

Why a Family Limited Partnership?

Family Limited Partnerships (FLP) are a way to structure or transfer a family enterprise to benefit the next generation while receiving a gift tax discount. The primary motivation for the formation of a limited partnership (LP) is to concentrate management and control while allowing for a future transfer of investment value to others. This may be as part of an estate plan. There are gift and estate tax benefits for this scheme.

There is no specific law of FLPs. FLPs are simply LPs restricted to one family or close group. An LP has limited partners who own, typically, 99% of the financial value of the underlying assets. A general partner with authority to make day-to-day business decisions owns the remaining 1% interest. The general partner may be paid a management fee.

The limited partners have limited liability, just as shareholders do. They cannot be required to contribute additional capital, or to pay the debts of the partnership. The general partner has unlimited liability. This liability can be capped by using a limited liability company (LLC) as the general partner. That entity, like the LP, has limited liability and its owners cannot be made to contribute additional capital or pay the LLC's debts.

LP interests are a good candidate for transfer for children or grandchildren under the U.S. federal annual gift tax exemption rules, which currently allow for a \$14,000 per person, per year exemption.

Under federal court guidance, a discount of 30% to 40% to fair market value should be achieved by this method. In other words, \$18,500 to \$21,600 of real estate financial value could be transferred each year to each child or grandchild without incurring a current US gift tax or a later estate tax. Day to day control of the property would be in the hands of the LLC, which would receive a fair market value management fee. Net rents would be distributed to the limited partners in accordance with their ownership interests, at such time as the general partner determines.

Upon or after the sale of the underlying real estate or a date to be fixed in the partnership agreement (say in 15 years), the limited partners would have the right to have their interest purchased or redeemed at fair market value. This would guarantee the limited partners the ultimate liquidity of their interests, while preserving the ability to achieve an immediate discount for gift and estate tax purposes. This provision would avoid the need for a buy-sell agreement upon the death of a general partner.

The LP Agreement can designate a successor general as the general partner or managing member of the LLC. The successor would assume the day to day management control and continue to receive the management fee and reimbursement of his/her expenses prior to any distributions to the limited partners.