EPISODE 683

[INTRODUCTION]

[00:00:00] ANNOUNCER: Welcome to The Real Estate Syndication Show. Whether you are a seasoned investor or building a new real estate business, this is the show for you. Whitney Sewell talks to top experts in the business. Our goal is to help you master real estate syndication.

And now your host, Whitney Sewell.

[INTERVIEW]

[00:00:24] WS: This is your daily real estate syndication show. I'm your host, Whitney Sewell. Today, our guest is Mark Pierce. Thanks for being on the show, Mark.

[00:00:32] MP: Well, you're welcome, Whitney. I'm glad to be here.

[00:00:35] WS: Mark is an attorney, an accountant, and the owner of Cloud Peak Law. With over three decades of experience, Pierce has truly seen it all, at least from a legal perspective. This is apparent from the diversity of fields in which he assists clients all over the years. Those fields range from bankruptcy and real estate planning to oil and gas and security.

Mark, I'm grateful to have you on the show. Why don't you give the listeners a little more about who you are and what you do a little bit? Maybe where you're located, and let's dive into some of these issues that I know other operators are having and I know I've received some questions lately that you and I discussed briefly before we started recording that I want to get into today that I know is going to help the listener. Give us a little more about who you are and your business.

[00:01:19] MP: I'd be glad to. Cloud Peak Law is located in Sheridan, Wyoming. Wyoming is an isolated state, to say the least, the least populated state in the United States. We have in terms of social distancing 4.8 people per square mile, so I'm not sure what they mean by the social distancing for us anyway. It is the premier LLC jurisdiction of the United States, the first state to recognize and to flush out what a limited liability company is. It also has become one of the premier trust jurisdictions in the United States as well. That is by design, the large financial industries within the state have pushed that to a conclusion.

I came back to Wyoming in 2012, eight years ago, for the purpose of providing commoditized legal services to people in a very specific area, those being LLCs and trusts. Over the last eight years, we've put together a trust and LLC formation, an operation administrating entity that allows people to get good, quick information regarding LLCs and trusts online, and to book online consultations with attorneys as well, who are schooled almost solely in trust and LLC administration. That's just begin to take off within the last couple years, and I hope that you will visit our website and take a look through those through that information because there's a great deal of information that you can go over there that relates directly to the real estate industry.

As a result of that, I brought my son in. We've got three or four programmers working for us now, several attorneys, administrative assistants, and all of that.

[00:02:51] WS: Well, Mark, again, I'm grateful to have you on the show. Just so the listeners know, I've had numerous questions recently about – once somebody gets into this business, which it is not an easy feat, but you get going. You get your business operating. But then you start – you have other growing pains, right? One of those is then you have – People start thinking about, "Well, how do I structure these things on the personal side?" As an operator, well then we start owning parts of different deals. Maybe we're investing passively as well. We're thinking about our family and our kids, and all these things start happening that maybe didn't happen before. I know it happened to me, and I started doing a lot of research and consulting people like yourself.

But I thought maybe you could help us talk through that a little bit, and even then maybe get into why the Wyoming entity or LLC is so popular, because I know that came up as well during many of these conversations. So, just on the personal side for an operator, just thinking through our structure of our entities, and whether we should have corporation, and what falls under those.

Maybe you have some suggestions or ways that we can think through those things?

[00:03:57] MP: Well, I have a different prejudism towards limited liability companies, just because I've been involved with them for the last 40 years in and out of the state. I practiced in Florida, I practiced in Colorado, California, Arizona, and it seems to me that the limited liability company gives you at least as much if not more protection in terms of liability than a corporation does, but it also allows you the flexibility of being taxed in the way that you want to be taxed. An LLC can be taxed as a passive entity, like a sole proprietorship, as a partnership, as an S corporation or as a C Corporation.

From the standpoint of tax flexibility, you get a lot more with that LLC than you would with a corporation, but you also get to pick and choose which aspects of the LLC code you want to apply to you, and then you can modify a great number of those applications. For instance, Wyoming has what they call a close limited liability supplement, so that you don't have to go through the regular corporate formalities and pretend that you've had a meeting every year, for example. You also don't have to have special meetings to adopt certain matters such as liquidations or asset acquisitions and dispositions. It gives you a lot more flexibility in the standpoint of running a small business, which most of us have.

