



WILLS, TRUSTS & ESTATES:

— PLAIN AND SIMPLE

Lifetime Gifting of Discounted Interests – Using FLPs & LLCs

By: Patricia C. Marcin, Esq. © 2013

Making gifts is one of the most simple, useful estate planning techniques. The annual gift tax exclusion in 2013 allows you to gift up to \$14,000 (or up to \$28,000 combined with your spouse) to an unlimited number of donees each year without any gift and/or estate tax consequences. If you currently hold

interests in partnerships (including family limited partnerships – “FLPs”, where only family members are partners) or limited liability companies (“LLCs”), each of you and your spouse could make gifts each year of such interests to your children, their spouses and your grandchildren (or trusts for their benefit).



The value of each gift of an interest in the FLP or LLC for gift tax purposes will be significantly less than the value of a gift of the property if it had not been in a partnership or LLC. This is because a gift of a partnership interest or LLC interest will qualify for substantial valuation discounts (which can range from 25% to 40%) for minority interest and lack of marketability. These discounts reflect the fact that the interests you would transfer to another person would give that person no control over the management of the FLP or LLC and that there is no readily available market in which to sell the interest. If you currently hold assets individually, they can usually be transferred to an FLP or LLC easily.

To illustrate, let's say that you and your spouse make gifts to each of your 2 children and their spouses each year. Assume you and your spouse own an LLC that holds commercial real property worth \$1 million. You would like to gift as much of the LLC as possible this year without any gift or estate tax consequences, so that your gifts fall within your annual exclusion amounts (\$28,000 together to each person). To keep the gifts to your children and their spouses within the annual exclusion amount, you can gift a total to them combined of \$112,000 in value (\$28,000 per person x 4). Assuming that a 35% valuation discount is appropriate, think of the \$1 million of real estate in the LLC as being valued at \$650,000, so that you and your spouse can gift about 17% of the LLC to your children and their spouses combined this year ($\$650,000 \times 17.23\% = \$112,000$). If the real estate were not held in an LLC so that discounts did not apply, you could gift a total of only about 11% of the LLC to them this year ($\$1,000,000 \times 11.2\% = \$112,000$). As you can see, the use of the LLC with discounts allows you to give away more “real” value each year and remain within the annual exclusion amounts.



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Note that one disadvantage of making gifts during your lifetime is that the donee will receive a basis in the gifted asset equal

to your income tax basis in the asset at the time of the gift. If, however, assets are not transferred until your death, the donee of the asset would receive a "step-up" in income tax basis equal to the fair market value of the asset at the time of your death. But with combined Federal and State estate tax brackets totaling over 50%, as opposed to about 20% to 30% for total combined Federal and New York State capital gains tax brackets, making such a gift still may make sense.

As a result of the valuation discounts, a partnership or LLC can be used as a vehicle to allow you to transfer significant wealth to your children and grandchildren, estate and gift tax free, while allowing you to retain control over the property and give you liability protection. As with all estate planning techniques, it is important to "run the numbers" and discuss proposed strategies with your advisors.

If there is a trusts or estates topic that you would like to know more about, please feel free to email me at pmarcin@farrellfritz.com with your suggestion and I will do my best to cover it in a future column.

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