



The Good and Bad of the Family Limited Partnership: Part II

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Introduction

Last month, we went over the good side of creating an FLP or Family Limited Partnership. This month, the Disadvantages and Conclusion to the article are discussed.

Disadvantages

Along with the advantages, there is a substantial downside, that downside is a substantial list of ways to derail the intent of the FLP and the advantages it sets forth.

1) Many promoters of the FLP actively encourage people to insert nearly all of their personal property into the FLP. Property included in the transfer typically includes their house, business interest, 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 could be done. The IRS sees right,

through it, brings it to court, and oftentimes, wins easily.

2) Failure to follow formalities is another fatal event to the FLP. Corporate structures, such as corporations, LLCs, S Corporations all have requirements on their formalities. Such formalities include a charter of some sort, minutes, elections, and etcetera. Failing to have or follow the charter and rules is a sure way to give the structure less credibility within a court or other state proceeding. It is nearly universal that those holding a corporation or FLP will not exactly follow the procedure necessary to uphold the use of the corporate entity or it's like. It is with this many FLPs fail and leave the owner with a large tax bill.

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A CASE STUDY

S Compensation/Withholding

The IRS has issued a fact sheet as a reminder for taxpayers concerning the compensation of S corporation officers. S corporations must remember compensation to its officers must be reasonable. The fact sheet also highlighted the fact that simply because an officer is also a shareholder does not mean that compensation to the officer

is not required to be treated as wages for federal employment tax purposes. Officers who provide more than minor services and are entitled to receive payment for such services are considered employees. However, this is not true for officers that provide little or no services.

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3) Forming the Entity, but placing nothing in it is another folly that is common. Many individuals go to great lengths and expenses to form an FLP, a lot of times they form very proper, well utilized entities in fact. The downfall is sometimes that they do not place sufficient assets in the FLP. This is also common with trusts that are written up by attorneys. 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.

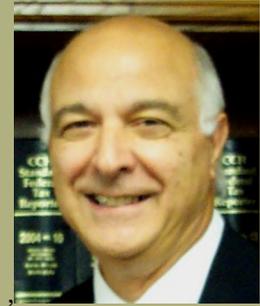
4) Failing to maintain the FLP can also mean the downfall of the entity. Each state has a mandatory fee for every entity registered within its borders. This includes corporations, partnerships, and all other entities. The FLP is no different in they must pay a fee. If this fee is not paid, eventually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

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,

as in some states offer only a charging order to creditors trying to collect from Limited Partnerships. A charging order allows creditors to accept distributive payment 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 charging orders, this is less favorable for an FLP. Discounts are also imperative.

Conclusion

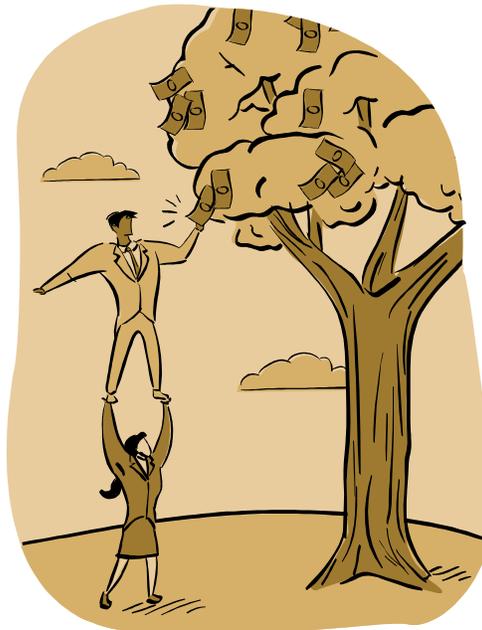
Estate and business succession should not be done in a one size fits all concept. While the Family Limited Partnership has its place for certain individuals, most people would benefit from other or additional estate planning. The fact is only 25% of those doing estate planning should have an FLP. Trusts, business planning, and a whole host of other instruments are available to properly plan the actions and courses to be taken when the time comes. The time to engage in business succession planning is today. Don't let your business become yet another statistic. Call the professionals at The Center for details and assistance with your business succession plan and estate planning.



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.

Points of Interest

- Along with the advantages, there is a substantial downside,
- Failing to maintain the FLP can also mean the downfall of the entity.
- Estate and business succession should not be done in a one size
- While the Family Limited Partnership has its place for certain individuals, most people would benefit from other or additional estate planning.



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A CASE STUDY CONTINUED:

Editor's Comment: Neither IRS regulations nor federal statutes provide guidance on when compensation is considered reasonable. However, numerous courts have provided some guidance. Factors used by courts to determine whether compensation is reasonable include: training and experience, duties and responsibilities, time and effort devoted to the business and comparable businesses for similar services. Readers are put on notice that if they perform services for their S corporations, they must have a "reasonable" salary and not keep their salary low and avoid paying payroll taxes.



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Frequently Asked Questions...



Q: I am planning on buying a large piece of equipment, is there any way I could deduct the cost of this equipment rapidly?

A: Right now, no. Unfortunately, Congress has failed to act in passing a new tax law for 2014. The problem with this, unlike in years past, is that Section 179 and Bonus Depreciation are unavailable. We have a hint that both advanced depreciation methods will be made available, but it is largely speculation at this point.

Q: I am interested in having my business valued for a number of reasons. Is a valuation done for estate planning purposes effective for other purposes such as financing as well?

A: Generally, you would want to have your valuation reviewed or updated to reflect accurate value to a bank or when using the valuation for other purposes.

Q: I am selling my house. Does the primary residence exclusion still apply?

A: While large gains on homes in this decade are rare, yes IRC Section 121 does allow a large exclusion. Under Section 121 of the Internal Revenue Code home sellers can exclude up to \$250,000 individually or up to \$500,000 jointly on their tax returns.

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