ESTATE PLANNING FOR FAMILY OWNED BUSINESSES AND LLCs

JEFFREY P. HART, ESQ.
KAREN L. McKENNA, ESQ.
Tarlow, Breed, Hart, Murphy & Rodgers, P.C., Boston

CHAPTER 1 .... **1**
§ 1.1 INTRODUCTION 1
§ 1.2 THE HYPOTHETICAL 1
§ 1.3 INTAKE MEETING 1
§ 1.4 ASSESSMENT OF THE CLIENT'S NEEDS AND GOALS 3
§ 1.5 CREATING THE ESTATE PLAN 6
§ 1.5.1 WILLS 6
§ 1.5.2 DURABLE POWERS OF ATTORNEY, HEALTH CARE PROXIES AND LIVING WILLS 6
§ 1.5.3 REVOCABLE TRUSTS 7
§ 1.5.4 LLCs 9
§ 1.6 CLIENT FOLLOW-UP 12

Chapter 1

§ 1.1 INTRODUCTION

Family businesses are estimated to comprise as much as ninety percent of the businesses in the United States. Such businesses are often the primary source of income for the owners and their families. While owners often groom one or more of their children to assume management and control of the family business, it has been estimated that two thirds of all family owned businesses fail upon transition to the next generation. In some cases, the owner has failed to consider or properly plan for the impact of estate taxes, possibly requiring the next generation to either sell the business in order to pay the taxes or to sign on with Uncle Sam for a long term payout arrangement under §6166. In other cases, the owner has failed to establish a plan for an orderly succession of the business to the chosen family members, possibly creating a family crisis.

This chapter gives an overview of some of the issues that should be considered when drafting estate plans for family business owners. In the format of a hypothetical estate plan, it reviews business succession considerations and briefly covers some issues surrounding choice of entity and how the type of entity chosen can impact the estate planning process.

§ 1.2 THE HYPOTHETICAL

John Smith is the sole owner of a successful residential real estate management business, SmithCo, that he operates through a series of nominee realty trusts in Massachusetts. John also owns, in his own name, two pieces of commercial real estate which are used in the operation of the real estate business. John has four adult children, two of whom are actively involved in SmithCo and two of whom are not involved, and according to John, are not interested in becoming involved, in SmithCo in the future.

In addition to SmithCo and the commercial real estate, John separately owns two pieces of residential real estate in his own name and one piece of residential real estate jointly with his wife, Mary. The Smiths have substantial liquid assets all of which are held in John's name. Mary owns very little property in herself.

John has contacted you because he is getting ready to retire and is concerned about ensuring the continued, successful operation of SmithCo. John has also expressed interest in asset protection planning to avoid personal liability exposure after retirement.

§ 1.3 INTAKE MEETING

Prior to the intake meeting, you provide John with a Client Questionnaire which gathers certain information about the John, his family, and his assets. John completes the Questionnaire with

the information as shown in Exhibit 1-A. You also ask John to provide you with a copy of his and Mary's existing estate planning documents.

In reviewing the Questionnaire, you note that SmithCo is John's most significant asset. You also note that John owns all of the commercial in nominee realty trusts, most of the residential real estate in his own name, and that Mary owns very little property in her own name.

John and Mary's existing estate planning documents consist of reciprocal Wills, a so-called Standby Trust for the children, and Durable Powers of Attorney for each of them, all signed in 1986. The Wills leave everything to the surviving spouse, otherwise in trust for the children in equal shares with each child receiving his or her trust share outright at age twenty-one.

At the intake meeting, it will be important to gather more specific information about John and Mary's family and goals. Questions might include:

1. Do any of John and Mary's children have issues (e.g. a disability, a drug dependency, or a pending divorce) that should be taken into consideration when deciding how that child should be provided for in John and Mary's estate plan.

2. Do John and Mary have any grandchildren, If so, is it important to John and Mary to provide for their grandchildren as well as for their children?

3. Will all children be treated equally?

4. How do John and Mary feel about their children receiving assets outright? Are they concerned about providing asset protection for their children's inheritances to protect their family wealth against a future divorce or from other creditors?

