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# LLCs for Estate Planning, Asset Protection and Family Wealth Preservation

Defending Against Attacks on Loans in Workouts, Defaults and Bankruptcy

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WEDNESDAY, DECEMBER 7, 2011

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

James M. Duggan, Principal, Duggan Bertsch, Chicago

Michael A. Passananti, Principal, Duggan Bertsch, Chicago

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ATTORNEYS AND COUNSELORS AT LAW

# Comprehensive Planning with Limited Liability Companies

Presented for: Strafford Publications

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**JAMES M. DUGGAN, M.B.A., J.D.**

James M. Duggan is a principal of DUGGAN BERTSCH, LLC, a Chicago-based business, tax, estate and wealth planning firm comprised of attorneys and accountants. Jim's practice has concentrated principally on business and corporate law, and estate and wealth planning, primarily as they relate to closely-held business interests and high net worth families. Jim's experience in the structuring and implementation of Family Offices, sophisticated tax planning, and asset protection planning strategies is nationally recognized, as is his role in the firm's development of a leading multidisciplinary planning protocol. In addition to giving frequent lectures and authoring articles in his areas of concentration, Jim also serves as a director on numerous for-profit and not-for-profit organizations.

Jim's educational background includes attaining a Bachelor of Science in Marketing from the College of Commerce and Business Administration at the University of Illinois at Urbana-Champaign (*Magna Cum Laude* - 1991), a Masters in Business Administration in Finance from the DePaul University Graduate School of Business (*Summa Cum Laude* - 1994), and a Juris Doctor from the DePaul University College of Law - 1994, where he was awarded positions on both the *DePaul Law Review* and *DePaul Business Law Journal*.



**MICHAEL A. PASSANANTI, J.D.**

Michael Passananti serves as advisor and counselor to entrepreneurs, wealthy families, executives, professionals, professional athletes, and closely-held businesses. Michael's comprehensive planning roles includes trusts and estate planning, family wealth transfer planning, business succession planning, asset protection planning, charitable giving, and corporate/business structuring. The goal of Michael's practice is to ensure that he pays a high level of attention to his clients so that their respective planning goals are achieved, their wealth is protected, and their wealth passes in the most tax efficient manner.

Michael earned a Bachelor of Arts in Business Administration with a concentration in Finance and Management from Augustana College in Rock Island, Illinois, where he graduated *Summa Cum Laude* and was selected by his professors as the top business student in his class. He attained his Juris Doctorate from DePaul University College of Law in Chicago, Illinois. In addition to speaking and writing in his areas of practice, Michael serves as Co-Chair of the YLS Estate Planning Committee for the Chicago Bar Association.

# The Multiple Benefits of LLCs

LLCs should be considered in any high net worth estate plan because the one vehicle offers multiple benefits in the following areas:

- Asset Protection
- Wealth Transfer
- “Family Office” Planning

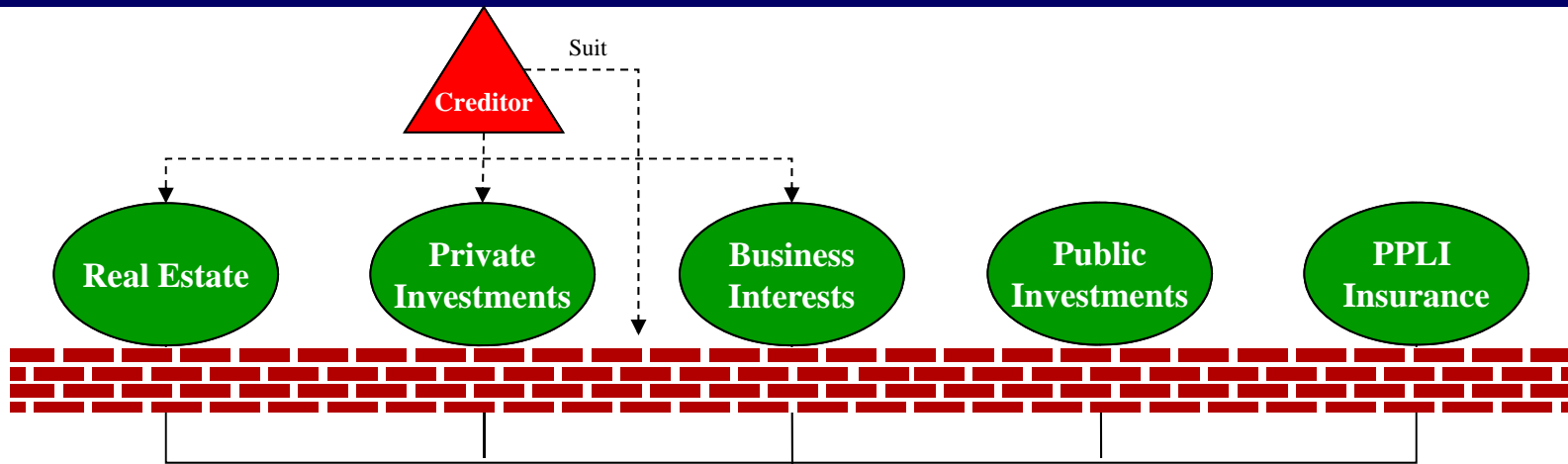


# Asset Protection with LLCs

The asset protection benefits of LLCs are derived from the following:

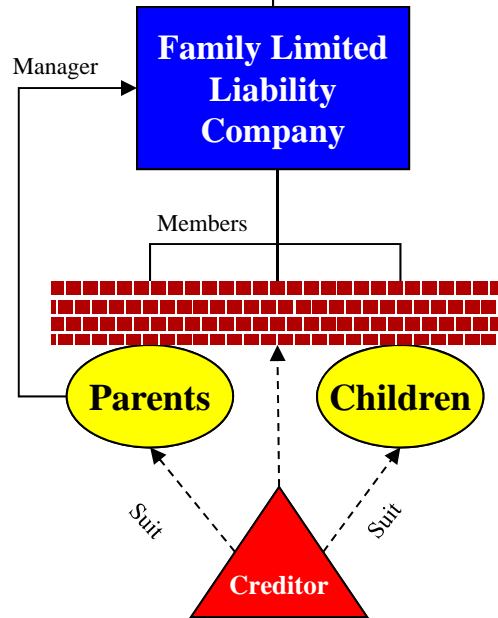
- Typical entity veil
- “Charging Orders” – a second level of protection
- Phantom Income Potential – Rev. Rul. 77-137
- Isolate Separate Property – pre-nuptial planning
- Avoids dissipation
- Gifts are of “indirect” interests, not actual assets

