

Prepared by:

August 2008

DAVID J. WILLIS  
Attorney at Law  
LoneStarLandLaw.com

## LLC FORMATION IN TEXAS

by David J. Willis  
Attorney at Law

A limited liability company (LLC) is a unique legal entity – a separate “person” in the eyes of the law. It has its own tax identification number (TIN) and files its own state and federal tax returns. It is neither a corporation nor a partnership but shares characteristics of both. Texas limited liability companies are governed by Title 3, Chapter 101 of the Texas Business Organizations Code (“BOC”). Advantages of an LLC include pass-through taxation and the ease of informal operation.

The owners of an LLC are referred to as “members” rather than shareholders or partners. An LLC may be formed by only one person. Members may be individuals, partnerships, other LLC’s, corporations, and/or any other type of legal entity. LLC’s generally operate through a “managing member” although officers may also be elected if the Company Agreement (formerly called the bylaws) so provides. LLC’s are subject to the new Texas margin tax as are other entities under the BOC.

The first thing investors should know about limited liability companies is this: *get one*. There are lots of good reasons. The main ones are (1) minimizing personal liability and maximizing asset protection; (2) organizing your investment business; and (3) tax benefits including one-time taxation of members’ profits. I will discuss the first two in this article but you should consult your accountant for a review of your particular tax situation.

A limited liability company, like a corporation, is a distinct legal entity with a life of its own. It has its own rights and duties. It files its own tax returns. However, it requires maintenance and continued respect for its independent status. It may be *your* company, but it must still be treated at arms length for legal purposes. You must undertake certain actions to maintain its separate character, and it is vital that you do so if you wish to avoid personal liability for the actions of the company or its agents and employees. The reason is the legal doctrine of “piercing the corporate veil.” Unless the company pays its state and federal taxes, maintains a bank account, conducts regular meetings, keeps records, and the like, then in the event of a lawsuit, a court may disregard the company’s existence and proceed directly against the members/owners personally. It will be alleged by the plaintiff’s attorney that the company is a sham and nothing but the personal “alter ego” of its owners, designed to shield them from the consequences of wrongful conduct.

Omitting company “maintenance” is the single biggest mistake that investors make concerning their companies. They do the initial paperwork, pay a filing fee, and then use the

company name in transactions without ever doing another thing to maintain the form and substance of the company's existence. This approach provides only the illusion of personal liability protection. It will not protect you from a clever plaintiff's lawyer who is determined to get a judgment against you personally. Remember, he or she will be looking for deep pockets and hard assets, wherever they can be found.

A new lawsuit is filed every 1.3 seconds. Literally millions of lawsuits will be filed this year. Many will award huge damages for such things as serving coffee that is too hot. Can you afford to leave your assets undefended in this legal environment?

Consult your attorney to determine whether an LLC best meets your needs. A Texas LLC or an out-of-state LLC registered to do business in Texas, preferably a Nevada LLC or a Delaware Series LLC, are good choices, although out-of-state LLC's are required to pay a stiff fee and maintain a registered agent with a physical address (ie., not a PO box) both in Texas and the state of origin. The Delaware Series L.L.C. may be useful for investors with multiple properties who want to utilize only one company but insulate each property or category of property from the other. For reasons of simplicity and economy, however, it is recommended that new investors start with a Texas LLC. There should be no rush to get chartered in another state since Texas has relatively favorable LLC laws.

After establishing your LLC, it is recommended that you then file a "DBA" certificate in the counties in which you operate, showing the name under which you will be publicly doing business. This further preserves anonymity, an important element in asset protection. For example, the name of your LLC as registered with the Texas Secretary of State might be "ABC, LLC." The company's DBA, however, might be "Wilshire Investments." Therefore, the face you show to the public should always be Wilshire Investments. As a technical legality, Wilshire Investments cannot be sued since it is not a legal entity. A claimant would have to research the DBA records to discover the true legal entity, which is of course ABC, LLC, and suit would then have to be filed against the company and service would be have to be made upon the company's registered agent.

