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Steals, Deals and Classifieds®

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Choice of Entity 101

- by John Hyre

One of the most common questions that real estate investors ask is: Which entity should I use? The correct answer usually depends on a large number of details... the exact nature and size of the business, the investor's source and type of income, the number of family members, etc. This article will set out some general rules for picking a structure. Your mileage may vary based on your own personal facts and circumstances.

Rule One: Limited Liability Company's (a.k.a. – LLC's) are generally the way to hold rentals and most lease-optioned properties.

The asset protection aspect of entities usually matters little when selecting an entity. That's because in most states, LLC's are cheap, provide the best asset protection and are tax chameleons, meaning that they can select how to be treated for federal income tax purposes. So when I say that a corporation works best for you, what I really mean is that an LLC that elects to be treated as a corporation is the best choice in most states.

What really distinguishes entity types is the tax treatment accorded each one. As such, choice of entity usually turns on the applicable tax rules. In fact, tax rules will determine the best entity for rentals, because they are the little darlings of the tax code. Specifically, rentals:

sell at favorable capital gains tax rates; generate depreciation deductions; generate tax upon sale that can sometimes be paid in installments, instead of all at once; can be exchanged for other real property tax-free; and may generate low-income housing credits. We want to select an entity that preserves these tax perks. Limited Partnerships ("LPs") and Limited Liability Companies ("LLCs") both achieve this goal better than any other entity. In most states, an LLC is cheaper and simpler to set up and run, so it is normally preferable to an LP. In addition to preserving rental property tax perks, LLC's are the most flexible entity. Corporations

have various restrictions on who can be an investor, what kind of income can be earned, etc. LLC's are thankfully free of such pesky (and time consuming) issues.

Rule Two: S-Corporations are usually the best way to flip properties.

First, let's distinguish S and C corporations. A C-Corporation is taxed on its income at special corporate rates. Any income that is paid to shareholders as a dividend is taxed again. This is the famous "double taxation" that applies to C-corporations.

For example: Trumpco Incorporated earns \$10,000 in taxable income. It pays a 15% tax on that income, or \$1,500, leaving with \$8,500 in after-tax income. It pays an \$8,500 dividend to Trump, its owner. If Trump is in the 35% tax bracket, he will pay \$2,975 in taxes on the dividend, leaving Trump with \$5,525 of the original \$10,000.

This double tax can quickly cost corporate shareholders more than 50% of their corporation's profits. Fortunately, the income of a C-Corporation can often be finessed to reduce the double tax. Oftentimes, creative means of getting money to shareholders (e.g. – renting equipment to the corporation, taking salaries, etc.) can also eliminate one layer of taxation.

To offset the double tax (or the administrative cost of getting around it), C-corporations have a few unique perks enjoyed by no other entity. Employees (including shareholder-employees) can get certain benefits (e.g. - medical, favorable retirement plans, tuition payments) tax-free.

S-Corporations do not get the above perks, but they also do not have double-taxation issues. As such, they are "pass-through" entities. Following the Trumpco example from above, the \$10,000 dividend to shareholders would only be taxed once, at the shareholders 35% rate. S-corporations are much simpler than C-corps, and therefore cheaper to operate. They are less flexible than LLC's, but have one important advantage: S-corporation dividends are exempt from social security taxation if the S-corporation owners are paid a reasonable salary. This feature is quite important, because income from flips (as opposed to

rentals) would otherwise be subject to a 15% social security tax.

For example: The incredible Flipboy makes \$80,000 in net income from wholesale flips done through an LLC. He would pay approximately \$12,000 (15% of \$80,000) in social security taxes. If he used an S-Corporation and paid himself a "reasonable" salary of \$35,000, he would only pay social security tax on the salary, or \$5,250. The remaining \$45,000 in profits would be distributed without paying additional social security taxes, saving Flipboy \$6,750 in social security taxes.

Limited partnerships are also exempt from social security taxes. Arguably, LP's are not required to pay a reasonable salary, meaning that all of the LP's profits can be sheltered from social security taxes. The catch: LP's are significantly more complicated than S-corporations and therefore more expensive to run. The extra benefit of an LP over an S-corporation for flips must be weighed against the cost.

Rule Three: C-Corporations often make sense for high-income individuals with self-provided benefits.

