debt. Bank deposits can be reached regardless of the account name if the funds are owed to the judgment debtor. Of coarse, community funds likewise can be garnished.

Contents of a safety deposit box can also be garnished. The bank can be sued in a garnishment action to obtain the contents of the safety deposit box.

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GARNISHMENT OF STOCK CERTIFICATES TO SATISFY A JUDGMENT

Judgment creditors can obtain your stock through the garnishment process. Creditors can seize certificates held by your or held for you by a third party, i. e. a mutual fund, stock broker, etc.

GARNISHMENT of PROMISSORY NOTES TO SATISFY A JUDGMENT

Monies that are owed to a judgment debtor in the form of a promissory note can be garnished.

TRUST FUNDS IN WHICH THE DEBTOR IS THE BENEFICIARY

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Monies from a trust fund can be subject to payment of the beneficiary's debts if the trust fund fails to contain what is known as a `` spend thrift clause''.

A spend thrift clause prohibits the beneficiary's creditor from attaching the trust and taking the moneys earmarked for the beneficiary out of the trust and then payment of the same to the creditor.

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Even if a spend thrift clause is included in a trust, once from the trust are paid to the debtor, the can then be garnished.

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WELFARE AND SOCIAL SECURITY BENEFITS

Welfare and social security benefits are generally exempt from garnishment.

There are other methods of collecting a judgment. One is a turnover order. A court can order you to turn over all of your non-exempt property to a court-appointed trustee. The trustee can then take the property and distribute it to creditors.

BANKRUPTCY CONCERNS

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WHAT IS BANKRUPTCY?

Bankruptcy is a legal method whereby an individual or company may be relieved of its debts pursuant to the United States Bankruptcy Statutes/code. You may have to file bankruptcy in the event one or more of the financial disasters occur.

WHAT TYPES OF BANKRUPTCY APPLY TO ME?

There are several Chapters under which most consumers or business may obtain bankruptcy relief. The typical Chapters are as follows: Chapter 7, 11 and 13.

CHAPTER SEVEN BANKRUPTCIES

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A Chapter 7 bankruptcy liquidates your non-exempt assets to pay your debts. Chapter 7 is the most frequently filed bankruptcy and is the one most commonly used by individual debtors.

A Chapter 7 bankruptcy allows the debtor to list his or her assets and debts; and then depending on the exemptions allowed, emerge from the bankruptcy debt free while retaining his or her property which falls into the category of exempt property.

CHAPTER ELEVEN BANKRUPTCIES

A Chapter 11 bankruptcy is used in situations where an on-going enterprise believes that it can propose a plan that will be accepted by its creditors which will allow the enterprise to reorganize by reducing its debt so that it can continue to stay in business pursuant to the terms of a chapter 11 plan.

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The enterprise attempts to emerge as a reorganized entity that will be successful and profitable pursuant to the terms of the chapter 11 plan. The key to a successful Chapter 11 bankruptcy is the ability to generate income in excess of expenses and provide more payment of debt to creditors than would otherwise be realized if the enterprise was liquidated under a Chapter 7 proceeding.

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In order for the plan to be approved, certain legal requirements must be met. The plan must either be approved by the requisite number and type of creditors or approved by the court under certain strict guidelines. For the sake of this letter, you should assume that you will be required to obtain your creditor's approval of your chapter 11 plan if you want to have a successful chapter 11 bankruptcy. Chapter 11 bankruptcies are time consuming and expensive. It is not always easy to have the plan confirmed by the court or approved by the creditors.

PREVIEW

CHAPTER THIRTEEN BANKRUPTCIES

Chapter 13, the Wage Earner Plan, allows an individual to reorganize pursuant to the terms of a chapter 13 plan. If the plan is approved or confirmed by the court the debtor may retain many of his or her assets. The debtor must then pay his or her debts pursuant to the terms of the chapter 13 plan.

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It is important for you to realize that if you cannot obtain confirmation of your chapter 11 or 13 plan, the bankruptcy may be dismissed or converted to a chapter 7. If the case is converted to a chapter 7, you may not be able to keep some non-exempt property that you may have retained under a successful chapter 11 or 13 plan.

LOSS OF CONTROL OF YOUR PROPERTY IN A BANKRUPTCY

Some debtors have filed bankruptcy, only to realize that they no longer control their assets or company, rather the court, trustee and creditors control the same.

You must realize that when you file a bankruptcy, your property -which is called the bankruptcy estate- is completely subject to the court's control. You are only allowed to control or retain your exempt property, if the same is allowed, unless you can navigate through the bankruptcy maze successfully.