# Asset Protection with LLCs



(1) **Statutory “Veil”**  
Protects Members from Claims Against LLC Assets

(2) **“Charging Order”**  
Protections LLC Assets from Claims Against Members



- Preferred Jurisdictions:  
U.S. – AK, NV, AZ, DE, WY  
Int’l – Nevis, Anguilla, Cook Islands

- Step into Economic Shoes
- Pay Tax on Phantom Income?
- Rev. Rul. 77-137
- Statutory assignee
- Settlement is Advisable
- Substitute for pre-nuptial agreement

# Charging Order Statutes

- 1) Non-Exclusive Remedy Statutes – e.g., MI, CO
  - a) A court “**may**” charge the membership interest of a member
  - b) Either **allows other remedies or is silent** on the matter – e.g., judicial dissolution, judicial foreclosures, equitable remedies, etc.
- 2) Exclusive Remedy Statutes – e.g., AK, NV, Nevis, Cook Islands
  - a) A court “**may**” charge the membership interest of a member, plus,
  - b) This is the “**sole remedy**” available to creditors of a member

# Charging Order Provisions - Colorado

## Colo. Rev. Stat. § 7-80-703 (2010)

- On application to a court of competent jurisdiction by any judgment creditor of a member, the court **may** charge the membership interest of the member with payment of the unsatisfied amount of the judgment with interest thereon and may then or later appoint a receiver of the member's share of the profits and of any other money due or to become due to the member in respect of the limited liability company and make all other orders, directions, accounts, and inquiries that the debtor member might have made, or that the circumstances of the case may require.
  - To the extent so charged, except as provided in this section, the judgment creditor has only the rights of an assignee or transferee of the membership interest.
- \* **No limitation on other remedies.**

# Charging Order Provisions - Nevada

## **Nev. Rev. Stat. § 86.401 (2010) Rights and remedies of creditor of member**

1. On application to a court of competent jurisdiction by a judgment creditor or a member, the court may charge the member's interest with payment of the unsatisfied amount of the judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the member's interest.
  
2. This section provides:
  - a) the **exclusive remedy** by which a judgment creditor of a member of an assignee of a member may satisfy a judgment out of the member's interest of the judgment debtor.
  - b) Does not deprive any member of the benefit of any exemption applicable to his or her interest.

**\* Charging Order is exclusive remedy.**

# Charging Order Provisions - Alaska

## **Alaska Stat. § 10.50.380: Rights of Judgment Creditor**

1. If a judgment creditor of a limited liability company member applies to a court of competent jurisdiction, the court **may** charge the member's limited liability company interest for payment of the unsatisfied amount of the judgment.
2. To the extent a limited liability company interest is charged under (1) of this section, the judgment creditor has only the rights of an assignee of the member's interest.
3. This section provides the **exclusive remedy** that a judgment creditor of a member or a member's assignee may use to satisfy a judgment out of the judgment debtor's interest in the limited liability company. **Other remedies**, including foreclosure on the member's limited liability company interest and a court order for directions, accounts, and inquiries that the debtor member might have made, **are not available** to the judgment creditor attempting to satisfy a judgment out of the judgment debtor's interest in the limited liability company and may not be ordered by a court.
4. This section does not deprive a member of the benefit of an exemption applicable to the member's membership interest.

**\* Charging Order is exclusive remedy plus other remedies are prohibited.**

# SMLLC Statutes - Wyoming

## Wyo. Stat. Amn. § 17-209-503 (2010)

1. This section provides the **exclusive remedy** by which a person seeking to enforce a judgment against a judgment debtor, **including any judgment debtor who may be the sole member**, dissociated member or transferee, may, in the capacity of the judgment creditor, satisfy the judgment from the judgment debtor's transferable interest or from the assets of the limited liability company.
  2. **Other remedies**, including foreclosure on the judgment debtor's limited liability interest and a court order for directions, accounts and inquiries that the judgment debtor might have made **are not available** to the judgment creditor attempting to satisfy a judgment out of the judgment debtor's interest in the limited liability company and may not be ordered by the court.
- \* **Exclusive remedy; specifically prohibits other remedies; specifically includes SMLLCs.**

# SMLLC Statutes – Cook Islands

## **Cook Islands Limited Liability Companies Act 2008, § 45: Rights of Creditor against a member**

6. The charging order remedy given by this section shall be the **sole and exclusive remedy** available to a Creditor in respect of a member's membership rights.
7. For the avoidance of doubt and without limiting the generality of subsection (6):  
    ...(d) **subsection (6) shall apply whether the limited liability company has a single member or multiple members.**

**\* Sole and Exclusive remedy; specifically includes SMLLCs.**



# Phantom Income with Charging Orders?

- Rev. Rul. 77-137 states that “an assignee acquiring substantially all of the dominion and control over the interest of a limited partner is treated as a substituted limited partner.”
- It is not on point and the “control” aspect leaves doubt – but the uncertainty creates litigation risk for creditor.
- Statutes help by calling Charging Order holder a full assignee.

# LLCs vs. Other Entity Forms

LLCs are preferred over other entity choices because:

- Corporations
  - do not have charging orders (except Nevada)
  - can lose stock in lawsuit
- Limited Partnerships
  - no general partner
  - no unlimited liability
- Limited Liability Partnerships
  - often are carve-outs of General Partnership Acts
  - LLC statutes are stand-alone

# Lessons from SMLLC Cases

**With much more case law to come, early lessons of SMLLC cases are:**

- 1) Albright; A-Z Electronics - Bankruptcy Courts will not issue charging orders with SMLLCs – a transfer to a BK trustee is a transfer of all rights;
- 2) Cognex Corp. - Beware of a new and different application of the “alter ego” theory in each state; and,
- 3) Olmstead - Statutory language matters – and not just for SMLLCs (Olmstead is a call for legislatures to respond with express SMLLC exclusivity language).

