

TOOLS OF WEALTH

USING THE LAW TO MAKE MONEY



TEN



**LEE PHILLIPS
SHARES THE
LEGAL TOOLS
OF WEALTH
WITH YOU**

THE IRS AND YOUR LIFE—A LIFE OR DEATH CROSSROADS

By Lee R. Phillips, JD

An LLC and an S corporation are two great asset protection tools and tax tools. HOWEVER, they are turning out to be a nightmare for many folks. The problem is many people have set up an LLC or S corporation and never done anything with it.

I don't know how many hundreds of folks I have run into that have been talked into setting up a Nevada company and then have never done anything with it. As part of the "set up," the registered agent company in Nevada (Wyoming, Delaware or any other state) has gotten them a tax ID number (Employer Identification Number – EIN).

But, because they never did any business or "activated the company," they figured that there was no need to file any tax returns for the company. They now have a disaster on their hands.



Since January 1, 2009, the IRS has a club it is swinging hard and it is mowing down would be entrepreneurs and real estate investors like cattle in a slaughter house. I am having many of my students ask if there is anything I can do.

The student that called this week got their letter from the IRS. It is for penalties due on a "non-activated" company that didn't have a tax return filed for 2010. With interest and penal-

ties the IRS has levied \$4718.51. That's just for 2010.

The penalty is at least \$135 per month per member or shareholder in the company – plus interest. It adds up real fast if you have a couple of "partners."

There are excuses (reasonable causes) that will allow the IRS to waive the penalties. They are

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WHY YOU NEED A MULTI-MEMBER LLC

By Kristy S. Phillips, JD

Double asset protection is one of the best advantages of an LLC. Double asset protection is the ability to protect your business from your personal as well as your business problems. It forces a creditor into the position where the best they can do is get a "charging order" to try and collect money from you. A creditor can come in many forms. It may be the guy who wins the lawsuit against you or the guy you owe money to, including the hospital or the doctor or maybe a bank that is foreclosing on one of your properties.

To give you an idea of how

charging orders work, consider the following example:

1. You have lots of assets. One of your assets is ownership interest in an LLC which owns and operates a rental property.
2. You are sued in an incident unrelated to the rental property. You lose and a \$1M judgment is entered against you.
3. The other party in the incident is now your creditor, and you are a debtor. The creditor will try and seize your LLC interest to cover the \$1M.
4. Generally the only thing the creditor would be entitled to is a "charging order" against your LLC interest.

5. A charging order is simply a lien which tells the LLC that if it decides to distribute any money to you, to give that money to the creditor instead. The creditor cannot force the LLC to actually distribute any money, nor participate in any way in management of the LLC, nor even usually get information on the LLC's activities.

6. This charging order concept is very beneficial to you because the creditor cannot force the LLC to make any distributions. The creditor may sit with its charging order for years, never receiving anything unless the LLC chooses to make a

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GOT QUESTIONS?

What are your needs, concerns, or challenges?

Email Lee with questions you would like to see answered in this newsletter.

Email: info@legalees.com



THE IRS AND YOUR LIFE—A LIFE OR DEATH CROSSROADS, CONT.

“the death, serious illness or unavoidable absence of the taxpayer.” But they don’t really count in the end. Here’s the official line:

To qualify as a reasonable cause, the death, serious illness or unavoidable absence must be that of:

1) the person who is responsible for filing the return or paying the tax if the return is an individual return, or

2) the person who has sole authority to execute the return or pay the tax if the return is a corporate, estate, or trust return.

3) the death, serious illness or unavoidable absence of a member of the immediate family or the person described in 1) or 2) above will also qualify as a reasonable cause. However, the death, serious illness or unavoidable absence of the person responsible for preparing the return or writing the check does not qualify for reasonable cause.

The duties of filing the tax return and paying taxes may be delegated. However, it is the responsibility of the taxpayer to see to it that all returns are filed and all taxes are paid timely and correctly.

Stated bluntly, there are no excuses.

If you have a dormant company that you have gotten a tax ID number for, I suggest you file tax returns immediately for all back years since 2009.

I suggest you get rid of the company immediately. File the papers with the state where the company was formed and have the company “killed.” I am not sure what will happen with companies that you have let lapse by not filing the state papers

each year and paying the state fees. Those companies are gone on the state’s books, but there is still a tax ID number out there on the IRS rolls.

Undoubtedly, the law was passed to let the IRS keep track of all the tax ID numbers they issue and make sure they get a reporting.

