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PERSPECTIVE

California contractors: Protecting assets from lawsuits

By William L. Porter

Allow me to first illustrate the issue with a familiar nightmare story, then let me describe the solution. The story is that of a longstanding family construction business. For decades, the business has been profitable. The owners have built considerable wealth and look forward to a happy and abundant retirement. There will even be something substantial left for the kids. Then comes the nightmare. First, one job goes bad, then another. Bills cannot be paid. Several key employees must be laid off. There are personal guarantees to suppliers. Personal assets are pledged to the bank. Suppliers sue. Ex-employees sue. The Labor Commissioner sues. The Employment Development Department sues. The bank seizes assets. Millions become pennies. Corporate and personal bankruptcies are unavoidable. In the course of a year, only a financial carcass remains. It has all come crashing down. The owners, in their senior years, become a peniless burden on their children.

Now the solution: Since 1970, California law has granted California residents substantial protection for their assets from legal claims of creditors through the use of a “private retirement plan” as defined under California



Since 1970, California law has granted California residents substantial protection for their assets from legal claims of creditors through the use of a ‘private retirement plan’ as defined under California Code of Civil Procedure Section 704.115.

Code of Civil Procedure Section 704.115. The retirement plan is entirely different than a 401k or traditional pension. Nor is it a tax planning device. Rather, it is a retirement planning asset protection plan. Under this code section, except generally as to claims for “child, family or spousal support,” the assets of the retirement plan become exempt from lawsuit claims and seizures. The assets of the plan are also recognized under federal bankruptcy law as exempt. The plan’s protection extends to protection from claims by both the Franchise Tax Board and the IRS. This is powerful protection that could have made the entire outcome for the contractor in the nightmare scenario described

above, turn out completely differently.

So, how is this protection achieved? There are a few simple steps. First, the plan documents are created by an attorney familiar with the legal requirements for California CCP 704 private retirement plans. The best method of establishing the private retirement plan is through the creation of an irrevocable trust for this purpose. Don’t let the “irrevocable” label scare you. There is no need to worry about loss of control. The client participant is generally also the beneficiary of the plan during his or her lifetime, assuring that there is no loss of control. Next, under the requirements of the plan documents, assets are re-characterized as trust-owned assets. Such assets can include, cash, stocks, bonds, real estate, equipment, LLC interests, and many other categories of assets. There is no legal maximum on the value of assets that can be placed in the trust as long as a need for retirement savings is demonstrated. The trust is tax neutral and there is no penalty on distributions. The beneficiary maintains control.

The final step is proper administration. The trust absolutely must be professionally administered. An attorney should never create a private retirement plan

trust for a client unless the plan will be professionally administered. There are excellent private retirement plan trust administrators who specialize in private retirement plan trusts and can serve as excellent plan administrators. Proper administration includes making sure that annual reports are issued and benefits and distributions are properly managed. The costs of both the private retirement plan trust setup and administration are generally quite low. For those with substantial assets and high litigation exposure, achieving the peace of mind available under the protection of a private retirement plan trust is generally well worth the minimal expense.

Don’t let lawsuits destroy your life savings. Use the law to protect yourself.

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