

Choosing a Business Entity For Your Real Estate Brokerage

Presented by
Jon Sargent, Esq.
JonS@frascona.com

Frascona, Joiner, Goodman and Greenstein, P.C.

www.Frascona.com



Choice of Business Entity

Entity Choices

- Sole Proprietorship
- General Partnership
 - Limited Liability Partnership
- Limited Liability Company *
- S Corporation *
- C Corporation



Choice of Business Entity

General Considerations

- Formation/Administrative Formalities
- Management Structure Flexibility
- Liability Protection, i.e. Limited Liability
- Capital Structure
- Tax Aspects



Choice of Business Entity

Formation / Administrative Formalities

- *General Partnership*
 - No formal statutory formation process;
 - No annual registration
- *Limited Liability Partnership*
 - Formal Statutory formation and organization process;
 - Annual registration



Common Legal Structures

Formation/Administrative Formalities

- *Limited Liability Company*
 - Formal Statutory formation and organization process;
 - Annual registration;
 - Should record company actions
- *Corporation (C&S)*
 - Formal Statutory formation and organization process;
 - Annual registration;
 - Should record corporate actions



Choice of Business Entity

Management Structure Flexibility

- *General Partnership*
 - Generally, each partner has equal management rights
 - Generally, any partner can bind the partnership
- *Limited Liability Company*
 - Management Power and Authority is with members and/or managers
 - No statutory requirement for officers & directors but can adopt a corporate structure
 - Management structure typically set forth in an operating agreement



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Management Structure Flexibility (cont'd)

- *Corporations (S Corp & C Corp)*
 - Bound by formal statutory requirements
 - Shareholders elect board (after initial election or appointment) and vote on certain matters
 - Management power by or under board of directors
 - Articles of Incorporation, bylaws, statutes and shareholder and director resolutions may restrict and more clearly define duties and responsibilities



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Owner Liability Protection

- *General Partnership*
 - Each partner has full personal liability for debts and obligations of the Partnership
- *Limited Liability Company*
 - Member liability limited to investment;
 - Creditor of LLC can come after assets of LLC
 - Pierce Corporate Veil
- *Corporation (S Corp & C Corp)*
 - Shareholder liability limited to agreed investment
 - Creditor of Corp. can come after assets of Corp.
 - Pierce corporate veil



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Owner Liability Protection (cont'd)

- Avoid any type of veil piercing argument by observing corporate formalities:
 - DO NOT COMINGLE FUNDS!
 - Properly document Company actions;
 - Sign all documents on behalf of Company and not in your individual capacity
- ❖ Note – several courts have pierced the corporate veil of single member LLC's



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Owner Liability Protection (cont'd)

- Limited liability provided by a business entity does NOT protect you for your professional activity as a real estate agent
- You must carry the appropriate E&O Insurance for your professional activities as a real estate agent
- Operating your real estate brokerage as a business entity allows you to stack insurance coverage



Choice of Business Entity

Capital Structure

- LLC / Partnership
 - Very Flexible
 - Can own Capital Interest and/or Profits Interest
 - Unlimited number and type of member/partner
 - Subject to tax rules, may allocate profits and losses in any manner desired
 - Multiple classes of ownership permitted
- S Corp
 - Limited to 100 shareholders;
 - Profits and losses must be allocated in accordance with stock ownership percentages
 - Single class of stock



Choice of Business Entity

Tax Aspects

Disregarded Entity

- A Single Member LLC is treated as a disregarded entity for tax purposes;
- Sole proprietor can receive liability protection by organizing as a SMLLC and still be taxed as a sole proprietor



Choice of Business Entity

Tax Aspects (cont'd)

Pass-Through Taxation

- Tax burden flows through the entity to owner
- Pass through entities = LLC / Partnership / S Corp
- Generally, pass through entities will have tax advantages over C Corporations:
 - No corporate level tax;
 - Losses pass through to owners;
 - Appreciated property may be contributed / distributed to entity taxed as partnership
 - S Corp – allows you to limit self employment taxes that you pay



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Tax Aspects (cont'd)

C – Corp. - Double Taxation

- Corporations are taxed as a separate legal entity
- Double Taxation =
 - Taxes are paid at the corporate level
 - Taxes are paid at the shareholder level



Choice of Business Entity

Benefits of Operating Your Real Estate Brokerage as a Business Entity

- Limited Liability Protection
- Tax Advantages
- Stacking Insurance Coverage
- Ability to have additional owners
- Ability to have agents working for your brokerage
- Estate Planning
- Provides an Exit Strategy



Choice of Business Entity

Which Entity is the Right Choice for My Real Estate Brokerage?

- On balance, LLCs tend to be the better choice of business entities due to their overall flexibility
- However, tax related issues may dictate the use of an S Corp.



Choice of Business Entity

Documents for Your Real Estate Brokerage

- *Brokerage Relationship Policy*
 - Addresses relationship between the real estate brokerage & the public
- *Office Policy Manual*
 - Needed if two or more agents working for real estate brokerage;
 - Addresses internal policies of the real estate brokerage
- *Independent Contractor Agreements*
 - All agents working for real estate brokerage are encouraged to have independent contractor agreements with the real estate brokerage
 - Note – Team members must be paid by the employing broker (C.R.S. 12-61-117)

Thank You

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