THE 3 BUCKET METHOD

FOR ASSET PROTECTION

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INTRODUCTION

"Your work is to keep cranking the fly wheel that turns the gears that spin the belt in the engine of belief that keeps you and your desk in midair" Annie Dillard, American Author.

The quote above might be the exact image in your mind when you think about all the effort it takes to keep your business running smoothly, without floating payroll, stalking the mail box for clients' checks or pulling funds from other stashes just to be sure your month is covered. This type of effort typically is what a lot of us sometimes do to just get by. As the saying goes, "**it happens", but there IS a way to have mastery of all of the moving parts in your business and in your life. You just need to get a hold of the right "buckets" to contain and protect your most special assets. These buckets embody my philosophy that I share with my clients when we do their asset protection and estate planning. I call it the 3 Bucket Method for Asset Protection and Estate Planning.

In this book, I will explain how by using the 3 Bucket Method, we identify different business opportunities and strategically separate risk into the three buckets. In addition to the 3 Bucket Method, there will be other items, to include in your estate plan that greatly enhances your asset protection mix, or as my wife likes to call it, your total asset health. I will explore the need for insurance that helps cover the cost of the lawyers who can defend you when bad things happen and provide funds to make right any unintended damages. The beauty of this method is that they all work together, can go into play all at once, or you can grow into them and bring them online one at a time.

Part of the reason I wrote this book is because a lot of businesspeople don't realize the magnitude of risk exposure, they put themselves in just by operating their business day-to-day. Some people unfortunately are one lawsuit away from getting wiped out because they're a sole proprietor. Basically, they and the business are one and the same. There is no separate business entity that protects them or if they do have an entity, 9 times out of 10, they don't have their documentation up to date. They use the company check book like a personal check book. They don't have a record of corporate or LLC minutes documenting different transactions. They don't account for any transactions in their minutes or anywhere for that matter, and that's the way they handle it. That creates a huge risk of exposure in a lawsuit.

In a lawsuit, the first thing that the opposing attorneys are going to ask for is to see your corporate or company book and the last three years of company tax returns. How are you going to answer those questions in a way that doesn't give a lot of ammunition that can be used against you? What can you do to make sure that you are okay, and you are not intimidated by the multitude of TV lawyers looking for their next lucrative case to profit from? Why put yourself in a position where you are worried about somebody wanting to sue you or create a problem?

The reality is, most of you may not even have a business. Some of you may have your sole proprietorship that you filed with the county clerk or have a “DBA”. That doesn't give you ANY protection. Perhaps you never realized that fact or maybe you just don’t want to think about it. Ignorance is bliss until something bad happens. By then, you realize that this lawsuit for a million dollars that sprung up because of a roll-over accident your employee caused won’t go away.

The other reality is that a lawsuit is going to follow you until you either die or you pay it off. And guess what? When you die, the lawsuit is going to go after your estate; and if you have amassed anything, the lawyers and those suing you are going to want to get their cut. The bottom line is you will end up paying now or paying later.

The advantage of employing the 3 Bucket Method is that you can set yourself up in a way that will *actually* protect you in this sometimes very scary business world. You ARE going to be able to weather the storms of life. You ARE going to be able to move forward and not be personally tied to the adverse times of life forever. Remember, the business entity can suffer the loss and die, and there goes the liability and you are in a safe zone. You subsequently move on and you do that by making sure that you've created some protection structures.

Next, you need to MAINTAIN those protection structures. If you don’t have company minutes for each year of operation, that document the transactions of the company, you are at risk. If you don’t have a record in your company book of the different intercompany loans, especially those that require different kinds of tax treatment, you are at risk.

It can get very expensive to hire your CPA and attorney to help you retrace your business’ steps to create the correct documentation that meets the high standards of the IRS for the years your record keeping fell through the cracks. You may not have ANY intercompany agreements and minutes in place. Do you want to open up a window of opportunity in which one of these ambulance chasing lawyers can probe into your business? I can hear them now. “Hey! These two companies don’t even act like they are two separate companies. Why would these separate companies lend money to the other without a promissory note? Why would they let this person have their office on that property without paying rent or having a contract?” Then, all of a sudden, there is a jury that appears and says, “Hey! You know what? That makes sense.”, and the jury has the right to believe they are the same person, especially when you have the same owners.

That is a risky way to do business. You are only opening up your weaknesses and, in a lawsuit, there's a lot of ways in which the opposing legal team can chip away at the armor of your business structure. It’s in your power to keep up the integrity of that armor.

We can certainly create the Cadillac or Mercedes system of protection. But like owning the Cadillac or Mercedes, if you don’t change the oil regularly, check the tire pressure and other aspects of routine maintenance, eventually that car can break down; inevitably at most inopportune time.

The same can be said of your business. If you don't have your business set up properly and up to date, it is likely you will find out at the worst possible time. You will say to yourself, “If I had only done these things, I would be in a better position to negotiate with strength.”.

Wouldn’t you want to say, “Hey, take whatever the insurance company is offering you because you're not getting more than that from me!”. Do you want to negotiate from a position of weakness in which all of your separate companies are collapsing, and the opposing side is ready to take it all? You don’t want to be in a position to say, “How much can I give you for you not to take my property away?” These are the things of business owners’ nightmares and scary things can and do happen to the unprepared.

The 3 Bucket Method is a proven method. My clients have used it. I use it myself for my personal investments and we have used it very successfully. The only requirement; <u>you have to commit to maintain it.</u>

So, have you asked yourself the right questions? Do you want to be informed and prepared? Do you want to be on the right path to sustained wealth? Do you want to be in a position where one unintended mistake or accident caused by an employee could cost you your whole livelihood because of a lawsuit? Have you considered having to start from the ground up again? Do you have the energy or resources to start again from scratch? Do you want to put yourself in a position where you lose all of your hard-earned business assets to lawyers hired by your heirs who are in turn fighting over your assets?