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There are many traps and obstacles to pass through. We cannot enumerate the complexity of bankruptcy practice in this letter, We can only inform you to consider the risks that are inherent when you file bankruptcy.

CATEGORIES OF PROPERTY IN A BANKRUPTCY

There are two types of property in bankruptcy law, exempt and non-exempt property.

1. Exempt property is the property which the debtor may keep after he or she has filed the bankruptcy if the exemptions are allowed by the trustee or court.

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2. Nonexempt property is property that is not subject to a federal or state exemption. This property may be taken by the Trustee or court and sold to pay for the debtor's debts. This is property, or its value, which creditors may eventually be able to obtain.

One of the first considerations in determining whether to file bankruptcy or not is to analyze your property to ascertain whether or not it is exempt or non-exempt property.

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If most of your property is non-exempt property and you, the debtor, desire to keep the property, generally a Chapter 7 bankruptcy would not be advised. You should consider filing a chapter 11 or 13 plan. Under the chapter 11 or 13 filing, it would then be up to your successful management and business skills to propose and fund a successful plan.

PREVIEW

CATEGORIES OF DEBT IN A BANKRUPTCY

There are two types of debt in bankruptcy, secured and unsecured.

1. A secured debt is the type of bill, loan or expense whereby the creditor retains a security interest in the property or goods sold to the debtor.

2. Unsecured debt does not have a security interest attached to it, consequently the creditor has not contractual and independent right to repossess the specific property that gave rise to the debt.

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In the event the debtor does not pay for the goods, the creditor may repossess the same pursuant to a contractual agreement which is commonly referred to as a security interest. Many Trustees require the security agreement to be "perfected" prior to recognizing the security agreement.

A common example of a secured debt is when a person buys a car and has the same financed at a local bank. The car dealer sells the car to the consumer. In order to pay for the car, the consumer obtains a loan at a bank. The bank advances the money to the car dealer and retains a security interest in the title to the vehicle to assure the bank that in the event the buyer does not pay for the vehicle, the bank can recoup its losses by selling the vehicle after it is repossessed pursuant to the terms of the security agreement and lien which is placed on the vehicle's title.

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You should understand that filing bankruptcy generally does not discharge or remove the security interest that a creditor has in a secured debt. Consequently, if most of your debt is secured, then even though the property may be considered exempt property, you will generally have to pay the debt in order to retain the property. If you cannot pay the debt, the secured creditor may repossess the property by foreclosing on its secured interest at the appropriate time after the creditor has obtained the court's approval.

If on the other hand, most of your debt is considered unsecured and the majority your assets are in the exempt property category, then your may emerge from the bankruptcy being debt free while retaining the exempt property which was not bound by a security interest.

THANK YOU

DISCLOSURE OF ALL ASSETS AND DEBTS IN A BANKRUPTCY

You must disclose all of your assets and make absolutely certain that the bankruptcy filing: the petition, schedules, statement of affairs, affidavits, etc. are totally true and correct.

DISCHARGEABILITY

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Although as a general rule you will be relieved from obligations for any and all debt that is listed in your bankruptcy petition, there are some types of debt that bankruptcy will not discharge.

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Discharge means that your bankruptcy frees you from having to pay that debt. Accordingly there are two types of debts from a discharge perspective: dischargeable & non-dischargeable.

Non dischargeable debts are those that you will still owe even if you file bankruptcy. An example of a non-dischargeable debt is money owed to the Internal Revenue Service for current tax years and within the statute of limitation time frame for owed income tax liability. Another example would be student and some government loans. Child support is also non-dischargeable. Furthermore, any debt or obligation that is owed as a result of fraud or intentional wrongful conduct is likewise non-dischargeable.

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Another example assume that you were involved in a civil conspiracy to defraud someone and a court awarded damages against you for that intentional conduct. Depending upon how the judgment is written, the holder of the Judgment may be able to obtain an objection to your discharge regarding that particular debt. Consequently you would still owe the debt after your bankruptcy was completed.

THE BANKRUPTCY PROCESS

The bankruptcy process begins by meeting with the attorney and ascertaining if you can work out an arrangement with your existing creditors that does not involve the bankruptcy court.

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It is sometimes possible to work out a composition with your creditors whereby your creditors will take lower monthly payments or reduce the debt in order for them to be paid so that you will not have to file a bankruptcy.

In the event you cannot work out a satisfactory arrangement with your creditors, and you need court protection, the next step in the process is to meet with the attorney and have the attorney review your assets and liabilities.

