Why You Should Flip Out and Over to a Single-Member LLC

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F. Philip Manns, Jr. and Timothy M. Todd, *The Tax Lifecycle of a Single-Member LLC*, 36 **Va. Tax Rev.** 323 (2017).

All professional estate planners are familiar with the family limited partnership (FLP) as a gift and estate tax vehicle to create fractional discounts for federal gift tax purposes and to reduce the decedent's gross estate for federal estate tax purposes. The main thesis of Professors Manns and Todd's piece is that a single-member LLC (SMLLC) is "the ideal initial entity in a gifting strategy." (P. 325.) They contrast the SMLLC with the FLP, which "the literature continues to describe and analyze," despite the fact that "the actual state law entity now is often an MMLLC [multi-member LLC]." (P. 344.) The professors discuss how an SMLLC "can be used to blunt the negative effects" (P. 325) (arguably, more successfully than an FLP) as to Internal Revenue Code sections 2512, 1015, and 2036, in part because of a Tax Court case, *Pierre v. Commissioner*.

In *Pierre*, the Tax Court held that, although an SMLLC may be disregarded under the check-the-box regulations for federal income tax purposes, those regulations do not provide for the LLC to be disregarded for federal gift tax purposes when a donor transfers an ownership interest in an LLC. (P. 344.) Professors Manns and Todd skillfully argue that, based on *Pierre*, a taxpayer can take advantage of the differing treatments of an SMLLC for federal income tax and federal gift tax purposes in the following situations (I do not cover in this jot all that the professors wrote).

First, as to section 2512 concerns about valuing gifts, SMLLCs offer advantages as a "first step in making gifts of entity interests." (P. 349.) At the initial creation of a partnership (as opposed to an SMLLC), wealth disappears because the "aggregate value of those partnership interests almost always is less than the total value of the assets transferred to, and now owned by, the partnership, because minority ownership interests in entities are disadvantaged compared to direct ownership of assets." (Pp. 348-49.) Professors Manns and Todd write that wealth disappearance is "permitted, or rather does not occur, when there is a 'bona fide sale for an adequate and full consideration in money or money's worth.'" (citing sections 2035(d), 2036(a), 2037(a), 2038(a)(1), and 2043(a)) (P. 349.) In transactions with donative intent (such as those among family members), the "bona fide sale" exception can apply "when the purpose for creating the entity is either (1) a business purpose or (2) a legitimate and substantial (or sometimes actual) nontax purpose." (P. 349.) The professors note that a SMLLC created to hold investment assets [prior to making gifts of entity interests] "more easily can fit within the second (legitimate and substantial nontax purpose) prong than an MMLLC can." (P. 349.)

Second, as to section 1015 concerns about a lifetime transfer of property with a built-in loss (which creates an adjusted gain basis and an adjusted loss basis for the donee), the *Pierre* case, per Professors Manns and Todd, makes section 1015 inapplicable as to an SMLLC. (P. 339.) Under *Pierre*, the SMLLC is disregarded when an LLC owner transfers an LLC interest such that, for federal income tax purposes, the owner transfers a proportionate share of LLC assets and not an LLC entity interest. (*Id*.) Accordingly, the value of the proportionate share of the LLC assets does not have a minority interest discount, which would exist if there had been a transfer of an LLC entity interest. Consequently, a taxpayer initially creating an SMLLC never, under section 1015, encounters the complicated situation of a partner having, as to her partnership interest, both an outside basis and an inside basis. (P. 340.)

Third, as to section 2036 concerns about a clawback into the decedent's gross estate of the value of all property transferred previously to the SMLLC, Professors Manns and Todd point to *Estate of Mirowski v. Commissioner*. In that case, the Tax Court did not require that the gross estate include property previously transferred to the SMLLC (which transfers reflected valuation discounts allowed). The professors summarized the *Mirowski* case's "roadmap for securing valuation discounts when an SMLLC is the starting vehicle for gifting entity interests": (1) create the SMLLC for "legitimate, actual, significant non tax reasons," (2) require in the operating agreement capital accounts under the applicable Treasury Regulations, (3) deny in the operating agreement the SMLLC creator from having the discretion to determine distribution amounts, and (4) avoid the negating factors from Estate of Purdue v. Commissioner (such as taxpayer on both sides of the transaction, taxpayer's dependence on partnership distributions, and taxpayer's failure to transfer property to the partnership, among other factors). (Pp. 368-69.)

Professors Manns and Todd's piece is thought-provoking. The literature focuses on the FLP as a federal gift and estate tax vehicle. The professors have successfully posited the SMLLC as "the ideal initial entity in a gifting strategy" (P. 369) to preserve valuation discounts and to preclude gross estate inclusion of property initially transferred to the SMLLC.

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