Believe me, the lawyers are eager to get their chunk and the more they get, the less is available for your heirs to divide. Do you want your assets to be available for your use for as long as you need them and beyond? Do you want to make sure that your road to generational wealth is fully paved with a direct route to provide for more than one lifetime? Having an estate plan is a key component to total asset health while protecting your family from disharmony. It can be heartbreaking to see how the family unit just unravels and the polarizing effects of fighting for money. I plan to share with you my philosophy and how I protect my clients from the bad things that can and in many cases, do happen.

The 3 Bucket Method consists of The Moving Parts Bucket (for operation successes), The Dirt

Bucket (for real estate) and the Paper Bucket (for your liquid assets and ownership interests). You will need to have proper insurance in place and an estate plan or succession plan for your assets.

It is important to make sure that the fruits of your success don't just end with you. Your wealth should continue onto your next generation; to the people you want to take over your businesses or to continue to provide for your family. The first strategy we call The Moving Parts Bucket.

SECTION ONE

The Moving Parts Bucket

What exactly do we mean when we say moving parts? Moving parts include any kind of business operation in which you have employees; and as almost 100% of business owners know, you can't control employees. Employees can cause damage they didn’t intend to. Imagine your assistant makes a quick trip to the corner store or runs down to a near-by fast food restaurant to get lunch for everybody. On the way back from their break, they get into an auto accident minutes from the office. Guess who's liable? The employer can be held liable for any damages that are done because the accident happened during their work time.

The same can be said for any kind of business that has equipment or heavy machinery. If you have trucks or tractors in your business, you want to make sure that you've got a separate entity for those types of business assets. You may even want to have a separate entity just to own that particular equipment and lease it back to your separate operations company.

The practice of separating the moving parts also comes into play if you are in a service business, like a law firm, dental practice or funeral home. Perhaps in your service business you don't have too many employees or only you are the service provider. These scenarios all constitute risk to the business owner.

The best strategy is to separate what can be considered your high-risk operations in your life. This would also include YOU, if you have an ongoing business or firm that depends on you for the bulk of the operations. Steps should be made to make sure you have a separate entity.

What exactly would separating yourself into an entity, as the main service provider, look like?

There are options. You could be a corporation or an LLC, however, you do NOT want to be a sole proprietor. I'll explain that concept more later. In addition, you want to make sure that you separate the different types of risks. If you have a business that has heavy machinery and another business that is a restaurant, you want to separate the two within the Moving Parts Bucket. Tidiness is important when dealing with multiple business. Keeping these types operations in the same entity will only create unnecessary connections and if one of the entities suffers damage through a lawsuit or is attacked by some means, the other entity or entities will get wrapped in the mess. The basic rule of thumb is to create a separate entity for each business operation, which I will dive into in greater detail later in this book.

The Dirt Bucket

"In real estate, you make 10% of your money because you're a genius and 90% because you catch a great wave." – Jeff Greene, American Businessman

We may hate to think that our real estate triumphs have been fueled more by luck than skillfully crafted study of the markets. Regardless of how you got to your own personal pot of real estate gold, you certainly need the right bucket to catch and care for that success; no matter how big or small your real estate portfolio may be. This leads our discussion to the second bucket of the 3 Bucket Method, the Dirt Bucket. Now as the name implies, this is where you want to keep your real estate.

I make it a personal rule not to put more than $500,000 dollars in aggregate value. That adds up to no more than $500,000 in total properties. In other words, in a simple entity for example, if you have three rental houses that add up to $450,000, I'm okay with keeping those in a single LLC. If you own a million-dollar property. Well, you're not going to create two LLCs to own that property. It just doesn't make sense. You want to make sure you have just one entity for a property worth more than a million dollars or more than a half a million dollars or whatever you deem is your risk threshold.

Why even keep them separate? Wouldn't it be more expensive to set up and maintain? Let me tell you why it isn't. Imagine you own a $50,000 little rental house. You keep it in the same LLC as your ranch that's worth over two million dollars. If somebody gets hurt or killed on the little rental property, guess what? If they get a BIG judgment against your LLC as the owner, they're going to be able to get the ranch along WITH the little rental because they are owned by the same person or entity. It's important to keep those different properties separate.

Another important strategy is to separate your properties based on the quality of the risk. For instance, a commercial property has a certain quality of risk that is different from a residential or even ranch property.

Think about having a store front. During operating hours, you have the public coming in and out of your store front property and there are associated risks that can occur, and someone might get hurt from those frequent contacts. Perhaps someone slips and falls in your store front. You may or may not be the owner of the property that makes up the store front. Maybe you are just renting the store front unit for your business. Whether you are renting to or renting from, you might be at risk and both of you, the business owner and the owner of the property can be involved in a lawsuit. The owner of the property often-times is named as one of the defendants in a lawsuit. Certainly, something to keep in mind.

Allow me now to expand a bit on the different quality residential rentals. Albeit a different type of risk than commercial rental properties, residential rentals have their danger zones to be keenly aware of. This, of course, is where people will choose to live, not work from; so, it may be safe to say they will take greater care in who comes in and out. With that said, you've got a little bit of risk mitigation built in. However, that does not negate the fact you still have somebody who is not you who will live in the rental and in there lies the risk. Literally. You've got stoves that if left unattended, can start a fire. You've got a potential risk in slippery wet floors or bathtubs and other things in which people can get hurt. Your tenants have visitors. Your tenants make barbecues. Your tenants may use a pool you installed for the complex. A slew of different risks can be associated to living in any home or apartment rental, in general; the list goes on and on. And let us not forget the risks associated with owning raw land. Yes, they may be different in scale and quality, because with raw land, there are not as many people coming in, especially if you prepare the entrance of your land and other access points with "No Trespassing", but ultimately somebody may come on to your property. It is important to remember, you will be liable for certain unfortunate events that happen on your raw land, depending on your state's laws. Keep in mind, if somebody comes onto your land and there's an obvious danger and you haven't placed a warning sign in an obvious place, you could be liable for it because you knew or should have known about the danger.

