



## The Legacy LLC™

*Increasing Family Wealth and Philanthropy while Preserving Investment Flexibility & Liquidity*

### **Overview**

We coined the term "Legacy LLC™" to convey common goals high net worth investors wish to pursue to preserve wealth and the family legacy, through investing and philanthropic giving across generations. The Legacy LLC is our modern, more flexible, and more tax efficient option vs. various trust structures that exist.

***Tax deductions and/or capital gains tax avoidance is allowed under the Tax Code on contributions of LLC interests to charity, even with the donor's ongoing control and management of the LLC, under certain circumstances.***

### **Summary**

In a typical structure, a taxpayer capitalizes an LLC with cash or appreciated assets and subsequently contributes membership interests of the LLC to an existing qualified charity. This qualifies for a tax deduction against ordinary income or tax exemption on the asset's sale, in an amount based on a qualified appraisal. The taxpayer continues as the LLC member with specific provisions that allocate the rights of the taxpayer and the charity within the LLC, with a focus on balancing the need for management flexibility and consistent with various IRS pronouncements and case law (e.g. Notice 2003-40).

Subsequently, a separate family trust, whose beneficiaries are designated by the taxpayer, may acquire the charity's LLC interests in order to (1) ensure that the charity actually receives the benefit of the contribution, rather than running the risk that no distributions are made before the LLC becomes defunct; (2) to 'freeze' the value of the family's holdings for tax purposes and (3) to provide for future tax free distributions of trust principal to the beneficiaries.

### **Background**

This customized strategy is a powerful solution to maximize family wealth and ongoing income while reducing taxes and philanthropic giving.

It is suitable for business owners and high-income W-2 employees and/ or investors in the elimination of capital gains tax.

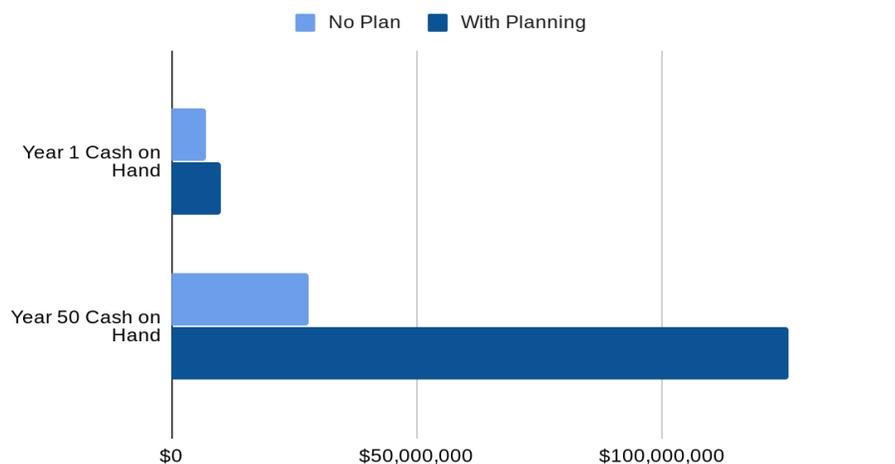


It is unique in reducing the traditional resistance of charitable giving due to – (1) Taxpayer loss of control over the money (2) Taxpayer loss of control over the disposition of the money (3) Taxpayer loss of investment control and (4) Taxpayer loss of access to use of the funds for financial planning purposes. In addition, family liquidity is optimized through ongoing reasonable salary or tax-free distributions to trust beneficiaries.

### **Benefits**

- Highly tax-leveraged philanthropic giving, including ordinary income tax deduction / or avoidance of capital gains.
- Potential annual tax-free distributions to family trust beneficiaries and reasonable salaries for services performed on an ongoing basis.
- Long term wealth increase of ~ 5x greater with the strategy vs. doing nothing is available for tax free distributions or ongoing investing. (E.g. \$10mm today equals \$126 million versus \$28 million in year 50).

Value of \$10,000,000



### **How It Works**

1. *LLC Formation.* Cash or (appreciated) assets are contributed to an LLC with taxpayer remaining as managing member long term (potentially for life).