5. Do they have any charitable inclinations?

6. Have John and Mary or either of them made any lifetime gifts? Have they filed any gift tax returns?

7. What is John and Mary's primary objective in establishing the estate plan (e.g. providing for the surviving spouse, tax avoidance, preserving assets for children and grandchildren)?

8. What are their plans for the ownership of the family business?

9. What is John's current income from SmithCo?

10. Should Mary have any role in the management of SmithCo after John's death?

11. Which of the children are currently active in SmithCo?

12. Does John want his children who actively participate in SmithCo to retain management and control of SmithCo after his death?

13. Would John consider transferring any of his interest in SmithCo to his children during his lifetime?

John and Mary's current estate plan will cause all of John's interest in SmithCo, as well as his other assets, to vest in Mary on his death, if Mary survives him. If Mary does not survive John, the four children will become equal owners of SmithCo and the rest of the family assets after John's death. This plan will have unintended estate tax consequences and does not appropriately address the business succession issues about which John is concerned.

§ 1.4 ASSESSMENT OF THE CLIENT'S NEEDS AND GOALS

After meeting with John and Mary, you learn the following:

- Two of John and May's children, Jason and Martha, are actively involved in SmithCo. Martha is currently serving as SmithCo's general manager and Jason is involved in assessing new properties for acquisition. Jason, while very knowledgeable about SmithCo's business, does not, in John's opinion, have the organizational or management skills necessary to manage SmithCo's day-to-day operations. Martha, on the other hand, has proven to be a competent and effective manager.

- John and Mary's other children, John, Jr. and Jeremy, have never shown any interest in SmithCo. While all of the children have worked at SmithCo at some point, John Jr. and Jeremy were not very enthusiastic workers and left SmithCo as soon as other opportunities presented themselves.

- John, Jr., Martha and Jeremy are all currently married and have good relationships with their spouses. John, Jr. has three children. Jeremy has twins. Martha does not have children and is unlikely to have any in the future. Jason is divorced and is supporting his daughter, who lives with his ex-wife. Jason lives in one of SmithCo's properties with his girlfriend who John and Mary do not like and who they believe has a drug problem.

- John and Mary would like to provide for their grandchildren if they can; however they are more concerned with providing for their children.

- In 2001, shortly after Jeremy's twins were born, John and Mary established so called section 529 plans for each of their five grandchildren and funded each plan with $100,000. John and Mary each filed a gift tax return reporting the gifts and electing the option to treat the gifts as made over a five year period. John and Mary have made no other gifts and do not intend to make any future gifts.

> **Practice Note**
> Section 529 Plans can be "frontloaded" with up to five times the annual exclusion amount without any gift tax consequences. IRC § 529(c)(2)(B). However, if this frontloading option is selected, you must file a gift tax return in order to alert the IRS of your election to treat the gift as made in five equal installments over five

years. The election to treat the gift as made over a five year period effectively uses up the donor's annual exclusion (as to the beneficiary) for the year of the gift and each of the four succeeding years.

- John and Mary are currently dependent on the income they receive from SmithCo. If John were to predecease Mary, he would like to ensure that she continue to have access to an equivalent amount of income. Mary does not want to be involved in the business after John's death.

- John is primarily concerned with setting up a plan for the successful continuation of SmithCo after his retirement and beyond. He wants Martha to continue to act as general manager and to have decision making authority after his death. John wants Jason to remain involved in the business but does not want him to have decision making authority unless Martha is unavailable. While he is willing to give away part of SmithCo now, John wishes to retain control for as long as possible.

- John believes that if John, Jr. and Jeremy were also involved in the business, much friction would result.

- To the extent possible, John would like to treat his children equally with respect to any inheritances they receive from the estate, but wants to ensure that the business passes to Martha and Jason. .

- John would also like all of his children to benefit from any sale of the commercial real estate.

- Mary is most concerned with treating her children fairly and is very sensitive to the fact that her children and grandchildren are all in different financial situations. Mary also wants to ensure that any benefit Jason receives from the estate will not end up in the hands of his girlfriend or ex-wife.

- Neither John nor Mary has any interest in making charitable contributions either during their lifetimes or at their death.

