# USE OF BUSINESS ENTITIES FOR THE ACQUISITION OF REAL ESTATE INVESTMENTS:
## FUNDAMENTAL APPROACH IN COMPARISON FOR FLORIDA LAND TRUSTS AND LLCS

**BY: KEVIN F. JURSINSKI, B.C.S.**
**FLORIDA BAR BOARD CERTIFIED ATTORNEY**
**OCTOBER 2015**

There are many factors that should be considered in a real estate investment. This article focuses on some of the key points when considering a real estate investment with a spotlight on the type of entities to be utilized when buying real estate for investment purposes. Additionally included in this article is a brief overview of some Best Practices for real estate investing. The article will also touch on concepts of asset protection in the acquisition of real estate and two (2) favored types of entities for acquisition of real estate in Florida: a Florida limited liability company and a Florida Land Trust.

### 1. Best Practices Investment Procedure:

Before any real estate investment is undertaken, there must be a strategy put in place for the purpose of the real estate investment.

The investor must make a series of business decisions on the real estate investments, which are particular to each particular real estate investor. The overarching theme, of course, is to follow the absolute maxims: *"You make money on real estate when you buy it" and "Protect your real estate investments to the full extent of the law."*

#### A. Proper Due Diligence and Inspection:

Proper due diligence investigation as to the title, a full inspection of the property itself and validation of the offering purchase price needs to be taken.

In today's marketplace, both in commercial as well as residential (and notwithstanding provisions under Florida law providing a Buyer with protection by requiring a seller to disclose all known material defects existing in a residential property and might be material to a buyer), it is absolutely essential that, prior to the real estate investment, the subject real property be fully inspected to ensure the Buyer's deposit is not put at risk and the Buyer is not acquiring a

property with construction defects. This inspection requires a complete physical inspection by a qualified inspector (generally a general contractor with special expertise in inspections and, potentially, an engineer) especially when commercial property is involved.

The effort should include some additional specific inspections, generally not included in a typical "general inspection" agreement, such as a certified roof inspection, a termite inspection, an open permit inspection, as well as a radon and mold inspection of the property. Recently, it has been observed that a number of recent radon tests in single-family homes are showing high levels of radon. This may be, in part, due to the current construction methods of sealing a home to prevent any material intrusion as a more preventative measure. The experience of the author has been over the last several years that radon inspection reports have been showing higher levels of radon than normally been evidenced in prior years possible due to enhanced construction methods to combat mold. Again, full and complete testing of the physical aspects of a property is key to successful real estate investing.

B. Title Examination:

**Insurable and marketable title is the goal.** As important as a physical inspection is, so is a review of the property's history, including a title search, review of the construction permits on the property, as well as work performed on the property. Without getting into detail, it is highly recommended by the author that the purchaser of the property obtain legal counsel to perform its own title inspection and issue its own title commitment since the goal of the acquisition is to acquire insurable and marketable title, with the emphasis on marketable title. Often times, a purchaser of property may find that they obtained a title policy on the property; however they end up only with insurable title not marketable title. There is a big difference between insurable and marketable title and it could result in issues for the investor if the investor only obtains a title policy issued by a title agent rather than having the investor's own legal counsel perform a thorough title review to determine both insurable and marketable title.

## 2. Asset Protection and Compartmentalization of Liability:

Another key point in real estate investment is determining what type of real estate entity will be used for title purposes. The fundamental concept is that almost all real estate, save and except potentially homestead parcels, should never be taken in the name of a real estate investor individually.

A. Premises Liability:

Under Florida law, an owner of real property has premises liability and has responsibilities, as the owner of the property, for a number of issues arising out of property ownership. While it is true that an insurance policy will afford certain coverage, it is also fundamental that insurance policies have specific exceptions, as well as specific caps on coverage. No insurance policy can absolutely protect the owner of real property from personal liability as would be the case when a real estate investor takes title in his/her own name versus taking title in the name of an entity which affords personal liability protection, such as a Florida corporation, a Florida limited liability company, or a Florida Land Trust.

B. Separate Ownership Assets into Separate Entities:

Further, sophisticated investors also recognize that placing numerous real property investments into one (1) entity exposes that entity and all of the holdings of that entity to liability from a claim arising from one (1) of these properties.

By way of example, an investor holding title to multiple separately titled parcels in either a Florida Land Trust or a Florida LLC (or any distinct legal entity) exposes all of the parcels to a claim arising from just one of the parcels. Despite all the parcels being titled separately, they are all in jeopardy in the event of significant damage/liability claim since they are all owned by the same entity.

As such, the concept of keeping properties in separate and distinct Florida Land Trusts, or Florida LLCs, should be considered under the theory of *"compartmentalization of liability"*.

