

# Howe Estate Planning Update

## F O R A D V I S O R S

### DON'T OVERLOOK BENEFITS OF SINGLE-MEMBER LLCs



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Limited liability companies (“LLCs”) are often the entity of choice for both business and estate planning because they offer asset protection as well as the potential for valuation discounting. One feature that makes an LLC more attractive than a corporation, from an asset protection standpoint, is the limitation on available remedies for creditors of LLC owners.

Creditors have a right to obtain satisfaction of the debtor’s obligations from the debtor’s assets. If one of the debtor’s assets is shares in a corporation, the creditor has the ability to take the shares. However, the creditors of a partner in a general partnership cannot take over ownership of the partner’s partnership interest. The creditors’ only remedy against that asset of the partner is what is called a charging order. A charging order specifies that if distributions are ever made by the partnership to the debtor partner, the creditor gets the distributions. The rationale here is that the other, non-debtor partners should not be forced

to be in partnership with a stranger, the creditor.

Generally, by statute, LLCs are treated like general partnerships in this respect. However, the single-member LLC may not be as bullet-proof an entity as some of our clients would like. In some states the charging order is not the exclusive remedy available to creditors of an LLC member. Moreover, several bankruptcy courts have disregarded the statutory limitations on creditors’ remedies when a single-member LLC is involved and allowed the creditor to “step into the shoes” of the single member. For these reasons, clients in need of asset protection planning have been advised to select the appropriate jurisdiction for their LLCs. The current darling is Wyoming, because its statute is the only one that specifically states that the charging order is the exclusive remedy against LLC membership interests, *including single-member LLCs.*

(Cont.)



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This does not mean that the single-member California LLC is dead, however. The first rule in estate planning always is figure out what the client wants. Forming an LLC in a foreign jurisdiction such as Wyoming feels like a lot of complexity and is not always desirable to our California clients. A California LLC may actually accomplish the client's goals, even though it doesn't have every bell and whistle available in the legal marketplace.

Remember, there are two basic types of creditor protection: inside-out and outside-in. It is true that a single-member California LLC may not give our clients maximum outside-in protection (protection of the LLC assets from creditors on the outside).

However, for many of our clients, such as those whose primary concern is protecting their personal assets from any liability they may incur as business owners and owners of rental property, inside-out asset protection, which means that liability for the activities of the entity is contained inside the entity, may be all the client really wants and needs. We can provide this level of protection and peace of mind to our clients with a California LLC, without unnecessarily complicating their lives. Again, as with everything we do for our clients, it is vitally important to find out what it is our clients want.

## GIFT PAYMENTS ARE DEDUCTIBLE FROM INCOME TAX BY DONEE



In a memorandum opinion filed by the United States Tax Court at the close of last year, the issue was whether payments of medical expenses and of real estate taxes could be deducted on the taxpayer's federal income tax return. In *Judith F. Lang v. Commissioner*, T.C. Memo. 2010-286, the taxpayer's mother made the payments in question

on behalf of the daughter directly to the medical service provider and the city tax collector, even though she had no legal obligation to do so. The tax court acknowledged that such payments would be considered gifts made by mother to daughter. In the case of the medical expenses, the gift would not be subject to gift tax because the



payment was made directly to the medical service provider. The payment made directly to the city tax collector would be a taxable gift, however the taxpayer had not exceeded her annual gift tax exclusion and therefore no gift tax was owing on that gift.

The IRS took the position that because the payments were made by the mother they could not be deducted on the daughter's income tax return. The court, however, analyzed the substance of the two transactions and determined that they were the same as if the mother had given the money to her daughter and the daughter had then paid her own medical and tax bills, hence the deduction by the daughter was allowed.

We often advise our clients that a gift tax-free way to give money to their heirs is to pay for their medical care, so long as payment is made directly to the medical care provider. It is important to also remind our clients that such payments can be deducted by the donees of these gifts.

## NEW FEDERAL INCOME TAX RULES FOR SAME-SEX COUPLES

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While the federal government does not recognize same-sex marriages for most purposes, this year for the first time certain same-sex couples will be covered by special rules for preparing their federal income tax returns.

Same-sex partners are not permitted to file joint federal tax returns.

But now registered domestic partners and legally married same-sex spouses in community property states will be required to report all income derived from employment and from property recognized by the state as community property half on one partner's return and half on the other partner's return, regardless of who actually earned the income.



This could result in a lower overall tax for some couples. In addition, these same-sex couples will be permitted to file amended returns applying this new rule going back to January 1, 2007, in California.



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## A PERSONAL NOTE FROM KIRSTEN HOWE

Dear Colleagues,

The proposed budget submitted to Congress on February 14, 2011, by President Obama included several proposed changes to the estate, gift and GST taxes. These changes include, among others:

- A return to the 2009 tax rules on January 1, 2013, which would mean an estate and GST exemption amount of \$3.5 million, a lifetime gift tax exclusion amount of \$1 million and a top transfer tax rate of 45%;
- Making portability of the unused estate tax exemption between spouses permanent;
- Requiring a minimum term of ten years for GRATs; and

- Limiting the protection afforded by allocation of GST exemption to a transfer to 90 years.

Various proposals aimed at limiting valuation discounting were included, as well. Whether or not Congress enacts any of the President's proposals remain to be seen, and of course you will read about it here.

Warmly,

*Kirsten Howe*

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