

LIMITED LIABILITY COMPANIES IN UTAH

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A. Using LLCs As An Estate Planning Vehicle.

To a great extent, the LLC has replaced the family limited partnership as a vehicle for estate tax planning. Prior to the availability of LLC's, one of the most commonly used estate planning techniques was the formation of a family limited partnership. The parents would create the family limited partnership and would initially own all of the general and limited partnership interests. The parents would then make gifts of limited partnership interests to their children and other descendants. The parents would typically claim minority and lack of marketability in determining the net value of the gifts. In addition the parents would make gifts in an amount less than \$10,000.00 per year, thus avoiding any gift tax or gift tax reporting requirements under the annual exclusion gift provisions of I.R.C. Section 2503(b). Over time, the parents would effectively transfer a substantial amount if not all of the value of their estates in this manner. In particular, this technique worked very well with gifting programs with real estate and other assets where it was disadvantageous to fractionalize the ownership of the underlying asset through annual gifts of undivided interests in such real estate and other assets. As general partners of the family limited partnership, the parents would nonetheless be able to retain control of the limited partnership and the assets it held.

This technique now has been replaced by the family LLC. Parents will form the family LLC and transfer assets to it while reserving management control to themselves. Then over a period of years, using the annual exclusion gift provisions on the Internal Revenue Code, the parents then make gifts of member interests to their children and other descendants. By naming themselves managers of LLC, the parents retain control of the LLC and its assets.

The substantial advantage of the family LLC over the family limited partnership is that the parents in the LLC have no personal liability for the activities of the family LLC unlike general partners in a family limited partnership.

In light of these advantages, many family limited partnerships have been converted into family LLC's. That conversion generally, with some exceptions, can be effectuated without tax impact given that assets can be distributed out of a partnership to individual partners in preparation for their contributing the same into a new LLC with no tax. See I.R.C. Section 731(a). In addition, if there is no change in the owners of the family limited partnership on the conversion to the LLC, arguably the LLC is the same partnership as the same as the former family limited partnership, because there has been no "termination" under I.R.C. Section 708. Effectively such a conversion transaction could be considered nothing more than an amendment and restatement of the limited partnership agreement to transform the family limited partnership into an LLC with no other impact on the existence of the partnership entity.

As with all family limited partnerships, it is important to note the applicability of Section 704(e). That Section provides that if the controlling member of the LLC has given LLC interests to non-controlling members who are members of the donor's family, the non-controlling members must, at a minimum, have a right to liquidate their LLC interest without financial penalty, or all LLC income will be charged to the donor. Importantly, the donor may actually view non-compliance with Section 704(e) as an estate planning advantage not only because the shifting of the income tax liability to himself would reduce the donor's estate while effectively making the gift of to the non-controlling family members income tax free (this is particularly effective if the marginal income tax rates of the members are similar), but also where the donor desires to impose restrictions on liquidation in order to qualify for lack of liquidity valuation discounts.

As to gifts of minority LLC interests to non-controlling members, the Service has recognized the availability of minority based valuation discounts in family gift situations. See Rev. Rul. 93-12, 1993-1 C.B. 202. In addition, if enough restrictions on transferability and control are included in the organizational documents, an additional liquidation discount for lack of marketability may be applicable. While many still feel that annual exclusion gifts of limited partnership and LLC interests and also discounts of the kind referred to above are allowable without limitation, that simply is not true. In this area, the old adage, "The pig gets fat, but the hog gets slaughtered," applies. Given the variety of strategies the Service currently is bringing to bear to attack deep discounting, one must be very careful in the amount and circumstances under which discounts are taken. For example, discounting probably will no longer be possible for LLCs holding liquid securities and investments or for LLC holding solely personal use assets (recall, under the new CTB Regulations, such entities are wholly ignored for tax purposes). In addition, where the objective is to maximize discounts, the LLC probably should be formed in a jurisdiction where the statutory default rule prohibits a member's withdrawal without the consent of the other members. In this regard, the Utah Legislature's 1998 amendment of U.C.A. Section 48-2b-132 is significant because it changed the Utah statutory default rule to one where a member's withdrawal without the consent of the other members is prohibited. Utah thus joins other states such as Colorado, Delaware and Arizona that currently have such defaults. Under the right circumstances, such as where an LLC holds primarily illiquid assets and keeps straight on allocations, modest discounts of up to 20% to 25% may be still be possible.

Extreme care must be taken when using an LLC to implement a leveraged gifting program in light of the IRS's continued aggressive efforts to defeat such strategies.