

Don't let a lawsuit rain on your parade!



# Asset Protection

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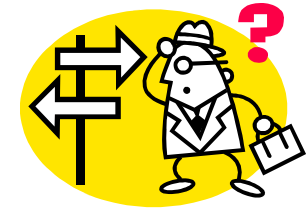
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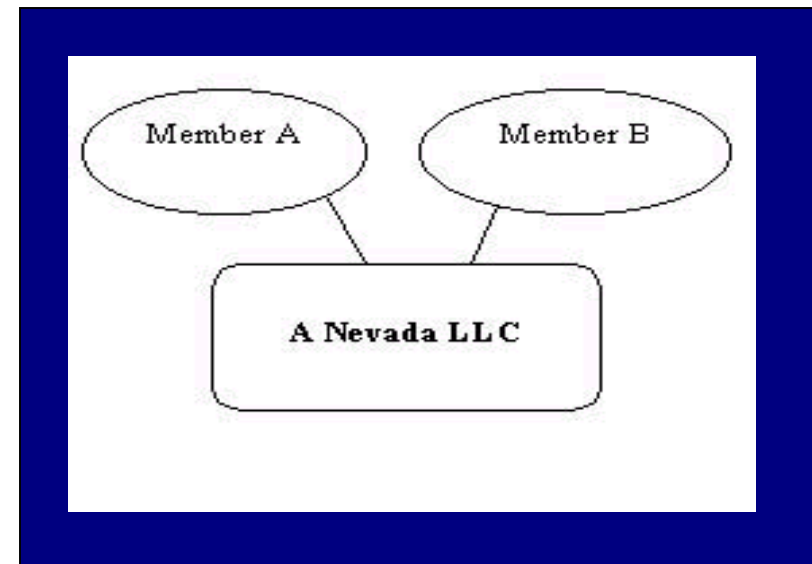
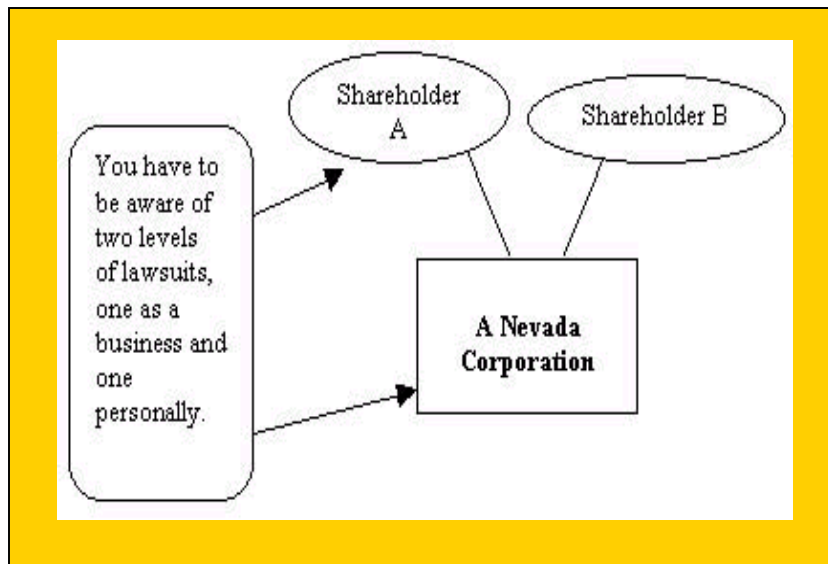
# Other Considerations in Choosing the Best Entity

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- n Let's, take the example of a group of investors. They all want to put money into an entity and invest in the stock market or a project. Would a corporation or LLC be better in this case? In this case the decision would be an LLC. Why?
- n 1. All the profits or losses would flow through at the end of the year not subject to self-employment taxes. Under Section 1402 there are three exceptions concerning distributions which will not be subject to self-employment taxes. They are;
  - n 1402 (a)1 rental income
  - n 1402 (a)2 interest and dividends
  - n 1402 (a)3 capital gains and losses
- n 2. If the investors formed a corporation they have to deal with double taxation and how to handle that. In other words at the end of the year the profits and losses would stay in the corporation and if any distributions were made, in the form of dividends, double taxation would occur. Also, the Personal Holding Corporation rules may come into effect, which would be a disastrous tax effect!
- n 3. If the investors were doing long term trades, and the amount was over \$100,000 per year, in a corporate tax bracket that would be taxed at about 22.25%, but flowing to you personally it would be taxed at 20%, the new long term capital gain rate!
- n 4. The LLC will offer more asset protection than the corporation. If you are running a business as a corporation or an LLC and the business gets sued, you will get the same result. You would worse case scenario, lose as many assets in the corporation as the LLC. There would be no difference. There is a major difference if you were sued personally. Let's diagram it out:



