



ESTATE PLANNING USING BUSINESS ENTITIES

Estate Management, Creditor Protection, and Tax Planning

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1. USING BUSINESS ENTITIES

1.1 Legal “Person”: Business entities — such as corporations, partnerships, limited-liability companies, limited-liability partnerships, and business trusts — came into being so that the business itself would be recognized separately from its owners. Most states recognize business entities as a “person”, which can enter into contracts, conduct business, sue and be sued, and generally act as a separate entity.¹

1.2 Limited Liability of Company Owners: The owners of a corporation, limited-liability company, business trust, or limited-liability partnership are not personally liable for — and the owners assets are not subject to claims for — the company’s debts (unless, of course, they agree to assume that liability). The same is true for the limited partners of a limited partnership, but it is not true for the general partner(s).

1.3 Protection of Company Assets: Business entities are usually not liable for the obligations of the owners, but if an owner with a controlling interest is sued, the creditor who wins a judgment can sometimes take control of the company and liquidate assets to satisfy the judgment. Under Nevada law, that is not legally possible with a limited partnership or a limited-liability company. Nevada law provides that a judgment creditor can get a “charging order”, which is essentially a lien on the income payable from the owner’s interest, but the judgment creditor cannot force a liquidation of the company because the charging order is the exclusive remedy provided under Nevada law.² Because of the public policies involved, it is possible that a single-member limited-liability company may not be protected from liquidation, but there has been no ruling by the Nevada Supreme Court on this issue.

2. ESTATE REDUCTION THROUGH GIFT GIFTING

2.1 Generally: If the net value of your estate³ exceeds the “applicable exclusion” for estate tax purposes (\$5,450,000 in 2016)⁴, your estate is potentially subject to the federal gift or estate tax. Once the exclusion has been exceeded, the tax rate is 40%.⁵

(a) Under current law, each donor can give any number of recipients \$14,000 during each calendar year without requiring a federal gift tax return or requiring the payment of any tax. There are additional exceptions.⁶ A gift that exceeds the annual exclusion amount is a “taxable gift”, and the lifetime applicable exclusion⁴ is diminished. Once the annual exclusion and lifetime applicable exclusion have been used up, a gift tax of 40% must be paid.

(b) The federal gift tax and the federal estate tax are designed to appear as the same transfer tax, but there are some important differences. First, there is no annual exclusion for the estate tax. Second, once the applicable exclusion has been used up, the gift tax is calculated on the *net* transfer actually received by the recipient and paid from assets other than the gift itself, whereas the estate tax is paid on the entire transfer *including* the tax. Thus, the gift tax is *tax exclusive*, and the estate tax is *tax inclusive*. Assuming that the taxpayer’s estate is large enough to trigger an estate tax, paying the gift tax is cheaper than paying the estate tax. Consider the following illustration:

(1) After all applicable exclusions and deductions have been used up, a taxable gift of \$1 million in the 40% tax bracket would generate a gift tax of \$400,000. Of the total gift and tax of \$1,400,000, the recipients end up with \$1,000,000 (71%) and the IRS ends up with \$400,000 (29%).

(2) Assume, instead, that the \$1,400,00 remains in the taxable estate at death. Since the 40% tax applies to the total amount, the tax is \$560,000 (40%), leaving \$840,000 (60%) to pass to beneficiaries.

(3) In both examples, the combination of the transfer and the tax totals \$1,400,000, but the lifetime gift results in the beneficiaries receiving \$160,000 more.

2.2 Selecting Assets to Give Away: Most people would rather not give their assets away, but many are willing to do so if it will save federal estate taxes. There are many types of gifts, but some are more effective than others at reducing the value of an estate for federal estate tax purposes.

(a) Giving away **cash** is very simple and straightforward, but it is usually one of the least effective methods of reducing one's estate. A cash gift eliminates liquid cash and its potential earnings.