As we stated above, C-corporation can provide certain perks and benefits tax-free. If you do not have a day job (or a spouse with a day job) that provides such benefits, getting them through a C-corporation can be very efficient from a tax standpoint. Also, I mentioned that C-Corporations pay taxes based on their own brackets. For example, the first \$50,000 of C-Corporation income is taxed at 15%. For people in the 35%+ tax brackets, running \$50,000 or so in income through the C-corporation at a 15% tax rate

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Location Brockton, MA

ARV: 120K Est rehab cost: 20K
4 BR 1.5 BA 1603 sq ft lot size 5227 sq ft
Sale Price: 42,000

This is a handyman special. All of copper
plumbing has been stripped from the
property but are short runs.

This property is awaiting the right owner
to upgrade to investment property Great
for first time home buyer with large family.
Property being sold in its "as-is as-seen"
condition. No warranties expressed or
implied. This will not last at this price!
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in 2000.

Contact Name: Joan McCabe
Contact Phone number: 617-438-2007
Email: mccabepj1@comcast.net

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Contact Phone number: 508-439-2172
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partner prospect avail with re-
habers that

bring me a prospect. I care most about the
area, that the house is not in run down or
heavy traffic area. More benign, not deep
city prospect. I have funding. Hoping to
uncover a prospect that is not already on
MLS, which I already have realitors pursu-
ing for me.

Contact Name: John Illich
Contact Phone number: 603-329-4398
Alternate Phone number: 603-548-8102
Email: illichj@comcast.net

Wanted: South Shore properties retail
Description: I am working with a buyer who
is looking for small SF homes on the south
shore that can be expanded for resale. I
am also working with a couple of low end
retail buyers. One is looking for a starter
home around \$200K (not in Brockton). He
does not mind a little work. The other is
looking for a condo in Weymouth, Quincy
or Abington. We have not yet determined
her price cap but I estimate it to be in the
150 +/- range. Please send me anything
you have. I would also like to be updated
regularly on any properties that you may
have outside of these specifications as
well. Please email me at info@marecs.
net with property updates only. Check out
www.marecs.net for our available proper-
ties. Please email me at info@marecs.
net with property updates only. Check
out www.marecs.net for our available
properties.

Contact Name: Jim Happnie

Location: Clearwater, Florida

Title: Cape Coral, FL - Bulk REO Package
- 12 Properties - \$960,850
Description: - Most less than 5
yrs old
- Many never lived in
- All meet most re-
cent hurricane
stan-

dards

- 3 Bedroom, 2 Bath minimum
- Move-in ready
- Rental Rates \$750-\$950
- Direct relationship with a local Property
Management firm (7 x 24)
- Cash Flow = \$116,850 per year
Contact Name: Al Piecuch
Contact Phone number: 603-930-0718
Email: Al@NHtoFlorida.com

Location: Brockton/New Bedford
Note Purchase ARV: 160k no rehab /
140K no rehab BR: 3 BA: 1 Looking
for investors who want to be part of our
buying group. Want to close within 2
weekshab/holding/finance costs \$148,900
ARV \$515,300
Contact Phone number: 508-326-9385
Email: icaniss at aol dot cominves-
tors. Quick cash closing or HM loan
requiredgraded.- Great location off Daniels
& Colonial Dr.
Contact Name: Al Piecuch
Contact Phone number: 603-930-0718
Email: Al@NHtoFlorida.com

Self Storage Units

>400 Units
Contact Name: Eileen Schwartz
Contact Phone number: 781-820-8368
Email: eschwartz@esscoveb@
com

Be sure to check out our new TUESDAY Meetings!

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Here are the groups you will be
able to attend (in alphabetical
order):

- BostonAREIA.com (Boston)
- CTREIA.com (Cromwell, CT)
- MassRealEstate.net (Pea-
body, Ma)
- MassREIA.com (Worcester
and Springfield)
- NEREIA.org (Chelmsford,
Ma)
- NHREIA.com (Manchester,
NH)
- REINGUSA.com (Nashua,
NH)
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[http://www.bostonareia.com/
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Choice of Entity 101

continued

can be quite favorable. I say "can be" because C-Corporations are fairly expensive to administer. Remember, the benefits must outweigh the costs (e.g. – extra tax returns, bank accounts, etc.).

