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## **SHOULD A SINGLE MEMBER PLACE RENTAL PROPERTIES INTO AN LLC?**

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### **Background**

While a typical Limited Liability Company is referred to as “LLC,” a Single-Member LLC is called “SMLLC.” A single-member LLC has only one owner. The owner could be unmarried, divorced, or married but owns the property separately from before the marriage or from inheritance. You have a choice of “checking the box” as a disregarded or corporate entity. Of course, you wouldn’t dare place real estate inside a **corporation**. A creditor can seize your shares of stock and reach your apartment by dissolving the corporation. The better choice is to **disregard** the LLC and include transactions in your own personal income tax return. This is what we mean by “disregarded” – it’s ignored for tax purposes. Legally, it’s still an LLC and will remain an LLC. You just don’t have to file any separate federal tax form for it.

### **Should You Use SMLLCs to Own Your Rental Property?**

If **liability protection, tax simplification, and gift tax planning** are important to you, by all means, consider it. SMLLC is recommended especially if you have substantial equity in your buildings. Real estate investors are concerned about **exposure to liabilities** that tag along with rental properties. This can range from personal injury claims when tenants slip and fall on the sidewalk to serious mold and asbestos problems. **Setting up an SMLLC to own real estate addresses the liability exposure problem.** ☺ It does so without adding tax complexity, since no additional federal tax forms are required. It’s also an ideal gift-giving technique by making it easier to transfer properties to your beneficiaries.

### **How Do You Report Disregarded Activity in Your Income Tax?**

If your SMLLC operates rental real estate, report your **rental activity in your personal Schedule E**. Report any **business activity in Schedule C**, as if the business is a sole proprietorship. No additional federal tax forms need be filed. ☺ California LLCs have to file only one Form 568.

### **Can SMLLC Avail Of 1031 Tax-deferred Exchange?**

**Yes**, of course. Here is how it works: simply treat the LLC exchange as if it were **personally yours**. Report the exchange in your personal income tax returns. The relinquished property given up and the replacement property received in the exchange can be held within the liability-limiting confines of the SMLLC. Even the IRS confirms that SMLLC can avail of this taxpayer-friendly exchange.

What if the rental given up is in your personal name and the property received is deeded to your LLC? Will the transaction qualify for a 1031 tax-deferred exchange? **Yes**, indeed. The exchange qualifies for tax-deferred treatment because both the relinquished and replacement properties will be considered **owned by you** for income tax purposes.

### **What About Property Tax Reassessments?**

**A Word of Caution:** Be wary of property tax reassessments. It’s not fun to receive supplemental bills for *mas dinero*. It’s a pain to go to appeals. **Solution:** Consider transferring the property to your **personal name first**, and then move it to your SMLLC later. Good day!

### **What About Lawsuits?**

Judgment creditors can seize stocks of your corporation, dissolve the entity, and distribute your property to themselves. Membership interests in an LLC are more protected. The creditor of a partner in an LLC is entitled to a charging order rather than outright ownership in the property itself. A charging order gives the creditor the right to receive distributions but not get any management or voting rights. **You, the manager of the LLC, determine if and when distributions are made.** In the meantime, your creditor could end up with a dilemma: pay tax on a phantom K-1 income but receive no actual distribution. This dilemma could soften up your creditor to be more reasonable in settlement proceedings. ☺ Corporate shareholders do not have such leverage.