

# **Limited Liability Companies & the Real Estate Investor**

*by Dyches Boddiford – [www.Assets101.com](http://www.Assets101.com)*

Limited liability companies are rapidly growing in popularity under favorable tax treatment and adoption in all fifty states and the District of Columbia. For the real estate investor, it opens up tremendous opportunities for true asset protection, anonymity, estate planning, and advantageous tax treatment.

A limited liability company (LLC) is an entity that combines the best features of the corporation and partnership. Like a corporation, a properly structured LLC possesses the corporate characteristic of limited liability in that it protects its owners (referred to as "members") from personal liability for the liabilities created by the entity. At the same time, a LLC with two or more members is treated as a partnership for federal income-tax purposes. This combination of limited liability and partnership "flow-through" tax treatment can be highly advantageous to the LLC's members.

To gain these advantages, the LLC must be properly formed and documented. State law governs the formation of an LLC. The statutes require a public document known as the "Articles of Organization" to be filed with the secretary of state of the state in which the LLC is to be formed. An internal document known as an operating agreement, similar to the by-laws of a corporation, details the arrangements agreed to by the members the LLC members.

All states allow a single owner. By default a single member LLC is transparent for tax purposes. Thus, tax information is simply entered on the owner's tax return, eliminating any additional accounting cost. At the same time the LLC provides liability protection under state law.

Real estate investors should be cautioned that the single member LLC, transparent for tax purposes, or the multi-member LLC, treated as a partnership, is only advantageous for long-term hold, investment property. If either of these is involved in dealer property (flippers) or any other active business, Self-Employment Tax will be due on the total profits from any dealer property or business.

Of course, you can mitigate this problem by choosing to have the LLC treated as a corporation for tax purposes. As of January 1, 1997, single and multi-member LLCs can elect corporate tax status using IRS Form 8832, commonly referred to as the "check the box" form. Investors are cautioned to consult their accountant about their particular situation when considering such an election.

The LLC is superior to a partnership entity form in that it provides all members with the benefit of limited liability. Unlike a partnership, where the general partner retains personal liability, an LLC can allow members to be involved in the management without exposing the members to personal liability for the LLC. Limited partners in a limited partnership, even though shielded from personal liability beyond the amount of their contribution to the partnership, cannot participate in the partnership's management.

The LLC can provide the same benefits as an "S" corporation without the "S" corporation restrictions. A corporation that elects to be taxed under the Subchapter S provisions of the IRC is referred to as an "S" corporation. By making this election, it becomes a "pass through" entity like an LLC taxed as a partnership. Except for certain special situations, the "S" corporation pays no federal income tax at the corporate level. Instead the "S" corporation's shareholders report their pro rata share of corporate income, loss, deductions, and credits on their own federal income tax returns.

Even though the LLC provides all this, it also has the flexibility to make special allocations of these items to members. And the LLC can be owned by any other entity where an "S" corporation ownership is severely restricted.

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