PAUL H. BURGESS, ATTORNEY-C.P.A.

525 SOUTH MAIN, SUITE 800/TULSA, OKLAHOMA 74103-4511 (918) 599-7755 VOL. 34, OCTOBER 2013

Tax & Financial Newsletter

Our last newsletter provided an overview of Wills and Revocable Trusts. This newsletter expands on those basic estate planning techniques with information about Family Limited Liability Companies ("FLLC"). An FLLC is a type of Limited Liability Company ("LLC"). It is partnership among family members that is created to allow joint ownership of family-owned assets, including the management thereof, sharing of profits, sales, and transfers to younger generations. An FLLC can be an excellent tool to accomplish family goals, and is usually more flexible than corporations and trusts.

FLLCs vs. CORPORATIONS AND S-CORPORATIONS

A classic problem with corporations, unlike FLLCs, is double taxation. Hence, corporations in the family investment and business settings can be cost prohibitive because of income taxes. Instead, an S-corporation is the entity choice to avoid double taxation. However, S-corporations must satisfy cumbersome IRS requirements to maintain its S status, liquidation taxes are due even if the shareholders retain the assets, and S-corporations are problematic for holding passive investments. Thus, many times an FLLC is more useful than a corporation or S-corporation.

FLLCs vs. TRUSTS

An Irrevocable Trust ("IT") and FLLC can achieve similar goals, but FLLCs are often a better fit under more circumstances. For example, ITs are common for holding passive investments (stocks, bonds, real estate, etc.) for several decades, and then distributing the investments outright to younger generations. But, income taxes can be quite expensive for ITs and if circumstances change, "unwinding" an IT is very difficult and even impossible. Thus, the FLLC may be a better entity choice than an Irrevocable Trust.

FLLC OBJECTIVES & BENEFITS

An FLLC's operating agreement provides flexibility for families to achieve their business, tax, and estate planning goals. Its provisions are different than those in a standard LLC operating agreement for third-parties in a commercial venture. There are nine specific benefits and objectives to an FLLC. They are:

1. Management is vested in the older generation while they also retain control over the assets;

2. Restrictions on transferring ownership interests, and should circumstances change, the owners can "unwind" the business with fewer or perhaps no liquidation taxes;

3. If estate taxes are an issue, minority and marketability discounts will reduce estate and gift taxes;

4. The earnings of the FLLC can be taxed to several owners and many times this will reduce income taxes;

5. Transfer expenses, generally from the older to younger generations, are reduced, especially for real estate and mineral interests;

6. Avoiding probate, and if the FLLC's assets are located in more than one state, ancillary probate(s) can be avoided;

7. Protecting owners from liability from hazardous assets and shielding the FLLC's assets from family members' creditors;

8. Management can avoid certain fiduciary duties that would be required if the assets were held by a trust or a corporation; and,

9. Orderly procedures for settling family disagreements.

AN FLLC EXAMPLE

Suppose an older couple with two adult children own real estate, an investment portfolio, and a business, all of which are very valuable. Further, assume they would like to transfer 20% of these assets to the younger generation. Also, suppose Mom and Dad are not quite ready to relinquish management control, and splitting up the assets for two 10% gifts does not make sense. The couple could form an FLLC instead. They would transfer all the assets to a new LLC; we'll call it Famco, LLC. The founding members would then appoint themselves the Famco managers and could create 100 ownership units. To complete their gifts, Mom and Dad would then transfer 10 Famco units to each child.

If estate and gift taxes are an issue, the Famco operating agreement, along with asset appraisals, would be designed to help justify the 20% gift was worth less than 20% of the fair value of the assets immediately prior to organizing Famco. Hence, wealth is transferred at less estate tax cost. Income taxes could also decrease because a fifth of the profits are now taxed to the children. Mom and Dad could further take advantage of the $13,000 annual gift tax exclusion by transferring Famco units each year to their children.

MORE ON THE FLLC OPERATING AGREEMENT

For families to meet their goals and take advantage of the benefits of an FLLC, a properly drafted operating agreement is crucial. Many times the agreement is a balancing act. For instance, in our example above, Mom and Dad desire to retain management control. But, if too much control is maintained or if the children's 20% does not provide much of an economic interest in Famco, the IRS could ignore the agreement for tax purposes. Of course, this negates the tax savings. However, it is still possible the other benefits listed above can be achieved. The point is, an FLLC can be a good business and estate planning tool even if tax savings is not the primary goal.

If you have any questions regarding your estate plan or circumstances, please contact me via email at pburgess@barberbartz.com or at (918) 599-7755. As a C.P.A., I can efficiently evaluate "the numbers," and as a lawyer, I can assist you with evaluating the legal alternatives. ⌘