When you get into real estate syndication by way of example, you're looking at getting a property, and then you get the proper, and you begin running that property and going through all of those issues. Then you get a second property, and then you get a third. Then it just becomes inevitable that you end up with more and more properties. The problem is you don't keep up on the corporate side with what it is that you're doing. You wake up one day and say, "My goodness!" Somebody points out and said, "Everything is at risk for everything else's liability." So you begin segregating them out into operating entities. Well, that's fine, but each one of those operating entities should probably located in the state where that real estate is, because it's not going to make any difference if you have a Wyoming company in Missouri. Missouri is probably going to apply Missouri law. Even though they shouldn't, that's what they're going to do.

You realized, "I need to put each one of the operating entities into a separate LLC. What I do with my passive interest because I've run into some things with that as well?" You put together a collective holding company at the top which holds each one of those operating subsidiaries.

Now, the holding company could also be an LLC because an LLC can hold other LLC interests. Then off to the side, you put a management company because then you get more deductibility on your expenses. You get a broader definition of what an expense is, so it lowers your tax implications. Plus, if a management company is running those operating subsidiaries, you can commingle all the funds, which you cannot do if you're operating those subsidiaries individually. So the management company takes all the money into a single pot, provides all the insurances that go on, provides all the operating expenses that go on, and then makes an accounting to each one of those entities at the end of every year, including a fee for running the management company.

That ultimately is where any real estate syndication company is going to come into play.

[00:06:58] WS: Nice, okay. That’s a lot to think through right there. I know you laid it out very quickly, and so it makes this seem so easy.

[00:07:05] MP: We’ve drawn pictures on the website for you. I know that I'm very visual, and it helps me to look at these things from the standpoint of where are your squares, where are your triangles, where are your circles? And then to see the cash flows back and forth and begin to understand what it is that I’m talking about, and that’s your legal structure.

[00:07:22] WS: Nice. I look forward to looking at these diagrams myself because I'm also very visual. I’d love to see that and be able to draw on it and think about where that money flows. It took me a while to figure those things out. I mean, wait a minute. How is this entity related to this entity, and are they related, and can they be, or should they not be? And money flowing from one to the other.

Is that like top entity?Is that holding these other entities? Is it owning those entities? Is money going to the first entity and then distributed to the others? Can you walk through a little bit of that?

[00:07:53] MP: Yeah, I’d be glad to and I think that's one of the best questions you get because, even with a close limited liability supplement applicable to your LLC, you have to watch the money flow because that’s what’s always going to trip you up. If you have a subsidiary that’s generating money, it wouldn't take that excess money and just invest it in another subsidiary directly. You'd want to strip that money up to the holding company. It's called equity stripping. You maintain enough equity in that operating subsidiary to provide for its day-to-day operations, typically two to three months with no revenues. Anything over that is stripped up to the holding company.

The holding company then makes additional investments into operating subsidiaries that need working capital but it does it in the form of debt. That way, it becomes a preferred creditor and not an equity holder or a combination of an equity holder for its initial investment. But a creditor adds to any additional cash infusions going in, invests that in with a promissory note, secures it either with real estate or personal property or both. Then it strips that money away over time in the form of distributions going back to repay the loan that's been made, which is a huge differential on your accounting, because now it's a repayment of a loan, not a repayment of capital. So if you start stripping money back up to that LLC and the taxes haven't been paid, then the LLC ends up paying the taxes first on income before it gets a return of its equity. Whereas if you distribute the debt repayment backup, you don't have that worry. That's a huge impact on a small business owner over time in terms of his cash flow.

You put the equity stripping in place, and then the holding company ends up with the money, and then the holding company can invest in new subsidiaries or make capital infusions into older subsidiaries or keep that money and distribute it out to the limited liability company holders, the members, which is key because that gives you a double envelope of protection. That way, each one of those LLCs at the bottom, the operating subsidiaries, are not liable for one another's debts, and the holding company isn't liable for debts. You as an owner behind the holding company have a double envelope protection as to those debts within those LLCs.

That's something that's been put into place in Standard Oil of Ohio in the 1880s, so it's not as if we've come up with it as a new idea.

