DODGING THE TAX BULLET: THE USE OF FOREIGN LIMITED LIABILITY COMPANIES BY RETIRED FARMERS TO LIMIT STATE INHERITANCE TAX LIABILITY FOR THE NEXT GENERATION OF SMALL FARMERS

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I. INTRODUCTION

Given the scope of and readership base of this law journal, we will assume that a large majority of the readers of this Note are legally trained and educated. For the duel purposes of making a point and keeping most of the readers at ease, the following is an example of a law school short answer hypothetical that might be seen on a typical Estate and Gift Tax final exam.

Early in his life, Farmer Jones ("Farmer") had purchased a small farm in Eastern Nebraska. Over the years, Farmer had been very successful and had bought an increasing amount of land as other smaller farmers were forced out of business. At the time of his retirement his farming operation had an assessed value of $800,000. When Farmer retired he rented the farm to Son, promising his only child that the farm would go to him when Farmer and his wife had passed away. Once his Son began managing operations on his own, Farmer and his wife decided to purchase a home in Arizona after many of their prior neighbors convinced them of the benefits of being "snow birds"[1] during the cold Nebraska months. As a result they lived in Arizona during much of the fall, winter, and spring, only visiting Nebraska for about four months out of the year. During his parents' retirement Son saw the value of the farm increase significantly due to national interest in bio-fuels.[2] A year ago Son's mother passed away, but Farmer continued to reside in Arizona with many of the friends he developed while living there. Then, just this past winter, Farmer died leaving a will which bequeathed the entire farm operation, currently as-

1. RANDOM HOUSE WEBSTER'S UNABRIDGED DICTIONARY 1808 (2nd ed. 2001) (1987) [hereinafter WEBSTER'S] (defining snowbird as "a person who vacations in or moves to a warmer climate during cold weather").

2. *See* RICHARD NEHRING ET AL., IMPACTS OF URBANIZATION AND BIO-FUELS PRODUCTION ON THE PRICE OF LAND IN THE CORN BELT: A FARM-LEVEL ANALYSIS 1 (2007), *available at* http://www.nercrd.psu.edu/TALUC/Papers/NehringUrbanInfluence.pdf ("We find that quality-adjusted land prices in the Corn Belt are significantly increased by the presence of . . . bio-fuel plants. . . . [H]edonic procedures indicate that a 10-percent increase in ethanol capacity leads to a greater then 0.3-percent increase in the quality-adjusted land price. . . . Clearly ethanol production in the Corn Belt is a new and not unimportant phenomenon influencing land prices").

sessed at $1,104,000,[3] to Son leaving all administration costs and debts to be paid from the $500,000 residue of the Farmer's estate with the remainder going to the local church. Given the federal and state death taxes currently in effect, what would be the tax consequences to Son?

At the end of the day Son will not be assessed any federal estate taxes due to the unified credit in 2009 which is set at $3,500,000.[4] However, he will be required to pay an inheritance tax of one percent on the entire value of the farm, minus his $40,000 exemption, of course.[5] This additional farm expense of $10,000 to Son will place an added burden on the farming operation. This burden only increases when decedent's estate qualifies for the federal estate tax, a state estate tax, and a state inheritance tax.[6] When faced with this particular problem, Son may have to sell $10,000 worth of farmland. Given the $1,159 average price per acre found in Nebraska,[7] this would amount to approximately nine acres of land.

Given the large amounts of inheritance taxes collected by states which have incorporated these laws into their codes,[8] it is hard not to see the impact this plays on the declining number and production outputs of small family

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3. NAT'L AGRIC. STATISTICS SERV., USDA, 2007 CENSUS OF AGRICULTURE: NEBRASKA STATE AND COUNTY DATA 7 (2009), *available at* http://www.agcensus.usda.gov/Publications/2007/Full_Report/Volume_1,_Chapter_1_State_Level/Nebraska/nev1.pdf [hereinafter NEBRASKA CENSUS] (showing the average value of a Nebraska farm's land and buildings is $1,104,392).

4. Internal Revenue Serv., What's New – Estate and Gift Tax, http://www.irs.gov/businesses/small/article/0,,id=164878,00.html (last visited Apr. 20, 2010) (indicating that the federal estate taxes will not be paid when the gross estate and the lifetime gifts do not exceed $3,500,000 in 2009).

5. NEB. REV. STAT. § 77-2004 (2009) ("In the case of a . . . son . . . the rate of tax shall be one percent of the clear market value of the property in excess of forty thousand dollars received by each person. . . . [I]n addition the homestead allowance . . . shall not be subject to tax"); *see also* NEB. REV. STAT. § 30-2322 (2009) (the homestead exemption does not apply in this situation because it requires the decedent to be "domiciled in this state" and the exemption only applies to spouses, minor children, and dependent children).

6. *See, e.g.*, MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) (Maryland's state inheritance tax statute); MD. CODE ANN., TAX-GEN. § 7-302 (West 2009) (Maryland's state estate tax statute).

7. NEBRASKA CENSUS, *supra* note 3.

8. *See* U.S. CENSUS BUREAU, STATE GOVERNMENT TAX COLLECTIONS: 2008 (n.d.), http://www.census.gov/govs/statetax/historical_data_2008.html (downloadable as an Excel Spreadsheet at the above mentioned website under "Summary Table") (according to the data from this report, states with an inheritance tax collected the following amounts of death and gift taxes in 2007: Indiana collected $165,582,000; Iowa collected $79,783,000; Kentucky collected $51,001,000; Louisiana collected $11,148,000; Maryland collected $243,425,000; Nebraska collected $6,844,000; New Jersey collected $698,694,000; Oregon collected $109,549,000; Pennsylvania collected $803,367,000; and Tennessee collected $103,464,000).

farms.[9] But by no means is taxation the only cause of this trend. Other factors such as "technological developments, economies of size and capital requirements, forms of ownership, operators' managerial ability, market conditions, price instability, credit financing, off-farm employment opportunities, transportations networks connecting urban to rural areas, government regulations, and commodity programs"[10] have also aggravated the problem. However, the avoidance of state levied death taxation is one area in which farmers can take pro-active steps to minimize the costs associated with them. One way in which to do this is to place real property associated with the farming operation into a limited liability company. Given the right set of circumstances, retired farmers can completely shield their family members from the negative consequences of inheritance taxation.

It should be noted that the tax shelter advocated within this Note is not for everyone. In order for a foreign limited liability company to act as a complete shield to inheritance taxation a farmer client must: (1) have retained ownership of farmland in jurisdictions which still levy an inheritance tax; (2) have moved out of the state permanently or temporarily; and (3) have established domicile within a state which does not assess state death taxes.[11] For these reasons this Note is primarily focused on "snowbird" clients who had farming operations in inheritance tax states, because they will most likely establish domicile in a tax friendly jurisdiction and have large amounts of assets within a state which levies inheritance taxes.

This Note is intended to advocate the use of foreign limited liability companies by those certain retired farmers mentioned *supra* in order for them to pass on their legacies without their children suffering from the burden of state inheritance taxation. As a preliminary matter, an analysis of the property interests in the relevant states will be given in order to determine what property is and is not taxable. Once this summary is completed, this Note will detail how foreign limited liability companies can shield certain property interests

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9. HomesteadCertification.com, Homestead Family Farm Decline, http://www.homesteadcertification.com/familyfarmdecline.asp (last visited Apr. 20, 2010) (reporting that very small farms, small medium scale family farms, and large scale family farms all experienced declines in their totals of the U.S. farm production from 1989 to 2003 by 25%, 30%, and 25% respectively; while very large scale and non-family farms experienced a 50% increase in farm production from 1989 to 2003).

10. Tesfa G. Gebremedhin & Ralph D. Christy, *Structural Changes in U.S. Agriculture: Implications for Small Farms*, 28 J. AGRIC. & APPLIED ECON. 57, 58 (1996), *available at* http://ageconsearch.umn.edu/bitstream/15226/1/28010057.pdf (describing factors leading to the "increased concentration of production agriculture, in correspondence with the decline in the number of farms . . . ").

11. *See infra* Part III.

from taxation. A discussion as to why "snowbird" clients are uniquely positioned to utilize this tax advantage will be given as well. This will be followed by an overview of the relevant state death taxes in each state so that the reader will be aware of which states' taxes transfer to children and which states provide taxing environments well suited for the establishment of this type of tax shelter. The Note will also present the argument as to why a due process violation emerges when a state attempts to tax these foreign limited liability companies, there by restricting the state legislatures from modifying their current law. Finally, arguments will be offered presenting the advantages of using a limited liability company over other business entities.

II. INHERITANCE TAXATION AND THE PROPERTY INTERESTS WHICH ARE TAXED: THE STATUTORY RESTRICTIONS ON THE TAXATION OF NON-RESIDENT INTANGIBLE PERSONAL PROPERTY INTERESTS

The American legal system has developed two distinct legal bases for the taxation of a person's property at death: estate and inheritance taxation.[12] Even though each of these tax theories are assessed only upon the death of the decedent, each justifies the levying of the tax for different reasons and therefore places its tax on respectively different parties involved in the property transfer.[13] Estate taxes are justified as being "a tax upon the transmission of property by a deceased person" and are therefore a tax on the actual estate.[14] Inheritance taxes, on the other hand, are assessed against the beneficiaries and are justified as "be[ing] an excise on the [beneficiary's] privilege of taking property by will or by inheritance or by succession."[15]

While there are fifteen states with an inheritance tax on the books,[16] the tax is only currently active within ten of the states.[17] They include Indiana,[18]

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12. Note, *Problematic Definitions of Property in Multistate Death Taxation*, 90 HARV. L. REV. 1656, 1658 (1977) [hereinafter *Death Taxation*].

13. *Id.*

14. *In re* Estate of Smith, 188 N.E.2d 650, 652 (Ohio 1962).

15. *Id.*

16. IND. CODE § 6-4.1-11-5 (2009); IOWA CODE § 450B.3 (2009); KY. REV. STAT. ANN. § 140.010 (West 2009); LA. REV. STAT. ANN. § 47:2401 (2009); MD. CODE ANN., TAX-GEN. § 7-202 (West 2009); MICH. COMP. LAWS § 205.201 (2009); NEB. REV. STAT. § 77-2001 (2009); N.J. STAT. ANN. § 54:34-1 (West 2009); OR. REV. STAT. § 118.010 (2009); 72 PA. CONS. STAT. § 9116 (2009); S.D. CODIFIED LAWS § 10-40-2 (2009); TENN. CODE ANN. § 67-8-303 (2009); TEX. TAX CODE ANN. § 211.051 (Vernon 2009); UTAH CODE ANN. § 59-11-103 (2009); WYO. STAT. ANN. § 39-19-103 (2009).