Generally, the attorney will require you to fill out a bankruptcy questionnaire or information sheet that requires you to list a large amount of information about you and your property.

After the attorney has had a chance to review the questionnaire, he or she can then recommend the most appropriate chapter for your individual situation.

THANK YOU

The bankruptcy petition is a very large, lengthy legal document. You must read it very carefully to ascertain that all the questions are answered correctly. You will be asked many important questions regarding your finances, taxes, property, obligations owed to other people, whether or not you have transferred property to others and many other rather detailed areas of questioning.

You must review the information contained in the bankruptcy petition with a fine tooth comb and advise your attorney if there are any errors or omissions. If you fail to list some of your

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assets, you may inadvertently be in the position of having a creditor assert that you have attempted to defraud the Bankruptcy Court.

PREVIEW

Once the bankruptcy petition is filed, you will be given a bankruptcy case number. It is at that point that you have now filed the bankruptcy.

RETAINING VS. ABANDONING SECURED PROPERTY

It is important to determine which secured property you want keep and which property you can no longer afford to pay for. You should decide which property to abandon and return to secured creditors and which secured property you desire to retain or keep.

In order to keep or retain property that is subject to a security interest, you must work out an amicable arrangement with the secured creditor. That generally means you must either become current on the payments that are owed and then continue to maintain the payments or agree with the creditor to a new payment schedule.

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If a secured creditor believes that you will not be able to pay the debt, he or she may file a Motion to Lift the Automatic Stay, and if successful, will then be entitled to repossess his or her property. (The automatic stay is discussed in more detail in the next section).

THE AUTOMATIC STAY

As soon as the bankruptcy petition is filed, you receive protection of the bankruptcy statute, under a provision which is termed the "Automatic Stay". Under the Automatic Stay, creditors are required to cease and desist collection activities and lawsuits against you and your property until they have obtained approval from the bankruptcy court to continue their collection efforts.

THIS DOCUMENT

Many unsecured creditors will be effectively barred from their collection efforts as a result of the Automatic Stay. Certain criminal and other activities are not barred by the Automatic Stay provision including but not limited to the following example: if you have written checks with "insufficient funds", the criminal actions that may be taken against you are not stopped by the bankruptcy automatic stay.

Generally secured creditors may not repossess your property once you have filed your bankruptcy until they have obtained a court order which allows them to repossess your property. This is accomplished by filing a Motion to Lift the Automatic Stay. The creditor obtains the court approval after the motion is ruled upon by either a default on your part, by your agreement or through a Court Order after the motion has been argued and ruled upon.

THANK YOU

THE CREDITOR'S MEETING

The Creditor's Meeting is a time when creditors have a right to review your bankruptcy in the presence of a Trustee.

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Creditors are entitled to ask you questions about the reasons for your bankruptcy filing, questions concerning your assets and liabilities and ascertain your intentions regarding the debts owed to the creditors.

PREVIEW

BOTH you and your spouse, if you are filing jointly, will be required to attend the Creditors Meeting. This means that you and your spouse will have to take off work and budget a morning or an afternoon to be available for questions at the creditors meeting.

At the Creditor's Meeting the Trustee will ask you questions, review the bankruptcy schedules and then make a determination as to whether or not he or she will allow the exemptions which you requested in your bankruptcy filing. The Trustee will also decide what to do with your nonexempt property. The Trustee may keep or abandon the property so that it may be used to pay your debts.

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The trustee can abandon his or her interest in nonexempt property. For example, a Trustee may abandon nonexempt property if you own a piece of property, other than your homestead and the same is encumbered by a debt or lien that exceeds its value. A Trustee may decide to abandon any interest in that property since it will not be economical for the Trustee to take the property, pay the debt off and then sell the property since its value is less than the secured debt against the property.

POST PETITION CHANGES AND REQUESTS FOR INFORMATION OR DEPOSITIONS

After the Creditor's Meeting, you may be requested by the Trustee to provide additional information regarding your bankruptcy schedules, debts or assets. The Trustee is entitled to request reasonable information and it is in your best interest to provide said information.

THIS DOCUMENT

In the event a creditor desires more specific information about your bankruptcy, your debts or assets, the creditor can use a procedure in bankruptcy which allows the creditor to take your deposition and explore whether or not there are grounds to contest your bankruptcy.

BANKRUPTCY DISCHARGE

After the Creditor's Meeting is completed, in the event there are no objections or contested matters, the Court will set a time where you will receive your discharge. This is the time when your bankruptcy case is closed and you receive a release from your dischargeable debts. Generally you will not be required to attend the discharge hearing unless there is a contest or objection, etc.