(b) Giving away **appreciating property** is a more effective use of the applicable exclusion, since it covers the current value of the gift, the potential earnings, plus the potential appreciation. This typically includes real property, marketable securities, and closely-held businesses.

(c) Giving away **undivided interests** in property can be even more effective, since the value of a fractional share of an asset has a fair market value (and a gift tax value) of less than its pro rata value. *For example, suppose you own forty acres of land that has been appraised at \$200,000. If you give away ten acres, the gift has a pro rata value of \$50,000. If you instead give away a 1/4 undivided interest in the forty acres, the fractional interest would be harder to sell and qualifies for a reduced valuation to reflect its lack of marketability. Perhaps the value of the gift would be worth \$40,000 or \$45,000, depending on the property and all market conditions.*

(d) Giving away **minority interests** in a valuable family business is one of the most effective ways that gifts can be maximized. A family business could be a corporation or a general partnership, but in most cases—unless another business entity already exists⁷—a **family limited partnership (“FLP”)** or a **limited-liability company (“LLC”)** is recommended. Limited partners (as to limited partnerships) and non-manager members (as to manager-managed limited-liability companies) have no vote, potentially reducing the fair market value of those interests. *Using the example in paragraph 2.2(c):*

(1) *If you give away 10 acres out of 40, the value may be \$50,000 (assuming the property can be subdivided and that the resulting parcels are comparable);*

(2) *If you give away a 1/4th undivided interest in the 40 acres, perhaps the market value of the gift might be around \$40,000; but*

(3) *If you place the property into a limited partnership or LLC and give away 1/4th of the profit interests, those nonvoting interests might be valued at \$25,000-35,000 for gift-tax purposes.⁸*

(e) When the fair market value of an asset that is being given away is less than its pro rata value, that market value is often expressed in terms of a “discounted value”. With respect to business interests, appraisers often discuss a “lack of marketability discount” and a “minority discount” (for lack of management control over the business). These “discounted” values are not discounts from fair market value, but reflect discounts from the pro rata value of the assets of the business in order to arrive at a fair market value that



truly reflects the market price for the business interest that is being transferred by lifetime gift or by a post-death transfer. For purposes of the federal gift tax, each interest being given is considered separately, but for purposes of the federal estate tax, all of the decedent's interests are considered together. Because of this, the controlling owner of a business is entitled to valuation discounts for lifetime gifts of minority interests, but his or her estate would not be entitled to the same discounts at death. This is another reason that makes lifetime gifts effective to reduce the taxable estate.

2.3 Gifting Methods: Once you have decided *what* to give away, you must decide *how*.

(a) The simplest form of a gift is an *outright* gift to the recipient. This is appropriate for those who are capable of managing the property being given and the income it produces.

(b) For recipients who are under the age of 18 or age 21, the gift might be made to a custodian under the Uniform Act on Transfers to Minors. This is often referred to as a *custodial* gift. The custodian holds title to the property being given and manages it until the recipient reaches age 18 (or 21 if age 21 is explicitly specified when the custodial gift is originally made).

(c) A gift to an *irrevocable trust* can be made for anyone, but it is particularly appropriate:

(1) To keep family assets—such as a farm or other business—consolidated while allowing multiple beneficiaries and even multiple generations to benefit from those assets;

(2) To provide for the professional or independent management of assets for minors and others who need or want such management;

(3) To protect the trust's assets from the threat of lawsuits, divorces, and other claims against the beneficiaries; and/or

(4) To reduce or eliminate federal estate taxes upon the beneficiaries' deaths even though they had the benefit from the income and use of the assets.

3. FOCUSING ON LLCs and LIMITED PARTNERSHIPS

3.1 Limited Partnerships and LLC's vs. Other Entities: The gift-tax consequences of minority interests can be accomplished through corporations and general partnerships, and those entities may be appropriate for your situation.

