

Family Limited Partnerships

Particularly in today's economy, taxpayers must look ahead to realize important income tax and estate planning goals. By doing so, they may also be structuring their assets to protect them from creditors, including the IRS. The law already provides the tools, in the form of trusts, tenancies by the entirety, and family limited partnerships.

The family limited partnership has advantages over other asset protection tools. For example, if both spouses are at risk, such as joint filers, revocable living trusts will not protect the couple or their assets. But a limited partnership will normally shield the assets, and the couple can maintain control as general partners. Limited partnerships also can reduce income and estate tax because the transferred interests are not charged to the donor/general partner. The independent reasons for forming limited partnership may help establish that there is not fraudulent intent for the transfer of assets to the partnership.

A family limited partnership may also prove to be an effective estate-planning tool. These partnerships have come under attack by the IRS lately because the IRS believes that many taxpayers who use these trusts try to undervalue the assets transferred to the partnerships to save estate and gift taxes. In the courts, those who set up family limited partnerships have met with mixed results that generally turn upon whether the taxpayer has tried to grab too much from the IRS. The balancing act here is to value gifts and limited partnership interests at reasonable discounts without losing tax advantages simply out of the fear of an IRS audit.

A district court, for example, recently rejected the IRS's arguments that a family limited partnership was formed to circumvent federal estate and gift taxes. The court found that the partners, including one who died just days after formation of the limited partnership, did not enter into the partnership with the intent to avoid federal estate and gift tax. They successfully used a family limited partnership to transfer family ranch property to their children over several years under the protection of the \$22,000 per donee annual gift tax exclusion allowed to married couples; and they valued the property that was transferred at a discount for gift tax purposes because each piece of property could be appraised as less valuable than the sum of its parts.

When considering any type of estate planning at the present time, an extremely important consideration is the impact that the estate and gift tax changes in the Tax Relief Reconciliation Act of 2001 affect various estate-planning tools, such as the family limited partnership. If and when the estate tax is actually repealed in 2010, family limited partnerships will be of less value with respect to saving money on family wealth transfers. However, even then, they will retain considerable value for many taxpayers in connection with the gift tax that will remain in effect.

Since the actual repeal of estate taxes under the Act is only scheduled to last for one year - 2010 and since there will remain in effect a combined estate and gift tax during the phase-in period from now until the end of 2009, the family limited partnership will continue to be an effective vehicle to save on estate and gift taxes. It will permit families to take advantage of the applicable discounting of minority interests, as well as making full use of the annual \$11,000 gift tax exclusion and the lifetime gift tax exemption. In addition, if the estate tax laws remain as they are currently written, in 2011 we will be back to the same estate tax rules that have been in effect before the enactment of the Tax Relief Reconciliation Act.

If you would like to explore further how a family limited partnership may serve as an effective assets protection tool in your particular situation, please call me. If you are interested in saving your family overall estate and gift taxes by using a family limited partnership, or if you have any further questions,

please consider setting up an appointment.