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HOT TOPICS IN TAX & ASSET PROTECTION PLANNING WITH CAROLE C. FOOS, CPA

David Mandell:

Hello, I'm David Mandell, host of the podcast. Thanks for joining us today. We've got a little bit of a different episode this week. We've done this maybe once or twice a season where, instead of interviewing a physician or someone out in the marketplace who has expertise outside of our firm, we are doing an internal version of the podcast today with myself and my partner, Carole Foos.

So in past seasons, you've heard from us and you've heard from Carole before on tax updates. She's our tax expert. So what we thought we would do in this episode is hot topics in tax and asset protection. And Carole's going to handle the tax topics and then she's going to hand the mic back to me and I'm going to handle the asset protection. We will put Carole's full bio in the show notes. I'm not even going to read her bio because most of you who listen to this know she is our tax person. She's CPA with 25 years or more of experience. She has helped a lot of our clients with new tax ideas. She handles the company's returns and my personal returns. So I have total faith in her. And with that, I'll hand the mic over to Carole.

Carole Foos:

Thanks, David.

So I just want to touch on a few topics, some things that happened in 2022 and then some topics that I think should be top of mind for our listeners as 2022 ends and we're moving into 2023.

First off, as I'm sure everyone is aware, the Inflation Reduction Act was passed in 2022. And while leading up to that, there were thoughts that we'd have a lot of tax changes this year. That really did not happen so much for individuals or for small business owners. But there were a couple of items in the Inflation Reduction Act that I think today's listeners should be aware of. First, there is an expanded tax credit for energy-efficient improvements, and that an energy-efficient home improvement credit is now extended to continue on through the year 2032. And it has increased so that you can take a credit for 30% of the cost of your improvement to your home up to a maximum of $1,200 per year.

So if you got new windows or added an energy-efficient HVAC, or furnace system, or just any type of shoulder panels, any energy efficient improvements, talk to your CPA about getting that credit. And making sure your CPA knows that you did that, so you get credit.

In addition, for those of you who are owners of small businesses, there is a separate energy credit for small businesses. And that improvement credit amount is up to $5 per square foot of your building. So again, if, as a business owner, you made some energy improvements to your building, also make sure that you're speaking to your CPA about getting those credits.

And then in addition to the energy-efficient improvements, there's also an expanded credit for clean vehicles. Under the old law, each manufacturer had a certain number of credits that people who bought their electric cars were able to take. That limited number has gone away. And the way the clean vehicle credit works now is if you bought an electric vehicle, if it's a car, and the manufacturer's suggested retail price is less than $55,000, you can take a clean vehicle credit on that car. If it is an SUV, the MSRP can actually be up to $80,000 and it would be eligible for that clean vehicle credit. So again, look into that as you're having your 2022 taxes prepared, or as you're doing year end meetings with your accountant.

Another thing that I want to note and make sure listeners are aware of is that the IRS recently announced they are increasing the interest rate on both overpayments and underpayments beginning January 1st to 7%. I say this because I want you all to be aware that as you are looking at withholding at year end or withholding going forward in 2023 as well as estimated tax payments both that fourth quarter of '22 that's due in January as well as your estimated payments in 2023, if you're not on a safe basis and you are short and would be assessed an underpayment penalty, you're looking at that 7% interest rate at least for the first quarter of 2023. So very important to make sure you're getting the correct amount of estimates paid in order to avoid that interest.

When I am talking to clients and thinking about what should they be looking at as we wrap up 2022 and as we're approaching 2023, 1 topic that's relevant for tax planning year in and year out is the timing of income and deductions. And what I mean by that is thinking about whether you're going to be in the same tax bracket in 2023 as you will be in for 2022. If your tax bracket is going to go up in 2023, then it makes sense to push some of your deductions out to 2023. It also makes sense to try to realize some income in 2022 when you're at a lower tax rate.

