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What to Know Before Creating an LLC for a Rental Property

CONTRIBUTED BY COLORADO REALTY & PROPERTY MANAGEMENT, INC.

Interested in joining the more than 11 million real estate investors making money off rental properties? It's a form of potentially passive income with great appeal, but like any investment, it also comes with potential risks.

One way to mitigate risk is by setting up a business that would own the property rather than buying it in your own name. Creating an LLC for a rental property can help manage income, taxes, and liability for your rental business.

If you've been wondering, "Should I put my rental property in an LLC?" this guide should help you answer that question and others related to the LLC business structure.

WHAT IS AN LLC?

LLC stands for limited liability company and is one of several business structures you could choose for your rental property. The structure ensures you are not held personally liable for any claims against the company or any debts owed. It allows you to be taxed as a partnership while getting the limited liability benefits of a corporation.

An LLC can be you alone, with a partner, or with a group, and the LLC holds ownership of any assets placed in it. It can have a separate tax ID number, open a bank account, and conduct business transactions.

BENEFITS OF AN LLC

Starting an LLC for rental property makes good business sense for four key reasons.

1. Limited Liability

When you own a property as an individual, you are personally liable for any legal actions, which means your personal assets are at stake. By operating through an LLC, only the LLC's assets would be at stake should there be any lawsuit or claim made. This is one of the primary benefits of an LLC for rental property holdings since your tenants could claim the business.

2. Separate the Assets

Because an LLC is easy to set up, creating a new one for each property makes sense. This insulates each property from liability claims made on any others. It provides the same separation protection you get for your personal assets.

3. Pass-Through Tax

An LLC allows you to take advantage of what is called pass-through taxation. A business structured as a corporation would typically be taxed on its profits, then you as the owner are taxed again when you take out income.

With an LLC, the company income passes straight through to you, and you claim it on your individual tax

return. Your rental income is only taxed once instead of twice.

4. Personal vs. Business

Any corporate structure is going to allow you to keep your personal and business expenses separated. This allows you to write off and claim business expenses on your taxes since you will have separate bank statements for yourself and the LLC for investment property.

CREATING YOUR LLC

What's involved in setting up your LLC for a rental property? It's important to understand when the best time is to do it, along with the potential costs in doing so.

WHEN TO CREATE YOUR LLC

The good news is whether you have your LLC set up before or after you buy, it's a relatively simple process to transfer ownership over to the LLC. However, if you plan to finance the purchase rather than pay cash, there are definite benefits to having the LLC set up before the purchase.

Transferring a mortgaged property could result in some additional headaches and costs:

- Notifying your mortgage holder of the title transfer
- Mortgage holder could close the loan and issue you a new one, which creates closing costs and potentially a higher interest rate
- Notifying tenants that the LLC now owns the property
- Update rental agreements
- Transfer could trigger new taxes like a title transfer tax

Creating the LLC first means the property deed is in the company name from the start and keeps you from dealing with these issues.

HOW TO CREATE YOUR LLC

Because the LLC is regulated at the state level, the rules and regulations for setting up a company might vary. But the basic process involves the following:

- Choose an available business name
- Fill out the Articles of Organization
- Create an LLC Operating Agreement
- Obtain any necessary licenses and permits
- Register your LLC with the state

Once you've done all that, you can issue leases in the business name and set up your bank account. Costs involved in setting up the LLC can come from registration fees, title transfer fees, and legal fees for creating or reviewing your operating agreement.

PROS AND CONS OF AN LLC

The LLC is a good structure for rental property

businesses, especially if you are going into business with other people or entities. But there are some drawbacks to be aware of as well.

Pros

- Limit your personal liability
- Separate and protect individual properties if you set up an LLC for each one
- Pass-through taxation keeps your income from being taxed twice
- Easily separate business and personal expenses

Cons

- Additional paperwork for initial setup and bookkeeping
- Can be more difficult to get a mortgage as an LLC
- Potentially higher interest rates on your mortgage
- Annual filings and fees

Despite the downsides, keeping your rental property in a dedicated business structure sets you up for success.

CONSIDERING CREATING AN LLC FOR A RENTAL PROPERTY?

Eager to get started in real estate investing? Creating an LLC for a rental property is a good way to protect yourself and your money from liability issues. Depending on the state you live in, you could benefit by making it easier to manage your income and taxes as well.



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