

TOOLS OF WEALTH



USING THE LAW TO MAKE MONEY

FOUR

DO YOU FORM A BUSINESS?

By Lee R. Phillips, JD

To form a business or not to form a business is often the question. There isn't any right answer, but forming a business (corporation or LLC) isn't always the solution to your problems. In fact, forming a business can create real headaches.

It Can Be Expensive

The first issue is the cost. If you're in California, just filing at the state is \$800 – each year. There are a number of states that hit you pretty hard for the filing fees. Once you make the state filing, you're on the hit list for the business license department, Chamber of Commerce, United Way, and sixty dozen other organizations. Even if you

don't cave into the pressure they put on you and give them money, it's a pain.

I had a poor gentleman come up to me several

years ago at an event, and he related a story that I have heard many times. I remember this story, because it had a tragic end. He wanted to do a little retail business. He wanted to do everything right, so he got an attorney involved. OK, maybe that wasn't the



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

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

CREDIT REPORTS

By Kristy S. Phillips, JD

I have been fighting a war with my mortgage company over flood insurance for my condo. Several months ago, the mortgage company requested proof of flood insurance. Our flood insurance is covered by the condominium association. I obtained a copy of the policy from the condominium association and faxed it to the mortgage company. Every month I would get a letter from the mortgage company. One month they would say the proof of insurance had been received and then the next month I would get a letter asking for proof yet again. At some point in the battle, the mortgage company ordered a flood insurance policy in my behalf and billed me for it. I fought the bill with the mortgage company, but my credit was dinged when I didn't pay. I found this out when I looked at my credit report. I was stunned to find out that this problem cost me two hundred points. I think everything

is straightened out now. But I was stunned how much this one incident lowered my credit score. My take home lesson is that it is important to look at your credit score.

Your credit score is based on three FICO scores at the three credit bureaus: Experian, Equifax, and TransUnion. You can get an estimate of these scores free at various websites, and the numbers tend to be in the same ballpark. You're entitled to one free report from each bureau every 12 months. It is a good idea to get an actual credit report every so often. It costs, unless you have been denied credit, but it is worth it. Your actual report gives you a better sense of what lenders see. You can scout it for mistakes. Your scores are only as good as the information they're based on. And a third of people who've pulled their reports have found errors, according to a Zogby poll. That's a good reason to read your report.

If you spot an error, like I did,

you can request a correction. I acted on it immediately and it took about three weeks to get the correction. I simply followed the instructions on the website. It is worth your time too. For instance if your credit line was misstated or you have an account that was mistakenly marked delinquent, getting the error fixed could raise your score as much as 200 points. A difference of 200 points can change a lot of things when you are trying to qualify for credit.

Here are some rules that help you keep a good credit score.

Never, ever be late. The biggest chunk of your credit score comes from your payment history. Just one late payment can shave 100 points off a 750-plus credit score. Lenders can't tattle on you to the bureaus until you're 30 days past due, but don't risk it.

If you miss a payment, but you get back on track within the next 30 days, you should "get

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right thing to do. In fact, it was totally the wrong thing to do.

The attorney set up his company, and the poor man became even poorer (financially speaking). The attorney charged him a little over \$25,000 to set up his company, get the business license, make the tax filings, and do everything. The only problem was \$25,000 was all this man had to launch his business. The business never opened its doors.

The obvious moral of the story is never get an attorney involved. I'm not trying to be funny. I'm serious. The fastest way to kill a deal is getting an attorney involved. I had a sage old man who had done very well explain to me that I should never get an attorney involved in my business. He was right.

Once you have an attorney involved, the attorney will control everything. It doesn't really matter what position the attorney holds. He controls. All he has to do is say, "you can't do that, because it violates a law or it's too risky." He has just controlled the decision, and you don't know enough to challenge him. If you did know enough to challenge him, you wouldn't need him.

Hire an attorney to answer a specific question or draft a specific document. Never involve them as a decision maker in your company.

