

FAMILY LIMITED PARTNERSHIPS

Managing Family Wealth

Family limited partnerships (“FLPs”) can hold business, personal or investment assets. They can be used to consolidate investments, to share income with family members in lower tax brackets, asset protection and for long-range estate planning.

The Wealth Strategies Group

at Atlantic Trust integrates estate, financial and investment planning through sophisticated assessment of goals with the objective of multigenerational capital preservation, family business continuity and strategic philanthropic objectives.

How They Work

- The parents set up a limited partnership and transfer capital assets into it. Within the FLP structure, the parents (or a trust or limited liability company [LLC] controlled by the parents) are the general partners, and the children (or grandchildren) are the limited partners. The general partners often “own” only a small proportion of the company (for example, 2%), while the limited partners own the majority interest. The general partners have complete responsibility and control of company activities and have liability for company debts and losses (this liability can be controlled by the use of a trust or LLC, formerly mentioned).
- The limited partners have no control or management rights. All limited partners’ “liability” is limited to the amount of their contribution to the FLP.
- One of the most attractive features of the FLP is its flexibility. Some estate planning strategies must be “irrevocable” in order to be effective. Once set up, these irrevocable tools cannot be changed or undone. In contrast, the FLP document can be modified to respond to changes in the family or business structure.

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Why Consider a Family Limited Partnership

- There are three primary reasons for creating an FLP:

Income Tax Benefits: Once the children or grandchildren own the majority of the partnership interest (as a result of estate planning transfers), most of the income generated flows through them and is taxed at their lower marginal tax rate. On the other hand, the general partners (the parents) have a great deal of control over whether and how income is distributed (in the form of salaries to themselves, for example).

Protecting Assets from Lawsuits: State limited partnerships statutes prevent the creditors of a limited partner from attaching FLP assets. While the creditors may get a “charging order” against the debtor’s FLP interest, as a practical matter, it is very difficult to collect the debt. An FLP may provide one of the most effective asset protection structures available today. Creditors of the general partner may attach the FLP assets; however, planning with a trust or LLC may avoid this problem.

Estate Planning Benefits: When the parents contribute assets to an FLP, or when they transfer interests in the FLP to children, they are transferring asset value and shifting asset growth and income from themselves to a younger generation. Consider the following hypothetical example in which an asset has a current value of \$2,000,000 and is expected to grow by 6% per year. Over time, the parents transfer 90% of the value to the children. Often, a gifted ownership interest can receive a discounted value because the non-controlling or minority interest lacks marketability. The “lack of marketability” discount should be carefully reviewed with your legal advisor.

Before considering a family limited partnership, there are a number of questions that the parent or parents must answer. Will the income shared with the child affect the parents’ lifestyle? Will a gift tax be due and payable when the transfer is made to the child? Will the transfer and income tax savings compensate for the increased complexity?

Family Limited Partnerships Are Not for Everyone

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- Additionally, legal counsel must be obtained. Because of the complexity involved, FLPs are not appropriate for every situation. The documentation for an FLP must be carefully designed to avoid violating both federal law and the law of the state under which the FLP is being created.

- Assets transferred to the FLP should be invested for growth.

- In light of recent cases, it is important that the FLP be structured properly. Among the factors that should be considered are the following:

The FLP should have significant business purpose other than to obtain discounts or reduce taxes.

FLP accounts should be managed separately from personal accounts and proper documentation should be retained.

FLP assets should not be used for personal expenses.

The FLP should be established while you are in good health.

The FLP should have an independent manager of the entity.

Advantages

- Flexibility of control of the entity and transferability of beneficial interest
- Allows aggregation of investable assets, resulting in access to a greater variety of investment options for beneficial owners of beneficial interest
- Asset protection
- Family participation
- Valuation benefit

Disadvantages

- Possible challenge by the IRS to the discount claimed
- Inclusion in your estate if too much control retained

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