Passing LLC Membership Interests Without Probate:

Domestic and Foreign Issues



Patrick J. Lannon
Shutts & Bowen LLP
200 South Biscayne Boulevard, Suite 4100
Miami, FL 33131
plannon@shutts.com

LLCs As Estate Planning Tools

- Estate planners often recommend LLCs for:
  - Creditor protection (inside and outside)
  - Family investment vehicle
  - Trust substitute, including for outright distributions from estates and trusts
  - ILIT Substitute
  - State Estate Tax avoidance
  - Estate tax minimization (discounts)

Shutts

LLCs as Business Entities

- Clients often already have businesses held in the form of an LLC
  - Greater flexibility than a corporation or partnership for voting, control, buy-sell, etc.
  - Joint venture
  - Operating agreements are often minimal and insufficient
  - Conversion of S-Corp to LLC with S-election

Shutts

Questions Posed

- Can an LLC Member designate a successor owner on death through a Pay on Death ("POD") designation?

- If an LLC Member can designate a successor owner on death, can the designation be made a binding inheritance agreement?

Shutts

Some Reasons These Questions Matter

- Centralized Partnership Audit Regime
  - IRS can now audit the partnership, rather than each partner
  - Certain partnerships can elect out of the centralized audit regime, forcing the IRS to audit each partner
  - To qualify to elect out, a partnership must have fewer than 100 “eligible partners”
  - Trusts (even revocable trusts) are not eligible partners, so a family business LLC taxed as a partnership must choose between the election and probate avoidance

Shutts

Some Reasons These Questions Matter

- Avoidance of Ancillary Probate for Foreign Residents
  - While LLC membership interests are intangible personal property and so arguably pass by domiciliary proceedings, the lack of clarity regarding the definition of “foreign personal representative” may lead to use of a Florida ancillary probate proceeding to clarify inheritance
  - As a practical matter at least some Florida probate courts recognize LLC membership interests as Florida probate assets, creating concern about ownership challenges if no Florida probate is opened

Shutts

Some Reasons These Questions Matter

- Inheritance Agreements for Succession Planning
  - Ensure succession of sensitive business or family assets without buy-sell provisions needed
  - Facilitate asset ownership for spendthrift children as an alternative to trust planning
  - Facilitate joint ownership of assets after divorce

Shutts

Current State of the Law

- POD – Florida Uniform Transfer on Death Security Registration Act does not clearly permit POD designations
- F.S. 711.501(9):

  (9) "Security" means a share, participation, or other interest in property, in a business, or in an obligation of an enterprise or other issuer, and includes a certificated security, an uncertificated security, and a security account.

Shutts

Current State of the Law

- Inheritance Agreements
  - *Blechman v. Estate of Blechman*
  - *Finlaw v. Finlaw*
  - *In re Est. of Cook*, Ark. Ct. App. 2020

- See Actionline, Fall 2021

Shutts

Current State of the Law

- Contrast *Tita v. Tita*, Florida 4th DCA 2015
  - Specific gifts of LLC interests in Will controls when the LLC exercised its right to redeem the estate interest upon the passing of the decedent
- Contrast *Potter v. Potter*, Maryland 2021
  - LLC interests that purport to transfer member interests at death are void for failing to create a trust or be executed with will formalities

Shutts

LLC Challenge - the new Will Challenge?

- Note that LLC POD or Inheritance Agreements may still be challenged after death – and the Personal Representative may have the duty to discover and bring the challenge
  - See Patrick J. Lannon *Challenging Inter Vivos Transfers Procured by Undue Influence: Factors to Consider*, Florida Bar Journal Vol. 82, No. 3, March 2008

Shutts

Practice Pointers

- It is a will alternative - § 732.502
- Contract to make a will alternative – § 732.701
- Buy-Sell alternative

- Estate planning attorneys should be reviewing entity documents such as by-laws, buy-sell agreements, and LLC operating agreements as part of every engagement, and Personal Representatives immediately need to review

Shutts

- **THANK YOU!**