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Asset and Liability Protection for Your Business or Rental/Investment Property

If you purchased real estate as part of a business purchase, if you inherited real estate, if you are retired and own properties you want to turn into rental properties, the organizational engineering you do is not just to save on taxes. The cheapest form of insurance you can buy may be the limited liability you gain when you keep your property in a limited liability company (“LLC”) or **limited partnership** designed to protect you from the liability associated with property.

Forming an entity to hold your property is not just **an attempt by an attorney to get paid for doing legal work**. Look up the name of any apartment house or other piece of investment property in Phoenix or in Arizona online at the **Corporation Commission**; then, once you have the name of the entity which owns the property, search for properties held under the name of the entity at the **Assessor’s Office**. These days, almost always, the property is held by an LLC. Why? Apart from tax reasons, the biggest reason to put an investment property into an LLC is to separate it as an asset from your other property.

Why an LLC rather than a corporation? For one thing, putting real estate into a corporation can have extremely negative tax consequences. But, more generally even for non-real property investments, e.g. your business itself, LLCs are now commonly used because they are easier to form and operate. Fifteen years ago, corporations were the rule, and LLCs were the exception. The IRS barely recognized LLCs, and didn’t really have a separate category for them on their forms. Most people opted for corporations. But LLCs, while they retain the same limited liability protection as a corporation, do not have the rigid structure and yearly responsibilities of a corporation. You need to file an annual report every year for a corporation, and have minutes (i.e. typed records) for each annual and special meeting as well. Also, with a corporate structure, there may be ego problems because someone needs to be the President, and someone needs to be the Secretary. In contrast, An LLC is run more like a partnership, with members rather than shareholders, and, if desired, a Manager(s) rather than officers. Overall, an LLC has fewer

requirements to keep it running from year to year and more flexibility.

Today LLCs are widely accepted. In fact, so many people have formed or are forming LLCs they are now widely accepted as valid entities. And, the IRS forms have been revised and now acknowledge the existence of an LLC as a valid business structure. So, today, most of the entities formed, and certainly many of the entities formed to hold properties, are LLCs.

Why use an LLC to separate a piece of real estate from your other assets?

To answer this, consider this question: What happens if the value of the property drops lower than the mortgage? If you need to divest yourself of the property, you may be responsible for the deficiency. But, if you are fortunate enough to own the property in an LLC - and not to have signed a personal guaranty - then you escape personal liability. In any case, whether you have a corporation or an LLC, it soon establishes trade credit with vendors, and you, the business owner, do not have personal liability for any debt which accrues. Also, either an LLC or corporation can shield its owners from personal liability for accidents or bodily injury on the property.

What if you have multiple properties, e.g. restaurants?

Keep in mind that if you put all your properties into one LLC, then have a problem with one property, the other real estate assets held by that same LLC are also in peril. One of many possible examples: Someone is injured on one of the properties owned by the LLC. With medical costs as high as they are, many choose to attempt to recoup their medical expenses by suing the property owner for negligence. These types of lawsuits may drag on for years, at great expense, which is why many property owners try to settle out of court, whether they believe they have legal liability for the injury or not. The consequences in the case of a judgment are serious:

A. If the owner of the property is you, personally, whatever judgment they get applies to you and all of your other properties, your bank account, family jewels, future earnings, etc. And this judgment stays on your public record and leaves you subject to execution or garnishment of your property until paid.

B. If you have three properties, and all three properties are in the same LLC, the total value of all three properties is in peril because you have “all of your eggs in one basket.”

C. However, if each property is in a separate LLC, then for each claim against the LLC, only the value of that single property held by the LLC is in peril, because that is all the LLC owns.

Obviously, “C” reduces your liability the most. You can be sure you are safe from catastrophic losses by isolating liability for each property in its own LLC. In fact, it is not uncommon to have a trucking business as a corporation, and then the “rig” itself in a separate LLC - again, to separate liability in case of claims against one entity or the other.

Note: We are talking here only of business property. We are not recommending that you put your personal residence into an LLC because in some states this will cause you to lose your homestead exemption, i.e. some level of equity which the creditor cannot have. Often, this protected equity is enough to make it unfeasible or unlawful for a creditor to take your home.

Forming an LLC is only one piece of what we call “organizational engineering.” Another important part

of owning an LLC is the Operating Agreement” which sets forth the ownership percentages, what percentage of ownership interest has been disbursed for each member, and the contribution each member made to get this percentage, and the voting rights and management authority of the members and managers. Here, we are talking about Money and power, so, this is obviously very important and often overlooked.

Please feel free to [call](#) or [e-mail](#) us for more information on this and other business law issues, or [visit our website](#) for more information.



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