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Could Your Family Benefit from a Family Limited Partnership?

Effective estate planning should address wealth transfer from a practical and cost-effective approach. One estate planning strategy that families with closely held businesses should consider is the family limited partnership.

What Is a Family Limited Partnership?

A family limited partnership is a partnership agreement that exists between family members who are actively involved in a trade or business. The partnership divides rights to income, appreciation, and control among the family members, according to the family's overall objectives. Under family partnership rules, the "family business" can include real estate or investments.

How Is This Arrangement Achieved?

Under the most common form of family partnership, you would begin by creating general and limited partnership interests in your business. Once the partnership is established, you then gift the limited partnership interests to your children. By holding the general partnership interest, you are considered the "general partner" and maintain control over the enterprise. Your children are the "limited partners," and the limited partnership interest lets them share in the ownership of your business as well.

A Sound Strategy for Transferring Ownership

A family limited partnership enables you to provide your children with an interest in your business while achieving many goals. First, you can gauge whether or not they possess suitable ownership abilities by involving them in the business. Second, it removes the asset from the parents' estate, thus lowering the estate tax liability, if properly executed. In addition, you can transfer the limited partnership interests in increments over time, resulting in a gradual, systematic transfer of ownership. Finally, and perhaps most importantly, there may be immediate income tax benefits.

Estate Tax Savings

The interests transferred to your children, including all appreciation since the transfer, escape inclusion in your estate when you die. Only the value of the taxable gift(s) will be included. This can result in estate tax savings down the road.

The Benefits of Leverage

By giving the partnership interests in increments over time, you can take maximum advantage of the \$12,000 annual gift tax exclusion. The exclusion increases to \$24,000 if you're married and if each spouse elects to give the maximum amount. The gift tax exclusion is indexed for inflation.

In addition, “minority discounts” — allowable reductions to the value of the gift because it is a minority interest — can lead to greater leverage of the annual exclusion and the unified credit. For instance, you may be able to discount the value of the gift up to 30 percent or more. However, in order for the discount to be valid, there must be a legitimate business reason for the partnership.

Generally, your wish to keep the business in the family is a legitimate reason to set up a partnership agreement — as long as you are joined together for the purpose of enterprise and not just to avoid taxes.

Income Tax Benefits

Aside from the estate planning advantages, the family limited partnership can result in substantial income tax savings. By including your children as partners and sharing partnership income with them, total family taxes may be reduced.

You should be aware, however, that if the income is unearned and the recipient is under age 14, “kiddie tax” rules will apply.

Other Opportunities Can Serve Your Family

In addition to family limited partnerships, there are other arrangements that can serve family interests:

Family partnerships are arrangements under which each partner must play a role in the management and day-to-day operations of the business. Many of the benefits are similar to that of a limited partnership, but the family members accept more liability and will be more involved in the business. As managing partner, however, you must always receive a minimum income share that is proportional to the value of your services.

In addition, minors typically cannot be partners unless there is someone who controls the interest for the minor.

Investment partnerships are partnerships that hold non-business assets such as securities and real estate that are likely to grow in value. Families can base a limited partnership on an investment partnership. In some cases, however, the arrangement would be considered an investment company, and gains and losses will be realized on the transfer of property to the partnership. Normally, under partnership rules, gains and losses are not realized when transferred to the partnership.

Seek Professional Guidance

The benefits of the family limited partnership can be significant. But they can only be realized if the arrangement is valid under the requirements of the IRS. If you would like to learn more about how your family could benefit from a family limited partnership or any other business solutions, contact **Jason M. Woodward, J.D.** today at financialattorney@gmail.com.