3. **Ownership held individually and/or as Tenants in Common versus Ownership held in an Florida Entity**

From a fundamental standpoint, it seems axiomatic that no Florida investor should hold Florida real estate in their personal name whether it's titled in their name or as Tenants in Common absent some serious consideration.

The point being is that placing your individual name on a parcel of real property (absent some discussions that are outside the scope of this document in regard to Florida Homestead property and Tenancy by the Entirety), results in the the owner of the property having personal liability for any act that occurred on the property.

Often a response to the caution to avoid holding title in a person's individual name is that most property owners holding income producing property or other types of property have liability insurance in place.

The question then needs to be asked: "I*s there sufficient insurance so that the owner does not have personal liability in the event of a casualty or extraordinary event which exceeds policy limits?*" The answer in almost every occasion is categorically "NO" since the owner could have personal liability over an excess of any policies and most policies aren't taken out for the significant exposure protection or a major event. Of course, there are also exclusions to coverage under insurance policies which might eliminate coverage for a certain risk or event. Therefore, the real question would be "*why would anyone put their name individually on property unless it was their homestead*?"

In reality, the short simple answer is that no Florida investor should ever own investment property in their individual names, absent their homestead. Even as to homestead, there is a caveat to consider placing the homestead property into a trust.

That's the starting point.

The next step is then if, in fact, the property should not be held in an individual's name, what are the other options?

## TYPES OF FLORIDA ENTITIES THAT CAN BE UTILIZED

There are a wide variety of types of entities to be utilized in Florida which may include:

A. Corporations
B. Limited Liability Companies (LLC)
C. Limited Partnerships (LP)
D. Florida Land Trusts

This article will focus on essentially the two favored formats for holding title to real property: Florida Limited Liability Company and the Florida Land Trust.

### A. Initial Comparisons for Florida Land Trusts and Florida LLCs.

Both the Florida Limited Liability Company and a Florida Land Trust provide protection from liability to its members since its members do not hold legal title to the property and are not personally liable for the acts of the manager or trustee respectively.

Kevin F. Jursinski, B.C.S.
Florida Bar Board Certified Real Estate Law, Business Litigation and Construction Law Attorney

Until the Florida Supreme Court case of Shaun Olmstead v. Federal Trade Commission 44 So. 3d 76; Fla. 2010, an owner of a membership interest in a Florida Limited Liability Company, whether a single-member or multi-member, could avoid liability for its ownership interests being seized by creditors and would only have distributions from the LLC attached by creditors. After the Olmstead case, however, that has changed. Single-member LLCs are no longer afforded the protection for its membership interest they once had. Single-member LLCs can have their LLC membership interest, just like stock in a Florida Corporation, attached and levied upon. On that point, the reason why, at least for asset protection purposes, real estate should not be held in a Corporation is because in the event of any judgment against the owner, the stock shares of that owner, as a tangible asset, can be levied upon and attached by a judgment creditor. That same position now can be said, at least for an LLC membership interest under limited circumstances such as a single member entity.

Other legal scholars are addressing the issue in which they believe that there could also be an expansion of the Olmstead holding to multi-member LLCs, although no legislation has been addressed to that particular point nor has any cases expanded the Olmstead holding. Be watchful of this concept.

## B. Cost Factors; Initial Cost and Annual Filing of a Florida LLC versus No Filing or Annual Filing for a Florida Land Trust:

There are cost factors in regard to consideration of a Florida LLC versus a Florida Land Trust. The formation of a properly prepared Florida LLC with an appropriate Operating Agreement, an Executive Business Summary and a Shareholder Buy-Sell Agreement, most likely costs no more than a properly prepared Florida Land Trust with a separate and distinct beneficiary agreement. Often times, preparation of the LLC actually is more expensive than a properly prepared Florida Land Trust. Be cautious because the author has seen a number of poorly drafted Florida Land Trusts, which of course, defeats the entire purpose. It is also essential that the formation of a Florida Land Trust be in place in conjunction with a specific Beneficiary Agreement, which has also been properly drafted. (See further discussion below regarding Privacy Protection)

### 1. LLC Origination and Annual Fees

The initial filing fee for a Florida limited liability company set by the Secretary of State is $160.00 and the annual fee is $138.75. Just having one Florida LLC would cost the investor, at the start of the second year, fees to the state in excess of $400 simply to remain viable as a Florida limited liability company. Of course, if annual fees increase, this would likewise increase. Consider the holding period for certain investments and the math would reflect that

there's an ongoing and continuing expense for a Florida LLC simply by payment of the State of Florida fees annually. Using the concept of "compartmentalization liabilities", if an investor chooses to have multiple LLCs for a number of holding periods, the costs would increase exponentially.

