Choice of Ownership Structure of Real Property (VA)

A Practical Guidance® Practice Note by Faisal Moghul and Terry Fox, Fox & Moghul

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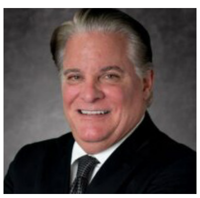

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This practice note examines the most common ownership structures used in acquiring both residential and commercial real property located in Virginia and discusses the primary considerations for the purchaser's counsel in choosing the appropriate ownership structure.

Title to real property in Virginia is conveyed by a deed that indicates the manner in which the purchaser or grantee intends to take title. This article focuses on ownership structures used to acquire fee simple title to real property, which is the default form of ownership in Virginia. See Va. Code Ann. § 55.1-110. Other forms of ownership of real property, such as life estates or leases, are beyond the scope of this practice note. The following issues should be considered when conveying fee simple ownership in Virginia:

- The type and intended use of the property
- Conditions and considerations under the Virginia property law
- The relationship of co-owners to each other
- Limitation of liability from third party and creditor claims
- How easy to transfer the interests in the property
- Taxation

For additional information on residential ownership structures, see Purchase and Sale of Residential Real Property. For information on ownership structures used by business entities, see Joint Venture Resource Kit, Thompson on Real Property, Thomas Editions § 12.16, and 12B Purchase and Sale of Real Property § 24.01.

Ownership Structures of Fee Simple Residential Property in Virginia

People can hold fee simple interest in residential property in Virginia either as a sole owner or as a co-owner with other persons.

For general information on residential conveyances in Virginia, see Residential Purchase and Sale Transactions Resource Kit (VA), Purchase and Sale of Residential Real Property (VA), General Warranty Deed with English Covenants (Residential) (VA), and Quitclaim Deed (Residential) (VA).

For general information on commercial conveyances in Virginia, see Purchase and Sale of Commercial Real Property (VA), Commercial Real Estate Ownership (VA), and General Warranty Deed (Commercial Transaction) (VA).

Sole Ownership

Fee simple absolute is the greatest possible estate in land without any conditions or limitations. This estate in land never automatically terminates because upon the death of the owner(s), it is then transferred to their heirs. Generally, an individual who owns residential real property as a primary or vacation home typically takes title to the property in fee simple absolute.

Co-ownership

Virginia recognizes the ability of two or more individuals to hold concurrent interests in a property. There are four types of co-ownership structures recognized under the Virginia law: (1) tenancy in common, (2) joint tenancy, (3) tenancy by entirety, and (4) coparcenary. This note provides a brief introduction of each co-ownership structure.

Tenancy in Common

A tenancy in common is a co-ownership structure where each tenant has a distinct and separate interest in the property, but with a common right of possession. "A tenancy in common requires no other unity than that of possession. The occupancy of the lands is undivided and neither of them knoweth his part in severalty. If two or more persons are entitled to land in such manner that they have an undivided possession, but several freeholds, they are tenants in common." See Hodges & De Jarnette v. Thornton, 138 Va. 112 (1924). To understand tenancy in common, real estate purchasers in Virginia need to understand that there are four types of unities in real estate ownership:

- Unity of time, which requires all tenants to acquire their interests in the property at the same time
- Unity of title, which requires all tenants to acquire their title by the same instrument—in the same deed or will
- Unity of interest, which requires each tenant to have an equal and same interest in the real property –and–
- Unity of possession, which indicates that each co-tenant has the same right to the possession of the property

The tenants who own a real property by tenancy in common only have a unity of possession and do not have a unity of interest, unity of time, or unity of title. Therefore, the tenants may acquire their shares in the property by different conveyances at different times. Their interests in the property may be unequal and the quantity of the estate may differ from tenant to tenant.

Also, unlike joint tenancy, or tenancy by survivorship, there is no right of survivorship attached to tenancy in common. Upon the death of a tenant, interests automatically go to heirs, or are distributed in accordance with a will or other instrument. A tenancy by common can be automatically created by dissolution of a joint tenancy, or by dissolution of a tenancy by the entirety by operation of law upon a divorce.

It is important to note that even though tenants can own unequal shares in a property, the common law presumes tenants in common to hold equal shares absent specific language to the contrary. See Smith v. Alderson, 116 Va. 986 (1914). It is advisable for co-tenants to have an agreement governing their relationship with regard to the property. In the absence of an agreement, a tenancy in common can present issues regarding the use and transferability of the property. If a dispute arises, any of the co-tenants may file an action requesting partition of the property.

For a discussion of the creation of tenancies in common, see Powell on Real Property § 50.02 and Thompson on Real Property, Thomas Editions § 32.06; possessory rights between co-tenants, see Powell on Real Property § 50.03; and termination, see Thompson on Real Property, Thomas Editions § 32.08.

Benefits

The benefits of owning real property as tenants in common include:

- **Flexibility.** Co-tenants may own unequal shares of ownership, need not be related or married, or acquire their interests at the same time.
- **Freedom.** Each co-tenant may sell its interest, without the consent of the other co-tenants or use its interest as collateral fora loan.
- **Security.** The property cannot be physically divided, unless a successful action for partition is obtained, because each co-tenant has an undivided interest in the property and a creditor of one co-tenant can only place a lien against that co-tenant's interest in the property.

Drawbacks

The drawbacks of a tenancy in common ownership structure include:

- **Estate planning.** There is no right of survivorship included in a tenancy in common, therefore when one co-tenant dies, the decedent's interest must go through probate since the other co-tenants are not entitled to inherit the decedent co-tenant's interest.