I rarely place a major business in a C-Corporation. Instead, I like to see secondary businesses put into a C-Corporation. For example, a C-Corporation that manages your rentals is paid what you choose to pay it (within reason!). You can pay it enough to fund your benefits, but not so much that double-taxation becomes an issue. If you put a major business into a C-Corporation, it may make "too much" income. At worst, the double tax kicks in, costing you big dollars. At best, your tax advisor finds a way to bail the income out of the company....and charges handsome fees for the favor! In my view, it is much easier to put the C-Corporation on an "income diet" than it is to "lose" the income later on (Sound familiar?).

Rule Four: Incorporate in Your Home State

I have yet to see a Nevada entity used to hold or flip properties that justified its cost. All of the benefits promised by Nevada entity hucksters (e.g. – privacy, no state tax) DISAPPEAR because you are doing business in YOUR state. Nevada entities CAN be used to reduce income taxes in SOME states by charging your in-state company interest – talk to someone familiar with YOUR state's rules to see if such an arrangement is legally possible AND worth the cost and hassle. Do NOT accept the word of a guy who sells Nevada entities for a living. Shockingly, he will assert that a Nevada company will save taxes, promote privacy, make you better looking and cure cancer...all without having the first clue about the laws in YOUR state. To a guy with a hammer, everything looks like a nail!

Rule Five: Your Mileage May Vary

These are general rules. Your business, personal situation or state's laws will often make for exceptions to the general rules. Get qualified advice!

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Accepting Clients & Solving Real Estate Investors' Tax Problems Across the United States

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Realestatetaxlaw.com Newsletter

Results Realized

FDI teams up with a company called GI Connect, which began US operations in 2008. The man behind GI Connect has 16 years in the Tele-Com industry, the last 6 running what may well be the world's largest wireless marketing company. They are said to have over 800,000 distributors worldwide, and millions of customers in over 60 countries. It is quite unusual to see a company grow so large overseas and then come to the US.

On July 4th, 2009 Financial Destination Inc., a 6 year marketer of membership services to help consumers save money and control debt, announced that Kuba Farbiarz, the founder of GI Connect and the creator of its proprietary technology and worldwide communication platform, was joining with FDI for the pre-launch and formation of FDI International. FDI Owner, Bill Andreoli, introduced Kuba Farbiarz as the newest member of the corporate staff. The new service for FDI is scheduled for release on 14 August 2009. A few highlights of the new service are:

- Make cell phone to cell phone calls to and from anyone in the world without roaming, long distance, connection charges, or per minute fees of any kind.
- Talk on your cell phone

FDI goes Global with Groundbreaking Technology in the Telecom Industry!

while flying in a commercial aircraft from coast to coast, without violating the "no cell phone" law, and at 0 cents per minute

- Free VoIP calls on Internet connections as slow as dial-up, that is, NOT requiring expensive broadband connections.

- Browse the internet on your laptop at broadband speeds, using your cell phone to connect, while simultaneously talking on the same phone, at 0 cents per minute

- Unlimited data download, with no data card, no credit check, and no contract for as little as \$10 a month.

With Kuba's proprietary technology, you are NOT having to deal with a startup company and all the potential problems that typically plague new companies. Mike Randolph, VP of Leadership Development for FDI explains, "FDI International is a TRUE Telecom company, not a reseller. This basically means "we own the tone"... or we own the network. When you pick up your telephone, the dial tone you hear is on OUR system, our network. FDI Int'l is a reseller ONLY in the area of cellular – for several reasons – but I'll get into that later. The most important thing that makes us different from ALL other Telecom companies is that we touch ALL 7 areas of the Telecom Industry. **There are only a**

handful of companies in the world can say that. The 7 areas of Telecom we touch are:

1. Residential,
2. Cellular,
3. VoIP – for those of you that don't know what that is, VoIP is "Voice over Internet Protocol", or in layman terms – talking over the internet,
4. Corporate Solutions,
5. Calling Cards,
6. Domestic and International Long Distance,
7. and Telephony Equipment – that's phones, switches, and etc.

The bottom line is that when you build your business with FDI Int'l, you can profit from EVERY area of the Telecom Industry – you are not restricted to just one small piece."

To learn more about this groundbreaking technology, learn how you can either become a customer or become a customer and create an additional stream of income by taking advantage of the income opportunity by visiting www.fdiipro.net to see the full presentation and then calling Bernadette at 603-834-4587 to answer any question and to get you started.



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