One more risk to be aware of with property of any type is the “attractive nuisance”. This could be a swimming pool in the backyard, heavy machinery parked on a commercial property or even a pond on raw land. These things can attract people, including children, who may not be able to discern the risk, and get hurt. You need to safeguard from this risk.

Now that we have separated our risks, we can move onto the next bucket, The Paper Bucket.

The Paper Bucket - The Harmony Within

"I do know that throughout history, all paper money has eventually come back to its true value, which is zero." – Robert Kiyosaki, American Author

Let the quote above be inspiration for what not to do. We want to fight to keep every asset we have and then sweat to multiply it. While sweating may not actually be a prerequisite to saving and multiplying your wealth, putting it in the next bucket is the Paper Bucket. In this bucket, we consolidate EVERYTHING. In this bucket, we would create a Limited Partnership or Limited Liability Company which would own your excess cash. The Paper Bucket would also own your stocks, bonds and other liquid assets that are not already protected by statute, either through the federal bankruptcy code or your state exemptions. Texas, where I practice, is one of the states with the most favorable exemptions. So, in Texas, some things, like your retirement accounts and your personal residence, would not be something that you would want to put into your paper bucket, since they are already protected. Now, I know what you're thinking. I just finished explaining to separate everything from each other and now we're putting everything back together! You're right. The difference is the risk. To illustrate my point, let me tell you about two types of risk: internal risk and external risk.

The internal risk is the risk that comes from inside the business. Similar to the gears in a machine, in the Moving Parts Bucket, the risk comes from these three things: the employees, the equipment and the things that the owner might do in the business contracts. When it comes to business entities contained in the Dirt Bucket, the risk comes from the property itself. Any dangers, hazards or the failure to maintain the actual property will present internal risks. Unlike the other two buckets, in the

Paper Bucket, there is no internal risk asset contained because this bucket should only own paper assets such as cash, securities, bonds and things of that nature. Just owning shares in a company does not put personal liability on the owner. For example, if you own stock in Apple and Apple gets sued for something outrageous, you're not personally going to be worried about your assets other than your stock in Apple. That Apple stock value may go down; even to zero, if Apple were to have a terrible loss. Hard to imagine, since Apple, as of the writing of this book, has been named the most profitable company in history. Either way, the rest of your personal assets would not be touched at all and you would never worry about it, thanks to the way our laws are set up. Just being an owner does not create personal liability.

External risk is the risk that comes from the outside. You can also consider it the risk that comes from the owners. For instance, if I, as the owner of a company gets sued and my company is structured in a LLC, in Texas, the only thing a judgment creditor can do is get a charging order against my interest. With the business entity structured in an LLC, I am not required to make distributions.

Subsequently, the judgement creditor would not be able to manage or control my assets. They would just be stuck, holding the charging order papers, not able to do a thing. Meanwhile, I don't need to have the money in my hands. My paper bucket entity can create another LLC to buy another real estate investment. I'll be ready for a fresh start with a new business from which I can be an employee and draw a salary from the new business.

The Rest of your Tool Kit

What else should be in your 3 Bucket Method Tool Kit? It can be critical that you make sure you have a personal and business liability insurance, not to mention the correct amount of insurance for your business. There are two reasons for this. Number one, you want to make sure that you are a good business citizen and ready to make things right when things at your business go wrong. Ask yourself, are you prepared with the right tools to take care of your customers if your employees do something that put your business in jeopardy? There is insurance for that, and you want to be sure you have that set up.

Additionally, you want to make sure that somebody is going to pay for the attorneys you may need to hire to defend you if there's a loss. It's not cheap. If you're footing the bill, you could easily spend a $100,000 in legal fees to defend your case right up to the date of trial. It can be very expensive. Make it a point to make sure you've got the liability insurance you need by checking in with an expert.

As you can see, identifying and separating your risk into different buckets as described in my 3 Bucket Method provides you, as the business owner, protection from both sides of the risk equation. By employing the 3 Bucket Method to enjoy the benefits of asset protection planning, you are smartly mitigating the vast majority of the internal and external challenges that face your important assets. And why do we do any of this?? To prepare a path towards *generational wealth*. Unlike wealth that we only enjoy in our lifetimes, generational wealth is wealth to be enjoyed and protected for our children, our children’s children and, God willing, the generations that follow. This leads the discussion to the benefits of estate planning.

Estate Planning for Generational Wealth

Some states have a very complicated and expensive probate system and as a result, it can be very costly to go to probate. In Texas, we have an efficient system, IF you have a Will. It is possible to take advantage of some potentially expeditious estate planning strategies, but you need to make sure that you've got some sort of plan. If you don’t have a Will, even in Texas, it can get very expensive to probate an estate. Saying that, the next thing you want to do is make sure you have an estate plan in place. That basically comes down to having your Will in order and in many cases, having your trust in place. You need the right instruments to make a smooth transition to the next generation. One of the most important things you can do in your lifetime is know who you are leaving your assets to before you die and ensure that they are able to receive those assets in an efficient manner.

A Living Trust may be an important component. This would allow you to avoid probate and the court process to reduce time and expense of transferring your assets to your family.

Some other documents, or “tools”, to have in mind are a Durable Power of Attorney; Medical Power of Attorney; Directive to Physicians, Family and Surrogates and Designation of Guardians. More about those later in this book.

