

Overview & Example of Family Limited Partnerships

1 Objective:

To establish an entity whereby the owners of property ("Husband & Wife") can allocate ownership to their children and grandchildren to minimize estate taxes, while still controlling the assets and the cash flow from the real estate (no stocks & etc, in this example). Current law enables taxpayers to utilize a Family Limited Partnership structure for this purpose (see the example flow chart).

2 Entity Mechanism

A Limited Liability Company is created that will be the General Partner in the Family Limited Partnership ("FLP").

A Family Limited Partnership is created with 100,000 total units, the General Partner interest holds 2% (2,000 units) and the initial Limited Partner block holds 98% (98,000 units) in our example.

The Husband & Wife own 100% of the Limited Liability Company, that owns the 2% General Partner interest in the FLP.

The Husband & Wife also own the initial 98% Limited Partner share of the FLP.

Then Husband & Wife contribute the properties to the newly formed Family Limited Partnership.

Now the Family Limited Partnership directly owns the properties, the Husband & Wife own an interest in the partnership.

3 Tax Strategy:

Under current law, established under Rev Rul 59-60 and Rev Rul 93-12, a discount is allowed for "Lack of Control" and "Lack of Marketability" for the value of the partnership interests in the Family Limited Partnership.

Let's assume that the properties have a fair market value ("FMV") of \$6 million at the time they were contributed to the FLP.

Let's also assume a 25% discount for Lack of Marketability and a 25% discount for Lack of Control.

Under this scenario the partnership is holding assets of \$6 million FMV, but are valued at \$3 million after applying the discounts.

Since there are 100,000 partnership units and the net value is \$3 million, this gives us a value of \$30 per unit share.

4 Gifting Advantage:

Remember, the fair market value of the underlying property is still \$6 million, but the value of the partnership shares are \$3 million.

Therefore, the Husband & Wife can now gift units of limited partner shares valued at \$30 per share, rather than to gift the direct ownership of the properties with a total value of \$6 million (or what would be \$60 per share before the discounting).

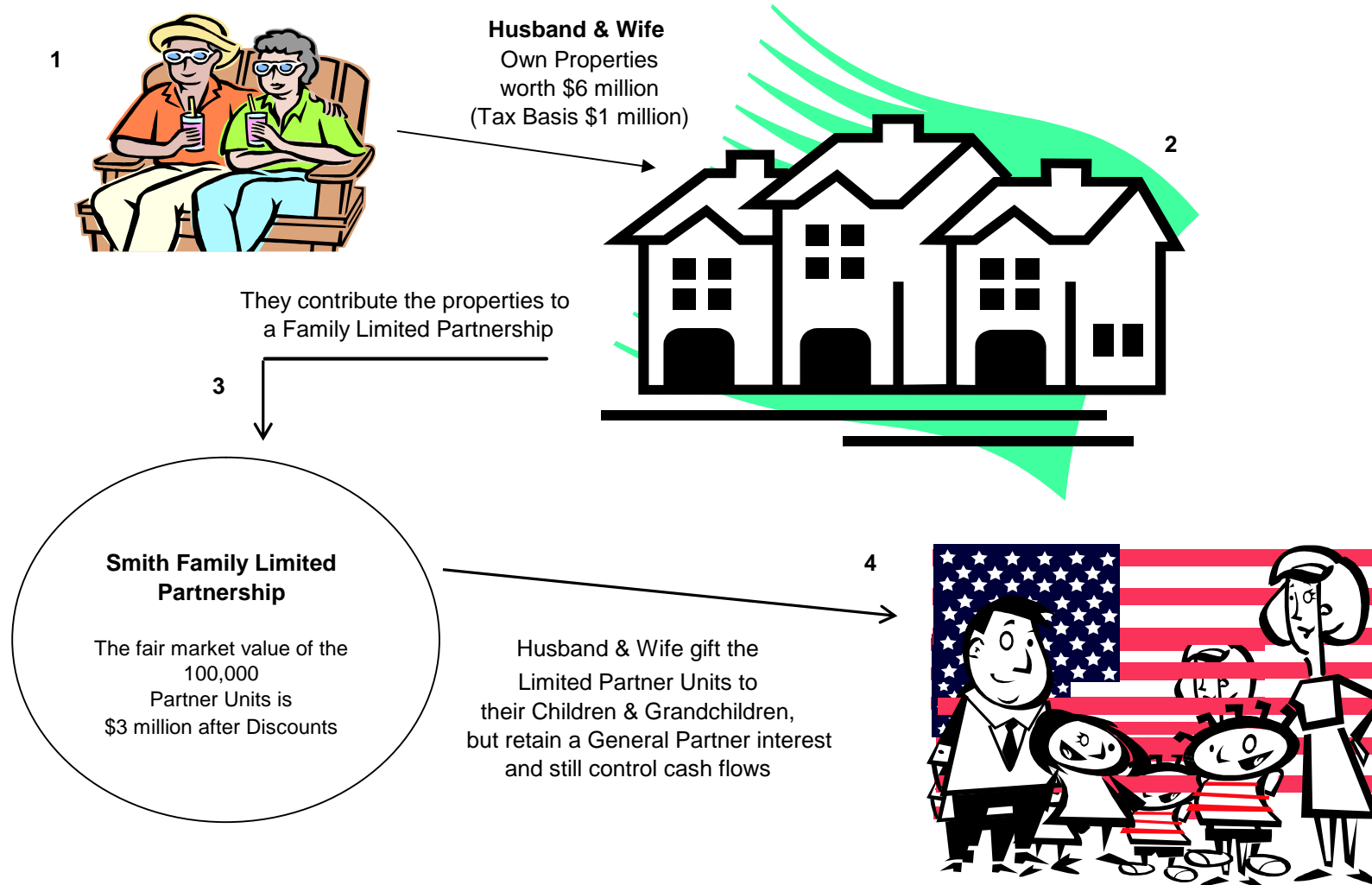
This enables the Husband & Wife to transfer wealth, while retaining control of the cash flow, at a faster rate by using the Family Limited Partnership structure. This also shields \$3 million of the underlying asset value during the gifting process.