- **Termination.** If there is a sale, loss of unity of possession, or a partition action, the tenancy in common may be terminated.

Joint Tenancy

A joint tenancy allows two or more people to have concurrent ownership of a property and share the same interest. Each tenant has identical interest and rights to the enjoyment of the entire interest. The most important characteristic of a joint tenancy is the survivorship.

It is important to note that in Virginia, the common law presumption concerning survivorship has been abolished. See Va. Code Ann. § 55.1-134(A). However, this statutory language merely removes the survivorship presumption at common law, and it does not preclude a joint tenancy structure from carrying survivorship. This is evidenced in Va. Code Ann. § 55.1-134(B), which states as follows:

> This section shall not apply to any estate that joint tenants have as fiduciaries or to any real or personal property transferred to persons in their own right when it manifestly appears from the tenor of the instrument transferring such property or memorializing the existence of a chose in action that it was intended the part of the one dying should then belong to the others. This section does not affect the mode of proceeding on any joint judgment or order in favor of or on any contract with two or more one of whom dies.

Va. Code Ann. § 55.1-134(B).

Thus, the intent of the parties that the interest be vested wholly in the survivor upon the death of the joint tenant must be clear on the face of the instrument. Some languages indeed have been rejected by courts in Virginia as merely conveying the real estate interest as tenants in common, not joint tenancy. For example, the court has ruled in Camp v. Camp that the disputed language "as tenants in common with the right of survivorship as at common law," only created a tenancy in common. See Camp v. Camp, 220 Va. 5953 (1979); see also Gant v. Gant, 237 Va. 588 (1989).

Another difference between common law and Virginia law is that the common law prohibits a grantor to convey a joint tenancy to itself and another, and such conveyance of interest would be considered as conveying only creates a tenancy in common. However, Virginia statute has permitted such conveyance, as stated in Va. Code Ann. § 55.1-108:

> Any person having an estate or interest in real or personal property may convey such estate or interest to himself or to himself and another or others, including to himself and his spouse as tenants by the entirety or otherwise, and the fact that one or more persons are both grantor or grantee or grantors and grantees in the same conveyance shall be no objection to the conveyance. The grantee or grantees in any such conveyance shall take title in like manner, and the estate vested in them shall be the same as if the conveyance had been made by one or more persons who are not also grantee or grantees.

Va. Code Ann. § 55.1-108.

A joint tenancy can be easily severed by one joint tenant conveying its interest to a third party. It is well-settled in Virginia that a joint tenant may "dispose completely of one's interest in the joint tenancy" without consent of the other joint tenant. Jones v. Conwell, 227 Va. 176 (1984). Such conveyance may be achieved by selling or transferring by will or other instruments.

Consider this example: If Tom and Jenny are joint tenants and Tom conveys his interest to a third-party John, Jenny and John are now tenants in common. Survivorship no longer exists in that the unities of title and time are destroyed. If Tom, Jenny, and John are joint tenants and Tom conveys his interest to John, Jenny and John would remain joint tenants as to two-thirds of the interest, but tenants in common as to Tom's former one-third interest. At the death of John, the one-third interest passes under John's will and the two-thirds interest inures to Jenny as the surviving joint tenant.

For a discussion on creation of joint tenancies, see Powell on Real Property § 51.02, Thompson on Real Property, Thomas Editions § 31.067-51, and Powell on Real Property § 51.03. For guidance on their termination, see Thompson on Real Property, Thomas Editions § 31.08 and Powell on Real Property § 51.04.

Benefits

The benefits of the joint tenancy form of ownership include:

- **Estate planning.** Probate costs and delays are avoided because title to the property passes to the surviving joint tenant(s) by operation of law upon the death of the other joint tenant.

- **Flexibility.** Joint tenants do not need to be related or married, though they enjoy the benefit of having an undivided, equal right to use and possess the property.

Drawbacks

- The main drawback of the joint tenancy form of ownership is the uncertainty that results from a possible partition of the property. If one joint tenant attempts to sell or mortgage its interest in the real property, the joint tenancy is destroyed, and the other joint tenant may sue for partition (physical division of the property) or, if partition is not possible, a forced sale. Similarly, if one joint tenant incurs a debt and its creditor has a judgment to collect that debt, the creditor can petition the court to partition the property and force a sale to collect the debt.

Tenancy by Entirety

Tenancy by entirety is another ownership structure that carries survivorship, but tenancy by entirety only applies to married couples. This ownership structure considers a married couple as a unity, and the couple must be legally married at the time of the conveyance for them to acquire tenancy by entirety. See Va. Code Ann. § 55.1-136. Tenancy by entirety thus allows each spouse has an equal and undivided interest in the real property.

A benefit of owning a property by tenancy by entirety is that when one spouse owes debt to a creditor, a judgment lien against the debtor spouse will not attach to the property held by tenancy by entirety until the tenancy is severed.

Pursuant to Va. Code Ann. § 55.1-136, the designation of a spouse as "tenants by the entireties" or "tenants by the entirety" is sufficient to make manifest the "intent that the part of the one dying should belong to the other" and to satisfy the requirements set forth in the Section 55.1-134 as to survivorship. Va. Code Ann. § 55.1-136.

Due to "unity" concept, a tenancy by entirety can only be terminated by divorce, death of a spouse, or by agreement between the spouses. Pursuant to Va. Code Ann. § 20-111, all rights contingent on the marriage, including right of survivorship to a real property as joint tenancy or tenancy by entirety, would be extinguished and a tenancy by entirety would be transferred into tenancy in common. Va. Code Ann. § 20-111.

