

Contents

Preface to the Fourth Edition / xiii

About the Author / xv

Chapter One

Introduction: Estate Planning Objectives and Techniques / 1

- A. Goals of Estate Planning / 1
- B. Available Techniques / 1
 - 1. Trusts / 1
 - 2. Corporations / 1
 - 3. Partnerships and LLCs / 2
- C. Avoidance of Estate and Gift Taxes / 3
 - 1. Exclusions and Exemptions / 3
 - 2. Eliminate Assets from the Gross Estate / 3
 - 3. Valuation Discounts / 3

Chapter Two

Using Limited Partnerships and LLCs to Achieve Nontax Benefits / 5

- A. Management of the Family Assets / 5
- B. Reduced Expenses / 6
- C. Protection from Creditors / 6
- D. Investment Policies / 7

Chapter Three

Choice of Entity: Introduction / 9

- A. Importance in Business and Estate Planning / 9
- B. Factors to Be Considered / 9
- C. Types of Entity / 12
- D. Multiple Entities / 13
- E. Goals of the Owners / 14

Chapter Four

Comparing S Corporations with C Corporations / 17

- A. Advantages of an S Corporation Over a C Corporation / 17
- B. Disadvantages of an S Corporation When Compared to a C Corporation / 18

Chapter Five

Comparing S Corporations with Partnerships (Including LLCs) / 19

- A. Formation / 19
 - 1. Partnerships / 19
 - 2. S Corporations / 20
- B. Operation / 20
 - 1. Partnerships / 20
 - 2. S Corporations / 21
- C. Transfers of Interests / 23
 - 1. Partnerships / 23
 - 2. S Corporations / 23
- D. Contributions of Property / 23
 - 1. Partnerships / 23
 - 2. S Corporations / 24
- E. Distributions / 24
 - 1. Partnerships / 24
 - 2. S Corporations / 25
- F. Redemptions / 26
 - 1. Partnerships / 26
 - 2. S Corporations / 26
- G. Reorganizations / 27
 - 1. Partnerships / 27
 - 2. S Corporations / 27
- H. Liquidations / 27
 - 1. Partnerships / 27
 - 2. S Corporations / 27

Chapter Six

Comparing Limited Partnerships with LLCs / 29

- A. Treatment of Liabilities / 29
- B. Passive Loss Rules / 29
- C. Distributions to a Withdrawing Partner or Member / 29
- D. Characterization of Income for Self-Employment Tax Purposes / 30

Chapter Seven

Choosing the Right Entity / 33

- A. Limited Partnership / 33
- B. LLC / 33
- C. C Corporation / 33
- D. Personal Service Business / 34

Chapter Eight

Entity Classification for Federal Tax Purposes / 37

- A. Background / 37
 - 1. Classification of Entities Under Pre-1997 Regulations / 37
 - 2. Erosion of the Differences Between Corporations and Partnerships / 37
- B. The Final Check-the-Box Regulations / 39
 - 1. Overview / 39
 - 2. Business Entities / 40
 - 3. Classification of Business Entities That Are Not “Per Se” Corporations / 42
 - 4. Transition Rule / 46
- C. Planning Considerations / 47
 - 1. In General / 47
 - 2. Trusts / 47
- D. Changes in Classification / 48

Chapter Nine

S Corporations: Estate Planning Issues / 51

- A. S Corporation Eligibility Requirements / 51
 - 1. Qualified Subchapter S Trust (QSST) / 53
 - a. QSST Requirements / 53
 - b. QSST Election / 55
 - c. Termination of QSST Status / 56
 - d. Trusts That Qualify as QSSTs / 56
 - (1) General Power of Appointment Marital Deduction Trust / 57
 - (2) QTIP Trust / 57
 - (3) Section 2503(c) Trust / 57
 - (4) Charitable Remainder Trust / 58
 - (5) Unified Credit “Sprinkle” Trust / 58
 - 2. Electing Small Business Trust (ESBT) / 58
 - a. Beneficiaries and Potential Current Beneficiaries / 59
 - (1) Beneficiaries / 59
 - (2) Potential Current Beneficiaries / 60
 - b. No Interest Acquired by Purchase / 61
 - c. ESBT Election by Trustee / 61
 - d. Taxation of ESBTs / 62
 - 3. One Class of Stock Requirement / 65
- B. Election of S Corporation Treatment / 66
- C. Overview of S Corporation Tax Rules / 69
 - 1. Income Tax Liability of S Corporation / 69
 - 2. Pass-Through of Income and Loss / 69

