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CHAPTER 10

Darkside Tales—Watch Your Back: Common Threats to High Net Worth Individuals: Protection of Personal Wealth and Safety

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Synopsis

The world is changing fast for high net worth individuals and their advisers. In addition to ever evolving tax laws, creating both opportunities and risks for clients with substantial assets, the tactics and targeted goals of numerous third parties impose an ever-increasing risk to the financial and personal safety of high-net-worth individuals. While such risks are not ubiquitous, they arise in ever more frequent circumstances. Being aware of warning signs that could indicate such a potential threat, as well as protecting our clients in advance against any such possible threats that could arise later, can make all the difference to these clients in the long run, both personally and financially.

¶ 1000 TAX AND TRUST PLANNING

Individuals with substantial assets face risks with respect to income, gift and estate tax. If not properly planned for, these taxes can decimate a family's hard-earned wealth.

For income tax considerations it is essential to engage regularly with a highly skilled estate and tax attorney and/or accountant who are familiar with the client's overall asset situation and can ensure that not only are transactions properly reported, but also that valuations are correctly obtained, all returns properly filed with sufficient disclosure, and that appropriate back up records are kept. Caution should be used in selecting the

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attorney and/or accountant, as the judgment and experience of the professionals are central to success. Numerous elections and judgment calls must be made on tax returns, so it is important to engage with a team that can properly advise. Your investment and wealth advisors can also contribute to this advice.

Trust planning is also essential. Trusts can provide key protection to the family over the term of a beneficiary's life. Here again, the selection of the trustee is critically important. A professionally experienced Trustee, either corporate or individual, is likely to be valuable to your family. At the same time, flexibility for the beneficiary should be weighed against the caution that can be provided by an experienced and prudent trustee. Professional investment of the trust assets is essential. Trusts can provide protection from third-party creditors, as they generally cannot force the distribution to them of assets in a trust that are only available to the beneficiary in the discretion of the trustee. Moreover, an experienced trustee can warn the beneficiary as to risks involved, as the beneficiary may not be able to recognize these risks, and can protect against claims by not distributing trust assets in the event of a threat. These threats can include pressure from a spouse, even in a happy marriage, to distribute assets which may then be dissipated or lost in a later divorce. Trusts can also protect against third-party creditors such as a business downturn or an accident. Sometimes a beneficiary will not recognize the limited nature of the trust assets and should be cautious not to exceed the permissible budget, remembering that the trust in general should be a safe haven for financial security, as opposed to a primary means of support for the beneficiary.

Trusts are invaluable mechanisms to reduce income, gift, estate and generation—skipping transfer taxes. The estate and gift tax is imposed at a rate of 40% when property passes to a younger generation. This rate can be higher or lower but the policy is to impose a substantial tax on property which is transferred to a younger generation. The Generation—Skipping Transfer Tax ("GST") is imposed in addition to the estate or gift tax at a further 40% for transfers of property to recipients who are two or more generations below that of the doner. When properly set up, observing numerous technical rules, trusts can: (i) reduce both federal and state income taxes, (ii) reduce or eliminate gift, estate and GST taxes, and (iii) can take advantage of certain exceptionally helpful exemptions which exist under current law.

Included in these exemptions is the GST exemption, which under current law permits assets to be held in trust for a potentially unlimited duration without being subject to the GST tax as wealth passes through these numerous generations. Thus, assets can be transferred into a long-term trust in a jurisdiction which permits a long-term trust such as Delaware, Wyoming, Nevada or South Dakota and the GST exemption can be applied to these assets on a gift tax return for that year. These assets, and the appreciation on them subsequent to the transfer, would then not be subject to transfer tax until after distribution to the beneficiaries and then not until a GST tax event has occurred. This opportunity, coupled with the magnifying effect of appreciation of the exempt assets, remains one of the most powerful tax saving opportunities available to high net worth clients today.

