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UNLOADING BAD REAL ESTATE

By Lee R. Phillips, JD
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LEE PHILLIPS
SHARES THE
LEGAL TOOLS
OF WEALTH
WITH YOU

Last month we had our exclusive boot camp in Salt Lake City. In the two days we work one-on-one with each member of the small group of participants. The entire group of participants totals about a dozen folks, so not only does everyone get an actual one-on-one planning session, the whole experience is nearly one-on-one. I had three of the participants ask to come to the office the day after the event and pay for "extensive legal counsel."

I was kind of shocked when they came, and each of them had basically the same problem. They had made a number of real estate investments three or four years ago. They had bought houses in the cities where the real estate gurus of the day were pushing investments - Vegas, Florida, California. They were each looking at declaring bankruptcy.

Even if you're not thinking of declaring bankruptcy, learning to protect your assets from bankrupt-

cy is important asset protection information. A bankruptcy trustee is a creditor, just like the guy who sues you or the bank that lends you money. If you can protect your property from a bankruptcy, you can certainly protect it from any other creditor. Some of the techniques even help protect your assets in a divorce.

About four years ago the "buying tours" were big with real estate gurus. One of the real estate gurus was selling houses by the dozens in Cape Coral, Florida. A couple of years ago one of my students called me and said they had bought three houses in Florida through the guru programs. The houses had been inflated in price, because the guru was controlling the market. The poor folks were now facing bankruptcy. They called to ask if they should sue the guru.

A lot of my students are in trouble because they dealt with the gurus. For example, in Cape Coral the guru would buy the land, develop the subdivisions, build the houses, and market them through seminars and telemarketers. He had the

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MAKE YOUR HEIRS AWARE

By Kristy S. Phillips, JD

If you really want to help your beneficiaries after you die, it isn't enough simply to sign your documents and establish an estate plan. You also have to make your heirs aware of where to find your documents. In addition to the estate documents, you need to leave a file with your other account and insurance information. You will avoid problems for your family by securing important documents and telling them where they are stored.

Seven years ago, we bought our beach condo at Siesta Key. Quarterly we get a bank statement for the couple who lived there before we bought it. We have tried to get in touch with

them with no luck. We believe the couple are now deceased and that their children (if they had any) probably don't know about the \$40,000 plus being held in the bank.

What will happen to this money? When a bank account is dormant for a specified period of time, the money in the account escheats (goes) to the state. Every state has its own time frame. A savings account might be considered dormant if there were no transactions for 365 days. That dormant account, depending on the state, would be escheated, or handed over, to the state anywhere from three to five years later. Some banks charge a fee when an account goes dormant, but they have to try to notify the

customer first. They send a notice to the last known address and remind the customer there hasn't been any activity on the account. Some customers respond, others ignore the letter and some never get the letter because they've moved or died. Can you afford to have that happen to your property?

It is not just bank accounts. At least 10 states have been investigating whether some of the country's largest insurers are failing to pay out unclaimed life insurance policies to beneficiaries. California and Florida have held public hearings on the issue in recent weeks.

Insurers say they are behaving

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GOT QUESTIONS?

What are your needs, concerns, or challenges?

Email Lee with questions you would like to see answered in this newsletter.

Email: info@legalees.com



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mortgage company that did the mortgages and the title company that did the closings. He had the management company that rented the properties and serviced the rental units. He had it all. All you had to do was supply the money, and you were going to be on easy street.

I recently went to Cape Coral with Robyn Thompson to evaluate a house in one of the guru developments. It was spooky. You drive through the subdivisions of nice houses and maybe one or two on the block are occupied. It is a ghost town of new houses.

Please be careful. If the deal is too good to be true, it isn't true. The same gurus and others who were doing the big deals five years ago have morphed into cheap REO housing deals. They buy the property in "tapes" or "tranches" and then sell them to you at an unbelievable price. They fix them up, rent them, and service them: it is totally turnkey. You just supply the money. Have you heard that one before?

A firm I associate with is suing several of the gurus because they sold the houses "free and clear," and checked out, and rehabbed, and rented, and . . . After the folks had paid their money, it turned out that there wasn't any house, or it was condemned, or it didn't have a roof, or the taxes weren't paid for a decade, and the list goes on. There are good deals out there, but do your homework. Don't just check out the property. Check out the promoter too. How many times has he been sued? What company name was he doing business under last month?

The people who come to the

boot camps become our friends. When the three of them came to my office, their stories unfolded. Each of them had made investments in single family houses for \$400,000 to \$600,000 several years ago, and they had \$400,000 to \$500,000 mortgages on them. The houses are only worth \$150,000 today. There is no way they will ever be profitable in the foreseeable future (decades).