17. Of the fifteen states that have inheritance tax statutes on the books, the five states that do not have operating inheritance tax statutes are: Michigan, South Dakota, Texas, Utah, and Wyoming. MICH. COMP. LAWS § 205.223(1) (2009) ("[s]ections 1 through 22 apply only to

Iowa,[19] Kentucky,[20] Louisiana,[21] Maryland,[22] Nebraska,[23] New Jersey,[24] Oregon,[25] Pennsylvania,[26] and Tennessee.[27] Of the five states with inactive inheritance tax statutes, three of them—Texas, Utah, and Wyoming—have the potential of becoming active only if there is change in the Federal Estate Tax Credit.[28] Michigan, on the other hand, would require a state decision on the legis-

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the estate of a resident or nonresident decedent dying before October 1, 1993 . . ."); S.D. CONST. art. XI, § 15 ("No tax may be levied on any inheritance, and the Legislature may not enact any law imposing such a tax."); TEX. TAX CODE ANN. §§ 211.051-211.053 (Vernon 2009) (indicating that the Texas inheritance tax is tied to the Federal Estate Tax Credit and is therefore no longer imposed); UTAH CODE §§ 59-11-103 to 104 (2009) (indicating that the Utah inheritance tax is tied to the Federal Estate Tax Credit and is therefore no longer imposed); WYO. STAT. ANN. §§ 39-19-103 to 104 (2009) (indicating that the Wyoming inheritance tax is tied to the Federal Estate Tax Credit and is therefore no longer imposed).

18. IND. CODE § 6-4.1-2-1 (2009) ("[a]n inheritance tax is imposed at the time of decedent's death on certain property interest transfers made by him").

19. IOWA CODE § 450.2 (2009) ("estates and property and any interest in or income from any of the following estates and property, which pass from the decedent owner . . . are subject to [an inheritance] tax").

20. KY. REV. STAT. ANN. § 140.010 (West 2009).

21. LA. REV. STAT. ANN. § 47:2401 (2009) ("a tax upon all inheritances, legacies, and donations and gifts made in contemplation of death, except such as are hereinafter specifically exempted").

22. MD. CODE. ANN., TAX-GEN. § 7-202 (West 2009) ("a tax is imposed on the privilege of receiving property that passes from a decedent and has a taxable situs in the State").

23. NEB. REV. STAT. § 77-2001 (2009) ("[a]ll property . . . shall be subject to [an inheritance] tax").

24. N.J. STAT. ANN. § 54:34-1 (West 2009) ("a tax shall be and is hereby imposed at the rates set forth in section 54:34-2 of this Title upon the transfer of property, real or personal, of the value of $500.00 or over, or of any interest therein or income therefrom . . . to or for the use of any transferee, distributee or beneficiary").

25. OR. REV. STAT. § 118.010 (2009) ("[a] tax is imposed upon a transfer of property and any interest therein, within the jurisdiction of the state . . . which passes to or vests in any person or persons . . . in trust or otherwise . . . to any property or interest therein or income thereof").

26. 72 PA. CONS. STAT. § 9106 (2009) ("[a]n inheritance tax for the use of the Commonwealth is imposed upon every transfer subject to tax under this article at the rates specified").

27. TENN. CODE ANN. § 67-8-303 (2009) (an inheritance "tax is imposed . . . upon transfers, in trust or otherwise, of the following property, or any interest in the property or accrued income from the property").

28. *See* TEX. TAX CODE ANN. § 211.053 (Vernon 2009) (stating that the Texas inheritance tax is tied to the Federal Estate Tax Credit); UTAH CODE ANN. §§ 59-11-103 to -104 (2009) (stating that the Utah inheritance tax is tied to the Federal Estate Tax Credit); WYO. STAT. ANN. §§ 39-19-103 to -104 (2009) (stating that the Wyoming inheritance tax is tied to the Federal Estate Tax Credit).

lative level to change its status.[29] The remaining state, South Dakota, would require much more: a change in its state constitution.[30] Though it seems unlikely that any of the required events will take place in the near future, one should be aware that additional states, specifically Texas, Utah, and Wyoming, have this ability.

With respect to the states that currently collect inheritance taxes, there is generally a consistency among their statutes with regards to the types of property interests which are taxable. These property interests are classified as either: (1) real property;[31] (2) tangible personal property;[32] or (3) intangible

29. *See* MICH. COMP. LAWS § 205.223(a) (2009) (stating that the inheritance tax was phased out in 1993).

30. *See* S.D. CONST. art. XI, § 15 (declaring inheritance taxation as unconstitutional).

31. *See* IND. CODE §§ 6-4.1-2-2(a)(1)-(3) (taxing the transfer of a resident's interests in "real property located [with]in [the] state, . . . tangible personal property which does not have an actual situs outside [the] state," and "intangible personal property"); IND. CODE §§ 6-4.1-2-3(a)(1) (2009) (taxing the transfer of a non-resident's interest in "real property located in [the] state" and "tangible personal property which has an actual situs in [the] state"); IOWA CODE § 450.2(1) (2009) ("The following . . . which pass from the decedent . . . are subject to tax . . . : (1) Real estate and tangible personal property located in this state regardless of whether the decedent was a resident . . . [and] (2) Intangible personal property owned by a decedent domiciled in this state"); KY. REV. STAT. ANN. § 140.010 (West 2009)) (taxing the following transfers: (1) "[a]ll real and personal property within the jurisdiction of this state and any interest therein belonging to inhabitants of this state[;]" (2) "all tangible personal property . . . belonging to inhabitants of this state that has not acquired [an outside] situs[;]" (3) "all intangible property belonging to persons domiciled in this state except partnership property located in another state which is subject to an inheritance or estate tax in that state[;]" (4) "all intangible property belonging to nonresidents that has acquired a business situs in this state[;]" (5) "all real property or interest therein within this state and all tangible personal property that has acquired a situs in this state and is not taxable elsewhere belonging to persons who are not inhabitants of this state"); LA. REV. STAT. ANN. § 47:2404(A) (2009) (taxing the following transfers: (1) "all immovable property and all tangible moveable property physically in the State of Louisiana, whether owned . . . by . . . a resident or nonresident", (2) "all movable property, tangible or intangible, owned by residents of the State of Louisiana"); OR. REV. STAT. § 118.010(3)-(4)(a) (2009) (taxing the following transfers owned by residents: "the appraised value of the decedent's real property located in Oregon, tangible personal property located in Oregon and intangible personal property located both in and outside of Oregon"); 72 PA. CONS. STAT. § 9116(b)(2) (2009) ("[w]hen the decedent was a nonresident, the tax shall be computed upon the value of real property and tangible personal property having its situs in this Commonwealth"); TENN. CODE ANN. § 67-8-303(a)(1)-(2) (2009) ("(1) When the transfer is from a domiciliary of this state [the following is taxable]: (A) Real property situated within this state; (B) Tangible personal property, except such as has an actual situs without this state; (C) All intangible personal property . . . (2) When the transfer is from a decedent who is not a domiciliary of this state [the following is taxable]: (A) Real property situated within this state; and (B) Tangible personal property that has an actual situs within this state."). *But see* MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) ("Except as provided in § 7-203 of this subtitle, [the tax exemption portion of Maryland's statute,] a tax is imposed on the privilege of receiving property that passes from a decedent and has a taxable situs in the State").

personal property.[33] Obviously real property retains its legal meaning of real estate or land.[34] Tangible personal property refers to property which is corporeal in nature and generally is "perceptible to the senses."[35] On the other hand, intangible personal property is incorporeal and "lacks a physical existence."[36]

Most of the states draw distinctions on when these property interests are taxable based on the residency[37] or domicile of the decedent.[38] While there

32. *See* IND. CODE §§ 6-4.1-2-2(a)(2), 6-4.1-2-3(a)(2) (2009); IOWA CODE § 450.2(1) (2009); KY. REV. STAT. ANN. § 140.010 (West 2009); LA. REV. STAT. ANN. § 47:2404(A) (2009); N.J. STAT. ANN. § 54:34-1(a)-(b) (West 2009); OR. REV. STAT. § 118.010(3)-(4)(a) (2009); 72 PA. CONS. STAT. § 9116(b)(2) (2009); TENN. CODE ANN. § 67-8-303(a)(1)(B), (2)(B) (2009). *But see* MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) (stating that Maryland imposes a tax on all property which "has a taxable situs in the State").

33. *See* IND. CODE § 6-4.1-2-2(a)(3) (2009); IOWA CODE § 450.2(2) (2009); KY. REV. STAT. ANN. § 140.010 (West 2009); LA. REV. STAT. ANN. § 47:2404(A) (2009); N.J. STAT. ANN. § 54:34-1(a) (West 2009); OR. REV. STAT. § 118.010(3)-(4)(a) (2009); TENN. CODE ANN. § 67-8-303(a)(1)(C) (2009). *But see* MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) (stating that Maryland imposes a tax on all property which "has a taxable situs in the State"); 72 PA. CONS. STAT. § 9116(b)(1) (2009) (stating that Pennsylvania taxes the transfer of all property previously owned by a resident).

34. *See* IOWA CODE § 450.1(d) (2009) ("'Real estate or real property' for the purpose of appraisal under this chapter of [the Iowa Inheritance Tax Code] means real estate which is the land and appurtenances, including structures affixed thereto"); *see also* BLACK'S LAW DICTIONARY 1254 (8th ed. 2004) [hereinafter BLACK'S] (defining real property as "[l]and and anything growing on, attached to, or erected on it, excluding anything that may be severed without injury to the land").

35. *See, e.g.*, IND. CODE § 6-4.1-1-13 (2009) ("'Tangible personal property' means corporeal personal property, such as goods, wares, and merchandise"); s*ee also* BLACK'S, *supra* note 34 (defining tangible personal property as [c]orporeal personal property of any kind; personal property that can be seen, weighed, measured, felt, or touched, or is in any other way perceptible to the senses, such as furniture, cooking utensils, and books").

36. *See, e.g.*, IND. CODE § 6-4.1-1-5 (2009) ("'Intangible personal property' means incorporeal property, such as money, deposits, credits, shares of stock, bonds, notes, other evidences of indebtedness, and other evidences of property interests"); *see also* BLACK'S *supra* note 34, at 1253 (defining intangible property as "[p]roperty that lacks a physical existence," such as "stock options and business goodwill").

37. *See* IOWA CODE § 450.2(1) (2009) (stating that the transfer of real and tangible personal property is taxed regardless of whether the decedent was a resident at the time of death); KY. REV. STAT. ANN. § 140.010 (West 2009) (indicating that taxable property interests are determined by the decedent's status as a resident or non-resident); NEB. REV. STAT. § 77-2001 (2009) (indicating that taxable property interests are determined by the decedent's status as a resident or non-resident); N.J. STAT. ANN. § 54:34-1(a)-(b) (West 2009) (stating that taxable property interests are determined by the decedent's status as a resident or non-resident); OR. REV. STAT. § 118.010(3)-(4)(a) (2009) (stating that taxable property interests are determined by the decedent's status as a resident or non-resident); 72 PA. CONS. STAT. § 9116(b)(1)-(2) (2009) (stating that taxable property interests are determined by the decedent's status as a resident or non-resident).

