

Overview of Tax Flexibility

Limited liability companies are typically taxed as partnerships, but they may also elect to be taxed as C or S corporations. They can even be structured as disregarded entities. This means they are completely ignored for tax. This opens unique planning opportunities not available through other entities. For example:

- Although neither partnerships nor corporations may own S corporation stock, a single member LLC that is taxed as a disregarded entity can. Thus we can provide a layer of protection to prevent S corporation stock from being seized if the LLC's owner loses a lawsuit.
- An offshore LLC may also elect to be treated as a disregarded entity. As a result, one can benefit from the advantages of offshore asset protection, while avoiding the reporting requirements imposed upon offshore trusts. Furthermore, a disregarded entity offshore LLC avoids the complex rules and tax traps that can arise from other offshore entities.
- If you use a limited partnership or corporation to hold your personal residence, it will be disqualified from the IRS exemption regarding capital gains if the home is sold. This exemption allows for a homeowner to sell their appreciated personal residence free of capital gains tax, for up to \$250,000 for a single person or \$500,000 for a married couple. Assuming a 15% capital gains tax rate, this represents a tax savings of \$50,000 to \$100,000. There are two criteria that must be met in order to qualify for this exemption: 1) one or both spouses must have owned the home for at least two out of the five years preceding the sale and 2) the house must be the primary residence during those years. Unfortunately, if a limited partnership or corporation owns the home, the criteria is not met. However, a disregarded entity LLC can hold the residence and still qualify for the exemption, since its activities are treated as those of its owner. (Note that some states require an LLC to have a business purpose. In this case you should pay rent to the LLC that owns the home you are living in. This will ensure the LLC will be respected as a separate legal entity.)
- A disregarded entity LLC's income is reported on the tax return of its owner. If this is a person, then the income is reported on their 1040 return, Schedule C. However, an LLC that holds non-income producing property, and does not generate profit from other activities, will not need to report, at least for federal (and most state) tax purposes. This not only makes such an LLC easier to use, it also makes such an LLC anonymous with the state where it was. It thus becomes an incredible privacy tool. An example of this is if one uses a disregarded entity LLC to buy their personal residence. This purchase can be made without disclosing the LLC owner. Then, even if the owner pays rent to the LLC, because the LLC is disregarded from its owner's activities for tax purposes, the LLC has no gain. Therefore the owner won't be required to list the LLC on any federal tax return.

One may argue that a grantor trust (which will be discussed in the next section) is also ignored for tax purposes, and therefore as appropriate for protecting a home from creditors. However, most states do not allow a grantor trust to provide asset protection if the grantor (the person that puts assets into the trust) continues to use the property. Therefore, a disregarded entity LLC is a

unique entity that both provides limited liability in a wide range of situations, and is also ignored for tax purposes.