Under this scenario, the transfer rate is double, since the value of the partner units is half the FMV of the actual underlying assets.

This mechanism also shields 50% of the underlying asset value received by each family member of the FLP, for their estate planning.

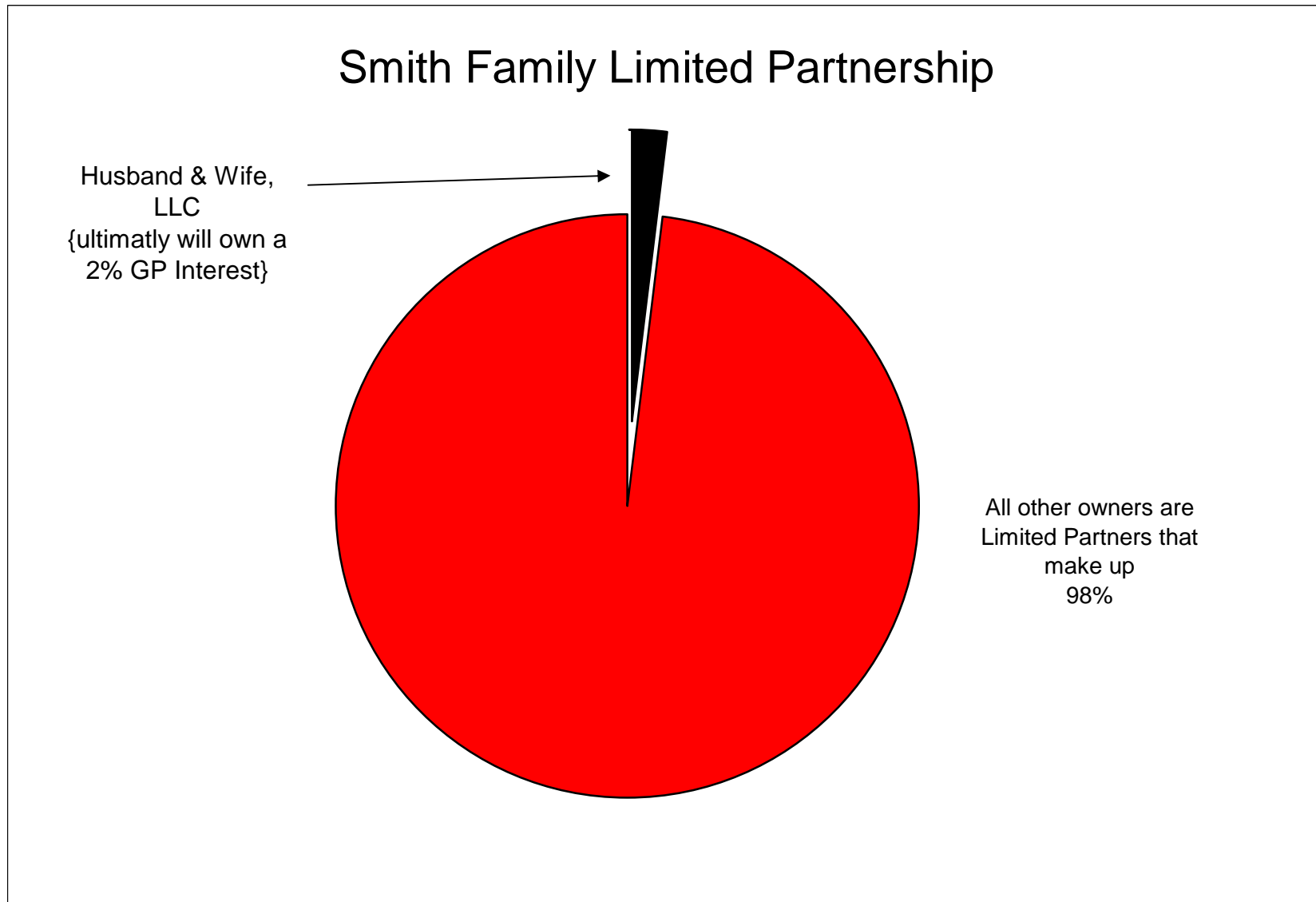
The goal is to ultimately have the Husband & Wife retain only the 2% General Partner interest for valuation for estate purposes.