You Can't Represent Yourself

You may not want a company in the form of a corporation or LLC, because the company creates problems. Let's say you set up an LLC or use a land trust to own your investment property, and you get the tenant from hell in the property. They violate every

rule in the book and specifically in the lease. Can you evict them?

The answer is no. "You" can't evict them. The company has to evict them, and you can't represent the company. You will have to hire a lawyer to represent the company. There is no *pro se* representation (you represent yourself) for a company. If you own the property, you can file your own eviction papers. If a company or a land trust owns the property, you have to get a lawyer to do everything.

Note that a living revocable trust is different than a land trust. In your living trust you are the grantor (the guy who puts the property in), the trustee (the guy who controls the property), and the beneficiary (the guy who gets the benefit). If you hold all three spots, the trust is a "grantor trust," and the courts will treat the entity as "you." You can represent yourself in court.

If you hold all three spots, it is impossible to get the "anonymity" that the land trust promises, and of course, there is never any asset protection offered by a land trust. So, the land trust gurus always have you use a third party trustee. Now you don't have a grantor trust, and you can't represent yourself.

If you are a sole proprietor or you own the property in your name or the name of your living revocable trust, then you can represent yourself. Creating a company to do business or own property causes other "attorney problems."

For example, let's say you have a wonderful lawyer. (OK, now I am getting into fiction. We all know any wonderful lawyer must be riding a uni-

corn and spraying rainbows out of his briefcase.) Let's say this lawyer does good work for you in everything you need him to handle. If you have a business entity, he may not be able to represent your business. You can't even use him to do your eviction because of ethics regulations.

Each state has ethical rules. The ethical rules address everything. For example, assume a client pays you in cash with a \$100 bill. When the client leaves, you discover that the client has actually given you two \$100 bills stuck together. This presents an ethical question. Do you just keep the extra \$100 bill, or do you tell your partner and split it with him? ☺ That type of dilemma would be covered in the ethical rules.

By opening a business entity, rather than operating as a sole proprietorship, you may be ensuring that come crunch time Randy the unicorn-riding attorney can't help you.

I practice in Utah, so a quick look at their rules can make the point. Rule 1.13(g) of the Utah Rules of Professional Conduct states that "A lawyer representing a business entity may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the entity's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the



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DO YOU FORM A BUSINESS, CONT.

entity other than the individual who is to be represented, or by the shareholders.”

It's a Conflict of Interest

Rule 1.7, by the way, is the rule on conflicts of interest. What the rule says is that if there is no conflict of interest, a lawyer in Utah can represent you and your business only if an officer or shareholder (other than you) gives him written permission to do so. If you are the only officer and director (manager) of the company, you may not be able to give Randy and his rainbow spraying briefcase authority to represent you.

If there is a serious conflict of interest, Randy can't represent you both and the entity under any condition. Conflicts of interest are pretty common – more common than you think.

Let's say you own a house. Your LLC manages the property and rents it to a tenant. Something goes wrong that is clearly the manager's fault (the manager hires a plumber that burns the place down), and the tenant sues. When the lawyer files the suit, he will name you, the LLC, the plumber, and half the world as defendants.

The perfect attorney, Randy, can't represent more than one of the parties. There is a conflict of interest between your interests and those of your LLC. The LLC (even if it is just you) has an interest in placing the blame on you while you have an interest in placing the blame on the LLC. Of course, everyone will blame the plumber, but he doesn't have any money. You're the deep pocket.

Now there are ways around this in some cases and with some lawyers, but this is just

an example to help clarify the problem.

You may ultimately get permission for the court to have Randy represent you and the LLC, but the fact that there are two parties (the LLC and you) will cause problems – problems that are going to cost you money, a lot of money to resolve. The plaintiff's attorney knows your problems, and he is going to make it as expensive and difficult as he can for you to address those problems.

Tie Up the Lawyers – Don't Be Tied Up By the Lawyers

If you live in a smaller or midsized city, you may want to start tying up lawyers in your city. Figure out who the good law firms are and who the “pain in the butt” attorneys are in your city. Then systematically have each firm and the pain in the butt guys do little legal jobs for you and your company.

