

WHAT'S SO SPECIAL ABOUT LLC'S?

Excerpted Quotes from Continuing Education of the Bar

Seminar on Asset Protection Planning

Using Limited Liability Entities

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(emphasis added)

Basic Tax And Legal Characteristics Of Business Entities

“Everywhere you turn for information about tax planning, business planning and asset protection planning, you’re hearing about limited liability companies (LLCs). So, what’s so special about LLCs? For the first time, U.S. businesses can qualify for unrestricted passthrough taxation and obtain limited liability for their owners. To see what makes LLCs so attractive, it helps to compare LLCs to other available forms of business entities, particularly corporations and partnerships.”

...

“The limited liability company (“LLC”) is a hybrid type of legal entity that combines certain traits normally associated with corporations with other traits normally associated with partnerships and other non-corporate legal entities. LLCs allow their owners (called “members”) to have the best of all worlds: Passthrough taxation, limited liability, flexibility in ownership and management structure, and personal asset protection.

While corporate statutes are generally written to accommodate the needs of businesses with large numbers of passive stockholders, **an LLC tends to be a more flexible and understandable business entity.**”

LLC Taxation

“Under the Check-the-box rules, U.S. corporations are taxed as corporations and cannot elect to be taxed otherwise. However, any other business entity that is not properly classified as a trust or otherwise subject to special treatment under the Internal Revenue Code **may elect its tax treatment.** A separate business entity with two or more members can generally elect to be classified as either a corporation or a partnership. An entity with only one member does not qualify as a partnership. However, such a single-owner entity may elect to be classified as a corporation or to be disregarded as an entity separate from its owner and thus to be taxed as a sole proprietorship.”

...

“Basically, it really is that simple. If you want passthrough partnership or sole proprietorship taxation for a domestic LLC, you do nothing. In that case, it’s really a “don’t check the box” rule.”

“If an LLC wants to be taxed as a corporation, it simply files a one-page form 8832, Entity Classification Election (included at the end of this outline), within 75 days after the date the election is to be effective, literally checking a box to elect to be taxed as a corporation. Once an LLC elects to be taxed as a corporation, it is a corporation for all federal tax purposes. So, a domestic LLC that has elected to be taxed as a corporation can elect to be taxed under Subchapter S as an S corporation as well (assuming it otherwise qualifies under the Subchapter S rules).”

LLCs and Estate Planning

“LLCs, ... can be used as estate planning tools in the same manner as family limited partnerships. If the LLC is properly structured, LLC interests should be discounted for estate and gift tax purposes for lack of marketability and lack of control. In addition to the discounted transfer possibilities, LLCs are simply a convenient way to transfer assets to

younger generations. There is no need to constantly re-title assets to reflect changing ownership; often transfer taxes on real estate, etc. can be avoided; ancillary probate can be avoided for real estate located outside the client's domicile, etc.

Until the end of the 1990's, limited partnerships were preferred over LLCs as estate planning vehicles because most LLC acts lagged behind limited partnership acts with regard to statutory provisions that were favorable for estate and gift tax discounting. However, many states have remedied the problem, **with the result that LLCs are the favored vehicle** in many states **for estate planning.**”

LLCs and Asset protection Planning

“There is an often overlooked but very important difference between being a shareholder of a corporation and a member of an LLC. The shares of a **shareholder of a corporation are vulnerable to claims of the shareholder's judgment creditors.** In many small businesses, this vulnerability could allow the creditor to control the business.

The membership interests of an **LLC are more protected.** In the U.S. and in offshore jurisdictions with U.S. style LLC acts, a creditor of a partner in a partnership or member of an LLC is entitled only to a “charging order”, rather than being entitled to execute directly against partnership assets. A charging order gives a creditor the right to receive any distributions that the owner of the interest would have received. A charging order is simply a court document that directs the manager(s) of the LLC to divert distributions that would otherwise go to the debtor member to the creditor to the extent of the unpaid judgment plus interest.

At first glance, the charging order may not seem like much protection. However, the economic rights to distributions are all that the creditor gets. The creditor does not get the management and voting rights that may go along with the LLC membership interest. The LLC's managers determine if and when distributions are made. It may be that distributions will not be made or that distributions will be significantly delayed. Some tax professionals believe that the **creditor may not be taxable** on the debtor-member's income, even if the creditor never receives any distributions with respect to the charging order. This belief is suspect, but the uncertainty in this area can make a creditor contemplating a charging order very uneasy. Furthermore, it may be possible to draft an LLC operating agreement to cause a creditor with a charging order **to be taxable.**

The charging order is not an attractive remedy to most creditors. As a result, the prospect of a charging order can often convince a creditor to settle on more reasonable terms than might otherwise be possible. Shareholders of a corporation have little such leverage. Thus, in addition to being a very useful business tool, **the LLC can be a valuable asset protection tool.**