So some of the things that you can do related to managing those income and deductions are delaying interest in dividend payments from your closely held businesses to either move them into 2022 or push them out 2023 depending on your tax situation. Deferring commission income, if any of you or your spouses earn any type of commission income, you may want to

think about the timing of that because individuals are cash basis taxpayers. So it's actually when you physically receive that income is when it's taxable.

Accelerating deductions such as mortgage interest and charitable donations. This is also important when you're thinking about are you going to be itemizing deductions both in 2022 and in 2023. Maybe for some of you, you're about to have your mortgage paid off. If that's the case, if that happens in 2023, you might take the standard deduction instead of itemized deductions next year. So you would want to likely speed up your charitable donations and pay some of what you would normally pay in 2023. Get those in 2022, take the deduction in a year when you're going to itemize.

The last point that I want to talk about is, again, something that I think is important year in and year out, and that is managing capital gains and losses. I'm sure if you've listened to many of our talks and podcasts, you might have heard us talk about this previously. It's really important for investment advisors, if you work with an advisor, to be trying to limit the tax drag on your investments. And one way to do that is to try to offset capital gains and losses within the same tax year.

In this year, when the markets had a lot of down days and down periods of time, you might have had some realized losses from changes in your portfolio this year. Keep in mind that capital losses can only be deducted to the extent that you have capital gains, plus an additional $3,000 of loss. So the greatest net capital loss you can take is $3,000. If you have capital losses that are greater than that, it might make sense to realize some capital gains on stocks that have appreciated, even if that means selling the stocks and then repurchasing them just to get a higher basis. So again, talk to your investment advisor, if you use a professional advisor, about what your realized gains are. This certainly holds true also going into 2023.

And another thing for you to think about is, it's not just at year end that you should be doing this. A lot of times, with fluctuations in the market, your advisor might be realizing gains or losses earlier in the year and you just want to be cognizant of timing of these things and taking advantage when you can of managing those gains and losses.

That's really what we wanted to cover on a tax basis. And David's going to add some important items on asset protection.

David Mandell:

Thanks, Carole, appreciate it. I'm sure everybody was listening intently because whenever Carole comes on to talk about tax ideas, I find that the audience is extremely focused.

Now what I want to talk about... You know me as the host of this podcast and you've heard me interview all sorts of smart and experienced people. We did have one episode specifically on asset protection. I believe that was season one when we interviewed Bo Loeffler, an attorney in Ohio. And we're going to hear about Ohio a bit in my update here. But for folks, so if you haven't heard that, or you want an update, or you want a refresher, I would go find that episode with Bo Loeffler.

But as a refresher, asset protection is one area of planning that we help clients with at OJM Group. It's what I've done as an attorney before forming OJM, and still have my small law practice. And it's an endeavor and a discipline whose goal it is to help clients shield either business, or practice, or personal assets from potential future liability. And those could be medical malpractice lawsuits we've heard about in the past. In some future podcasts, you're going to hear about personal guarantees. It could be lawsuits stemming from employee issues, from car accidents, from other types of business arrangements. Any kind of liability that you can think of, asset protection planning is a way of structuring one's affairs so that liability cannot reach or has a difficult time reaching those assets. And instead, can put you in a position where you're either completely protected, or you can negotiate a favorable settlement in that kind of worst case scenario.

And the way we approach it, we have approached it my whole career is, there's the legal element to it. And I did this as a lawyer again exclusively with my career until forming OJM. There's certainly a insurance element to it. I mean, we are some folks who recommend and review insurances for clients at the business, and practice, and personal area. And then there's a financial element in terms of exempt assets, things like homestead, or qualified retirement plans, or cash value insurance, or different kinds of annuities, et cetera. And all of that is covered in our book, Wealth Planning for the Modern Physician. So if you haven't gotten that book, if you've been listening to this podcast, or this is a topic that you haven't thought about before, I'd recommend that you do that.