If you start a new company, do NOT get a tax ID number until you absolutely have to, and then start filing taxes.

I’ve been talking about the IRS and taxes, but the IRS is about to start playing a lot bigger role in your life. You do understand that the IRS has tripled in size under Obama and is going to police Obamacare. This law has to be stopped. The public has no clue what is coming. The IRS has been given power to directly access your bank accounts to collect health care payments and penalties. Whether or not a legal challenge to that will stop it remains to be seen, but this is the way the law is worded.

There’s the 3.8% tax on all passive income (rents, real estate sales, interest, dividends, stock sales, etc.) Yes, it only hits the rich. The alternative minimum tax was only to hit the rich. Have you looked at 2012 tax laws? If your AGI is over \$49,450 this year, you will be subject to the alternative minimum tax. (That’s \$76,450 AGI for married couples.) In my view, it’s only a year or two until the 3.8% will apply to everyone – trust the politicians.

The Affordable Health Care Act has imposed a 2.3% tax on the GROSS income of all medical device manufacturing companies after the first \$5 million in revenue. Several of the big medical device manufacturing companies

have already fled the US. Obamacare doesn’t outsource jobs. It kicks the whole company out of the US.

Medications under the new Obama regulations are already in short supply. I need



a medication, which has always been easy to get, but it is now unavailable and on back order. The pharmacy said they get 10% of the supply they need. It isn’t a life issue for me, but my life is starting to change thanks to Obamacare.

Midrin was the oldest migraine headache medication on the market. It was very effective. Under new regulations, it has been taken off the market, even though no adverse side effects have been reported in 50 years. It has been taken off the market because it never went through the FDA testing process, and since it is a cheap non-proprietary product, it is too expensive for any company to spend the money to get it tested. It predated the FDA, and under new regulations, you can’t get it any more.

Nearly all generic drugs have gone up 300% - 3,000% due directly to Obamacare. Go ask your pharmacist. The Affordable Health Care Act was supposed to make insurance more affordable. Your health insurance didn’t go

down. It went up even faster.

Obamacare openly moves us toward the Canadian and European medical system. I travel to Canada to speak frequently. Since Obamacare was signed, I have kept track. Four out of my last five flights back to the US, I have been with a person coming to the US for medical care. I have never sat next to someone going to Canada for medical treatment.

I tell my cancer story in Canada and people come up to me after and talk about the cancer stories of their family members. The standard scenario for a cancer diagnosis in Canada is, “Let’s watch it for a year and see how aggressive it is so we will know how to treat it.”

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On the other hand, many Canadians will say how great their system is. I always ask one question, “Have you ever been critically ill?” The answer is 100% of the time – no.

In his mid 60’s my father-in-law lived in Toronto for a year. He would have died of a simple medical condition if he hadn’t been put in a private car and rushed to Niagara, New York, for medical treatment. He would have bled to death internally wait-

ing his turn for medical care in Canada.

When the Prime Minister of Canada goes to Florida for his heart surgery, because he didn’t want to unfairly butt in line on the waiting list in Canada, what more needs to be said?

Obamacare and many of the regulations that have recently been put in place are dangerous to all of us. In my opinion, as a multiple time cancer survivor, this law has to be stopped. Too much is at stake.

I do not want to hurt the feelings of my many friends who support President Obama, but in my professional opinion, I feel strongly our best choice is Mitt Romney, or our lives could change drastically. I feel that they will not change for the better. Kristy and I know the Romney family. Mitt is a good, honest

man with a lot of experience, and he will work with the democrats and republicans to heal the rift in our country. That’s just the kind of man he is.

Our current neighbor was living in Boston when he had a heart attack. He was in Mitt’s church congregation. Mitt and his boys shoveled this man’s driveway and sidewalks all winter every time it snowed. The neighbor reports it was usually Mitt himself.

I will try to stick to the taxes and legal stuff from now on, because whatever happens will have happened by my next newsletter, but I had to say something this time. I truly believe that our lives and our businesses depend on the outcome of this election. Whatever happens, we will continue on the best we can. And I will be here to support you.■



If your AGI is over \$49,450 this year, you will be subject to the alternative minimum tax. (That’s \$76,450 AGI for married couples.)

WHY YOU NEED A MULTI-MEMBER LLC, CONT.

distribution. This usually gives you leverage to negotiate a settlement with the creditor where you pay less than the amount owed, and in return the charging order is removed and the judgment is considered satisfied.

