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REAL ESTATE E-BRIEF

Limited Liability Companies: Are They All Talk and No Action?

In the real estate market, it is common for a limited liability company (an "LLC") to be formed for the purpose of ownership, investment, development, operation, management and leasing of real property. Since their inception under state law more than 20 years ago, LLCs have grown steadily in popularity. Today, they are often seen as a more favored option to corporations because they couple liability protections available to corporations with certain favorable tax treatments of a partnership or other disregarded entity. However, the protections afforded by an LLC are not unlimited, and there are certain limitations real estate professionals should understand.

Contractual Liabilities

Generally, an LLC provides its members protection from all contractual liabilities undertaken by the company. The LLC is obligated to perform the actions it agrees to do by contract, and breaching that obligation results in contractual liability. For example, if an LLC contracts to lease a new building for \$5,000 per month, failure to have the new building approved for occupancy on the commencement date of the lease is a breach of the lease. The buyer would have a cause of action against the LLC for breach of contract. However, if a member of an LLC contractually agrees to take on personal liability for the obligations of the LLC, then such agreement is enforceable against the member in accordance with its terms (e.g. if a member of a tenant LLC were to guaranty the LLC's performance under a lease, then such member could be pursued by the landlord for the LLC's breach, such as the failure to pay rent).

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Tortious Liabilities

However, protections afforded an LLC for tortious liabilities, or “bad acts,” is limited if damage is caused by a member acting on behalf of the company. For example, if a person runs a red light and causes a car accident while driving from the LLC’s offices to the site of the leased property, both the LLC and the individual driver may be liable for any resulting damages and injuries. If that driver is also a member of the LLC, he or she cannot use the LLC’s shield of limited liability as protection from personal liability. Even if the LLC’s organizational documents include an indemnification clause requiring the LLC to indemnify the member for such liabilities, that protection only reaches so far as the value of the LLC’s insurance coverage and other assets. If the damages and injuries caused by a member exceed the LLC’s resources, the member may be personally liable for the remainder.

Despite the limitations set forth above, the use of LLCs remains quite popular in the real estate market. Whether an LLC is the right fit for purposes of a real estate acquisition, operations or business depends on a myriad of factors. Please consult with your tax and legal advisors for assistance in choosing an entity structure most suitable to you.

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