(a) There are significant tax disadvantages that can occur when real estate is owned by a **corporation**, particularly at the time the corporation is liquidated. Some of those disadvantages can be diminished if the corporation elects to be taxed as an "S corporation", but it is possible to inadvertently lose S corporation status. If the corporation did not originally make an S corporation election, it can do so later, but that will not usually cure all of the tax problems that come from putting appreciating property into a corporation.

(b) A **limited-liability company** (LLC) or **limited partnership** (LP) may be more attractive than a corporation. While clients usually make gifts to their children and grandchildren, they do not want to give their offspring the powers of a general partner, and the younger generations do not really want the attendant liabilities either. For both parties, the limited partner's and LLC member's lack of personal liability and lack of voting control are an appropriate combination.

3.2 Creating a Limited Partnership: A limited partnership is formed in Nevada (and in other states that have adopted the Revised Uniform Limited Partnership Act) by having two or more partners execute a partnership agreement and a certificate of limited partnership. The certificate of limited partnership is filed with the Secretary of State.

(a) Initially, the creators of the partnership make a capital contribution to the partnership, ideally consisting of appreciating assets. The partnership gives them back partnership interests, usually in the form of a percentage interest in the profits and losses.

(b) The partnership interests are issued in two classes: general partnership interests and limited partnership interests. The general partners have the control and the limited partners are entitled to income distributions. If there are several general partners, they will often select a “managing general partner” or a “president” to handle the partnership affairs during the ordinary course of business.

3.3 Creating a Limited-Liability Partnership: A limited-liability company (“LLC”) is formed by having all of its “members” sign a document entitled “Articles of Organization”, which is filed with the Nevada Secretary of State. The members also sign an “operating agreement”, which is similar to a partnership agreement, but this does not need to be filed. The company’s business is directed and controlled by elected “managers”, which may or may not be members of the company.

(a) A Nevada LLC with two or more members is, by default, a partnership for federal income tax purposes,⁹ and it is essentially equivalent to a limited partnership without a general partner.

(b) All members of an LLC have limited liability, just like the shareholders of a corporation and the limited partners of a limited partnership.

(c) The Nevada statute states that members and managers of a limited-liability company are not proper parties in a lawsuit against the company, and it also provides that, as a general rule, a creditor or claimant against a member may obtain an income interest in the membership interest rather than the right to force a liquidation of the company.

3.4 The Price of Doing It Right: The company (whether a limited partnership or a limited-liability company) must be established and maintained as a separate legal entity, and certain formalities must be observed.

(a) No owner can have an interest in any specific business asset. Any attempt to allocate assets to specific owners will usually frustrate the intent of the entire transaction.

(b) All transactions relating to the business’ property must be done through the business. The property cannot be treated as though it belonged outright to the partners/members or to any one partner/member. If a partner/member wants to use business property for personal use, the partner/member would normally be required to pay a reasonable rent for the use of the property. For this reason, it is usually inappropriate to put the family residence into a limited partnership or limited-liability company, even if all partners/members are family members.

(c) All transactions must be done in the correct order. While it is possible to gift assets to a child and then have the child contribute the assets to the partnership or LLC, the gift is not a gift of a limited partnership or LLC interest, and the gift-tax discount may not be as significant.

(d) There will be additional accounting and legal fees over the years. Federal tax

returns must be filed for the partnership or LLC, and each partner/member must report his or her share of business income, whether or not such income was actually distributed.¹⁰ State reports have to be filed annually, and a resident agent must be appointed to accept notices and summonses in the event of litigation.