Ideally, your personal name should never appear on any deeds or leases, and a tenant should never write a check to you personally. Do business using the assumed name of your LLC and use a dedicated operating account. Avoid any form of personal guaranty on legal documents. Property management should always be conducted by your LLC acting through the name of its DBA.

Although there is no such thing as a "bulletproof" plan to avoid personal liability or protect assets, the rule is: the more fences a plaintiff and his attorney have to jump, and the more money they have to spend in order to get to you, the better. One way or another, plaintiffs have to pay their lawyers, and that means either cash or contingent fee - and few good lawyers will take a real estate fraud case on a contingent fee, particularly if they know they will have to penetrate a bona fide LLC before they can get to any real assets.

Even if you have an operating LLC, you may still be sued in your personal capacity. Your lawyer should then send out discovery (including interrogatories and requests for

production) to find out if the other side has any basis for holding you personally liable. If no such basis exists, he or she should file a motion for partial summary judgment to have your personal name removed from the case as a defendant. If you have properly maintained your LLC, this motion should be successful. If not, this defense can be reasserted at trial.

An LLC is also a useful device for organizing your business, particularly in separating your business from personal affairs. Failing to do this is a common mistake of novice investors and can create legal and accounting problems. Running business income and expenses through your personal account may not be illegal, but it can complicate your defense if you are sued. It will be alleged that you “commingled funds.” Again, this may not always be contrary to law, but it will arouse the suspicion of the judge and jury and may result in your defense failing the “smell test.” This sort of error can also result in your being held personally liable for damages. Why risk it? Set up an operating account in the name of your LLC in which all income from tenants (including cash) and related expenses are clearly shown, coded separately for each of your properties. A separate account for security deposits is advisable. If you get sued it is very likely that you will be asked for an accounting and to produce your bank statements. Being prepared for this is an essential part of your asset protection strategy.

In setting up an LLC, one of the first things to consider is a company name. Unfortunately, the easy ones tend to be taken, so you will need to be creative. You can get name availability information by calling the Texas Secretary of State at (512) 463-5555. You may also visit them at [www.sos.state.tx.us](http://www.sos.state.tx.us). Currently, the filing fee plus special (expedited) handling is \$325. Other fees include the cost of a corporate book (a good investment) with an official seal and printed membership certificates, which ranges from \$80 to \$120. Then there are legal fees. At this time, our fees are \$650, which is significantly below what is charged by many firms.

When you have an available name, contact your attorney and tell him who the original members are going to be and what percentage of ownership each will have. Generally, LLC's have a managing member or co-managing members. Who will be serving in these capacities? You will also need to choose a registered agent with a physical address (not a PO Box) in Texas. The registered agent will receive official company mail from the Secretary of State and the Comptroller and be the person who is served with process if the company is sued.

In summary, every investor should consider having at least one LLC. LLC's can be inexpensively established using an internet service, but these services are no substitute for an attorney who will tailor his advice and documents to your unique circumstances. Moreover, you will not have the benefit of a lawyer's advice at the beginning or with “follow-up,” ie., the help you need to establish and maintain the company. For these reasons, you should contact a good real estate lawyer who knows how to use LLC's as part of an investment program. The secret is to pro-actively defend your anonymity and assets from the start and then stick to the plan.

## **DISCLAIMER**

Information in this article is provided for general educational purposes only and is not offered as legal advice upon which anyone may rely. Legal counsel relating to your individual

needs and circumstances is advisable before taking any action that has legal consequences. Consult your tax advisor as well. This firm does not represent you unless and until it is expressly retained in writing to do so.

*Copyright © 2008 by David J. Willis. David J. Willis is board certified in both residential and commercial real estate law by the Texas Board of Legal Specialization. More information is available at his web site, LoneStarLandLaw.com.*