SECTION TWO

A Deeper Dive

Earlier, I discussed that within the moving parts bucket, you want to make sure you are keeping what makes up your operations and your business entities safe. Easy enough to say, right? So, you may ask, what does that actually entail? How does that work in the real world and what are the different entity options that I have? What do these proverbial buckets look like? Allow me to focus on Texas, because that's where I'm licensed to practice, but these concepts are fairly universal, so check with your legal advisor in your state. In Texas, you can do business as a sole proprietor, which means you don't have a business entity, but instead, you and the company are one and the same. This business set up can badly unravel and if things don't go well, an adverse judgment can follow you way past the moment you pay it. I'm certain the negative effects will keep stalking you. This can make your life difficult, especially if the other side's attorneys are really aggressive.

Another form of business is a partnership, which means you and another person or more decided that you are going into business together, but you didn’t want to create an entity. And with the powers of mathematics, all you have managed to do is multiply the risk by the number of partners involved. So, one of you is the money partner and the other is the sweat equity partner and lawsuit springs up. Guess who they're going to go after first. That's right, the money partner. The sweat equity partner will be on the hook, but when you don't have anything to lose, there's nothing for them to go after.

The next form of business may be something that more people are familiar with, a corporation.

Corporations are entities that provide a separation of management and ownership.

The way the Corporation works, looks like this: you have your shareholders who are the owners of the business and as owners, shareholders don't have the liability if/when anything that goes wrong within the Corporation, so they're protected from any risk that is associated with the operation of the business. A Corporation allows for providing professional management that can make decisions about the business, yet, they don't necessarily own any of the business. This benefit provides some risk protection to the owner or owners. Corporations have another thing going for them, in that they've been around for a long time. Over 100 years, actually, and there's a lot of history on how the courts interpret the bylaws and not the Corporation and the state statutes. In a nutshell, there's substantial knowledge base of understanding on how Corporations work for your business. The problem with Corporations lies in how we pay taxes within a corporation. As of the writing of this book, Corporations can only pay taxes in one of two ways. When your entity is a C-corporation, the company pays its own taxes and gets a deduction for employee expenses but not deductions for dividends that are paid out as profits to owners. Keep in mind, although it provides protection for the owners from what happens in the business, it doesn't really protect the business from what the owners do. This goes back to our charging order situation. There isn't a charging order statute for Corporations. In other words, if you own a corporation and you personally get sued, they can get a judgment against you, take the shares of your corporation and liquidate them. In Texas, the Corporation is given a 21-day notice to either pay off the judgment or turn over your shares.

Effectively, the result is, the person who sued you has now taken over your ownership. And if you've got partners, guess who the new partner in the corporation is? It's the person who sued your business partner. That's a clear weakness of a corporation.

The next form of business is a more popular business entity structure. It's called the limited liability company, or LLC. The LLC has a shorter history than the Corporation. There are some notable differences and similarities to the two.

Unlike a Corporation, the owners are called members and the managers who run the business are called managers. Like a Corporation, it separates management and ownerships and offers the same protection, where the owners are not liable for anything that happens in the business. But the difference is, in the LLC, if an owner is sued and there's a judgment against them, the only thing that can remedy this is a charging order against them. A charging order is an order from the court that issued the judgment rendered that says, "LLC, if you make a distribution to Mr. Jones, you have to make it to Mr. Smith who won the lawsuit and has judgment". Well, in the LLC, we are not required to make distributions. Those who have set up their business entity in the LLC, don't have to make distributions to ANYBODY and have protected themselves in that manner. This is what makes the LLC a popular business entity structure. Another benefit is that it has more flexibility and it's less formal than the Corporation.

That flexibility presents itself at tax time. The LLC can be taxed in many different ways, depending if you qualify, based on that number of owners in the LLC. For example, if the LLC consists of just you or you and your spouse, you have an opportunity to elect to be what is called a "disregarded entity”. A disregarded entity is not required to file a tax return, the profits are reported on the owners Form 1040 Tax Return. That is the default position, unless you elect otherwise. If you have two or more members, you can elect to be taxed as a Partnership, as a Corporation, or as an S-Corporation. As you can see, there are different opportunities available to maximize the flexible nature of the LLC business entity structure. Your homework will be to look at your personal tax situation with a tax professional to see how this type of tax election best fits in with your overall asset and income mix so that it can provide you the best tax outcome. One mistake you do not want to make is deciding on anything purely based on the taxes. If you let the taxes determine what business you pursue or how you set things up, you are not necessarily going to have a profitable business. You want to set your business up in a profitable way while considering the best tax practices.

There is one more business entity available in Texas, and in most states, that I would like to shed some light on. This option is more complicated, and

I plan to cover it only briefly with you at this time without too much detail. If you would like to read more on this entity type, read my book The Road Map to Rich. This business form is called the Limited Partnership. The Limited Partnership consists of at least two partners, a limited partner and a general partner. You can have as many limited partners and as many general partners as you like. The general partner in this situation has full control of the business and calls all the shots, but at a price, which is personal liability. When something goes wrong in a Limited Partnership, the general partner has personal liability for whatever happens, and they are NOT protected. Typically, the work around our firm will employ is to create the LLC to be the general partner that is owned by whoever the members or the managers are set to be. At that point, the LLC should work just like any other LLC as I have described before. The limited partners are then like the title implies, with limited liability, limited risk and they have limited voice and vote. Basically, the limited partners don't get much of a say unless the general partner is breaching their duties under the partnership agreement. It should be noted that typically, it is difficult to establish that the general partner is breaching their duties because they have broad powers which they need to be able to manage the business and provide the necessary protection. There are a few other nuances and little wrinkles that are more complex, but in a nutshell, those are the different entity structures for business that we can implement in Texas. I explain this in more detail in my book The Road Map to Rich.