While trusts present valuable planning opportunities, a number of potential issues must be carefully observed. These include: carefully analyzing the income tax rules that apply to both grantor and non-grantor trusts, being aware of S corporation and partnership tax issues, properly planning for cryptocurrencies and digital assets, taking into account future unknown living expenses of the grantors, being sure to avoid foreign grantor trust issues with US beneficiaries and observing reporting requirements for foreign persons or trusts as well as planning for a non-US spouse or foreign assets, including forced heirship rules. These are just some of the issues that a client should consult with a tax and trust professionals about when preparing a trust.

A new development should be noted for high net worth individuals, which is the new IRS Global High Wealth Group which has been installed in response to a notable shift in mobility and wealth concentration. This includes the launch of a new initiative on July 15, 2020 by the IRS Large Business and International Division to audit high net worth individuals. This indicates the need for increased caution and skill in preparing income, gift, and estate tax returns.

¶ 1001 ADDITIONAL OPPORTUNITIES FOR PROTECTION OF ASSETS FOR HIGH NET WORTH INDIVIDUALS

In addition to the use of trusts, other opportunities exist for protection of assets. Included among these are Homestead protection available in certain states, such as Florida and Texas, which can protect the property identified as homestead from claims of certain creditors.

Numerous technical rules apply, for example in Florida regarding the rights of a spouse or minor children to the homestead property, but the exemption from creditors' claims can be quite valuable.

Note that a residence can be owned by a client's trust, which can protect it from claims in a divorce or in a business downturn. Alternatively, a trust may be able to lend money to the beneficiary in exchange for a note, to provide further protection of the asset, but "spendthrift" rules of the trust or governing law should be analyzed before proceeding in this way.

Community property can present opportunities and pitfalls for the preservation of assets. In the state of California, earnings of both spouses during marriage are considered community property, unless a premarital agreement provides otherwise. Thus, in general, each spouse should be entitled to one half of the assets earned by either spouse during marriage. While this creates an economic partnership for the spouses, it clearly can provide an unexpected result for spouses who are not familiar with community property prior to getting married and living in California. Your client should consult with a matrimonial attorney in California prior to agreeing to be subject to this regime. One major advantage of community property rules is that an asset held as community property will be entitled to a step up in basis to the date of death fair market value (or could be stepped down if the fair market value is lower than the original purchase price) for the entire property for basis purposes upon the death of the first spouse to die. One downfall of community property is that for a marriage that has lasted more than 10 years prior to a divorce, the spouse who earns more income could be required to pay the spouse who earns less income approximately one half of the differential for a period extending up to as long as life. The details should be discussed with a matrimonial attorney.

In this context, it is notable that a beneficiary designation in certain deferred income plans, such as certain IRAs, can take precedence over state community property laws. Thus, a spouse who anticipates ownership of one half of the earnings of the other spouse under community property state law could be caught off guard by the beneficiary designations of their spouse in certain deferred income plans, because these federal laws trump the state laws. *See Boggs v. Boggs*, 117 US 1754 (1997). Similarly, life insurance beneficiary designations can trump expectations of a spouse under state community property laws. *See Orr v. Prudential Insurance Co., et al.*, 2012 U.S. Dist. LEXIS 82022 (June 12, 2012) and *Egelhoff v. Egelhoff*, 532 U.S. 141 (2001).

Other areas for concern are in a business context, when one should exercise extreme care in hiring to check references and confirm not just the qualifications and professional experience, but also the personality and ethics of those we hire, to ensure that they are cooperative, thoughtful and trustworthy. It goes without saying that a person who works with you intimately is likely to be very much aware of sensitive information and is trusted with your business contacts, so they should be vetted with extreme care before being hired.

Another area which demands extreme care is when your loved one is in a hospital. While doctors can be incredibly knowledgeable and can save the lives of those we love, the family should be present to help with communication with the patient and to weigh in on critical care decisions. Doctors are busy and make judgments based upon the needs of the hospital as well as the patient, and you should not only help to evaluate recommendations from the doctor but also serve as a sounding board and a protective mechanism for your loved one while he or she is in the hospital. An important note is to have conversations with your loved ones while they are healthy as to a range of outcomes, should there be medical issues and what their detailed wishes are, as the healthcare proxies and medical directives can be general in nature and don't provide all the answers you might need to know in a range of medical outcomes.

