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## FAMILY LIMITED PARTNERSHIPS

A partnership is a consensual arrangement between two or more persons to join together to engage in a business or other profit motivated activity. A limited partnership is a form of partnership where at least one partner's liability is limited solely to the assets the partner contributes to the limited partnership, and that partner is precluded from participating in the day-to-day management of the limited partnership. A Family Limited Partnership ("FLP") is a limited partnership where most or all of the partners are members of the same family.

Although there are many technical requirements that must be adhered to in order for a FLP to pass muster with the Internal Revenue Service ("IRS"), a FLP, if properly structured and administered, can provide many benefits in the estate and gift tax arena. Because of the costs involved in creating and maintaining a FLP, it is not a strategy that is attractive to everyone despite the claims of many purveyors of FLP arrangements.

One of the most attractive aspects of using a FLP from an estate tax minimization planning standpoint is the availability of various valuation discounts, such as lack of marketability and minority interest discounts, to depress the value of limited partnership interests gifted to family members or trusts for the benefit of family members. Often, clients are able to reduce the value of the assets conveyed to a FLP by thirty percent or more. In other words, if \$2 million of a client's assets were transferred to a properly structured FLP in return for partnership interests, the value of the FLP partnership interests received by the client may have a value, for transfer tax purposes, of only \$1,400,000 or less.

Another benefit of using a FLP is the ability to include children or other "junior" family members in the management and control of the management of the FLP and the cashflow generated by the FLP. Using a FLP may also, to a certain extent, provide some protection from future judgment creditors.

Generally, a FLP is formed by having all partners enter into a formal limited partnership agreement and filing a certificate of limited partnership with the state agency designated under state partnership law. There may be reasons that would cause a family to consider establishing the FLP under the laws of a state other than Florida. The initial and annual filing fees will vary from state

to state. In addition, the state laws governing certain aspects of limited partnerships will vary from state to state.

There are certain type of assets that should not be transferred to a FLP. One example is stock in a S Corporation because the transfer of S Corporation stock to a FLP will cause the termination of the S election. Moreover, there may be undesirable estate tax consequences when funding a FLP with stock in a closely-held corporation if the transferor of the stock is the sole or managing general partner of the FLP and the transferor owned at least twenty percent of the voting stock of the closely-held corporation.

When appreciated marketable securities are transferred to a FLP, no gain will be recognized unless more than eighty percent of the non-cash assets of the FLP consists of readily marketable securities and the transfer results directly or indirectly in the diversification of the interests of the transferor. A transfer generally results in diversification of the interests of the transferor if two or more persons transfer nonidentical assets. This problem will generally not arise if a multiple stock portfolio is contributed by one partner and the other partners transfer cash assets which exceed one percent of the value of the total assets transferred to the FLP.

Because many families who establish a FLP for estate planning purposes wish to obtain the substantial benefit of the available valuation discounts, several significant costs will necessarily be incurred. One vital cost involved in forming a FLP is the fee to be paid to the law firm that will advise and counsel the family and draft the actual limited partnership agreement. This cost is necessary because of the valuable expertise needed to avoid the multitude of traps for the unwary contained in both the income tax provisions, the estate tax provisions and the special valuation rules of the Internal Revenue Code. Additional legal services may be required of a law firm located in a state other than Florida if the FLP is being established in such other state.

Another very significant cost is the fee paid to the business appraisal firm that values the partnership interests to be gifted to other family members, such as children, grandchildren, nieces and nephews. Failure to obtain a comprehensive business valuation from a professional business valuation firm that contains the analyses required by federal tax law will result in uncertainty as to the probable value of the partnership interest transferred to other family members. If the partnership interests that are gifted are undervalued, penalties and interest, as well as unexpected taxes, may be due and owing. If the partnership interests being gifted are overvalued, the transaction fails to provide the full tax savings that would otherwise be available with the proper use of the valuation discounts. Additional appraisals prepared by other types of appraisers, such as real estate appraisers, may also be needed, depending on the types of assets transferred to the FLP.

The initial and annual filing fee that must be paid to the applicable state agency, and the annual accounting fees for preparing an annual partnership income tax return, are also costs that must be taken into account when one is considering forming a FLP.

In conclusion, the use of a FLP in conjunction with estate and business planning can be a viable tool resulting in significant reductions in transfer (gift, estate and generation-skipping) taxes, as well as many other non-tax motivated goals and obligations. However, the proper

implementation of a FLP is a very complex and sophisticated endeavor which requires the use of experienced professionals who understand the numerous requirements of both state and federal laws and have the ability to identify all of the issues and to assist clients in properly resolving those issues. Although the cost of properly implementing and administering a FLP may appear expensive, generally, the benefits to clients who have substantial assets and desire to minimize transfer taxes, as well as achieve various non-tax goals and objectives.

The attorneys in the trusts and estates practice group of Nash, Moule & Kromash, LLP are available to provide clients of our law firm with legal advice and assistance in properly forming and maintaining a FLP.

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