THANK YOU

REAFFIRMATION OF PRE-PETITION DEBTS

In the event you desire to retain either credit with a merchant or property subject to a security agreement, a creditor may insist that you sign a reaffirmation agreement.

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A reaffirmation agreement is a contract which states that you agree to pay pre-petition bankruptcy debt and become obligated to pay that debt notwithstanding the bankruptcy filing even though the debt could have been discharged in the bankruptcy proceeding.

PREVIEW

This means that you will owe the creditor the money that you owed before you filed your bankruptcy. By signing a reaffirmation agreement you continue to owe that creditor the debt even though the bankruptcy discharge could have wiped out the debt.

RE-FILING FOR BANKRUPTCY

Once you file a bankruptcy, you must wait a certain length of time before you can for bankruptcy protection. Depending upon the type of bankruptcy filed in the past and the type of bankruptcy you desire to file in the future, there are certain time limitations and we will be happy to discuss this with you when the need arises.

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For the sake of simplicity, you should be aware that you should not plan to file bankruptcy shortly after being discharged from a prior proceeding.

OTHER CONSIDERATIONS & SPECIAL TYPES OF PROPERTY

In the event that you inherit property or that you may receive or become entitled to you must disclose this to the trustee if this occurs shortly after you file your bankruptcy or after the creditor's meeting. Many trustees will give you a letter at the Creditor's Meeting informing you that you must notify the Trustee if you receive an inheritance within six months after you filed bankruptcy.

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You must also provide written notice to the Trustee of or property that you may receive as a result of a Final Divorce Decree, with the exception of child support which occurred either before you filed bankruptcy or within six months after you filed bankruptcy. Likewise you are required to notify the Trustee of any that you may receive as a beneficiary of a life insurance policy or as the result of a death benefit that you acquire or become entitled to receive if received prior to the filing of a bankruptcy or within six months after the date you filed your bankruptcy petition.

You must also advise the Trustee of any transfers, conveyances, and gifts, of the property which have not been scheduled and which have been made within one year prior to the date of the bankruptcy.

THANK YOU

INCOME TAXES

You are still responsible for filing income tax returns and reporting income for items not transferred to the bankruptcy estate. The trustee will generally maintain that he or she is entitled to your income tax refund if one is due after the filing of your bankruptcy. The Internal Revenue Service is a priority creditor in a bankruptcy case.

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ABSTRACT OF JUDGMENT LIENS

PREVIEW

The Texas Property Code sets forth a procedure to remove abstract of judgment liens. This procedure must be used to remove an abstract of judgment that has been filed against you.

Contrary to popular belief, the filing of a bankruptcy and obtaining a discharge does not remove abstract of judgments filed of record.

Title companies require the liens to be removed before they will issue ``good or clear title" to a person who has abstracts filed against him or her. The filing of an abstract of judgment creates a lien on your property. The above procedure must be used to remove the lien.

You should understand that the discharge that you receive in bankruptcy court will not remove abstract of judgments, consequently you will have to have them removed after the bankruptcy filing. This is a separate procedure and a separate expense. We can discuss this with you in more detail if you have any questions.

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FEDERAL EXEMPTIONS

When a person files bankruptcy, they are given an option to claim their exempt property under their state law (which defines exempt vs. non exempt property) or choose the exemptions allowed under the United States Bankruptcy Code, Chapter 11 USC, Section 522 (d). The code refers to the person claiming the exemption as the "debtor". The exemption may be claimed by property owned by the debtor or a dependent of the debtor.

WHAT ARE SOME OF THE CONSEQUENCES OF DYING WITHOUT A WILL IN TEXAS?

THIS DOCUMENT

The State Bar of Texas and the American Bar Association, as well as most state bars, recommend that every adult person have a will.

DEFINITION OF INTESTACY

If you die without a will, you are considered to have died intestate. Consequently, your property will be distributed pursuant to the state's probates code provisions relating to intestacy.

HARDSHIPS IMPOSED BY DYING INTESTATE (WITHOUT A WILL)

Perhaps one of the most important reasons for having a will is to streamline and reduce the probate process and to simplify the winding up one's financial affairs.

THANK YOU

Intestacy can create hardships for your family and can significantly increase the cost of closing out your financial affairs. It may cost your heirs significantly more money to have your estate administered if you have not executed a valid will which appoints an Independent Executor to serve without the requirement of posting a bond.

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If you had a will and the will provided for the appointment of an independent executor to serve without bond, the cost of probating your will and winding up and administering you estate would have been relatively inexpensive compared to what it can cost if the court must appoint an executor to administer the estate.

