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Tax Payer Victory Provides Insight and Roadmap to Family Limited Liability Company Strategy

Usually when you open any of the trade journals you see nothing but gloomy news on the use of the Family Limited Liability Company (FLLC) and its sister strategy Family Limited Partnerships (FLP). The FLLC is a powerful concept that allows a family to do sophisticated estate, income tax, and asset protection planning. If used properly, it allows the family to transfer wealth at a discounted value to family members, while simultaneously shifting income to lower tax rates, and improve their protection as it relates to creditors.

Why Are Advisors Hesitant to Recommend?

Naturally, the IRS is aggressively attacking the FLLC/FLP concept on many fronts. With the IRS's aggressive posture, and the increase in the estate tax exemptions, many professionals have been hesitant to recommend this concept to their clients. However, a recent taxpayer victory in the use of the concept has provided a roadmap to advisors and their clients on how to use this strategy.

Mirowski v. Commissioner: A Roadmap

In this case the creator of the FLLC was an 80-year-old mother of three. She was the widow of the doctor who invented the heart defibrillator implant (the Pacemaker). In 1992 she made a trust for each of her children. She gifted a portion of the interests in her patent rights to those trusts. In 2001, a month before his death, she created a single member LLC and made several substantial transfers to it. She then gifted 16% in the LLC to each of the three trusts, retaining 52% interest in her name. She died unexpectedly four days later.

After the estate tax return was filed, the IRS claimed a $14 Million dollar deficiency in estate taxes. The IRS argued that it was includable under Section 2036(a). The family argued the Section 2038 exception for includability "due to adequate consideration" for non-monetary reasons. The Tax court ruled for the family that nothing was includable.

What Can We Learn From the Mirowski Case That We Can Use to Help Our Clients?

First, the family had significant Non Tax reasons to form the FLLC. These included: (1) joint management of the family's assets by her daughters and grandchildren; (2) maintenance of the family's assets in a single investment pool through the FLLC to maximize investment opportunities; and (3) ensuring all daughters treated equally at death. Second, Mom retained no powers or interests with regards to the LLC units transferred to her daughters. Third, there was a long, supportive, and well-documented history that the family worked together and discussed business together as a family.

If you know of any family that we can talk to regarding this strategy, please let us know. If you want a copy of the case, send us an email and we can forward you a copy. As always, thanks for your referrals and support.