- John and Mary both agree that saving taxes should be a priority in their estate planning. They want to establish as simple a plan as possible that will accomplish their estate and business planning goals. They are not interested in long term trusts to benefit their grandchildren.

Based on your discussions with John and Mary, you conclude that their current plan does not accomplish their goals. While their current plan does avoid all estate taxes on the death of the first of them to die (by virtue of the entire estate passing outright to the surviving spouse and thus qualifying for the unlimited marital deduction under § 2056(a) of the Internal Revenue Code), it does not fully utilize their exemptions from Massachusetts and federal estate tax and will likely result in a higher estate tax liability on the death of the survivor. In addition, their current plan does not address any of John's concerns about passing control of SmithCo to Martha.

You also point out to John and Mary that John's ownership of all of SmithCo and most of the real estate creates a great disparity in the value of John's estate and the value of Mary's estate. While some of the tax problems inherent in John and Mary's existing estate plan could be cured with properly timed and executed disclaimers, if Mary were to predecease John even a disclaimer by John of his entire interest in Mary's estate would not enable Mary's estate tax exemptions to be fully utilized.

> **Practice Note**
> If John died before his new estate plan was implemented, his current Will "overfunds" the marital deduction and wastes his federal and Massachusetts estate tax exemptions. In this event, Mary could disclaim a portion of the property left outright to her under John's Will thereby causing the property to pass equally to John, Jr., Martha, Jason and Jeremy, as if John had predeceased Mary. Treas. Reg. § 20.2056(d)-2; IRC § 2518. Since the disclaimed property would not pass to Mary, it would not be part of her taxable estate and both John's and Mary's Massachusetts and federal exemptions could be used.

In order to address all of John and Mary's concerns while still accomplishing their tax avoidance and business succession goals, you propose the following:

1. That a new estate plan be prepared consisting of so called "pour over" Wills (Wills that leave the residue to the Trustees of a revocable trust established by the testator), revocable marital deduction / credit shelter trusts, durable powers of attorney, health care proxies and living wills. The provisions directing the disposition of SmithCo and the other Smith family assets will be contained in the revocable trusts. Any assets that are part of the revocable trusts will not be subject to probate in Massachusetts and the trusts themselves will not become public records.

2. That John and Mary establish a Delaware LLC to be owned 50% by John's revocable trust and 50% by Mary's revocable trust. The LLC will own two Massachusetts single member LLCs which will acquire title to the two commercial properties.

3. That John convert SmithCo from a series of nominee realty trusts to a (master) Delaware LLC which will be the parent company (i.e., sole member) of five single member Massachusetts LLCs which will acquire title to the various residential income properties owned and managed by SmithCo. John will be the manager of the LLCs. The master LLC will contain the terms and conditions by which Martha will assume control of SmithCo. (Consideration should also be given to establishing a Delaware "Series LLC" to save on Massachusetts filing fees.)

4. That John and Mary take steps to ensure that both spouse separately own an amount of property at least equal to the federal estate tax exemption amount.

§ 1.5 CREATING THE ESTATE PLAN

§ 1.5.1 WILLS

John's pour over Will is attached as Exhibit 1-B. Mary's Will is a mirror image of John's. John's Will directs the disposition of John's tangible personal property (Article 2), the payment of his debts, expenses and taxes (Article 3), and the "pour over" of his remaining assets to his revocable trust (Article 3). It is important to keep in mind that John and Mary's revocable trusts must be executed prior to the execution of their Wills in order for the pour over clause to be effective.

Article 4 appoints Mary as John's Executor and Martha as alternate Executor if Mary is unable to serve. Article 4 also instructs that the Executor be named temporary Executor if necessary. Since it can be time consuming for an Executor to be appointed, and since no one other than John's Executor is authorized to operate his businesses, to pay his bills or to deal with his assets, an expedited appointment of a temporary Executor could be important. M.G.L. c. 192, § 13. Note that because it is intended that the ownership of the new LLCs will be transferred to the new Family Trusts as soon as the they are executed, it will be the successor Trustees who will take control of the business on John's death, making it unlikely that an Executor, temporary or permanent, will be called on to operate the family business.]