(e) If gifts of limited partnership or LLC interests are to be “discounted” for gift-tax purposes, it is imperative to engage a qualified business appraiser to give an appraisal of the partnership or LLC interests that are being transferred. Not every appraiser is qualified to give an appraisal that justifies the discounts for lack of voting control and lack of marketability. In many cases, the appraiser will have to give an appraisal of the underlying assets, and appraisal of the partnership or LLC as a whole, and then an appraisal of the interests being transferred. It is not uncommon for qualified appraisers to charge a minimum of \$3,500 to \$10,000 or more for the appraisal, depending on the nature and extent of the business’ assets. In the long run, however, this puts you in a better position to avert, deter, or defend against an IRS challenge to the valuation of the gifts. Under the IRS rules, the taxpayer has the burden of proof (i.e., “guilty until you prove yourself innocent”), and a proper appraisal is good preventative medicine against an attack by the IRS virus.

(f) The IRS is likely to challenge the “discounted value” for a gift of a LLC or partnership interest if the company is formed just prior to death or while the donor is incompetent or if the assets require no management (such as cash and marketable securities). It will reduce the chance for an IRS dispute if steps are taken to make sure that:

- (1) The creation and existence of the company can be justified for nontax reasons;
- (2) The company is operated consistent with (a) its governing documents; (b) applicable state law; (c) general business formalities; and (d) generally accepted accounting principles;
- (3) The valuation (appraisal) of the entity is done by an independent valuation firm or appraiser who has experience and credentials for business valuation, and the written valuation report is based on this specific company’s facts and circumstances;
- (4) Assets of the company are (a) properly titled; (b) not commingled with personal assets; and (c) not used for personal purposes without the payment of rent;
- (5) Distributions and allocations are made consistent with each member’s or partner’s interest in the company, with no favoritism to the older generation and no payment of personal expenses with company funds; and
- (6) The general partners or managers actively run the business, not merely collect income from investments.

4. SELLING LP AND LLC INTERESTS

4.1 Transfers by Sale: Just as the value of a nonvoting limited partnership (“LP”) or limited-liability company (“LLC”) interest can be “discounted” for gift tax purposes, it can be discounted for purposes of a sale. So, one benefit of a sale of LP or LLC interests is the fact that the intended beneficiaries can purchase interests at a discount. If the asset is appreciating, another benefit is the shifting of appreciation to the purchaser. If the purchaser (child, grandchild, trust) cannot

afford to pay cash for the LP or LLC interest, the seller can accept a promissory note. While that promissory note will remain an asset in the seller's taxable estate, it is a "frozen" (if interest only is paid) or a diminishing (if principal payments are made), rather than an appreciating asset.

4.2 Gift and Sale to Irrevocable Grantor Trust: Selling "discounted" LP/LLC interests to an irrevocable grantor trust is an estate-reducing technique that can be used when making gifts is inappropriate or undesirable (such as where a person has used up their applicable exclusion for gift and estate tax). Using the trust provides more control and flexibility.

(a) A "grantor trust" is a trust whose income is taxed to the trust's settlor (or grantor). If the settlor has certain powers over the trust (such as the right to change the trust's beneficiaries) or if the trustee is a "related or subordinate party" with respect to the settlor, federal income tax law will require the settlor to pay the income tax for the trust's income, even when someone else actually receives that income. A revocable trust is an example of a grantor trust, but the assets of a revocable trust are includible in your taxable estate. An irrevocable trust that is designed to exclude assets from the settlor's taxable estate for federal estate tax purposes can be intentionally designed to be a grantor trust for income tax purposes. The irrevocable grantor trust can be designed as a generation-skipping trust (which includes "dynasty" trusts).

(b) Irrevocable grantor trusts¹¹ can be used to purchase assets from a grantor without triggering a capital gain on the sale. If the grantor trust purchases nonvoting LP/LLC interests, they can be purchased using the appraised value that includes a "discount" for lack of marketability and lack of voting control.

(c) Perhaps a hypothetical example will make this easier to understand.

(1) Suppose you have an apartment complex that you bought for \$600,000, and it is currently appraised for \$1 million. You are concerned that if you keep the property, it will continue to appreciate in your estate, which will increase your overall estate tax.