[00:10:04] WS: What's the best way to track some of this? I know after we get numerous entities in place, like it can kind of get complicated, right? Like you were even talking about, you have to have that annual meeting, and things like that that, time gets away from you and I forgot to document that meeting. Or is there other ways that that you all have found it to track these things and make sure that we stay ahead of all the regulations that we're supposed to have in place?

[00:10:26] MP: Basically, if you have a Wyoming entity and you have the close liability supplement, you don't have to go through the meetings. You don't have to go to the formalities. You can do it informally, and it doesn't count against you, in the event that a creditor wants to break through your liability shield in that LLC.

The one thing that you do get in trouble with is going to be the accounting of the cash flow of monies. What I have advocated over the years, particularly for real estate people because they always get into a quarter of this, a third of that, or a managing entity over here, put together a management company. That way, you have one cash account and then you have sub-accounts underneath. Not cash, but sub-accounts created on your accounting, so you know where the money went, and whose money it is, and what expenses are incurred, but you've just got one pot for the money. Because you consolidate these for tax purposes at the end of the year, the accountant doesn't care. They just put them all into one big pot and make a filing on behalf of that holding company, which is typically a partnership that flows out with the K-1's to you.

That's my advice. That gets rid of almost all the corporate formalities, and then the management company allows you essentially to co-mingle without actually commingling for legal purposes.

[00:11:36] WS: Okay. When do we need to have something like that? Somebody that's getting started in the syndication business, when should we have that like management entity like that and other entities in place?

[00:11:46] MP: Well, I think once you get up to about three or four properties and you see additional opportunities coming down the road, then that's when you seriously need to begin thinking about that. I know you've got to wrap your head around it and feel comfortable doing it, but it seems to me that once you get to three or four properties, the next property almost becomes automatic. By the time you get to 10, they start flowing in. I have a nephew of mine who's in his 40s. I think he's got 130 properties now, and he started when he was in the young 20s. The first five were hard. The next five were a lot easier. The next 10 were difficult. Then after that, it just became a matter of things coming through the door and doing them. It became very systemic for him.

I would recommend at that three to five level, really begin thinking about that. Broaden your perspective on whether or not your accountant can handle that and assist you in putting together the accounting mechanism for it. Get an attorney that can go through. We can do that for you. You can get a local attorney to do it. Go through and explain what the liability is and the benefits to it and then just implement it. I think it's a matter of discipline. It’s going to be something that's different than what you're used to doing. But if you develop that discipline, it benefits you in the long run. Not just for tax purposes but also for legal purposes as well.

[00:13:03] WS: What about when – Those entities we were talking about. I know you mentioned you don’t want to have a property in certain states in order to have an entity most likely in that state holds that property. But then personally, when we have these other entities, whether it’s the holding company or the management company, are those going to be Wyoming entities, even if we don’t live there? Is that what you would suggest or how do you think through that, or is that where you resident at?

[00:13:29] MP: Well, there's two ways to think about it. You’ve got that operating company that’s owned by a holding company, and that is what they call a single-member LLC. Wyoming, by statute, as a result of a Supreme Court case that wasn't decided correctly, but as a result of a statue came back and said, “A single-member LLC is an LLC for liability purposes for every purpose under our LLC Act.” There are a number of other states that have come back in, and you can have a single-member LLC. But somehow judicially, they’ve created an exception saying, “We don't believe the single-member LLC operates to isolate liability within that LLC. We think it’s nothing more than your back pocket, and therefore we’re going to pierce that veil.”

Theres a case that came out of Florida that a lot of attorneys cite for that proposition, I don't think that case is a good citation for it because I read through that case and it’s really egregious factual circumstances. Somebody who’s involved in fraud, somebody who’s stolen money, that sort of thing. That makes it a lot easier for a court to say, “Look, we’re just going to set this thing aside.” But who knows? Let’s say you do real estate operation in Georgia and you come in and you say, “Look, I’m going to buy a 10-unit apartment complex. Should I use a Georgia LLC or a Wyoming LLC? Will Georgia recognize that single-member LLC?” The answer is maybe and maybe not. Well, why wouldn't you do a Wyoming LLC, authorize it to do business in Georgia, and register with Georgia, and do business in Georgia, because the Georgia court then comes back in and says, “Look, that Wyoming LLC, Wyoming law says they recognize it. We have to apply Wyoming law under the full faith and credit clause of the Constitution.” You’ve at least got a shot of recognizing the LLC that way, where's Georgia may not recognize its own single-member LLCs.

