

# THE ABEL LAW GROUP, PLLC

**MIKE A. ABEL**

ATTORNEY AT LAW\*

**Gilbert Office**  
1734 E. Boston St. Ste. 103  
Gilbert, AZ 85295

PHONE: (480)-478-4515  
FAX: (480)-624-5968  
[mikeabel@yahoo.com](mailto:mikeabel@yahoo.com)

**Chandler Office**  
1035 W. Queen Creek Rd. Ste. 101  
Chandler, AZ 85248

\*LL.M. International Taxation  
Admitted in Arizona, Ohio and  
South Carolina

## **COMMON ASSET PRESERVATION TERMS**

### **ASSETS**

**Active Asset** – An Active Asset is an asset, through its use or operation, can create liability for its owner. E.g. A car, boat, motorcycle, 4-wheeler, or a business.

**Passive Asset** – A Passive Asset is an asset which by its very nature, cannot create liability for its owner. E.g. A savings account, 401K, brokerage account, art collection, etc.

### **BUSINESS ENTITIES:**

**Corporation** - A corporation is a legal entity that is separate and distinct from its owners. Corporations enjoy most of the rights and responsibilities that an individual possesses; that is, a corporation has the right to enter into contracts, loan and borrow money, sue and be sued, hire employees, own assets and pay taxes. It is often referred to as a "legal person."

**C-Corporation** – A C-Corporation is a corporation which elects to be taxed in its own right and separate from its owners. A C-Corporation distributes profits to its shareholders via dividends which are taxable to the recipient.

**S-Corporation** – An S-Corporation is a Corporation which elects to not be taxed on its profits but instead all profit is apportioned to its shareholders to be taxed on the shareholders own individual tax return.

**Limited Liability Company** - A limited liability company (LLC) is a corporate structure whereby the members of the company cannot be held personally liable for the company's debts or liabilities. Limited liability companies are essentially hybrid entities that combine the characteristics of a corporation and a partnership or sole proprietorship. While the limited liability feature is similar to that of a corporation, the availability of flow-through taxation to the members of an LLC is a feature of partnerships.

**Operating Agreement** – An Operating Agreement is an agreement entered into between the members of a Limited Liability Company that sets out the rights and responsibility of the members as well as the governance of the company.

**Member / Unit Holder** – The person or entity that owns an interest in an LLC.

**Manager** – The person or entity appointed to manage the day to day affairs of an LLC.

**Manager Managed Limited Liability Company** – A Manager Managed Limited Liability Company is an LLC whereby the owners chose to appoint one or more Managers to manage the day to day affairs of the LLC. The Manager may or may not be an owner / member of the LLC.

**Member Managed Limited Liability Company** – A Member Managed Limited Liability Company is an LLC whose members reserved the management rights of the company to themselves. All members have a right to manage the day to day affairs unless restricted through an operating agreement.

## **INCOME**

**Active Income** – Active Income is income derived from services which are performed. This includes wages, tips, salaries, commissions and income from businesses in which there is material participation.

**Passive Income** – Passive Income is generally income received on a regular basis, with little effort required to maintain it. e.g. rental units, interest from savings, dividends, some profit distributions from ownership, capital gains, etc.

## **RISK**

**External Risk** – An External Risk is a risk created in our personal lives that can threaten the assets which we own. e.g. An automobile accident, someone slips and falls at your home, your lawnmower throws a rock, etc.

**Internal Risk** – An Internal Risk is a risk that is created through the activity of a business, corporation, LLC or other entity. Through the use of various business entities, we try to limit the liability created through the operation of a business to the business in order to protect the personal assets of the owners.

## **TAXATION**

**940 Tax** – Federal Unemployment Tax. Generally, the employer pays 6% on the first \$7,000 of an employee’s wages.

**941 Tax** – Withholding Tax for Social Security, Medicaid and Medicare for W-2 employees. This withholding is comprised of two portions, the employee’s and the employer’s portions. The employee’s portion equals 7.65% of the first \$118,500 of their gross wages and 1.45% thereafter. The Employer “matches” these contributions for a total of 15.3% of the employee’s wages. These amounts are broken down to 12.4% for Social Security and 2.9% for Medicare.

**Check the Box** – Check the box is a tax term referring to the availability of an LLC to choose how it wishes to be taxed. Normally an LLC is considered a disregarded entity if it has a sole member and a partnership if it has more than one member. Through “Check the Box” tax regulations, the members of an LLC can change this “Default Classification” and instead choose to be taxed as a C-Corporation or S-Corporation.

**Disregarded Entity** – The term “Disregarded Entity” refers to an entity that although it retains all of its corporate characteristics, the IRS does not recognize the entity as separate and apart from that of its owners and thus all business activity is reported on the owner’s schedule C of their tax return. This would be limited to a single member LLC. In Arizona, like all other community property states, LLCs owned by a husband and wife are considered single member LLCs and are thus disregarded for tax purposes.

**Self-Employment Tax** – Self-Employment Tax refers to the payment of a self-employed individual’s payment of Social Security and Medicare. The individual is responsible for paying the entire 15.3% reflected as 941 Tax payments. They will pay 12.4% Social Security Tax on their first \$118,500 of earnings and 2.9% on all earnings without limit.

**Taxed as C-Corporation** – An LLC can choose to be taxed as a C-Corporation. While this causes the corporation to pay tax on the company’s income, the shareholder does not pay tax on the dividends until received. So the corporation can retain its earnings and use them for expansion or to distribute them at a later date.

**Taxed as S-Corporation** – A company chooses to be taxed as an S-Corporation so it is treated as a corporation for tax purposes however, it pays no corporate income taxes as all of its profits are apportioned to its shareholders who must then include the income on their personal income tax returns. An LLC generally chooses to be taxed as an S-Corporation when the owners want to pay themselves a wage to reduce their employment taxation.

## **MISCELLANEOUS**

**Charging Order** - A court-authorized right granted to a judgment creditor to attach distributions made from a business entity, such as a limited partnership (LP) or limited liability company (LLC), to a debtor who is a partner of the business entity.

The charging order is usually limited to the dollar amount of the judgment and is akin to a garnishment of wages or income. It does not give the creditor management rights in the entity, nor can the creditor interfere in the management of the entity to which the debtor is a partner/member.

**Equity Stripping** – Removing or transferring equity from one asset to a holding company. Generally created through a lien.

**Growing Equity Note and Deed of Trust** – Generally used when stripping equity out of a piece of real estate. The note calls for quarterly payments to be made at the option of the borrower. Should the borrower decide not to make such payments, the interest is capitalized and added to the loan balance. In doing so the amount of the lien increases on a yearly basis.