

Presenting a live 90-minute webinar with interactive Q&A

Estate Planning Using LLCs and Limited Partnerships

Achieving Estate Tax Savings Through Valuation Discounts, Protecting Against Creditor Claims

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Today's faculty features:

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Limited Liability Companies and Limited Partnerships: Creditor Protection and Estate Tax Savings

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Roadmap of this Presentation

- This presentation will be broken into two portions
 - Asset protection of LLCs/LPs
 - External vs. internal protection
 - Valuation discount planning with LLCs/LPs
 - How do valuation discounts work?
 - Understanding IRC §2704(b)
 - Nevada Restricted LLC/LP legislation

Asset Protection

- Protection of external assets from internal liabilities
 - LLC- Like a corporation, external assets are generally protected from internal liabilities
 - LP- The general partner is personally liable for internal liabilities
 - Form an LLC to be the GP of the limited partnership
- Protection of internal assets from external liabilities (see next slide)

Charging Orders

- Internal assets can be protected from external liabilities for both LLCs and LPs
- Charging order protection
 - What is it?
- Pick a state where the charging order is the exclusive remedy
- What if the state statute allows a foreclosure of the charged interest?
- Equitable remedies (see next slide)

Charging Orders – Equitable Remedies

- Not all sole remedy states have language saying that no equitable remedies apply
- Examples of equitable remedies
 - Reverse veil piercing – opposite of veil piercing
 - Constructive trust – unjust enrichment
 - Resulting trust – entity holding on behalf of
 - Alter ego – no business purpose / personal assets

Charging Orders – Who pays the Tax?

- ❑ Does the creditor pay the income taxes?
- ❑ Rev. Rul. 77-137 – voluntary assignment
- ❑ Charging order – involuntary
- ❑ Owner vs. lien holder – Who pays the tax?

Combining the LLC/LP with a Trust

- Why is a charging order good, but not ideal?
- Combine it with an asset protected trust
 - Transfer to a Domestic Asset Protection Trust
 - Transfer to a discretionary Dynasty Trust for the benefit of transferor's beneficiaries
- Example: Form LLC with 1% voting / 99% non-voting
 - Transfer 99% non-voting interest outright to transferee
 - Transferee beneficiary gets sued: What happens?
 - Transfer 99% non-voting interest to Dynasty Trust
 - Transferee beneficiary gets sued: What happens?

Charging Orders – Single Member LLC

□ Case law

- 2003 - Ashley Albright (Colorado)
- 2006 - A-Z Electronics, LLC (Idaho)
- 2006 - In re Modanlo (Maryland)
- 2010 - Olmstead v. FTC (Florida)

□ State legislation

- Wyoming - 2010
- Nevada – 2011

Olmstead v. FTC (Florida)

□ Olmstead v. FTC

- Shaun Olmstead and Julie Connell operated an advance-fee credit card scam
- FTC got a \$10M+ judgment against them
- They each had multiple single member LLCs
- Unlike Florida's LP charging order statute, its LLC statute did not make the charging order the exclusive remedy
- Therefore, the court was able to use another Florida statute to subject the membership interest to levy and sale under execution
- In 2011, Florida passed a new statute that says that LLCs are limited to the charging order, but court can order a foreclosure sale for single member LLC if judgment won't be paid within a reasonable time

Charging Orders – Corporations

- Nevada is the only state where corporations get charging order protection
 - Includes single shareholder corporations, but must be less than 100 shareholders
 - Not a publicly-traded corporation or a subsidiary of a publicly-traded corporation
 - Not a professional corporation
- No equitable remedies (except alter ego theory) can apply to a Nevada corporation

Charging Orders – Opportunities

- Pick a state where charging order is exclusive remedy
 - Set up new company, or
 - Domestication (statutory conversion), or
 - Merger, or
 - Set up holding company

Charging Orders – Examples

- Example #1: California LLC with \$2M of marketable securities
- Example #2: California LLC with \$2M business
- Example #3: Five California LLCs each with real estate

Charging Order – Which State Law?

- Two bad cases
 - New Times Media, LLC v. Bay Guardian Company, Inc. (May 11, 2010)
 - Delaware LLCs
 - Charging order issued in California court
 - American Institutional Partners, LLC v. Fairstar Resources, Ltd. (March 31, 2011)
 - Delaware LLCs
 - Charging order issued in Utah court

Valuation Discounts

- Estate planners often use valuation discounts to move wealth out of a client's estate at a low value
- Example: \$1.5 million; gift 99% non-voting LLC interest
 - Lack of voting control
 - Lack of marketability

Examples

- Example #1: Client owns 100% of LLC that operates a business
 - How do we proceed?
- Example #2: Client owns 99% LP interest with 1% GP interest owned by Client's LLC – business is operated out of the limited partnership
 - How do we proceed?
- Example #3: Client owns a large publicly-traded stock and bond portfolio
 - How do we proceed?

