ARNOLD & PORTER LLP

PIECES OF THE PUZZLE

A Newsletter from Arnold & Porter's Private Client Services Team

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Home Ownership in an LLC

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Many private clients ask us whether it makes sense to own a home in a single-member limited liability company (LLC), rather than, say, in their revocable trust or in their individual names. (In community property states, a single-member LLC includes an LLC owned by a married couple or by a revocable trust that, in each case, elects to be treated as a disregarded entity for federal tax purposes.) While holding a home in an LLC creates some administrative burdens and additional costs, it also offers several benefits.

Benefits of LLC Structure

Privacy. Home ownership in an LLC provides a layer of anonymity that many of our private clients desire. In order to maximize this confidentiality, the name of the LLC should be generic, and the address of the LLC and agent for service of process, both of which are available in the public records, should not be easily traceable to the individual member. In addition, in some jurisdictions, such as California, the name of the manager of the LLC (or if no manager, the name of each of the members of the LLC) must be included in a Statement of Information filed with the Secretary of State, which is also publicly available. (Delaware has no such requirement.) Some private clients will appoint a trusted individual or family member with a different surname as manager of the LLC to further shield the name of the ultimate owner. (The LLC operating agreement can be drafted to minimize the manager's powers and to allow the member to remove the manager at any time and without cause.) For privacy purposes, it is better to own a house in the name of the LLC from the date it is acquired, rather than transferring it into an LLC later, because the deed transferring the property from an individual into the LLC is a public record. Finally, it should be noted that a client's revocable trust can be the member of an LLC, and thus, upon the client's death, the LLC interest would pass outside of probate thereby providing an additional layer of privacy.

Gifting. Once a home is owned in an LLC, it may be advantageous for gift tax purposes to convey minority membership interests in the LLC to family members. Gifts of minority membership interests in an LLC can be discounted for valuation purposes, thus allowing the gifting party to minimize use of his or her gift and estate tax exemption amount. This should be coordinated with a trust and estates attorney and CPA and will require appraisals and potentially a lease agreement whereby the LLC leases the house to the majority member (assuming that member is occupying the house).

One other consideration in California is that Proposition 58, which excludes from property tax reassessment transfers of primary residences between parents and children, would not apply to transfers of LLC interests. Therefore, prior to gifting an LLC interest, the client must consider

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whether the gift would trigger a reassessment of the house. (Typically, assuming the property was originally acquired by the LLC, if the transfer does not result in a change of control of the LLC, it would not trigger reassessment. If after acquiring the property the client later contributed it to an LLC, however, cumulative transfers of more than 50% of the LLC interests would result in reassessment, regardless of whether there was a change in control.) If a client wishes to use the Proposition 58 exception in the future, the LLC may convey the property back to the client without triggering a reassessment of the house (or any transfer tax), and, thereafter, the client may transfer the property to the child.

Limited Liability. As a general rule, and befitting the name, an LLC's members (*i.e.*, owners) do not have personal liability for the obligations of the LLC. Thus, home ownership in an LLC may protect an individual from certain catastrophic liabilities that may not always be covered (or fully covered) by ordinary homeowner's insurance. To preserve this protection, however, it is important to maintain and respect the separateness of the LLC entity. Hence, the LLC should have a separate bank account from which all property related expenses (property taxes, mortgage, insurance, utilities, repairs, improvements, *etc.*) should be paid. In addition, all utility accounts should be opened in the LLC's name. Finally, the LLC should be adequately capitalized, taking into account the value and expenses associated with the home.

Other Issues

Title Insurance. Generally, a more robust form of title insurance is available to individuals purchasing single family homes. Most title companies will allow a single member LLC to obtain such coverage as well, but it is important to confirm this with the title company when purchasing the property. In some cases, a title endorsement (available at a nominal cost) may be required. Furthermore, a client that acquires a house in his individual or trust capacity and later contributes the home to a single member LLC should check his or her title policy to make sure it remains in effect following the transfer.

Home Loans. Some mortgage lenders may be leery of the LLC structure, preferring to loan to an individual. In our experience, this is becoming less of an issue, with private banking departments becoming more and more comfortable with this structure.

Taxes/Costs. A single member LLC is typically a pass-through entity and is disregarded for federal income tax purposes. Some states, however, require that LLCs pay an annual minimum tax or fee ($800 in California; $300 in Delaware). California also imposes a gross receipts tax on LLCs, (which caps out at $11,790 for gross receipts in excess of $5 million) which could come into play on the sale of the house. In addition, a client may incur modest additional accounting fees relating to the LLC.

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In our experience, after due consideration of the benefits and burdens, we find that many of our clients choose to own their homes through an LLC.