You could either do a Georgia LLC and hope that it works out or do a Wyoming LLC and have an additional line of defense towards it working out. That’s the analysis that we've gone through, but we leave it up to the client to come their own conclusion.

[00:15:30] WS: Yeah. Well, on that note, I guess maybe you could dive in a little bit more on just asset sheltering and risk avoidance, some of those things, even tax minimization, that we need to be thinking about as an operator.

[00:15:42] MP: Well, I think with real estate you get a lot of tax benefit, particularly on the frontend because of the depreciation that you have. The question is the deductibility of expenses. If you have a management company, the management company owns your automobile and use that automobile to drive around and look at the properties. It’s deductible, plus then you can put in things like health insurance, life insurance, key man life insurance, travel expenses back and forth, that normally for a single-member LLC or for a passive entity or single, a sole proprietorship you couldn't deduct. So you get a great deal more deductibility on expenses on the management company partnership side of the holding company that you would just through a passive or sole proprietorship.

I think one of the best ways in which to shelter money for tax purposes and then also for liability purposes, and this is overlooked a lot, is you get a pension fund going. You’re basically a single-member LLC off to the side. Establish a pension fund and stuff as much money in there as you can. It reduces the gross income for tax purposes, and almost every state in the United States says, “Nah, you know, that’s sacrosanct. Your creditors can't come after that.” It gives you a pot of money that, if everything disappears on you, at least you’ve got money that you can go borrow from, or money you can live on in retirement.

Second issue I think, which is something that's overlooked by a lot of people, your best liability insurance is just that, insurance. If you have an umbrella policy that covers these things, most everything is covered by your insurance policy, and attorneys are lazy. They take these things on on a contingent fee basis and they want to generate cash flow. The problem with a lawsuit is it takes time, three to five years in a lot of places. If you can come in with a policy limit and a liability settlement, and they take the policy limit and release you, you don't have any personal liabilities. It's up to the insurance company to make the payment, and most attorneys and litigants are happy to have that. I think insurance and pension funds are some of your best lines of defense that you can have.

The other way that you can do it if you put equity stripping in place, those operating subsidiaries up to the holding company, and then on top of the holding company you put an asset protection trust in place, and you distribute the monies from the holding company, the asset protection trust, and then you domicile that money in a state that has good solid asset protection trust laws. You can't get into it because in Wyoming you have to prove by clear and convincing evidence that that's fraud. That's almost impossible to do.

Second thing is once you get to Wyoming, they put a cloak over it. You can't find out who the other members are. You may not even be able to find out who the managers are because the court is going to ask, "Why do you want to know these things?" Most attorneys will say, "Because I'm on a fishing expedition," and I'm paraphrasing there, "But I'm on a fishing expedition." Well, I was going to say, "Well, that's great but not here." That's how you cloak that money, and you get it out and you get it away, and each one of those companies is anonymous.

The result of that having anonymity is people will know about them, so they don't know to ask about them either, and that's what allows you to take that money and take it out of the public purview and keep it away from potential predators.

[00:18:51] WS: Yes, I've heard that about Wyoming entities for a while now, and that's why I have one as well. Well, Mark, anything – Unfortunately, we have to move on to a few final questions but anything else about asset sheltering or tax minimization that you'd like to highlight before we move on?

[00:19:09] MP: I've gone through I think just about everything on the tax side of it. I think that what you need to do as a business owner is to find an aggressive tax professional, not somebody who just reads the book and tries to apply it and not have any liability from it. I think one of the difficulties I've always had with your blocks outlets, like H&R Block is they'll say, "If you get fined for penalty, we'll pay it." Then they're not taking very many chances at that rate as well, and I find that a lot of accounts become just overly conservative on the deductibility of items. So find an aggressive accountant. That will help you more than anything else.

Second thing is in the asset protection side, I know that we've had a real gravitation away from liability, but it always seems to me that the people that come in who are the most well prepared for asset protection issues are the ones that have had friends, family, and themselves having gone through these things that they never thought would pop up to grab them. Some people say, "Well, what could go wrong?" I don't know but I'm surprised by what does go wrong, so I think if you plan in advance and do these things in advance, you're going to be able to shelter those assets and maintain that liability and get the deductibility for tax purposes.