An interesting situation arises when a couple intends to own a property by joint tenancy with survivorship. The nexus between Va. Code Ann. § 55.1-134 and the common law conception of a married as a unity seems to automatically convert a joint tenancy created by married couple into a tenancy by entirety. Virginia case law has indicated that when a deed transferring title to a married couple evidences an intent of survivorship, such deed conveys a tenancy by entirety, not joint tenancy. See Allen v. Parkey, 154 Va. 739 (1929). See also Burroughs v. Gorman, 166 Va. 58 (1936).

Due to the available case law, it seems that a married couple can only co-own a property either by tenancy in common or by tenancy by entirety in Virginia. However, a 1995 federal district court distinguished Parkey, holding that language in promissory notes, one payable to co-grantees "or the survivor of them" and one payable to co-grantees "or the survivor," which contained no indication that the co-grantees were husband and wife, despite that they were married at the time of the bankruptcy was filed, only created joint tenancies, not tenancies by entirety. See Wolfe v. Sprouse, 183 B.R. 739 (W.D. Va.), ***aff'd**, **91 F.3d 133 (4th Cir. 1996)*** (table decision). See also Royal Insurance Co v. Kelly, 8 Va. Cir. 410 (Cir. Ct. 1987) (holding that husband and wife holding real estate as joint tenants with the full common law right of survivorship were not tenants by the entirety for public policy reasons). Also, courts respect the intent of the parties notwithstanding the tenancy created in the deed and may be willing to impose the equitable doctrine of reformation to affect the original intent. See Pleasants v. Pleasants, 221 Va. 1017 (1981).

For further discussion, see Powell on Real Property § 52.02, Thompson on Real Property, Thomas Editions § 33.06, and Powell on Real Property § 52.03. For guidance on termination, see Powell on Real Property § 52.05 and Thompson on Real Property, Thomas Editions § 33.08.

Benefits

The benefits of the tenancy by the entirety form of ownership include:

- **Protection from creditors.** Both spouses own 100% of the property, therefore if there is a judgment or other lien against tone of the spouses, the creditor will not be able to collect on a lien or judgment against one spouse
- **Estate planning.** Probate costs and delays are avoided because title to the property passes to the surviving spouse by operation of law upon the death of the other spouse.

Drawbacks

- The main drawback of the tenancy by the entirety form of ownership is inflexibility. Tenants by the entirety both own undivided interests in the property, therefore neither spouse can sell, lease, mortgage, or encumber their interest in the property without the consent of the other spouse. Similarly, the property cannot be subdivided or partitioned without the consent of both spouses.

Tenancy in Coparcenary

Tenancy in coparcenary is a type of co-ownership established by common law when lands descended from the ancestor to two or more females and there are no surviving male heirs. Thus, this type of estate is created only by descent and never by purchase. It arises where lands of inheritance descend from the ancestor to two or more persons as joint heirs. This estate lies somewhere between a joint tenancy and a tenancy in common. Like joint tenants, coparceners can sue and be sued jointly with respect to the land and can convey to other coparceners by release. Like a tenancy in common, however, there is no survivorship. In Virginia, an estate in coparcenary arises under the so-called Descent and Distribution Statute. See Va. Code Ann. §§ 64.2-200–64.2-202.

Since this form of co-ownership rarely arises and the General Assembly has eliminated all references to the term "parcenary" in the recodification of Title 64.1, this note only provides a reference to the concept.

Ownership Structures for Fee Simple Commercial Real Property in Virginia

There are many considerations that must be taken into account before choosing the entity for owning commercial or investment real property, including but not limited to, individual member, partner, or shareholder liability for the debts of the entity, exit strategies and their attendant tax consequences, management structure, and the ease and expense of organization. The primary entities used for commercial real property ownership in Virginia in this are:

- Sole proprietorship
- Partnerships, including general partnerships, limited partnerships (LPs), and limited liability partnerships (LLPs)
- Corporations, including "S" corporations and "C" corporations
- Limited liability companies (LLCs), including special purpose LLCs

Sole Proprietorship

A sole proprietorship is "[a] form of business in which one person owns all the assets of the business in contrast to a partnership, trust or corporation. The sole proprietor is solely liable for all the debts of the business." Black's Law Dictionary 1392 (6th ed. 1990). Simply put, a sole proprietorship is a natural person who directly owns all assets used in the business.

Unlike a corporation which is regarded as an entity separate and distinct from its owner, sole proprietorships do not have any separate existence of their own, and do not provide the owner the liability protection that is the hallmark of certain entities, like LLCs. Accordingly, ownership of real property by a sole proprietor is not recommended given the unlimited exposure to liability that the owner potentially faces.

Although Virginia does not require any formal registration for sole proprietorships, certain types of practices may require licenses, or have other registration requirements. For example, see Va. Code Ann. § 54.1-411(B) requiring that, "[e]xcept for . . . sole proprietorships that do not employ other individuals for which licensing is required, any person . . . or other entity offering or rendering the practice of architecture, engineering, land surveying, landscape architecture or offering the title of certified interior designer shall register with the Board (the Department of Professional and Occupational Regulation)." Va. Code Ann. § 54.1-411(B).

Partnerships

There are two specific statutes that are relevant to the discussion regarding partnerships in Virginia. The first is the Virginia Uniform Partnership Act (1996) (UPA) (Va. Code Ann. § 50-73.79 et seq.), which governs general partnerships (GPs) and registered limited liability partnerships (LLPs). The second is the Virginia Revised Uniform Limited Partnership Act (RULPA) (Va. Code Ann. § 50-73.1 et seq.), which applies to limited partnerships (LPs), including limited liability limited partnerships (LLLPs). In Virginia, there are three basic types of partnerships—general partnerships, limited partnerships, and limited liability partnerships (LLPs).

