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# Family Limited Partnerships preserve wealth

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Family Limited Partnerships (FLPs) are traditional limited partnerships formed under the laws of a specific state. Typically, the entity is formed to hold various types of assets including real estate, tangible assets, and/or marketable securities. Families use FLPs to achieve many goals, including as a means to:

- Maintain control of the family assets
- Promote the efficient and economic management of the assets and properties under one entity
- Increase overall family wealth
- Make annual gifts without fractionalizing the underlying family assets
- Restrict the right of non-family members to acquire interests in the family assets
- Protect family assets from claims of future creditors
- Prevent the transfer of a family member's interests as a result of failed marriage

### How are FLPs Formed?

The senior generation usually forms a partnership (or a limited liability company) and transfers assets in return for general and limited partnership (or LLC) interests. These interests carry certain rights as to distributions, cash flows, or access to assets based on the state law provisions specific to the state of governance.

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Assets are generally investment real estate, marketable securities, or other assets that are expected to appreciate. General partner interests range generally from 1% to 5%. Alternatively, limited partner interests range from 95% to 99%. Further, general partner interests are usually held by the senior generation or by a separate entity whereby the senior generation retains control of the entity and the underlying assets.

Subsequently, gifts are generally made to the junior generation of limited partnership interests as a means of transferring value and assets out of the estate of the senior generation. An additional benefit to utilizing a FLP is in the way it allows taxpayers to more efficiently utilize the estate and gift tax structure in transferring assets and optimizing the amount of the gift. This is a direct result of the fact that an ownership interest in limited partnership is substantially different than a direct ownership interest in the assets held by the limited partnership.

### An Example

Assume that husband and wife own real estate rental properties worth \$2 million. They transfer these assets to a FLP. Later, they transfer a 10% interest to their child. This transfer will typically be taxed for gift tax purposes based on the fair market value (FMV) of the asset transferred. If a 10% interest in the underlying assets had been directly transferred, the taxable value would be \$200,000 (\$2,000,000 x 10%).

However, through the use of a FLP,

the couple can leverage the amount of the gift. The taxable value would not be a pro rata interest in the underlying assets, due to the nature of the interest transferred. Rather, the taxable value would be the amount for which a hypothetical buyer would pay for a 10% interest in a limited partnership. This interest would consider the fact that a limited partner's interest cannot and does not have access to the assets, cannot force any distribution or effectively control the ability to receive a return on his or her investment.

As a result, the transferred interest would be discounted for these ownership and marketability issues. Accordingly, a transfer of a 10% interest in the FLP may be valued as follows:

FMV of real estate held	
in FLP .....	\$2 million
Interest gifted .....	10%
Pro rata value of interest	
gifted .....	\$200,000
Lack of control	
discount - 20% .....	\$40,000
FMV nonmarketable	
10% interest .....	\$160,000
Marketability	
discount - 15% .....	\$24,000
Discounted value of interest	
gifted .....	\$136,000

By using this type of transfer structure, the taxpayers have effectively reduced their exposure to estate and gift taxes by \$35,200 (\$64,000 x 55% marginal estate/gift tax rate) or about 18%.

Numerous tax court decisions involving FLPs can provide guidance on the structuring, operating and documenting of FLPs.

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