The other thing in Wyoming is that if you have a Wyoming entity that reports out of Wyoming, there's no IRS office here. The odds of being audited in Wyoming are infinitesimally small because nobody can get here. They won't admit that, but I think that's the case, and my feeling is that if it's under a million bucks, they're just going to leave you alone because nobody wants to drive up from Denver to deal with you.

[00:20:40] WS: Especially out of the middle of nowhere in Wyoming, right?

[00:20:42] MP: Yeah, exactly right.

[00:20:44] WS: It's an amazing place out there. No doubt about it. Mark, what's a way that you've recently improved your business that we could apply to ours?

[00:20:52] MP: We have worked hard at automating, systematizing and now automating because we found that most clients – We try to come in with the frequently asked questions. Where do things go? My feeling is that if you have a real estate business and you're generating monies, you're having expenses, get a bookkeeper in place to systematize, systematize,

systematize. Or get something that works as you expand your real estate operations so that, when you get your 10th real estate operation, it's got the same account of books and accountability that your first five had. That is going to be that and that's the discipline that we talked about earlier. As dull as it is, setting up the bookkeeping, that's the thing that's going to save you at the end of the day. So that's one way.

The second item is go online. Get these services all online. Get up into the cloud. That way, you've got access from anywhere and you can hire and fire people or bring them in. They don't have to be in your hometown. You don't have to have an office for them. You can employ better people that way or the people that you want to employ get used to working on the Internet.

[00:21:53] WS: What's the number one things that's contributed to your success?

[00:21:55] MP: I read this book a couple of years ago, and I can never pronounce this gentleman's last name, but it is *The Second Machine Age*, and it dealt with artificial intelligence, primarily systemization, and its effects on almost every aspect of the American economy. I read that and I read with the impact was going to be on accounting and the law and these things. I said, "Well, why don't I get out in front of that?" As a result, I began attending seminars and really focusing on developing this business so that it would serve people on a high-volume basis, but better than what most attorneys and most accountants are willing to do through a face-to-face meeting. I give you a lot of information so that by the time you come in to talk to me, you spend a very small amount of time and we have a wonderful conversation. You walk out with great representation of what. A 299 LLC price includes the EIN. How do you beat that? You can't go talk to an attorney for half an hour for that amount of money.

So that was the thing that got me in front of this and then I realized, given my background as a CPA, as an attorney, as a business owner, as an entrepreneur essentially, I don't fear change. I think that the practice of law, listening to most attorneys, most Supreme Courts that manage those attorneys, I think they're scared to death and don't know what to do because, at the end of the day, we don't need as many attorneys as we have. I think we can cut the number of law schools by three quarters, and you'd had too many attorneys coming out, given the effect of AI over the next 10 years.

That would be the gravamen of the success at that point, is get out in front of it and change or it'll change you, and you're best to be out in front. I'd rather act than react.

[00:23:37] WS: Reminds me of the book *Who Moved My Cheese*?

[00:23:40] MP: Yeah, exactly right.

[00:23:43] WS: Mark, how do you like to give back?

[00:23:46] MP: There are a number different things that we do in giving back. I'm a very heavily involved in a number of issues regarding patriarchy and the getting rid of the gender discrimination, getting rid of the racial discrimination that we've got, opening of the diversity of our company to allowing people in who will diversify us. That's principally what we're doing. We're developing a program right now.

We call it Law Office in a Box, where we come in and we provide all the back office services to you, the SEO marketing and that, but you have to go out as an attorney and go into that community and make it work for you. We're focusing some of our initial efforts on a couple different states in the South, with the idea that let's get rid of the racial connotation. Let's get rid of the gender connotations, let's open this thing up. That's how we're trying to give back.

[00:24:32] WS: Well, Mark, I'm grateful to have met you. I'm grateful to have you on the show. You provided a ton of value to the listeners and myself. How can they get in touch with you and learn more about you?

[00:24:41] MP: We have website, wyomingllcattorney.com. You can get on to that website. You can book an appointment with me or you can give us a call.

[END OF INTERVIEW]

[00:24:49] WS: Don't go yet. Thank you for listening to today's episode. I would love it if you would go to iTunes right now and leave a rating and written review. I want to hear your feedback. It makes a big difference in getting the podcast out there. You can also go to the Real

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[OUTRO]

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