General Partnership

A GP is a type of business structure that is managed and operated by two or more partners for profit. Va. Code Ann. § 50-73.88 defines it as "the association of two or more persons to carry on as co-owners a business for profit forms a partnership, whether or not the persons intend to form a partnership." Va. Code Ann. § 50-73.88(A).

Similar to a sole proprietorship, each partner in a general partnership has unlimited individual and joint liability for the partnership's debts and obligations. Va. Code Ann. § 50-

73.96(A). Note, however, that a partner is not personally liable for partnership obligations incurred before being admitted as a partner. Va. Code Ann. § 50-73.96(B).

Generally, each partner has equal rights in the management and conduct of the partnership business. In this respect, any act by a partner outside the ordinary course of the partnership's business requires the consent of all the partners (see Va. Code Ann. §§ 50-73.99(F), (J)). Furthermore, in the partnership context, all partners are agents of one another. Va. Code Ann. § 50-73.91. One partner's knowledge is deemed held by all partners and the partnership itself. Va. Code Ann. § 50-73.80.

In Virginia there are no formal requirements for starting a general partnership. It is considered the default structure where two or more partners manage and operate a business without filing any appropriate registration documents with the State Corporation Commission. See Va. Code Ann. § 50-73.88. In addition, Va. Code Ann. § 50-73.81 provides that "[t]o the extent the partnership agreement does not otherwise provide, this chapter [UPA] governs relations among the partners and between the partners and the partnership."

Partners owe fiduciary duties of loyalty and care, as defined by the UPA, to the partnership and the other partners. Pursuant to these standards, partners must discharge any duties to the partnership and the other partners consistently with the obligation of good faith and fair dealing. Va. Code Ann. § 50-73.102(A)–(D).

A GP is a "pass-through entity," which is defined an entity where the partners report their share of the income, gains, losses, deductions, and credits from the entity on their own tax returns.

Benefits

The benefits of the general partnership structure of ownership include:

- **Pass-through taxation.** Partners can take advantage of the profits and losses of the partnership on their personal income tax return.
- **Flexibility.** There are no operational requirements for a general partnership, therefore the partners have great flexibility in how the partnership is operated.
- **Simplicity.** A general partnership is very easy to establish. It is advisable for a general partnership to file a fictitious name with the Virginia State Corporation Commission, and for a federal employer identification number, however these steps are not required.

Drawbacks

The drawbacks of the general partnership structure of ownership include:

- **Liability.** Partners are jointly and severally liable for all claims, debts, obligations, and other liabilities of the partnership. This is the primary drawback of a general partnership, which is why it is not commonly used as a vehicle for owning real estate.

Limited Partnership

A limited partnership is created by filing a certificate of limited partnership filed with the Virginia SCC. Va. Code Ann. § 50-73.11; see also SCC: Certificate of Limited Partnership. There is a $100 to file a certificate of limited partnership. See Va. Code Ann. § 50-73.17(B)(2)(a). As indicated above, limited partnerships (LPs) are governed by the Virginia Revised Uniform Limited Partnership Act (RULPA) (Va. Code Ann. § 50-73.1 et seq.).

LPs have two classes of partners: one or more general partner(s) and one or more limited partner(s). See Va. Code Ann. § 50-73.1.

Except as provided by RULPA or the partnership agreement, general partners have the rights and powers of a partner in a partnership without limited partners. Va. Code Ann. § 50-73.29(A). The partnership agreement may grant to all or a specified group of limited partners the right to vote on any matter (on a per capita or other basis). See Va. Code Ann. § 50-73.23.

General partners are jointly and severally liable to third parties for all of the LP's obligations. Va. Code Ann. §§ 50-73.29(B), 50-73.96(A). Typically, general partners tend to be a corporate entity that is responsible for the control and management of the partnership.

Barring certain exceptions, a limited partner is generally not liable for the LP's obligations unless they are also a general partner, or they participate in the control of the business (but only to persons who transact business with the LP and reasonably believe that the limited partner is a general partner). See Va. Code Ann. § 50-73.24(A). Because limited partners cannot control an LP without losing limited liability, it is a good vehicle when raising capital with silent investors. Limited partnerships are treated as pass-through entities for tax purposes like general partnerships. Partners are taxed on their personal income tax returns for the profits and losses of the business.

Benefits

The benefits of the limited partnership structure of ownership include:

- **Limited liability.** Limited partners do not have responsibility for the debts and obligations of the business and are only ever liable for the amount of capital they have contributed to the entity. This limitation on liability makes it easier for a business to attract investors.
- **Pass-through taxation.** Partners can take advantage of the profits and losses of the partnership on their personal income tax return.
- **Limited partner benefits.** Limited partners generally enjoy limited liability for the business, and subject to the terms of the partnership agreement limited partners may also be able to vote on any matter on a per capital or other basis. See Va. Code Ann. § 50-73.23.
- **Capital raising considerations.** Because limited partners cannot control an LP without losing limited liability, it is a good vehicle when raising capital with silent investors.

