

# *Legal Basis for Smooth Transfer of Property*

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## Form of ownership

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- Entities other than individuals can own land with the same rights as individuals
- Ownership options
  - Individual
  - Trust
  - Business (LLC)

## How do we transfer property?

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- All records affecting land are recorded in the Probate Judge's office in the county where the land is located
- There are only two documents that will transfer an interest in land:
  - Deed
  - Will

## Transferring an interest in property with a Will

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- Effective at death (not at the end of the probate period)
- Subject to debts of the estate
- Outright transfer with no conditions
  - Smooth transfer but no transition

# Transferring an interest with a Deed

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- Effective on delivery
- “To have and to hold to the said grantee, his heirs and assigns forever.”
- Generally, can’t make use of property conditional with a deed
  - I give my property to my son for as long as he manages it as a tree farm
- Partial interests can be transferred,
  - For example, I give a one-tenth interest in the farm to my son
  - The problem, Son gives one-tenth interest to land speculator

# Using a Trust to hold land

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- Timing and condition of distributions
  - You could incorporate your management plan into a trust
- Trustee manages property
- Provides for incapacity
- Avoids probate and ancillary probate
- Revocable versus irrevocable
- Term
  - Rule against perpetuities (life in being plus 21 years)

# Tax planning using Trusts

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- Revocable trust
  - No gift tax
  - Entire value included in your estate
- GRAT (grantor retained annuity trust)
  - Estate freezing technique (removes income and future appreciation from your estate)
  - Grantor gets an annuity interest and pays income tax on trust income
  - Beneficiaries get a remainder interest which is a taxable gift
  - Property can remain in trust after the grantor's interest and the grantor can be the trustee

## Example GRAT

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- \$500,000 asset growing at 8% in a 15-year GRAT with a 5% 7520 rate

Annuity	Payments to grantor	Taxable gift	Ending balance
25,000	375,000	240,508	907,282
30,000	450,000	188,610	771,521
35,000	525,000	136,712	635,761
40,000	600,000	84,814	500,000



## Why use a business entity

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- Maintain control while giving interests to family members (unity of management)
- Limited liability
- Creditor/asset protection
- Limited withdrawal rights
- No taxation at the entity level
- Discounted values for entity interests

## Why use a business entity

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- Perpetual life
- Avoids ancillary probate
- Can be used to reduce estate taxes
- Provides a succession plan
- Economies of scale
- Qualification for special tax provisions

# Business Entities in Alabama

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- Single Owner

- Sole proprietorship
- Limited liability company
- Corporation, S or C

- Multiple Owners

- General partnership
- Limited partnership
- Registered limited liability partnership
- Limited liability company
- Corporation, S or C

# Liability of Owners

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GP/RLLP	LP	LLC	Corp.
<p>All partners are liable jointly and severally for all obligations of the partnership</p> <p>A partner in an RLLP is not personally liable</p>	<p>General partners are jointly and severally liable for the debts of the LP</p> <p>Limited partners are not personally liable</p>	<p>Members are not liable for obligations of the LLC for acts or omissions of any other member</p> <p>A member may become liable because of his own conduct.</p>	<p>A shareholder is not personally liable for the acts or debts of the corporation (except amount contributed)</p> <p>“Piercing the corporate veil”</p>

# Participation in Management

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GP/RLLP	LP	LLC	Corp.
Partners have a statutory right to participate in management	General partners participate in management but Limited partners are prohibited from participating in management	Members or managers may participate in management as provided in the articles of organization	Shareholders participate in management by electing directors to determine policy and appoint officers

# Transferability of Interest

GP/RLLP	LP	LLC	Corp.
<p>A partner's or member's interest is transferable, but the assignee only gets the income interest.</p> <p>Unless provided otherwise the assignee only becomes a partner/member with the unanimous consent of the other partners/ members.</p> <p>The partnership/operating agreement can limit a partner/member's right to withdraw or assign his interest.</p>			<p>Shares are freely transferable, subject to restrictions in the organizational documents</p>

# Classification for Tax Purposes

GP/RLLP	LP	LLC	Corp.
<p>Generally taxed as a partnership which means “flow through” taxation (entity files an information return, but the owners pay the tax on their individual returns.)</p> <p>Income is from self-employment so FICA rate = 15.3%, except for limited partners or members who are not managers.</p> <p>Entity can elect to be taxed as a corporation.</p>			<p>A C-corp. is subject to double taxation</p> <p>An S-corp. is taxed similar to a partnership</p>

# Allocation of Profits and Losses

GP/RLLP	LLC	LP	Corp.
<p>Per capita (regardless of contribution), unless modified by the partnership agreement.</p> <p>In general, may be allocated in any manner the partners agree so long as the allocation is in accordance with the partners' interests or otherwise has substantial economic effect.</p>		<p>Pro rata to contributions (unless modified by the partnership agreement)</p>	<p>Profits – pro rata to number of shares, (plus salary)</p> <p>C-corp. – only profits are passed to s/h</p> <p>S-corp. – profits and losses are allocated to s/h</p>



## Family Limited Partnerships or Limited Liability Companies

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- 100% control regardless of ownership percentage (2% is the lower limit)
- Creditor protection
- Limited withdrawal rights
- No taxation at entity level
- Succession plan
- Can be used to reduce estate taxes
- Can be used to avoid ancillary probate
- Perpetual life

## Family Limited Partnership or Limited Liability Company

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- FLP

- General partner has unlimited liability
- Have to pay withdrawing partner

- LLC

- Unlimited liability for all members
- Don't have to pay withdrawing member

## Disadvantages

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- Expense of forming the business entity
- Privilege tax – minimum of \$100/year up to \$500/year for a family business
- Separate tax return (Form 1065)

# Forming the Business

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- FLP

- File Certificate of Limited Partnership with the Probate Judge
- Develop the partnership agreement

- LLC

- File Articles of Organization with the Probate Judge
- Develop the operating agreement

# Discounts

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- Lack of control (minority discount)
  - Little voice in partnership operations
  - Cannot obtain his pro rata share by compelling the partnership to liquidate
  - Cannot transfer his management rights
  - Cannot compel distributions
  - Must pay taxes on his allocable share whether it is distributed or not

# Discounts

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- Lack of Marketability
  - Few unrelated parties would be inclined to purchase an interest in a family business without receiving substantial discounts
- Amount of Discount
  - The combined discount typically ranges between 25 and 35 percent