AUGUST 21, 2011

Strictly Business

A Business Law Blog for Entrepreneurs, Emerging Companies, and the Investment Management Industry.

ABOUT THE AUTHOR

Alexander J. Davie is an attorney based in the Nashville, TN area. His practice focuses on corporate, finance, and real estate transactions. He works mainly with emerging companies, venture funds, entrepreneurs, and startups. His firm's website can be found at **www.alexanderdavie.com**.

In his corporate practice, Mr. Davie has worked extensively with his clients on all aspects of their businesses, including company formation, business planning, mergers and acquisitions, vendor and customer contracts, corporate governance, debt and equity financings, and securities offerings. In addition, he has represented investment advisors, securities brokers, hedge funds, private equity funds, and real estate partnership syndicators in numerous private offerings of securities and in ongoing compliance. Prior to returning to private practice, Mr. Davie served as the general counsel to a private investment fund manager.

In his real estate practice, he has participated in property acquisitions, mortgage financings, and commercial leasing matters throughout the United States. He has represented developers, governmental entities, life insurance companies, banks, and owners of malls, shopping centers, industrial parks, and office towers. He has worked on a number of transactions involving the syndication of real estate partnerships, advising sponsors on both real estate and securities issues.

Should new business owners set up their business as a Wyoming LLC?

Previously, I have written about the advantages and disadvantages of incorporating in Delaware or Nevada as a small business owner. With regards to Delaware, my conclusion was that, for most small companies, the disadvantages outweigh any advantages. With regards to Nevada, my view was that it is highly uncertain that many of the advertised benefits of incorporation in Nevada, such as greater asset protection and greater liability protection, would actually materialize. In this piece, I'll cover my thoughts on another state that is frequently pitched as a good place for forming your business: Wyoming.

Wyoming limited liability companies are heavily marketed on the internet as a great option to form a new business. Wyoming has the distinction of being the first state to have a limited liability company statute, which apparently was created as special interest legislation for an oil company. Because of Wyoming's long history with LLCs, Wyoming LLCs are highly promoted as being superior to the LLCs of other states (usually by companies that offer to do the formation for you…for a fee). The fact that Wyoming was the first state to have an LLC statute doesn't really benefit a business owner, of course. The three major substantive selling points that are used to promote Wyoming LLCs are: (1) superior asset protection, (2) lower taxes, and (3) lower fees. For the reasons described below, it is highly unlikely that a business owner would actually realize any of these benefits if they were to organize their business as a Wyoming LLC.

The first major substantive selling point is that Wyoming LLCs supposedly have superior asset protections. Wyoming law provides that the sole remedy available to creditors of owners of LLCs is a charging order. A charging order is an order by the court directed to the company ordering the company to send all distributions that would have gone to the owner/debtor to the judgment holder instead. This limitation can make it more difficult for a creditor to collect on their judgment because the creditor will not be able to force the debtor to sell his ownership interest in the company. Usually, after a creditor obtains a judgment against a debtor, the creditor is entitled to sell the debtor's personal property to satisfy that judgment. However, if the creditor's sole remedy is a charging order, then the creditor is entitled to whatever distributions are produced from the ownership interest (if any at all), but the creditor cannot transfer or sell that ownership interest. Having this protection can give a debtor more leverage in negotiating a settlement. However, the charging order limitation is not unique to Wyoming. Most states' LLC statutes provide that the sole remedy to a creditor of a member is a charging order. It is true that Wyoming has extended the charging order limitation to single member LLCs, whereas many other states do not provide such a protection in the case where an LLC has only one owner. However, it is important to note that if a lawsuit takes place in your home state or in some other state besides Wyoming, conflicts of laws principles may cause the law of a state other than Wyoming to control whether a creditor may be able to obtain a lien on or a forced sale of a debtor's interest in a Wyoming single member LLC. In other words, judges often have a lot of discretion as to which state's laws apply in multi-state cases and often begin with the assumption that the law of the forum applies, unless a party can show that another state's laws have greater contacts or interests in the case. Therefore, you cannot be sure that your own home state won't go ahead and apply its own law to the situation, notwithstanding whatever Wyoming law states. Therefore, for people interested in asset protection, I'd recommend taking steps other than forming a Wyoming LLC. See my post on Nevada corporations and LLCs for links to more information on what steps your should take for asset protection.

Another major selling point that is used in promoting Wyoming LLCs is that Wyoming has no income tax. Unfortunately, since most LLCs are pass through entities, which pay no taxes themselves, this is of limited benefit. For instance, if you live in another state that has a personal income tax, and form a Wyoming LLC, all the income would be passed through to you and you would still end up paying state income taxes. Therefore, forming an LLC in Wyoming is not an effective tax avoidance method. In addition, if your state does impose an income tax on LLCs at the entity level (which for instance my own state of Tennessee does), and your LLC operates a business in your state, then your LLC would still end up paying the state income tax regardless of Wyoming's income tax, because it is the entity's presence in a state which controls whether it is taxed there, not its state of incorporation.

The final major selling point that is used to promote Wyoming LLCs is that the fees to organize them and the ongoing annual fees are lower than other states. This is certainly true. But if you live outside of Wyoming, and organize your business as a Wyoming LLC, your business will almost certainly be doing business in your home state. In that case, your LLC will be required to qualify to do business in your state, which usually involves paying a fee equal to what your company would have paid had it simply been organized in your own home state. Therefore, you are unlikely to realize any cost savings from organizing your LLC in Wyoming (Nevada and Delaware entities present this same issue as well).

As with Delaware and Nevada entities, I don't think there is much advantage to using a Wyoming LLC, as opposed to an entity formed in your home state (unless of course, your home state is Wyoming). You will end up incurring double the fees, because you will have to pay Wyoming's fees and then pay your own state's fees to obtain authorization for your Wyoming LLC to do business in your own state. Despite this additional cost and complication, it is uncertain whether you will see any of the benefits, such as greater asset protection, that are often promised in connection with incorporation in Wyoming, nor are you likely to see any tax savings. In addition, if there were ever litigation among the owners, you may be forced to conduct that litigation in Wyoming, which could end up being highly inconvenient and expensive. Therefore, unless there is some specific reason to set up your company in Wyoming, I'd avoid using a Wyoming LLC.

As always, your final choice in entity selection should be based on your own specific situation. Therefore, before making any final decisions on your form of business, you should speak with your attorney.

Contact Information

Alexander J. Davie
Attorney at Law
1109 Davenport Boulevard, # 211
Franklin, TN 37069
Phone: (615) 585-3546
Email: adavie@alexanderdavie.com