BALDWIN HASPEL BURKE & MAYER LLC LAW OFFICES

Family Limited Partnerships Limited Liability Companies

Practice Areas
- Business Formation

Although family limited partnerships (FLPs) have been used for the management of family property and businesses for many years, they have drawn widespread attention recently as a way to obtain valuation "discounts" for federal gift and estate tax purposes. A FLP is a type of partnership. In a general partnership, all partners usually have a voice in the management of the partnership and all of the partners are personally liable for their pro-rata share of the partnership's debts and obligations. However, in a FLP, there are two classes of partners: the general partner(s) and the limited partners. The general partner runs the partnership and makes all decisions regarding the partnership, except to the extent restricted in the partnership agreement. The limited partners, on the other hand, are more like silent investors with little or no control over day-to-day operations of the partnership. As a result, general partners are personally liable for the partnership's debts and obligations but the limited partners are not.

In most FLPs, the parents (or an entity owned by the parents such as an S corporation) are designated as the general partners, either concurrently or successively, thereby maintaining control over the partnership assets. The children and/or grandchildren are designated as limited partners. The parents also can own limited partnership interests and can transfer some or all of their interests to their descendants over time through gifts or other means to save estate and perhaps income taxes. If the parents no longer can or desire to serve as general partners, the torch can be passed to someone else, thereby providing a continuity of management and family training.

The FLP is a practical vehicle to consolidate assets and provide long-term accumulation of wealth while at the same time affording a positive method of control. Generally, assets such as real estate and/or marketable securities can be transferred to a FLP on a tax-free basis. The FLP prevents the fragmentation of assets to heirs at death, including real estate and/or marketable securities, since the heirs inherit an interest in the FLP, not the specific assets themselves. The FLP also facilitates transfer of assets by gift or otherwise, since partnership interests are transferred rather than undivided fractional interests in real estate or specific shares of stock.

The FLP also can offer creditor protection. A creditor can seize only the debtor's partnership interest, not the underlying assets owned by the FLP. Since the holder of a limited partnership interest has no voice in the daily affairs of the partnership, the seizing creditor cannot compel distributions from the partnership. However, the creditor, as limited partner, will be taxable on the creditor's pro-rata share of partnership profits.

A new entity has emerged called the limited liability company (LLC). The LLC can choose how it is to be taxed - usually the choice is to be taxed as a partnership. Unlike the general partner of the FLP, none of the members of the LLC are personally liable for the LLC's debts and obligations. Also unlike the FLP, all of the members of the LLC, if desired, can have a voice in the LLC's management without subjecting themselves to personal liability for the LLC's debts and obligations. However, the LLC can provide for one or more Managers who will control the day-to-day operations of the LLC and make all decisions except to the extent restricted in the LLC's Operating Agreement or Articles of Organization. The LLC can have both voting and nonvoting interests. The LLC also affords protection of the LLC's assets from the members' creditors.

The LLC, like the FLP, can be funded on a tax-free basis with investment assets, such as real estate and/or marketable securities. For gift and estate tax purposes, the value of an interest in an FLP or LLC may be worth less than a percentage of the underlying fair market value of the entity's assets. Discounts may be appropriate to reflect the lack of marketability of the interest and minority interest. However, such discounts need to be supported by independent appraisals of the FLP or LLC interest.

Clients with sizable estates should examine the tax and non-tax advantages of using FLPs or LLCs in their overall estate planning. Many clients are not adverse to giving property away during lifetime but don't want to give up control. A FLP or LLC allows you to retain control and reduce taxes.