

The LLC Capitalization Tactic

One advanced and innovative method to equity strip is via the LLC capitalization technique. The concept goes like this: Two people form a limited liability company (LLC) to run a business (which could be some legitimate, yet easy-to-do activity, such as investing in stocks and bonds.) Under the LLC acts of every state, each member (member being the LLC equivalent to partner) can obligate the other, per a written agreement, to contribute capital (assets) to the company so that it has a means to operate. One member contributes a smaller amount of assets up front to capitalize the company, in exchange for a small but significant ownership interest (usually a maximum of 5 %). The other member promises to make a large capital contribution over time, in exchange for an upfront large interest in the company (95 to 99 %). Because the first member contributed his capital up front, but the second member did not, the LLC places a lien on the second member's property to ensure that he fulfills his obligation to capitalize the LLC over time. As long as the LLC is not considered an insider under applicable fraudulent transfer law and the obligation is valid, its fulfillment demonstrable, and it makes sense in a business context, we create a rock-solid lien against the second member's property.

It's important to note in this scenario that the second members promised contribution could take many forms. It could be a promise to contribute cash, services, equipment, or other property. And after the lien expires, the members could dissolve the LLC and typically return their capital back to them – tax free. Furthermore, you can equity strip almost any asset via this method – whether it be accounts receivable, real estate or personal property. Indeed, you have maximum flexibility when equity stripping via an LLC capitalization and you can set practically any terms to fit within the realm of normal business practice.