CHAPTER 83

Planning with Wyoming LLCs

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Clients who desire a simple and effective strategy to protect their assets from future lawsuits, and to get discounts in value for estate and gift tax purposes should consider incorporating Wyoming Limited Liability Companies into their planning.

Limited Liability Companies are not all created equally. Some states have excellent statutes that provide clients with good asset protection and good discounts for estate and gift tax purposes. Other states have less-effective statutes. You will want your attorney to compare the various state laws to find the state that offers you and your assets the most protection with the least red tape and administration headaches.

In 1977, the State of Wyoming invented the Limited Liability Company in the United States. It gave us another choice for a business entity. Wyoming's legislature blended the best features of a corporation with the best features of a partnership, and called this new entity a Limited Liability Company (LLC). It was five years before other states caught on and began to copy the Wyoming statute. Over the next 20 years, all of the other states and the District of Columbia enacted LLC statutes.

The word "Close" conveys the notion that this new business entity is perfect for a small closely held family business or venture, such as a family investment company or a family real estate company. Compared to the other available choices of business entity, such as the Family Limited Partnership, the Wyoming Close LLC is by design much simpler to set up and administer. When the Wyoming Close LLC statutes are compared with the LLC statutes of other states, it is deemed one of the best in the country for maximum 1) creditor protection, 2) discounting of the value of assets in the LLC, and 3) low fees and administration of the LLC.

Wyoming is tax-friendly to individuals and business entities. Wyoming has no inheritance tax or gift tax. It has no state income tax, inventory tax, use tax, intangibles tax, or ad valorem property tax. Nor does it have a franchise or excise tax (many states do). The Wyoming Close LLC is a flow-through entity like a partnership and Subchapter S Corporation, so it is not taxed at the business entity level.

The Wyoming Close LLC is a known quantity, whereas other planning strategies that may provide similar benefits, such as an offshore asset protection trust, possess certain inherent levels of risk. For example, the offshore asset protection trust requires a connection with the offshore country, such as having a trustee who resides in that country, and the assets are subject to the laws of a foreign jurisdiction.

The Wyoming Close LLC can be coupled with many other tried and tested estate planning strategies to enhance the long-term benefits to a family, such as making gifts or selling units of the LLC at discounted values (see below).

Residents of any state can establish a Wyoming Close LLC. Minimum contacts must be made with the state by having a Registered Agent appointed to represent the LLC in the state of Wyoming. The Registered Agent can be any individual who resides in Wyoming, or it can be a corporation with an office in Wyoming.

FIRST CONSIDER THE FIVE TIERS OF ASSET PROTECTION PLANNING

1. Take advantage of existing laws to protect some of your assets through the use of life insurance, annuities, retirement accounts, and, where appropriate, Tenancy by the Entireties property.
2. Increase your professional liability insurance and/or your umbrella coverage.
3. Domestic Asset Protection Plans (Level I): Form an LLC, such as the Wyoming Close LLC, to protect the assets in the LLC.
4. Domestic Asset Protection Plans (Level II): Form an LLC to protect assets in the LLC *plus* an Asset Protection Trust, such as the Wyoming Asset Protection Trust, to protect the distributed income from the LLC.
5. Offshore Asset Protection Plans.

ASSET PROTECTION FROM INSIDE LAWSUITS

Example of an Inside Lawsuit: Mom and Dad are retired and live off Social Security and the income from a jointly owned rental house. Included in Mom and Dad's $1 million estate is the rental house worth $70,000. They get $350 a month rental income. It's a nice supplement to their Social Security income. There's a fire! A tenant dies in the fire. Whom do you think the victim's family sues? The owners of the rental house, of course. Who are the owners? Mom and Dad. There is a dispute over who's at fault, so a jury has to decide. If the victim's family wins the lawsuit, and if Mom and Dad's liability insurance is not enough to cover the judgment awarded by the jury, most of Mom and Dad's assets can be seized to satisfy the judgment.

How a Wyoming Close LLC would have protected Mom and Dad's assets from seizure, if an LLC had owned the rental house: This lawsuit against Mom and Dad is known as an inside lawsuit. It's a lawsuit resulting from an accident involving an asset inside the LLC. If the victim's family obtains a judgment against the owner of the rental house, the LLC is the owner — not Mom and Dad. Thus, only the asset owned by the owner (i.e., the rental house) is subject to seizure. Mom and Dad's other assets are not subject to seizure.

