Building Financial Security with Family Limited Partnerships

When considering the “Big Three” financial components of financial security: asset protection, tax savings, and estate planning, business owners need to successfully plan ahead. Regarding your business interests and potential tax exposure, it is important to develop strategies to protect your hard-earned assets and save wherever possible. A **family limited partnership (FLP)** may help you achieve those goals. Let’s take a look at how an FLP may help to minimize your liability, take advantage of tax savings, and plan your estate.

Types of Partnerships

A **general partnership** is created when two or more people join together to establish a trade, business, or profession, sharing in the profits and losses. In this type of partnership, every partner is presumed to be the authorized agent of the partnership and of all other partners for all purposes within the scope and objectives of the business. As a result, all partners have unlimited liability.

A **limited partnership** consists of two or more persons with one or more general partners and one or more limited partners. A limited partner has no right to participate in the management and operation of the partnership business or to interfere in any manner with its conduct or control. There is no liability for the limited partner, with regard to the business, beyond his or her capital allocation.

A family limited partnership is an entity formed as a statutory limited liability partnership under state law in which the only partners are family members. FLPs must have business purposes and a fixed duration of years. Business owners establishing FLPs can act as general partners, hold many of the limited partner interests, and maintain 100% control of assets. Because only you and your family will own all FLP interests, the entity can be dissolved relatively easily.

FLPs also provide a measure of asset protection. Once assets are transferred to an FLP, the limited partners own partnership *interests,* rather than the specific assets themselves. Under many state partnership laws, the only remedy generally available to a creditor against a partnership interest is in the form of a **charging order** by a court. A charging order is considered a limited remedy, in that the creditor’s interest against a partner is limited to distributions of income or principal made from the partnership.

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Wealth Preservation

In addition to offering asset and creditor protection, the FLP is also a valuable wealth preservation tool. For tax purposes, an FLP is considered a “pass through” entity, and therefore, is nontaxable as a separate entity; the income passes to the owner and will be taxed accordingly as ordinary income, capital gains, etc.

Income tax savings result when FLP income is shifted to children in lower income tax brackets. The “kiddie tax” makes this a less effective strategy for younger children. While children will be taxed on their share of the FLP’s income, this income does not have to be distributed to them.

For estate planning purposes, an FLP can be a valuable tool because it allows you to give limited partnership interest to your children, but still retain control over the entity. Children, as limited partners, cannot transfer their partnership interest without your consent (as the general partner), and they have no personal liability for partnership debt or obligations.

Gifts of limited partnership interests to your children can generate substantial valuation discounts because they are minority interests and lack marketability. They can also be made tax free if under the annual exclusion amount ($14,000 for single filers or $28,000 for joint filers in 2015). Further, you may give away up to $5.43 million in 2015 during your lifetime tax free, but doing so will reduce the amount you are able to transfer tax free at death. Gifts that qualify for the annual exclusion will not reduce this amount. Moreover, these gifted interests are excluded from your estate.

While there are many benefits to establishing a family limited partnership, there are also some drawbacks, such as expenses for establishing and maintaining an FLP. Because, FLPs are complex, proper planning is essential. For specific guidance, be sure to consult your tax professional.

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