So this next 10, 15 minutes, I'm going to just talk about some updates, where we are today? What's changed in 2021 and '22 in terms of asset protection? And I want to talk about some statute changes and then a couple number of cases.

So statute changes -- every state has exemptions. And we use in our books the sliding scale of asset protection minus five to plus five, where plus five is the highest level of protection you can get. Exempt assets are plus five because essentially the state and even federal law says, "This is a value of an asset that cannot be touched no matter how big the lawsuit is."

So an exempt asset, as example where I live in Florida, could be my homestead. And it doesn't matter if someone has a billion dollar judgment against me, but they can't touch my home. And I could even file for bankruptcy and get rid of that judgment in full and keep my home in full. So these are very powerful statutes. And they generally, when they change, they change for the better in terms of the client. Not always though, sometimes the creditors are able to change the laws better for them, for credit card companies and banks, et cetera.

An example I'll just point you to that happened in the last year or so, last couple of years, is California... And I mention it, obviously, it's the large largest state population-wise. And so we have a lot of listeners, I'm sure, and clients from California. Well, for decades, all the way back when I was in law school and before, the exemption for homestead in California ranged between $75,000 and $150,000 depending if you were single or married, what your age was. Maximum of 150. And for single clients, it was 75. Well, that changed. Finally, the statute changed in California where now the new homestead that was passed has a minimum of 4300,000 and a maximum of $600,000 if the county where you live, the average sale price of homes in that county in the previous year was over $600,000. So for most of the large counties and populous counties around cities in California, that's easily going to be met. So a lot of people now have a $600,000 exemption when they had a $100,000 before.

Now it may not cover their home because in California, you have a lot of homes worth a lot more than $600,000, but certainly in the right direction. California also improved their 529 exemption. And other states have done this as well. So the lesson here for you, if you're listening, if you don't know what your exemptions are in your state or you haven't looked at them for a while, you should make sure that they are what you think they are. Get with someone like us or another advisor to review those. And if you haven't thought about asset protection planning at all, you might want to at least know what your exemptions are in your state because they may be helpful or they may be pretty minimal. Very, very wide range within 50 states. So that's statutes.

Now let's talk about a number of cases. The first case I'm going to talk about is called Manichaean Capital versus Exela Technologies. And we'll actually do a link to that case in the show notes if you want to read. I'll put all the links in there. And so why am I bringing this case up? Because it impacts Delaware limited liability companies or LLCs, which, for many of us in the field, were considered a top state for LLCs. And many physicians may have used those in their asset protection plans over the last 10, 20, 30 years. But this case puts some uncertainty there and raised a lot of eyebrows and made folks like me think I don't really want to use Delaware anymore for LLCs. And in fact, in my law practice, even considering re-domiciling

clients who've had Delaware LLCs for a long time to another state like Ohio, which we're going to talk about.

So this is a pretty complex corporate litigation case. I don't want to get into all the specifics, but the bottom line is that the plaintiffs in the case had a judgment. They have the right to a large amount of money, tens of millions of dollars because of a merger, an acquisition. But the LLC that they came after did not have money in it, did not have enough to satisfy them. So they want to go up the chain from that LLC to a parent entity, called a parent subsidiary. That's what we call it in the law in terms of when one company owns another. So they want to go up, pierce the subsidiary, that's who they have the judgment against, and move up the chain to the other entity where it has more assets. This is called reverse piercing. Reverse piercing.

Now, asset protection attorneys expected this claim for reverse piercing to be rejected by the Delaware court since Delaware had been known as what's called a charging order exclusive remedy state. And what that means is, the statute says, "If you want to sue an LLC and get to it, the only thing you should be able to get is a charging order." And as Bo Loeffler explained in his podcast episode, and as we go into great depth in our books, charging orders aren't really that beneficial to plaintiffs. They certainly give them rights but they keep them outside of the LLC. You can't get inside. You can only get a distribution. So as asset protection advisors, we like relying on states that say, "Hey, the only thing you can get is a charging order." And we thought Delaware was one of those states because that's what it says in the statute, exclusive remedy.

