Legacy ADVISORS GROUP

M & A UPDATE®

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The Family Limited Partnership and the Mess It Has Become

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Introduction

Many people have heard of the Family Limited Partnership, otherwise known as the FLP. The amazing thing, the terms Family Limited Partnership and FLP do not appear in the Internal Revenue Code or any of the accompanying regulations. Quite simply, a FLP is a limited partnership or a Limited Liability Company (LLC) that is utilized in estate planning. Because of their popularity, many promoters (including attorneys, accountants, and financial planners) improperly use the FLP to line their wallets and their bank accounts. As a result, the FLP has become an overused, cookie cutter like entity to too many people in their estate planning. The unfortunate results are detailed below:

1) Many promoters of the FLP actively encourage steps that are too aggressive. As a result, individuals insert nearly all of their personal property into the FLP. Property included in the transfer typically includes their house, business interests, recreational property, and any and all possessions. Including all personal property in the FLP, to the point where it is impossible to be financially viable, is often fatal to the instrument. This is the worst possible thing that can be done. The IRS sees right through it, brings it to court, and often times easily wins.

2) Failure to follow formalities is another fatal event to the FLP. Corporate structures, such as C corporations, LLCs, and S corporations have requirements regarding their procedure for continued existence. Such formalities include a charter or by-laws, minutes, elections, etc. Failing to have or follow the charter and rules regarding procedure and formalities is a sure way to give the structure less credibility with a court or other state proceeding. It is nearly universal that those holding a corporation or FLP will not follow the procedure necessary to uphold the use of the corporate entity or its like, without the aid of counsel. It is with this many FLPs fail and leave the owner with a large tax bill.

3) On the other hand, forming the entity, but placing nothing in it is another folly that is common. Many individuals go to great lengths and expenses to form a FLP. A lot of times they form very proper, well-utilized

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A CASE STUDY

The Tax Court has stated that a U.S. Court of Appeals properly ruled on the valuation of a limited partnership. In 2000, a family formed a limited partnership with the intent of reducing estate taxes, preserving and resisting fragmentation, and being a financial educational media for the children. An internal buy-sell agreement was created to reduce the value of the shares under a right of transfer that was retained in the parents.

The taxpayer argued that the LP was properly valued with discounts for lack of control and marketability. The Appellate Court ruled that the taxpayer failed to establish its burden of proof in achieving the three part test for limited partnerships, and thus assessed a higher value. The Tax Court agreed with the Appeals Court seeing the substance over form argument and ruled that the stock was properly valued by the Appellate Court.

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entities in fact. The downfall is sometimes that they do not place sufficient assets in the FLP. This is also common with trusts. Once the instrument is created, you must put assets in it, otherwise the instrument is of no use and the assets outside the entity do not benefit.

4) Failing to maintain the FLP can also mean the downfall of the entity. Each state has a mandatory fee for every entity registered within its borders. This includes corporations, partnerships, and all other entities. The FLP is no different in they must pay a fee. If this fee is not paid, eventually the entity is administratively and involuntarily dissolved. The result, no benefits from the existence of the FLP.

5) Jurisdictional Issues can also present problems. In any legal or tax strategy, it pays to know the jurisdiction. From a legal perspective bankruptcy laws differ. Some states offer only a charging order to creditors trying to collect from limited partnerships. A charging order allows creditors to accept distributive payments instead of collecting the principal and assets of the company. It is a less preferred method of collection to the creditor. If states do not allow a charging order, yet offer asset collection methods instead, this is less favorable for a FLP.

Conclusion

The good news is that there are plenty of estate planning vehicles which are more appropriate for estate planning than the cookie cutter FLP. Intervivos and irrevocable trusts tend to lead the way for many people. The key for many people and estate planning experts is that many variables must be considered instead of creating a potentially ineffective FLP. The Center advises and creates many estates and trusts, for the purpose of estate planning. Estate planning should begin immediately if you don't have one. Don't let time go by, start planning now and be sure to use a knowledgeable and informed professional.

