



Minimizing the Risks of Owning Hot Investment Properties

by Heidi C. Freeman and Kristen E. Simmons

With more and more investors flocking to southern Nevada to invest in the hot real estate market, it is important for investors to be informed of the risks of owning property in their own name. For example, if an accident occurs on the property, the owner of the property may be sued individually, and the creditor can access the owner's personal assets to satisfy a judgment. Alternatively, if the owner causes an accident and is personally sued, the investment property may be levied to satisfy the judgment against the owner. This article will discuss how using an entity to own investment property can protect both the owner's personal assets from liabilities arising from the property, and the property from the owner's personal liabilities.

The purpose of holding investment property in an entity, rather than by the owner individually, is to create a protective seal around the property. The proper type of entity will form a shell around the property that it owns. The property held within the shell will be exposed to liabilities arising from the property, but assets held outside the shell, such as the owner's personal assets, will be shielded from the liabilities inside the shell. There are three main types of business entities that protect owners from the liabilities of the entity—a limited partnership, a corporation and a limited liability company.

A limited partnership (composed of general partners and limited partners) creates a protective seal around the partnership assets, but only for the limited partners. A limited partner's personal assets are protected from the liabilities of the partnership. However, all of the general partner's assets are subject to attachment by the creditors of the partnership. By comparison, the personal assets of every owner (shareholder) of a corporation are protected from the corporation's creditors. Likewise, a limited liability company (LLC) also insulates the personal assets of all owners (members) from attachment by the creditors of the company.

While a corporation and an LLC both insulate the personal assets of the owners from the debts of the business, a corporation does not protect the business from the debts of the owners. An unpaid creditor of a corporate shareholder may take the shareholder's stock in satisfaction of the debt. The creditor will be entitled to vote the shareholder's stock, enabling the creditor to control the business if the creditor attaches more than fifty-percent of the voting stock. To prevent the non-debtor shareholders from becoming "partners" with a creditor of a debtor-shareholder, closely-held corporations sometimes engage in buy-sell agreements. Under a buy-sell agreement, if a shareholder is sued individually, the corporation or the other shareholders may purchase the debtor-shareholder's stock, in order to prevent

the creditor from owning an interest in the company. However, buy-sell agreements are not a perfect solution since the debtor-shareholder will still lose his entire interest in the business and the corporation or the other shareholders must incur a cost to purchase the debtor-shareholder's stock.

Unlike a corporation, if a member of a Nevada LLC is personally sued, then, under Nevada law, the creditor's only remedy against the member's LLC interest is a "charging order." With a charging order against the member's LLC interest, the creditor has the rights of an assignee. As an assignee, the creditor only has an equity interest in the LLC; the creditor cannot vote and may not sell the LLC interest. The debtor-member may continue to vote his LLC interest and he may continue to operate and manage the business. With a charging order, the creditor will only collect money from the debtor-member if the LLC makes a distribution to its members. The charging order requires that all distributions made by the LLC to the debtor-member be paid to the creditor until the creditor's claim is satisfied. Since the debtor-member still controls the LLC, the debtor-member may control the timing of distributions and it may be a long time before the creditor can collect on the debt.

Nevada's LLC laws offer the greatest protection to LLC members because the charging order is the exclusive remedy of a creditor. Nevada is one of only a handful of states to make the charging order the exclusive remedy. Under the laws of states that do not make the charging order the exclusive remedy the creditor of a member may be awarded other remedies. For instance, the creditor may foreclose on the member's LLC interest or a judge may order a sale of the LLC interests.

Creating a Nevada LLC to own investment property protects the owner and is not as complicated as many people may think. The members of a Nevada LLC do not have to be Nevada residents and the Nevada LLC may own real estate outside of Nevada. For more information, please contact the authors at (702) 341-6000. ★

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