John's Will also contains provisions granting his Executor certain powers to deal with the other property in his estate (Article 5) and to operate any businesses that may become part of his estate (Article 6). In addition, Article 6 releases the Executor from liability for any losses associated with the operation of the business provided the Executor acted in good faith. Assuming the business interests are assigned to John's Family Trust, the business provisions contained in his Will will likely not be utilized.

Articles 7, 8 and 9 address various administrative issues and direct what will happen if both John and Mary die simultaneously.

§ 1.5.2 DURABLE POWERS OF ATTORNEY, HEALTH CARE PROXIES AND LIVING WILLS

While John and Mary each have existing Durable Powers of Attorney, these documents were executed 17 years ago, so they are quite "stale." If it became necessary for Mary to act under John's existing Power of Attorney, the person or institution to whom she presented it might refuse to accept it as a valid delegation of power. It is therefore prudent to re-execute Durable Powers of Attorney periodically, even if the power holders will remain the same. The same is true for Health Care Proxies, which appoint another person as the declarant's health care agent to make medical decisions when the declarant is legally incapacitated. Living Wills, which set forth the declarant's intention that no heroic measures be undertaken in the event that of certain terminal and irreversible illnesses, have no legal effect in Massachusetts; however a Living Will could be relied on by the declarant's health care agent as an indicator of the declarant's intention should the agent ever be faced with that issue. Living Wills may also be recognized in other states where the declarant may be resident from time to time.

John's Durable Power of Attorney, Health Care Proxy and Living Will are attached as Exhibits 1-C, 1-D and 1-E respectively. John has named an alternate (Martha) under both his Durable Power of Attorney and his Health Care Proxy in case Mary is unable to act when necessary.

§ 1.5.3 REVOCABLE TRUSTS

John and Mary currently have only a so-called Standby Trust to hold property for minor children, if both John and Mary died during their minorities. The disposition of all of their property is currently determined by their Wills, by beneficiary designations (for their life insurance policies), and by operation of law (e.g. for their jointly owned property). While the current arrangement does treat John and Mary's children equally upon the death of the survivor of them, it does not accomplish any other of their estate or business planning goals.

The Code provides spouses with a marital deduction which allows an individual to leave an unlimited amount of property to a spouse free of federal estate tax. IRC § 2056(a). Massachusetts also provides for an unlimited marital deduction through incorporation of the provisions of the Internal Revenue Code. Property left to a spouse, whether outright or in trust, will be taxed in the estate of the surviving spouse if it is not consumed by the surviving spouse before his or her death. IRC § 2044 provides for the inclusion of "qualified terminable interest property" in the estate of the surviving spouse (discussed below).

The federal estate tax exemption is $1,000,000 for 2003 and is incrementally increasing to $3,500,000 by 2009. In 2010, the federal estate tax is repealed but (under current law) will return in 2011 with a $1,000,000 exemption. The Massachusetts exemption from estate tax is $700,000 for 2003 and incrementally increasing to $1,000,000 in 2005, where it will remain. The disparity in the amount of the federal and Massachusetts exemptions creates some tax planning complications which are addressed below. The principal estate tax problem with John and Mary's current plan is the failure to fully utilize both of their available estate tax exemptions because all of the first decedent's property is left to the surviving spouse.

In the past, it was possible to defer all estate tax until the death of the surviving spouse by causing the decedent's estate to be divided into two separate trusts: (1) a so called "credit shelter" or "by-pass" trust (referred to as the "Residue Trust" in the John Smith 2003 Family Trust, attached as Exhibit 1-F) which would receive property equal in value to the decedent's remaining exemption from the estate tax and which could be managed for the benefit of the decedent's spouse, children, or others; and (2) a "marital trust" which would receive the rest of the decedent's property and would be held for the sole benefit of the decedent's surviving spouse. The tax formula for creating the maximum marital deduction is most often either a pecuniary marital clause or a fractional share marital clause (an explanation of these clauses is beyond the scope of this chapter).