Drawbacks

The drawbacks of the limited partnership structure of ownership include:

- **Administrative costs.** Virginia law has certain requirements with respect to the creation of a limited partnership, including filing a certificate with the VA SCC along with the payment of filing fees. In addition, a separate entity is usually created to serve as the general partner, which involves more filings and fees and an added layer of complexity. Separate tax returns and corporate records must be maintained for both entities, which increases administrative costs.
- **General partner liability.** The general partner is fully liable for the debts and obligations of the business and must maintain enough net worth in order to insulate the limited partners from liability. If a limited partner becomes active in the business beyond the actions permitted in Va. Code Ann. § 50-73.24(B), that limited partner risks having general-partner personal liability.

Limited Liability Partnership

Limited liability partnerships (LLPs) are governed by Virginia Uniform Partnership Act (1996) (UPA) (Va. Code Ann. § 50-73.79 et seq.).

In Virginia, LLP status is available for general partnerships by filing a statement of registration as a registered limited liability partnership with the SCC. See Va. Code Ann. § 50-73.132(A); see also SCC: Statement of Registration as a Virginia Registered Limited Liability Partnership. There is a filing fee requirement of $100 to file a statement of registration as a registered limited liability partnership. Va. Code Ann. § 50-73.83(F)(1)(a).

An LLP structure allows the partners to obtain limited liability without giving up their right to share in managing the company. Partners are not directly or indirectly liable for the LLP's debts, obligations, or liabilities incurred, created, or assumed while it is an LLP. See Va. Code Ann. § 50-73.96(C).

LLPs are often used in a professional partnership setting (e.g., licensed professionals such as doctors, lawyers, engineers) to insulate each partner from malpractice or negligence of their fellow partners. LLPs are not used for real property ownership in most cases because LLPs are governed by the UPA. An LLC, which provides a similar form of limited liability, is often favored over an LLP because an LLC provides a more formal management structure.

Benefits

The benefits of the LLP structure of ownership include:

- **Pass-through taxation.** Partners can take advantage of the profits and losses of the LLP on their personal income tax return.
- **Limited liability.** Partners are insulated from any liability, debt, or obligation of the LLP.
- **Partners are free to manage.** LLP partners have the freedom to advise, interact with, and approve or disapprove of the partnership's business without the fear that they will lose the type of limited liability an LLP offers.

Drawbacks

The drawbacks of the LLP structure of ownership include:

- **Complexity.** An LLP structure involves certain filing and maintenance requirements. See Va. Code Ann. § 50-73.132(A) and Va. Code Ann. § 50-73.83(F)(1)(a) (governing the filing requirements of an LLP).
- **Management.** An LLP is governed by the UPA, which governs all general partnerships. LLCs are often preferred over LLPs because LLCs have a more defined management structure.

Corporations

A corporation is a business entity created by investors (shareholders) who invest money, property, or both to fund the corporation's capital stock. Virginia corporations are governed by Virginia Stock Corporation Act (VSCA) (Va.

Code Ann. § 13.1-601 et seq.). A corporation is formed by filing articles of incorporation with the SCC. See Va. Code Ann. § 13.1-619. Furthermore, there is a filing fee of $25 for the articles of incorporation, a charter fee of $50 for each 25,000 authorized shares (for 1 million or less authorized shares), or $2500 if the corporation has more than one million authorized shares. See Va. Code Ann. § 13.1-615.1(A); see also SCC: Charter Fee / Entrance Fee Schedule for Domestic and Foreign Corporations.

The articles of incorporation include the name of the corporation, the aggregate number of authorized shares, the full street address of the corporation's initial registered office, the name of the initial registered agent, and a statement that the agent is either a resident of Virginia and either a director of the corporation or a member of the Virginia State Bar; or a domestic or foreign corporation, limited liability company, or registered limited liability partnership authorized to transact business in Virginia. See Va. Code Ann. § 13.1-619(A).

On the other hand, the bylaws of the corporation establish the rules and framework for managing the corporation. The bylaws may contain any provision consistent with the law and with the articles of incorporation. See Va. Code Ann. § 13.1-624(B). The bylaws do not need to be filed with the VA SCC. Generally, the initial directors or incorporators of the corporation adopt the bylaws. Note that unless the articles of incorporation reserve the power to the shareholders, both the shareholders and the directors may amend, repeal, or adopt the bylaws. See Va. Code Ann. § 13.1-714.

Corporations are managed by a board of directors who are named at the time of incorporation (or shortly thereafter) but may change over time. The board of directors must have at least one director but the articles of incorporation or bylaws may fix a higher number. The number of directors may be increased or decreased by amendment to, or in any manner provided in, the articles of incorporation or the bylaws. See Va. Code Ann. § 13.1-675(A).

The shareholders hold stock or shares in the corporation. The articles of incorporation may authorize multiple classes and series of shares (usually common shares and preferred shares) with different rights and preferences associated with each class. See Va. Code Ann. § 13.1-638. Shareholders have limited liability for the corporation's debts and obligations because the corporation is an independent entity, distinct from its shareholders. Va. Code Ann. § 13.1-644 and ("the proposition is elementary that a corporation is a legal entity entirely separate and distinct from the shareholders or members who compose it"); C.F. Trust, Inc. v. First Flight Ltd. Partnership, 266 Va. 3, 9 (2003) (quoting Cheatle v. Rudd's Swimming Pool Supply Co., 234 Va. 207, 212 (1987)); accord Bogese, Inc. v. State Highway and Transp. Commissioner, 250 Va. 226, 230 (1995). However, under certain circumstances where the shareholder ignores the separate existence of the corporation—by commingling personal and corporate assets, for example—then shareholders may be held personally liable under the doctrine of corporate veil piercing. See Dana v. 313 Freemason, A Condominium Ass'n, 266 Va. 491 (2003) ("The decision to ignore the separate existence of a corporate entity and impose personal liability upon shareholders for debts of the corporation is an extraordinary act to be taken only when necessary to promote justice."). While there is no bright-line rule, the Virginia Supreme Court noted in O'Hazza v. Executive Credit Corp., 246 Va. 111, 115 (1993) that personal liability can accrue when