Moving Parts Bucket in the Real World

Okay, so now you have your business set up in the right business entity structure. Again, not a partnership and not a sole proprietorship but rather in one of these three entities: an LLC or Limited Liability Company, my preferred type; a Corporation, my second preferred; and finally, a Limited Partnership, which can be employed in the right circumstances. In an operating or "the moving parts bucket", we are looking at implementing the LLC more than anything else. Now we ask, what are you going to put in your LLC? Let me give you an example to understand what would be best.

I have many clients in which we've set this type of structure. Let me tell you about a trucking business. Raul, who has a trucking operation, basically hires truck drivers, has trucks and they travel throughout the United States delivering stuff for his customers. Let's unpack that scenario. Raul and his partners are the business owners and have business assets and equipment such as 18-wheelers, tractors and trailers that are heavy-duty machines that can cause a lot of damage. Truck drivers are human beings and can have accidents or make unintended mistakes that have consequences. Raul and his partners' operation owners also have customers whose merchandise they are transporting on the highways that can be damaged if there is an accident. How do we mitigate those types of risks in the moving parts bucket for this particular line of business? For Raul and his partners, we created an LLC to be the trucking business. As a result, the trucking company LLC gets hired to move freight throughout the country. They then set up another LLC to own the trucks that make up the equipment. As you may know, these trucks are expensive pieces of equipment. Purchased new, these trucks can be well over a hundred thousand dollars each. Our technique is to separate that equipment from the business operation by protecting them in a separate LLC. We will call it the equipment LLC. Why, you ask? Well, if there is a lawsuit against the trucking LLC because an employee of the trucking company was in an accident, only one truck might be lost because it is damaged and out of commission, and not the whole fleet. Let me explain further. The rest of the fleet is owned by the equipment LLC company that is set up with a contract that holds that responsibility for maintenance of the trucks. Any consequences from the misuse or damages are the trucking LLC's only.

If someone sues the LLC that hired the driver that had the accident, they can only get the desks, computers and other miscellaneous stuff they have since that company does not essentially own the trucks. Basically, they can't take away what isn't "owned", since the trucking LLC is just leasing the trucks from the equipment LLC that was created. To reiterate, if you have the ownership of the equipment outside of the trucking LLC, in that lawsuit, the only truck that is getting lost is the one that was in the accident because of the damage sustained. So, we're able to push all the liability onto the trucking LLC. As you can see, in the trucking LLC we have all the risk and we have as few assets as necessary. Be sure to have enough assets to properly (low value assets) or leased (high value assets). Now, back to Raul. He actually ended up with three LLCs in his moving parts bucket: the equipment LLC, (for the trucks that are leased to the trucking LLC), one for trailers (yes, the trailer LLC), that carry the merchandise and one for the trucking LLC, the main business.

Now, let me tell you about my friend Miguel who is in the construction business. He is a general contractor and operates his business as an LLC and has certain equipment like backhoes and other heavy equipment, in a separate LLC. He put that into a separate company and has that company lease the equipment to his general contractor LLC.

As you can see, we create different entities in the moving parts bucket. One of the benefits in regard to taxes is that lease income is not subject to employment taxes, as of the writing of this book. As a result, you save about 15 percent when you are both the employer and the employee. This allows you to move income and create income that has a lower tax liability. And all of this is perfectly legal as long as you are doing it within the acceptable ranges of the rent that you are charging. You can't charge a ridiculously high rent that doesn't make any sense for what you are doing. It has to have a business purpose and has to make business sense when you are doing this. I hope this helps you understand the different things you want to put in the moving parts bucket.

The Dirt Bucket in the Real World

Now let's explore the Dirt bucket. In the dirt bucket, you want to put your real estate investments in there. You will want to separate it based on risk. The key thing is to determine your personal risk tolerance level. For me, it's $500,000. For you, it might be $750,000 or $250,000. Or perhaps it’s a single asset that is in excess of your risk limit. In this case, the best strategy is to use a single LLC.

Banks like it when you have a single entity for your assets. So, if you've got a million-dollar property the banks are going to be very happy that you do not have it just in YOUR name, but rather, in an LLC all by itself. Why? Well, number one, banks hate to deal with anyone who is not their customers. With that said, if you use an LLC dirt bucket for your real estate investments, they won't have to worry about you doing something that creates a liability, for example, getting sued and then consequently having to deal with someone else trying to take away that particular asset or any associated equity from you. Reason number two is, if you have your real estate in an LLC in which the property is the only asset and they are the only lender, then they're not worried about anything else going on in your life. They can focus their attention on other things knowing this real estate asset is isolated in an LLC. The main concern, in their eyes, is if you are paying your note on time. The caveat to that is, residential mortgage lending companies are not going to be able to lend you money in the name of your LLC. If you move your home to an LLC or are seeking a home mortgage, lenders will not be able to provide the loan to an LLC for real estate. This, and other issues may arise that you need to be aware of when creating these business entity structures. Keep in mind, there is not a 100% way of mitigating all risk and situations need to be evaluated on an individual basis. I would be happy to discuss your particular situation in an attorney/client privilege conversation.