Family Limited Partnerships - Flow Chart Illustration



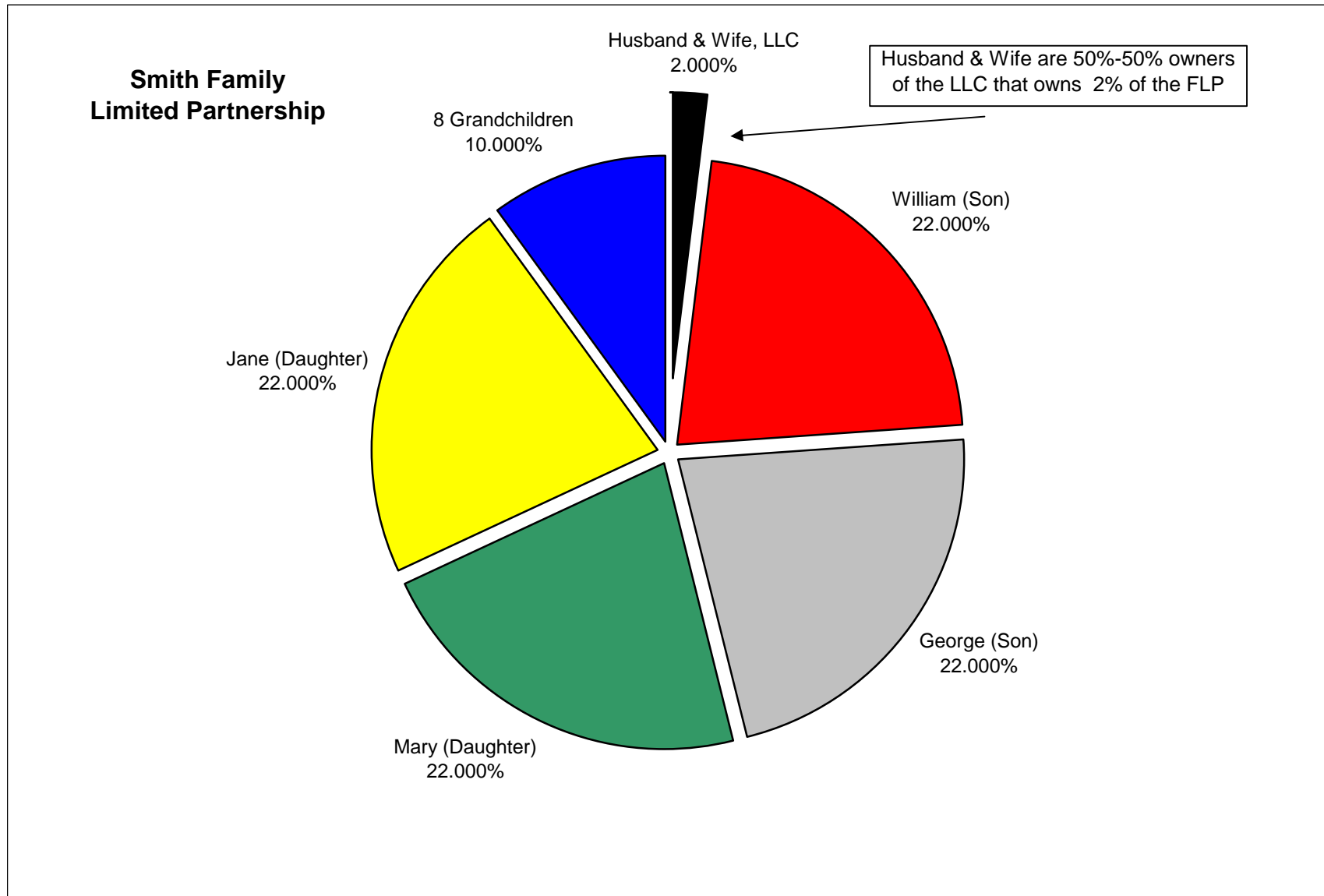
Notes: In our example, the fair market value of the real estate property is \$6 million dollars (no stocks or other assets). The value of the Family Limited Partnership units are \$3 million, after applying discounts. Due to the carryover basis rules, the tax basis of the property at contribution still remains \$1 million. The partnership will continue to record the property at tax basis, net of future improvements and depreciation. A sale of the property would still result in a taxable capital gain (currently estimated to be \$5 million).