2. *Donation of LLC Interests.* Donation of up to 99% of LLC membership interests donated to existing third-party charity for a current income tax deduction (up to 50% of AGI) and/or capital gains tax avoidance<sup>1</sup>.
3. *Formation of Defective Beneficiary Irrevocable Trust.* To ensure the legitimacy of the charitable strategy, i.e. that the charity ultimately receives value in the amount claimed for the tax benefit, rather than running the LLC 'into the ground' without ever charity ever receiving the donation<sup>2</sup>, a new trust is formed at the direction of taxpayer and purchases the LLC interests at fair market value. Taxpayer's family
4. *Ongoing Management.* Assets continue to be managed within the LLC on a potentially tax favored basis of trust principal to beneficiaries until b. the death of the donor, whereupon the assets in the LLC revert to the charity.
5. Additional estate planning available to enhance the value of the estate and / or charity as desired (e.g. tax favored purchase of life insurance).

## Examples

### W-2 Income

Bob forms Smith Investment Holdings, LLC, a Delaware single member LLC. He contributes \$500,000 of cash and marketable securities to the LLC. Bob retains a one percent managing member interest and donates a 99 percent interest in the LLC to a qualified charity. The valuation of the LLC interest on Form 8283 reflects a ten percent discount for lack of marketability and control. The gift for tax purposes is valued at \$450,000. the deduction is taken on Schedule A of Form 1040. The tax benefit is \$211, 500.

As managing member, Bob will manage the LLC's investments in a balanced investment portfolio. He plans to make annual distributions of \$15,000 to the charity while retaining a management fee of \$15,000 per year but elects to defer recognition.

---

<sup>1</sup> Both a tax deduction against ordinary income AND capital gains tax elimination may be available if the charity owns the contributed asset for a *material* period of time prior to resale.

<sup>2</sup> The Internal Revenue Service issued Notice 2004-30 to warn against such arrangements.



All the LLC's income (99%) is earned on a tax-free basis. The LLC assets are beyond the control of Bob's personal creditors. Bob submits a new W4 to his HR to reduce his tax withholding- instead, he will fund the LLC with additional capital contributions and elect to issue and donate additional LLC interests to the charity.

In the future, Bob and the charity may agree to have the charity sell its LLC interests to a DBIT whose ultimate beneficiaries are his children. This is done to ensure that the charity actually realizes value from the charitable contribution and to ensure the LLC remains within his family's control across generations.

### **Capital Gains Tax**

Bob owns a gym that he wants to sell to a third party for \$10 million. He contributes the gym ownership to a Legacy LLC™ which he forms, as described herein. The Legacy LLC™ thereafter sells the gym. At the time of the contribution, Bob under certain circumstances, may be eligible for a charitable deduction equal to the fair market value of the gym. More notably, at the time of the sale, no capital gains taxes are due as it is owned by the charity.

Subsequently, additional transactions may be undertaken such as the charity's sale of its membership interests to a DBIT with a specified ongoing interest charge payable to the charity, in an amount that provides the charity full value for its assets while providing a family wealth accumulation vehicle to Bob that is far superior to a lack of planning. In addition to the foregoing, additional wealth leveraging tools such as life insurance, etc. may further replace or enhance wealth to the estate.

### **Legal Authorities**

The viability of the tax advantages of a The Legacy LLC™ strategy requires that the charities are treated fairly. A sample selection of some legal authority upon which a taxpayer's customized planning follows:

#### **Charitable Contribution of Partnership Interest is Allowed.**

##### *Revenue Ruling 60-352*

Where the partnership held installment obligations constituted a "disposition" of the installment obligations held by the partnership. The logic of the ruling of the IRS in not recognizing the partnership as a separate entity for installment obligations is open to debate. However, if the IRS ruling is correct, any charitable contribution, gifts, and other transfers of partnership interest would trigger a disposition as to all



of the installment obligations held by the partnership at the time of the applicable transfer, and therefore, gain would be recognized by its applicable partners.

### ***Revenue Ruling 75-194***

If a partner contributes an interest with liabilities to a charity, the transaction is bifurcated into a charitable contribution and a deemed sale. The amount of the charitable contribution is equal to the amount by which the FMV of the partner's share of the partnership assets exceeds the partner's share of the liabilities.

