

5 Ways an FLP Can Benefit Your Estate Plan

The family limited partnership (FLP) is an estate planning arrangement that has received considerable attention recently. An FLP is one way to transfer the current and future value of assets out of your estate for federal estate tax purposes.

How Does an FLP Work As a Planning Tool?

To set up an FLP, you:

1. Form a limited partnership,
2. Transfer growth-type assets to the partnership in exchange for general and limited partnership interests, and
3. Keep the general partnership interest and make gifts to your children of some or all of your limited partnership interests, using your \$10,000 gift tax annual exclusion or your \$675,000 unified credit exemption equivalent (that will gradually increase to \$1 million by 2006).

An appraiser determines the value of your gifts by taking into account minority interest, lack of transferability and lack of marketability discounts, often ranging from 25% to over 50%. But an FLP's nonvaluation aspects are what makes it an especially valuable and flexible estate-planning vehicle.

Five Benefits

Let's take a closer look at five benefits an FLP offers:

1. Control, control, control. As the general partner under an FLP arrangement, you have control. Accordingly, you operate the partnership and make all business and financial decisions. You determine when to buy, when to sell, when to borrow, when to lend partnership assets and when to distribute partnership income or assets to the partners.

But this control is not quite absolute because you are acting on behalf of limited partners and have a fiduciary duty to consider their

interests. When financial risk is involved, you may want the FLP's general partner to be a corporation (or limited liability company) that you control. Then, as president of the corporate general partner, you can run the FLP without personal liability.

2. Flexible use of family assets. An FLP can serve to keep some assets within the family and available for use by all family members. For example, you can transfer your vacation home (one that is likely to appreciate) to an FLP. You and your children will have the beneficial ownership of the vacation home. You could base use of the vacation home on a relationship between percentages owned and prime-use days or on a rental arrangement. Either way would remove part of the appreciation from your estate.

An FLP also may have applications in connection with art, stamp or coin collections.

3. Trust substitute. If you don't want to give cash-type or voting-interest property directly to your children, consider gifts to trusts for their benefit. But income may be taxed to the grantor or taxed to the trust at higher rates than to individuals. Also, you can't act as trustee without adverse tax consequences.

An FLP can act as a trust substitute. Because as general partner you control timing of distributions from the FLP to your limited-partner children, you may have more direct flexibility than under a trust arrangement.

4. Ease of giving. If you've considered making annual exclusion gifts of interests in a family corporation or in real estate to your children, you may have had to deal with the inconvenience of giving fractional shares of stock or small, undivided real estate interests. This can become cumbersome. But if the FLP owns the shares of the family corporation or real estate, you can give units of limited partnership interests with relative ease and without any registration or recording complexities.

5. Ability to diversify and combine investments. Another advantage of an FLP is that it allows you to combine various investment assets in the partnership and then give a partnership interest in the whole package to your children.

Combined parcels of real estate or an entire stock portfolio can go into the FLP, giving your children an interest in the entire investment portfolio. In addition to reducing

administration costs, an FLP will make working with investment advisors easier because a single entity owns the entire portfolio.

Three FLP No-Nos

Using an FLP requires some care and professional guidance. You'll want to keep these basic rules in mind:

1. You can't use an FLP to hold S corporation stock because tax law does not allow partnerships to be S corporation shareholders.
2. A child active in managing the FLP might be considered a general partner for liability purposes. To avoid this, consider placing your gift in trust or making your child an employee of a management company.
3. If different family members are contributing securities to an FLP, special tax rules apply to creating an investment company and having a deemed sale or exchange. When contributed property already has appreciated, special rules apply as to who pays tax on the built-in gain.

4. The IRS has increased its scrutiny of FLPs. As a result, before proceeding, you and your advisors must weigh all risks against the benefits of creating an FLP.

FLP Offers Many Estate Planning Advantages

An FLP offers many estate planning and asset management advantages. The possibility of leveraging gifts to your children by using deep valuation discounts merely adds to the attractiveness of using an FLP in your estate plan.

If you would like to discuss the benefits of creating an FLP in your situation or would like assistance in setting one up, please give us a call. We are ready to help you with FLPs and other estate planning tools.