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LEGAL ADVICE TO HELP MINIMIZE TAXES AND PROTECT ASSETS

MAJOR TAX COURT DECISIONS REQUIRE ATTENTION TO PLANNING WITH FAMILY LLCS AND PARTNERSHIPS

In two recent estate tax cases—*Estate of Powell* and *Estate of Cahill*—the Tax Court sided with the IRS and included assets in a taxpayer's estate that had been previously gifted to family members. These cases have significantly altered planning considerations for family limited partnerships ("FLPs") and family limited liability companies ("FLLCs").

Assets You No Longer Own May Be Pulled Back Into Your Estate

Many individuals transfer interests in FLPs and FLLCs for estate, business, and tax planning purposes. Often, they retain nonvoting interests in FLPs or FLLCs, sharing the right to liquidate the company with the other interest owners. Prior to *Powell* and *Cahill*, this did not raise serious concerns that the value of the company would be included in their estate.

In *Powell*, nine days before Mrs. Powell's death, her son formed an FLP. He made himself general partner, with sole power to determine the timing and amount of distributions. The FLP could be liquidated on the written consent of all limited and general partners. Two days later, while Mrs. Powell was medically incapacitated, the son, as trustee of his mother's revocable trust, transferred $10 million in assets to the FLP in exchange for a 99% limited partner interest. The son then used his mother's power of attorney to transfer the 99% limited partner interest to a charitable trust, despite having no authority to make this charitable gift under the power of attorney.

There were numerous legal theories the Tax Court could have employed to include the value of the FLP in Mrs. Powell's estate (for example, lack of a non-tax purpose, sham transaction, or void partnership). Instead, the Tax Court took a somewhat surprising position and included the assets of the FLP in Mrs. Powell's estate merely because she owned a limited partnership interest at death and was required to consent (along with all the other partners) to a liquidation of the FLP.

In *Cahill*, the Tax Court applied the rule from *Powell* to another area of estate planning, indicating that the Tax Court may continue expanding the rule to new situations. Although both *Powell* and *Cahill* involved aggressive, deathbed planning, the long-term impact of these cases is unclear.

Take Planning Steps to Minimize Tax Risk in Light of *Powell* and *Cahill*

Powell and *Cahill* restrict the control you can have over FLPs and FLLCs without causing the assets held by the FLP or FLLC to be included in your estate. The IRS may try to include the entire undiscounted value of the FLP or FLLC in your estate if you have retained an interest that entitles you to:

- Vote on behalf of the company,
- Liquidate the company,
- Manage the company,
- Affect distributions, or
- Participate in investment strategies.

You should discuss the effects of these legal developments with your tax advisor.

In 2019, the unified estate and gift tax exemption for each individual is $11.4 million, subject to annual increases for inflation through 2025. Past 2025, it is anyone's guess what the exemption will be. A new democratic Congress and President could also reduce the exemption prior to 2026. If the exemption is reduced, the tax your estate pays may be exponentially higher if you take no action.

The tax professionals at CEC recognize that your family and business situations are unique and require individualized treatment. Please call us to discuss planning options to help you avoid becoming a target for the IRS.

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