# Multi-Member Case Law

For a comprehensive analysis of state-by-state charging order cases, please see:

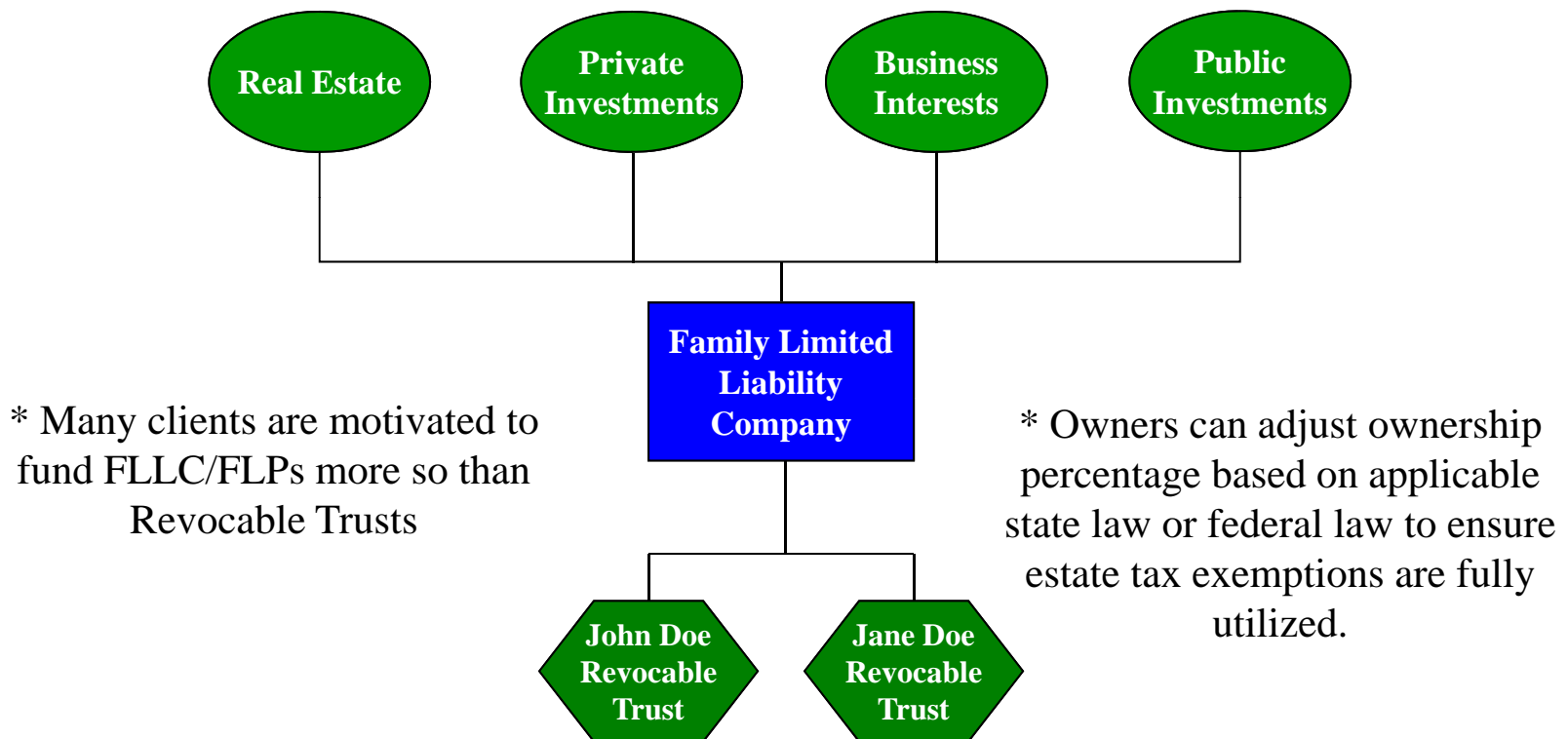
*Fifty State Series: LLC Charging Order Case Table (Dec. 2010)*

**Carter G. Bishop**

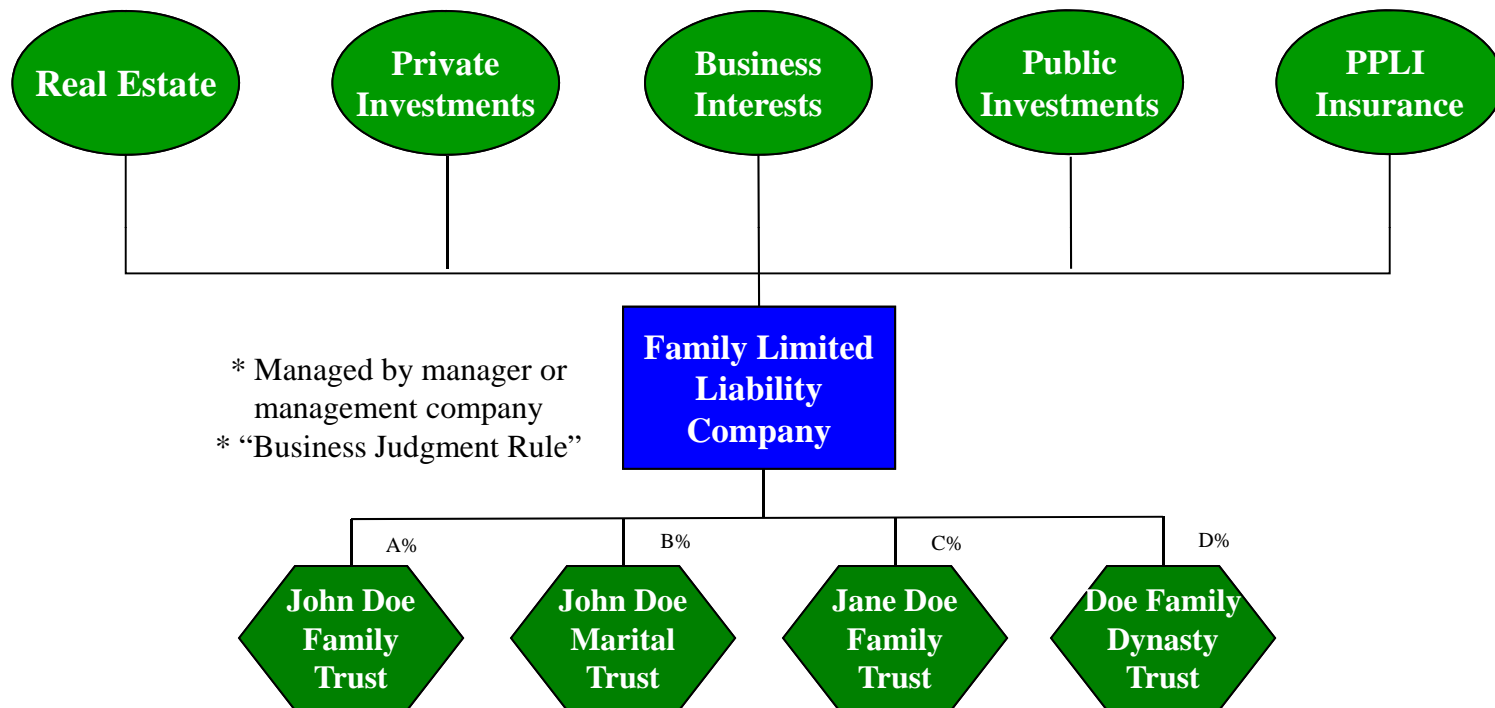
**Professor of Law, Suffolk University Law School**