38. *See* IND. CODE §§ 6-4.1-1-7, 6-4.1-1-11 (2009) (stating that in Indiana a person is considered a non-resident decedent if they were "not domiciled in Indiana at the time of . . . .

is this distinction among the states, it has no bearing on how the transfers of the real and tangible personal property located in the state are taxed—they are all taxable regardless of who the decedent is.[39] However, in regards to intangible property interests, the states generally only tax a transfer of this type if it was held by a resident prior to his or her death.[40] As such, transfers of a non-resident's intangible property interests go untaxed by the state.[41] There are

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death" and considered a resident if they were "domiciled in Indiana at the time of . . . . death"); IOWA CODE § 450.2(2) (2009) (stating that in Iowa the transfer of a person's intangible personal property will be taxed if the decedent was domiciled in the state); KY. REV. STAT. ANN. § 140.010 (West 2009) (stating that transfers of intangible personal property belonging to people domiciled in Kentucky are subject to taxation); TENN. CODE ANN. § 67-8-303(a)(1),(2) (2009) (stating that the taxability of property interests transfers are dependant upon whether the decedent was a domiciliary of Tennessee).

39. *See* IND. CODE §§ 6-4.1-2-2(a)(1)-(2), 6-4.1-2-3(a)(1)-(2) (2009); IOWA CODE § 450.2(1) (2009); KY. REV. STAT. ANN. § 140.010 (West 2009); LA. REV. STAT. ANN. § 47:2404(A) (2009); MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) (indicating that all property with a taxable situs in the State, which includes property located in the state, is taxable); NEB. REV. STAT. § 77-2001 (2009); N.J. STAT. ANN. § 54:34-1(a)-(b) (West 2009); OR. REV. STAT. ANN.§ 118.010(3)-(4)(a) (West 2009); 72 PA. CONS. STAT. § 9116(b)(1)-(2) (2009); TENN. CODE ANN. § 67-8-303(a)(1)(A)-(B), (2)(A)-(B) (2009).

40. *See* IND. CODE § 6-4.1-2-2(a)(1)-(3) (2009); IOWA CODE § 450.2(2) (2009); LA. REV. STAT. ANN. § 2404(A) (2009); N.J. STAT. ANN. § 54:34-1(a) (West 2009); 72 PA. CONS. STAT. § 9116(b)(1)-(2) (2009); TENN. CODE ANN. § 67-8-303(a)(1)(C) (2009). *But see* KY. REV. STAT. ANN. § 140.010 (West 2009) (taxing the transfer of intangible personal property of nonresidents which have a business situs in Kentucky); MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) (taxing the transfer of all property interests with a business situs in Maryland, including intangible personal property of a non-resident); NEB. REV. STAT. § 77-2001 (2009) (taxing the transfer of all non-resident property interests located within the state of Nebraska); OR. REV. STAT. § 118.010(4)(a) (2009) (taxing the transfer of non-resident "intangible personal property located in Oregon").

41. *See* LA. REV. STAT. ANN. § 47:2404(A) (2009) (stating that "the tax shall not be imposed upon any transfer of intangible movable property owned by a person not domiciled in this state at the time of his death"). *See generally* IND. CODE § 6-4.1 (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property); IOWA CODE §§ 450.1-450B.7 (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property); N.J. STAT. ANN. §§ 54:34-1 to 54:34-16 (West 2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property); 72 PA. CONS. STAT. § 9111(h) (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property); TENN. CODE ANN. §§ 67-8-301 to 67-8-705 (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property). *But see* KY. REV. STAT. ANN. § 140.010 (West 2009) (taxing the transfer of intangible personal property of nonresidents which have a business situs in Kentucky); MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) (taxing the transfer of all property interests with a business situs in Maryland, including intangible personal property of a non-resident); NEB. REV. STAT. § 77-2001 (2009) (taxing the transfer of all non-resident property interests located within the state of Nebraska); OR. REV. STAT. § 118.010(4)(a) (2009) (taxing the transfer of non-resident "intangible personal property located in Oregon").

some slight variations on this general rule. In some states a nonresident's intangible property interest can be taxed if it has a situs in the taxing state.[42] However this does not negate the fact that every state is statutorily precluded from taxing a non-resident's intangible personal property interest when the situs is located outside of the state.[43] Therefore, if farmers with real and tangible personal property within inheritance taxing states could qualify as a nonresident and somehow convert these assets into intangible personal property with an out-of-state situs, their property would be completely shielded from inheritance taxation.

III. UTILIZING FOREIGN LIMITED LIABILITY COMPANIES AS TAX SHELTERS: WHY THEY CAN BE USED AND WHO CAN BENEFIT FROM THEIR PROTECTION

Limited liability companies are a relatively new type of business association which combines the pass through taxation of a partnership and the limited liability of a corporation into a single entity.[44] Prior to their "advent . . .

42. *See* KY. REV. STAT. ANN. § 140.010 (West 2009) (taxing the transfer of intangible personal property of nonresidents which have a business situs in Kentucky); MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) (taxing the transfer of all property interests with a business situs in Maryland, including intangible personal property of a non-resident); NEB. REV. STAT. § 77-2001 (2009) (taxing the transfer of all non-resident property interests located within the state of Nebraska); OR. REV. STAT. ANN.§ 118.010(4)(a) (West 2009) (taxing the transfer of non-resident "intangible personal property located in Oregon").

43. *See* LA. REV. STAT. ANN. § 47:2404(A) (2009) (stating that "the tax shall not be imposed upon any transfer of intangible movable property owned by a person not domiciled in this state at the time of his death"); MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) ("Except as provided in § 7-203 of this subtitle, [the tax exemption portion of Maryland's statute,] a tax is imposed on the privilege of receiving property that passes from a decedent and has a taxable situs in the State."); NEB. REV. STAT. § 77-2001 (2009) (taxing the transfer of non-resident's intangible personal property only if located within the state of Nebraska); OR. REV. STAT. § 118.010(4)(a) (2009) (taxing the transfer of non-resident's intangible personal property only if located within the state of Oregon). *See generally* IND. CODE §§ 6.4.1-1-1 to 6-4.1-12-12 (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property which has a situs outside of Indiana); IOWA CODE§§ 450.1-450B.7 (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property which has a situs outside of Iowa); KY. REV. STAT. ANN. §§ 140.010–140.360 (West 2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property which has a situs outside of Kentucky); N.J. STAT. ANN. §§ 54:34-1 to 54:34-16 (West 2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property); 72 PA. CONS. STAT. §§ 9101-9196 (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property); TENN. CODE ANN. §§ 67-8-301 to 67-8-705 (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property).

44. Carter G. Bishop & Daniel S. Kleinberger, Limited Liability Companies: Tax and Business Law (RIC), ¶ 1.01[1] (2009).

it was impossible to have both the tax status of a partnership and the liability shield of a corporation."[45] The limited liability company phenomenon began in 1977 when the Wyoming legislature passed the first LLC Act,[46] but it only really took off after the IRS released its opinion holding that Wyoming limited liability companies would be classified as partnerships for taxation purposes.[47] Since then "all fifty states and the District of Columbia have LLC statutes, and, as of 1995, more than 210,000 LLCs had been formed."[48] Today, they "provide an advantageous legal structure for a wide variety of business ventures, including [1] businesses that would otherwise be conducted as . . . general partnerships [or] limited partnerships; . . . [2] businesses [and venture capital arrangements] whose interests are not publically traded; . . . [3] joint ventures between corporations; . . . [4] professional firms; . . . [and] [5] estate planning arrangements."[49]

A. *Foreign Limited Liability Company Tax Shelters: The Nuts and Bolts as to How They Protect*

In regards to estate planning, specifically the type promoted in this Note, the most important aspect of limited liability companies is how the law characterizes the member's interest in both the company and the company's assets. In every state, statutes expressly say that a member's interest in a limited liability company is a personal property interest.[50] Since that interest is incorporeal and "lacks a physical existence," it is also intangible in nature.[51] Because the interest the members possess is in the legal construct of a limited liability company, they have no interest in any of the property that the construct owns.[52]

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45. *Id.* ¶ 1.01[2].

46. *Id.* ¶ 1.01[3][a].

47. *Id.* ¶ 1.01[3][b].

48. *Id.* ¶ 1.01[1] (citing Susan Pace Hamill, *The Limited Liability Company: A Catalyst Exposing the Corporate Integration Question*, 95 MICH. L. REV. 393, 403 (1996)).

49. *Id.* ¶ 1.02.

50. *See, e.g.,* ALASKA STAT. § 10.50.370 (2009); CAL. CORP. CODE § 17300 (West 2009); DEL. CODE ANN. tit. 6, § 18-701 (2009); IDAHO CODE ANN. § 30-6-501 (2009); KAN. STAT. ANN. § 17-76,111 (2009); MICH. COMP. LAWS § 450.4504(1) (2009); N.H. REV. STAT. ANN. § 304-C:45 (2009); OKLA. STAT. tit. 18, § 2032 (2009); WIS. STAT. § 183.0703 (2009).

51. *See generally* BLACK'S, *supra* note 34, at 1253 (defining intangible property as "[p]roperty that lacks a physical existence" such as stock options and business goodwill); Riverboat Dev., Inc. v. Ind. Dep't of State Revenue, 881 N.E.2d 107, 110-111 (Ind. T.C. 2008) (stating that under Indiana law a membership interest in a limited liability company is intangible personal property).

52. Bishop & Kleinberger, *supra* note 44, ¶ 5.04[2][c].

> The construct may well own real property, but individual members have no interest in that underlying realty. An enabling statute may explicitly recognize this property structure, but, with or without a statutory confirmation, the structure follows inevitable from the fact that a limited liability company is a separate legal person.[53]

Therefore, the only taxable interest that members possess in limited liability companies, for purposes of inheritance taxation, is an intangible personal property interest.

It is the characterization of a member's interest as intangible personal property which allows non-residents to utilize limited liability companies as shields against inheritance taxation. As stated *supra*, members have no interest in property owned by their limited liability company.[54] Once a non-resident member transfers all of the real and personal property that he owns in an inheritance tax state into a foreign limited liability company the property interests are no longer owned by the member.[55] Instead, the company holds the real and tangible personal property interests and the members are left with only a property interest in the limited liability company.[56] Since the only property interest

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53. *Id.* (citations omitted). *See, e.g.*, ALASKA STAT. § 10.50.350(a) (2009) ("[p]roperty transferred to or otherwise acquired by a limited liability company is the property of the company and is not the property of the members individually"); ARK. CODE ANN. § 4-32-701(b) (2009) ("[a]ny interest in real property may be acquired in the name of the limited liability company, and title to any interest so acquired shall vest in the limited liability company rather than the members individually"); HAW. REV. STAT. § 428-501(a) (2009) ("member is not a co-owner of, and has no transferable interest in, property of a limited liability company"); MONT. CODE ANN. § 35-8-701(1) (2009) ("member has no interest in specific limited liability company property"); IDAHO CODE ANN. § 30-6-501 (2009) ("This Act does not include ULLCA § 501(a) which provided: 'A member is not a co-owner of, and has no transferable interest in, property of a limited liability company.' That language was a vestige of the 'aggregate' notion of the law of general partnerships, and in a modern LLC statute would be *at least surplusage* and perhaps confusing as well.") (emphasis added); WIS. STAT. § 183.0701(1) (2009) ("property originally transferred to or subsequently acquired by or on account of a limited liability company is property of then limited liability company and not of the members individually"); Hackl v. Comm'r., 118 T.C. 279, 290 (2002) (holding that ownership interest in an Indiana limited liability company is "personal property separate and distinct from the LLC's assets"); *In re* Calhoun, 312 B.R. 380, 384 (Bankr. N.D. Iowa 2004) (indicating that owner's property interest in an Iowa limited liability company "is narrowly confined to the intangible rights represented by the . . . ownership documentation"). But see Colorado, Florida, Nebraska, and Wyoming statutes lacking any specific statutory provision stating members of an LLC have no interests in the property and assets held by the LLC. COLO. REV. STAT. §§ 7-80-101 to 7-80-1101; FLA. STAT. §§ 608.01 to 608.705 (2009); NEB. REV. STAT. §§ 21-2601 to 21-2653 (2009); WYO. STAT. ANN. § § 17-15-101 to 17-15-147 (2009).

