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Because of the huge revenue potential to the government, the IRS often targets large estates for audit and aggressive treatment. Although the statistical likelihood of any federal tax return becoming the subject of an audit is at historic lows, large estates which the IRS thinks may generate significant additional revenue via an audit are a clear exception to this rule.

Therefore, it is so important that things be done "right" in the formulation and execution of your estate plan. Although they have lost a bit of their luster in recent years, ***Family Limited Partnerships*** have been a useful estate-planning tool, but if implemented improperly, the results are often disastrous. The detailed machinations of a Family Limited Partnership are beyond the scope of an ***ALERT***, but basically, placing assets into a limited partnership can reduce the size of an estate. Ownership in a limited partnership decreases what the value of the asset was in the hands of the transferor, because the limited partnership fractionalizes ownership among other individuals (typically members of the transferor's family), and it subjects the control of the asset to the dictates of the limited partnership. The operation of the limited partnership typically establishes discounts to the value of the limited partnership asset due to legal provisions that affect the liquidity and control of the asset; considerations which did not exist before the limited partnership was implemented.

One of the fundamental principles underscoring much of the *Internal Revenue Code* is the so-called economic reality test. Stated another way, transactions need to be arranged to reflect business, economic and legal reality. Transactions not reflecting those realities, or transactions organized solely to take advantage of a quirk in the law, may not be recognized for tax purposes. What has happened too frequently in the estate-planning world when Family Limited Partnerships are involved is that the Family Limited Partnership is organized, but it never transacts business. For example, the Family Limited Partnership is formed to hold and control real estate, but the deeds of conveyance are never signed or recorded until the transferor is on her deathbed. The IRS will argue that these limited partnerships never had a valid business purpose and were formed for no reason other than to try to gain a reduction in the size of the decedent's estate.

The IRS has been very successful in contesting estate values with this "no economic reality" approach, so be careful. As is the case with many tax-planning techniques, every "t" must be crossed and every "i" dotted. This is especially true for a Family Limited Partnership estate planning strategy.

Make sure your punctuation is in order!

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