Legacy ADVISORS GROUP

M & A UPDATE®

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The Family Limited Partnership

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The Center for Financial, Legal & Tax Planning, Inc.

Introduction

Many people want to enrich their children and grandchildren with their wealth, possessions, and business interests which they own. The problems in the past have been inability to control the assets once they were given and the potential of facing estate tax issues when assets are substantially appreciated. The device known as "The Family Limited Partnership" or FLP has been developed through case law and has survived scrutiny from the IRS to become a legitimate estate and business planning vehicle.

What is an FLP?

An FLP is an estate planning device that allows the general partner to fund the device, transfer value to heirs, keep general control over the assets, and utilize various other strategies to reduce gift and estate taxes. In practice, an FLP is similar to a trust in so far as assets are transferred for the current and future benefit of others while allowing the grantor/general partner to keep control over the assets. The FLP differs from a trust in that it provides for tax and nontax advantages while offering potential unlimited life and can keep operating after the grantor's/general partner's death. While the trust still has a well established place in estate planning, the FLP's niche in the business world is a little less established, but not devoid of its advantages.

The Limited Partnership (the LP portion of FLP) is a legitimate business entity under state statute. Legally, the General Partner is potentially liable for all the debts and claims against the entity to the extent of the business assets in the LP and personally held assets. The Limited Partners, on the other hand, are not subject to personal liability and are only liable for debts and claims to the extent of their investment in the FLP. The General Partner's liability may be absolved by owning the general partner shares through an S Corporation or a Limited Liability Company.

How to Begin

An FLP is simply a Limited Partnership formed under state statute and owned by family members. One person (usually a parent) retains a 1% or 2% interest as the

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A CASE STUDY

The Tax Court has partially upheld the discounts applied in the valuation of two closely held companies for estate tax purposes. In the case, when the decedent died she held a 43% interest and 23% interest in two closely held corporations. The estate tax return claimed a 68% discount for the decedent's interest in one company and a 65% discount for the other. However, the IRS found that these discounts should have been closer to 30% and and 23%. The Court disagreed with the IRS, holding that the materials submitted by the estate supported the previously claimed discounts. Overall, the Court found that the IRS's expert did not take into consideration appreciation in some assets and the fact that the decedent had a smaller ownership interest in one company, providing less control. But the Court did conclude that the estate discount for lack of marketability was too high.

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Cover Story

General Partner. The children are then granted up to a 98% interest, over time, as Limited Partners

The importance of the details of formation of the Limited Partnership should not be overlooked. While a typical partnership can be formed with no written agreement, the Limited Partnership REQUIRES that it be formed according to state statute. Beyond the formal creation requirements, case law has developed providing guidance regarding particularities in BOTH creation of the entity and in operation of the entity. One key ingredient being that the FLP have a valid, stated business purpose for its existence. If the particularities are overlooked, the IRS is free to scrutinize the FLP as a tax avoidance device and given the fierce history the IRS has had against FLPs, it is imperative that these particularities not be overlooked or disregarded.

Discounts

The FLP will require that a professional business appraiser value the entity from time to time. There are discounts that can potentially be taken when the FLP is appraised. The first potential discount is the "control" discount. Since the limited partners have largely abbreviated rights to begin with AND lack of any element of control, their interest in the FLP is discounted to reflect the lack of control that they do not possess. The second discount that can be taken is one for lack of marketability. The simple fact is that interests in small, non publically traded businesses lack overall marketability. An interest in a family owned limited partnership is equally as unmarketable. While discounts for lack of control and lack of marketability can be justified, extending and taking discounts without justification can be fatal to an otherwise well crafted valuation.