Contents

3. Transfers between Spouses or Incident to Divorce / 70
4. Tax Treatment of Distributions / 70
- D. Transfer of S Corporation Stock / 71
 1. Shareholders' Agreement / 71
 2. Gifts of Subchapter S Stock During Life / 72
 - a. Estate Tax Planning / 72
 - (1) Outright / 72
 - (2) In Trust / 72
 - b. Shifting of Income / 73
 3. Transfer of Subchapter S Stock Upon Death / 74
 - a. Income in Respect of a Decedent / 74
 - b. Transfer by Will / 74
 - (1) Executor's Discretion to Make Non-Pro Rata Distribution / 75
 - (2) Executor's Authority to Make Allocations to Permitted S Corporation Shareholders / 75
 - c. Estate Administration Considerations / 76
 - (1) S Election / 76
 - (a) Existing S Corporation / 76
 - (b) Existing C Corporation / 77
 - (i) The Shareholders' Income Needs / 77
 - (ii) The Effect on Net Operating Loss Carryovers / 77
 - (iii) Loss of Fiscal Year / 78
 - (iv) Employee Fringe Benefits / 78
 - (c) Existing Partnership or Sole Proprietorship / 78
 - (2) Income Tax Considerations / 78
 - (3) Section 303 Redemption / 78
 - (4) Section 6166 Installment Payment / 79
 - (5) Election of Fiscal Year for Estate / 79

Chapter Ten

Formation of the Entity / 81

- A. Advantages and Disadvantages of Using an LLC versus a Limited Partnership / 81
- B. Valuation Issues, Including Discounts / 82
- C. The IRS's I.R.C. § 2036(a) Challenge / 88
- D. Using Formulas to Define Transfers / 92
 1. Introduction / 92
 2. The IRS's Position / 93
 3. Designing the Formula / 93
- E. Step Transaction Doctrine / 95
- F. Antiabuse Regulation / 96
- G. Tax-Free Formation / 98

Contents

- H. Family Partnership Rules / 100
 - 1. Introduction / 100
 - 2. Bona Fide Transaction / 101
 - 3. Capital as a Material Income-Producing Factor / 101
 - 4. Capital Interest / 101
 - 5. Basic Tests as to Ownership / 102
 - 6. Conclusion / 103

Chapter Eleven

Special Valuation Rules Under Chapter 14 / 105

- A. Introduction / 105
- B. Transfers of LLC and Partnership Interests / 105
- C. Transfers of Interests in Trusts / 107
- D. Rights and Restrictions / 108
- E. Lapsing Voting and Liquidation Rights / 109
- F. Applicable Restrictions / 114

Chapter Twelve

Other Transfer Tax Issues / 119

- A. Annual Exclusion / 119
- B. Retained Interests or Powers / 120

Chapter Thirteen

Grantor Retained Annuity Trusts / 123

- A. Introduction / 123
- B. Definition of Qualified Annuity Interest / 123
- C. Planning / 125

Chapter Fourteen

Installment Sales to Grantor Trusts / 129

- A. General / 129
- B. Grantor Trusts / 129
 - 1. Definition / 129
 - 2. Grantor Taxed as Owner of Trust Assets / 130
 - 3. Identification of Grantor / 130
 - 4. Triggering Provisions for Grantor Trust Treatment / 130
 - 5. “Intentionally Defective” Grantor Trust / 133
 - 6. Trustee / 134
- C. Sale to a Grantor Trust / 134
 - 1. Benefits / 134
 - 2. Disadvantages / 135

Contents

3. Funding of a Grantor Trust / 135
4. Role of Life Insurance / 135
5. Nontax Benefits / 135
6. Appropriate Assets to Be Sold to a Grantor Trust / 136
- D. Tax Consequences / 136
 1. Income Tax / 136
 2. Gift Tax / 137
 3. Estate Tax / 138
 4. Generation-Skipping Transfer (GST) Tax / 138
- E. Death of Grantor Before Satisfaction of Note / 139
- F. Alternatives to Installment Sale / 140
 1. Entity Freezes / 140
 2. GRATs / 141
- G. Conclusion / 142

