



# How Is Your Real Estate Titled?

## Why You May Want to Consider Some Alternatives

Why might you want to hold real estate in something other than your own name?

If you are contemplating a real estate purchase, planning for a significant renovation project or thinking about renting out your summer home, you may want to consider how that property is titled. In addition, if you are thinking of keeping a vacation home or other property in the family for generations to come, it may make sense to utilize an estate planning instrument rather than parsing out fractional interests to your children. Although people frequently hold real estate in their own names, there are many reasons to use another vehicle, such as a limited liability company (LLC) or trust.

Consider Michael, a well-known author. He has personal assets of \$30 million, including a family home

in Connecticut worth \$4 million and a vacation home in Colorado valued at \$2 million. His basis is \$2.5 million in the Connecticut property and \$1.9 million in the Colorado property. Originally, he owned the homes in joint name with his wife, but since her death a few years ago, he has held both in his individual name. He recently decided to renovate the top floor of his Connecticut home to create a studio space for his son who is an artist. Michael is also contemplating buying a small home in Florida to escape the cold Northeast winters and to spend more time near his daughter and grandchildren. Since his estate is large enough that it will be taxed at both the state and federal level, Michael is interested in transferring assets out of his estate tax-efficiently. (In 2019, the federal unified estate and gift tax basic exclusion amount is \$11.4 million, which means an individual can give up to \$11.4 million during life or at death without

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incurring any federal gift or estate tax. Many states, including Connecticut, impose their own gift and/or estate taxes.)

Michael may want to consider alternatives to holding his real estate personally for the following reasons.

### Privacy

On occasion, fans will show up at Michael’s door to talk about their favorite books or to request an autograph. Although Michael enjoys interacting with his fans, it is disconcerting to him when they come to his home unannounced. Real estate deeds are public records, and with the rise of the internet, it has become much easier to access these records and determine who owns what and lives where. State laws vary, but one of the most basic reasons to purchase your home through an LLC or trust is to prevent (or at least inhibit) strangers from determining where you live or what property you own.

In Michael’s case, there will likely always be a record connecting him to his existing homes (as a prior owner), but if he transfers them into an entity, then the entity will be listed as the current owner. As for the new home in Florida, he can make the purchase through an LLC and avoid having his name on any public record associated with the property.

### Limited Liability

Before Michael begins the renovation of his home in Connecticut, he may want to transfer that property into an LLC to limit his liability. For anyone planning to build on new land or undergo a renovation or other significant construction project, holding the property in an LLC can limit your exposure to liability as it relates to any accidents that may occur. The same logic applies if you are planning to rent out your vacation home or an apartment building. If you own multiple properties, you should consider holding them in separate LLCs or creating a series LLC so that one property is not subject to the liabilities of another.

For example, if a construction worker falls down the stairs while

working on the renovation project, sustains a brain injury and sues Michael for \$10 million, all of Michael’s personal assets would be subject to the lawsuit. However, if Michael had previously transferred his home into an LLC, only the assets within the LLC (the Connecticut property) would be at risk. A simple transfer into an LLC could limit his liability to \$4 million, thus protecting \$26 million of his personal assets.

It is important to note that limiting liability by using an LLC will only be effective where the formalities are respected (for example, assets cannot be commingled, and property-related expenses must be paid by the LLC, not out of a personal account). Further, you may encounter some obstacles, such as the application of real estate transfer taxes or a co-op board withholding approval, but experienced advisors can help you navigate the process.

### Estate Planning

Michael’s family has a tradition of spending a week together in Colorado each year to celebrate the holidays, and his children and their families use the property at other times throughout the year. Michael would like to preserve this property for his children and grandchildren so that they can continue making memories there long after he is gone.

People who wish to keep a home or vacation property in the family for future generations often transfer interests in such assets to trusts for the benefit of family members. There are tax efficiencies that can lead to this decision, but it is also easier from a practical standpoint to have one entity hold and administer this type of asset rather than having multiple children (and eventually grandchildren) owning small fractional shares of a family home outright. These transfers take different forms depending on the goals of the client. Some of the most frequently used methods are as follows.

