

LLCs — Who Needs ‘Em?

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As a real estate attorney, I have many clients who want to invest in rental property but don't know what the first step is after they have decided which property to purchase. I typically will recommend that the client start an LLC (Limited Liability Company) in order to be the purchaser of the property or to transfer already purchased properties into the entity's name. By using the LLC, you have personal protection from lawsuits and foreclosures, you have several tax advantages available to you that you wouldn't as an individual, and the LLC can be set up in a short period of time and easily maintained.

Personal Liability Protection: One way to protect yourself would be to have an LLC own the rental property. The LLC, like a corporation, provides “lawsuit protection” for its owners. For example, Investment Property, LLC owns property located at 123 Main Street, Any Town, Minn., and it is rented to a family with teenagers. One night, the teenagers decide to have a bonfire party and invite 20 people over. One of the friends, Joe, is injured when he falls into the bonfire. Joe is rushed to the hospital with burns on his arms and back. Who will be sued for the injury to Joe? Whoever has an interest in the property: Is that the parents of the teenagers as the renters and/or you as the owner? Now, the renters should be included because they are responsible for the actions of their children, but why are you, as the owner of the rental property, included in lawsuit? Because typically landlords have more money than the renters and the injured party wants someone to pay for their injuries. If, in the example, the owner is found liable, the LLC is liable and only the assets held in that LLC can be used to pay the judgment.

Personal Credit Protection: One of the other advantages of having an LLC to hold real estate is that if the property is foreclosed for non-payment of the mortgage, the foreclosure will be against the LLC and will not create personal liability for the members unless you personally guaranteed the loan. The same holds true for debts of the LLC, as long as you do not personally sign the debt obligation.

Tax Advantages: The Limited Liability Company is the business entity of choice for rental property owners because of tax advantages afforded to them by the IRS. The LLC is taxed as a partnership with pass-through profits and losses, all while giving the owners the personal protection of a corporation. This can mean being taxed at the 15 percent rate instead of the 40 percent rate.

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Easy to Set Up and Maintain: For my firm to set up an LLC for you, you would choose a name for the LLC and tell us who you want to be the owners and officers. We take it from there. We file the Articles with the Secretary of State, obtain tax identification numbers, draft operating documents and place them in a Minute Book. This Minute Book is very important to maintain. You will have three things to do each year: (i) tax return; (ii) annual registration with the Secretary of State; and (iii) Annual Minutes. Because you are asking the public to give you the same protections as a big corporation, you have to act like one and maintain this Minute Book.

Typically, the advantages of an LLC outweigh the disadvantages, so why not stop by and see if an LLC is right for you?

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