Bankruptcy is their only option to get out from under the bad mortgages. Each of them have a home that is paid off and another piece or two of real estate that are almost paid off. They also have stocks, bonds, etc., worth a couple of hundred thousand dollars.

In each case, they had been to see a bankruptcy attorney who had told them that they would lose all their cash, stocks, bonds, and other "savings." Of course, the other "good" pieces of real estate would be lost also, in addition to the "bad" pieces of real estate.

In order to protect the individuals' assets, we had to take advantage of state laws and federal bankruptcy laws. The two interface in bankruptcy cases. Certain assets are protected by state laws and some are protected by federal laws. The trick is to convert the unprotected assets into protected assets without violating fraudulent conveyance laws.

They had each been told by the bankruptcy attorney that they would lose their home. In two of the cases, that was flat out wrong. Each state has "homestead" laws. Some are good and some are really bad. Texas and Florida will totally protect any money you have in your house. Ne-

vada will protect up to \$500,000, and other states go down from there to nothing. So how well your house is protected depends upon which state you live in.

If you live in a state that doesn't give your house much protection, you can "strip" the equity out of your house by getting a mortgage and turning the equity into cash. Now, what do you do with the cash? If you bank it or give it to the kids, it is still available to the bankruptcy trustee.

If you get the cash out of your house or take your stocks and bonds and try to "hide" those assets, you won't succeed. Every state has fraudulent conveyance statutes. In bankruptcy cases, any assets moved away from yourself (hidden) within 4 years prior to the bankruptcy can be recovered by the bankruptcy trustee and sold to pay your debts. Pretty much anything you have done in the past year to transfer assets away from yourself can be brought back and given to your creditors. Giving property to your kids or spouse won't work.

You can "get around" the fraudulent conveyance laws by not "getting rid of your asset," but by changing the form of the asset. Different assets are treated differently under bankruptcy laws.

For example, IRAs are protected from bankruptcy under the Rousey v. Jacoway, US Supreme Court case in 2006. All ERISA plans are protected. Those are the retirement plans and benefit plans (401(k) and HRAs). Life insurance and annuities are protected by some states.

One asset that you may not think needs protecting is your business. The "corporate

shield" protects you from a bankruptcy in the business, but it does nothing to protect your business if you declare bankruptcy personally. So, your business has to be protected. You can't just give the stock to someone else.

In most states, assets in an LLC are protected from personal bankruptcy. You should have a multiple member LLC, because Colorado, Florida, and Utah have specifically made single member LLCs fair game for creditors.

You can change the nature of your asset by moving it into an LLC. You have to be very careful to get an equal value back, so that it is a true 351 IRS Code section transfer. Almost all attorneys aren't going to get that one. Just ask your attorney what a 351 exchange is. If the answer is "What?" get another lawyer.

One of the boot camp participants told us the bankruptcy attorney had told them they would lose their house and about \$250,000 in their stocks, bonds, and savings. Upon an analysis, it was obvious that their house should be protected under their state's homestead laws. They weren't in Florida or Texas where there is a 100% homestead protection, but their state had enough to protect the value in their house.

Their state laws allowed each spouse to put up to \$15,000 a year into a life insurance premium. Payment of a premium is not considered a fraudulent conveyance and the life insurance policy is exempt property in a bankruptcy. You can legally back date a policy up to a year. So with last year's \$30,000 and this year's, that's \$60,000 for two of them, that can be



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moved into an asset that is protected in a bankruptcy.

Using life insurance as an investment vehicle is a tricky situation. You have to be very careful to use the right insurance policy. Most insurance agents aren't going to come up with the right policy. You may end up losing most of what you put into the policy. I don't care what your agent tells you, be careful, or your money won't be there when you want it back. Most agents have never studied or looked at the policy you need, because they won't make any money selling it to you.

The rest of the stocks, bonds and cash (including the equity stripped out of the good piece(s) of real estate, were

moved into a multi-member LLC. We were careful to follow the Section 351 rules. However, we went one step further. There are several good investments that give good returns and also give about a 90% depreciation in the first year. So, on the books of the company, a \$150,000 investment is only worth about \$15,000 as soon as the investment is made. The \$15,000 is the value after depreciation of the investments.

The LLC was then sold to a family member for \$15,000, which was the book value of the company. The sale for full book value of the company is not a fraudulent conveyance, because the full value

of the company was received in the sale. We sold the company just to remove the investments one step further from the bankruptcy.

The couple now has \$15,000 in cash, a home protected from the bankruptcy, a piece of property with no equity, and a life insurance policy protected from bankruptcy. Of course their IRAs and retirement are safe under federal law. The \$15,000 will be spent on the bankruptcy attorney and living expenses between now and the time the bankruptcy takes place.

The bottom line is the couple will lose little or nothing other than the bad real estate in their bankruptcy. That's a far different outcome than their bank-

ruptcy attorney had told them they could expect. His job isn't to protect your assets, it's to get you through the system as fast as possible (with the maximum legal fee).