In June of 2001, the Economic Growth and Tax Relief Reconciliation Act, or EGTRRA increased the federal estate tax exemption (and scheduled the eventual repeal of the estate tax) as mentioned above. EGTRRA also included a phase-out of the federal credit for state death taxes paid. Prior to EGTRRA; Massachusetts had a "sponge tax" which required a decedent's estate to pay a Massachusetts estate tax in an amount equal (in most cases) to the federal credit for state death taxes paid as calculated on the decedent's federal estate tax return. In response to the

reduction in the state estate tax credit brought about by EGTRRA, Massachusetts adopted a new estate tax law which "decouples" its estate tax from the federal estate tax for decedents dying after December 31, 2002. The new Massachusetts estate tax law increases the Massachusetts estate tax by ignoring the phase-out of the federal state death tax credit and fixing the law (and consequently the estate tax paid to Massachusetts) as it stood in the year 2000.

Under the new Massachusetts law the Massachusetts estate tax exemption will be less than the federal exemption until 2011, assuming the federal law remains unchanged. This means that estates that generate no federal estate tax may be required to file a Massachusetts estate tax return and may owe Massachusetts estate tax. The differential between the Massachusetts and federal exemptions will increase as the federal exemption increases over the next several years, and Massachusetts estates will see a corresponding increase in the state estate tax due as follows:

Year	Massachusetts Exemption	Federal Exemption	Massachusetts Tax Payable on Differential
2003	$700,000	$1,000,000	$33,200
2004	$850,000	$1,500,000	$64,400
2005	$950,000	$1,500,000	$64,400
2006	$1,000,000	$2,000,000	$99,600
2007	$1,000,000	$2,000,000	$99,600
2008	$1,000,000	$2,000,000	$99,600
2009	$1,000,000	$3,500,000	$229,200
2010	$1,000,000	no estate tax	unlimited
2011	$1,000,000	$1,000,000	$0

Prior to the new Massachusetts law, most estate plans for married individuals were drafted to defer all estate taxes (federal and state) until the death of the surviving spouse through use of the marital deduction formula clause as discussed above. Under the new Massachusetts law, many of these existing estate plans, without amendment, will generate a Massachusetts estate tax on the death of the first spouse to die as shown above.

Total deferment of estate tax can still be achieved if the credit shelter trust were funded only with the amount of the Massachusetts exemption from estate tax, but this would cause the remainder of the decedent's assets to qualify for the marital deduction and would thus waste the decedent's federal exemption up to the amount of the difference. In order to defer all estate tax on the death of the first spouse to die and still fully utilize the decedent's federal exemption, it is now necessary to cause the difference to be held in a separate trust for the surviving spouse which qualifies as "qualified terminable interest property" under IRC § 2056(b)(7) for federal estate tax purposes. This will allow the executor to elect to treat the differential trust as marital deduction property for Massachusetts estate tax purposes but *not* for federal estate tax purposes.

By having both John and Mary execute revocable trusts that employ the marital deduction planning described above, it will be possible for them to meet their goal of avoiding and deferring taxes to the extent possible. John's revocable trust, entitled the "John Smith 2003 Family Trust," is attached as Exhibit 1-F. Mary's revocable trust is a mirror image of John's.

In addition to providing the instructions for the overall disposition of their assets, the Family Trusts will also address the business succession issues raised by John. Placing the commercial real estate in LLCs and converting SmithCo to an LLC will result in limited liability, allow the use of valuation discounts in the estate taxable values of the business and real estate, and will address control issues by naming Martha to succeed John as the Manager of the various LLCs. However, the Family Trusts must still address the asset allocation among the four children to ensure that SmithCo ends up in Martha's and Jason's hands while treating all four children equally. To accomplish this goal, the trusts will identify SmithCo as a Family Business Asset and direct that, after the death of John and Mary, all Family Business Assets should first be allocated to and among the shares of the Trust established for Martha and Jason. To the extent that allocation of the Family Business Assets to Martha's and Jason's shares of the Trust would cause those shares to be larger than their siblings shares, only then will Family Business Assets be allocated to John, Jr.'s and Jeremy's shares. The trust provisions (and the LLC Operating Agreement) will grant Martha and Jason the option to purchase the Family Business Assets allocated to their brothers' trust shares. To ensure that the business succession plan can be readily implemented, the payment terms should be affordable to Martha and Jason. It is contemplated that Martha and Jason will borrow against the business to make these purchases.

