Abstract: Many companies choose *not* to combine real estate and other assets into a single entity. There are justifiable legal reasons for doing so, but there are also potentially beneficial tax reasons for holding real estate in a separate entity. This article delves into the tax side, discussing how to avoid mistakes and maximize benefits. A sidebar looks at the advantages of separate entities for family businesses.

Consider separating real estate assets from your business

Many companies choose *not* to combine real estate and other assets into a single entity. Perhaps the business fears liability for injuries suffered on the property. Or legal liabilities encountered by the company could affect property ownership. But there are valid and potentially beneficial tax reasons for holding real estate in a separate entity as well.

Avoiding costly mistakes

Many businesses operate as C corporations so they can buy and hold real estate just as they do equipment, inventory and other assets. The expenses of owning the property are treated as ordinary expenses on the company's income statement. However, when the real estate is sold, any profit is subject to double taxation: first at the corporate level and then at the owner's individual level when a distribution is made. As a result, putting real estate in a C corporation can be a costly mistake.

If the real estate were held instead by the business owner(s) or in a pass-through entity, such as a limited liability company (LLC) or limited partnership, and then leased to the corporation, the profit upon a sale of the property would be taxed only once — at the individual level.

Maximizing tax benefits

The most straightforward and seemingly least expensive way for a business owner to maximize the tax benefits is to buy the property outright. However, this could transfer liabilities related to the property directly to the owner, putting other assets — including the business — at risk. In essence, it would negate part of the rationale for organizing the business as a corporation in the first place.

So it's generally best to hold real estate in its own limited liability entity. The LLC is most often the vehicle of choice for this, but limited partnerships can accomplish the same ends if there are multiple owners. No matter which structure is used, though, make sure all entities are adequately insured.

Tailoring the right strategy

There are many complexities to a company owning real estate. And there's no one-size-fits-all solution to protecting yourself legally while minimizing your tax liability. But if you do nothing and treat real estate like any other business asset, you could be exposing your business to substantial risk. So please contact our firm for an assessment of your situation. We can help tailor a strategy that's right for you.

Sidebar: The benefits of separation for family businesses

Family businesses face many distinctive challenges. One is that several family members may participate in the ownership of the company. Under such circumstances, separating real estate ownership from the business creates more options to meet the needs of multiple owners.

Let's say that a family business is passing from one generation to the next. One child is very interested in owning and operating the business but doesn't have the means to finance the purchase of both the business and its real estate.

If the two are separated, it's possible for one sibling to take over the business while other siblings hold the real estate. In this case, everyone can benefit: The child who buys the business doesn't have to share control with the other siblings, yet they can still reap benefits as property owners.