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## Asset Protection for (Many) Real Estate Investors

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Q. In addition to the California residence where we live, my spouse and I own several homes which we rent for investment purposes. Although our rental properties are managed in a responsible and business-like manner, we are still concerned that a lawsuit could ruin us financially. We've been told that forming a Limited Liability Company (LLC) can protect our rental properties from civil judgments. Is this true?

A. Real estate investors who own residential properties generally face potential civil liability from two different types of claims: claims based on contract (rental agreements) and claims based on injury to persons or property.

Claims based on contract, in the context of residential rental properties, typically are brought by the property owner, not by a tenant or third party, and generally relate either to the non-payment of rent or the creation of a nuisance (where the tenant disturbs other tenants or engages in illegal activity).

Claims based on injury to persons or property, on the other hand, typically are brought by a tenant or third party, against the property owner. These are the types of claims which owners of rental properties often seek to protect against through the use of LLCs.

The cost of creating an LLC varies from lawyer-to-lawyer and from state-to-state. Legal fees for creating a California LLC generally run anywhere from \$1,000.00 or so, to more than \$5,000.00. Secretary of State filing fees are in addition to legal fees.

If your rental properties are all located in California, you might consider creating a California LLC. If, however, your rental properties are located in a state or states other than California, you might consider creating an LLC in a state where at least one property is located, or a state such as Nevada or Delaware, which are considered "friendly" to this type of asset protection strategy. However, regardless of where one or more of your LLCs are created, because you are a California resident, California will want you to register your foreign (e.g., non-California) LLCs with the California Secretary of State – and pay California taxes thereon.

California charges the same minimum annual fee for registration in California of a foreign LLC as it charges to maintain a California LLC: \$800.00. In addition to California's minimum annual LLC fee (annual fees may be higher, based on gross receipts), each LLC will be responsible for obtaining and maintaining appropriate business licenses and permits, and for filing various tax returns.

The total cost of operating an LLC – when taxes, tax return preparation, and licenses and permits, are considered – can easily total \$2,000.00 per year or more.

Holding rental properties in an LLC may also complicate financing or refinancing, as well as create future difficulties in structuring tax-deferred exchanges.

Rather than using LLCs for asset protection purposes, married couples or unmarried persons, who solely own rental properties, might be able to adequately protect their assets with insurance. Every parcel of real property must be insured. Thus, the

cost of insuring any particular property will be incurred regardless of whether the property is held in an LLC.

In addition to an individual policy insuring each rental property (primary policy), an owner/investor can usually obtain an “umbrella” policy which acts as a secondary policy and which covers that portion of any claim which exceeds the dollar amount of the primary policy. Several millions of dollars of umbrella insurance coverage often can be purchased for much less than the annual cost of maintaining an LLC.

The above-described strategy of using insurance as a means of asset protection is presented for informational and educational purposes only, and does not constitute legal advice. Before selecting an asset protection strategy, owners of rental property should consult with an attorney.

Earle Law Offices provides trial and appellate litigation, as well as non-litigation, legal services in the areas of bankruptcy, business law, constitutional and civil rights law, family law, real estate law, tax law, and trusts and estates.

\* Mr. Earle is licensed to practice law in all California state trial and appellate courts, the United States Supreme Court, the United States Court of Appeals for the Fourth and Ninth Circuits, federal trial courts in the Northern District of California, and the United States Tax Court. He has served as a Judge Pro Tempore for the Santa Clara Superior Court, and is also a licensed Real Estate Broker.

Mr. Earle received his law degree from the Santa Clara University School of Law, where he served as an Editor of the school’s Law Review, and where he received awards for academic excellence. He received his undergraduate degree, with honors, in business administration from the University of La Verne.

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