### ***Sec. 1.170A-1(e), Income Tax Regs***

No deduction is allowed for a charitable contribution where the transfer is subject to a condition or power that on the date of the gift is not "so remote as to be negligible.

### ***Notice 2012-52, 2012-35 I.R.B. 317).***

Donations to a single member LLC of a 501(c)(3) organization are treated as charitable contributions to the parent tax-exempt organization.

## **Joint Ventures with Charity OK**

### ***PLR 201129033***

The donor owned both voting and non-voting shares of stock of a corporation. He wanted to give a portion of his non-voting shares to a charity.

The IRS ruled in favor of the taxpayer, finding that the voting shares and non-voting shares constituted separate and distinct property interests, rather than being fractional parts of a single property interest. The donor did arrange for the corporation to agree to pay an annual dividend on the non-voting shares so that the charity would receive some clear economic benefit.

Furthermore the PLR stands for the proposition that if a donor transfers an income interest in property to a charity and retains the underlying property or transfers such property and retains the income interest, the donor does not receive any income tax deduction unless the interest that goes to the charity is in the form of a qualified remainder interest in a charitable remainder trust or a qualifying income interest in a charitable lead trust.



**PLR 20042009**

Private foundation's initial and subsequent investment in a family-run partnership will not be an act of self-dealing under section 4941(d)(1)(A). The Service also ruled that the withdrawal of any interests or assets in those partnerships will also not be an act of self-dealing.

**PLR 200715015**

Receipt of a limited partnership interest from a corporation and royalties therefrom will not result in unrelated business taxable income to the trust, will not be excess business holdings or constitute an act of self-dealing, and will not jeopardize the trust's tax-exempt status.

***Fakiris v. Commissioner, T.C. Memo. 2017-12***

Taxpayer, a real estate owner/developer, was not entitled to a charitable contribution deduction for a gift of real estate because he retained dominion and control over the real property he had contributed by retaining a right to direct the transfer of ownership of such property.

**Notice 2003-40**

A charity's ownership of S Corp stock (or any other substantially similar arrangement) where the ongoing K-1 income / tax burden is diverges from the economic realities or where the charity's valuation is artificially suppressed by the existence of warrants is subject to heightened scrutiny as a 'listed transaction' by the IRS.

**Restrictions on Charity Ok**

***Hackl v. Commissioner***

(1) Donees can be prohibited from selling their ownership interests without the donor's approval; (2) the LLC operating agreement can give the donor (who was also the LLC's manager) discretion to make or not to make cash distributions to the members; (3) the donees can be prevented from withdrawing their capital accounts or redeeming their interests without the donor's approval; and (4) the operating agreement of the LLC can specify that no single owner could cause dissolution of the LLC. In such instances, however, a purported gift may not qualify for the annual federal gift tax exclusion as LLC interests failed to confer a substantial present economic benefit on the donee.

**IRc 678**

Person other than grantor treated as owner for tax purposes when holding substantial controls.

**PLR 200949012**



Beneficiary will be treated as the owner of a trust for federal income tax purposes before and after the lapse of Beneficiary's power of withdrawal regarding any transfer to Trust.

***PLR 201012050***

General principle of Rev. Rul. 78-197, which relates to donations of closely held corporate stock, applies to LP/LLC interest donations, but details of LP/LLC structure should be considered. –See also IRS CCA 201507018 (9/16/14).

**Non-Tax Business Purpose**

***Estate of Samuel Black v. Commissioner, 133 T.C. No. 15***

Ensuring that the Husband's (control person) buy and hold investment philosophy is implemented is a legitimate and significant non-tax purpose for establishing the family partnership.

**Valuation**

***Petter v. Commissioner, T.C. Memo. 2009-280***

A gift tax charitable deduction is allowed for the year of the original transfer (rather than later when the reallocation was made after the value for federal gift tax purposes was finally determined). This result is appropriate because "regardless of what might trigger a reallocation, [the] transfer could not be undone by any subsequent events."

***Estate of Christiansen v. Commissioner, 104 AFTR2d 2009***

Transfers that are determined by formula, rather than specific number, are permissible.