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GET SMART ABOUT REAL ESTATE!

Learning the Law™ Seminar
25th in a Series
September 15, 2004

HOW SHOULD YOU OWN COMMERCIAL REAL ESTATE?
Presented by
JAMES K. COONS, ATTORNEY

I. TYPES OF OWNERSHIP

A. Sole Ownership:
1. Owned by single person – no management disputes.
2. Formation involves few formalities and start-up costs.
3. Unlimited personal liability of owner – personal assets at risk.

B. Partnership (Tenants in Common/Joint Tenants):
1. Two or more co-owners – need not be equal.
2. Usually requires express agreement, preferably written. If no partnership agreements exist, the provisions of Uniform Partnership Act apply.
3. Each partner has unlimited personal liability for all business obligations.
4. Any partner can obligate partnership – even if unauthorized.
5. Rarely the best choice since 1994 when Oregon law began allowing limited liability companies.

C. Corporation:
1. Artificial, intangible entity owned by one or more persons. Each person with an ownership interest holds stock in the corporation.
2. Corporation is a separate legal entity.
3. Liability of shareholder is limited to his/her interest in the corporation. Personal assets should be safe from corporation's creditors.
4. Allows ability to raise capital by selling stock in the corporation.
5. Long-term continuity – business continues even after death or withdrawal of an owner.
6. Possible "double" taxation problem; however, this is usually avoided by use of "S" form of corporation for tax purposes.

D. Limited Liability Company (LLC):
1. An unincorporated association which combines the flexibility and tax status of a partnership with the limited liability protection given to owners of a corporation.
2. Owners are called members. An LLC usually does not have officers or directors.
3. LLC is a separate legal entity.

4. Liability of members is limited to his/her interest in the LLC – comparable to a corporation.
5. Long-term continuity comparable to a corporation.
6. For tax purposes profits and losses are passed through to the members – the LLC is not subject to taxation.

II. WHICH APPROACH BEST PROTECTS YOUR PERSONAL ASSETS?

A. In most situations either a corporation or a limited liability company (LLC) offers the most protection for your personal assets. Each of those entities offers equivalent liability protection. Except in unusual circumstances the liability of the owners is limited to the assets of the business.

B. Are corporations and LLCs “bullet proof”? No- but if properly set up and correctly managed they provide powerful liability protection.

III. TAX ISSUES

A. LLCs have more flexible and favorable tax treatment than corporations. For example:
   1. LLCs are generally not subject to any tax on distributions from the business to its owners.
   2. LLCs are generally not subject to any tax upon liquidation of the business.
   3. Because of differences in tax treatment of certain liabilities, LLCs are often more attractive than S Corporations for real estate investments.

B. Because of these potential tax advantages and the significant benefit of limited liability protection, LLCs are often a preferable choice for ownership of commercial real estate.

IV. POTENTIAL DOWNSIDE TO LLC

A. Some lenders will charge a higher interest rate if the property is owned by an LLC rather than by individuals.

B. The lender may also require the individual members to personally guarantee payment of the loan. However, the individual members should not be personally liable for lawsuits from other parties.

V. SHOULD YOU CHANGE YOUR BUSINESS FORM?

A. If you are a sole proprietor or a partnership and own or plan to purchase property, especially investment property, you should seriously consider changing to an LLC.

B. If you are currently a corporation, the conversion of a corporation into an LLC is generally a taxable transaction. Therefore changing to an LLC is often not worthwhile.