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Weighing the what-ifs of trusts and LLCs

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By Beth Pinsker Gladstone

NEW YORK (Reuters) - If you own real estate of any kind, you've got an asset that needs to be protected - and not just against wind and rain.

While most homeowners buy insurance as a matter of course, they are less likely to set up trusts and limited liability companies (LLC) - the kinds of structures that can protect you from legal hazards like lawsuits and probate of your estate after you die.

Any arrangement that involves a lawyer can be a tangled - and expensive - undertaking. But sidestep trusts and LLCs at your own peril, or that of your heirs, say estate planners. If you plan on passing on real estate after you die, "you need to review your estate plan to see what you need," says Jonathan Graham, dean of education for the National Institute of Certified Estate Planners and a lawyer in Plymouth, Massachusetts.

While there's no data on the split between those who have trusts and those who don't, there are certainly many among the more than 100 million homeowners in the U.S. who haven't taken this step. Picking the right arrangement for your family is tricky, because there are several key differences between LLCs and trusts. Here are some pros and cons:

INCORPORATE YOURSELF

Setting up an LLC is a no-brainer if you have an income-producing property of any kind. The LLC's main purpose is to reduce liability, because lawsuit claims are against the LLC and not the owner's personal assets. This provides protection if the LLC is maintained properly, says William Bronchick, who has his own law practice in Aurora, Colorado and is chairman and president of Colorado Association of Real Estate Investors. "It's borderline malpractice to allow a client to take a deed in his own name," Bronchick says.

LLCs also afford a degree of privacy, because only the company name is listed in public databases. Costs to file vary by state, depending on whether you do the paperwork yourself or hire a lawyer. When Curtis Arnold, the chief executive officer of Cardratings.com, set up an LLC in Little Rock, Arkansas for his rental properties, it cost him $500.

If you don't make much money from renting out your vacation home, or you just own a personal residence (or two), then advisers point toward living trusts instead, which can be custom-crafted to each family's circumstance.

"A good adviser should provide the information and let the client decide," says Graham, who has a trust set up for his family, and also has rental properties in an LLC. He adds that clients should be wary of any underpriced offering - less than $1,000 - from an estate planner, because it may just be a way for them to get into your finances and reap more fees. A crack-down on so-called "trust mills" makes dodgy advice less prevalent, he notes.

"Our concern is people selling a product, not giving legal advice," says Sally Hurme, senior project manager of the Association of American Retired People (AARP). Hurme has out-of-state property in a trust for the purpose of avoiding probate. "Estate planning should be done, but you have to carefully evaluate," she says.

Here are some of the most common trust structures:

The Qualified Personal Residence Trust (QRPTs)

QPRTs are irrevocable trusts, which means they can't be changed without the permission of beneficiaries. They are typically set up so an owner can live in the property for a fixed term (something like 20 years), and then the property passes to the heirs.

Because the benefactor must pay some kind of agreed-upon rent from that point on, QPRTs lost favor during the downturn. But because you can lock in the value of today's depressed property values, QPRTs provide a special tax advantage down the road since the house transfers at the price set at the trust's inception.

Sarah McLeod, an associate of Miller Nash LLP, a law firm in Seattle, says looming tax changes make it a good time to reconsider QPRT, especially for high-value real estate, because the gift exemption now is $5 million per taxpayer, but if Congress doesn't act, it could go back to $1 million in 2013.

REVOCABLE TRUSTS

Bronchick, who argues that QPRTs are "oversold," opts instead to recommend "revocable" trusts. Revocable trusts do not need permission from beneficiaries to change. They are also a lot more flexible and are especially helpful if you own property in multiple states and want to avoid going through probate in all of them.

These trusts are customized around a family's situation, and can last for one generation or many. If you imagine your grandchildren frolicking around your family beach home with their own children, you may want to consider a "dynasty" trust, which preserves property ownership beyond one generation. Some couples each create a trust, with the other as the beneficiary, or their children. Or you may just want to pass your property onto your own children and let them decide what to do with it.

ALL OF THE ABOVE

Sometimes it makes sense to layer LLCs with trusts, putting you in the "all-of-the-above" category. "If you need an LLC, then your estate is complex enough that you need more advance estate planning - and for that you likely need a trust," Graham says.

In addition to the LLC for his rental properties, Arnold, of Cardratings.com, also set up two revocable trusts - one for his wife and one for himself - to pass on their personal residence to their six children.

"It honestly gets confusing for me, even though we set them up," he says. "My parents were teachers, and they never had any of this stuff. It goes to show you that you can set up these entities and you don't have to be wealthy. You shouldn't be intimidated."

(Editing by Linda Stern, Lauren Young; Desking by Andrew Hay)