



FAMILY LLC

Have Your Cake and Eat It Too

There is some wisdom to the old saying “if it sounds too good to be true, it probably is.” However, a notable exception to this is the Family Limited Liability Company (“FLLC”), which can accomplish important estate planning goals, save taxes by leveraging the federal estate and gift tax exemption, and protect family wealth from creditors.

FLLC Overview

- With a FLLC, family members (usually mom and dad) create a LLC and transfer assets to the company in exchange for FLLC membership interests.
- Assets transferred to the FLLC may include marketable securities, real estate, or family business interests; however, the FLLC must have a legitimate business purpose to be respected by the IRS. For this reason, it is better to fund the FLLC with a diverse mix of assets rather than only marketable securities.
- Gifts of FLLC membership interests can be made all at once or annually over an extended period.
- The FLLC operating agreement typically names the founding members (or one of them) as managers to oversee the FLLC’s affairs and imposes certain restrictions on members.

FLLC Advantages

- **Control and Management of Family Wealth.** A FLLC allows older generations to keep control of family wealth even after gifting membership interests to younger generations by restricting the ability of FLLC members to transfer membership interests outside the family, force distributions from the company, or liquidate their membership interests. This can help accomplish important family estate planning goals and facilitate the smooth transition of family business interests.
- **Leverage of Federal Estate and Gift Tax Exemption.** A FLLC membership interest is typically considered to be worth less than its pro-rata share of company assets for federal estate and gift tax purposes due to the restrictions associated with it. Such valuation discounts allow a FLLC member to leverage his or her federal estate and gift tax exemption when gifting a portion of his or her membership interest as compared to making gifts of the underlying FLLC assets. For example:
 - Mom and dad form a FLLC and transfer \$10,000,000 of property to the company and each subsequently gift a 10% membership interest to an irrevocable trust.
 - Although a 10% member’s pro rata share of the company assets is \$1,000,000, because the member has no control over company affairs and it is unlikely that a third-party buyer would be interested in purchasing a 10% membership interest, the gift might be discounted by as much as 35% and valued at \$650,000 instead of \$1,000,000.
 - After applying discounts, each gift only uses \$650,000 of federal gift tax exemption.
 - Thus, the FLLC enables mom and dad to remove \$2,000,000 from their combined estates using only \$1,300,000 of federal estate and gift tax exemption. The value of this leverage increases as the value of the FLLC assets appreciate.
 - Discounts may also apply to any FLLC interest owned by mom and dad at the time of death such that the FLLC also leverages the estate and gift tax exemption on post-death transfers.
- **Asset Protection.** FLLC members are protected from debts and liabilities associated with the FLLC. The FLLC can also protect the company and its assets from a member’s creditors (including a divorcing spouse) when the membership interests are properly held.