Points of Interest

- **The FLP has become an overused, cookie cutter like entity to too many people in their estate planning.**

- **Many promoters of the FLP actively encourage steps that are too aggressive.**

- **The key for many people and estate planning experts is that many variables must be considered instead of creating a potentially ineffective FLP.**

Dr. Bart A. Basi is an attorney, CPA, and the Senior Advisor of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes. Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the Financial, Legal & Tax Advisory which may be read in various industry-specific trade publications.

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A CASE STUDY CONTINUED:

Editor's Comment: Family Limited Partnerships have their place in tax planning; however, they have very serious limitations as well. The business purpose for forming FLPs has to be legitimate and any buy-sell agreements have to be valid, enforceable, and reasonable to escape skepticism. FLPs are not one size fits all. There are many other valid tax and estate planning vehicles available to achieve the goals taxpayers desire.

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Avoiding Common Mistakes in Selling Your Business – Waiting Too Long

Mike Ertel, CBI/ M&AMI/ CM&AA

Selling a business you've spent most of your working life to build is one of the most important personal and financial decisions most business owners will ever make, and for that reason, it's important not to wait too long.

The best time to sell any business is when you don't need to – not when the owner's health, or other personal circumstances, or business pressures demand it. When the business is doing well, and has a string of successful years immediately behind it, with the promise of doing as well or better in the coming years, it will attract the most qualified buyers and bring the best price and terms. When it appears that the business is no longer growing and may be headed for a period of declining sales and profits, its selling price will be much lower.

From experience, we recommend that our selling clients begin the process 2-3 years before they believe they will really need to sell the business. While some businesses have sold in as short as six months, the average tends to be closer to a year, with some businesses requiring 2-3 years before finding the right buyer and the right deal. In addition, some business may benefit from making a few changes/improvements to their business to command the best price and terms and it may take from a few months to a year or more to implement those changes.

If you know of a business owner who's thinking of selling or buying a business and who might benefit from a free, confidential, consultation with us, have them contact me at: mertel@legacyadvisorsgroup.com

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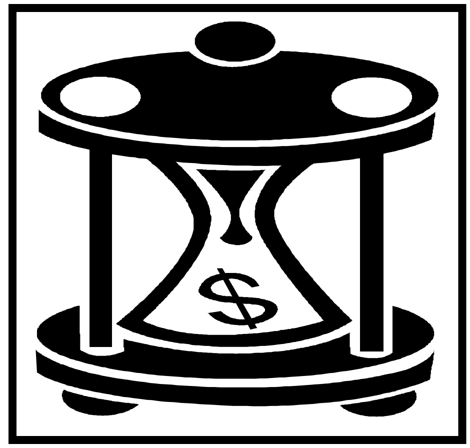

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Frequently Asked Questions…

Q: I own my own business and I am considering retiring. What should a business person do in order to retire?

A: Business people are in a unique situation when it comes to retirement and no two situations are exactly alike. Some business owners have large retirement accounts; others have nothing in formal retirement accounts. Other business owners have family looking to take control of the business, while others have family in other career paths. Generally though, the business owner should work and take steps towards maximizing his or her own wealth when it comes to a business. Simply closing shop or auctioning assets is usually not the way to go. It is worthwhile to sit down and talk to a professional.

Q: I am a business owner, how much can I put in retirement accounts?

A: We publish a newsletter each year with the applicable retirement account amounts. The most commonly used retirement device, the IRA, can take deposits of up to $5000 this year and have a $1000 catch up for those aged 50 or above. If you would like a copy of our retirement account tax tip, please call our office.

Q: I must amend an older tax return. How much time do I have to amend a previous year's tax return?

A: For the most part you have 3 years from the filing date or 2 years after the taxes have been paid to amend a tax return, which ever is later.