So we all thought that when this case came, that the Delaware Court would say, "No, you don't have a right to even come after a reverse pierce because what you get is a charging order." But that's not what the court did. The court said, "In this circumstance, we're going to allow a reverse piercing case to move forward." And they specifically acknowledged that the Delaware allowed this remedy. Even if it was just in extreme circumstances, they allowed it. This surprised most of us. We thought that the plaintiff wouldn't even be allowed to bring this cause of action. The fact that the court allowed it was surprising, and not in a positive way.

So if you are listening to this and you have a Delaware LLC... And I think there's probably hundreds if not thousands of physicians who have... because it was a legitimate, and still is, a legitimate jurisdiction. And again, I'm happy to say that I've created these for clients in the past because of my thoughts about Delaware, and I was certainly not out on a limb on that. But because of this case, and we'll see what happens as it moves forward, but even if the plaintiffs lose, the fact that the court allowed them to bring this action means that they're open to this kind of claim. And other courts are going to see that in Delaware. And now maybe this isn't such a great place to have LLCs if your goal and one of your motivations is asset protection

planning for the assets in that LLC. And there are better places for it. So what's the lesson to take out of this case? Jurisdiction matters where you have your LLC, and it changes.

So now let's talk about a couple of cases, again, regarding LLCs out of Ohio. One's called Wick v. Ach, and the other is Berns Custom Homes v. Johnson. Again, why am I covering this here? Well, it's a contrast to the Delaware case. These are two Ohio cases where you see the courts support the stronger LLC protections. And this is one of the reasons why when a physician's coming to us now, I'm recommending Ohio often using Bo Loeffler, the attorney I talked to on the podcast because he's one of the four attorneys who wrote the statute for the updated LLC and trust statute in 2012 and authored the update to the update in 2021 and '22. So he's really ground zero for this law. And in fact, he was the one who updated me on these cases at a conference that he was at.

So the first case is called the Wick case, and here the plaintiff brought an action alleging many cause of actions against Ach, including reverse veil piercing against Ach's LLC, the exact same claim we just saw in Delaware. We want to get past the LLC court, we want to get into the assets when we have a judgment against the LLC owners. The trial court dismissed that reverse veil piercing claim. And the appellate court affirmed that dismissal. So again, while we see Delaware allowing the case to go through, we see Ohio saying, "Nope, you don't have a right to that cause of action." They appeal it and they lose because the appellate court supports that. So here we see the court's clearly indicating that under Ohio law, reverse piercing of an LLC is not a valid legal claim in sharp contrast to the Delaware case. Wow, Ohio looks a lot better, doesn't it?

Now we have the Berns' case. And this is a case attacking ownership in an LLC again. The plaintiff asks for a receiver to be appointed as receivers have significant powers to go after LLC assets, or really any assets whatever the case involves if a receiver is appointed. Again, the court here rejected the claim saying that, "Ohio LLC law does not allow receivers to be appointed in a claim against an LLC membership interest. And that Ohio law is clear that the charging order is the sole and exclusive remedy for plaintiffs in this situation." Again, putting this such in contrast to the Delaware case, this is what we thought the Delaware court would do. No, this is what Ohio Court does. So again, not surprising, this is why I'm choosing, and many attorneys are choosing, Ohio for their jurisdiction of choice.

What's the takeaway? Jurisdiction matters. Not every LLC is going to be judged, and created, and protected in the same way. So you have a choice, if you're using an LLC to own a building in Florida, where I live, you're going to use a LLC in Florida because that's where the site is, that's where the property is. But if you're using an LLC to own securities investments or

accounts that maybe are based on the internet, you have a lot more choice. And this is where we should start to see the choice of using the right LLC in the right jurisdiction.