(2) You form a limited-liability company (LLC) and you are initially the 100% owner. Under state law, the recipient of any transferred interest is a nonvoting "transferee" rather than a voting member, so even you decide that you can give away 80% of the total membership "units" without losing control because the 20% you retain represents the only voting interest. The next step is to transfer the LLC membership units representing the 80% interest in the company to the irrevocable grantor trust.

(A) As discussed above, the lack of marketability discount and the lack of voting control discount will apply to determine the fair market value of the units being transferred. For ease of calculation, let us assume that the business appraiser determines that your nonvoting LLC interests are entitled to a 40% valuation discount. While a 1% interest in the LLC has a pro rata value of \$10,000 (1% of \$1 million), because of the valuation discounts, each 1% interest has a fair market value of \$6,000, which would make the purchase of 80% equal to \$480,000.

(B) For a number of reasons that are too complex to mention here, it is not advisable to have a trust that has no assets purchase all of the units. A common rule of thumb is to fund the trust with a gift of about 10% of the total amount the trust will own. If you want to have the trust own \$480,000 of LLC interests, a gift of \$48,000 would be recommended. You

would have to use \$48,000 of your applicable exclusion for gift and estate taxes (or pay the gift tax if the applicable exclusion was previously exhausted). It is assumed that the \$480,000 will be paid by a promissory note that bears adequate interest and is secured by the LLC interest being sold.

4.3 Consequences of the Gift and Sale Technique: In this example, 80% of a \$1 million appreciating asset has been transferred in the form of a \$48,000 cash gift and a \$480,000 sale. Because of the valuation discount, 40% of the value of the pro rata value (\$320,000 in this example) of the transferred interest in the company is neither treated as a gift nor treated as part of the purchase price. If the effective estate tax rate for your estate is 40%, this factor alone would save \$128,000 in federal estate taxes. If you consider post-transfer appreciation, the savings could be much greater.

(a) During your lifetime, the LLC would divide its income between you (20%) and the irrevocable grantor trust (80%), and the grantor trust would take that income and make payments to you on its purchase-money promissory note. So long as the trust maintains its grantor trust status, all income received by the trust will be taxable to you. In essence, you will be paying the income tax for the trust's beneficiaries, but this is not a gift because it is a legal obligation imposed by the tax code. When the trust ceases to be a grantor trust,¹² the tax on the trust's income will be paid by either the trust (if accumulated) or by the trust's beneficiaries (if distributed).

(b) Upon your death, the 20% of the LLC that you still own, together with the unpaid balance on the purchase-money promissory note from the irrevocable grantor trust, will be included in your estate for federal tax purposes. On the other hand, the income and appreciation on the 80% interest, in addition to the amount of the valuation discount, will be excluded from your taxable estate.

(c) Please note that it is imperative that the terms of the promissory note be honored. If the trust's cash flow will be insufficient to pay the interest on the promissory, this may not be the appropriate estate planning technique.

5. POTENTIAL PROBLEMS

5.1 Non-Tax Purpose: The IRS and the courts will disregard a business entity (such as an FLP or LLC) for federal estate tax purposes if the sole purpose of the entity was to reduce the estate tax.¹³ In order for the business entity to be recognized, there must be one or more significant non-tax reasons for creating the entity. These purposes might include: centralized management (to avoid waste and imprudent investments); succession planning (which includes structuring the business to avoid family disputes and limiting transferability to avoid interference from "outsiders"); preservation of property; consolidating and reducing asset-management and asset-investment expenses; and protection against the claims of creditors.

5.2 Indirect Gifts: If assets are put into a business entity and interests in that entity are given away on the same day, the IRS may treat the transaction as a gift of the assets instead as a gift of the business entity interests,¹⁴ resulting in no chance for valuation discounts for gift-tax purposes.¹⁵

5.3 Annual Exclusions: The tax laws permit a donor to give \$14,000 per calendar year without triggering a gift tax, but the law requires that the gift be the gift of a "present interest" in order to qualify for that annual gift tax exclusion. The gift of a business interest may not be considered a present interest gift if the donee has no ability to have any immediate benefits from the gift, such

as the ability to sell the interest or begin receiving income distributions.¹⁶ For most family business entities that do not generate regular income distributions, it is best to assume that a gift of a business interest will not qualify for the annual exclusion.

