Estate Tax Savings and Increased Creditor Protections When You Incorporate LLCS and Limited Partnerships into Your Estate Plan

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If you have questions related to this article, please contact our Estate Planning attorneys: Jennifer Schiffer jschiffer@beankinney.com, Jon Kinney jkinney@beankinney.com or John Bryan jbryan@beankinney.com.
November 2012

Did you know that incorporating limited liability companies ("LLCs") and limited partnerships ("LPs") into your overall estate plan can result in significant estate tax savings and offer greater asset protection from creditors? This article seeks to introduce you to two types of corporate entities, the LLC and LP, discuss the basic steps of forming these entities and explain some of the benefits of incorporating them into your estate plan.

An LLC is a type of business entity that shields its creator from personal liability. To better understand how it works, consider a person who owns multiple rental properties. Property owners are easy targets for lawsuits, and unfortunately, lawsuits tend to be a natural by-product of the rental business. Savvy property owners often transfer their rental properties into multiple LLCs rather than owning their assets outright in their individual name. The benefit of having an LLC own your property is that upon a successful lawsuit, the Plaintiff generally cannot recover a judgment against all of your personal property; instead, the judgment is limited to the property within the LLC. This is an asset protection strategy that is well-known and well-utilized by many small business owners seeking to separate their business liabilities from their personal ones.

An LP, or limited partnership, is a different type of business entity from an LLC, but offers similar benefits. An LP is a partnership with one or more general partners who manage the business, and one or more limited partners who invest in the business but have no management role. The limited partners in a limited partnership enjoy limited liability, while the general partners do not. To increase the personal liability protection for the general partner, consider forming an LLC to serve as the general partner of the limited partnership.

If you are in a high-risk profession and likely to be sued, holding assets in an LLC or LP may offer greater protection from future creditors (this should not be seen as a strategy for current obligations). Consider working with an estate planning attorney to create an asset protection strategy that manages your risks. Not only will holding assets in an LLC or LP protect the assets within the entity from outside liabilities, (e.g., if you're in a car accident and found personally liable, the business assets held in your LLC may be better protected from such liability), but also assets outside your LLC are more protected from liabilities within the LLC or LP (e.g., if a tenant has an injury on your rental property, your personal assets outside the LLC or LP may be protected

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from any claims they may advance against the entity).

Another benefit of holding assets in an LLC or LP is that there are limited remedies that a claimant can seek as recovery. In many states, a claimant against an LLC or LP can only recover a charging order against the entity. This means that the claimant only gets paid if an income distribution is made from the entity. If a distribution is not made, then the claimant does not get paid. This generally makes parties bringing the claim more amenable to a settlement rather than pursuing their claim to the less favorable outcome of a charging order. It's important to know the laws in your state and determine if a charging order is the exclusive remedy or if the court could impose other remedies. If your state does not have charging orders as an exclusive remedy, many commentators recommend establishing your LLC or LP interest in a state that does.

To maximize your protection, also consider coupling your LLC or LP interest with an asset protection trust or a dynasty trust. This takes the protection of an LLC or LP one-step further. Not only does it mean a creditor is likely to have a charging order as their only remedy (in a sole-remedy state), but unlike the scenario above where no distributions can be made, if you couple your interest with a trust, distributions are still possible. If the trust provides for distributions to the transferor's beneficiaries (e. g., your spouse or children), then they are likely able to continue receiving distributions under the trust, even in the face of a charging order issued against the entity. By setting up an LLC or LP interest and coupling it with a trust naming multiple beneficiaries, such as a spouse or children, assets are protected, but they can still be used for the benefit of other beneficiaries.

In addition to limiting liability, LLCs and LPs also offer opportunities for estate tax savings. Estate planning attorneys understand the benefit of discounting and use it often. Discounting is a legitimate valuation method that is commonly used throughout the industry to transfer a greater amount of an individual's wealth, tax-free. The discounting process takes the value of an asset and considers various factors that may affect its overall fair market value, such as lack of control, lack of marketability, etc.

Here's an example of how discounting works with LLC and LP interests. Let's say you own a non-voting interest in an LLC which owns several properties. You have a minority interest in the LLC (meaning you own less than 50% of the interest in the entity) and there are three other owners with equal interests. The total value of the LLC is $20 million and your one-quarter share would be worth $5 million without discounting. Now consider the following: You're a minority shareholder, meaning you have to act in consultation with three other owners; you have a non-voting interest, meaning you lack voting control; and as a result of these factors, you lack marketability, because who would buy a small, minority interest in an LLC for its full value when they have to deal with three other owners and lack voting control? The reality is, few will, and as a result, your interest's value is actually less than $5 million after the appropriate discounts are applied.

Discounting can make a significant difference when making a gift or valuing a person's estate for estate tax purposes. This year, the lifetime gift tax exemption is $5.12 million per individual. By effectively utilizing appropriate discounting methods, taxpayers may be able to transfer more wealth and stretch their exemption further.

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