Family Limited Partnerships - Entity Structure



- 1 The Husband & Wife are 50%-50% members of a Limited Liability Company (LLC) that owns a 2% General Partner interest in the Family Limited Partnership.
- 2 The remaining 98% is gifted to the 4 Children and 8 Grandchildren, as Limited Partnership shares, so that they acquire Limited Partnership interests.
- 3 Sometimes the Husband & Wife cannot initially gift out all of the Limited Partnership shares. In that case, the Husband & Wife retain Limited Partnership shares (in Revocable Trusts), that will be gifted to others under their annual gift exclusion in future years.

Family Limited Partnerships - Typical Ownership Goals



The goal of the Husband & Wife is to achieve the above allocation ownership. Any future grandchildren will need to receive subsequent LP Units from their respective parent. Each family member may eventually desire to reallocate their respective shares as needed for estate planning.

Family Limited Partnerships: Gifting Based upon Fair Market Value

	Partner/Member Name	ID #	Relationship	# Units Owned	Initial Capital by Gift (at \$30 per Unit)	Partner Type
1	Husband & Wife, LLC	11-2222222	[LLC Entity]	2,000	\$ 60,000	General
2	Husband (or Revocable Trust)	444-11-2222	Father	-	\$ -	N/A Fully Gifted
3	Wife (or Revocable Trust)	555-11-2222	Mother	-	\$ -	N/A Fully Gifted
4	William Generic	111-22-3333	Child/Son	22,000	\$ 660,000	Limited
5	George Generic	111-22-3344	Child/Son	22,000	\$ 660,000	Limited
6	Mary Generic	111-22-3355	Child/Daughter	22,000	\$ 660,000	Limited
7	Jane Generic	111-22-3366	Child/Daughter	22,000	\$ 660,000	Limited
8	Jane Smith Gift Trust	22-1111111	Grandchild	1,250	\$ 37,500	Limited
9	Mary Smith Gift Trust	22-1111122	Grandchild	1,250	\$ 37,500	Limited
10	John Smith Gift Trust	22-1111133	Grandchild	1,250	\$ 37,500	Limited
11	James Jones Gift Trust	33-1111111	Grandchild	1,250	\$ 37,500	Limited
12	John Jones Gift Trust	33-1111122	Grandchild	1,250	\$ 37,500	Limited
13	Mary Jones Gift Trust	33-1111133	Grandchild	1,250	\$ 37,500	Limited
14	George Generic, Jr	44-1111144	Grandchild	1,250	\$ 37,500	Limited
15	William Generic, Jr	55-1111155	Grandchild	1,250	\$ 37,500	Limited
Total					100,000	3,000,000

Note:

The gifting of shares are based upon the revised Fair Market Value of the shares (determined after applying appropriate discounts). In our example we assume that the entire \$3 million was gifted in the first year. Generally, any limitations on the gifting will result in the Husband & Wife retaining some Limited Partnership Units in Revocable Trusts, that will eventually be gifted to others by future annual gifting. Part of the planning difficulty is the fact that estate tax laws are constantly changing.