54. Bishop & Kleinberger, *supra* note 44, ¶ 5.04[2][c].

55. *See id.*

56. *Id.*

all inheritance tax states are statutorily precluded from taxing is a non-resident's out-of-state intangible personal property interest,[57] and because ownership in a foreign limited liability company is also this type of interest,[58] the taxing state is barred from collecting inheritance taxes on both the member's interest in the limited liability company and on the property now owned by the business. The only states that can assess inheritance taxes on the member's interest are the states in which the member currently is domiciled or the state in which the limited liability company is located.[59] As long as those states do not have an inheritance tax, none will be collected.[60]

B. *The Snowbird: The Retired Farmers Who Can Benefit from Foreign Limited Liability Company Tax Shelters*

It should be obvious by this point that the type of estate planning advocated in this Note is not for everyone. However, there is one type of client in particular who can benefit from a foreign limited liability company tax shelter: the "snowbird." A snowbird is "a person who vacations in or moves to a warmer climate during cold weather."[61] Generally these people will migrate from the northern states to the Sunbelt states in the winter, "particularly Arizona, Florida, and Texas."[62]

57. *See* KY. REV. STAT. ANN. § 140.010 (West 2009); MD. CODE ANN., TAX-GEN. § 7-202 (West 2009); NEB. REV. STAT. § 77-2001 (2009); OR. REV. STAT.§ 118.010(4)(a) (2009).

58. *See* Bishop & Kleinberger, *supra* note 44, ¶ 5.04[2][c] (indicating that membership interest is characterized as intangible personal property); *see also* BLACK'S, *supra* note 34, at 1253 (defining intangible property as "[p]roperty that lacks a physical existence" such as stock options and business goodwill"); Riverboat Dev., Inc. v. Ind. Dept. of State Revenue, 881 N.E.2d 107, 110-111 (Ind. T.C. 2008) (stating that under Indiana law a membership interest in a limited liability company is intangible personal property).

59. *See* IND. CODE § 6-4.1-2-2(a)(3) (2009); IOWA CODE § 450.2(2) (2009); KY. REV. STAT. ANN. § 140.010 (West 2009); LA. REV. STAT. ANN. § 47:2404(A) (2009); NEB. REV. STAT. § 77-2001 (2009); N.J. STAT. ANN. § 54:34-1(a)-(b) (West 2009); OR. REV. STAT. § 118.010(3)-(4)(a) (2009); TENN. CODE ANN. § 67-8-303(a)(1)(C) (2009). *But see* MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) (stating that Maryland taxes on all property which "has a taxable situs in the State"); 72 PA. CONS. STAT. § 9116(b)(1) (2009) (stating that Pennsylvania taxes the transfer of all property previously owned by a resident).

60. For the sake of convenience, it would therefore be prudent to establish the limited liability company in the same state in which the member resides.

61. WEBSTER'S, *supra* note 1.

62. Stephen K. Happel & Timothy D. Hogan, *Counting Snowbirds: The Importance of and the Problems with Estimating Seasonal Populations*, 21 POPULATION RES. & POL'Y REV. 227, 227 (2002).

While national statistics on the number of snowbirds traveling in the United States currently "remain[s] an elusive topic for U.S. demographers,"[63] there are some state specific statistics which give a slight indication as to the large numbers of people traveling south for the winter.[64] According to Arizona estimates, approximately 273,000 long term seasonal residents visit their state during the peak snowbird season.[65] Likewise in Florida, a survey done in 2005 approximated that 698,000 "snowbirds" flock to the Sunshine State during the peak season.[66] That same survey also found that the state had roughly 617,000 "sunbird" residents, which are defined as permanent residents who "spent more than thirty consecutive days" in another state.[67] These numbers, researchers suggest, will only increase given "the aging baby boom, longer life expectancies, and rising household wealth . . . ."[68]

However, not all "snowbirds" will be able to take advantage of the foreign limited liability tax shelter. It can only be utilized when the "snowbird" has established domicile outside of the inheritance tax state.[69] While it is impossible to approximate how many "snowbirds" fit this description, a second look at the Florida survey suggests that a little less than half of traveling retirees might qualify.[70] As stated *supra*, 698,000 migrating retirees were classified as short term "snowbirds", whereas, 617,000 consider themselves residents of Florida.[71] It is this second type of retirees that this Note is focusing on because of their propensity to establish domicile in a state other than their original one.

Nevertheless the domicile status of the second is not a foregone conclusion. Since "[t]he determination of domicile is a question of fact, not law," an estate planner will have to look at many factors to determine if their snowbird client would qualify as a non-resident.[72] These factors include:

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63. *Id*.

66. *See id.*

65. *Id.*

66. Stanley K. Smith & Mark House, *Snowbirds, Sunbirds, and Stayers: Seasonal Migration of Elderly Adults in Florida*, 61B J. GERONTOLOGY: SOC. SCI. S232, S233 (2006).

67. *Id.* at S235.

68. Happel & Hogan, *supra* note 62.

69. *See, e.g.*, LA. REV. STAT. ANN. § 47:2404(A) (2009) (indicating that intangible personal property, like a person's interest in a limited liability statute says nothing about LLCs company, is not taxed when the decedent is not domiciled in Louisiana).

70. *See* Smith & House, *supra* note 66, at S233, S235.

71. *Id.*

72. George A. Wilson, *Domicile and Avoiding Ancillary Administrations*, in KOREN: ESTATE AND PERSONAL FINANCIAL PLANNING, § 20:3 (2009).

> (1) [t]he amount of time the person spends at the residence; (2) [t]he activities carried on at the residence; (3) [w]ho lives at the residence with the individual and the relationship among the habitants; (4) [w]hat tangible personal property is kept at the residence; (5) [t]he person's apparent attitude toward the residence; (6) [t]he individual's intention to return to the residence when absent; and (7) [t]he person's apparent attitude toward other places with which contact has been made.[73]

Because the test for domicile is so case specific, a cautious attorney should have their client take certain steps in order to firmly establish domicile.[74] Steps which the client can take within their new domicile include filing a declaration of domicile, maintaining a physical presence and financial accounts in the new state, changing their domicile on all relevant documents, registering to vote in the new state, filing tax returns locally, and obtaining a new drivers license.[75] It is also a good idea for the client to terminate any prior organizational memberships he or she may have had in their original state.[76] While not all of these things are required in order to establish domicile, "[c]ompliance with as many items as possible . . . may later prove important in establishing evidence that a change of domicile was intended and did in fact take place."[77]

IV. STATE DEATH TAXATION: WHERE THE PROBLEM LIES AND WHERE TO FIX IT

Once a judgment has been made that the client can establish or has established domicile in a state that does not assess an inheritance tax, then the question remains as to whether a foreign limited liability company should be utilized. As discussed *supra*, the transfer of a decedent's property can be assessed at the state level by either estate or inheritance taxation.[78] Since states can tax in either or both of these two ways, it is important for clients seeking to use the tax advice advocated in this Note to know which states assess these taxes.[79]

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73. *Id*.

74. *Id*. § 20:4 (providing checklists that should be utilized by clients who want to affirmatively change their domicile).

75. *Id.*

76. *Id.*

77. *Id.*

78. *Death Taxation*, *supra* note 12.

79. *See, e.g.*, MD. CODE ANN., TAX-GEN. § 7-202 (West 2009); MD. CODE ANN., TAX-GEN. § 7-302 (West 2009) (indicating Maryland has both an inheritance and estate tax); IOWA CODE § 450.2 (2009) (indicating Iowa's only death tax is the state inheritance tax); N.C. GEN.

Knowledge of states with active estate taxation is vital when choosing a state in which to establish their tax shelter so that they are not escaping one death tax only to be slapped with another. Likewise, an understanding of specific provisions of a state's inheritance tax code will allow clients to know how much their expected transfers will be taxed, so they can make informed decisions regarding their estate planning. Since the primary focus of this Note is to help shield farm transfers made to immediate lineal descendents from inheritance taxation, the rest of this section will discuss the inheritance tax consequences of this type of transfer in each taxing state. This section will also provide an overview of estate taxation, so that wise choices can be made regarding the implementation of a foreign limited liability company tax shelter.

A. *States with Inheritance Taxation: The Good, the Bad, and the Ugly*

In order to know if the establishment of a foreign limited liability company would be proper in a given situation, an assessment of the inheritance tax consequences must first be made. Two types of provisions commonly found in each inheritance tax code which determine the amount of the tax collected are those concerning: (1) the types of exemptions available,[80] and (2) the applicable tax rates for certain individuals.[81] While inheritance tax statutes all contain these types of provisions, they often differ slightly in scope and effect.[82] These variations equate into massive differences in regards to the amount of the tax assessed against the decedent's beneficiaries.[83] While some of the states have

STAT. ANN. § 105-32.3 (West 2009) (indicating North Carolina's only death tax is the state estate tax).

80. *See, e.g.*, MD. CODE ANN., TAX-GEN. § 7-203 (West 2009) (listing the exemptions allowed under the inheritance tax law); N.J. STAT. ANN. § 54:34-4 (West 2009) (detailing the exemptions allowed under the New Jersey inheritance tax law).

81. *See, e.g.*, 72 PA. CONS. STAT. § 9116 (2009) (indicating the rates of taxation for various classes of individuals); TENN. CODE ANN. § 67-8-314 (2009) (stating the rates of taxation for different classes of individuals).

82. *Compare* IOWA CODE § 450.9 (2009) (granting a complete exemption to children), *and* NEB. REV. STAT. § 77-2004 (2009) (imposing a one percent tax rate on transfers to children), *with* LA. REV. STAT. ANN. § 47:2402(1)(d) (2009) (granting a $25,000 exemption to children), *and* 72 PA. CONS. STAT. § 9116(a)(1) (2009) (imposing a four and one half percent tax rate on transfers to children).

83. *Compare* IOWA CODE § 450.9 (2009) (granting a complete exemption to children results in no inheritance tax collected by the state), *with* 72 PA. CONS. STAT. § 9116(a)(1) (2009) (imposing a four and one half percent tax rate on transfers to children, which results in a $45,000 tax inheritance tax on a one million dollar transfer).

provisions which are very favorable to the transfer of assets to children,[84] others are not.[85] In order to determine which clients would most benefit from utilizing the tax shelter advocated in this Note, it is necessary to discuss each state's exemptions and tax rates.