> the shareholder sought to be held personally liable has controlled or used the corporation to evade a personal obligation, to perpetrate fraud or a crime, to commit an injustice, or to gain an unfair advantage . . . Piercing the corporate veil is justified when the unity of interest and ownership is such that the separate personalities of the corporation and the individual no longer exist and to adhere to that separateness would work an injustice. [internal citations omitted]

On the other hand, directors must execute their duties "in accordance with their good faith business judgment of the best interests of the corporation." See Va. Code Ann. § 13.1-690. This is also known as the business judgment rule. Subsection (C) of Va. Code Ann. § 13.1-690 (also known as the "safe harbor") provides that as long as directors have performed their duties in accordance with this standard, they will not be personally liable for any action taken with regard to the corporation. Va. Code Ann. § 13.1-690(C).

The tax treatment of corporations differs depending on the type of corporate form used. A C corporation is taxed both at the entity level and at the shareholder level, while an S corporation is considered to be a pass-through entity for income tax purposes and only the shareholders are taxed on the corporation's profits. These differences are examined below.

Benefits

The main benefit of the corporation structure of ownership is limited liability. Shareholders of a corporation have limited liability for the debts and obligations of the corporation as long as corporate formalities are carefully observed. This makes the use of a corporation attractive to investors which allows a business to attract the capital it needs to start its business.

Drawbacks

The drawbacks of the corporation structure of ownership include:

- **Complexity.** The formation and maintenance of a corporation according to Virginia law can be cumbersome and costly compared with other types of entities. Articles of incorporation must be filed, books and records must be kept, and other corporate formalities can be time-consuming and costly.
- **Shareholder control.** Shareholders that own a controlling or majority share of the corporation's stock may have control over the management of the business, while shareholders owning a minimal amount of shares may have no control over the management of the business.
- **Double taxation.** If a corporation does not elect to have S status as discussed below, it is considered to be a C corporation. A C corporation is taxed on its profits and that same profit distributed as dividends is then taxed again at the shareholder level. Recently enacted laws (such as the Tax Cuts and Jobs Act of 2017 (TCJA)) may influence the impact of this disadvantage as discussed below.

C Corporation

A corporation formed in Virginia is considered a C corporation by default. See 26 U.S.C. § 1361(a)(2). A C corporation is a shareholder-owned entity and has the benefit of corporate limited liability. A C corporation is required to pay taxes on its income before it pays dividends to its shareholders, who then must also pay income taxes on the dividends they receive. This concept is called double taxation. Double taxation, rather than pass-through taxation, is often considered a drawback of using a C corporation entity. It, in turn, makes it a less attractive option for holding real property and real estate.

There are certain additional complexities in determining whether a C corporation is the right entity to hold real estate and real property from a tax perspective. Following the passage of the Tax Cuts and Jobs Act of 2017, a number of alterations to the Internal Revenue Code came into effect which may affect the choice of business entity for holding real property. See, e.g., 26 U.S.C. § 11(a), (b). However, as of 2022, several sections of the TCJA are no longer in effect. For an in-depth discussion of the implications of the TCJA on the choice of entity, see Rosann Torres, et al., Tax Cut and Jobs Act of 2017 – An Analysis §§ 1.05, 1.28, 1.36.

S Corporation

Any corporation, including Virginia corporations, may be eligible for S corporation status if they meet the standards of a small business corporation. See 26 U.S.C. §§ 1361–1363. Provided that the corporation meets those requirements, it can file to elect S corporation status via Form 2553 with the federal Internal Revenue Service. The Virginia state government honors the federal election without more, but any S corporation in Virginia must file a Form 502 income tax return. See Virginia Department of Taxation, Tax Bulletin 05-6 (May 6, 2005).

An S corporation is a corporate entity, like a C corporation. Unlike a C corporation, an S corporation is a pass-through entity for taxation purposes. This means that all incomes "pass-through" to the shareholders and are not taxed at the corporate level. However, S corporations are subject to certain limitations to which C corporations are not subject. For example, the IRC taxes S corporation property transfers in certain circumstances. See 26 U.S.C. § 1362. Additionally, S corporations have to be defined as a small business corporation by the IRS. See 26 U.S.C. § 1361(b)(1). A small business corporation cannot have (1) more than 100 shareholders, (2) any shareholders that are not individuals other than certain trusts and organizations (see 26 U.S.C. § 1361(c)(2), (6)), (3) nonresident alien shareholders, or (4) more than one class of stock. See id. As a result, most S corporations tend to be much smaller and with a few investors.

Limited Liability Companies

A limited liability company (LLC) combines the limited liability of a corporation with the pass-through tax treatment of a partnership. This favorable liability and tax treatment makes the LLC a popular choice for many individuals when forming their business entities. The Virginia Limited Liability Company Act (VLLCA), Va. Code Ann. §§ 13.1-1000–13.1-1099.27, also provides a lot of flexibility in establishing the rules that govern a Virginia LLC. Many of the rules in the VLLCA are default rules and can be contracted around by the parties to the article of organization or the operating agreement. See, e.g., Va. Code Ann. § 13.1-1024(A)–(J). A Virginia LLC is formed by filing articles of organization with the Virginia State Corporation Commission (VSCC), and they must meet statutory requirements set forth in Va. Code Ann. § 13.1-1011.