PREVIEW

The court appointed administrator may have to post a bond and have his or her actions approved by the probate court prior to winding the affairs of your estate.

The Texas Probate Code allows a person to name an independent executor in his or her will.

The independent executor can very quickly and inexpensively wind up your affairs, pay your bills, sell unneeded assets, and distribute your property according to the terms of your will.

One aspect of this procedure that makes it so quick and cheap, is that the executor does not have to obtain court approval for the above actions.

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The executor is only required to file the will for probate, attend the probate hearing, take the oath to serve as the executor, obtain letters of testamentary (to act for the estate) and then file an inventory and an appraisement that lists the property owned by the deceased.

The executor is entitled to pay the debts and distribute the assets of the estate without court supervision. This saves a lot of time and a lot of attorney's fees!

This is a very cost efficient way of handling probate since your estate only pays for the attorney's time in getting the will approved by the probate court. Thereafter your estate does not have to pay the attorney to obtain court approval every time the executor wants to pay bills, sell property or distribute the assets to the beneficiaries.

THIS DOCUMENT

You may lose that right if you die without a will because the probate court may supervise the entire distribution of the estate.

The estate can then be eaten up by attorney’s fees from court appointed attorneys and receivers as opposed to being paid directly to your heirs and beneficiaries.

The problem in Texas without a will is that you lose your free agency to decide how you want your property and assets distributed and plan for your family. You now defer to the state's intestacy laws, which may or may not be acceptable to you. You also increase the probate process and cost. The moral of the story is that every adult should have a will

THANK YOU

LIVING TRUSTS AVOIDING PROBATE AND PROTECTING ASSETS

WHAT IS A TRUST?

A trust is a legal arrangement whereby property may be given by a donor or trustor to a trust for the use and benefit of another person known as the beneficiary.

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PREVIEW

Trusts are useful for protecting and preserving property and in some instances in reducing tax liability. Trusts may be created and effective while the donor is alive or may take effect at the donor's death. The person who controls the trust property is known as the trustee. The trustee acts for in behalf of the beneficiary named in the trust document.

A common trust, known as the revocable living trust, is used frequently by estate planners. It has some advantages and some disadvantages. A living trust is created while the donor is alive. A trust typically created in a donor's will becomes effective upon the donor's death is known as a testamentary trust.

The donor can also be both a beneficiary and the trustee. This means that a donor can have full control over all of the assets placed into the trust. Note there may be some tax considerations which would suggest some third person be named as the trustee, however you should discuss tax consequences of trust and estate planning with a qualified tax advisor such as a CPA (Certified Public Accountant) or tax / estate planning attorney.

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LIVING TRUSTS

A living trust is therefore a trust that is created during the donor's lifetime whereby property is placed into the trust for the use and benefit of the parties named in the trust agreement. The donor can be one of the beneficiaries named in the trust.

In order to create a trust the donor transfers ownership of the assets that he or she would like to place in the trust from himself as an individual to a trustee, who will serve as trustee of the trust.

THIS DOCUMENT

Trusts should always be memorialized with a written document. Once the donor transfers money from himself to the trust, the assets are no longer in his or her personal name, this gives rise to the ability of a trust to reduce or avoid probate when a person dies. If all of a person's assets are in the name of a trust when a donor dies then obviously there is nothing to probate.

In a living will the donor transfers his or her property to the trust, then the donor names a trustee. If the donor remains as trustee, then he or she maintains full control over all his or her assets contained in the trust. The donor can manage and use the property, including buying , selling, leasing, giving or spending as he or she sees fit.

WHAT ARE SOME ADVANTAGES OF HAVING A LIVING TRUST?

THANK YOU

The property placed in the living trust does not have to be probated. Those assets would be given directly to the beneficiaries pursuant to the terms of the trust agreement thus avoiding the expense and delay of probating a will.

One advantage of a living trust is therefore to avoid probate. In some states, the probate process is an extremely complicated, expensive and lengthy ordeal.

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Texas, as well as some other states, have a simplified and an inexpensive probate system, therefore a living trust may not be as desirable in Texas as compared to some other states. Since

Texas has an efficient probate system, many Texas attorneys still prefer the use of a conventional will and having the will probated instead of setting up a living trust.

PREVIEW

One reason for this is that in Texas a person is allowed to name an independent executor who can probate the will and act without posting a bond and act without direct court supervision concerning the administration of the estate. The independent administration–without bond therefore reduces the cost of probate and simplifies the process.