Family Limited Partnerships: Allocation of Tax Basis

Carryover Tax Basis of Assets at Contribution = \$1,000,000

Smith Family Limited Partnership						
<u>Name:</u>	<u>ID#</u>	<u>12/31/2000 Ownership</u>	<u>12/31/2000 Capital Accounts</u>	<u>2001 Increase/ (Decrease) by Gifting</u>	<u>2001 Revised* Capital Accounts</u>	<u>2001 Revised* Member Ownership</u>
Husband & Wife, LLC	11-2222222	0.0000%	\$0	\$20,000	\$20,000	2.0000%
Husband (or Revocable Trust)	444-11-2222	50.0000%	\$500,000	(\$500,000)	\$0	0.0000%
Wife (or Revocable Trust)	555-11-2222	50.0000%	\$500,000	(\$500,000)	\$0	0.0000%
William Generic	111-22-3333	0.0000%	\$0	\$220,000	\$220,000	22.0000%
George Generic	111-22-3344	0.0000%	\$0	\$220,000	\$220,000	22.0000%
Mary Generic	111-22-3355	0.0000%	\$0	\$220,000	\$220,000	22.0000%
Jane Generic	111-22-3366	0.0000%	\$0	\$220,000	\$220,000	22.0000%
Jane Smith Gift Trust	22-1111111	0.0000%	\$0	\$12,500	\$12,500	1.2500%
Mary Smith Gift Trust	22-1111122	0.0000%	\$0	\$12,500	\$12,500	1.2500%
John Smith Gift Trust	22-1111133	0.0000%	\$0	\$12,500	\$12,500	1.2500%
James Jones Gift Trust	33-1111111	0.0000%	\$0	\$12,500	\$12,500	1.2500%
John Jones Gift Trust	33-1111122	0.0000%	\$0	\$12,500	\$12,500	1.2500%
Mary Jones Gift Trust	33-1111133	0.0000%	\$0	\$12,500	\$12,500	1.2500%
George Generic, Jr	44-1111144	0.0000%	\$0	\$12,500	\$12,500	1.2500%
William Generic, Jr	55-1111155	0.0000%	\$0	\$12,500	\$12,500	1.2500%
Total		100.0000%	\$1,000,000	\$0	\$1,000,000	100.0000%

*** Note:**

The above revised capital accounts are the starting point before recording income or loss activity for the year.

The re-allocation of ownership %'s for tax purposes, is based upon the revised partnership units owned as first determined under the gifting rules.

The tax basis of the property is \$1 million, which was the carryover tax basis of the property when contributed by the Husband & Wife.

Husband & Wife, LLC: The General Partner

	Member Name	ID #	Relationship	% Owned	Initial Contribution	Title
1	Husband Revocable Trust	444-11-2222	Husband	50%	\$ 5	Treasurer
2	Wife Revocable Trust	555-11-2222	Wife	50%	\$ 5	Chief Manger
			Total	100%	\$ 10	

Notes:

- 1 In our example, this LLC is owned by the Husband & Wife, that becomes the new General Partner in the Family Limited Partnership.
- 2 All of the cash flow from the Family Limited Partnership is distributed to the General Partner, which is a Limited Liability Company. This cash distribution is a deductible expense of the Family Limited Partnership, as an Asset Management Fee.
- 3 This LLC is the Management Entity for the Family Limited Partnership. It receives an annual Asset Management Fee of up to \$300,000 (5% of the appraised value).
The LLC will incur expenses, such as Legal & Accounting, as well as management fees paid to an outside property manager firm.
- 4 Either the Husband or Wife should be designated as the Chief Manager of the LLC. Income distributed to the Chief Manager should be subject to Self Employment Tax.
- 5 The value of the LLC for estate purposes, upon the 2nd death (remaining spouse), should include the value of the net cash flow stream.