Equity holders of an LLC are called members. A Virginia LLC can be managed either by the members, or a subset of them, or a manager, appointed by the members. To establish a manager-managed LLC, the operating agreement or articles of organization must explicitly vest management authority in a manager, otherwise it is member-managed. Va. Code Ann. § 13.1-1022(A). The rights and obligations of members of an LLC are established at a baseline level in the VLLCA. See Va. Code Ann. § 13.1-1023. However, it is typical for most default rules to be contracted around in an operating agreement, which functions in much the same manner as bylaws in a corporation. See Va. Code Ann. § 13.1-1023.

Members of an LLC have limited liability for the debts and obligations of the LLC and for the acts or omissions of any other member, manager, agent, or employee of the LLC. Va. Code Ann. § 13.1-1019. A member can only be liable for its own negligence and wrongful acts provided they fall outside the scope of its duties to the LLC. Cf. Tri-State Coach Corp. v. Walsh, 188 Va. 299, 307 (1948).

Generally, an LLC will be taxed as either a pass-through or disregarded entity by the IRS. See I.R.S. Pub. 3402 2–4 (Mar. 8, 2020). Unless a single member LLC elects to be treated as a corporation for income tax purposes by filing IRS Form 8832, it is considered to be a disregarded entity, meaning that incomes from the LLC are treated as income on the individual's own taxes, through the owner's personal income tax return. A multi-member LLC is by default treated as a pass-through entity (similar to a partnership) that pays income tax through the individual members based on their share of ownership in the LLC, but it may also elect to be treated as a corporation for tax purposes. See 26 C.F.R. § 301.7701-2 (as amended in 2019); New Partnership Tax Audit Rules for more information on the tax treatment of an LLC that elects to be treated as a partnership.

Benefits

The benefits of the LLC structure of ownership include:

- **Limited liability.** Members of an LLC enjoy limited liability for both the debts and obligations of the LLC and the negligent acts of other members. The amount of limitation on liability can be up to the member's interest in the LLC. See Va. Code Ann. §§ 13.1-1019, 13.1-1025.
- **Favorable tax treatment.** LLC's provide more flexibility and opportunity than any other kind of entity with regard to their treatment for income tax purposes. Multiple-member LLC's may be treated as pass-through entities to avoid double taxation or an election may be made to be treated as a corporation. A single member LLC is taxed as a disregarded entity unless the member elects to be taxed.
- **Flexibility.** An LLC can consist of members of many different types, regardless of individual or entity status. Participation in management also does not explicitly defeat the limited liability status of any member or manager. Additionally, many of the rules can be contracted around in the LLC's operating agreement, meaning the members are (mostly) free to ensure that the entity is governed in a way that is appropriate to its circumstances and the members' needs.
- **Ease of complying with corporate formalities.** It is generally speaking easier to fully comply with the corporate formalities required of a Virginia LLC than of a Virginia corporation. In particular, the flexibility allowed of LLCs gives them a lot more room to relax what would otherwise be strict corporate formalities requirements. This in turn is good for smaller business who may not be prepared to maintain all appropriate records and follow all applicable requirements.

Drawbacks

There are two main drawbacks of establishing a Virginia LLC:

- **Filing compliance and certain maintenance requirements.** The first main drawback of the LLC structure is ensuring you comply with filing and maintenance requirements involved with forming an LLC. The VLLCA has specific sections that govern the naming, formation, filing requirements of an LLC, and the contents of the LLC operating agreement. See here for more information. In addition, an LLC in Virginia must register for certain business taxes and services administered by the Virginia Department of Taxation and the Virginia Bureau of Workers' Compensation. Visit the Department of Taxation's website and the Workers' Compensation Commission's website for more information.
- **Dearth of available case law on key issues**. The second main drawback of an LLC is that, unlike Delaware or New York, case law governing the rules and regulations of LLCs is relatively thin and still being established. As such, a Virginia LLC may be subject to rules that an LLC would not be subject to in a state with a more developed case law. When deciding whether to establish a Virginia LLC, or any LLC, it is important to determine how predictable the courts of that state will be in enforcing the common law and statutory law surrounding that entity.

Joint Ventures

A joint venture is not specifically a type of entity. Rather, it is an enterprise between two or more people or entities in which one entity determines that its goals would be better suited to engaging with the other rather than themselves. In that sense, a joint venture operates similarly to a partnership that has a distinct end (being the end of the object of the joint venture).

Joint ventures are generally established where "two or more [entities or] persons jointly undertake a specific business enterprise for profit or losses with each to have voice in control and management [of the venture.]" Ortiz v. Barrett, 222 Va. 118, 131 (1981). A joint venture in Virginia can be either contractual or it can be a separate entity, established for the purposes of the venture. It is possible to utilize a joint venture structure with different types of entities, such as partnerships, corporations, or limited liability companies. Since most joint ventures formed to acquire, develop, and operate real property among parties seeking to limit their liability and minimize costs, it is usually preferable to use an LLC.

Real estate joint ventures are often formed between parties with different levels of experience and capital. They are a way for parties with a lot of experience in holding and managing real property to work with parties that have capital to fund the management and holding of that real property. In those ventures, there is usually at least one operating member or partner (an entity with the operational knowledge to acquire and manage real property) and a capital member or partner (an entity with the capital necessary to fund the venture). Generally, the capital member's role is limited to provision of capital and does not extend to procurement of real property.