1. *The Good States: States Which Do Not Assess Inheritance Taxes on the Children of the Decedent*

There are currently four states which do not assess inheritance taxes on the transfer of assets to children: Iowa,[86] Kentucky,[87] Maryland,[88] and New Jersey.[89] In Iowa, the exemption is given to the surviving spouse, the lineal ascendants, and lineal descendents.[90] Kentucky grants its exemption to the surviving spouse, parents, lineal decedents, and siblings.[91] A slightly more extensive exemption is granted in Maryland, which includes the spouse of the decedent, lineal descendents and their spouses, parents, grandparents, siblings, and business entities which consist of owners that already receive an exemption.[92] In New Jersey an exemption is granted to domestic partners as well as

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84. *See, e.g.*, IOWA CODE § 450.9 (2009); KY. REV. STAT. ANN. § 140.080(1)(c)(4) (West 2009); MD. CODE ANN., TAX-GEN. § 7-203(b)(2)(i)-(vii) (West 2009); N.J. STAT. ANN. § 54:34-2(a)(1)-(2) (West 2009).

85. *See, e.g.*, IND. CODE § 6-4.1-5-1(b) (2009) (assessing a graduated inheritance tax on the non-exempt property transferred to children); NEB. REV. STAT. § 77-2004 (2009) (granting a $40,000 exemption on the transfer of assets to children and assessing a one percent tax on all non-exempt property that is transferred to children); 72 PA. CONS. STAT. § 9116(a)(1) (2009) (assessing a four and one half percent inheritance tax on the transfer of all assets to children).

86. IOWA CODE § 450.9 (2009) ("the entire amount of property . . . passing to the surviving spouse . . . lineal ascendants, children including legally adopted children and biological children entitled to inherit under the laws of this state, stepchildren . . . and other lineal descendants are exempt from tax").

87. KY. REV. STAT. ANN. § 140.080(1)(c)(4) (West 2009) (stating that Class A beneficiaries have an exemption on their total inheritable interest); *see also* KY. REV. STAT. ANN. § 140.070(1) (West 2009) (Class A beneficiaries include: "[a] child by blood, stepchild, child adopted during infancy, [and a] child adopted during adulthood who was reared by the decedent during infancy").

88. MD. CODE, TAX-GEN. § 7-203(b) (West 2009). ("'Child' includes a stepchild or former stepchild").

89. N.J. STAT. ANN. § 54:34-2(a)(2) (West 2009) (stating that no taxes will be imposed on children, adopted children, or lineal decedents).

90. IOWA CODE § 450.9 (2009).

91. KY. REV. STAT. ANN. § 140.080(1)(a) (West 2009) (surviving spouse); KY. REV. STAT. ANN. §§ 140.070(1), 140.080(1)(c)(4) (West 2009) (parents, lineal descendants, and siblings).

92. MD. CODE ANN., TAX-GEN. § 7-203(b)(2), (b)(1)(ii) (West 2009) ("'Child' includes a stepchild or former stepchild").

spouses, parents, grandparents, children, and lineal decedents.[93] Given these states' sweeping prohibitions on the taxation of family members,[94] there is no reason to create a foreign limited liability company tax shelter to shield children from the imposition of inheritance taxes.[95]

2. *The Bad States: States Which Assess Inheritance Taxes on Children, but May Not Pose a Problem for Certain Clients*

Farmers looking to pass on their legacies in Louisiana, Oregon, and Tennessee need to evaluate the effects of the tax laws on their expected transfers to determine if the anticipated taxation is great enough to warrant a shielding of their property.[96] In each of these states the size of the farming operation needs to be considered when deciding upon the benefits of the approach promoted herein because they either have very minuscule tax rates,[97] or they

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93. N.J. STAT. ANN. § 54:34-2(a)(1)-(2) (West 2009).

94. *But see* MD. CODE ANN., TAX-GEN. § 7-302 (West 2009) (indicating that Maryland has an estate tax); N.J. STAT. ANN. §54:38-1(a)(2) (West 2009) (indicating that the New Jersey estate tax is decoupled from the federal estate tax credit and that estate taxes will be assessed on the transfer of property to children). For this reason it may be wise to set up a tax shelter for property located in New Jersey regardless of the complete exemption given to children on the assessment of inheritance taxes.

95. *But see* IOWA CODE § 450.10(1) (2009) (indicating that an increasing percentage tax will be assessed when property "passes to a brother or sister, son-in-law, or daughter-in-law"); KY. REV. STAT. ANN. § 140.070(2) (West 2009) (stating that an increasing inheritance tax will be assessed on all Class B beneficiaries: "a nephew, niece, or a nephew or niece of the half blood, daughter-in-law, son-in-law, aunt or uncle, or a great-grandchild who is the grandchild of a child by blood, of a stepchild or of a child adopted during infancy"); KY. REV. STAT. ANN. § 140.080(1)(d) (West 2009) ("[a]ll persons of Class B . . . . [will receive a] $1,000 [exemption]"); N.J. STAT. ANN. § 54:34-2(c)(2) (West 2009) (imposing a transfer tax on siblings, daughter-in-laws, and son-in-laws which ranges from a low of 11% on transfers in excess of $25,000 to a high of 16% on transfers over $1,700,000).

96. *See* LA. REV. STAT. ANN. § 47:2403(A), (E)(4) (2009) (indicating an inheritance tax rate between .4% to .6% for transfers made to children suggesting that only very large transfers will benefit heavily from a tax shelter); TENN. CODE ANN. § 67-8-316(b) (West 2009) (indicating that there is a million dollar exemption on the value of the estate as a whole, which suggests that only very large transfers will benefit heavily from a tax shelter); OR. REV. STAT. § 118.160 (2009) (listing the exemptions for the state inheritance tax for certain time periods); PATRICK J. GREEN & STEPHEN KANTOR, THE NEW OREGON INHERITANCE TAX A/K/A WHAT'S A LITTLE MORE CHAOS? 5 (2005), *available at* http://www.dwt.com/portalresource/lookup/wosid/intelliun-1501-1152/media.pdf (indicating that Oregon has a one million dollar exemption of the value of the estate as a whole, which suggests that only very large transfers will benefit heavily from a tax shelter).

97. *See* LA. REV. STAT. ANN. § 47:2403(A), (E)(4) (2009) (tax rates between .4% to .6% for transfers made to children).

provide for very large exemptions.[98] Due to the extremely particularized nature of each state's tax law, they will be examined individually.

While Louisiana gives a paltry exemption of $25,000 to transfers made to children and other direct descendents,[99] the nonexempt property is taxed at a very low tax rate.[100] Once the exemption is deducted from the value of the transferred property, the first $20,000 is only taxed at a rate of .4%.[101] Then everything in excess of the initial $45,000 is taxed at .6%.[102] Given that the average value of a farm in Louisiana is roughly $633,268,[103] the typical transfer of a farm to a child would equate into approximately $3,610 in inheritance taxes.[104] Given the small tax consequences, a tax shelter may not be the appropriate route.

However, in a larger farming operation a foreign limited liability company might be necessary. In Louisiana there are currently 1,103 farms with average market values of $2,396,561 in land and buildings[105] and 819 farms which are valued at $5,926,902 on average.[106] Inheritance taxes assessed on the

98. *See* TENN. CODE ANN. § 67-8-316(b) (West 2009) (exemption of a million dollars on the value of the estate as a whole); GREEN & KANTOR, *supra* note 96, at 5.

99. LA. REV. STAT. ANN. § 47:2402(1)(d) (2009).

100. LA. REV. STAT. ANN. § 47:2403(A) (2009) ("no tax shall be collected or be due on the amount exempt by R.S. 2402; the tax shall be two percent on the fair market value thereof at the time of death on the next twenty thousand dollars, and three percent . . . on any amount in excess of the sum of the exemption plus twenty thousand dollars"); LA. REV. STAT. ANN. § 47:2403(E)(4) (2009) ("[f]or deaths occurring after June 30, 2003, the tax rates provided in this Section shall be reduced by eighty percent").

101. LA. REV. STAT. ANN. § 47:2403(A), (E)(4) (2009) (showing the rate of 2% is reduced by 80% to get to a rate of .4%).

102. LA. REV. STAT. ANN. § 47: 2403(A), (E)(4) (2009) (showing the rate of 3% is reduced by 80% to get to a rate of .6%).

103. *See* NAT'L AGRIC. STATISTICS SERV., USDA, 2007 CENSUS OF AGRICULTURE: LOUISIANA STATE AND PARISH DATA 7 (2009), *available at* http://www.agcensus.usda.gov/Publications/2007/Full_Report/Volume_1,_Chapter_1_State_Level/Louisiana/lav1.pdf [hereinafter LOUISIANA CENSUS] (indicating that the average farm has land and buildings with estimated market values of $554,270 and machinery and equipment with an estimated market value of $78,998).

104. *See* LA. REV. STAT. ANN. § 47:2402-2403 (2009). After reducing the 2% and 3% tax rates applicable under § 2403(A) by the 80% discussed in section 2403(E)(4), the taxable rates are .4% and .6% respectively. Since under § 2402(1)(d) the first $25,000 is exempt, only $608,268 of the transfer is taxable. The first $20,000 is taxed at .4%, which equates into an $80 tax. The rest of the transfer is taxed at .6%, which equates into a tax of $3,529.58.

105. LOUISIANA CENSUS, *supra* note 103, at 65 (referring to farms with 1,000-1,999 acres of land).

106. *Id.* (referring to farms with 2,000 or more acres of land).

land and buildings of these farms would be approximately $14,189[107] and $35,371[108] respectively. As such, it may be worth it to set up a limited liability company to hold these client's assets.

Oregon, on the other hand, grants a very large exemption to all transfers of property.[109] Unlike many of the states that tax inheritances,[110] Oregon does not give an exemption to the transfers of children directly,[111] but rather, offers a million dollar exemption on the value of all the decedent's taxable property as a whole.[112] Property that exceeds this exemption then gets taxed by an increasing tax rate.[113] These rates are determined by prior federal statutes due to Oregon's decision to tie their inheritance tax law to the federal tax law as it operated in 2000.[114]

Given the large exemption granted under Oregon law it is possible that many clients will not need a tax shelter.[115] The average farmer owns approximately $804,145 in land and buildings and $79,175 in machinery and equip-

107. *See* LA. REV. STAT. ANN. §§ 47:2402, 47:2403 (2009). Under § 2402(1)(d) the first $25,000 is exempt. This leaves $2,371,561 of the transfer which is taxable. The first $20,000 is taxed at .4%, which equates into an $80 tax. The rest of the transfer is taxed at .6%, which equates into a tax of $14,109.37.

108. *Id.* Under § 2402(1)(d) the first $25,000 is exempt. This leaves $5,901,902 of the transfer which is taxable. The first $20,000 is taxed at .4%, which equates into an $80 tax. The rest of the transfer is taxed at .6%, which equates into a tax of $35,291.41.

109. GREEN & KANTOR, *supra* note 96, at 5 (2005) ("In 2006 and thereafter, the Oregon Exemption increases to an equivalent federal unified credit of $345,800, or a Federal exemption of $1 million").