Further, a registered agent must be named and a registered agent office established. Retaining the service of an attorney to act as a registered agent may also result in an annual expense.

Contrast the cost of using a Florida LLC with a Florida Land Trust.

2. No Origination Filing Fee; No Annual Costs

A Florida Land Trust doesn't require any State of Florida origination fees for filing with the Secretary of State.

The State of Florida doesn't require an annual fee to maintain the viability of a Florida Land Trust unlike a Florida LLC.

Florida Land Trusts, like the Florida LLCs, protects the Florida Land Trust beneficiary like Florida LLC member(s) from direct liability of property ownership since legal title of the property is held by the Florida Land Trustee and not the beneficiary. The Florida Land Trustee has no personal liability to third parties for acts in reference to the property. The real property (the "res") stands for the debt of the Florida Land Trust.

Even though the beneficiary's interest is considered personal property, the beneficiary controls how the Trustee administers the real property. In contrast, a Florida LLC's members only own a membership interest in the LLC and the decisions of the LLC are made by the manager.

3. Summary of costs and issues of using a Florida LLC versus a Florida Land Trust:

a. Land Trusts require no Florida origination fee or filing fee with the Secretary of State.

b. Florida Land Trusts don't require an annual fee to the state that needs to be paid for the continuity of existence such as a Florida LLC does.

c. Florida Land Trust affords the beneficiary with no liability for title since bare legal title to the property is held by the Florida Land Trustee who, likewise, has no personal liability on the property.

Kevin F. Jursinski, B.C.S.
Florida Bar Board Certified Real Estate Law, Business Litigation and Construction Law Attorney

d. The Trust asset itself (the Trust "res") is the only asset that stands for any debt of the Florida Land Trust.

e. The Florida Land Trustee has no personal liability

f. Even if the Florida Trustee is the 100% owner of the beneficial interest, there is no merger of the Trustee and the beneficiaries distinct positions. [unlike the Olmstead Theory]

g. There is no registered agent required for a Land Trust.

## C. Privacy Benefits of a Florida Land Trust over other types of entities

Florida Land Trusts offer privacy in terms of transferring interest. The transfer of a beneficial interest in a Land Trust is not recorded in the public records and is only maintained in the specific Florida Land Trust file and not accessible by third-parties. It is clearly favorable over property being held in an individual's name when any prospective transfer has to be made public record with attendant recording costs and public notice.

Further, Florida Land Trusts are not registered with the Secretary of State and there is no need for a registered agent/manager or any disclosures of the Land Trust's place of business to be recorded in the public records in the State of Florida.

## D. Ease of Transferring in the Event of Death and Avoidance of Probate

Interest in a Florida Land Trust or a Florida LLC is personal property and not real property. In a Florida Land Trust, if the contingent beneficiaries are listed in the Trust documents, similar to a beneficiary designation in other contracts such as insurance policies, such identification of contingent beneficiaries will allow for the avoidance of Probate, since the asset is transferred upon the death of the beneficiaries, pursuant to the terms and conditions of the trust, outside of Probate.

Trusts, like LLC's also have continuity of life since most Trusts contain provisions for a successor Trustee in the event of resignation or death.

## E. Internal transfer of interest without necessity of Deeds

Unlike holding property in the name of an individual, if a Florida Land Trust beneficiary decides to transfer its beneficial interest, and subject to the provisions for restriction on transfer, the beneficiary simply signs or transfers it's beneficial interest to a third party. No deed is required for the transfer of the equitable ownership of the property from one beneficiary to another. Additionally, no information of transfer is required to be made to anyone or needs to be recorded anywhere. The State of Florida now requires that documentary stamp tax be paid upon the value of the transfer of the beneficial interest (Florida Statute 201.021). No transfer needs to be recorded in the public records. No recording fees are charged but rather the fair market value of the actual percentage of ownership of the beneficial interest transferred is used to calculate a documentary stamp tax at the rate of $.70 per $100.00, similar to the transfer of a deed. However, there are no recording costs and no identification of the third parties in the public records of a transfer of such interest continuing on-going privacy and anonymity.

## E. Privacy of a Land Trust

As indicated above, unlike a Florida LLC, there is nothing recorded with the Secretary of State records as to the creation of a Land Trust. The title to the property is listed solely in the name of the Trustee with no identification of the beneficiaries listed.