Once a will has been probated, the court issues Letters of Testamentary to the independent executor. That person may then administer the will pay the expenses and bills and then distribute the property without court approval or supervision. The executor is only required to file an inventory and an appraisement for the court listing the assets in the estate as of the date of the person's death.

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Avoiding probate costs and expense can become a significant expense if the donor owns real property in more than one state. The use of a living trust can circumvent the need for probate proceedings in other states where property is owned. A probate in Texas generally will not transfer title to real estate in other states to the heirs in a state other than Texas, therefore an ancillary or another probate is generally required to transfer property to the named beneficiaries when the property is owned in more than one state.

Ancillary probates are supposed to be simpler and less complicated than a main probate, the difficulty and expense is that attorneys must be consulted in each state where property is owned and the ancillary probate procedures must be complied with; this generally requires paying a filing fee and obtaining an attorney to handle the ancillary probate. Consequently, in this situation, a living trust could avoid some probate expense.

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MORE FLEXIBILITY WITH A LIVING TRUST

Another benefit of a living trust is its flexibility. The donor can select himself or any other person to be the trustee. The trustee then has full control over the assets in the trust as dictated by the terms of the trust. If the donor is the trustee he or she can change or alter the terms of the trust at anytime.

The donor can revoke or cancel the trust at anytime if he or she is the trustee. When the donor dies, the living trust, which actually is a revocable living trust, states how and when the donor's property shall be distributed. Assets can be distributed to the beneficiaries in the time periods, amounts, and manner as stated in the trust document.

THANK YOU

For instance, the donor can specify that a certain amount of money should be used to finance the education of a child or grandchild. Likewise the donor could reserve or specify that from proceeds from the estate could be used for payment of medical expenses or special needs of the beneficiaries such as a disabled or handicapped child.

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PRIVACY

The living trust document is generally not filed with the probate court; therefore its terms are not open for inspection by the public. On the other hand a will must be filed with the probate court in order to be admitted to probate. It then becomes a public document. The will may then be inspected and reviewed as any other public document. Therefore, if you are interested in complete privacy, a trust may be preferable to a will.

PREVIEW

LITIGATION AND CONTEST

Law books are full of suits where unhappy heirs have sought to contest a deceased person's will. A will can be contested if it can be proved that the person writing the will, the testator, was unduly influenced to make gifts to one person or another or that some one in a position of trust benefited in the will by unduly influencing the testator. The unhappy relatives can argue that some other party inserted their desires in the testator's will due to their position of trust.

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Many of the disadvantages of trusts, probate and wills can be avoided by the use of a family limited partnership!

HOW TO OWN PROPERTY

Property should be owned so that the most protection allowed by law is afforded- that is why you should consider a family limited partnership. What we mean by this is that you should analyze the source of income and the possible consequences or contingencies that may be tied to the receipt and production of said income. The following types of ownership are listed below--most of them offer little or no asset protection. A family limited partnership avoids most of the problems discussed below:

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JOINT TENANCY

Property held jointly with rights of survivorship may provide some asset protection, but at the same time, creates liabilities. If two parties have equal right to control or own property, in the event one party suffers a liability, all of that property may be taken by that party's creditors, and thereby deprive the other owner from his or her ownership in that property.

FAMILY LIMITED PARTNERSHIP

Limited Partnerships provide a method to own property and control the management, supervision and transferability of the ownership of the property interests.

THANK YOU

The advantage of a limited partnership as an asset protection tool is found pursuant to the Texas Revised Limited Partnership Act Section 7.03. This section appears to limit the rights of a judgment creditor to a charging order against only the income produced from that partner's interest in the partnership. The creditor may seek the appointment of a receiver to take the debtor's share of the partnership's profits.

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To the extent that a partnership interest is charged in this matter the judgment creditor only has the rights of an assignee of the partnership interest. Therefore, if the general partner has the right

to hold a distribution of income pursuant to the Limited Partnership Agreement, the judgment creditor may receive nothing for his or her interest in the limited partnership that the creditor has obtained.

PREVIEW

An example of how limited partnership can be used to shelter assets is as follows:

Assume a husband and wife have declared their home, which is paid for and debt-free, as their homestead. Yet, they own substantial real estate that can not be used as their homestead.

Pursuant to a statutory marital partition agreement, the husband and wife divide the property into equal shares. Then, the husband and wife contribute their undivided interest in the land into a family limited partnership.

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They donate the land in exchange for a limited partnership interest of 50% each. One party is designated as the general partner. Thereafter, the husband and wife create two spendthrift trusts, each one for their children.