110. *See, e.g.*, LA. REV. STAT. ANN. § 47:2402(1)(d) (2009). *But see* TENN. CODE ANN. §§ 67-8-301 to 67-8-705 (2009) (lacking any specific inheritance tax exemption for children of the decedent).

111. *See generally* OR. REV. STAT. §§ 118.005-188.840 (2009) (lacking any type of individual exemption for children).

112. GREEN & KANTOR, *supra* note 96, at 5 (2005) ("In 2006 and thereafter, the Oregon Exemption increases to an equivalent federal unified credit of $345,800, or a Federal exemption of $1 million").

113. *Id.* at 7 (indicating that the Oregon tax rates are from 0.8% to 16.0%).

114. *See* OR. REV. STAT. § 118.010(2) (2009) ("[t]he tax imposed under this section shall equal the maximum amount of the state death tax credit allowable against the federal estate tax under section 2011 of the Internal Revenue Code."); OR. REV. STAT. § 118.007 (West 2009) ("[a]ny reference in ORS 118.005 to 188.840 [more commonly known as the Oregon Inheritance Tax] to the Internal Revenue Code means the federal Internal Revenue Code as amended and in effect on December 31, 2000, except where the Legislative Assembly has specifically provided otherwise"). *See also* GREEN & KANTOR, *supra* note 96 at 3 (2005) (stating that the Oregon legislature modified their inheritance tax law on August 27, 2003).

115. *See generally* GREEN & KANTOR, *supra* note 96, at 39 (stating that approximately 2% of Americans fall within an income bracket which would allow them to be taxed federally under the estate tax and by inference approximately 2% would be susceptible to the Oregon tax).

ment,[116] which is well within the million dollar exemption. However, since the property of the estate as a whole is valued for inheritance tax purposes,[117] estates which have over a million dollars in taxable property will be subject to the tax even if the farming operations would be appraised at less.[118] Furthermore, there are approximately 4800 farms with average building and land values exceeding one million dollars in Oregon.[119] If any of these farmers had enough equity built up in their farming operations, their children would be susceptible to Oregon's inheritance tax.

Similar to Oregon, Tennessee does not give a specific exemption to children,[120] but instead grants a maximum single exemption on the net estate of the decedent.[121] Currently that exemption is equal to one million dollars.[122] The value of the net estate above and beyond the single exemption is taxed at 5.5% for the first $40,000, 6.5% for the next $200,000 (anything between $40,000 and $240,000), 7.5% for the next $200,000 (anything between $240,000 and $440,000), and 9.5% for anything over that amount ($440,000).[123] Given the large exemption granted in Tennessee[124] and the fact that most farms have a value of $467,420,[125] it may not be necessary to establish the type of tax shelter discussed herein. However, since the exemption is

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116. *See* NAT'L AGRIC. STATISTICS SERV., USDA, 2007 CENSUS OF AGRICULTURE: OREGON STATE AND COUNTY DATA 7 (2009), *available at* http://www.agcensus.usda.gov/Publications/2007/Full_Report/Volume_1,_Chapter_1_State_Level/Oregon/orv1.pdf. [hereinafter OREGON CENSUS].

117. OR. REV. STAT. § 118.010(1) (2009) ("[a] tax is imposed upon a transfer of property and any interest therein, within the jurisdiction of the state, whether belonging to the inhabitants of this state or not, which passes to or vests in any persons . . ."). *See also In re* Smith, 188 N.E.2d at 652 (stating that estate taxes are "a tax upon the transmission of property by a deceased person").

118. GREEN & KANTOR, *supra* note 96, at 5 ("In 2006 and thereafter, the Oregon Exemption increases to an equivalent federal unified credit of $345,800, or a Federal exemption of $1 million").

119. *See* OREGON CENSUS, *supra* note 116, at 69 (adding together all farms, despite their estimated acreage, with values over $1,000,000).

120. *See* TENN. CODE ANN. §§ 67-8-301 to 67-8-705 (2009) (lacking any specific inheritance tax exemption for children of the descendent).

121. TENN. CODE ANN. § 67-8-316(b) (2009) ("there shall be allowed against the net estate a maximum single exemption against that portion of the estate distributable to one (1) or more beneficiaries of . . . . [one million] [i]n 2006 and thereafter").

122. *Id.*

123. TENN. CODE ANN. § 67-8-314(1) (2009).

124. *See* TENN. CODE ANN. § 67-8-316(b) (2009).

125. NAT'L AGRIC. STATISTICS SERV., USDA., 2007 CENSUS OF AGRICULTURE: TENNESSEE STATE AND COUNTY DATA 7 (2009), *available at* http://www.agcensus.usda.gov/Publications/2007/Full_Report/Volume_1,_Chapter_1_State_Level/Tennessee/tnv1.pdf. [hereinafter TENNESSEE CENSUS].

given on the net estate and not on each individual transfer of assets,[126] and because there are approximately 6,000 farms with values exceeding one million dollars,[127] it is likely some farmers may still benefit from establishing a foreign business entity.

3. *The Ugly States: States Which Assess Inheritance Taxes on Children and Most Likely Could Benefit from a Tax Shelter*

There are, of course, those states in which the use of a foreign business entity as a tax shelter is generally a foregone conclusion.[128] In states such as Nebraska, Indiana, and Pennsylvania the combination of high tax rates and low exemptions placed on transfers of property to children results in taxation which requires some sort of tax planning.[129] However, the benefits stemming from the use of the tax shelter advocated in this Note will vary given the differences on rates and exemptions found in each state.[130]

Out of the three states mentioned *supra*, Nebraska imposes the least burdensome inheritance tax on children.[131] This is largely based on the 1% tax rate adult children and immediate relatives receive on the transfer of all non-

126. TENN. CODE ANN. § 67-8-316(b) (2009).

127. TENNESSEE CENSUS *supra* note 125, at 65 (adding together all farms, despite their estimated acreage, with values over $1,000,000).

128. *See, e.g.*, IND. CODE § 6-4.1-5-1(b)-(c) (2009) (assessing a graduated inheritance tax on the property transferred to children that does not fall within the $100,000 exemption given to children); NEB. REV. STAT. § 77-2004 (2009) (granting a $40,000 exemption on the transfer of assets to children and assessing a 1% tax on all non-exempt property that is transferred to children); 72 PA. CONS. STAT. § 9116(a)(1)(i) (2009) (assessing a 4.5% inheritance tax on the transfer of all assets to children).

129. *See generally* IND. CODE § 6-4.1-5-1(b)-(c) (2009) (assessing a graduated inheritance tax on the property transferred to children that does not fall within the $100,000 exemption given to children); NEB. REV. STAT. § 77-2004 (2009) (granting a $40,000 exemption on the transfer of assets to children and assessing a 1% tax on all non-exempt property that is transferred to children); 72 PA. CONS. STAT. § 9116(a)(1)(i) (2009) (assessing a 4.5% inheritance tax on the transfer of all assets to children).

130. *See* IND. CODE § 6-4.1-5-1(b)-(c) (2009) (assessing a graduated inheritance tax on the property transferred to children that does not fall within the $100,000 exemption given to children); NEB. REV. STAT. § 77-2004 (2009) (granting a $40,000 exemption on the transfer of assets to children and assessing a 1% tax on all non-exempt property that is transferred to children); 72 PA. CONS. STAT. § 9116(a)(1)(i) (2009) (assessing a 4.5% inheritance tax on the transfer of all assets to children).

131. *Compare* NEB. REV. STAT. § 77-2004 (2009) (assesses a 1% tax rate on all non-exempt property transfers to children), *with* IND. CODE § 6-4.1-5-1(b) (2009) (assessing a 1% to 10% graduated inheritance tax on transfers of non-exempt property to children), *and* 72 PA. CONS. STAT. § 9116(a)(1)(i) (2009) (stating that transfers to lineal descendents are taxed at 4.5%).

exempt property, along with the $40,000 exemption they are granted.[132] Given that the average Nebraskan farmer has a $1,261,819 farming operation,[133] a complete transfer to an only child results in an average inheritance tax of $12,218.19.[134] While this tax does not impose a significant hardship on the average transferee, it does impose a hardship. This only increases as the value of the farming operation exceeds the state average.[135]

Indiana's inheritance tax statutes also expose children to a large amount of tax liability. While the state grants a $100,000 exemption to an inheritance given to children and grandchildren,[136] the transfer of the average million dollar farming operation would still leave the transferee with a tax obligation on nine tenths of his or her inheritance.[137] The non-exempt property would then be taxed at an increasing tax rate, which can be as low as 1% if the value of the property is less than $25,000 or as high as 10% on the value of

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132. NEB. REV. STAT. § 77-2004 (2009) ("In the case of a father, mother, grandfather, grandmother, brother, sister, son, daughter, child or children legally adopted as such in conformity with the laws of the state where adopted, any lineal descendant, any lineal descendant legally adopted as such in conformity with the laws of the state where adopted, any person to whom the deceased for not less than ten years prior to death stood in the acknowledged relation of a parent, or the spouse or surviving spouse of any such persons, the rate of tax shall be one percent of the clear market value of the property in excess of forty thousand dollars received by each person. . . . In addition the homestead allowance . . . shall not be subject to tax"); *see also* NEB. REV. STAT. § 30-2322 (2009) (stating that the homestead exemption only applies if the decedent was domiciled in Nebraska and if the homestead is transferred to a spouse, minor child, or a dependent child).

133. NEBRASKA CENSUS, *supra* note 3, at 7 (stating that the average value of a Nebraska farm's land and buildings is $1,104,392 and the average value of all machinery and equipment is $157,427).

134. *See* NEB. REV. STAT. § 77-2004 (2009). Under § 77-2004 the first $40,000 is exempt. This leaves $1,221,819 of the transfer which is taxable. Since all nonexempt property is taxed at 1% under § 77-2004, the inheritance tax will equate into $12,218.19.

135. *See* NEBRASKA CENSUS, *supra* note 3, at 64 (stating that the average value of a Nebraska farm's land and buildings is $1,104,392 and that 8,107 farms have a value of land and buildings that exceed two million dollars).

136. *See* IND. CODE § 6-4.1-3-10 (2009) ("[t]he first one hundred thousand dollars . . . of property interests transferred to a Class A transferee . . . is exempt from the inheritance tax"); IND. CODE. § 6-4.1-1-3(a)(2)-(4) (2009) ("[a] 'Class A transferee' means a . . . lineal descendent of the transferor . . . [, a] stepchild of the transferor . . . . [, and a] lineal descendant of a stepchild of the transferor").

137. NAT'L AGRIC. STATISTICS SERV., USDA, 2007 CENSUS OF AGRICULTURE: INDIANA STATE AND COUNTY DATA 7 (2009), *available at* http://www.agcensus.usda.gov/Publications/2007/Full_Report/Volume_1,_Chapter_1_State_Level/Indiana/inv1.pdf. [hereinafter INDIANA CENSUS] (stating that the average value of an Indiana farm's land and buildings is $868,699 and the average market value of machinery and equipment is $103,427, which equates into an average farm valued at $972,126).

property exceeding one and a half million.[138] Therefore, on the average farm, the tax imposed under these rates creates a total liability of $45,250.[139] Obviously clients owning Indiana farmland would benefit from any tax shelter given the current alternative.