### *Revocable Trust/LLC*

If your goal is simply to ease the burden of transition at your death, you may want to consider a revocable trust, an LLC or a combination. This option functions best for personal residences, vacation homes and undeveloped land and is particularly relevant for people who own homes in multiple states. Couples often hold their real estate as joint tenants with rights of survivorship, which means that this issue becomes pertinent after the first spouse's death. If you own real estate in your individual name at the time of your death, your executor will need to go through the probate process in each jurisdiction in which you own property, and multi-state probate is costly and time consuming. If, on the other hand, you transfer your real estate into your revocable trust or an LLC, then you can avoid ancillary probate in those states where you are not a resident but own property. In addition, if you use an LLC, you can transfer your interest in the LLC to your revocable trust in order to avoid probate on those assets in your home state as well.

For example, as discussed, it may make sense for Michael to transfer the Connecticut property into an LLC prior to the renovation project. He may then transfer his LLC interest, along with his property located in Colorado, into his revocable trust. And if he purchases the Florida property directly through his revocable trust, he will not need to transfer it at all. This planning will avoid ancillary probate in Colorado and Florida, and the Connecticut property will no longer be subject to probate in Connecticut.

### *QPRT*

Another common strategy is to transfer real property into a qualified personal residence trust (QPRT). The QPRT creator transfers a residence into the trust for a designated term during which the creator (and the creator's spouse) may continue to live in the residence. Assuming the transferor survives the term of the QPRT, she must then begin paying rent if she wants to stay in the home. This allows the creator of the trust to reduce the size of her estate not only by the value of the residence she transferred, but also by the amount of rent she is paying. The rent is an additional tax-free gift to her beneficiaries, since no transfer tax is due on the payment of rent.

In Michael's case, the Colorado property would be best situated for use in a QPRT because the family will continue to use it for the foreseeable future and because the fair market value of the property is not significantly higher than his basis of the property. The property transferred to a QPRT will not receive a step-up in basis at Michael's death (whereas there would be a step-up if he died owning the property outright), so it is best to use property with a relatively high basis, or you may end up forgoing a significant tax advantage by using a QPRT.

Michael will use up some of his basic exclusion amount to fund the QPRT with the property, but if the term is relatively long and interest rates are high, the amount he uses will be significantly less than the value of the property. Assuming he survives the term assigned to the QPRT, the Colorado home will be out of his estate, and Michael will begin paying rent to the trust, which will reduce his taxable estate even further and build up cash in the trust, which can be used for maintenance of the property as needed. When Michael dies, the Colorado property will remain in trust for the benefit of his children and grandchildren so that they can fulfill his wish for them to continue their annual gatherings and make more memories together.

### *Minority Interest Transfers*

If your personal assets are well over the basic exclusion amount, as Michael's are, you may want to use a combination of an LLC and a trust to remove valuable property from your estate. One way to accomplish this is to transfer property into an LLC and then gift a minority interest in that LLC to a trust for the benefit of your children.

For example, if Michael transferred the Connecticut home into an LLC and thereafter gifted a 49% interest in the LLC to a trust, the value of that 49% interest for gift tax purposes would be much lower than half the fair market value of the residence. This is because it would not be easy to find a buyer for a minority interest in a private entity holding a family's residence. Appraisers assign a discount for noncontrolling interests in nonmarketable assets. As a result, Michael would effectively be transferring an interest worth \$2 million but may only have to use between \$1.2 million and \$1.4 million of his basic exclusion amount. Similar to the QPRT, if Michael plans to remain in the home, he would need to enter into a lease agreement with the entity holding the property.

### **Conclusion**

In addition to being thoughtful about future real estate purchases, you may want to evaluate how your current property is titled and whether it makes sense to transfer it to another entity. If you have any questions about alternative real estate holding options, please reach out to your Brown Brothers Harriman wealth planner or relationship manager. ■



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