CHAPTER 81

Multiple Business Entities as an Asset Protection Tool

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It is common to see a business accumulate various assets (cash, real estate, securities, etc.) not related to the direct operation of the business. Aside from other potential issues and/or risks, doing so subjects all of the assets to the vulnerabilities of each individual asset. Imagine an ice cream company so popular that it has enough profits to invest in apartment buildings. One day, an accident occurs in the boiler room of one of the apartment buildings and a maintenance worker is severely injured. A lawsuit is filed and a judgment is entered in favor of the worker. Unfortunately, the accident leaves the maintenance worker paralyzed for life, with significant damages as a result. Presumably, he will seek recovery from the building's insurance carrier but, alas, the building is underinsured for such a catastrophe. Where else will the worker look to recover the remaining damages? As owner of the apartment building, the ice cream company is liable and will potentially lose all of its assets, including its ice cream inventory.

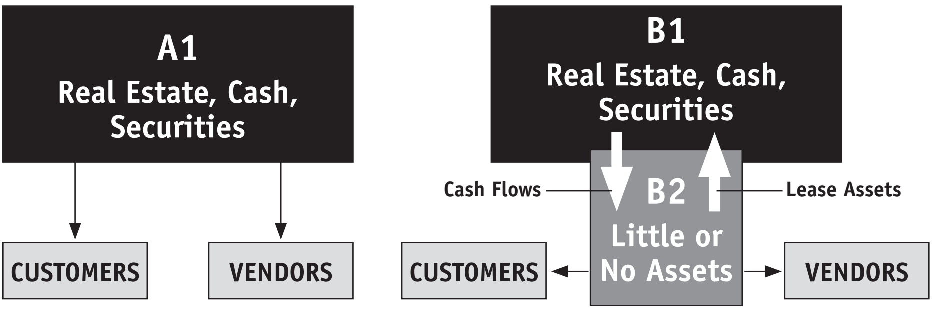
One possible solution is to simply remove the assets from the business by distributing them to the owners. However, this approach simply shifts the risk from the business to the owner. In other words, while the assets are in the business, they are subject to the business's creditor claims, and when distributed to the owner, the assets are subject to the owner's creditor claims. A comprehensive approach to asset protection must address both of these competing interests.

Fortunately, there is a relatively straightforward solution to this dilemma.

The business owner should consider establishing multiple divisions of the company. In its basic form, this means creating an operating company and a holding company. The holding company (also known as the management company) manages the other divisions (i.e., other companies) and receives compensation for its efforts. Additionally, the holding company owns most, if not all, of the assets, and loans those assets to the operating company.

It is important to ensure only the operating company contracts with any outside vendors and customers. This way, only the operating company is subject to risk of loss due to vendor and customer claims and lawsuits. Even in the case of a potential claim or lawsuit, because the operating company does not own any assets (rather, it leases assets provided by the holding company), the operating company has no assets to lose. Notably, the operating company will have recurring cash flows and receivables that may be subject to creditor claims, but most of these funds (minus operating expenses, of course) should be consistently paid to the holding company in the form of management fees.

ILLUSTRATED EXAMPLE: Business One "A1" owns its own assets, and contracts directly with its customers and vendors; thereby subjecting itself to creditor risk. Business Two holds its assets in "B1" and contracts with vendors and customers through "B2"; thereby limiting its liability only to those assets within "B2."



Utilizing this strategy will, admittedly, cause additional administrative, accounting, legal, and logistical difficulties. Yet, for a company with substantial assets, it is easy to see that the asset protection benefits quickly outweigh the burdens. For those for whom the benefits don't (yet) outweigh the burdens, there is another solution: Series LLCs.

For our purposes, suffice to say that although LLCs are relatively young in comparison to other business forms, they have quickly become the top entity choice for businesses, based upon their easy manageability and asset protection capabilities. LLCs are especially ideal for the multiple entity approach explained earlier. However, while they may be the ideal entity choice for our strategy, maintaining multiple LLCs does not deal with the problem of added administrative, accounting, legal, and logistical burdens.

In 1996, Delaware became the first state to enact a series limited liability company statute and, since then, a handful of states have developed similar statutes. A series limited liability company provides limited liability to the owners (members, in the case of LLCs) of each entity in the series. Each series of an LLC is essentially its own separate entity, with distinct assets, liabilities, managers, and members.

This structure is similar to the multiple entity approach explained earlier, but different in a few important respects. The primary difference is that a single operating agreement can be used to easily establish (and terminate, if need be) multiple and separate LLCs. This feature, at least partially, lessens the added cost and administrative burdens of the multiple entity approach. However, because very few statutes and very little case law and administrative guidance exists on the use of series LLCs, it is especially important to seek advice from a knowledgeable attorney.

Robert B. Vaksman, Esq., LL.M is among a small group of our country's most distinguished tax and business law practitioners. He dedicates his career to providing comprehensive solutions to families and businesses.