One of the worst states to transfer property to children is Pennsylvania. First, there are no exemptions for children built into the tax scheme.[140] The only exemptions granted to family members are the complete exemptions given to surviving spouses[141] and parents receiving a transfer from a child under age twenty-two.[142] Additionally, transfers to children are taxed at the relatively high rate of 4.5%.[143] While this is substantially lower than the rates given to other transferees,[144] it still results in a $29,851 tax[145] on the average Pennsylva-

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138. IND. CODE§ 6-4.1-5-1(b) (2009) (stating that the tax rates on non-exempt property transferred to Class A transferees are as follows: (1) if the property is $25,000 or less, a one percent tax is assessed; (2) if the property is over $25,000 but not over $50,000, $250 plus a two percent tax on the value over $25,000 is assessed; (3) if the property is over $50,000 but not over $200,000, $750 plus a three percent tax on the value over $50,000 is assessed; (4) if the property is over $200,000 but not over $300,000, $5,250 plus a four percent tax on the value over $200,000 is assessed; (5) if the property is over $300,000 but not over $500,000, $9,250 plus a five percent tax on the value over $300,000 is assessed; (6) if the property is over $500,000 but not over $700,000, $19,250 plus a six percent tax on the value over $500,000 is assessed; (7) if the property is over $700,000 but not over $1,000,000, $31,250 plus a seven percent tax on the value over $700,000 is assessed; (8) if the property is over $1,000,000 but not over $1,500,000, $52,250 plus eight percent tax on the value over $1,000,000 is assessed; (9) if the property is over $1,500,000, $92,250 plus ten percent tax on the value over $1,500,000).

139. Under the tax tables provided in the Indiana Code, section 6-4.1-5-1(b), a million dollar farm with an exemption of $1,000,000 has a transferred property value "over $700,000 but not over $100,000,000". This transferred property value is taxed "$31,250, plus 7% of net taxable value over $700,000", which equals $45,250. *See* IND. CODE § 6-4.1-5-1(b) (2009).

140. *See generally* 72 PA. CONS. STAT §§ 9101-9196 (2009) (lacking any exemption strictly for children of the decedent).

141. 72 PA. CONS. STAT. § 9116(a)(1.1)(ii) (2009) (stating that transfers to "a husband or wife shall be [taxed] . . . [a]t a rate of zero per cent for estates of decedents dying on or after January 1, 1995").

142. 72 PA. CONS. STAT. § 9116(a)(1.2) (2009) ("Inheritance tax upon the transfer of property from a child twenty-one years of age or younger to or for the use of a natural parent, an adoptive parent or a stepparent of the child shall be at the rate of zero per cent").

143. 72 PA. CONS. STAT. § 9116(a)(1)(i) (2009) ("Inheritance tax upon the transfer of property passing to or for the use of any of the following shall be at the rate of four and one-half per cent: (i) grandfather, grandmother, father, mother . . . and lineal descendants").

144. *Compare* 72 PA. CONS. STAT. § 9116(a)(1) (2009) (stating that transfers to lineal descendents are taxed at 4.5%), *with* 72 PA. CONS. STAT. § 9116(a)(1.3) (2009) (stating that transfers to siblings are taxed at 12%), *and* 72 PA. CONS. STAT. § 9116(a)(2) (2009) (stating that transfers made to all other individuals not specifically mentioned in other areas of section 9116 are taxed at a rate of 15%).

nia farm of $663,364.[146] Any way you look at it, transfers of Pennsylvania property would substantially benefit from a tax shelter.

C. *The Current Status of State Estate Taxation: Where To and Where Not To Set Up A Foreign Limited Liability Company Tax Shelter*

Although a review of the states with inheritance taxation revealed where the major problem areas are located,[147] a discussion of the national condition of state estate taxation is required in order to pinpoint the appropriate states in which to create a limited liability company. It would be foolish to avoid the inheritance tax of one state only to be hit with an estate tax in another. To be truly safe from state death taxation, a client needs to be a resident of and establish a limited liability company in a state with neither death tax.

Until recently most states had legislation, known as a "sponge tax" or "pick up tax," that tied their estate tax rate to the federal estate tax credit[148] formally granted under the federal estate tax law.[149] Under this federal law, the United States government granted each state and the District of Columbia a varying credit dependent upon the size of the estate.[150] However, in 2001, the federal government passed the Economic Growth and Tax Relief Reconcilia-

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145. *See* 72 PA. CONST. STAT. §9116(a)(1) (2009). Under § 9116(a)(1) all transfers to children are taxed at a rate of 4.5%. This equates into a inheritance tax of $29,851 on a $663,364 farm.

146. NAT'L AGRIC. STATISTICS SERV., USDA, 2007 CENSUS OF AGRICULTURE: PENNSYLVANIA STATE AND COUNTY DATA 7 (2009), *available at* http://www.agcensus.usda.gov/Publications/2007/Full_Report/Volume_1,_Chapter_1_State_Level/Pennsylvania/pav1.pdf. [hereinafter PENNSYLVANIA CENSUS] (stating that the average value of a Pennsylvania farm's land and buildings is $590,376 and the average value of all machinery and equipment is $72,988).

147. *See supra*, Part IV (A) (The states that assess inheritance taxes on the transfer of property to children, and are thus the "problem states" are: Indiana, Louisiana, Nebraska, Oregon, Pennsylvania, and Tennessee).

148. *See* 26 U.S.C. § 2011 (2009).

149. *See, e.g.*, ALA. CODE § 40-15-2 (2009) ("The estate tax hereby levied shall be levied only so long as and during the time an inheritance or estate tax is enforced by the United States . . . and shall only be exercised or enforced to the extent of absorbing the amount of any deduction or credit which may be permitted by the laws of the United States . . . ."); COLO. REV. STAT. § 39-23.5-103 (2009) ("[a] tax in the amount of the federal credit is imposed on the transfer of the gross estate of every domiciliary"); DEL. CODE ANN. tit. 30 § 1502 (2009) ("the amount of the tax shall be the amount of credit allowable under the provisions of the federal estate tax laws for estate, inheritance, legacy and succession taxes paid to any state."); N.D. CENT. CODE § 57-37.1-04 (2009) ("the North Dakota taxable estate must be equal to the maximum tax credit allowable for state death taxes against the federal estate tax imposed with respect to a decedent's estate which has a taxable situs in this state . . .").

150. 26 U.S.C. § 2011 (2009).

tion Act ("EGTRRA") which effectively repealed all traces of the state death tax credit by the year 2005.[151] As a result, most states with estate tax statutes coupled to the federal tax credit were left with no alternative legislation on the books from which to assess an estate tax.[152]

The response by the states to the EGTRRA was varied. A few of the states, like Connecticut and North Carolina, decoupled their estate tax from the tax credit allowing them to continue collecting estate tax revenue.[153] Other states passed separate death taxes statutes which were completely unconnected to the federal tax code.[154] The rest of the states with "pick up tax" statutes essentially decided not to modify or pass any new legislation resulting in the elimination of estate taxation within their borders.[155] Due to the above mentioned changes in the state tax codes and pre-existing laws or lack thereof, thirty-three states do not have an estate tax.[156] Each of these states, minus Indiana, Louisiana, Nebraska, Pennsylvania, and Tennessee, of course, would be appropriate places to establish a limited liability company tax shelter.

151. *See* 26 U.S.C. § 2011(f) (2009) ("Termination.—This section shall not apply to the estates of decedents dying after December 31, 2004"); *see also* H.R. Res. 1836, 107th Cong., 115 Stat. 38 (2001).

152. *See, e.g.*, ALASKA STAT. § 43.31.011 (2009); CAL. REV. & TAX. CODE § 13302 (West 2009); TENN. CODE ANN. § 67-8-204 (2009). *But see* MICH. COMP. LAWS § 205.201(6) (2009).

153. *See* CONN. GEN. STAT. § 12-391(d)(1) (2009) ("With respect to the estates of decedents who die on or after January 1, 2005, . . . a tax is imposed upon the transfer of the estate of each . . . resident of this state [which] . . . shall be determined using the schedule in subsection (g) of this section"); N.C. GEN. STAT. § 105-32.2(b) (2009) ("The amount of the estate tax imposed by this section is the amount of the state death tax credit that, as of December 31, 2001, would have been allowed under section 2011 of the Code against the federal taxable estate").

154. 50 STATE STATUTORY SURVEYS: TAXATION DEDUCTIONS AND CREDITS, FEDERAL ESTATE TAX CREDIT ABSORBED OR DECOUPLED (West 2009) ("Some states avoided references to the earlier federal tax code and instead created tables or formulas designed to replicate the pre-EGTRRA federal estate tax credit amounts. A few states levied separate inheritance or estate taxes designed to be unconnected to the federal tax code").

155. *Id.* ("After EGTRRA, more than thirty states either allowed their estates taxes to fade away, with no new legislation, or decided to eliminate their estate taxes. These thirty-some states absorbed the lost federal estate tax credit revenues").

156. *See id.* (listing that the following states do not have estate tax: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Delaware, Florida, Georgia, Hawaii, Idaho, Indiana, Iowa, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, New Mexico, North Dakota, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, West Virginia, and Wyoming).

V. THE DUE PROCESS CLAUSE: WHY STATE LEGISLATURES CANNOT TAX FOREIGN BUSINESS ENTITY TAX SHELTERS

Even though the viability of the foreign limited liability company tax shelter is based on the current state statutory provisions prohibiting the taxation of intangible personal property of non-residents,[157] the state legislatures are prevented from shoring up this opening in their tax codes due to the Fourteenth Amendment's due process clause.[158] Under the due process clause "[n]o state shall . . . deprive any person of life, liberty, or *property*, without due process of law."[159] Due process is violated, in regards to inheritance taxation, when a state taxes a person's interest in property when it does not have jurisdiction to do so.[160] Since states have no jurisdiction over the transfer of non-resident interests in out-of-state entities which have sole ownership in their underlying assets,[161] and because members have no interest in the property held by limited liability companies,[162] legislatures attempting to broaden the scope of taxable

157. *See* LA. REV. STAT. ANN. § 47:2404(A) (2009) ("the tax shall not be imposed upon any transfer of intangible movable property owned by a person not domiciled in this state at the time of his death"); MD. CODE ANN., TAX-GEN. § 7-202 (West 2009) ("Except as provided in § 7-203 of this subtitle, [the tax exemption portion of Maryland's statute,] a tax is imposed on the privilege of receiving property that passes from a decedent and has a taxable situs in the State"); NEB. REV. STAT. § 77-2001 (2009) (taxing the transfer of non-resident's intangible personal property only if located within the state of Nebraska); OR. REV. STAT. § 118.010(4)(a) (2009) (taxing the transfer of non-resident's intangible personal property only if located within the state of Oregon). *See generally* IND. CODE ANN. §§ 6-4.1-1-1 to -12 (West 2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property which has a situs outside of Indiana); IOWA CODE ANN. §§ 450.1- 450B.7 (West 2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property which has a situs outside of Iowa); KY. REV. STAT. ANN. §§ 140.010 – 140.991 (West 2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property which has a situs outside of Kentucky); N.J. STAT. ANN. §§ 54:34-1 to 16 (West 2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property); 72 PA. CONS. STAT. §§ 9101-9196 (2009) (lacking any assessment of an inheritance tax on the transfer of a non-resident's intangible personal property).

