Family Limited Partnerships

Keep It All in the Family with FLPs

The Family Limited Partnership, or FLP - pronounced "flip" - is designed to reduce the value of your estate for estate tax purposes while allowing you to maintain full control of the investments and assets inside the partnership.

FLPs are established much like traditional limited partnerships. There are two parties involved: the general partners, who control the trust, and limited partners who have a share in the profits (but no control). The general partners (often, you and/or a spouse) design the partnership to give limited partnership shares to family members. General partners control the operations of the FLP and make day-to-day investment decisions. They can also receive a percentage of the FLP's income in the form of a management fee.

Limited partners (your heirs) have an ownership interest in the FLP, but they have very limited control. They share in the income generated by the FLP, depending on how many shares they own. When the FLP is dissolved, a proportionate amount of FLP property will pass to each limited partner.

Setting Up a FLP

FLPs have come under increased IRS scrutiny in recent years, so you should work with a reputable estate planning attorney. With the attorney's assistance, you can place your assets within the FLP using your estate tax credit. For instance, a husband and wife can each transfer up to $2,000,000 ($4 million total) into the FLP and allocate those assets to the limited partnership side. They can then place a smaller amount (e.g. $12,000) in the FLP for the general partnership side. There are usually no taxes incurred when funding a FLP with your assets.

In the beginning, you and your spouse own both General Partner and Limited Partner shares. Over time, you gift to your heirs Limited Partner shares using your annual $12,000 gift exclusion. Don't worry about giving away too much of the shares. Based on current tax law, the General Partners may own as little as 1% of the FLP's assets and still retain control. That means you can still buy and sell assets, dispose of property, and declare any distributions of FLP shares.

Leverage Your Estate Tax Credit

FLPs allow you to pass on more than the maximum $2 million (in 2006; $4 million per couple) Unified Estate Tax Credit. A gift of $2 million in limited partnership assets often may appraised at a substantially lower dollar amount. That's because there is no "market" for LP shares - they lack control and cannot be sold to others. This lower appraisal is called "discounting" the value of LP shares. Avoid discounting the shares too aggressively, however - the IRS could take exception and invalidate your FLP.

Protection Against Creditors

Because of their lack of control, LP shares are most undesirable to creditors. Creditors will find it difficult to seize limited partner shares, since they are not publicly traded.

Creditors also don't want to pay tax on income they don't receive. If the partnership has earned income, but the general partner does not declare a distribution, each general and limited partner is required to report a proportionate share of the earned income on his or her personal tax return, without actually receiving any dollars with which to pay the tax.

Two More Advantages of FLPs

FLPs are considered an "intangible asset" - most likely, only the state of your domicile will be able to impose any inheritance tax on Partnership units. This is ideal for real estate investors owners who own property in several states.

FLPs can provide additional retirement income - as mentioned previously, FLPs can provide general partners with management fees. This fee reflects the work you do as the general partner to maintain the FLP as a working business, and is considered earned income.

Family Limited Partnerships involve significant costs and risks involved, and are not ideal for highly appreciated assets. FLPs must also be drafted by an experienced estate planning attorney, and have a tangible business intent. For this reason, we strongly urge you to consult with a professional with specific expertise in this area.