The trustee of each of the trusts may be a partner, such as a financial planner, CPA or attorney. The husband and wife then make a formal gift to each of the two trusts out of the separate property limited partnership interests.

Since the husband and wife are separate donors, by taking advantage of the $11,000.00 gift exclusion each year, they can give away $22,000.00 to each trust per year. This is pursuant to Internal Revenue Code Section 2503(b).

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At the conclusion of the limited partnership creation and transfer, the husband and wife no longer own a real estate community asset which is 100% subject to the claims of the husband and wife's creditors. Instead, the limited partners own an interest in a limited partnership which owns the land.

The limited partnership interests are owned by a husband and a wife. In this situation, the limited partnership provides that 85% in interests of the limited partners must consent to an amendment, change or dissolution of the limited partnership. Therefore, a creditor cannot force a dissolution of a partnership and a sale of the property.

THANK YOU

The creditor, therefore, may own an interest in the limited partnership, but effectively, cannot do anything with the land. The limited partnership must be designed for strict ownership in order to preclude assets from being transferred to third parties. Rights of first refusal and buy-sell provisions are required. The above is also appropriate in order to continue the management and control of the family assets in the limited partnership.

Generally, the person with the most liabilities should own the least amount of property. Therefore, consider this example:

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A business that has the ability to produce a large amount of income but at the same time may have substantial risks, can be set up as a limited liability company. This could be the initial

shock-absorber from a lawsuit. That company should own the minimal equipment necessary to do some of its business functions, as long as that equipment does not have large values.

PREVIEW

If the equipment is readily expendable and has a short useful life, then it would be appropriate to keep that equipment in the company. Certainly, office supplies and miscellaneous day-to-day items should be owned by the company. Large-ticket items, such as buildings, heavy machinery, or expensive pieces of personal property or equipment that have long useful life can be owned by another entity and leased to limited liability company. This way, those assets may be protected and may be used by the business to generate money. Yet, the ownership of said equipment, if the equipment can be protected from liabilities incurred with the business.

A children's trust may own the equipment and then lease the equipment to the limited liability company. The assets of the children's trust are generally protected from lawsuits against the business.

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An irrevocable trust may also be set up to hold life insurance on the business owners so that the death of the surviving spouse, the insurance will not be subject to federal or state taxes.

Since the trust is irrevocable, a tremendous asset protection is available for the assets and the irrevocable trust. The trust can own more than one life insurance policy. It can own more than just life insurance.

For assets over and above the business corporation, you should consider family limited partnerships for these other assets that are not involved or related to the production of your primary income or any potentials, such as your medical practice, dental practice, or corporation that you work for.

THIS DOCUMENT

Since a judgment creditor only gets a charging order against the limited partnership interest, investment properties and assets can be owned and maintained in a limited partnership. The creditors may not be able to remove the general partner of the limited partnership. Therefore, the creditor has no say-so in how the property is managed or income distributed therefrom.

CORPORATIONS

Subchapter "S" Corporation

A corporation may be considered to be an "S" or a "C" corporation for purposes of Internal Revenue taxation purposes.

THANK YOU

When a corporation is formed, the taxpayer has a right to have the corporation taxed as a Subchapter "S" corporation by filing an election with the Internal Revenue Service.

An "S" corporation, although a corporation for all intensive purposes, is taxed as though it was a partnership rather than a corporation. Accordingly, all incomes, deductions and credits flow directly to the individual shareholders rather than to the corporation.

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Significant changes were made under the Internal Revenue Code pursuant to the Tax Reform Act of 1986.

"S" corporations had a unique status prior to 1986 concerning liquidation of the corporation and the taxation of the receipts to its shareholders. Under current tax law, liquidation of corporations and its taxation issues is complex and requires the assistance of tax and legal professionals. You should not attempt to do this on your own.

You should contact your tax attorney and/or Certified Public Accountant. The scope of this paper is not to discuss the complicated tax aspects, but practical business applications that most individuals should consider when deciding whether to have their corporation taxed as a "C" or an "S" corporation.

Due the passive loss limitation rules of the Internal Revenue Code, an attorney and an accountant should be consulted prior to choosing an "S" or a "C" corporation.

SOME ADVANTAGES OF AN "S" CORPORATION

Income losses/credits flow directly to the shareholders in the percentages of their stock ownership of the corporation.

This "pass-through" of income/losses eliminates the double-taxation feature applicable to corporate profits. If a "C" corporation has $100,000.00 income and pays $60,000.00 of that income to a shareholder as an employee, the shareholder pays personal income tax on the $60,000.00 that he or she received. The remaining $40,000.00 would be taxed to the corporation, so that the corporation would pay income tax on the $40,000.00 that it received.

