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How To Protect Your Assets With a Series Limited Liability Company: The Never Revealed Secrets That Others Don't Know

By James C. Mulder

Background

Limited Liability Companies first appeared in the United States in, of all states, Wyoming in 1977. But Wyoming didn't invent LLCs, the concept actually originated in Germany and in some Latin American countries which called them "limitadas". Some US oilmen liked the limitada concept in Panama and sought out the friendly legislature of Alaska to enact a limited liability company statute. Alaska didn't pony up, but Wyoming did and the rest is history. Texas adopted its first Limited Liability Statute in 1991. Now all 50 states and the District of Columbia have adopted LLC statutes.

The Series LLC

Enter the Series LLC which was first created in Delaware in 1996. As of July 2010, the following additional states have adopted the Series LLC in some form or fashion: Iowa, Oklahoma, Illinois, Tennessee, Utah, Nevada, Wisconsin, and now, Texas.

Formation

A Series Limited Liability Company, or Series LLC, is an entity created under state law by the filing of a Certificate of Formation with the Secretary of State, that has the appropriate provisions to permit it to be a Series LLC. You also need a Company Agreement under which the Series LLC is to be operated. This needs to be very carefully drafted if the Series LLC is to be used to its potential and should include provisions regarding how each should be taxed.

LLCs are easier to operate than a corporation and the Series is just as simple if the owners are all the same. There is no requirement for annual minutes like there is for corporations.

Taxation

An LLC, series or individual, with two or more owners by default is taxable as a partnership, i.e. a flow-through entity for income tax purposes. This means that owners receive their portion of income tax attributes of the





LLC. The LLC will file an IRS form 1065 income tax return but does not pay income taxes. However it may also elect taxation as a C or S corporation. Similarly, a single owner LLC, series or individual, may be taxable as a disregarded entity (schedule C, F, or E, as appropriate, on his or her 1040) or as a C or S corporation but not as a partnership. If the sole owners are a married couple in a community property state, the IRS considers it a single owner LLC.

Asset Protection - Basic

Under state law, an LLC has certain features that affect the member (owner) liability for the company and creditor rights involving the company or even a separate liability of an individual who happens to be an owner. Owners of the company do not have personal liability for the enterprise. Instead, liability for company activities is limited to the assets of the company, i.e. an owner's investment. Likewise, an owner would not ordinarily have personal liability for company obligations absent a personal guaranty.

A Series Limited Liability Company provides considerable asset protection to owners carrying on a business that has several asset classes or that has several locations. Each asset class or location can be owned by a different series LLC and provided all the books and records and title to the assets are accounted for separately from other series LLCs, only the assets in a single series LLC are liable for the debts and claims associated with that series LLC. Additionally, no assets of a series LLC are attachable by creditors of another series LLC in the same "family".

An LLC also provides significant protection from the judgment creditors of the individual owners of the series LLC, if a judgment is entered against the owner after the creation of the series LLC for something unrelated to it.

The LLC statute provides asset protection by dictating the rights of an owner's creditor. Creditors of an owner have no right to become an owner, to demand company assets, or to compel distributions. Texas law provides that a judgment creditor's SOLE remedy is a charging order from a court to charge the owner's interest in the LLC with a requirement that if a distribution is to be made to the owner, it is to be made to the creditor. That is a big if and there is no obligation to make distributions to an owner, provided the Company Agreement is drafted properly.

An owner of a corporation has no such protection in law. For companies and for individuals with assets at risk to a future creditor, the asset protection features of the LLC are clearly the most substantial reason for utilizing this form of asset protection. And with the advent of the Series LLC, it is even more compelling.

Other Advanced Tips

Remember this rule: A judgment creditor can always get to the non exempt assets of the debtor. If one LLC owns multiple parcels of real estate, a judgment creditor whose liability arose from one of the properties can levy on all the real estate and have it sold at public auction. If each parcel of real estate is owned by a separate series LLC,



and the books and records are maintained correctly and if that is all that a particular series LLC owns, then there are no other assets for the creditor to get and the other parcels are protected.

Before the Series LLC, usually one LLC owned many assets because of filing fees, franchise reports and other rigamarole. Accordingly, all assets in that one LLC would be at risk to a liability of the business. To avoid the danger of “all eggs in one basket” a Series LLC may be structured with several series entities to own separate “risky” assets, i.e. those that have potential to create liability.

How to Best Set Up My Series LLC

The preferred solution is for the registered Series LLC to be a holding company and have it own one or more subordinate series limited liability companies. An asset protection design can involve wholly-owned subordinate series LLCs (taxable as disregarded entities) to hold risky assets. or to conduct business activities that have inherent risk. By insulating a risky asset or business activity from the rest of the assets and non risky business activities, only that particular series LLC contains the risk and therefore this plan protects the other series LLCs and its assets and the Owners from attachment. In a real estate scenario, the series LLC is the owner of one single property, so only that property would be at risk.

You should create your own “Bank” Series holding LLC to be the lender to any other series LLCs for operating capital and take a lien back against the series LLC assets to secure the loan. A creditor of the series LLC will have to pay off the loan to your Bank Holding LLC first before satisfying its judgment.

Other Benefits

A Series LLC can be used to reduce the size of the estate of the owner through discounts for lack of marketability and, possibly, lack of control. This can result in lower estate tax exposure. Note, that there is a move in Congress and at Treasury to eliminate this benefit.

An LLC can be considered a security under Texas law, so contributing Uniform Transfers to Minors Account assets to an LLC before the minor attains the age of control can allow you to defer complete control over the funds at an inappropriate age or time for the minor.

An LLC can be an effective tool in which to put assets that are to be given to children by elderly parents that may want to qualify for Medicaid for nursing home assistance, instead of fractionalizing the funds between children who may or may not manage the funds well. This way the Manager of the LLC can keep control of the gifted assets to ensure availability for needs of the family as a whole.

This article has been a brief overview of some of the benefits of the Series Limited Liability Company. We offer a 1-hour initial conference at no charge to discuss your asset protection issues. At the end of that conference we can usually quote you a fixed fee to prepare your asset protection plan and the cost for the preparation of the legal structures needed to implement your plan.



James C. Mulder has over thirty years of experience in Wealth Transfer, Tax and Asset Protection planning. He is Board Certified in Estate Planning & Probate Law and in Tax Law by the Texas Board of Legal Specialization.



One of only a few attorneys in the Houston area Board certified in both Estate Planning & Probate Law and in Tax Law, Mr. Mulder concentrates his practice primarily in wealth transfer, tax, and asset protection planning.

The implementation of such planning includes very comprehensive planning and may involve the preparation of very comprehensive wills, trusts, business organizations and family partnerships. Mr. Mulder has prepared over 1,000 asset protection plans. Mr. Mulder is a frequent speaker on estate planning and on asset protection planning.



A Parent LLC can have numerous Subsidiary LLCs

Both the Parent LLC & Subsidiary LLC have the same Managers. Each Subsidiary LLC may have different Members.

