REAL ESTATE RESOLUTIONS: TRUST VERSUS LLC

Situations can arise where it’s advisable for clients to hold real estate interests in an entity rather than in their personal names; some clients desire anonymity, liability protection or avoidance of probate. When deciding how to own property, it’s also important to consider the type of property, number of owners and goals of the client. Two of the available options for clients are holding real estate in an irrevocable trust or in a limited liability company (LLC). Both a trust and an LLC are created under state law, but they are two very different legal vehicles offering distinct advantages and disadvantages.

Irrevocable Trust

An irrevocable trust allows property to be held in trust for the benefit of the named beneficiaries. The trust document establishes the terms of management of the real estate and nominates a trustee to carry out the terms. When the property held in trust is sold, the proceeds are distributed as designated in the terms.

An advantage to owning real estate in a trust is that in many instances, probate is avoided. When the property is sold, the proceeds are distributed as designated in the terms, and any tax due is paid from the proceeds. Another advantage of a trust is that it can be created to avoid creditors of the owners. Once the property is in the trust, the real estate is not part of the owner’s probate estate, and any income taxed independently. This means that the individual owner can’t freely make decisions concerning the property, rather, he or she must abide by the terms of the trust and the decisions of the trustee. Another drawback is the expense. It can cost upwards of a couple thousand dollars to draft an irrevocable trust, and some require annual trustee fees as well as additional legal fees to manage down the road.

LLC

While an LLC is typically thought of as operating a business, it can be used to manage and purchase property. An LLC is relatively easy to form by paying and filing Articles of Incorporation with the Ohio Secretary of State. An LLC can have one owner or multiple and they’re usually governed by operating agreements, which establish the terms of management and the relationship between the members. The LLC can be managed by one or more of its members or a manager. Members can dissolve the LLC by agreement at any time and — after payment of any debts — distribute any assets.

However, LLCs don’t necessarily avoid probate. Unless transfer on death provisions are used, the interest in an LLC passes through probate and is considered part of the deceased member’s estate.

A main advantage is liability protection. Placing real estate owned in an LLC can protect that asset from liabilities of the owner and the owner from some liabilities arising out of the real estate. If the property is subject to a lawsuit, members can only be sued within the constraints of what the LLC owns and not beyond that. For example, if someone hurts themselves on the property’s front steps and sues, the claimant can only proceed against the LLC, not the members’ personal assets. Additionally, if the owner of an LLC has liabilities, the owner’s creditors cannot seize the membership interest of an owner, rather, they are limited to a charging order by which they can recover distributions that might be made to the owner.

To set up a proper LLC or irrevocable trust, find a real property attorney at cbalaw.org.