

# Choosing a Business Entity For Your Real Estate Brokerage

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# Choice of Business Entity

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## Entity Choices

- Sole Proprietorship
- General Partnership
  - Limited Liability Partnership
- Limited Liability Company \*
- S Corporation \*
- C Corporation



# Choice of Business Entity

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## General Considerations

- Formation/Administrative Formalities
- Management Structure Flexibility
- Liability Protection, i.e. Limited Liability
- Capital Structure
- Tax Aspects



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## Formation / Administrative Formalities

- *General Partnership*
  - No formal statutory formation process;
  - No annual registration
- *Limited Liability Partnership*
  - Formal Statutory formation and organization process;
  - Annual registration



# Common Legal Structures

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## Formation/Administrative Formalities

- *Limited Liability Company*
  - Formal Statutory formation and organization process;
  - Annual registration;
  - Should record company actions
- *Corporation (C&S)*
  - Formal Statutory formation and organization process;
  - Annual registration;
  - Should record corporate actions





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## Management Structure Flexibility

- *General Partnership*
  - Generally, each partner has equal management rights
  - Generally, any partner can bind the partnership
- *Limited Liability Company*
  - Management Power and Authority is with members and/or managers
  - No statutory requirement for officers & directors but can adopt a corporate structure
  - Management structure typically set forth in an operating agreement



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## Management Structure Flexibility (cont'd)

- *Corporations (S Corp & C Corp)*
  - Bound by formal statutory requirements
  - Shareholders elect board (after initial election or appointment) and vote on certain matters
  - Management power by or under board of directors
  - Articles of Incorporation, bylaws, statutes and shareholder and director resolutions may restrict and more clearly define duties and responsibilities



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## Owner Liability Protection

- *General Partnership*
  - Each partner has full personal liability for debts and obligations of the Partnership
- *Limited Liability Company*
  - Member liability limited to investment;
  - Creditor of LLC can come after assets of LLC
  - Pierce Corporate Veil
- *Corporation (S Corp & C Corp)*
  - Shareholder liability limited to agreed investment
  - Creditor of Corp. can come after assets of Corp.
  - Pierce corporate veil





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## Owner Liability Protection (cont'd)

- Avoid any type of veil piercing argument by observing corporate formalities:
  - DO NOT COMINGLE FUNDS!
  - Properly document Company actions;
  - Sign all documents on behalf of Company and not in your individual capacity
- ❖ Note – several courts have pierced the corporate veil of single member LLC's



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## Owner Liability Protection (cont'd)

- Limited liability provided by a business entity does NOT protect you for your professional activity as a real estate agent
- You must carry the appropriate E&O Insurance for your professional activities as a real estate agent
- Operating your real estate brokerage as a business entity allows you to stack insurance coverage



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## Capital Structure

- LLC / Partnership
  - Very Flexible
  - Can own Capital Interest and/or Profits Interest
  - Unlimited number and type of member/partner
  - Subject to tax rules, may allocate profits and losses in any manner desired
  - Multiple classes of ownership permitted
- S Corp
  - Limited to 100 shareholders;
  - Profits and losses must be allocated in accordance with stock ownership percentages
  - Single class of stock



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## Tax Aspects

### *Disregarded Entity*

- A Single Member LLC is treated as a disregarded entity for tax purposes;
- Sole proprietor can receive liability protection by organizing as a SMLLC and still be taxed as a sole proprietor



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## Tax Aspects (cont'd)

### *Pass-Through Taxation*

- Tax burden flows through the entity to owner
- Pass through entities = LLC / Partnership / S Corp
- Generally, pass through entities will have tax advantages over C Corporations:
  - No corporate level tax;
  - Losses pass through to owners;
  - Appreciated property may be contributed / distributed to entity taxed as partnership
  - S Corp – allows you to limit self employment taxes that you pay





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## Tax Aspects (cont'd)

### *C – Corp. - Double Taxation*

- Corporations are taxed as a separate legal entity
- Double Taxation =
  - Taxes are paid at the corporate level
  - Taxes are paid at the shareholder level



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## Benefits of Operating Your Real Estate Brokerage as a Business Entity

- Limited Liability Protection
- Tax Advantages
- Stacking Insurance Coverage
- Ability to have additional owners
- Ability to have agents working for your brokerage
- Estate Planning
- Provides an Exit Strategy



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## Which Entity is the Right Choice for My Real Estate Brokerage?

- On balance, LLCs tend to be the better choice of business entities due to their overall flexibility
- However, tax related issues may dictate the use of an S Corp.



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## Documents for Your Real Estate Brokerage

- *Brokerage Relationship Policy*
  - Addresses relationship between the real estate brokerage & the public
- *Office Policy Manual*
  - Needed if two or more agents working for real estate brokerage;
  - Addresses internal policies of the real estate brokerage
- *Independent Contractor Agreements*
  - All agents working for real estate brokerage are encouraged to have independent contractor agreements with the real estate brokerage
  - Note – Team members must be paid by the employing broker (C.R.S. 12-61-117)

# Thank You

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