The commercial real estate LLCs are not identified as Family Business Assets because John and Mary indicated that all of their children should benefit from these properties. It is likely that John, Jr. and Jeremy will actually receive a higher percentage of these LLCs due to the fact that Martha's and Jason's shares were funded fist with SmithCo interests. However, since Martha will succeed John as Manager of the commercial real estate LLCs, Martha will control the management of these properties as well.

§ 1.5.4 LLCs

The use of limited liability companies allow the family to solve at least three of the family's objectives. The first is the transfer of control of SmithCo and the commercial real estate to Martha. The second is the reduction of John and Mary's liability exposure with regard to SmithCo and the commercial real estate. The third is the reduction of the taxable value of their estate through the availability of valuation discounts.

Control of SmithCo has been partially addressed by requiring SmithCo to be allocated to Martha's and Jason's shares of the Family Trust. However, simply allocating SmithCo to Martha's and Jason's shares would not ensure that Martha will retain control of SmithCo's operations - in fact, if that was all that was done, control of SmithCo would be shared equally between John and Martha. In addition, since SmithCo is currently a sole proprietorship, it would be a difficult task to identify and allocate the various assets comprising the business after the proprietor's death. Finally, a sole proprietorship does not offer any personal protection from liabilities arising in the course of SmithCo's business. Therefore, John should convert SmithCo to a business form that will give him some protection from liability and which will also give him some control over management succession.

John has several choices when considering which business entity form SmithCo should take: C Corporation; S Corporation; general or limited partnership; or limited liability company. Each has different characteristics which are summarized in the table below.

	C Corporation	S Corporation	General or Limited Partnership	Limited Liability Company
Taxation:	Income is taxed to corporation at corporate rates. Compensation paid to owners is taxed to owners and deductible to the corporation.	Income is taxed to owners at their personal income tax rates regardless of whether it is distributed to them or retained by the corporation. MA imposes an additional excise tax on large S corps and on financial institutions.	Income is taxed to owners at their personal income tax rates regardless of whether it is distributed to them or retained by partnership. Local taxation of personal property may be higher. Special allocations of profits and losses are possible.	Income is taxed to owners at their personal income tax rates regardless of whether it is distributed to them or retained by company. Local taxation of personal property may be higher. Special allocations of profits & losses are possible
Capital Structure:	Requires only one shareholder and may have an unlimited number of shareholders. Capital may be comprised of any form of equity, including common stock, preferred stock and convertible debt.	Requires only one shareholder but cannot have more than 75 shareholders. Corporations, partnerships, LLCs, non-resident aliens and most trusts cannot be shareholders. May only have one class of stock.	Must have at least two partners and may have an unlimited number of partners. There are no capital or debt restrictions.	Requires only one member and may have an unlimited number of members. There are no capital or debt restrictions.
Limited Liability:	Owners are not liable for corporation obligations.	Owners are not liable for corporation obligations.	General Partners have joint and several liability for partnership obligations. Limited Partners are not liable for partnership obligations provided they do not actively participate in management of partnership.	Members are not liable for company obligations.

	C Corporation	S Corporation	General or Limited Partnership	Limited Liability Company
Formation:	Requires filing of Articles of Organization with Secretary of State, adoption of by-laws and issuance of stock certificates. Filing fee is $275.	Requires filing of Articles of Organization with Secretary of State, adoption of by-laws and issuance of stock certificates. Filing fee is $275.	Limited Partnerships must file a Certificate of Limited Partnership with Secretary of State. Filing fee is $200. There is no filing requirement for General Partnerships.	Requires filing a Certificate of Organization with Secretary of State. Filing fee is $500.
Exit Strategies	Capital gain recognized on sale of stock. On sale of corporation, corporation incurs 34% tax and shareholder incurs 20% tax on liquidating distribution.	Capital gain recognized on sale of stock. On sale of corporation, shareholder incurs 20% tax on liquidating distribution.	Capital gain recognized on sale of partnership interest except in limited circumstances. On sale of partnership, partners incur tax on liquidating distribution.	Capital gain recognized on sale of LLC interest except in limited circumstances. On sale of LLC, members incur tax on liquidating distribution.