It is advisable that any capital member ensure that the operating member of the joint venture have expertise in the development, acquisition, and/or financing of the specific asset classes or real property markets in which the joint venture will operate. Additionally, the operating member(s) should have skill in day-to-day management of the real property. The operating member, on the other hand, should ensure that their capital member is capable of funding the whole operation.

Joint ventures, when structured around LLCs, commonly include an operating agreement setting forth each member's respective rights regarding A common joint venture structure is a structure whereby the capital member and the operating member form a new LLC. The parties then enter into an operating agreement for LLC which sets forth the parties' agreement as to their respective rights and obligations. These include:

- Each parties' share of the distributions
- Required contributions to the LLC
- Provision of management responsibility
- Rights of withdrawal dissolution
- Authority of each party to work on behalf of the LLC
- When each party has access to books and records
- Any minority protections
- Any restrictive covenants
- Deadlock resolution
- Restrictions on transfer of interests in the joint venture or in the real property itself
- Financial reporting requirements
- Rights and rules regarding shared assets
- Supply commitments, provision by any party of proprietary and/or confidential information
- Management of any necessary employees –and–
- Any other rights, obligations, and remedies that may be necessary

An important consideration whenever one is establishing a joint venture for real property acquisition, ownership, and management, is whether the parties require a lender to finance it. In those circumstances, the joint venture may need to establish a single purpose entity. A single purpose entity is usually an LLC or an S corporation whose sole purpose is to hold title to the real property. By doing so, the real property is insulated from collateral claims by creditors for anything other than the real property itself. Another feature of these single purpose subsidiary LLCs is that they also usually need to be "bankruptcy remote." A bankruptcy remote LLC is one where the LLC is required to have the affirmative approval of an independent manager or director to file for bankruptcy. These provisions would usually be found in the LLC's operating agreement. This is to prevent the property owner SPE from being affected by a bankruptcy of the parent entity or any of its members. There are a number of other restrictions that are unique to the operating agreements in these sorts of entities that tend not to be found in other LLCs.

For more information on the use of joint ventures as an ownership structure for real property, see Real Estate Joint Ventures Real Estate Joint Ventures for Commercial Real Estate Development, and Real Estate Joint Venture Resource Kit (90/10 Real Estate Joint Venture). See Joint Venture Organizational Chart (Real Estate Transaction) for a visual depiction of a standard LLC joint venture structure.

Foreign Entities

If a foreign (out-of-state) business entity wishes to purchase Virginia real property, local counsel in its jurisdiction of formation should be consulted as to the appropriate ownership structure based on the same considerations discussed in this note. A foreign company that intends on transacting business in Virginia must file a foreign registration statement with the Secretary of State and receive a certificate of authority from the VSCC. See Va. Code Ann. § 13.1-758. However, merely "owning, protecting, and maintaining property," without more, does not constitute "transacting business" as a foreign corporation or LLC. See Va. Code Ann. §§ 13.1-757(B)(9), 13.1-1059(A)(9). However, note that establishing whether you would fall under this exception is a fact-specific determination. Virginia, broadly speaking, defines transacting business on a statutory level in terms of what does not qualify. For a definition of what does not constitute transacting business in Virginia, see Va. Code Ann. § 13.1-757 for foreign corporations and Va. Code Ann. § 13.1-1059 for foreign LLCs. For the application for certificate of authority or registration, see Va. Code Ann. § 13.1-759 for foreign corporations, Va. Code Ann. § 13.1-1052 for LLCs, Va. Code Ann. § 50-73.138 for foreign LLPs, Va. Code Ann. § 50-73.54 for limited partnerships, and Va. Code Ann. § 13.1-1052 for LLCs; and for names, see Va. Code Ann. § 13.1-762 corporations, Va. Code Ann. § 50-73.56 for limited partnerships, and Va. Code Ann. § 13.1-1054 for LLCs.

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Faisal Moghul is a seasoned trial attorney whose practice is devoted to high-stakes business and commercial litigation. He has been selected to the prestigious Super Lawyers Rising Stars shortlist for five (5) years in a row (2016-2020), and his prior successes have been profiled in the Virginia Lawyers Weekly. He has successfully represented numerous small-medium sized businesses (SMBs) and individuals in state and federal courts on a variety of business and real estate matters. Mr. Moghul has also authored several publications in the areas of real estate and business law, including his latest co-publication with the American Law Institute titled Caveat Emptor vs Seller Disclosure in Residential Real Property Conveyances (April, 2021).

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Mr. Fox has over two decades of experience representing developers, real estate brokers, community association boards, title companies, and commercial landlords as well as tenants on a full range of complex real estate matters, including commercial property acquisition, disposition, development and leasing, complex lien and title disputes, land use and zoning, mortgage fraud, residential and commercial purchase and sale contract disputes, construction/contractor (Classes A,B and C) disputes, easement/boundary line and adverse possession issues, partition and allotment actions, plat modifications and HOA related disputes.

As a licensed settlement agent, Mr. Fox has a noted expertise in title disputes, and his Continuing Legal Education Seminars (CLEs) on curing complex title defects with real estate have received national recognition. Mr. Fox's sophistication in this subject matter is reflected in the fact that he has handled more than 3,000 commercial real estate transactions for multi-national entities like Exxon Mobil Corporation. Additionally, Mr. Fox has been practicing trademark law since 1993 and has intellectual property clients from Hawaii to Connecticut, and has successfully prevailed before the United States Patent & Trademark Appeals Board. In addition to his trademark experience, he also has extensive experience in intellectual property transfer and licensing joint ventures.