158. *See* R.I. Hosp. Trust Co. v. Doughton, 270 U.S. 69 (1926) (holding that due process was violated when the state of North Carolina levied an inheritance tax on shares of a New Jersey corporation held by the estate of a Rhode Island resident, even though two thirds of the corporation's assets consisted of North Carolina real property).

159. U.S. CONST. amend. XIV, § 1 (emphasis added).

160. *Doughton*, 270 U.S. at 80 ("[i]t goes without saying that a state may not tax property which is not within its territorial jurisdiction").

161. *See generally id.* at 84 (holding that a statute which assesses inheritance taxes on the transfer of a non-resident's stock in an out-of-state corporation is unconstitutional as a violation of due process even though the corporation owned assets in the taxing state).

162. Bishop & Kleinberger, *supra* note 46, ¶ 5.04[2][c].

property interests to include a nonresident's interest in a foreign limited liability company under their inheritance tax codes will face constitutional scrutiny.

In 1926 the United States Supreme Court granted certiorari in *Rhode Island Hospital Trust Co. v. Doughton* to address the question of whether a state could assess an inheritance tax on the transfer of a non-resident decedent's stock in an out-of-state corporation solely on the grounds that the corporation owned assets within the taxing state when they.[163] In this case the decedent, George Briggs, was a resident of Rhode Island who owned stock in a New Jersey corporation, R.J. Reynolds Tobacco Company, which owned substantial amounts of real estate in North Carolina.[164] The State of North Carolina placed an inheritance tax on the transfer of the decedent's stock on the theory that the decedent had an interest in the real estate holdings of the corporation because two thirds of the corporation's assets resided in North Carolina.[165] The Court held that the North Carolina statute allowing for a tax to be assessed in this situation was unconstitutional on due process grounds.[166] The Court concluded that "[a] state has no power to tax the devolution of the property of a nonresident, unless it has jurisdiction of the property devolved or transferred."[167] Since "[t]he owner of the shares of stock in a company is not the owner of the corporation's property,"[168] North Carolina had no jurisdiction to tax the shares of the decedent in this case.[169] The only states that had jurisdiction to tax the transfer of stock were the state of the decedent's residence and the state of incorporation.[170]

The Court also concluded that the transfer of a non-resident's shares in a foreign corporation could not be taxed on the theory that the corporation is domesticated in the taxing state.[171] The Court explained, "[i]n an addendum to its opinion in this case, the Supreme Court of North Carolina suggest[ed] that the jurisdiction of [North Carolina] to tax [George Briggs'] shares of the New Jersey corporation may be based on the view that the corporation has been domesticated in North Carolina."[172] However, the Court held that since the corporation was "authorized to do and does business in the state . . . and pays a fee for the permission to do so[,] . . . [it was] not . . . re-incorporated in the

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163. *Doughton*, 270 U.S. at 80.
164. *Id.* at 79.
165. *Id.* at 81.
166. *Id.* at 84.
167. *Id.* at 80-81.
168. *Id.* at 81.
169. *See id.* at 83.
170. *See id.* at 84.
171. *Id.* at 84.
172. *Id.* at 83-84.

state."[173] Instead, the New Jersey corporation was "still [considered] a foreign corporation and the rights of its stockholders [were] to be determined accordingly."[174]

While the *Doughton* case concerned the transfer of intangible personal stock interest in a corporation,[175] its holding also applies to a foreign limited liability companies holding assets physically located within an inheritance tax state. In *Doughton*, the Court stressed that taxation on the transfer of non-resident shares in a foreign corporation violated due process because: (1) corporate shareholders only hold a personal interest in the corporation;[176] (2) corporate shareholders have no interest in the assets owned by the corporation;[177] and (3) doing business within an inheritance taxing state does not create jurisdiction to tax the transfer of a non-resident's interest in the foreign corporation when the taxing state requires a fee for this privilege.[178] All three of these main characteristics also apply to limited liability companies. All states recognize a member's interest in a limited liability company as personal property,[179] all states recognize that a member has no interest in specific property owned by a limited liability company,[180] and all states require foreign limited liability companies to pay a fee for doing business within their jurisdiction.[181] As such, any attempt by legislatures to broaden the scope of their inheritance tax codes to encompass non-resident transfers of their interest in foreign limited liability companies would violate due process.

VI. UTILIZING THE LIMITED LIABILITY COMPANY: A BETTER APPROACH

While there are many different types of business entities available, a growing number of people are turning to limited liability companies.[182] Even though many of the various business entities can also provide non-resident

173. *Id.* at 84.
174. *Id*.
175. *See generally id.*
176. *Id.* at 81.
177. *Id.*
178. *Id.* at 83.
179. *See* Bishop & Kleinberger, *supra* note 44, ¶ 5.04[2][c].
180. *See id.*
181. *See, e.g.*, WIS. STAT. § 183.0114(p), (w) (2009) (stating that a foreign limited liability company is required to pay $100 fee when they register within the state and a $65 annual reporting fee).
182. *See* Bishop & Kleinberger, *supra* note 44, ¶ 1.01[1] (indicating that as of 1995, more than 210,000 limited liability companies have been established).

farmers with a tax shelter against inheritance taxes,[183] there are advantages to utilizing a limited liability company.[184] Because each of the different business entities are drastically different in how they operate, they will be addressed individually *infra*.

A. *The Better Tax Shelter: Limited Liability Company v. Corporation*

The main advantage of using a limited liability company over a corporation as a foreign tax shelter is pass-through federal income taxation. "Corporations generally pay federal income tax at the entity level, and their stockholders pay a second tax on receipt of distributions."[185] Limited liability companies, on the other hand, only have to pay income taxes once due to its classification "as a partnership for federal income tax purposes."[186] This difference has obvious advantages for clients, like those focused on in this Note, who are concerned about tax savings.

Another advantage that limited liability companies have over corporations is "significantly greater flexibility . . . in structuring its operations and management."[187] While "[c]orporation statutes generally require that a corporation must be managed by a board of directors on behalf of passive stockholders," limited liability companies are allowed to modify their management structure in their operating agreement.[188] "Thus, an LLC may be managed by: all of its members, some but fewer than all of its members, managers appointed by the members, or some combination of members and managers."[189] This flexibility is extremely beneficial given that many retired "snowbird" farmers will most likely want to abdicate a major amount of control over the day to day farming operations to their children while they are away.

183. *See, e.g.*, R.I. Hosp. Trust Co. v. Doughton, 270 U.S. 69 (1926) (holding that statutes attempting to assess an inheritance tax on transfers of nonresident shareholders' stock in foreign corporations is a violation of due process).

184. *See, e.g.*, Louis G. Hering, et al., *Limited Liability Companies: Legal Aspects of Organization, Operation, and Dissolution* (BNA) No. 67-2nd, at A-5 (2006) [hereinafter *Limited Liability Companies*] (indicating that limited liabilities companies, unlike corporations, have pass-through income taxation, which means that income taxes are not assessed at the income level).

185. *Id.*

186. *Id.*

187. *Id*. at A-6.

188. *Id.*

189. *Id.*

B. *The Better Tax Shelter: Limited Liability Company v. General Partnership*

While partnerships, unlike corporations, have pass-through taxation, their greatest disadvantage as tax shelters is their inability to provide limited liability for their owners.[190] In a general partnership, partners are personally liable for all the debts of the partnership.[191] Members of a limited liability company, on the other hand, are "not liable . . . for any debt, obligation, or liability of the entity.[192] However, it should be mentioned that limited liability companies do not bar members from all possibility of personal liability. They may still be susceptible under a corporate veil piercing theory, especially in "extreme circumstances involving fraud or similar bad conduct."[193]

Another distinct disadvantage of utilizing partnerships as tax shelters is the possibility that the courts of two different states, the state of domicile and the state in which the partnership is located, will inconsistently characterize the decedent partnership interest and double taxation will result.[194] In these situations the domicile state determines the interest to be intangible personal property and the situs state considers the partner to have an interest in the underlying partnership property.[195] But, "[t]he possibilities for such conflicting characterizations of partnership interests are limited since the Uniform Partnership Act . . . usually is construed as" meaning that partnerships interests are intangible personal property.[196] "The Act, however, may not always prevent conflicts even between states which have adopted it."[197] Some states "do not construe the statute to require the conversion of partnership property."[198]

C. *Advantages Over Other Business Entities*

Limited liability companies also have an advantage over limited partnerships. Unlike limited liability companies, which shield personal liability for all of its members, limited partnerships only shield the limited partners from liability.[199] General partners, however, "are personally liable for the debts of

190. *Id.* at A-7.
191. *Id.*
192. *Id.*
193. *Id.*
194. *Death Taxation*, *supra* note 12, at 1673-74.
195. *Id.* at 1674 (citing Tinsley v. State Tax Comm., 235 So.2d 698 (Miss. 1970)).
196. *Id.*
197. *Id.*
198. *Id.*
199. *See Limited Liability Companies, supra* note 184, at A-7.

the limited partnership."[200] Furthermore limited partnerships also suffer from a lack of flexibility in how the management is structured.[201] In order to protect their limited liability status, limited partners are unable to participate in the management of the partnership.[202] Limited partnerships are also unlikely to be managed by non-partners because "the general partner then would be in the position of bearing unlimited personal liability for the acts of the manager."[203]

The advantage that a limited liability company has over an S corporation is much slighter. S corporations, like limited liability companies, shield owners from personal liability stemming from the debts of the entity.[204] They also "act as pass-through entities [for income taxation purposes] with respect to certain items of gain, loss, income, deduction, and credit."[205] However S corporations "are subject to substantial limitations that do not apply to LLCs."[206] One such limitation is that S corporations "must have only a single class of stock."[207] This "requirement may . . . preclude S corporations from making special allocations and disproportionate distributions to their stockholders."[208] This will pose a problem for any retired farmer who would, during his lifetime, prefer to allocate the profits from his farming operation in differing amounts.

VII. Conclusion

The use of limited liability companies as tax shelters is a great way to shield certain family farming operations from the burden of inheritance taxation. Because of the amount of taxing savings this type of estate planning provides, the next generation of farmers is more likely to successfully continue a tradition of small farm ownership. This is especially important considering the current state of the United States, which is seeing, and will most likely continue to see, a decrease in the profits of the average American family farm. Furthermore, limited liability companies offer the most flexible type of tax shelter and have clear advantages over other business entities. While this type of tax shelter is not available for everyone, certain "snowbird" farmers have an opportunity to, and most definitely should, utilize this tax shield.

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200. *Id.*
201. *Id.* at A-6.
202. *Id.*
203. *Id.*
204. *See generally id.* at A-7 (stating that limited liability companies, similar to corporations, have limited liability status).
205. *Id.* at A-5.
206. *Id.* at n.5.
207. *Id.*
208. *Id.*