

PROTECTING YOUR ASSETS WITH AN LLC



PROTECTING YOUR ASSETS WITH A LIMITED LIABILITY COMPANY

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INTRODUCTION:

Have you thought about what would happen if you were sued? There are 18 million lawsuits filed in the United States each year. But that isn't the whole story. Have you heard of "deep pocket syndrome"? Deep pocket syndrome occurs when somebody filing a lawsuit proceeds to file against anyone who is even marginally connected whatever incident got everything started. The list includes the shopper who spilled milk on the supermarket floor, the employee who failed to clean it up quickly, the supermarket that hired the employee, the designer of the "defective" shelf that held the milk, and the manufacturer of the "defective" milk carton. This kind of lawsuit is brought on to ensure that the person with the money, or "deep pockets," is covered by the claim for damages.

It's easy to see how this domino effect could lead to as many as 50 or 60 million people being sued each year. What can you do about it? For one, you can create what many consider a premiere asset protection entity, the Limited Liability Company, or LLC. The LLC has evolved as a popular alternative to the Family Limited Partnership for asset protection. With a Family Limited Partnership, the general partner(s) must have ultimate liability for partnership acts and liabilities. For assets that can generate a liability to a third party, such as going concern businesses, rental properties or commercial properties, this could expose a person or family to unlimited losses, **since the person(s) to whom others harmed by the FLP will look for their losses and injuries to be compensated.**

Of course, such exposure does not exist for those who use the FLP for assets that cannot generate liability to a third party. An example might be an FLP that is formed for holding and managing a family's investment assets, which is a valid business purpose.

The LLC is even useful for those who prefer the limited partnership form of doing business for other reasons. Where the partnership engages in business activities that could conceivably generate a liability to third-parties, the personal assets of the individuals who create the FLP can be protected if the General Partner is a Limited Liability Company. The reasons for this arise from the nature of the LLC as an entity, and are detailed below.

What makes the LLC even more attractive as a form of doing business or holding assets is that the entity may actually be disregarded for income taxation purposes. That is, the owners of the entity claim all income generated by the entity, and take the ordinary business related deductions against the income, even though there is an independent and legally recognized business entity actually generating the income. It is a "pass-through" entity and allows the owners to be taxed as a sole-proprietorship or general partnership, and still get creditor protection for the activities of the business. Compared to the double-taxation experienced by owners of C Corporations, and the limitations that apply to S Corporations (which are also "pass-through" entities), the LLC has more to offer with less drawbacks for more business owners and investors than ever.

WHAT IS AN LLC?

An LLC is a form of business / investment entity not unlike the limited partnership, and is similar to the real estate or business operating limited partnerships with which many are familiar. However, there is one important difference – all owners of an LLC, called members, are protected from liability caused by the LLC's business/investment activities.

Management of the LLC can be left to all members, or it can be concentrated with one or more select members. Restrictions can be placed on the sale or transferability of member interests. These features are much like the Family Limited Partnership. They make the LLC as valuable planning tool not only for asset protection purposes but for estate planning and estate taxation purposes as well. (For more information on the FLP as a planning tool, call The Zimmer Law Firm for a copy of our report on the FLP.)

HOW IS AN LLC FORMED?

One should consult and retain an attorney to be sure that the LLC's creation and operation comply with the law.

The first step in Ohio (and many other states) is the filing of Articles of Organization and the Appointment of Original Agent with the Secretary of State. A modest filing fee is required. Check on your state's specific requirements. In some states, such as Ohio, even one person in business alone can start an LLC. The attorney will then prepare an LLC Operating Agreement for you. The operating agreement defines and governs all aspects of the operation of the LLC.

Once the LLC is properly formed, you transfer your business and investment assets into the LLC in return for:

Managing Member Interest↓ You receive a managing member interest. Generally, you only receive 1% or 2% of the total LLC interests in the form of a managing member interest. That means you control all of the decision-making for the LLC's activities. We find that control is very important to our clients.

Member Interest↓ You receive the remaining ownership of the LLC in the form of a member interest. Member interests do not give the non-managing member any rights in LLC income or activities. While the managing members may not treat a non-managing member unfairly, a non-managing member essentially has no control or rights. But the non-managing members have the right to share in LLC profits.

Of course, in some LLCs these formalities of two different classes of membership interests may not be necessary. For example, a husband and wife in business together may find this formality overkill, and have only one class of member interests. The LLC allows the flexibility of keeping things as simple as you wish in such circumstances. The decision on how many member interests to set up, and the rights that attach to each member interest, should be made after consultation with qualified legal counsel.

You are now the proud owner of your very own LLC. Now what happens? If you are in business you will operate your business affairs as usual, but now you have creditor and legal predator protection, described below.

If you are interested in saving estate taxes, you may gift your children some of your LLC interests. That means that you are not the only member of the LLC. The benefit of doing this is to transfer assets that may appreciate in value over time to your children who will inherit eventually anyway. Since you are the Managing Member, you could gift all but your Managing Member interest and still control the assets of the LLC. The effect is to save estate taxes that would apply to your estate had you died with full ownership of the LLC assets.

You may also be able to save even more estate taxes if "valuation adjustments" will apply to your LLC. This complex but very powerful strategy is similar to the popular and

powerful technique of leveraging gifts through the Family Limited Partnership and using the FLP to save estate taxes. For more information, contact our office for a report on the FLP.

ENTER THE CREDITOR

Here's how the LLC protects your assets from creditors and legal predators. Suppose that you are successfully sued. Your creditor gets a judgment from the court. With that judgment, the creditor can levy against and seize many of your personal assets and even take some of your wages, if any. But when it comes to taking the assets of your LLC, it's a different story.

