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Planning Ahead

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Revisiting the Family Limited Partnership

Forming a Family Limited Partnership (FLP) or Limited Liability Company (LLC) to own and operate a family business is a common estate planning strategy. It facilitates family participation and prepares for transfer of the business to the next generation. It has the added tax benefit of a creating a valuation discount so a decedent's estate will be worth less, and less estate tax will be owed on death. The value of a decedent's 25% interest in a FLP with assets worth $10,000,000 should be worth less than 25% of $10,000,000. After discounting for the limited rights of a minority interest, the value of the 25% interest might be reduced from $2,500,000 to $1,750,000, for example. Other goals of the FLP or LLC include the ability of the head of the family to retain control, asset protection for family members, and restrictions on transfer of interests to keep the business in the family.

In order to achieve all these goals, it is important to comply with required formalities, such as maintaining an up to date Partnership Agreement or Limited Liability Company Operating Agreement. Assets must be held in the name of the FLP or LLC. Personal assets must be kept segregated and the FLP or LLC cannot be used for personal expenses. Income must be reported in proportion to ownership interests. The business should be reviewed to be sure it is operated in conformity with the Partnership or Operating Agreement.

Going further, an assessment should be made whether the FLP or LLC remains useful or desirable. For one thing, the current estate tax exemption is so high that the goal of reducing estate tax may not be relevant in some cases. Secondly, the discounted valuation on death may mean a lower income tax basis for surviving family members after a parent dies. Property tax planning is another issue. If there is a change of control of the FLP or LLC when the parent dies, any real estate owned by the FLP or LLC will be reassessed. There is no "Parent-Child" exclusion from property tax reassessment when interests in real estate pass through an entity. Finally, children may be unhappy with restrictions that limit their ability to leave their interest in the FLP or LLC to a spouse or charity. Dissolution of the FLP or LLC might be considered.

If documents need to be updated or business operations tightened up, now is the time to do it.

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