The choice of entity is rarely obvious as there are competing benefits and drawbacks from each. As the Smith family business is a real estate operation, an LLC (taxed as a partnership) would provide the family with the ability to specially allocate profits, losses and cash flow, to obtain tax basis from a member's share of the mortgage indebtedness, and the flexibility to easily create special rules for the leadership and governance of the company. Currently, all 50 states and the District of Columbia have adopted LLC statutes. The Massachusetts Limited Liability Company Act is contained in M.G.L. c. 156C and was recently amended to allow single member LLCs. The Massachusetts Act contains provisions which may cause undesirable gift tax results under the special valuation rules of Chapter 14 of the Internal Revenue Code. IRC § 2704(b) directs that any restrictions in an LLC Agreement that limit the company's ability to liquidate and that are more restrictive than would otherwise be imposed under state law will be disregarded for valuation purposes. Such restrictions in an LLC Agreement allow valuation discounts on the value of gifts given to family members and on the LLC interests includible in the business owner's taxable estate. In order to obtain these discounts, it is often advisable to organize the LLC in a state, e.g., Delaware or Rhode Island, whose LLC Act contains default provisions that favor discounted valuations. The SmithCo, LLC Agreement is attached at <u>Exhibit 1-G</u> and is organized under Delaware law.

John's concerns about limiting his liability exposure with regard to his commercial real estate operations and his decision to install Martha as the manager of the company can also be addressed by transferring these properties to one or more LLCs. Using separate, single member LLC's to hold each parcel of real estate will insulate each LLC from liabilities arising with regard to another property. A parent company LLC as the owner of a series of single member LLCs will provide a convenient way to coordinate management of the commercial real estate and will also facilitate gifting should John decide to embark on a lifetime gifting program.

> **Practice Note**
> Creditors bringing suit against an LLC member cannot obtain ownership of the member's LLC interest, but will be restricted to obtaining a "charging order" against the interest. The creditor will have no right to liquidate the interest and will only be entitled to distributions otherwise distributable to the original member (which management may be unlikely to approve). Despite the fact that the creditor may receive no current distributions from the LLC, the creditor will be subject to income taxation on the income allocable to the interest for which the charging order was obtained.

Note that the new Delaware LLCs will have to register as a foreign LLCs doing business in Massachusetts and pay any associated fees. M.G.L. c. 156C, § 48. The following information must be contained the foreign LLCs' Certificates of Organization that are filed with the Massachusetts Secretary of State:

- the name of the foreign LLC, and, if different, the name under which it proposes to do business in Massachusetts;
- the jurisdiction of the LLC's organization;
- the general character of the business the LLC proposes to carry on;
- the address of the LLC's principal office;
- The name and address of the LLC's Managers;
- the address of the LLC's principal office in Massachusetts
- the name and address of the LLC's Massachusetts resident agent for service of process
- The proposes date, if any, of the LLC's dissolution; and
- The name of any other person in addition to the Manager who is authorized to execute legal documents on behalf of the LLC.

§ 1.6 CLIENT FOLLOW-UP

Since most estate and business planning documents are complicated, it is often advisable (although time consuming) to include in the clients' document agenda a management summary of the major provisions of the plan and an illustrative flow chart. This would permit the clients to periodically refamiliarize themselves with the overall plan. A sample flow chart of John and

Mary's plan is included as Exhibit 1-I. It is important to alert the client that review of these materials is not a substitute for reading the documents themselves.

With the dramatic changes in the federal estate tax laws (and the corresponding changes in state estate tax laws) in recent years, the fluctuations in the stock market, and the fact that John and Mary have now adopted a fairly complex business succession plan, it would be advisable to schedule a follow up meeting with the Smiths at the end of one year in order ensure that the plan remains up to date and that they are fully versed in the plan details. If there have been changes in their circumstances or their overall goals (e.g. they would like to incorporate generation-skipping planning or charitable planning into the plan), or the tax laws have changed or been eliminated (e.g. the sunset provision of the estate tax has been repealed) the meeting could lead to amending their existing documents or creating a whole new plan.