



Legal Tools to Plan for the Future: Business Entities that Can Achieve Multiple Benefits

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Owning and operating one's business in a properly structured business entity can yield substantial dividends, both presently and in the future. Present benefits include income tax advantages from characterizing expenditures that minimize taxable income, from more sophisticated retirement savings options available to entities that shelter income from current taxes, and asset protection. This article addresses future benefits, from asset protection, business succession and estate tax minimization. The present benefits noted we leave to a future discussion.

Asset Protection

Hotel owners should always be concerned with asset protection. Can guests or others be injured while on your property? Are chemicals used on your property? Can someone be the victim of a serious violent crime while at your property? Could an earthquake result in damage or a drastic reduction in business precipitating a bankruptcy? Yes, is the clear answer to any of these questions. Will insurance protect you? Without umbrella coverage, the answer is likely to be no. With an umbrella policy, the answer is maybe, maybe not.

The most effective form of protection for your personal assets is to make certain that your hotels are owned by a business entity, either a limited partnership or a limited liability company. In California, there are some advantages to a limited partnership that will often make it a preferred entity. For discussion, let's assume that either can be used and we will refer to it as an "Entity," and the partners or members as "Owners".

For hotel owners with multiple properties we always recommend that the owner hold each asset in its own entity. Why subject one property to the potential liability that could occur at another property? Our maxim is: "Bad Stuff Happens! Contain the damage and don't let it bring down your empire." The cost of implementation and maintenance is negligible compared to the exposure.

Business Succession

Assume that one family owns a hotel and either all the grown children participate in the business or one of the children participates in the business. The Entity Operating Agreement can include buy/sell provisions that protect the family from outsiders, or provide for the orderly transfer amongst family members, thereby maintaining family harmony.

If the Entity has a number of unrelated owners what happens when the Managing Owner dissolves, becomes disabled or dies? That Managing Owner's spouse or children may very well step into the departing Managing Owner's shoes. Do the remaining Owners want a new partner? What if they have different ideas about the business? What if a divorce subsequently occurs with the new Owner? What if the new Owner wants to sell the hotel? The Entity Operating Agreement can provide for these situations, protecting the surviving Owners from negative consequences of becoming partners with individuals they really don't know.

Let's consider the situation where a family with three grown children owns the hotel, and one of the children is active in the business. When the last parent dies, the active child could be voted out of his/her livelihood and career by the others. If the hotel is owned by an Entity, the Entity Operating Agreement could provide for the orderly succession and transfer through buy/sell provisions. These provisions may also be structured to consider (i) how to determine the value of the asset, thus the price of a buyout, and (ii) the cash flow of the business to permit a buyout over time such that the active child can finance the acquisition without incurring debt or being forced to sell. Both considerations foster harmonious relations amongst family members with different interests and agendas, who might otherwise become adversaries negotiating against their siblings. Without these provisions, conflict is not atypical, and can be incredibly unpleasant for the siblings, cousins, nieces, nephews, tearing

the essential fabric of the family structure. What a shame and so unnecessary!

Maximize Wealth Transfer/Minimize Estate Tax
In 2008, a married couple can exempt up to \$4 million from estate taxes using a properly drafted revocable living trust. In 2009, the combined exemption increases to \$7 million before all estate taxes are eliminated in 2010, only to revert to a combined exemption of \$2 million in 2011. That's the tax law presently. Admittedly, it makes little sense but that's often the case. Please don't blame me, I didn't write it or vote for it. My guess, which is nothing more than a guess, is that after 2009 we will see some level of exemptions from estate taxes between 2008 and 2009 levels, that is, between \$4 million and \$7 million.

If a married couple owns a home and a hotel in California, it is very likely that the couple's assets will at least exceed \$4 million. Using an artfully structured Entity to own the hotel, or a series of entities for multiple properties, we can facilitate the tax advantaged present transfer of minority interests to future generations without compromising control or present economic benefit. By gifting portions of certain classes of interests in the Entity to future generations we can freeze the value of one's estate and eliminate all future appreciation from tax consideration. Remember, I said we do this without giving up control or economic benefit. Ultimately, if we gift enough value to reduce the taxable estate below the exempt amount, we succeed in transferring wealth to one's heirs tax-free. Frequently, we accomplish this without incurring any gift tax, estate tax, or income tax; obviously an enormous benefit to the Owners.

Parting Thoughts

It is rarely too late to plan for the future. It is never too early to think about the future. It is rarely too early to realize benefits from effecting plans for the future. It is almost never too late to improve one's business practices both for today and tomorrow. The legal form in which you do conduct your business can significantly impact the degree of success you achieve for yourself and your family.

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