States are starting to limit the charging order protection to make it easier for a creditor to satisfy his judgment. There are a couple ways state LLC laws can be changed. One is by court rulings and the other is through the legislative process. In a couple of court cases, judges in Florida and Colorado have gone against the charging order concept because the LLC involved only a single member. These

rulings make it necessary to have more than one member in an LLC in those states, if you want to be assured of getting the charging order protection.

New Jersey and Utah legislatures have passed laws requiring multi-member LLCs if you are to get the charging order protection. You may be thinking that you don’t need to worry about this because this isn’t happening in your state. But the point is that this is the way the law is moving. Your state may not currently have these laws, but limiting charging order protection for single member LLCs is the wave of the future. I would recommend that no matter which state

you are in you use a multi-member LLC. You would be wise to take heed.

I would also take care to use this information to help you sort out when you may be getting poor advice. Last month I was approached by a real estate investor in Florida. He asked me if I was familiar with a certain “asset protection group.” I told him that I had not heard the name. He continued to explain that he was using them to form 12 LLCs—one for each of his twelve properties. The group had told him to form the LLCs outside of Florida. I started trying to explain that this was overkill, but I could tell he didn’t want to hear what I was going to say.

He just wanted me to confirm that he was doing the right thing.

So I tried a different approach. I asked him why he was forming out-of-state LLCs. He told me that it was because Florida had the Olmstead case, and he didn’t want to form a multi-member LLC in Florida. I asked where he had been advised to form the LLCs. I was pretty certain that he would say Nevada. After all Nevada has passed SB405, which seeks to address those fears by stating unequivocally that a creditor of a single member LLC is solely entitled to charging order protection. Nevada

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U S I N G T H E L A W T O M A K E M O N E Y

WHY YOU NEED A MULTI-MEMBER LLC, CONT.

hopes this will cause people all over the country to form LLCs in Nevada. In May of 2012, in *Weddell v. H2O*, the Nevada Supreme Court again ruled for the rights of LLC members where a creditor has obtained a charging order against a member of the LLC. Nevada has good laws in this area.

I was ready to tell this investor that I generally don't recommend forming a Nevada LLC if you don't live in Nevada. Neither the ruling in this new case nor the statute changes the fact that if you are doing business in Florida, Nevada laws won't apply to you if you are sued in Florida. The lawsuit won't be in the Nevada courts, it will be in the Florida courts. The lawsuit will always be in the state where you live or are doing business. Your home

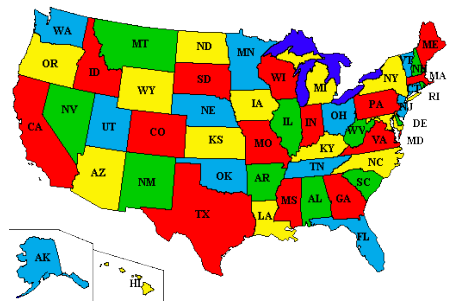
state court is likely going to apply the charging order law of your home state, not of Nevada, despite your LLC being organized in Nevada.

Some people reading this article may be thinking I'm wrong because the conflict of laws doctrine known as the "internal affairs doctrine" should apply. Without boring everyone to tears, this doctrine basically holds that when it comes to the affairs of the owners of a company, the law of the state of organization (i.e., Nevada) applies, regardless of which state suit is brought in. The internal affairs doctrine is real.

However, the problem with application of the "internal affairs doctrine" to the Nevada statute is that when it comes to a single member LLC, charging orders aren't

an "internal affair" since there are no other owners to protect. It is rather a collection procedure issue, which is an area where local law applies regardless of the state in which an entity is organized.

I didn't get a chance to give all these arguments to my investor friend. He told me that he was forming his single member LLCs in Utah. If you are dealing in Florida and Utah, it is guaranteed you need a multi-member LLC if you want any charging order protection. I knew that the advisors he was trusting were taking him for a very expensive ride. When I started to explain about the Utah statute, he turned a deaf ear. I could see that I was too late



to help him. I am writing this article in hopes of saving you from such a mistake.

You do not need to pay an arm and a leg to some misinformed advisor if you want to set up LLCs. Just listen to the LLC discussion in the *Accumulation and Preservation of Wealth* Business Planning Section. Lee walks you through everything you need to know. If you have more questions, give us a call. You will not only save money year after year, you will save a lot of grief, if you or your company ever gets sued. ■