

The Lessor's Lien

Most lease agreements contain a lessor's lien clause. These liens are not part of an intentional asset protection program; rather they are liens that arise in the normal course of business. A lien may be used to ensure that someone meets an obligation. In this instance, the lessor wants to make sure that the lessee fulfills his lease obligations so the lessor oftentimes encumbers the lessee's accounts receivable, furniture, equipment, inventory, and other assets. Of course, in this situation, the lessor is not attempting to protect the lessee's assets against other creditors, yet that is exactly what the lessor is accomplishing.

The best asset protection planners understand how liens are used in such everyday business arrangements, and the planner capitalizes on such processes. Utilizing a standard business arrangement for asset protection is especially desirable because it appears that there was no intentional asset protection scheme. Because normal business arrangements often use accounts receivable to secure a lease agreement, a lessor's lien is an especially good way to protect this valuable asset.

The best type of lessor's lien, of course, is one that is held by a company who is friendly towards the lessee, because we can then draft the lease and lien terms to best suit our needs. Often, we will take property from a business, sell it to another business, and then lease it back to the original business. This lease-back arrangement has two benefits: First you protect one piece of property by titling it to a separate entity and when you lease back the property to the original entity, you put a lessor's lien on a second asset. For example, an LLC could sell an office building to a second LLC, lease the building back to the first LLC and subsequently place a lessor's lien on the first LLC's accounts receivable. As simple as the concept sounds, a lessor's lien in this or similar circumstances requires a high degree of skill to do correctly. The trick is to transfer the original asset into a separate entity in a manner that won't be considered a fraudulent transfer. Also, you must structure each entity so that they'll be respected as separate entities if challenged in court. For example, sometimes if one entity is sued and the managers of that entity also happen to manage the second entity, both entities may be considered one entity under the theory of interlocking directors. This pierces the veil of the second LLC which will not only avail the first LLC's creditor of the second LLC's assets and also invalidate the reason for a lien on the company's accounts receivable.

Avoid Sham Mortgages

You can discourage a lawsuit with a mortgage recorded against your assets because your creditor may simply assume that the mortgage is bona fide. Even a paper mortgage can discourage a would-be litigant. Don't rely on sham mortgages though. Assume that your creditor will challenge the validity of your mortgage. Be prepared to satisfy the court that you owe an enforceable debt for the amount of the mortgage. When your mortgage holder is a friend, relative or affiliate, the mortgage can expect close scrutiny. A more inquisitive or aggressive creditor may challenge the validity of your mortgage. If you borrowed money, do you have the cancelled checks to prove the loan? If you gave the mortgage to secure a debt for services, can you prove that the services were actually rendered and were reasonably priced?

Another limitation of third party liens is that the total value of the secured party's claim

against the collateral may still leave an exposed equity. For example, a real estate developer who owns separate parcels of land may arrange for a mortgage to be held by a third party in order to reduce her equity in the land. The mortgage granted by the developer to the third party and recorded on the county records offers no protective value until a cash loan or other value is given to the developer. If a plaintiff wins a lawsuit against the developer, the plaintiff can have the county sheriff attach and sell the property to satisfy the judgment. While the sheriff's sale will not extinguish the mortgage held by the third party, it would be cold comfort to the developer, who nevertheless lost her property.

Except for the appearance of a lien against the developer's properties, the developer's arrangement will not withstand a plaintiff's attorney who wants to sell the developer's property to satisfy the judgment unless a valid debt is presently owed to the third party mortgage holder. The difficulty for the asset protection planner is to show actual cash loans to the developer to create that valid lien.

And what will the developer do to protect the cash received from the lender? If the transaction is small enough, this presents less of a problem. However, you may need complex arrangements to protect property worth several hundred thousand dollars or more. The challenge for clients with millions to protect can usually only be met with creative and aggressive planning. This may call for transferring the loan proceeds to one or more offshore entities, investing the proceeds in exempt assets or to buy offshore annuities or some other sophisticated insurance-based product, or to secure an obligation-based lien.

Another challenge when planning complex third parties liens involves the federal tax law. Not every asset protection consultant, attorney, or CPA has adequate knowledge of the federal income, gift, and estate tax laws to safely apply these arrangements. There are common tax traps that apply to third party liens held by decontrolled entities or some other third party. Because of its tax complexities, many asset protection specialists avoid using foreign entities in their plans. On the other hand, the most effective asset protection transactions may require a foreign corporation, trust or other foreign entities for privacy purposes and to remove the liquid assets from the grasp of predatory litigants.

Structuring secured liens on your personal assets or the assets of your business can be effectively accomplished only with careful planning, attention to detail, and by observing the applicable laws involved over the life of the lien. You must clear a number of hurdles in order to avoid problems with the lien itself, such as the fraudulent transfer laws and tax concerns. This complexity creates a two-edged sword: It requires a high degree of knowledge and skill in several different legal areas to succeed. The costs involved can be significant when you consider the legal fees, taxes, and special business services, such as foreign managers. Yet, done properly, the complexity of the transaction can impose a formidable barrier to the average plaintiff looking for a fast lawsuit recovery. As more Americans enter the ranks of those concerned about lawsuits, and as they educate themselves on asset protection, there will be more demand for sophisticated asset protection strategies. Third party secured lien arrangements will be high on that list.