In the next tax year, if the corporation paid that $40,000.00 to the shareholder who previously received the $60,000.00, that individual shareholder would now have to pay income tax as a dividend on the $40,000.00 he or she received in the new year. Therefore, the shareholder has had to pay two income taxes on the $100,000.00, and the corporation also had to pay tax on the $40,000.00;

Income that is distributed to the corporate shareholders retains the character that the income had at the corporation's level; and,

SOME DISADVANTAGES OF "S" CORPORATIONS:

The corporation may have no more than 70 shareholders in order to elect Subchapter "S" status;

The shareholders are taxed on the earnings of the "S" corporation, even if those earnings are not yet distributed to the shareholder and are retained by the corporation;

The corporation can not issue a second class of stock unless the only distinction between the classes relates to voting rights. "C" corporations, on the other hand, can have various classes of stock. This may be important for voting or for control purposes;

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PREVIEW

Shareholders are limited to individuals or certain trusts. Therefore, non-residents/ aliens of corporations are not allowed to be shareholders in a Subchapter "S" corporation;

Corporations must also meet some specific eligibility requirements which should be discussed with your tax advisor or attorney;

In most situations, corporations are required to have calendar years, rather than fiscal years; and,

Shareholders-employees may not receive certain fringe benefits that may be available to employees in "C" corporations when the employee owns less than 2% of the corporation's stock.

LOSS OF CORPORATE PROTECTION

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In recent years, the trend has been to continue to pierce the corporate veil, and render the owners of the business liable, notwithstanding the corporation. A simple test has been devised that must be followed at a minimum to insure corporate protection.

Failure to observe corporate formalities, such as:

1. failure to hold meetings;

2. failure to keep the property in the name of the corporation;

3. failure to sign as the correct officer of the corporation;

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4. failure to have corporate authorizations, ratifications, and

5. resolutions for transactions;

6. failure to have regular Board of Directors meetings;

7. failure to have regular shareholders meetings;

8. failure to have annual shareholders meetings;

9. failure to issue the corporate stock, or maintain the stockholder’s ledger;

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10. failure to maintain up-to-date corporate records, resolutions and ratifications;

11. failure to have the required initial organizational meeting;

12. failure to adopt corporate by-laws;

13. failure to maintain a proper accounting records;

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14. failure to advertise and serve notice that the business is operating as a corporation and is no longer a sole proprietorship, partnership or other entity;

PREVIEW

15. failure to transfer assets into the corporation and capitalize it properly;

16. failure to get proper state and local business licenses in the name of the corporation;

17. failure to transfer assets, property, records, etc. into the name of the corporation; and/or

18. failure to file state and federal report forms;

19. Non-payment of dividends;

20 Insolvency of a debtor corporation at the time of transfer

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21. Siphoning corporate funds by a dominant stockholder;

22. Non-functioning of the other officers or directors;

23. Absence of corporate records;

24. The use of the same business or office location by the corporation and its individual stockholders;

25. The fact that the corporate is merely a facade for the operations of the dominant stockholder;

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26. Giving improper guarantees for, or on behalf of, the corporation;

27. Sale of a controlling interest for less than fair market value;

28. Profiting from inside the corporation;

29. Short swing profits;

30. Failure to disclose material facts, transactions for the companies in which the officers or directors have conflicts of interest and benefit from;

THANK YOU

31. Violating the articles or by-laws of the corporation;

32. Failure to file or report corporate taxes;

33. Failure to register the corporation in other states;

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34. Loans to officers or directors or stockholders that benefit the individual to the detriment of the corporation, causing the corporation to incur unnecessary expenses, liabilities, or tax liabilities; and

35. Excessive compensation or dividend payments.

When one or more of these elements is present, the theory of piercing the corporate veils for purposes of establishing personal liability exists.

Although some practitioners may automatically recommend a Subchapter "S" status for persons desiring to form a corporation, it is best to have a tax attorney and tax advisor to review your individual needs and circumstances to determine whether or not a "C" or "S" status best benefits your corporation.

CONCLUSION

Asset protection is available, however you must carefully analyze your income and assets. Then you may determine the best entity to hold the assets while still deriving the income.

Thereafter you must follow all corporate or partnership rules to enjoy the protection that the law affords, failure to follow the tax or state rules can void the protection you would have otherwise received.

I hope this letter illustrates the reasons why you should have your business and personal affairs reviewed or managed by competent tax, financial and legal professionals.

Very truly yours

[Attorney’s Name]

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