Another opportunity for protecting your clients and family is to segregate assets for children in order to protect them from the claims of a subsequent spouse who is not their parent. Life insurance, or other appreciating assets, placed in a trust for children can do this very well, while also providing tax saving opportunities. A related note is to segregate property between children, to avoid coownership which can lead to disagreements and damage the family relationship.

A growing area of concern is the increasing use of conservatorship of the person and the estate by third parties in the context where the proposed conservator wants control over the client but the client may not really need such conservatorship. This has been used increasingly in situations where the spousal relationship has deteriorated as an additional weapon to circumvent divorce and allow one party to gain control over the assets and decision making of the other. You should be on guard for this kind of activity and document your client's mental acuity when there is reason to be concerned about this kind of attack, which may be launched by relatives who are more interested in the assets of the client than his or her personal well-being.

Unfortunately, there are some third parties who may try to abuse the trust and proximity of our clients for their personal financial gain without any regard to the effect on our clients. These predators take advantage of the actual biochemical reaction to love which can reduce a person's ability to reason, a condition which has been studied and documented by medical studies. In order to be protected from these unexpected betrayals of trust, we should identify "red flags" so that we can recognize a dangerous situation before it develops into a full-blown threat.

Red flag indicators which may possibly indicate such predatory behavior include the following: a person who exclusively uses cash (avoiding credit cards which can provide a trail as to his or her activities and location), a person who asks for a client's ATM card and code—spouses have done this and then shown that they are withdrawing money surreptitiously from their spouse's account, a person who has an undisclosed safety deposit box, a burner phone or a private post office box—these are hard to detect, but for example a client can inquire at his or her local post office to see if his or her spouse or partner has a private PO Box, which may be an indication of activities that that person does not want the client to be aware of; oil and gas interests can also be purchased by a spouse trying to circumvent community property laws as well as foreign bank accounts. While these must be reported pursuant to US tax laws, some of these bad actors are fairly good at avoiding disclosures. Looking on a spouse's or partner's Facebook and other social media postings can provide a client some hints as to the activities of the other party—does that person hold themself out as single although he or she are married? While this may seem incredible, there have been numerous cases where a spouse is on social media finding other partners, although the person is already married. Spouses owe each other a duty of honesty and some states make this very explicit. Therefore, if a client's spouse has a locked file cabinet and refuses the client access to it, that should cause your client concern for a number of reasons. Cryptocurrency may be another opportunity for a person to avoid fair treatment of the spouse as it can be difficult to identify or locate.

Some of the warning signs can be gleaned during the dating period. When a client sees problem behavior he or she should not avoid recognizing it. It can be difficult to do this, because of the momentum of a relationship that seems overall positive, but it is so much better to avoid problems prior to marriage by not proceeding to marriage. In general, trust is essential and you should be sure that you feel safe prior to proceeding into a marriage.

Finally and even more extremely, one must be very careful as to one's personal safety. If the spouse or partner of a client has exhibited a tendency to be violent, the client should truly consider eliminating contact with that person, as outcomes can be very unexpected. Violent behavior tends to escalate and those who are not familiar with such activity are likely to underestimate the danger to themselves or to loved ones.

Notably, certain environments give rise to extreme danger and should be kept in mind as a general precaution. While it is hard to believe, some spouses have been murdered by the other spouse while hiking on cliffs in the mountains. Another set of murders have occurred on boats—these cases are much more numerous than one would anticipate. A spouse can have a motive to murder the other spouse due to life insurance, assets that pass to the surviving spouse on death and a will which benefits them.

While all of the foregoing is shocking, for the same reason, it is important to be aware of these potential threats. An honest person does not expect others to be dishonest and certainly not to behave in a criminal way. That is why we have to be on guard as to possible warning signs, so that should a third-party not behave as we would have hoped and expected, we can be alert to identify the indicators of potential danger before it is too late.

¶ 1002 CONCLUSION

All of the foregoing are insights which are hoped will be valuable to others, gained after decades of experience of multiple clients in my career. It is helpful to share the experiences with others so as to help protect them, so that their hard earned wealth can benefit those they love and that they can lead a happy, safe and productive life, free from dangers that they might not anticipate.