Have each one of them draft a lease for you doing business as the LLC. Make sure your name and your company's name go on the attorney's records – particularly the bills. Have the pain in the butt attorneys do an eviction for you doing business as your company. Have them all do something for you. Pay them for a consultation on how to protect yourself from a hypothetical lawsuit filed by a tenant.

This isn't a trick. This is good business. Once the firm (one member or 500 members) has represented you, the firm can't represent anyone coming against you. You have now blocked anyone in town, who might try to sue you for any reason, from being able to use the firm or any attorney working for the firm.

Conclusion

You may not want to start a formal business first thing. My rule is wait until you are making money, owning property or hiring employees. If you don't have any money, you won't get sued anyway. Don't spend all your money on lawyers until you know your business ideas can make enough money to justify the legal expenses.

Learn how to use lawyers, not be used by lawyers. Plan for the disaster by making sure you can get the representation you want for yourself and your company. Also play the elimination game and make sure your opponents can't pick the lawyers you don't want to go up against.

Weigh the risks and benefits of having a company. The companies will give you a “corporate shield,” but they may make life more expensive and a much bigger hassle for you. It's all a balancing game.

I'll help you, as one of my select students, any way that I can. I'm happy to answer phone questions, as always. (Note that we still have the same phone number and we don't have a voice mail system.) We do have a good firm, and can help many out of state people, if they come to us and ask for help.

Have a great holiday season and enjoy your family. My mother died a young 80 last week due to medical malpractice. Hold your family close and don't let the doctors or lawyers get a hold of them. Thanks for all your support. Lee

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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

CREDIT REPORTS, CONT.

back the lion's share" of the points you lost. If you are more than 90 days late, then the damage can stick for years. If a lot of time has passed since a one-time late payment was made, and it is still on your credit report, you can call your issuer and plea for a good-will adjustment to your credit report. (It may be a long shot, but it is worth the try.)

Remember the magic 20%. The second biggest factor in your score is how much you owe vs. how much credit has been extended to you. The part of this that's easiest to finesse is your credit card utilization rate, or your total card balances compared with your total credit limits, meaning each card's balance relative to its limit. For example: if you've charged \$5,000 on cards and have \$50,000 in credit, your rate is 10%. For the best score today, 10% is

ideal, but you can probably creep up to 20% and keep a high rating.

Unfortunately, with banks lowering credit limits and canceling unused cards, it's harder to maintain such a low percentage. In the previous example, if your available credit is cut to \$20,000, your rate shoots to 25%. That could sink your score by as much as 50 points, says Ulzheimer. The lesson: Know your limits, watch for changes, and stay under 20% on each card and in total (0% if you'll be applying for a loan soon).

If you are already above 20%, paying down debt is the obvious way to lower your utilization rate. But another strategy is to apply for an additional credit card to increase your overall credit limit. That may cause you to lose a few points in the short term—so

don't do it if you're about to apply for a mortgage—but it should pay off in the long run.

Keep oldest cards in play. As noted, credit issuers these days are eagerly canceling cards that are not in use. Besides reducing your limit and increasing your utilization ratio, having an account closed can hurt you in another way, especially if it's among your older ones.

See, 15% of your score rides on the length of your credit history. The longer you ably manage revolving debt, the better you look. So don't cancel your oldest cards. And don't let them get canceled on you. You can move a recurring charge to each card so they stay active.

Already ditched or been ditched? A new card can help with your utilization rate (as discussed above), but there's little you can do to help the



"history" component of your score, except to keep other old accounts in use.

There are other factors involved in your score, but they're not as easy to manipulate. For example, every time somebody pulls your credit, your score is lowered. This is harder to control. Ten percent of your score is based on how well you manage a mix of credit types, such as mortgages, car loans, and credit cards. But you don't want to go out and, say, finance a car just for a score boost, because you can easily get a 750-plus score with just a few well-tended credit cards.

It is important to keep on top of your credit score. A little housekeeping can make a big difference. ■