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Tuesday Jul 14 2015

Loomis Legal Roundup

Setting up an LLC Could be Beneficial

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Own a business or rental property? Switching to an LLC could protect your family's home and personal assets. In California, a limited liability company (LLC) is a legal "entity" with one or more owners who, in most cases, are not personally liable for the debts and obligations of the LLC. An LLC protects its owners like a corporation while allowing them to be taxed as a sole proprietor or partners.

When should I consider forming an LLC? Any time you own something that involves customers or assets with some level of legal risk, such as a business or a rental property, I normally suggest owning that asset in the form of an LLC for several very important reasons.

Tax benefits

First, an LLC is a great way to maintain a separate accounting of all income and legitimate expenses related to the LLC. There are lots of tax deductions available to an LLC: mileage on behalf of the LLC, office equipment, supplies, telephone, website and Internet service expenses, some educational expenses, marketing and advertising, LLC-related travel expenses and many more. Any accountant or CPA can help you maximize your deductions against income generated from the LLC, or if no income, then reduce other income taxes you may owe.

Protect your family's assets

Second, and most importantly in my mind, is the limitation of liability that a LLC provides. In California, owners of an LLC are not personally liable for debts and obligations of the LLC. Of course, there are exceptions such as personally guaranteeing the debts of the LLC; participation in tortious or illegal conduct; receiving improper distributions; or commingling personal and LLC matters.

Limitation of liability means that a creditor, or someone that sues the LLC and obtains a judgment, can only reach the assets of the LLC but not any non-LLC property of the owners. It's even more important where there are multiple owners. In a standard partnership, owners are subject to "joint and several" liability. This means that if one partner can't pay his fair share, the other partner(s) will be liable. Thus, owning a portion of an LLC can shield you from losing any more than your ownership interest in the LLC. For example, you own a small business or rental property; someone comes onto the property, slips and falls, sues you for negligence and wins a judgment against the LLC. Only assets held by the LLC can be attached to satisfy the judgment. In most situations, your home, retirement savings and other assets such as personal cash, vehicles, boats, are not able to be reached by the judgment holder. Of course, if liability exceeds your LLC's insurance coverage, you may lose part or all of your ownership in the LLC but your other assets are protected.

Estate-planning benefits

Third, owning an interest in an LLC may be a good estate-planning technique. LLC members enter into a separate private agreement called an Operating Agreement. The Operating Agreement spells out how the LLC will be operated, amount of ownership and how ownership interests may be transferred. By setting up restrictive rules on how ownership interests may be transferred, there are well established IRS benefits that can reduce the value of the LLC due to its restrictive (or illiquid) form of ownership. This may enable LLC owners to pass property through their estate plan at a lower than fair market valuation. As always, consult your tax advisor on any valuation issue such as this as the IRS rules can be tricky.

Keep your business private

Fourth, you can keep your ownership in the LLC anonymous. You can use an attorney or an inexpensive service to be the public agent for service of process, thus cutting down on the amount of junk mail and sales calls you typically will get when you list yourself and your home or business address as the contact information required by the state of California. LLCs are very simple to set up. California currently charges \$70 to file the LLC's "Articles of Organization" and charges an annual minimum \$800 tax for the "privilege" of operating an LLC in California, but in most cases, the benefits outweigh the costs of owning an LLC in California.

For more information about the benefits and rules of owning and operating an LLC, see a competent legal and/or tax advisor.

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