Now we know that we want to have a separate dirt bucket for our real estate or "dirt" so to speak, but how does that work? Let’s unpack this and see how this bucket plugs into the overall system. But before we get to that stage, let's talk about the different types of real estate that can come into play. Imagine you are interested in beginning your journey as a real estate investor. Typically, the first way a lot of people start on this real estate path is by buying a residential property and renting it. It might be a small house, a condo or maybe a small apartment complex. There can be a lot of available inventory coupled with a high need for affordable housing in your area, which makes this type of investment appealing. You may even consider renting out the house you used to live in and have moved on from when you outgrew it. I'm not going to be able to cover every single type of real estate, because one property type is almost as different as the other, but I'm going to cover some general concepts to keep in mind. You can learn more about different types of real estate and real estate strategies in my book The Road Map to Rich. Commercial property is our next concept to digest and in and of itself, is pretty broad. Commercial property can include some residential type properties, like a big apartment building. It can include a business center or a shopping strip center. It can be one unit in a shopping center, or it might be structured as a condominium in which there is common ownership of the parking lot and buildings. However, inside each unit there are individual owners. Raw land is another type of investment. You can have a ranch that you use for hunting, grazing, ranching or farming. That raw land has a value. It may or may not always be income producing. It may just be a little something that you invested in for the future. It could be a property that you bought that is undeveloped and you're just waiting for the growth of the city or county to reach your property and enjoy the increase in value in that part of the town or city. You may be in a situation where you're not going to be generating a lot of income from your raw land investment. If you have the cash flow and the ability to pay the taxes and maintain that property, then that's a whole other discussion. Let’s say that land is the investment you've chosen. Having it in an LLC works really well. Your administrative costs will be relatively low because your real estate is not going to require many transactions. You're basically going to be paying one check for taxes and one check for your insurance, if you've already bought the property free and clear. Those are the three general types of real estate properties that are out there.

Let me tell you about my client, Jorge, who has around 2 million in rental properties in South Texas. He has a higher risk tolerance than me. His property is located in two regions and he decided to separate his risk along those lines. We created two entities, one to own his northern properties and another to own his southern properties. Jorge has separated his risk and will not lose everything in the event of a lawsuit.

Remember, each of these have different associated risks. If you have multiple properties that are valued at less than half a million dollars, in my example I mentioned earlier, you could bring all the properties together. As I mentioned before, sometimes your properties are from different risk pools. In other words, some might be commercial, some might be residential, some might be raw land and maybe they don't all add up to $500,000. You will still want to consider separating them by their different risk qualities.

The Paper Bucket in the Real World

"The most important asset you need to protect in order to manage the demands of a job or an investment portfolio is your production of energy. And, just like with money, if you do a great job managing your energy, you'll get a great return." – Jim Loeh, American Psychologist

As the quote above illustrates, if you do a great job managing your money, you will experience a great return on your investment, and I can help you create and use the right tools to do so. In the Paper Bucket, you will have an opportunity to do some estate planning that will allow for additional asset protection. This is a place where you might consider doing a Limited Partnership. I know I said before there are few situations when I recommend a Limited Partnership entity. This is one of those. Before we move forward with that concept, let me first say, as I explained previously, your Paper Bucket is where you want to have all your liquid assets. This will include your paper assets, your membership certificates in your other companies and your excess cash from your business. This would be the time to pull out that excess cash and be sure it's not sitting in your personal bank account. Additionally, make sure that you also have your ownership in stocks and anything that's not already protected by statute in your Paper Bucket entity. Of the three buckets, this is the only bucket that has only one company, typically. That can change if you are a married couple and you have separate property that is in different buckets or has different ownership interests. I don't plan to get into much detail about family situations, but I can discuss with you in person. That's just outside of the scope and detail of this book.

Again, in your Paper Bucket, you're going to go ahead and have either an LLC or a Limited Partnership with the purpose of holding your shares in your other businesses, your cash, etc. Using this method has helped many of my clients, especially those who are in partnerships with other people. The Limited Partnership is the preferred entity that my clients use to invest for a few reasons. If there's a disagreement in what the distributions are going to be especially if one of the partners in the deal gets a charging order. The investment in the new venture is done by the paper bucket LLC, not the individual, thereby further protecting and insulating my clients. Basically, if there's a charging order or if there is a problem personally with the other partner, it's not going to affect their investment in that other company. The charging order will go to an actual person who owns The Paper Bucket. Another reason my clients use a Limited Partnership for the Paper Bucket is because this is where we've consolidated all of their assets within the business structure and it becomes owned centrally with this company. Another way to look at it is, the Paper Bucket becomes their personal mutual fund. The personal mutual fund is going to be what my clients can leave to their heirs, to their chosen charity or WHATEVER they want to do with their assets. It provides for their estate plan. They can give part in life to have their heirs learn to manage the wealth they will eventually receive.

The Collaborative Effort

"Collaboration is like carbonation for fresh ideas. Working together bubbles up ideas you would not have come up with solo, which gets you further faster." – Caroline Ghosn, American Businessperson

For most businesspeople who are just starting out, it's safe to say they don't have all three buckets in place. They may not need all three or their business has not yet matured enough and are just not there yet. That's okay. And although each of the three buckets can be implemented on their own, there is truth in the quote above, and collaboration, like carbonation, certainly mixes up things in a good way. By putting the Moving Parts Bucket and Dirt

Bucket together to work side by side for your business, you will experience a tangible maturation of your business. You will feel the “next level” approaching. How will you know when to take your business to the next level? Maybe you started out by renting a location. Whatever your business or service is, you've grown and need more space and maybe you made some money and are now tired of paying rent. Now do you buy or rent? Rent and ownership of your business space should be considered carefully and is a whole separate ball of wax. In some cases, renting is the smartest thing to do. In other cases, ownership is the smartest thing to do. You may want to own the property even though, in the big scheme of things, you may be better off just renting. But for our example, let's say your business is growing and you need more space. You have decided to stop renting and own your own space. That will allow for more control over your environment. There is also, what I call, the “third case”, where sometimes you just need to do what you WANT to do. You will usually know best how to handle each situation and the reality is, what you really want to do is what will result and oftentimes we learn a whole lot more in “the third case”. The key in the third case is that you are aware of the pros and cons of the options, but you decide with maximum knowledge.

