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LLCs in Estate Planning

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Summary of LLCs

- Organizations formed under state law
- Hybrid characteristics - allow for pass-through taxation (like a partnership or disregarded entity) and limited liability for members and managers (like a corporation)




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Benefits of LLCs

- Provide for efficient management of assets
- Provide liability protection for owners
- Flexibility in governance and ownership
- Ability to transfer value and retain control
- Allows for use of discounts
- Perpetual existence allowed
- Minimal filing requirements and annual fees




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Estate Tax/Gift Tax Benefits

- Use of discounts for estate/gift tax planning
 - Lack of control
 - Lack of marketability
- Legitimate and significant non-tax purpose requirement




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Key Requirements

- Separation of assets
- Adequate capitalization
- Organizational formalities must be followed




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Most Common Uses in Estate Planning

- Real estate LLCs
 - Rental properties
 - Family cabins/family farms
 - Investment real estate
- Investment LLCs
- Operating LLCs



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Initial Considerations

- Members
 - Single Member
 - Multi-Member
- Taxation
 - Disregarded entity
 - In WI, LLCs owned by married couples qualify as disregarded entity.
 - Partnership taxation
 - Corporate taxation (C v. S)

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Initial Considerations

- Management
 - Member Managed
 - Manager Managed
- Voting
 - Voting/non-voting split
- Initial Capital Contribution
- Obtaining EIN
- Terms of Operating Agreement

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Key Sections of Operating Agreement


- Purpose statements
- Capital contributions (initial and additions)
- Voting rights
- Management authority
- Transfer restrictions
- Conflict resolution
- Effect of partnership audit rule changes

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Out of State Real Estate LLCs

- Can be used to avoid probate in a state in which the member is not a resident.
- Member interest in a LLC is personal property, so contributing real estate converts it from real property to personal property.
- LLC interest can then be contributed to client's Trust during lifetime or using TOD or other non-probate direction.



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Rental Real Estate LLCs

- Efficient way to mitigate risk of owning rental real estate
- Multiple parcels/multiple LLCs
- Consider outstanding mortgages before funding
- Title and property insurance policy updates
- Leasing and contract formalities
- Not ideal for primary residences
- Separate EIN recommended




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Family Cabin/Family Farm LLCs

- Efficient way to mitigate risk of owning property used by others
- Provides for efficient management structure
- Transfer restrictions can ensure property stays in the family
- Owners can contribute additional capital to cover expenses
- Can provide for gradual transition to next generation
- Allows transfer of ownership interests without giving up management rights
- Use of discounts can create tax efficiencies



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Investment Asset LLCs

- Provide for centralized management of diverse assets
- Transfer restrictions can ensure assets stay in the family
- Owners can contribute additional capital
- If funded with marketable securities, careful consideration should be given to contributions, structure, and timing
- Use of discounts can create tax efficiencies




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Funding LLCs into Trusts

- Consider transfer restrictions in operating agreements and buy-sells
- Consider effect on LLC financing and outstanding personal guaranties
- Consider effect on voting/management
- Lifetime v. death transfers
- Tax considerations
- Valuation requirements




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754 Election

- Election that allows the inside basis of partnership assets to be adjusted upon a transfer caused by a partner's death.
- Eliminates the discrepancy between the outside basis of the partnership interest and the successor's share of the partnership's inside basis in its assets.
- Benefits only the deceased partner's successor in interest.
- Can increase the depreciation deduction for the successor to the decedent's interest and reduce gain upon sale.
- Not available for an S or C Corporation.




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Special Considerations

- Cash flow/tax responsibility of grantor if funding LLCs into grantor trusts
- S-Corp ownership restrictions if LLC taxed as an S-Corp
- Real estate transfer tax exceptions if property being contributed to LLC
- Step-up v. carry over basis
- Fraudulent transfers



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