



Economic and Market Insights

April 22, 2016

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Why a Limited Liability Company Can Be an Advantageous Form of Ownership for the Real Estate Investor

In recent years, the Limited Liability Company (LLC) has become a familiar form of ownership for real estate investors. Investors are concerned about liability and are looking for effective ways to protect their assets.

Historically, many investors have relied solely on liability insurance for protection. The advantages of liability insurance are that it can be inexpensive and is much easier to put in place than going through the process of forming an LLC. However, liability insurance can present substantial risk. Liability policies will most likely have limits, exceptions and carve-outs that will enhance the owner's potential exposure.

As the name implies, the LLC offers investors limited liability. Normally, LLC members limit their liability to the amount invested in the LLC. If the worst case scenario were to occur, investors can feel comfortable knowing that their liability will be limited to the assets they have invested in the LLC. While this amount may be substantial, it will not include your family home and investment portfolio.

Many investors will form an LLC for each of their real estate investments. The advantage here is that each investment will then be isolated from the others. If you become involved in a lawsuit with one of your LLCs, you can continue to operate your other investments to maximize your return. You are not worried that the assets of another of your investments might become involved in the lawsuit. To effectively limit your liability, each LLC should operate under its own Tax ID Number, with its own bank account.

One of the big advantages of the LLC as a form of ownership is that it offers pass-through taxation. This means that the owner is not liable for taxes at the business level. The pass-through allows the company profits or losses to be reported on the individual tax return, which is most likely at a lower rate. Some forms of corporate ownership would require double taxation at the business and the individual level.

Forming and maintaining an LLC is not complicated or onerous. With an LLC, you do not issue stock and hold annual meetings, and written minutes are not required. The management structure of an LLC is also very flexible. The organizational structure can be established as agreed upon by the company's owners. The LLC can be managed by its owners, members, or managers. The entity can be owned by a single individual or multiple owners or business entities, and then be managed by owning members or a member-appointed manager.

- Compared to liability insurance, LLCs offer an opportunity to limit risk exposure.
- Forming separate LLCs for each investment can isolate each LLC's liability from the others.
- With pass-through taxation, the owner is not liable for taxes at the business level.

Anyone concerned about protecting their assets can form an LLC. The articles of organization, including the name and the registered agent, need to be filed with the state in which the LLC is being created. You will also need an operating agreement. Many states do not require the Operating Agreement to be filed with the Secretary of States, so it is important to keep the agreement in a safe place so you do not lose it. While you can do all of this yourself, it is recommended that you consult with an attorney to form an LLC.

If you are interested in learning more about the special services The Commerce Trust Company can assist you or your business with, please contact Roger Kummert at (314) 746-3213.

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