Thus, the LLC serves to isolate "hot" assets (real estate, for example) from "cool" assets (stocks, bonds and cash, for example). If a hot asset is inside an LLC and the LLC is sued, cool assets are protected from the lawsuit.

ASSET PROTECTION FROM OUTSIDE LAWSUITS

Example of an Outside Lawsuit: Dad is in an automobile accident. He accidently ran a stop sign. However, a teenage passenger in the other car is now paralyzed from the neck down and will spend the rest of her life in a wheelchair. There is not a dispute about who is at fault. Dad is at fault. It is only a matter of whether Dad's liability insurance will cover the damages. If not, the injured victim will be able to obtain a judgment against Dad. Most of Dad's assets can be seized by the victim to satisfy the judgment she obtains against Dad.

How a Wyoming Close LLC would have protected Dad's assets from seizure, if brokerage accounts, savings accounts, etc. had been owned by an LLC: This lawsuit against Dad is known as an outside lawsuit. It's a lawsuit resulting from an accident outside the LLC.

The law in Wyoming provides that the sole remedy of a judgment creditor is to obtain a Charging Order. This is a court order that charges the managers of the LLC with the duty to pay any income that is being distributed to Dad to his judgment creditor, rather than to Dad. If the judgment creditor actually asks for and obtains the Charging Order, she may only receive the distributions from the LLC to Dad if the manager of the LLC decides to make any distributions. The manager may decide to make no distributions in any given year. Some practitioners feel the judgment creditor still may have to pay income tax on the undistributed income. The reality of this structure is that most judgment creditors will go back to the negotiating table and try to settle within the insurance limits.

FAMILY & BUSINESS REASONS TO FORM AN LLC

There are many reasons to create an LLC beyond creditor protection and discounting of assets for estate planning, however. Just a few of the reasons follow:

1. **Promoting Family Harmony.** The Wyoming Close LLC promotes family harmony by permitting children and/or grandchildren to participate in management of the family wealth as Members of the LLC. However, only Managers of the LLC control the LLC. Thus, although the children and grandchildren are involved as Members, they have no vote. The LLC promotes knowledge and communication about family wealth among all family members who are Members of the LLC.

2. **Management & Control.** The Wyoming Close LLC permits family members to consolidate fractional interests in assets and to provide consolidated management of the assets. The Managers of the LLC control the assets of the LLC. For example, a parcel of real estate owned jointly by parents and children as tenants-in-common so that each owns an undivided interest in the parcel, can be contributed to the LLC to consolidate ownership and to name one or more Members as the Managers of the LLC.

3. **Protecting Family Wealth.** The Wyoming Close LLC protects family wealth by restricting the right of a non-member to acquire an interest in the LLC or in the assets of the LLC. The LLC also provides protection to family wealth by preventing the transfer of a membership interest as a result of a failed marriage. The assets owned by the LLC are protected from future judgment creditors of the Members of the LLC.

4. **Dispute Resolution.** The Wyoming Close LLC provides an orderly buy-sell arrangement between and among the Members of the LLC and their families without fractionalizing assets of the LLC. In addition, the LLC insures that any disputes regarding family wealth owned by the LLC will be resolved privately by mediation or arbitration rather than publicly through the court system.

ESTATE PLANNING REASONS TO FORM AN LLC

1. **Valuation Issues/Discounts.** The Operating Agreement of the Wyoming Close LLC contains the maximum restrictions allowed by Wyoming statutes on Members of the LLC. These restrictions include restrictions on the transfers of membership interests and restrictions on liquidation of membership interests. These are "friendly" restrictions for family members because the approval of the family Member-Managers is all that is required. But a buyer outside the family will not be willing to pay 100% of the fair market value of the assets owned by the LLC because of the restrictions. A professional business appraiser will determine the fair market value of the membership interest, and this will usually result in discounts of 25% to 50%, or greater.

