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1031 EXCHANGE: HOW TO HOLD TITLE TO INVESTMENT REAL ESTATE

Many investment advisors recommend that real estate investments be owned by Limited Liability Companies. This is to create an organization structure and to protect the investors from premises liability. The creation of a Limited Liability Company, with a separate tax ID number, is generally the creation of a partnership for income tax purposes. The LLC must file a partnership tax return.

Instead, we recommend two different ownership structures:

A) For single or married individuals, we often recommend that title to real estate be held as simple co-owners. We then recommend that the premises liability issue be addressed with the correct insurance. This structure eliminates the need for a separate tax return. It also eases the 1031 exchange process. When an LLC sells a relinquished property, the LLC must also buy the replacement property. Unfortunately, the underwriting requirements of many mortgage companies prevent the purchase of replacement property in the name of the LLC. Very often, we start an exchange in the name of an LLC, only to find that the customer needs to purchase the replacement property in their individual names. When this occurs, we can only recommend that the customer change to a lender that allows LLCs on title with personal guarantees from the individuals. This is usually a portfolio lender (a local bank). If clients insist on buying in their individual names after selling in their LLC name, then they run a large risk that the 1031 tax deferral will fail.

B) For two or more unrelated individuals who want to invest together, we recommend that each individual form their own single member (owner) LLC. Then the separate LLCs go on title as co-owners to their respective fractional interests. We recommend this because single member LLCs are "disregarded" for income tax purposes. They do not have to file partnership tax returns. Instead, the income tax results of that LLC go on the member's individual tax return. Moreover, when the property is disposed of, each single member can decide whether a 1031 exchange transaction is desired. The LLC structure provides the premises liability protection without the additional tax preparation or 1031 exchange complications of a partnership. Organization structure can be provided by a co-ownership agreement.

CONCLUSION: When titling real estate, thought must be given to the exit strategy in addition to the holding strategy.

Please call www.1031x.com at 888-899-1031 or email info@1031x.net for a free consultation!