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Planning to buy a building for your business? Do it outside of the corporation

For immediate release

Irvine, Calif.—May 4, 2005—“If you are an entrepreneur looking to purchase a building for your business, do it outside of the corporation,” says Tax Partner Jim Katherman of Stonefield Josephson, a California-based certified public accounting firm. Katherman says that when your corporation owns buildings and real estate, you may have higher taxes and less flexibility. “When you must move to a new space to accommodate growth, it is common to think about purchasing a building. However, if the title to the property belongs to your corporation, you may suffer dire consequences when you pay taxes, sell your business, apply for a loan, or deal with creditors.”

Katherman says there are several reasons to avoid placing a building in the business. “One day you may want to sell your business. The buyer may not want to own a building or may plan to relocate—that limits your salability. What’s more, your company would be taxed at full rates on the gain. Regular corporations do not receive the favorable capital gains rates that are enjoyed by individuals.” Katherman adds that securing a business loan can be more difficult when real estate and the mortgage are involved. “The mortgage often creates an excessive debt ratio in the bank’s eyes.” Ownership of real estate has an additional consequence, cautions Katherman. “Business creditors can go after your building; they may view it as a valuable asset.”

What is the best way to approach building ownership? “You want to own the building separately from the business, then lease it to the business,” says Katherman. “The building can be owned by an individual or individuals, by a limited liability company, by a limited partnership, or a family limited partnership, for example.” When the building is owned outside the regular corporation, the benefits go beyond lower taxation, says Katherman. “Owners can gift shares of the building to family. They can refinance the building and cash out. They can raise the rent, assuming it is reasonable. Owners can look into tax-saving alternatives such as a Section 1031 Like-Kind Exchange when buildings are bought and sold. And, of course, individuals will generally receive favorable capital gains rates upon the sale of the building.”

Katherman says that once your corporation owns real estate, it is usually difficult and prohibitively expensive to remove that real estate from the corporate entity. “The typical corporate business is better off avoiding ownership of the building in the first place. Think about it: You incorporated to shield your personal assets from business risk. Don’t leave your real estate vulnerable to creditors and taxing authorities because you did not plan your real estate transactions carefully.” Katherman elaborates that these tax consequences do not necessarily apply to S-corporations, but that it is nevertheless a good idea to keep your real estate outside of an S-corporation as well. For additional information on the tax and business consequences of real estate transactions, contact Jim Katherman at 949-653-9400 or jkatherman@sjaccounting.com

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