## F. Asset Protection: Avoidance of Judgment

In the event a beneficiary of a Land Trust happens to have a judgment against them, that judgment will not attach to the real property pursuant to Florida Statute 55.10 by the recordation of certified copies in public records in the county in which the real property of the Florida Land Trust is located. That is because:

1. The property is not titled in the individual's name but rather the Trustee; and

2. The recording of the judgment acts only attach to real property and not personal property of the beneficiary.

This is important because it controls the determination that a properly recorded judgment lien against a beneficiary(ies) is not a lien as against the real property. The protection of the real property is based upon the fact that there is no merger of the ownership interest of the Trustee and the Trust, even in situations in which the Trustee and the Beneficiary are one and the same. This is codified in Florida Statute 689.071 (5):

> *"…the doctrine of merger does not extinguish a land trust or vest the trust property in a beneficiary or beneficiaries of land trusts, regardless of whether the*

*trustee is the sole beneficiary of the land trust."* (Fl. Statutes 689.071 (5) "Doctrine of Merger Inapplicable.)

Contrast this with the single-member LLC as in the Olmstead holding:

As such, the liability of a beneficiary against who a judgment is entered does not impact the land trust title. Conversely, a claim against the Trustee does not impact the beneficiary's interest.

> *"… the beneficiaries of a land trust are not liable, solely by being beneficiaries, under a judgment, decree, or order of any court or in any other manner for a debt, obligation, or liability of the land trust. Any beneficiary acting under the trust agreement of a land trust is not liable to the land trust's trustee or to any other beneficiary for the beneficiary's good faith reliance on the provisions of the trust agreement. A beneficiary's duties and liabilities in a land trust may be expanded or restricted in a trust agreement or beneficiary agreement."* (Fl. Statute 689.071 (8(a)).

## G. Property Held in Name of Trustee of a LLC Avoids Multiple Parties on Deed

Like the authority vested in an LLC manager, a Trustee is the only one required to transfer title, mortgage property, or to take action as it relates to the property and can do so only by the direction of the beneficiaries, having legal title held by a Trustee versus having multiple names of individuals on the property and avoids a number of issues such as exposing those individuals to liability. It also requires approval and signatures by each one of the individuals in the event of a transfer or encumberance be placed on the property which is avoided by having a Land Trust or a potential LLC with the authority designated to the manager. Further, title of the property is not clouded or made unmarketable as a result of a judgment against one of the individual owners IF the owner simply has a beneficial interest rather than holding legal title.

## H. Transfer of a Land Trust from an Individual does not result in acceleration of debt

If an individual owns a residential unit with a mortgage on it and transfers it to a corporation or an LLC in that situation the Lender can claim acceleration of debt based upon the "due on sale clause" contained in most mortgages. However, Federal law prohibits the triggering of the "due on sale clause" involving a transfer of a "residential unit" into a Land Trust.

U.S. Code Title 12, Chapter 13, Section 1701j-3 limits the lender from accelerating the note when there is a transfer of a "dwelling unit" to *"an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the*

*property"*. In this case, a property that is originally acquired in the name of "Jane Jones", an unmarried woman, can be transferred to a Florida Land Trust to "Jane Jones, Trustee" or "John A. Smith", Trustee of a Florida Land Trust in which "Jane Jones" is the beneficiary without triggering the due on sale clause in the underlying mortgage. Florida Land Trusts have Federal protection from lenders precluding acceleration of the debt which supersedes State law. This is another distinct advantage at enabling property to be transferred, allowing the financing to remain intact, without requiring a refinance with the attendant additional costs in underwriting.

## I. Favorable Tax Rates

From the standpoint of tax rates, generally there would be an individual Capital Gain rate applied to a Land Trust members' interest on transfer versus a Corporation or Foreign Corporation which may be taxed at a higher rate. For more information on your particular situation, please consult with your individual tax advisor and, of course, address the issues relating to the specific property in question.

## J. Summary

In summary, this article emphasizes proper due diligence and investigation of the real property investment before purchase. Investors should refrain from holding property in their individual names. There should be a specific effort undertaken either on the acquisition of the property or after the acquisition of the property to move the property from the individual's name into a separate entity, if the individual took title in his/her individual name or Tenants in Common. As indicated above, if there is an existing mortgage on the property that, in it of itself, precludes the transfer of the title, except for to a Florida Land Trust due to acceleration by a lender.

Readers of this article should consider the key points identified above as well as to consider the fact that the most sophisticated investors plan their investments and consider a multiple number of viewpoints including how title is acquired, how title is held, inspections of the property, due diligence, how property is managed, and also from the standpoint of asset protection and minimization of State and Federal taxes.

**DISCLAIMER: This Article is not written for legal advice and is published for informational purposes only. The Article is intended to address observations as to certain elements currently in existence with Florida LLCs and Florida Land Trusts. As such, readers are cautioned to this caveat and disclaimer.**

Kevin F. Jursinski, B.C.S.
Florida Bar Board Certified Real Estate Law, Business Litigation and Construction Law Attorney