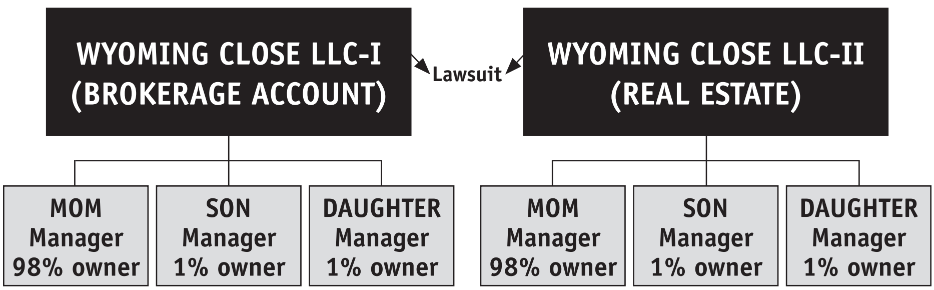
2. **How the LLC Affects Estate Taxes.** At death, the assets in the Wyoming Close LLC are no longer owned by the decedent. The decedent only owned a membership interest in the LLC. During lifetime, the value of the assets owned by the LLC is not reflected on a financial statement. Only the membership interest in the LLC is listed. At death, however, the value of the membership interest must be determined by a qualified business appraiser for estate tax purposes. The discounted value of the LLC membership interest is reported on IRS Form 706 Federal Estate Tax Return, which results in less estate tax owed and increases the amount passing to beneficiaries.

3. **How the LLC Affects Gift Taxes.** In terms of gifting, again, the assets in the Wyoming Close LLC are no longer owned individually; the individual only owns a membership interest in the LLC. If lifetime gifts are made to other family members, trusts for family members, or charities, the value of the membership

interest must be determined by a qualified business appraiser. The discounted value of the LLC membership interest is reported on IRS Form 709 Federal Gift Tax Return, which results in less gift tax owed and increases the amount passing to beneficiaries. More value can be gifted to beneficiaries using only the annual gift tax exclusion amount, currently $12,000 ($13,000 in 2009).

4. **How the LLC Affects Income Taxes.** The Wyoming Close LLC is usually taxed as a partnership, a flow-through entity. In other words, the LLC does not pay income tax. Rather, each member of the LLC must pay his or her pro rata share of the income tax. If a gifting program to children and grandchildren is implemented so that they receive membership interests in the LLC, each child or grandchild who owns an interest in the LLC must pay income tax on his or her pro rata share of the taxable income produced by the LLC. The gift of LLC interests to the children or grandchildren can shift income taxes to family members who are in lower income tax brackets, without fractionalizing the income-producing asset.

Illustration of Using Two LLCs (One to protect a Brokerage Account, and one to protect Real Estate)



ACTION STEPS

1. Mom creates and funds LLC-I with her brokerage account.
2. Mom creates and funds LLC-II with real estate (other than her personal residence).
3. Mom creates a Revocable Living Trust (RLT) to avoid probate.
4. Mom transfers her ownership interests in her Investments LLC to her RLT.
5. Mom transfers her ownership interests in her Real Estate LLC to her RLT.
6. Mom then funds her RLT with her other assets. The RLT avoids probate.

* In some cases LLC units are funded after death by TOD (Transfer on Death) provision in order to avoid a state's Franchise & Excise Tax.

SUMMARY OF BENEFITS

- Mom's brokerage account and real estate are now protected from seizure by a judgment creditor. Thus, if Mom has an automobile accident and the other party sues her and obtains a large judgment, the judgment creditor will not be able to take Mom's brokerage account and real estate away from her.
- Mom's assets are not subject to the jurisdiction of the Probate Court. In other words her estate will avoid Probate.
- Mom's brokerage account will be valued less in the LLC than if it had not been in the LLC. It is expected that a discount will be available for estate and gift tax purposes in the range of 25% - 40%.
- Mom's real estate will be valued less in the LLC than if it had not been in the LLC. It is expected that a discount will be available for estate and gift tax purposes in the range of 40% - 55%.
- Family harmony results from the children being involved in the ownership of Mom's assets.
- Mom may later pass management responsibility to kids.
- Mom and the children are illustrated as all being Managers (optional).

Cecil Smith has law offices in Memphis and Nashville, Tennessee. Carol Gonnella has offices in Jackson, Wyoming. Cecil and Carol limit their practices to estate planning, asset protection planning, charitable planning, business planning, and post mortem settlement of trusts and estates.