

Five ways an FLP can benefit your estate plan



By Marc Singer, CFP

The family limited partnership (FLP) is an estate planning arrangement that has received considerable attention recently. An FLP is one way to transfer current and future value out of your estate for federal estate tax purposes.

How does an FLP work as a planning tool?

1. You form a limited partnership.

2. You transfer growth-type assets to the partnership in exchange for general and limited partnership interests.

3. You keep the general partnership interest and make gifts to your children of some or all of your limited partnership interests, using your \$10,000 gift tax annual exclusion (indexed for inflation beginning in 1999) or your \$625,000 unified credit exemption equivalent (gradually increasing to \$1 million by 2006).

An appraiser determines the value of your gifts by taking into account minority interest, lack of transferability and lack of marketability discounts, which can often range from 25% to over 50%. But, it is the nonvaluation aspects of an FLP that make it an especially valuable and flexible estate planning vehicle.

1. Control, Control, Control

As the general partner under an FLP arrangement, you have control. Accordingly, you operate the partnership and make all business and financial decisions. You determine when to buy, when to sell, when to borrow, when to make loans of partnership assets, and when to make distributions of partnership income or assets to the partners.

This control, however, is not quite absolute because you are acting on behalf of limited partners and have a fiduciary obligation to consider their interests.

When financial risk is involved, you may want the general partner of the FLP to be a

corporation (or limited liability company) that you control. Then, as president of the corporate general partner, you can run the FLP without personal liability.

2. Flexible Use of Family Assets

An FLP arrangement can serve as a way to keep certain assets within the family and available for use by all family members. For example, you can transfer your vacation home (one that is likely to appreciate) to an FLP. Through your gifting program of limited partnership interests, you and your children will have the beneficial ownership of the vacation home. You could base use of the vacation home on a relationship between percentages owned and prime use days, or on a rental arrangement. You would, in all events, remove a portion of the appreciation from your estate. An FLP may also be useful with an art, stamp or coin collection.

3. Trust Substitute

If you don't want to make gifts of cash-type or voting-interest property directly to your children, you may want to consider gifts to trusts for their benefit. However, under some trusts, income will be taxed to the grantor or taxed to the trust at higher rates than to individuals. Also, you can't act as trustee without adverse tax consequences.

An FLP arrangement can act as a trust substitute. Because as general partner you can control the timing of distributions from the FLP to your limited-partner children, you may have more direct flexibility than under a trust arrangement.

4. Ease of Gifting

If you've considered making annual exclusion gifts to your children of interests in a family corporation or in real estate, you may have had to deal with the inconvenience of gifting fractions of a share of stock or small, undivided interests in real estate. This can become cumbersome. However, if the FLP owns the shares of the family corporation or real estate, you can gift units of limited partnership interests with relative ease and without any registra-

tion or recording complexities.

5. Ability To Diversify And Combine Investments

Another advantage of an FLP is that it allows you to combine various investment assets in the partnership and then gift a

partnership interest in the whole package to your children. Combined parcels of real estate or an entire stock portfolio can go into the FLP, giving your children an interest in the entire investment portfolio. In addition to reducing administration costs, an FLP will make working with investment advisors easier because a single entity owns the entire investment portfolio.

Three FLP No-No's

Using an FLP requires some care and guidance. Here are some basic rules to keep in mind:

1. You can't use an FLP to hold S corporation stock because tax law does not allow partnerships to be S corporation shareholders.

2. If your child is to be active in the management of the FLP, he or she might be considered a general partner for liability purposes. Consider instead placing your gift in trust or making your child an employee of a management company.

3. If different family members are contributing securities to an FLP, special tax rules apply to creating an investment company and having a deemed sale or exchange. When contributed property already has appreciated, special rules apply to who pays tax on the built-in gain.

4. The Internal Revenue Service is increasingly giving greater scrutiny to FLPs. As a result, you and your advisors must analyze all risks in conjunction with the benefits of creating an FLP before proceeding.

FLP Offers Many Estate Planning Advantages

The FLP arrangement offers many estate planning and asset management advantages. The possibility of leveraging gifts to your children through the use of deep valuation discounts merely adds to the attractiveness of using an FLP in your estate plan.

If you would like to discuss the benefits of creating an FLP in your situation or would like assistance in setting one up, please give us a call. We are ready to help you with

FLPs and other estate plan

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