Back to my example, and how you implement the Moving Parts and the Dirt Bucket to work together. By owning your own space for your business, you have now transitioned to a two-bucket operation with the addition of the Dirt Bucket to your Moving Parts Bucket. How did that happen? Simple. You used the Dirt Bucket in the form of an LLC to buy that new office building, shop, new warehouse or new store front. Pretty easy, right? It's important to have the ownership of your business space owned by a separate company, and I prefer an LLC. I typically don't recommend Corporations for real estate businesses. Corporations create a lot of tax liabilities and under current law, that will hit at the moment you want to sell the property. With the Dirt Bucket now in place, the Dirt Bucket entity that owns the business space (the building or raw land, whatever the case may be depending on your business) then rents the business space to your Moving Parts Bucket entity. You have to make sure that you have very specific lease agreements in place to ensure the success of employing these two buckets together. The lease agreements must have clear explanations as to who has responsibility for what. It is critical that your Moving Parts entity is the one that has the majority of the risks and is the one that then has the responsibilities. Why? Because it doesn't own any assets and has very little to lose.

This is the ideal way to structure your business and will result in a lease agreement between your operations company, the Moving Parts Bucket, and your real estate company, the Dirt Bucket. Before you finish checking off your to-do list as complete, the next step is making sure that you have insurance in place to cover the general liability property in the event there is ever a lawsuit and if you need the ability to terminate the contract. Additionally, you want to have insurance to pay for the attorneys to represent the owner of the property, as well as separate attorneys to represent the business owner that operates in that location.

To give you a real world visual, some of our clients that have put this strategy into practice have the operations of the business, equipment leasing and real estate ownership in the business space in one entity. They charge rent space to their equipment leasing company. That becomes an expense to the operations company that is deductible; which then becomes income to the real estate company in order to make enough money to cover the note, pay the property taxes and any other expenses that the real estate company is going to be responsible for. Essentially, that is how those two buckets connect and minimize your risk as a business owner.

Gifting Assets

"In suggesting gifts: Money is appropriate, and one size fits all." - William Randolph Hearst, American Publisher

It's always nice to receive, but in the business world, it can be nicer, or in the least, more strategic, to give. So, let's discuss gifting your assets. As of the writing of this book, the estate tax credit is right around 11.2 million dollars per person. For married couples, we are talking about 22+ million dollars' worth of assets. This is the total amount a person can leave to their heirs without being subject to the estate tax. As of the writing of this book, it is 40%. Anything over this is subject to estate tax. Saying that, not a lot of people are going to be too worried about the estate tax. However, there is a gift tax which uses up those applicable exclusion amounts, the credit we discussed above. If you are strategic, you can transfer your money without paying the estate and gift tax. How exactly does that work? Perhaps you want to gift part of your company, but you don't want to let go of the control. You can make a gift of a Limited Partnership Interest and you can continue being a general partner through an LLC and you can continue being a limited partner. When you make distributions and you want to give distributions to your kids, they would get distributions based on their percentage ownership in the partnership. This is another example of using a Limited Partnership as the type of business entity for gifting. If, on the other hand, you decide to use an LLC for gifting instead, that’s when you have majority rules and you need to make sure you keep a majority interest to keep the control.

But before you make your gifts, you've got to look at the equation carefully. Will it be worth gifting property if you create a capital gains bill for your kids? Here is how you don’t want to shoot yourself in the foot with your generosity. Let's say your assets are worth a million dollars and you want to give your kids a million dollars. The million dollars comes in the form of a real estate asset, like a family farm that you inherited from a relative that died 40 years ago. The basis, or cost of the property, was received at the date of death of your last relative that owned it who left to you. And let's say that the basis is $300,000, but it's worth a million dollars today. If you sell it, today you're going to have a capital gains tax based on the difference of $700,000 that you could be taxed on assuming the capital gains rate at 20%, the tax bill will be $140,000. Alternatively, if you gift it to your kids, they will receive it with the tax basis of $300,000. If they decide to sell it, they're going to pay the capital gains tax based on the $700,000 profit. If your kids inherit it there will be an adjustment in the basis on date of your death. When that adjustment happens, it's called a "step up in basis". As a result, since you have to pay tax on the value at the date of death, the IRS lets you increase your basis to the fair market value at the date of death.

So, the basis that your kids inherited at is going to be a million dollars and if they sell it for that same million dollars, there would be no capital gains tax due at that time. At that time, you will need to decide whether you want to do any gifting or not, and you have some options. Using a Limited

Partnership, you can transfer up to 99% without losing control. Using an LLC, you are limited and can't gift more than 51%. Once you go past 51%, you lose the ability to have full control of the entity. For some things you may need 70% of the vote. With that being said, you want to be sure you carefully draft your company agreement before you start making gifts. Another element for discussion for the Paper Bucket is “who owns the Paper Bucket?”. Another layer of privacy can be created when creating trust and this strategy typically works best when we create everything upfront. For some clients, we've created trusts and the trust owns the Paper Bucket. The trust becomes an instrument and does not need to be filed anywhere. A trust would also say and control who will get your shares in the partnership or LLC when you pass away. When discretion and privacy is a priority, using a trust could wind up being the dead end for somebody trying to poke around and find out who owns what. The individual person’s name that is the donor never appears anywhere. If you don't have a trust, you should at least have a Will. Let me take a moment to take my estate planner hat off and speak to you as your good friend because I can’t say it enough, EVERYBODY needs to have a Will. If you own anything or if you have kids, you need to have a Will. It is that simple. Having or not having a Will can be like night and day. With a Will in place, you can say how things are to be distributed upon your death which allows for instruction and a smooth transition for your family. Not having a Will can create firestorm of uncertainty as well as a financial burden due to infighting between family members, ultimately causing all kinds of problems that could have easily been avoided. Sometimes equal and fair are not the same thing.