5.4 Unintended Consequences: Some creative gift-giving techniques can backfire and produce unexpected and undesired results. In recent years, the IRS has successfully challenged valuation discounts when the taxpayer has been sloppy in the setup or implementation of the plan.

(a) Do not try to have your cake and eat it, too. You cannot give away a partnership or LLC interest without giving up the income and other benefits of that interest. If you do, the gift may be ignored by everyone, including potential creditors and the IRS. So, if you give away a 10% share to your children or other beneficiaries, then they are entitled to 10% of the partnership or LLC income. Some have attempted to draw off more income under the guise of taking compensation for management services, but this does not work if the compensation is excessive. If you want the income from a partnership or LLC interest, do not give it away. *Do not give away the tree except to the extent you are willing to give up the fruit.*

(b) Similarly, if you use assets owned by a business entity without paying rent, the business entity may be ignored by everyone, including potential creditors and the IRS. If, for example, you live in a vacation home owned by an LLC without paying fair-market rent, a creditor might be able to persuade a court that the LLC is a sham, and you should be treated as the real owner of the home. The IRS would make the same argument to include all assets of the LLC in your estate for federal estate tax purposes.

(c) Gimmicks to “freeze” or fix the value of your partnership interest at an artificially low value do not work under current tax law. Buy-sell agreements are often used to set the value of a business interest, but unless certain guidelines are met, the IRS is not bound by that agreement. A poor buy-sell agreement can result in a forced sale at an amount that is not even sufficient to pay the federal estate tax.

6. CONCLUSION

6.1 Control: A limited partnership or LLC allows you to reduce your estate without losing control. The general partners or managers are in control of the business, and the limited partners/non-manager members have no vote except to replace general partner(s)/managers under the terms of the partnership or operating agreement.

6.2 Maximizing Gifts: Limited partnership or LLC interests in a family venture are unmarketable and without control, and therefore have little value. Valuation discounts of 25-30% are considered easily justifiable, and even a 45-50% discount may be justified in appropriate circumstances. Of course, a higher valuation discount triggers a higher probability of additional scrutiny by the Internal Revenue Service.

6.3 Sale to An Irrevocable Grantor Trust: Gift giving is not the only estate-reduction strategy that works. A sale of nonvoting LP/LLC interests can be very effective at reducing one’s taxable estate, while at the same time shifting income, income tax, and appreciation to your intended beneficiaries.

6.4 Final Admonition: The overall estate-planning benefits can be significant if lifetime gifts are made using business interests, but it has to be done right in order to work. Do not try to cut corners. Involve qualified professionals to prepare the legal documents, to assist with transferring assets to the entities created, to appraise the property, and to prepare the federal gift tax return (IRS Form 709) when it is due. It is absolutely essential to have complete and accounting records

that are compliant with proper business accounting rules, and a certified public accountant can be an invaluable team member (if not the captain of the team). By doing it right, you are in a better position to accomplish your estate-planning objectives without having to worry about challenges from disgruntled family members or from the IRS.

NOTE: This memo provides general information only and does not contain legal, accounting, or tax advice. For brevity, this memo is oversimplified and should not be relied on for any particular situation. Although this memo may discuss tax issues, this is not a “covered opinion” as defined in Circular 230 issued by the U. S. Treasury Department, and nothing in this memo can be relied upon to avoid any tax penalties.

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NOTES:

¹NRS 0.039 defines “person” to include “any form of business or social organization” and specifically mentions “a corporation, partnership, association, trust or unincorporated organization”.

