WHETHER YOU'RE A REAL ESTATE INVESTMENT GREENHORN or veteran, you know how easy it can be to get wrapped up in the excitement of finding, buying, selling and renting properties. Yet taking the right actions to protect those properties – and your own personal financial health – is a critical part of success in this business.

Many investors approach asset protection simply: They hold their properties in their own names. But some investors may want to reconsider that decision. By holding real estate in one's own name, it’s possible to lose your investment if you run into any legal or financial difficulties. For example, if your teenager runs a stop sign on the way home from school and injures another driver in the process, you could lose your investment to a court judgment for the injured party.

Consider another scenario. If someone slips and falls on property that you own, guess what? You, the investor, can be sued and lose your real estate along with all your other assets. It’s not a pretty picture.

The good news is that it’s straightforward and time-effective to set up an entity to hold your properties, thereby protecting your assets and your personal finances. A number of alternatives exist, including corporations, general partnerships, limited partnerships, trusts and limited liability companies. Each has its own pros and cons. But after weighing them, there’s a high probability you’ll find that a limited liability company (LLC) generally offers the best method of asset protection for individual investors working alone or in small groups.

Whatever your situation, there’s a choice that’s right for you. Because every individual and every situation is different, be sure to set up a meeting with your legal counsel and discuss the options before implementing any strategies discussed here. You and your family will be glad you did.

A SEPARATE CASE FOR LLCs
TAKING YOUR CHARGING ORDERS

Investors who decide to set up an LLC can feel good about taking care of their property and themselves. With the LLC, if by some chance one of those slip-and-fall incidents described in “CYA: Cover Your Assets,” occurs, the liability (which we’ll call a “front-door liability”) will be isolated to the LLC’s assets and thereby not affect your other assets. And if you get into a run-the-stop-sign scenario (“back-door liability”) and someone sues you personally, that person...
The ABCs of Asset Protection

THE CORPORATION
A corporation, created for a small fee by your state of choice, acquires the real estate. You, as the investor in the corporation, own the stock in the corporation. When it comes to liability, the corporation – not the individual – is liable for accidents on your property.

Pros: It prevents the “slip-and-fall” risk from affecting your assets that are not owned by that corporation. In other words, a corporation structure isolates the liability arising from the real estate so that it limits the risk to only that particular real estate.

Cons: A corporation won’t protect you from a run-the-stop-sign situation. The injured person in that scenario still can sue you individually, and the court can transfer your stock to the injured party. Result: The injured person gets control and ownership of your real estate, and even can take other, non-real estate assets that you own. In addition, you may incur double taxation when assets are distributed out of the corporation (the corporation pays taxes, and the individuals receiving distributions pay taxes).

THE GENERAL PARTNERSHIP
A general partnership is an arrangement between you and one or more other individuals to co-own the property.

Pros: You share the risk of ownership with others. And if that run-the-stop-sign individual sues you, he or she will be less able to take your property, thanks to inherent charging order protections (see “A Separate Case for LLCs: Taking Your Charging Orders”).

Cons: The slip-and-fall person can sue you personally, getting to your other assets – and can also get to the assets of the co-owners of the property.

THE LIMITED PARTNERSHIP
In a limited partnership, you and one or more other persons also co-own the property. You own your interest in the limited partnership as a general partner and/or a limited partner; every limited partnership needs at least one general partner and at least one limited partner. You can form a limited partnership in any state.

Pros: If you are a general partner, you share the risk of ownership with the other general partners. But if you’re only a limited partner, the slip-and-fall victim cannot generally hold you personally liable. Also, if a run-the-stop-sign individual sues you, he or she will be less able to take the real estate due to charging order protections.

Cons: The general partner in this structure can be sued personally by the person in the slip-and-fall scenario.

THE TRUST
Trusts are arrangements between you (the “settlor”) and a person or entity (the “trustee”) to manage the assets of the trust – such as real estate.

Pros: Trusts can, in certain states, protect those assets transferred by you to the trust (such as real estate) from your personal creditors.

Cons: Trusts are not typically used to protect you from liability arising from the assets in the trust. Trusts also are more expensive to create than the other entities discussed in this article, and can be more restrictive in their maintenance.

THE LLC
The limited liability company is an entity similar to the limited partnership – with the exception that you can own the LLC by yourself or with partners. It consists of one or more members (owners) and one or more managers. The managers can be, but do not need to be, members.

Pros: An LLC arrangement prevents the slip-and-fall risk from affecting your assets that are not owned by the LLC. So, like the corporation, it isolates the liability arising from the real estate by limiting the risk to only that particular real estate. If you get sued in a run-the-stop-sign situation, that person is less able to take the real estate due to charging order protections (so long as you do not own 100 percent of the LLC). And assets typically can be distributed out of the LLC with no income tax consequences.

Cons: None for the purposes described here.

If someone slips and falls on your property that you own, guess what? You, the investor, can be sued and lose your real estate along with all your other assets.
To add insult to injury for the creditor, the Internal Revenue Service has issued Revenue Ruling 77-137, which suggests that a creditor who holds a charging order may even be taxed on any income of the LLC – even though he is not receiving any distributions from the LLC. This serves as an effective deterrent to a creditor obtaining a charging order.

Unfortunately, charging orders create a waiting-game scenario. The fact that a creditor is not able to receive any benefit until a distribution is made from the LLC also means that the LLC member cannot receive distributions himself from the LLC so long as the charging order remains in place. In these situations, it may come down to who can hold out the longest with regard to not receiving any distributions from the LLC.

**SINGLE-MEMBER VS. MULTI-MEMBER LLCs**

In recent years, single-member LLC’s have become a preferred choice because they offer the asset protection we’ve described while requiring only a single owner. But a recent case in Colorado may provoke some second thoughts and tip the scales toward multi-member LLCs.

The ramifications of the *In re Ashley Albright* case are clear: A real estate owner should not use a single-member LLC where back-door asset protection is a major concern. While asset protection is still a valuable result of an LLC, to realize these benefits at both the back door and front door, the LLC must include other members who have more than minimal interests. While these additional members need not be on equal footing with the dominant member, their interests cannot be a mere token interest.

So even though a single-member LLC has limited use in the asset protection field with regard to the investor’s personal back-door creditors, the single-member LLC can still serve as an effective shield to prevent front-door creditors of the LLC itself (a slip-and-fall claim relating to the real estate owned by the LLC) from bringing any claim against its member.