The final case I want to talk about I think is extremely applicable to physicians. If any of you listening here own rental real estate or your practice owns the real estate in which the practice operates, you've often... And I think it is the right advice... you've gotten the advice to own that real estate in an LLC, limited liability company. And if it's the case where you're using it with the practice, then the practice, which is typically a corporation, a PC, rents the property from the LLC. It's called an LLC leaseback. You put the property in LLC and then you lease it back to the operating practice or business, kind of standard operating procedure.

Well, this is an IRS case and this case is called TBS Properties LLC versus United States. In this case, an Arizona corporation was found liable for over $150,000 in unpaid taxes from 2015 through 2017. The corporation owned and operated a restaurant in the Phoenix area, could easily be a medical practice. The real estate on which the restaurant operated was held by a separate LLC. Again, this leaseback concept. Well, in the case, the corporation operating the restaurant was owned by a family trust and the LLC was owned by a marital trust. The same taxpayers set up both the family trust and the marital trust, and the trust had the same co-trustees. So this is very similar, again, to a practice being owned by a bunch of physicians and the LLC being owned by the same or very similar physicians, same ownership on both the LLC and the corporation.

Well, in an effort to collect the corporation's unpaid taxes, the IRS entered a lien against the real property owned by the LLC, asserting that the LLC was the alter ego of the corporation. And hence, was liable for its debts. So the corporation owes the money, they're going after the LLC, that's where the property is. The district court denied the LLC's motion for summary judgment. So what that means is the LLC said, "Hey, you got the wrong case here." Or, "This can't be done because we don't owe any money. We're the LLC. That's the IRS. This court case should be dismissed because they're coming after us, we don't owe any money." And that's called summary judgment. That's one of the ways you can get rid of it early on is to ask for summary judgment. With all the facts and the whole thing going to court, you try to get a summary judgment, kind of summarily dealt with.

So the LLC brought that motion for summary judgment. The court said, "No." They said that, "The reason we're going to let this case go forward because the IRS proffered sufficient evidence to support its alter ego theory at the beginning of the case." In particular, the court relied on evidence that, number one, the entity shared common officers, directors and owners. Okay, I don't see anything wrong with that. But number two, the entities failed to enter a formal lease agreement. And number three, the corporation routinely transferred money to the

LLC without appropriate formal documentation. I mean, this is right out of what I recommend physicians avoid every single day at OJM Group and in my law practice, which is, if you're going to set up an LLC to have property, whether it's leasing, or it's the lessee or the lessor, you got to have a real lease. You got to follow that lease. You got to treat it with the same formalities you would if it was a third party at arm's length.

So if your practice has a lease from an LLC that you and your partners control, you better make sure there's a lease there, and that you're following it, and all the terms, and it's reasonable because if you ever need to rely on the fact that it's separate and you don't want that LLC dragged in a malpractice action or you don't want the practice dragged into a slip and fall, you got to do it right. And that's what this case is showing. So what's the lesson? Formalities matter. Formalities matter. I know it, lawyers know it. A lot of times, physicians gloss over it, and you don't want to do that. So if you want to take advantage of LLCs and asset protection, you follow the formalities.

So with that, we've given you a little bit of an update. Hopefully, you found these cases interesting, you found Carole's insight on where we are tax-wise, and maybe a couple of tips in your specific situation. With that, Carole, thank you for being on. We appreciate it. And-

Carole Foos:

Glad to be here.

David Mandell:

You're welcome. Glad to have you.

And to all the listeners, again, thank you for listening. We'll have another episode in a couple of weeks, as we always do, dropping on Thursdays. And if you're a physician who has an interesting story, as we've had docs in all types of specialties, and you think you might want to be a guest, shoot me an email, reach out. We're always looking for new guests that we wrap in season three in the spring and even as we look out to season four. So with that, thank you. Let your colleagues know. And look for another episode in two weeks.