²NRS 86.401 (as to limited-liability companies) and NRS 88.535 (as to limited partnerships).

³“Estate”, “assets”, and “property” are used interchangeably to refer to everything that you own. For federal estate tax purposes, it does not matter whether your estate passes under your will, under a revocable trust, by beneficiary designation, by right of survivorship, or otherwise.

⁴Internal Revenue Code § 2010(c) provides for an “applicable exclusion”, which is the cumulative amount that can pass free of gift and/or estate tax. The applicable exclusion is \$5,340,000 for 2014, \$5,430,000 for 2015, and \$5,450,000 in 2016. For the applicable exclusion in prior years, see <https://rushforthfirm.info/advintro.html#ae>.

⁵The maximum rate imposed for federal estate tax purposes is currently 40%. For the rates in prior years, see <https://rushforthfirm.info/advintro.html#ae>.

⁶During each calendar year, each taxpayer can exclude certain gifts from the imposition of the gift tax. There is an “annual exclusion” applicable to gifts made to each donee (recipient) during each calendar year. This amount is \$14,000 for gifts in 2013 through 2016 and is subject to cost of living increases. Other exclusions that have no dollar limitation include: (1) tuition you pay directly to the educational institution for someone else; (2) medical expenses you pay directly to the health-care institution for someone else; (3) gifts to your spouse; and (4) gifts to a charitable organization for its use. The “applicable exclusion” that is available for taxable transfers during life and at death will not be affected except as to gifts that exceed these exclusions. Gifts that exceed the annual exclusions and the lifetime “applicable exclusion” will trigger a gift tax.

⁷If another business entity already exists, it may be advisable to make gifts of that entity after converting some of the ownership interests into nonvoting interests if nonvoting interests do not already exist.

⁸The values and “discounts” discussed are for illustration purposes only. There is no exact formula for determining a discount for gift and estate tax valuation. As is discussed in 3.4(e), an appraisal prepared by a qualified appraiser is the best evidence of the value of a partnership interest that is being given away.

⁹Federal tax law allows an LLC to elect (on IRS Form 8832) to be taxed as a corporation under Subchapter C or Subchapter S, but, unless such an election is made, a one-member LLC will be disregarded (i.e. treated as a sole proprietorship) for tax purposes, and a multiple-member LLC will be taxed as a partnership.

¹⁰The partnership agreement can include a provision requiring a minimum distribution to cover tax payments due to the IRS.

¹¹Many irrevocable trusts were not intended to be grantor trusts for income tax purposes, but due to a “defect” in the drafting of the trust instrument, the trust was classified by the IRS as a grantor trust. Because of that, some people refer to an irrevocable trust that is a grantor trust as a “defective grantor trust”, and when that “defect” is intentional, the trust is sometimes called and “intentionally defective grantor trust”. This memo does not use the term “defective” because the grantor trust status is intentional.

¹²For future flexibility, the irrevocable grantor trust is designed so that the grantor trust status can be irrevocably cancelled.

¹³For the IRS’ position, see Letter Rulings 9719006, 9723009, 9725002, and 9730004. See also *Malkin v. Commissioner*, TC Memo 2009-212 (2009).

¹⁴*Helvering v. Hutchings*, 312 U.S. 393 (1941) began the indirect gift concept, and *Robinette v. Helvering*, 318 U.S. 184; 30 AFTR 384 (1943) began the gift-on-formation doctrine. See also *Shepherd v. Commissioner*, 115 TC 376 and Reg. § 25.2511-1(h)(1).

¹⁵*Strangi v. Commissioner*, 115 TC 478; aff’d by 239 F.3d 279 (5th Cir. 2002).

¹⁶See *Hackl v. Commissioner*, 118 T.C. 279, 294 (2002), aff’d 335 F.3d 664 (7th Cir. 2003) and *Price v. Commissioner*, T.C. Memo 2010-2 (January 4, 2010).