

Selecting The Right Form of Ownership For Your Properties Can Save You Big Time -- The LLC-Partnership May Be The Way To Go!

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The proper entity structuring (forms of ownership) is extremely important for both beginning and veteran real estate investors. The Wrong entity (or entities) can cost you thousand dollars in taxes, or in lawsuits! The three principal reasons for astute entity structuring are:

- 1. Asset Protection** (to protect your personal assets from being attached)
- 2. Tax Reduction\Tax Savings** (you want to legally pay as little as possible)
- 3. Audit Proofing From IRS your taxes** (NO audits = big savings!)

In most cases the single best form of ownership that can do all three of the above is a Limited Liability Company (LLC), that is elected to be taxed as a partnership. An LLC is an unincorporated business entity filed under state law, in which all owners (called "members") have limited legal liability. It is a hybrid entity that combines some of the major legal asset protection advantages of corporations and limited partnerships, yet the excellent tax advantages of general partnerships.

While it is a distinct *legal entity*, for tax purposes an LLC is not a distinct tax entity as there is no "LLC IRS tax form". For federal income tax purposes IRS regulations permit a simple choice of tax entities including a sole proprietor, corporation or partnership. The entity choice is now automatic and is done by filing IRS Form 8832.

***IMPORTANT TAX TIP: Become a two (or more) member LLC; elect to be a partnership; and file partnership form 1065. Reason: To attain the excellent tax advantages of partnerships, including a low-IRS audit profile.** Even if you are the sole owner, you can still have a partnership (of two or more people). You can be a 99% partner and the other partner can be 1% (or whatever). Other partners can be your spouse, children (of majority age), parents, CPA, attorney, trusted friend, or another entity that you own such as a corporation, partnership, trust or another LLC.

There is no perfect entity for any business, including real estate. However, LLC's may be the closest yet to that near-perfect entity. Besides asset protection, an LLC-partnership can have all of the excellent tax advantages of a general partnership, yet avoid the tax disadvantages of C-corporations, S- corporations and limited partnerships as follows:

- 1) **Very Low Audit Risk.** Two or more member LLC's can file a partnership tax return, which is one of the least audited IRS returns.

2. 2) **There is no double taxation, no basis limits, no tricky tax traps**, such as with C-corporations and even S-corporations.
3. 3) **Distribution of funds from an LLC-partnership will not necessarily result in current tax**, as it would from an S-corp, because of the basis limitations.
4. 4) **No gain is recognized to a member\partner upon the distribution of property**, even if it is appreciated property where the value is higher than its adjusted basis (On the other hand, a distribution of appreciated property from corporations will be taxed as non-cash “phantom” income even though the property is not sold.)
5. 5) **LLC-partnerships can do a 1031 tax-free exchange** (with certain planning strategies)
6. 6) **LLC Members, treated as limited partners, can be exempt from social security taxes from active income, such as dealer profits.**
7. 7) **LLC members can bypass passive loss limitations on deducting rental property losses even if their income is over \$150,000** (unlike limited partners).
8. 8) **LLC partnerships do not have the basis imitations for deducting tax losses** (unlike S-corporations).

There are other advantages:

(1) **Asset Protection:** Provided you adhere to the proper formalities, LLC's are separate entities distinct and apart from you. Consequently, they create a thick wall around your personal assets and thus protect these assets outside of the entity such as your home, second home, personal savings, investments, jewelry, antiques, etc. As a sole proprietor or general partnership your assets are easily vulnerable to the clutches of creditors and the clients of sue-happy attorneys.

(2) **Limited liability for ALL Owners:** LLC's have the corporate characteristic of limited liability for ALL of the owners (members). An LLC does not need an individual or entity (such as a general partner) who is personally liable for debts. NO LLC member is personally liable. This is unlike a limited partnership, where there must be at least one general partner personally liable for all debts. This causes the necessity of additional cost and paperwork to incorporate the general partner. This is not necessary with an LLC.

There are even more advantages too numerous to mention.

If you own rental properties and also own personal assets, you do not want to own your properties personally. Besides asset protection, you also should consider tax reduction and IRS audit-proofing. Generally, the best form of ownership will be the LLC-Partnership and in some cases the Limited Partnership (LP).

The above are excerpts from *The Real Estate Investor's Goldmine of Brilliant Tax Strategies*, A Tax Reduction System And Special Forms Software Package that contains 9 chapters on entity structuring, by Albert Aiello. Al will discuss this and will share with you his vast experience and extensive research and will show you how you can legally save a bundle of taxes every year yet still make a lot of money, without IRS problems and without having to pay high-priced tax advisors in his special presentation on March 17, 2005 at [East Bay Wealth Builders Club Meeting](#) in San Ramon, California.