

PROTECTING YOUR ASSETS WITH THE LIMITED LIABILITY COMPANY



Are you worried about being sued? Well, you should be. There are more than 15¹ million lawsuits in the United States each year. But that isn't the whole story. Have you heard of the "deep pocket" syndrome? The deep pocket syndrome is where the person who claims to have been harmed files suit against anyone who is even marginally connected with the incident. The list includes the shopper who spills the milk on the supermarket floor; the employee who fails to clean it up quickly; the supermarket that hires the employee; the designer of the "defective" shelf that holds 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. As you can see, this domino effect could lead to as many as 50 or 60 million people being sued each year. What can you do about it? Create what many consider to be the premiere asset protection entity, the Limited Liability Company, or LLC.

WHAT IS AN LLC?

An LLC is one of the most popular estate tax and asset protection planning devices. An LLC is a form of business/investment entity not unlike the limited partnership (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. With a limited partnership, however, the general partner(s) are liable for partnership liabilities.

HOW IS AN LLC FORMED?

The estate planning attorney prepares an LLC agreement for you. 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 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 98% 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.

You are now the proud owner of your very own LLC. You are the 2% managing member and control the LLC. Now what happens? You will give your children some of your LLC interests. That means that the LLC has members other than yourself.

¹http://www.legalreform-now.org/menu3_3.htm

ENTER THE CREDITOR

If you are successfully sued, the creditor receives a **charging order**. 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. 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 distributions from all members and the creditor receives nothing.

WHAT ACTION DOES THE CREDITOR TAKE?

Obviously, the creditor does not just disappear, but because the charging order provides so little leverage, creditors frequently settle the claim for less than face value. Those who might consider filing an unjustified lawsuit may change their minds when they realize all they will receive is a hollow charging order.

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 your children 10% of the LLC, they are entitled to 10% of any distributions that you decide to make, but they cannot force you to make any distributions.

SUMMARY

A properly designed and operated LLC is a formidable deterrent to unjustified lawsuits, and a significant negotiating advantage against a successful creditor. While an LLC should never be formed to defeat the interests of an existing creditor, the sooner you create your own LLC, the safer your family is from "deep pocket" syndrome.

Note: If estate tax reduction is one of the other purposes of the LLP, additional restrictions may be required.