Chapter Fifteen

Overview of Partnership Taxation / 143

- A. Introduction / 143
 1. General / 143
 2. Election Not to Be a Partnership / 143
- B. Formation of Partnership / 144
 1. General Rule / 144
 2. Special Situations / 144
 - a. Transactions with Partner not Acting as a Partner / 144
 - b. Assumption by Partnership of Liabilities in Excess of Partner's Basis / 145
 - c. Partnership Interest as Compensation for Services / 145
 - d. Depreciation Recapture / 146
 - e. Recapture of Farm Deductions / 146
 - f. Installment Obligations / 147
 - g. Other Situations / 147
 3. Basis and Holding Period for Partnership Assets / 147
 4. Allocation of Items with Respect to Contributed Property / 147
 5. Basis for Partnership Interest / 148
 6. Continuing Adjustments to Basis / 149
 - a. Increases in Basis / 149
 - b. Decreases in Basis / 149
 - c. When Adjustments Determined / 150
- C. Tax Accounting Matters / 150
 1. Generally / 150
 2. Separately Stated Items / 151
 3. Choice of Taxable Year / 151
 4. Reporting Income by Partners / 152
 5. Change of Partnership Year / 152
 6. Tax Elections / 153

Contents

- 7. Basis Adjustment Elections / 153
 - a. Mechanics of Election / 153
 - b. Allocation of Adjustment / 154
- D. Operation of Partnership / 154
 - 1. Partners' Distributive Shares / 154
 - 2. Special Allocations / 155
 - a. Economic Effect / 155
 - b. Substantial Effect / 156
 - c. Failure to Satisfy Test / 156
 - 3. Current Distributions / 157
 - 4. Guaranteed Payments / 158
 - 5. Transactions Between Partner and Partnership / 158
 - a. Losses Disallowed / 158
 - b. Gains Treated as Ordinary Income / 158
 - 6. Close of Taxable Year / 159
- E. Transfer of Partners' Interests / 159
- F. Liquidation of Partner's Interest / 160
 - 1. Generally / 160
 - 2. Gain or Loss / 160
 - 3. Basis of Distributed Property / 160
 - 4. Payments to Retiring or Deceased Partner's Successor / 161
 - a. Payments Made for Partnership Property / 161
 - b. Other Payments / 162
 - c. Allocation of Retirement Payments / 162
 - 5. Disposition of Distributed Property / 162
 - a. Unrealized Receivables / 163
 - b. Inventory Items / 163
 - c. Recapture Property / 163
 - d. Other Property / 163
- G. Unrealized Receivables and Appreciated Inventory / 163
 - 1. Generally / 163
 - 2. Unrealized Receivables / 164
 - 3. Appreciated Inventory / 164
 - 4. Application of I.R.C. § 751 to Distributions / 165
- H. Limited Partnerships / 165
- I. At-Risk and Passive Loss Rules / 166
 - 1. At-Risk Rules / 166
 - a. General Concepts / 166
 - b. Amount at Risk / 167
 - c. Recapture of At-Risk Losses / 168
 - 2. Passive Loss Rules / 168
 - a. General Concepts / 168
 - b. Application to Partnerships / 169
- J. LLCs / 170
 - 1. Introduction / 170
 - 2. Treatment of Liabilities / 171

Contents

3. Limitations on Passive Losses / 171
4. Cash Method of Accounting / 172
5. Characterization of Income / 173
6. Partnership Representative / 173
7. Conversion of General Partnership or Limited Partnership into an LLC / 173

Chapter Sixteen

Drafting the Operating Agreement for an LLC / 175

- A. Introduction / 175
- B. Important Provisions in an Operating Agreement / 176
 1. Business Purpose / 176
 2. The Economic Arrangement Among the Members / 176
 3. The Management Structure / 176
 4. Dissolution and Liquidation / 177
- C. Classification for Income Tax Purposes / 177
- D. Self-Employment Income / 177
- E. Estate Planning Issues / 178
- F. Other Tax Considerations / 180

Chapter Seventeen

Sample Forms / 183

- A. Limited Partnership Agreement of the [Name] Limited Partnership / 184
- B. Certificate of Limited Partnership / 206
- C. Deed of Gift—Limited Partnership / 208
- D. Cover Letter—Limited Partnership / 210
- E. Operating Agreement of _____, LLC / 214
- F. Articles of Organization of _____, LLC / 234
- G. Consent of Organizer / 235
- H. Deed of Gift—LLC / 236
- I. Cover Letter—LLC / 238
- J. Table of Internal Revenue Code and Treasury Regulations / 242

Index / 249

Appendices and Sample Forms can be found online