There is a lot you can do to "unload" your bad real estate investments and keep most of your wealth. We're having another boot camp September 19-20. We'll be covering strategies like these to protect your assets whether you are facing bankruptcy or not. Call 800-806-1998 to register. ■



A Durable Power of Attorney for Healthcare—A durable power of attorney allows your designee to make health-care decisions on your behalf if you are incapacitated. The document should be compliant with federal health-information privacy laws, so that doctors, hospitals and insurance companies can speak with your designee. You may also need to fill out an Authorization to Release Protected Healthcare Information form.

A Living Will—The living will and the power of attorney constitute what are called "advance directives"; some states consolidate these into a single form. The best place to get this document is from your local hospital. Terminally ill patients may wish to have

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lawfully. Under policy contracts, they aren't required to take steps to determine when a policyholder dies, but are only required to pay a claim when beneficiaries come forward. Can you imagine paying for life insurance all those years only to have it escheat to the company?

The financial consequences of failing to keep your documents in order can be significant. According to the National Association of Unclaimed Property Administrators, state treasurers currently hold \$32.9 billion in unclaimed bank accounts and other assets.

I recommend you take some time, maybe this week, to create a comprehensive folder of documents that your beneficiaries can access in case of an emergency. It is not fun to be left scrambling to find and organize a hodge-podge of disparate bank accounts, insurance policies

and brokerage accounts.

You can store the documents in a folder at home, say in file drawer, or better yet a fire-proof safe. Just be certain to show someone where it is and the safe's combination. You can also have your attorney keep your papers. Attorneys will be glad to do this. It usually means more money for them. Some people lock their documents away in a safe-deposit box. I don't recommend this because the bank won't let your heirs have access to the box until after your heirs get a court order. If your heirs have your trust and it is fully funded, they won't have to go to court.

Here is a rundown of the most important documents you'll need to have signed, sealed and delivered. You should start collecting these as soon as possible and update them every few years to reflect changes in assets and

preferences. Some — such as copies of tax returns or recent child-support payments — need to be updated more often than others.

The Essentials for your File

An Original Will—A will allows you to dictate who inherits your assets and, if your children are under age, their guardians. Dying without a will means losing control of how your assets are distributed. Instead, state law will determine what happens.

A Living Revocable Trust—A living revocable trust allows your heirs to avoid probate and is private and harder to dispute. A will, by itself, is like a compass that points toward the closest courthouse. A revocable living trust can be changed anytime during your lifetime. After you transfer ownership of various assets to the trust, you can serve as the trustee on behalf of beneficiaries you designate.

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U S I N G T H E L A W T O M A K E M O N E Y

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their doctors sign a do-not-resuscitate order as part of this form.

Proof of Ownership Documents—You should keep documentation of housing and land ownership, cemetery plots, vehicles, stock certificates, savings bonds, bank accounts, any partnership or corporate operating agreements, and a list of brokerage and escrow mortgage accounts.

If you don't tell your family that you own such assets, there is a chance they never will find out.

File any documents that list loans you have made to others, since they could be included as assets in an estate. Similarly, keep a list of any debts you owe to avoid surprising your family. Wills and living trusts generally are drafted to include provisions

for how debts should be settled, and creditors have a stipulated period of time in which to file a claim against the estate.

It is a good idea to keep the last three years of tax returns available, too. Looking at last year's returns offers a snapshot of what assets we should be looking for this year. This also will help your personal representative file a final income tax and estate return and, if necessary, a revocable trust return.

Be sure to list any safe deposit boxes you own. Register your spouse or beneficiary's name with the bank and ask them to sign the registration document so they can have access without securing a court order.

Copies of life insurance policies are among the most important documents for your

family to have. Family members need to know the name of the carrier, the policy number and the agent associated with the policy.

Be especially careful with life insurance policies granted by an employer upon your retirement, since those are the kind that financial planners most often miss. New York state alone is holding more than \$400 million in life insurance related payments that have gone unclaimed since 2000, according to the state comptroller's office.

You should also draw up a list of pensions, annuities, individual retirement accounts and 401(k)s for your beneficiaries. An IRA is considered dormant or unclaimed if no withdrawal has been made by age 70 1/2. According to the National Association of Unclaimed



Property Administrators, tens of millions of dollars languish in unclaimed IRAs every year.

If your heirs don't know about these accounts, they won't be able to lay claim to them, and the money could languish. The U.S. Department of Labor estimates that each year tens of thousands of workers fail to claim or roll over \$850 million in 401(k) assets. This is a tragedy for the beneficiaries.

Take some time this next week to get your records together. Tell your beneficiaries where you are keeping these records. That way they won't lose what you have worked your whole life to give them. ■