

ARTICLES - PAGE 1 OF 2

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SHOULD YOUR INVESTMENT PROPERTY BE OWNED THROUGH A LIMITED LIABILITY COMPANY?

By Dennis L. Voelkel, Esq.

Several years ago, hardly anyone had heard of limited liability companies (“LLC”). Now businesses operate as LLCs in all states, and the press and media have nothing but good things to say about them. Is all the hype justified? Much of it is, especially where the business involves the ownership of real estate. Limited liability companies offer an unprecedented combination of corporate-like liability protection and partnership pass-through taxation. In addition, if anonymity is a goal, you can achieve this by naming the LLC whatever name you desire so long as it is followed by the words “limited liability company” or a variation or abbreviation of these words.

Unlike limited partnerships, limited liability company “members” don’t have to limit their participation in the firm’s management to protect their personal assets from the firm’s creditors. Yet they can qualify for true partnership taxation.

LLCs also have a number of distinct advantages over S corporations for many businesses. They are not restricted to a single class of stock as S corporations are, so LLC members have a greater ability to allocate gains, losses, deductions, and credits. Also, there are no limits on the number or kind of shareholders, giving LLCs greater access to capital. In addition, LLCs have certain tax advantages over S corporations when it comes to the ownership of real estate.

All of this makes LLCs the entity of choice for holding real estate for start-up ventures. However, should established investments be transferred into an LLC? The answer is maybe. If the real estate is presently held in the name of one or more individuals, the property could and probably should be transferred and held in an LLC so as to achieve the liability protections to which the owners of LLCs are availed. In the case of multiple individual owners, holding property in an LLC will also provide for centralized management of the real estate, avoiding disputes that occasionally arise between individuals holding real estate as tenants-in-common. The transfer of real estate by an individual into an LLC generally will not result in a taxable event for income tax purposes.

ARTICLES - PAGE 2 OF 2

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Similarly, if the real estate is presently owned by a general partnership, the general partnership can usually be converted to an LLC, thus achieving liability protection, without causing a taxable event for income tax purposes. In fact, the conversion of a general partnership to an LLC can typically be accomplished without even changing your federal identification number because both entities are treated as partnerships under the tax code. There are very few circumstances today in which a general partnership is the entity of choice for real estate investments or for other types of businesses.

If the real estate is presently owned by an established corporation and the real estate has appreciated since it was purchased, the tax cost of converting to an LLC is probably prohibitive because distributing the real estate from the corporation will result in a taxable event.

In summary, most start-up real estate ventures should typically be organized as LLCs, and existing ventures should at least consider converting to an LLC.