A Trust is another way to distribute your estate. The difference is that you transfer your estate to the trust and when you die it passes based on the Trust without court involvement. In many states, this is the best way to go. Now, it's better to have something rather than nothing. I will say that I've had the experience where the popular online generated Wills are admitted into probate and they work, but they created a lot of problems for the family because the online generated Will didn't include certain language that allowed for independent administration, which makes probate easier in Texas. The online generated Will sometimes didn't distribute the assets in a way that was based on the heirs involved in the family business, in this case. For the majority of my clients, just writing a Will on a computer, does not address a slew of issues that need to be considered. Think about your hair style for a moment. Sure, you can cut your own hair, but why would you when you can have your hair cut by a studied professional who can see and style your hair from all angles, giving you the best result. Some things are best left to the help of a professional who has expertise in dealing with your situation so that you're able to make the best plan for you. You don’t just wake up and say, “I’m going to write my entire Will right after I drink my cup of coffee”. Consider the bigger picture and make a plan, your Estate Plan. And no matter the size of your estate, plan on how things are to be distributed upon your death because the reality is, death is the end of the road for all of us at some point.

Not Quite Dead Yet

“Lancelot:	Brave, brave Concorde! You shall not have died in vain!
Concorde:	Uh, I'm-I'm not quite dead, sir.
Lancelot:	Well, you shall not have been mortally wounded in vain!
Concorde:	Uh, I-I think uh, I could pull through, sir.
Lancelot:	Oh, I see.”

— Monty Python and the Holy Grail

Another possible reality is that you might not quite die. You might become incapacitated, perhaps as a result of a stroke, or car accident. You may be in a situation where you become permanently or temporarily disabled and can’t take care of yourself.

Even in times like these, you may be in a situation where you need to take a business action and you can’t. What in the world can you do then? In the real world, unfortunate things like this, happen all the time. But you don’t have to feel helpless because there are tools you can put in place that will offer you and your family security. Let me provide an example. Let's say you found a piece of raw land with plenty of potential. You then put a contract on this piece of raw land for $100,000 and soon after suffer a car accident that puts you in a coma that you will recover from, but not until after four months. You're not able to make decisions or sign any closing documents in that time. Meanwhile, while you were sleeping in your coma, Wal-Mart announces that they are going to set up their new Supercenter right next door to your contracted property, bringing its worth from $100,000 to one million dollars. Your seller is very likely going to try to get out of the deal. They're going to say you since you can’t sign the closing, they will want to cancel the contract, let the time expire and then you end up losing your opportunity. They, in turn, will try to sell it to somebody else for a million dollars. Instead of you making the money and your family benefiting, it’s going to be this other person. So how do you protect yourself? You need the right documents with the power to protect you. With a Durable Power of Attorney, you can make sure that whoever you decide is the Power of Attorney can sign those closing documents for that property for $100,000 on your behalf. You will then own the property and turn around and sell it for the million dollars and you and your family can benefit from that lucrative deal as opposed to the seller who wanted to back out. I hope that sends home the importance of these powers of attorney.

Next to consider is having a Medical Power of Attorney. A Medical Power of Attorney is somebody you have chosen to make health care decisions. This person can be the same person as your Durable Power of Attorney or a different person.

It is also important to consider who will be your designated guardian. A designated guardian is somebody you have chosen to take care of you, if there is a court proceeding that needs to happen due to your illness or otherwise. It is better to select the best person to represent you in court ahead of time and not rely on the court's good judgment. There are plenty of occasions when no one has been selected and someone without the best intentions presents themselves in front of the court and says, “Hey, I want to be the guardian” and just like that, it’s done. One of the greatest benefits to having these documents in place is removing the burden from your family to make these hard decisions at the end of life. There is a document we can create called Directive to Physicians, Family and Surrogates where you can indicate that if you're in a terminal condition or in an irreversible condition what you want to happen. Do you want them to just pull the plug and let you die as gently as possible or do you want them to do everything they can to keep you alive? You have the power to choose and with the proper documents in place, you will have the security that you know what you want will happen.

A Trust can also be invaluable in the management of your assets while you are incapacitated. The Trustee will manage your assets and be sure your best interests are protected. In your most vulnerable moments, you can say you took charge, removed those hard decisions away from your family and made your family’s life easier.

Life Insurance

"If a child, a spouse, a life partner, or a parent depends on you and your income, you need life insurance." – Suze Orman, American Author

It is very easy to underestimate the value of life insurance. Like creating an estate plan, it can be another reminder of your own mortality. Life insurance, however, is essential to the overall health of your family and business finances. It can be imperative to make sure you have enough life insurance to take care of all you planned for you and your family. We can help you analyze your liabilities, your goals and what you want to accomplish, but ultimately, you are the one that needs to make that determination. Perhaps you want to make sure all of your kids are able to go to college even if something happens to you. You want to make sure that still can happen and can still be a viable situation. Life insurance is also a protected asset which can provide protection to your estate.

Conclusion

The 3 Bucket Method is a proven system to protect your assets in the real world. It is not a magic bullet that makes you invincible, (nothing can do that) but rather a system that compartmentalizes risk to minimize your personal exposure and loss. This system can help anyone who wants to protect what they have worked so hard for. You must commit to maintaining the system for it to continue to provide you with its protection and reduce your risk of loss. Until you take the first step, you are at risk of losing all you have earned up to this point and into the future.

Contact us today for your appointment to take the first step protecting your business and start implementing The 3 Bucket Method for yourself before it is too late. Call us today, 956-267-5176.

This educational book has been provided by The J.M. Dickerson Law Firm PLLC.

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