The creditor receives a **charging order** from the court that applies against the LLC. A charging order is a judgment against the member telling the LLC that any distributions of profit that would otherwise be made to the debtor member must instead be paid to the creditor. But the creditor has no power to interfere in LLC matters. The charging order is a very hollow victory. Because the managing members decide if profit is to be distributed to the members, the managing members can withhold profit distributions from all members and the creditor receives nothing. The creditor's judgment becomes meaningless and of little or no practical value.

WHAT HAPPENS TO THE MONEY IN THE LLC?

As managing member, you have complete control and access to the assets and income of the LLC. If you give membership interests to your children, then they are entitled to receive income from the LLC in a share that is the same share as their membership interests bear to all membership interests. Thus, if you have given your children 10% of the LLC, they are entitled to 10% of any income distributions that you decide to make, but they cannot force you to make any distributions. Depending on the structure of the LLC, there may be other ways that you can take assets from the LLC in addition to the income. Thus, your control over the LLC and its assets continues as if you never made the LLC, but now you have creditor and legal predator protection in your favor. Plus the LLC allows you excellent estate tax planning opportunities that you may not have otherwise been able to take advantage of in your old form of asset ownership.

DO-IT-YOURSELF LLC'S

We have encountered clients over the years who file the initial papers with the Secretary of State to start the LLC process, but then drop the ball and fail to complete all the necessary formalities. Or who complete the set-up process and then manage the affairs of the company in a way that would allow a court to “pierce the corporate veil” and treat the LLC and the owners as alter egos of one another.

In either such case, the benefits of the LLC would be unavailable if a claim or lawsuit were brought. Another risk is setting up the LLC with an inappropriate income tax election choice.

Templates for LLC Operating Agreements are available online for little or no cost. Extreme caution should be exercised with such documents as every state has its own laws to be observed if you want full benefits and protection from an LLC. Plus, individual attention on a case by case basis must be made to asset transfers to the LLC, as there is a right way and a wrong way. There is a minefield of hidden legal issues that may relate to assets to be transferred to your LLC that website offerings cannot help with.

One of the many pitfalls of do-it-yourself planning is that it is a one-size fits all approach. Although they may provide some useful information and some amount of guidance, websites cannot be tailored to your individual needs, goals, or concerns. You must have the self-realization to identify your unique circumstances, the understanding of what they mean and how they affect the “LLC-in-the-box” option, and what to do with them.

For these reasons and others beyond the scope of this report, DIY planning with an LLC is risky and ill-advised. The minor cost savings up front could pale in comparison to the significant costs later from mistakes and overlooked issues.

SUMMARY

A properly designed and operated LLC is a formidable deterrent to unjustified lawsuits, and a formidable negotiating advantage against a successful creditor. While an LLC can not be formed to successfully defeat the interests of an existing creditor, the sooner you create your own LLC, the safer your family is from "deep pocket" syndrome.

ABOUT THE ZIMMER LAW FIRM

Zimmer Law Firm, LLC is a charter member of the American Academy of Estate Planning Attorneys. It is the only member firm in Southwestern Ohio. The Firm has been providing quality estate planning services since it was founded in 1993. The fastest growing demand for its services has been asset protection from the cost of long term nursing care. Whether you need an Elder Law attorney, an attorney for general estate planning with trusts or

wills, or an attorney to help settle an estate, our team of qualified staff are here to help you and your loved ones.

In these turbulent times, access to an experienced lawyer to protect your estate and accomplish your goals is more important than ever. If you or your family would like a complimentary consultation to discuss your estate plan or how to protect your estate from depletion to pay for long term nursing care, call us today at **513-721-1513** or visit our website at **www.zimmerlawfirm.com**. Check our website for upcoming seminars, or learn more about the firm at www.avvo.com where you will also find testimonials from our clients. See why *Cincinnati Magazine* recognizes us as a Five Star Wealth Manager. If you would like to receive email announcements for upcoming seminars, call to be added to our seminar mailing list.

A MESSAGE FROM THE FIRM FOUNDER



The goals of Zimmer Law Firm are to make asset protection and estate planning pleasant, easy, and understandable processes for clients. We believe that planning is much more than just creating legal documents. Rather it is about establishing relationships with clients and their family by providing a continuum of services through the passages of their lives. What we do makes an important difference and we take great professional pride and satisfaction in that.

If you or your loved ones would like a complimentary consultation to review your estate plan or to implement a plan, visit our website at www.zimmerlawfirm.com or call us today at 513-721-1513 (Toll-Free 1-866-799-4050) to schedule an appointment. See for yourself why *Cincinnati Magazine* has recognized the Firm as a Five Star Wealth Manager. For the latest news about estate planning or upcoming law firm events, subscribe to our blog and “like” us on Facebook. Check our website for upcoming educational events. We continue to expand our capabilities and services to meet the demands of a complex and changing estate planning world. Our experience has shown us what was a solution yesterday may no longer be adequate to fully protect our clients today.

This report reflects the opinion of the Zimmer Law Firm. It is based on our understanding of state and federal laws and is intended only as a simple overview of the planning issues. We recommend you do not base your own planning on the contents of this report alone. Review your estate planning goals with a qualified estate planning attorney.

ABOUT THE ACADEMY

The Academy is a national organization dedicated to promoting excellence in estate planning by providing its exclusive membership of attorneys with up-to-date research on estate and tax planning, educational materials, and other important resources to empower them to provide superior estate planning services. The Academy expects members to have at least 36 hours of legal education each year specifically in estate, tax, probate and/or elder law subjects.. The Academy has also been recognized as a consumer legal source by *Money Magazine and Consumer Reports Money Adviser*, and its Education Department has been quoted by other consumer press.

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