**[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1565595](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1565595)**

# Estate Plan Funding Efficiency & Motivation

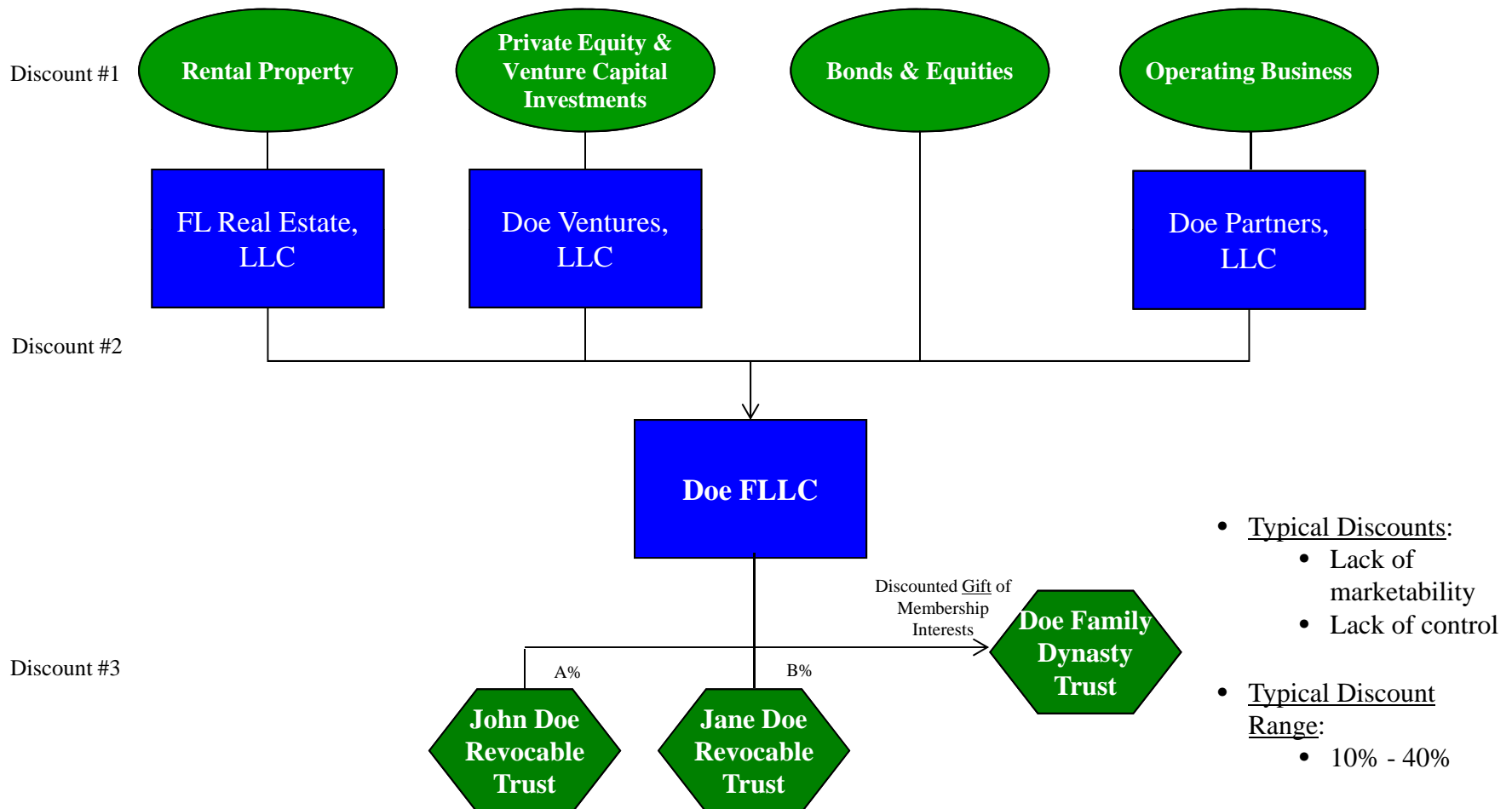


# Checks & Balances on Generational Wealth

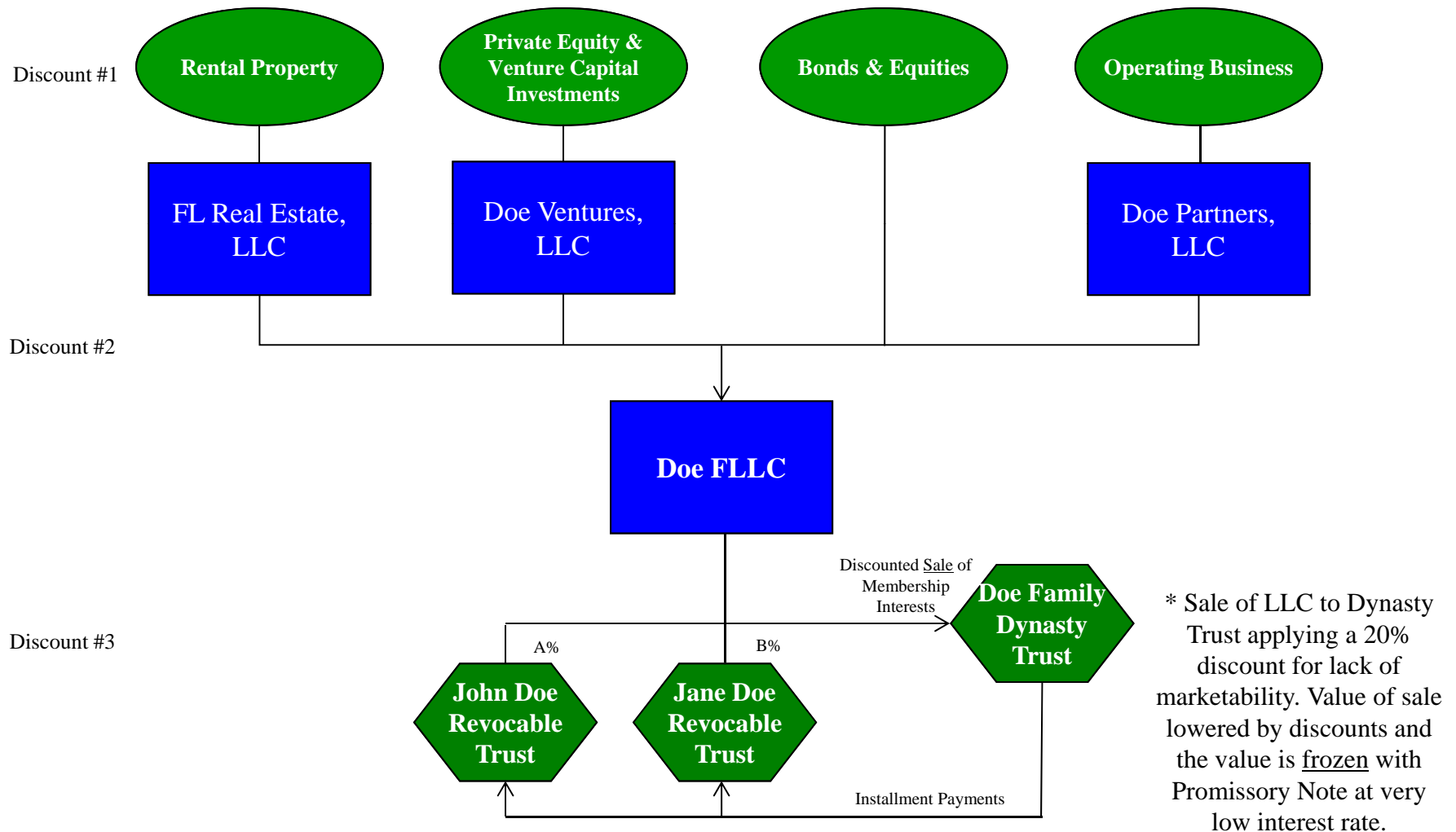


- Trustees work in conjunction with Manager on distributions to the trusts
- Trustees oversee investment activity and decisions of the Manager
- Trustees may replace manager if his, her, or its performance/duties are lacking

# Leveraged Gifting Vehicle



# Leveraged Sales Vehicle





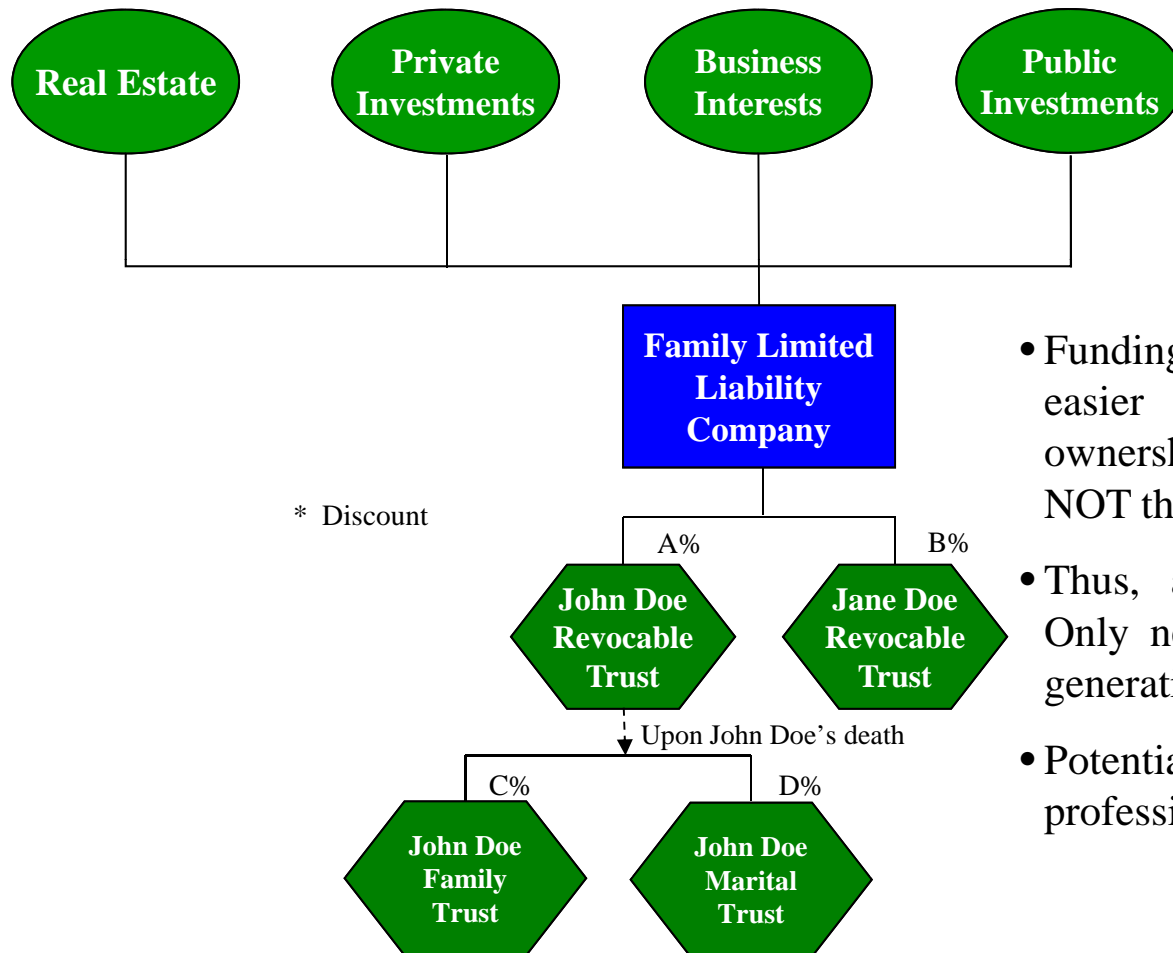
# Compliance for Lifetime Gift/Sale of LLC Interests

- 1) See *Adequate Disclosure Rules* under **Reg. 301.6501(c) - 1(e)**. On a pure gift, it is good practice to disclose:
  - a) Appraisal of all underlying assets (property, land, equipment, etc.)
  - b) Valuation of LLC by a qualified valuation professional.
  - c) All related transaction documents
- 2) Avoid the **Step-Transaction Documents** (let some time pass) to ensure discounts are honored.
- 3) On a sale or part sale of LLC interests, **do you provide the kitchen sink on your gift tax return?**
  - a) Pro – statute is running and adequate disclosure is met.
  - b) Con – too much information, which is NOT required.