# 2 Types of Corporations



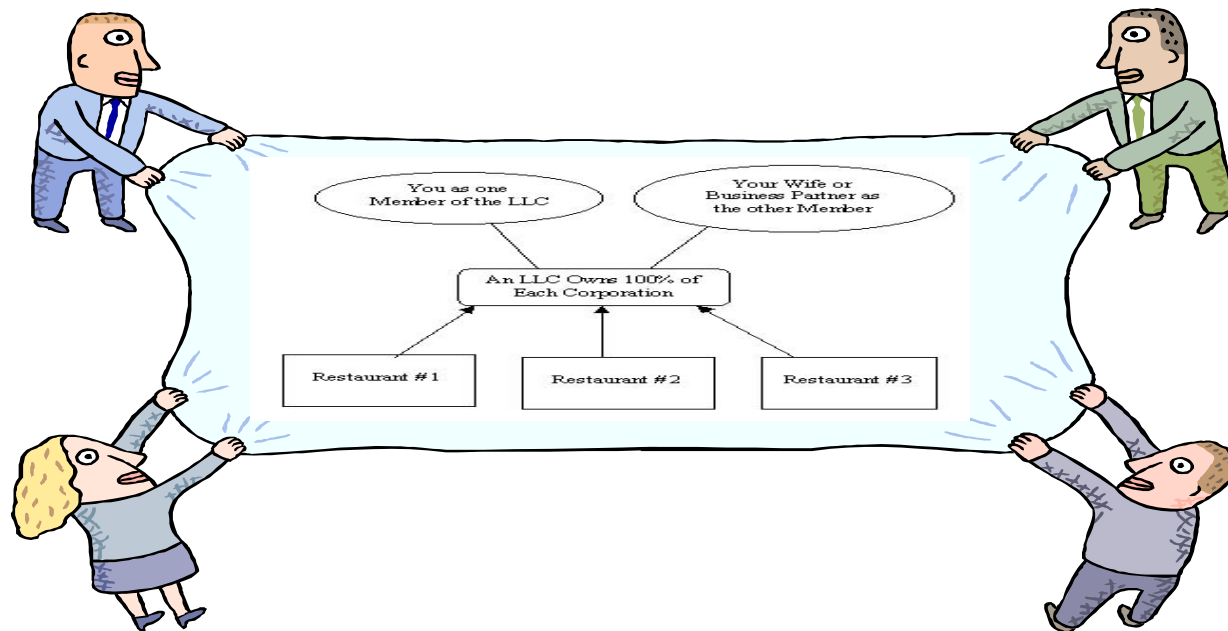


# Corporate Safeguards

- n Again, if the Corporation or LLC gets sued, it is the same worse case scenario result. The corporation or LLC will lose all of its business assets. That is why you never have many assets in your main operating company.
- n If you as a shareholder of the corporation or member of the LLC gets sued personally, there is a different result! When a creditor sues you personally and your insurance doesn't cover it, like *punitive damages*, you can lose your percentage of stock in the corporation to satisfy the judgement. If you owned a controlling interest in the corporation and lost, you would lose control of your entire company. This is how an individual *lost his entire \$3 million dollar California corporation* recently! Typically, when a creditor gets control of your company he/she doesn't want to run the company. He/she just liquidates it and takes the money or sells it! A corporation's stock must be protected. An LLC would be an ideal vehicle if it were taxed as a partnership. Let's explain if you were sued as a member of an LLC why that would be different and you would not lose control of your company.
- n Now, let's say you form an LLC and it is a year from now and you owe a creditor money. As most creditors do, they will try anything to get the money out of you. First, it is important to understand what creditors rights are in this situation. LLCs act like limited partnerships when it comes to the rights of creditors to impose claims against the property of the LLC or against a Member's personal property. If LLC property is held in its name, the member has no rights to it other than when it is distributed. Distribution in turn is allocated and timed according to the operating agreement, usually upon the vote of the members.

# Best Entity

- n You will learn that the LLC is the best entity to protect investments. What about rental property? The LLC would be better for the same reasons. Again, what if you owned 3 restaurants in your hometown and you formed 3 separate corporations because you wanted to separate out liability from a business lawsuit.
- n The reason you would do this is because if one restaurant were sued it would not affect the other two restaurants! But what if you owned the stock personally in all three restaurants and you were sued personally and lost? You would lose control of all three restaurants! Some people think their state laws will protect their stock. That is true, but only to a certain amount. Also, many believe their insurance will protect them in every situation, that is simply not true. Transfer your stock into an LLC as a management company and have it formed as a partnership (you would need one other partner; your wife or business partner would be ideal). Now if you were sued personally, you don't own stock in the corporation. The LLC does and the legal remedy is back to the charging order! Here is how that looks in a diagram:



# Test Question

- n Here is a test question: Would you want the LLC that is managing the stock of those three corporation to do business with the public, i.e. own title to a piece of rental property? **NO! Absolutely not! Why?** Remember earlier, we discussed the difference between an LLC and a corporation operating a business and if either one was to be sued as a business, you would get the same worst case scenario result, a loss of all the assets! Currently in this example, the LLC is only managing corporate stock and is not doing business with the outside public! When you title the piece of rental property to the LLC it is now doing business with the public and if someone sues the owner of the rental property and finds out it is an LLC and the LLC also owns 100% controlling interest of 3 successful corporations operating restaurants, you can then lose control of all three restaurants

