



# WealthKeepers

## How Many LLCs Should I Have?

### One if it's a Series LLC

By James C. Mulder

I encounter many business owners that have formed their business as a limited liability company (LLC) and think they have protected themselves from creditors. Many of them think that since their business is in an LLC that they have protected it. It is true that putting your business in an entity will provide the owners with protection from a creditor of the business, but all of the assets of the business are still fair game for such a creditor. As I have discussed before, consideration needs to be given as to how many assets are vulnerable to the business and how they might be structured to better protect them from a business claim. This is also true of real estate investors who really aren't operating a business, if all they do is collect rents. This type of income is considered passive income and not subject to earned income self employment and Medicare taxes, but they are just as vulnerable to a tenant claim as an operating business is to any other claim from its products or services. I am talking about here is structuring the "business" assets in such a way as to limit a creditor of the "business" from forcing a liquidation of all of those assets.

Let's look at two common examples.

#### Real Estate Investor

Mr. Smith owns 5 single-family rent houses and two duplexes in one LLC. Each one has its own mortgage, but the equity in each property is building up. All properties are rented and Mr. Smith is the only one involved in collecting rents and taking care of tenant problems. In other words, he doesn't have any employees or property managers. Mr. Smith does have a bank account in the LLC name and is depositing all lease payments in this account. Some of the leases however are in his name as Landlord, not the LLC. Several problems are present here:

1. Mr. Smith has all his eggs in one basket.
2. Mr. Smith is the named landlord on one or more leases.
3. How does Mr. Smith have his property insurance on these rental properties listed with his P&C insurance company?

Regarding 1 above, if one tenant has a claim against the Landlord, if it is Mr. Smith on the lease, even though he transferred the property to his LLC, he may have some "splaining" to do and could be held personally liable. Furthermore, should the claim be large enough to exceed his insurance coverage, if the

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insurance company decides it is an insured claim, or if the claim is not covered, the equity in all 7 properties are at risk to satisfy this one claimant. The property that gave rise to the claim may have a large mortgage against it, but maybe one or more of the other 6 properties have little mortgages, thereby making them a prime target to pay off the claim, not the one in which the claim arose.

Regarding 2 above, once the LLC became the owner of the property, Mr. Smith should have notified his Tenants that the new landlord is the LLC and all rent checks should be made out to it.

Regarding 3 above, if his insurance company does not have the LLC as a listed insured, there will be no coverage. I see many clients that try to get by with adding other properties to them personally and think that they will save premiums, but if the insurance company does not show the LLC as owner, there is no coverage.

What should Mr. Smith do? Well, he should set up one designated series LLC and form a separate subsidiary series LLC, each one owning a single property and let the Registered LLC be holding company to own 100% of each subsidiary series LLC. By doing this he can use the Registered LLC as a private bank and let it get a second lien on all of the properties by lending money to each series LLC to take care of expenses and even mortgage payments. What this will do is eventually make the holding “Parent” LLC as the first lien holder on all properties. Now if a claim occurs, only one property and its equity will be at stake and that equity can be very minimal with proper planning and time.

## **Operating Business Owner**

Mr. Smith owns an aerial photography business. He owns land, building, airplanes, expensive cameras and developing equipment. The planning here is to look at the assets of the business, determine if they, in and of themselves, could create a liability, and if so, isolate that from the assets that don't create a liability. So, the land and building, if maintained, don't create a liability to a customer of the business, unless the roof falls in while the customer is in the office. Mr. Smith should consider registering a series LLC holding company and form a sub series LLC to put the land and building. Because, in all likelihood, the customer of the business who has a liability claim against the business is going to sue because the aerial photographs weren't as represented, or maybe relying on them caused a major liability to the customer's business, which is totally unrelated to the land and building or any equipment. Its complaint is something the business itself caused. Similarly, the cameras and developing equipment won't hurt a customer. So

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they can be isolated in an equipment series LLC. The airplanes can cause a liability unrelated to the business as it can crash into a residential area or business and cause great damage. So, each plane should be in an individual series LLC different from the equipment and land LLCs to isolate them from the business and its land, building and equipment. Now, if the company causes a liability and it doesn't own the land and building, the airplanes, or the equipment, but merely leases them for fair value, those valuable assets necessary for the business to operate will not be vulnerable to such a claim.

Another overlooked asset is the name of the business or product and goodwill associated with it. Again, a name is not going to hurt someone. So, planning to carve out the name and goodwill associated with it will protect it from a future creditor of the business, but more likely will also allow for licensing of the name (s) and save additional income tax if the business or its assets are sold to a bona fide buyer of the business. So it too should be in a separate series LLC. Since there is no cost associated, consider LLCs for many classes of assets.

Care must be taken in this example as potential income tax liabilities may exist to implement this planning and Mr. Smith needs to know what his company's income tax liability is should he implement this plan.

I hope the foregoing has been informative about series LLC planning for your business or real estate.

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