# Keeping out of the 2036 Zone After Transferring LLC Interests

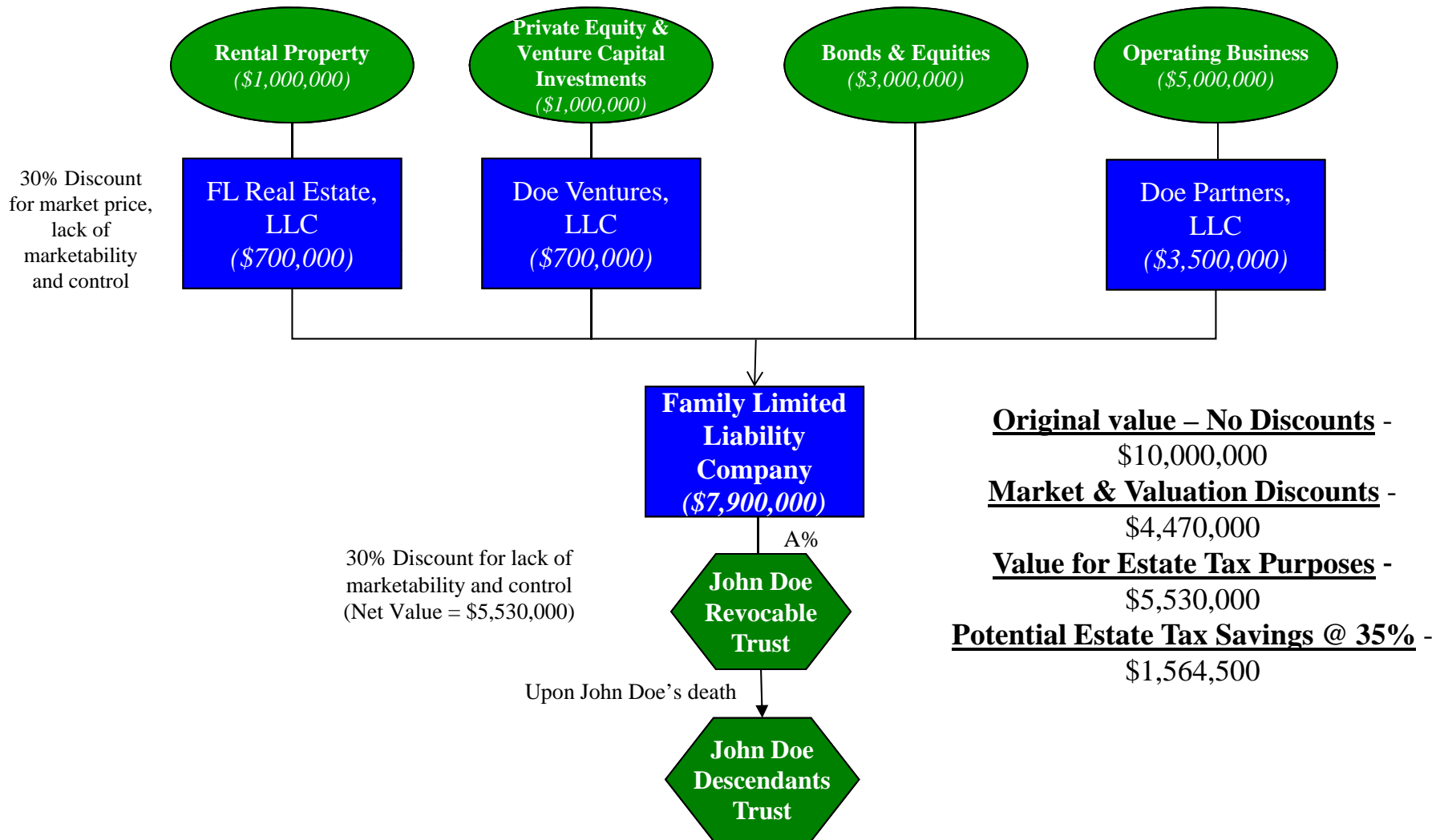
- 1) **Non-tax reasons for creation** – See *Estate of Mirowski*, T.C. Memo. 2008-74 and *Estate of Schutt*, T.C. Memo 2006-1126 – There needs to be significant and legitimate non-tax reasons for creation.
- 2) **Surrender Possession/Enjoyment of Assets** –
  - a) **Leave enough in Mom/Dad’s Estate to live**  
(see *Estate of Recton* – T.C. Memo 2007-367 and *Estate of Bigelow* – No. 05-75957, 9<sup>th</sup> Circuit)
  - b) **Don’t take income streams disproportionately**  
(see *Estate of Kurby* – Nos. 06-1201, 06-1203, 8<sup>th</sup> Circuit)
- 3) **Bon-A-Fide Sale Exception** – Have descendant's contribute assets and/or sell the interests to the descendants for arms-length consideration.

# Ease of Post-Mortum Planning/Funding



- Funding Administration becomes easier because the percentage ownership of the LLC changes and NOT the titling of assets
- Thus, assets owned within may Only need to be retitled once for generations to come
- Potential long-term cost-savings in professional fees

# Post-Mortum Estate Tax Savings



# Family Offices

What is a “Family Office”?

# Family Office Defined

A Family Office is not a specific thing. It is a concept – a customized planning structure for affluent clients that serves to optimize long-term family wealth management, centered around a business entity.

# Benefits of a Family Office

A well-conceived Family Office structure can:

- Institutionalize wealth management;
- Formalize asset ownership investment and access;
- Centralize management, bookkeeping, and administrative activities;
- Organize and consolidate reporting, financial statements, and compliance;
- Crystallize long-term family planning objectives;
- Formalize the rearing of future generations and elevate respect for wealth;
- Prioritize between for-profit and philanthropic goals;
- Maximize input, understanding, and collaboration among professional advisors;
- Minimize costs and areas of exposure to loss,;
- Maximize deduction planning; and,
- Realize the legacy the senior generation intended.