State Law Discount Ceiling

- IRC §2704(b) - If an interest in an entity is transferred to or for the benefit of a member of the transferor's family, any applicable restriction is disregarded in valuing the transferred interest.
- Treas. Regs. §25.2704-2(b) - An applicable restriction on the ability to liquidate the entity that is more restrictive than the state law default restriction is disregarded.

Examples

- How does IRC §2704(b) work?
 - Example #1: LLC operating agreement says unanimous vote to dissolve
 - Example #2: LLC operating agreement says distributions only on days when sky is purple

Picking a Jurisdiction

- We generally want to maximize the valuation discount under IRC §2704(b)
 - Many states: LLC/LP default statute says unanimous vote to dissolve
 - Many states: LLC/LP default statute says 1/2 or 2/3 vote to dissolve
 - Slightly smaller valuation discount

Nevada Restricted LLC/LP

- Until 10/1/09, the discounts from state to state were somewhat uniform
- Nevada SB 350, signed into law 5/29/09, effective 10/1/09
- Nevada Restricted LLC/LP – ability to lock-in assets for up to 10 years



Helping your Practice

- ❑ Separates you from every other estate planning advisor
- ❑ No matter what your competitor is recommending, you will always beat their recommendation
- ❑ You will be considered the expert



Putting the Appraisers on the Spot

- During the Nevada 2009 legislature, as soon as the bill made it through the Senate, we asked two business valuation appraisers to answer five hypothetical questions?

Hypothetical #1

- 10-yr. lock-up
 - Appraiser #1 – 10% to 30+%
 - Appraiser #2 – 15% to 35%
- If normal LLC/LP discount = 35%,
Restricted LLC/LP discount = 45% to 70%

Hypothetical #2

- 5-yr. lock-up
 - Appraiser #1 – 5% to 20+%
 - Appraiser #2 – 10% to 25%
- If normal LLC/LP discount = 35%,
Restricted LLC/LP discount = 40% to 60%

Hypothetical #3

- 1-yr. lock-up
 - Appraiser #1 – 3% to 10%
 - Appraiser #2 – 3% to 10%
- If normal LLC/LP discount = 35%,
Restricted LLC/LP discount = 38% to 45%

Hypothetical #4

- Only income/growth can be distributed
 - Appraiser #1 – 3% for 1 yr. / 10% for 10 yrs.
 - Appraiser #2 – 2% for 1 yr. / 15% for 10 yrs.
- If normal LLC/LP discount = 35%
 - Restricted LLC/LP discount = 37% to 38% for 1 yr.
 - Restricted LLC/LP discount = 45% to 50% for 10 yrs.

Hypothetical #5

- Only highest federal/state income tax liability can be distributed
 - Appraiser #1 – 2% for 1 yr. / 10% for 10 yrs.
 - Appraiser #2 – 3% for 1 yr. / 15% for 10 yrs.
- If normal LLC/LP discount = 35%
 - Restricted LLC/LP discount = 37% to 38% for 1 yr.
 - Restricted LLC/LP discount = 45% to 50% for 10 yrs.

Ways to Access Locked-in Assets

- 1. Amend articles of organization or certificate of limited partnership after gift tax SOL has run
- 2. Management fee
- 3. Loan

- DO NOT put this in a written proposal
- This SHOULD NOT be a part of the plan
- But know that this can be done if the client needs additional funds

Steps to Create Restricted Entity

- If it's a Restricted LLC...
 - Check the box on the Articles of Organization
 - Attach separate page with specific restrictions
 - Add the restrictions to the Operating Agreement
- If it's a Restricted LP...
 - There's no box to check, so attach a separate page specifically making the election and including the specific restrictions
 - Add the restrictions to the Partnership Agreement

Steps to Change to Restricted Entity

- What if you already have an entity that you want to change to be a Nevada Restricted Entity?
 - Domestication (statutory conversion)
 - Merger
 - Holding company



Uses for Restricted Entity

- Gift to Dynasty Trust using the \$5.12M exemption
- Installment sale to income tax defective Dynasty Trust
- Gift to Grantor Retained Annuity Trust



Gift to Grantor Retained Annuity Trust

- A gift of Restricted Entity interests to a GRAT seems to be an ideal technique
 - Huge leverage
 - Nearly zero gift tax risk



In our Practice

- What results have we gotten?
- How large are the valuation discounts?
- How many of these have we been doing in comparison to using regular LLCs/LP?



Future of Valuation Discounts

- Proposal to modify the 2704(b) rules to look at standards prescribed in the Treas. Regs. rather than state default laws on restrictions on liquidation