# Different Levels of Family Office Planning

Based on a client's level of wealth, complexity, and objectives, a family office structure generally falls into one of three categories:

- Virtual Family Office (“VFO”)
- Single Family Office (“SFO”)
- Multi-Family Office (“MFO”)

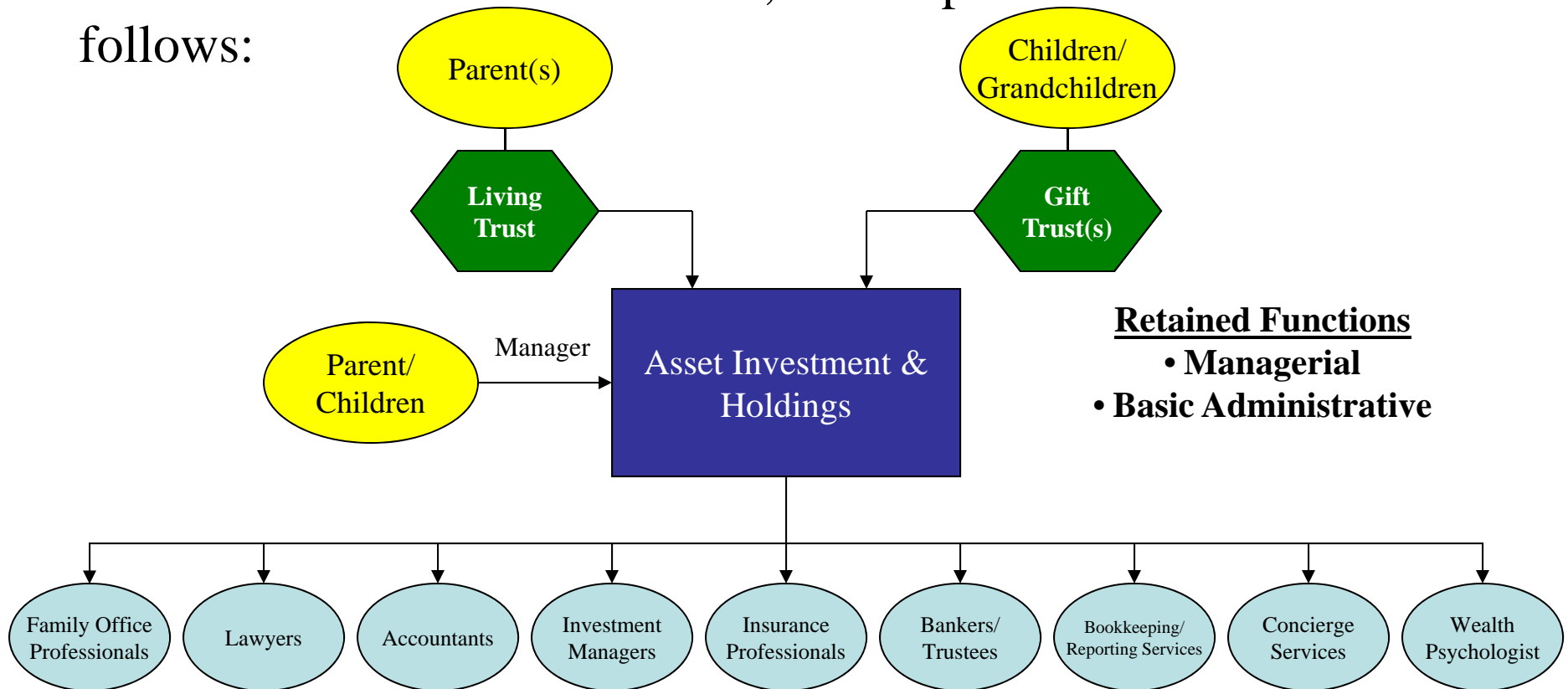


# The Virtual Family Office

- The Virtual Family Office (“VFO”) is a Family Office structure in which the key functions of the VFO are outsourced to professional advisors and service providers with key management decisions being made by a small nucleus of family members.
- A VFO generally involves establishing an entity for this purpose but does not involve the establishment of a separate physical office location.
- Few, if any, employees are utilized in a VFO.
- VFOs are most common for the smaller asset base or for simple asset/business structures.

# Sample VFO Structure

Although each VFO Structure will necessarily differ based on client facts and circumstances, a sample VFO structure is as follows:

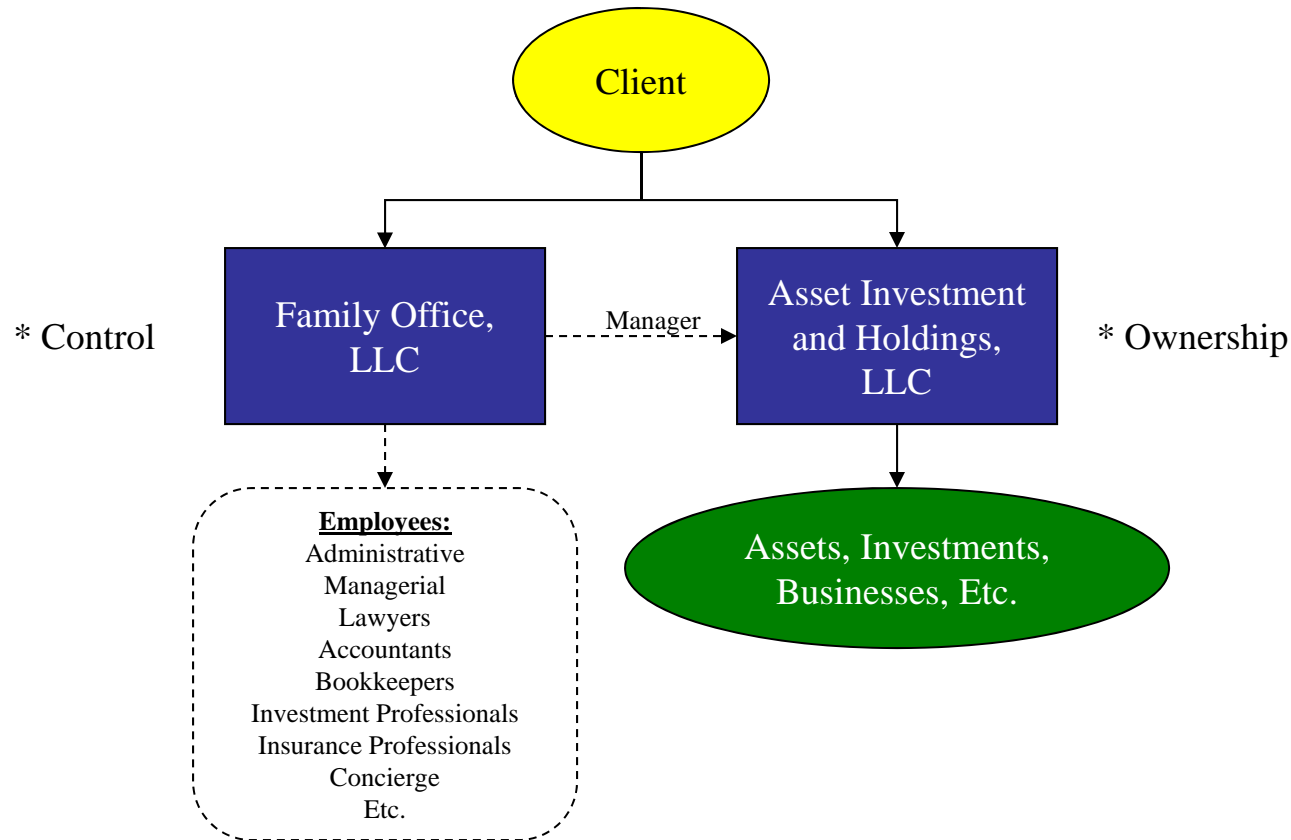


# The Dedicated Single Family Office

- The Single Family Office (“SFO”) is a Family Office Structure in which many if not all of the principal functions of the Family Office are retained internally.
- Outsourcing is used, but primarily as support for in-house Family Office activities.
- An SFO generally involves a separate physical business location or a comprehensive home office facility.
- An SFO typically includes multiple employees including administrative, managerial, and professional.
- An SFO is most common for ultra high net worth clients and those with complex asset/business structures.

# Sample SFO Structure

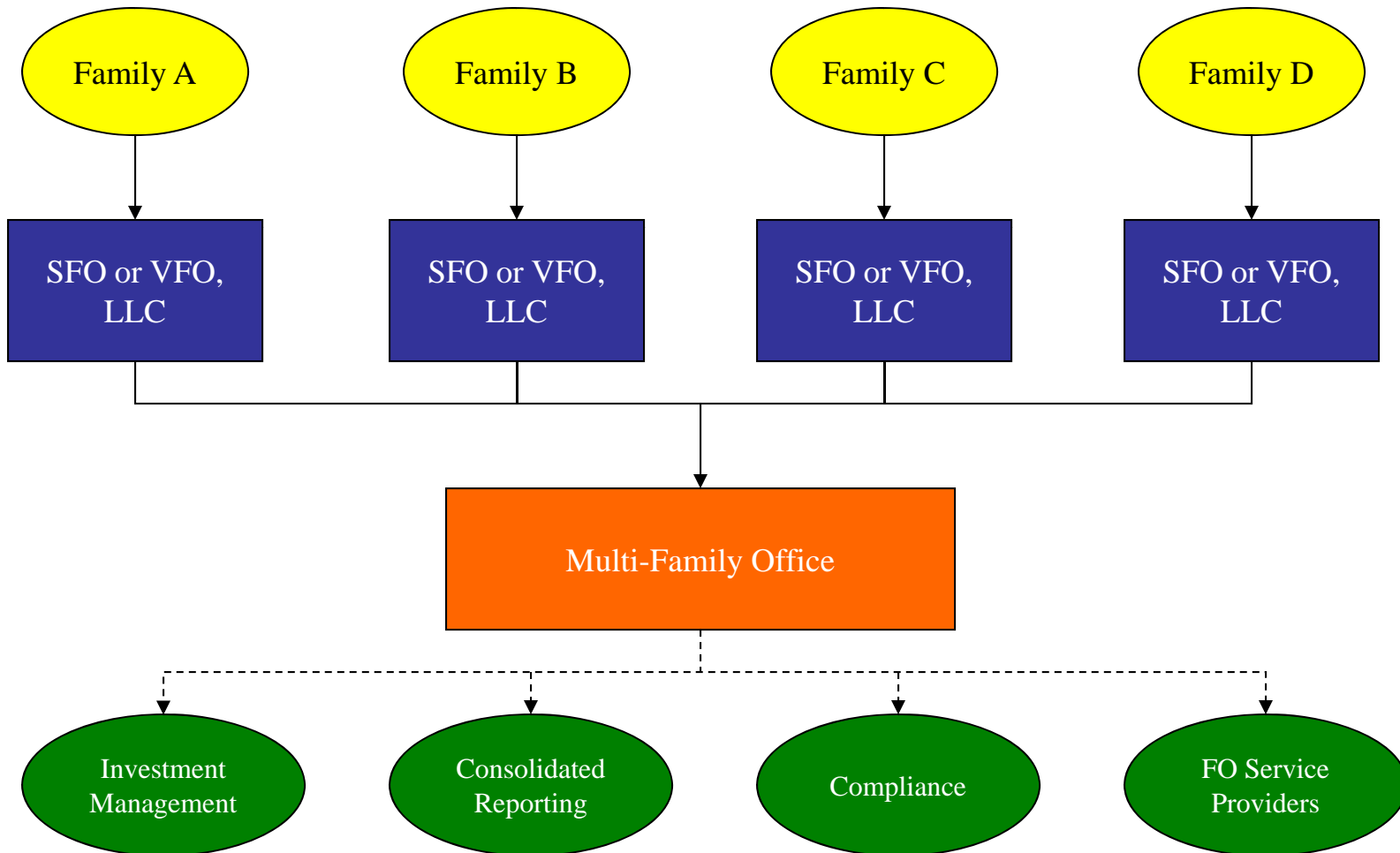
Although an SFO structure will differ based on client facts and circumstances, a sample SFO structure is as follows:



# The Multi-Family Office

The Multi-Family Office (“MFO”) is a platform to combine multiple Family Offices to achieve greater efficiency, investment access and efficacy, and reduce cost structure by aggregating assets and services.

# Sample MFO Structure



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