Conclusion

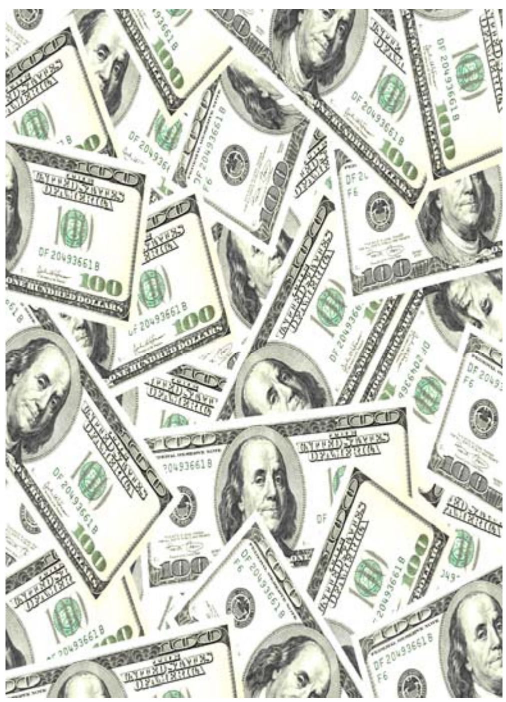
The FLP is one device/strategy of many that can be taken to plan for tax and business issues that your estate will face upon your death. The FLP is an extremely useful and tested device that can be applied in your estate and business planning. If you are interested in forming an FLP or would like more information, feel free to contact the professionals at The Center at (618) 997-3436.

A CASE STUDY CONTINUED:

Therefore, the Court upheld the majority of the discount applied by the estate, resulting in a savings in estate tax.

Editor's Comment: **The value given to a business can have a great impact on the amount of estate tax that is assessed. In this case, the estate value was dependent on the valuation of the decedent's interest in more than one company, making the overall value of the estate more difficult to determine.**

It is important when determining values such as these that an expert with adequate experience in valuation be used in order to save the taxpayer as much money as possible. In this case, the Court found the estate's expert to be more accurate than the IRS's expert.



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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Points of Interest

- The device known as "The Family Limited Partnership" or FLP has been developed through case law and has survived scrutiny from the IRS.
- The importance of the details of formation of the Limited Partnership should not be overlooked.
- While discounts for lack of control and lack of marketability can be justified, extending and taking discounts without justification can be fatal to an otherwise well crafted valuation.

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Is This the Right Time to Sell Your Business?

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

It seems that more and more business owners are asking me that question these days. Given the recent "perfect storm" of collapsing financial markets, tighter credit, growing unemployment and a worsening economic recession, it's a very fair question.

My answer is generally in two parts. First, for most business owners, determining the right time to sell your business depends upon a great many factors, including your health, your spouse's health, your retirement plans and retirement savings, your management succession plan, the current financial health of your business and its immediate prospects for the future, and last but not least, the state of the overall economy, just to mention the most obvious factors. Clearly, this is not a question that can be answered without a careful analysis of many, interrelated factors. Equally clearly, there is no one time that is right for every company and owner.

The second part of my answer goes something like this: It has been my experience that even in difficult times such as we're experiencing now, there is almost always a market for a really well run company with a proven track record of generating above average cash flows, and with bright prospects for continued future growth. Strategic buyers and private equity groups report that they are still actively looking to source new deals, and are successfully closing deals, albeit with somewhat greater equity infusions, and in some cases with somewhat more seller financing.

In view of the above, a better question might be: What can I be doing now to maximize the value of my company when I'm really ready to sell it?

We've addressed some specific strategies to maximize business value in previous articles; my point here is that this may be an ideal time, when the business is not stretched to its limits, to invest in actually implementing those value improvement ideas. When the general economy comes roaring back, as it always seems to, and probably sooner than we think, most business owners will once again be so busy trying to keep up with the growing demand for their products and services that they will quickly complain that they simply don't have the time to make needed improvements. This time around, commit to yourself that you won't fall into that mental trap.

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 mikeertel@legacyadvisorsgroup.com

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Frequently Asked Questions…

Q: Does a down economy affect business succession planning?

A: For the most part, it can be advantageous to start a succession plan during a down economy or even sell a business interest to a succeeding generation. During recessions, business values ordinarily go down slightly. While this is usually a bad thing for the business owner, transferring part or all of the business via a sale or gift during a recession can make the sale a less taxing option or if the business owner were to sell to the next generation, the lowered value could make it easier for the next generation to buy the business.

If you are looking for maximum value, start your business succession planning now and sell during the next upswing the economy experiences.

Q: How long do I have to rollover a retirement distribution?

A: You have 60 days to rollover a retirement distribution from the day that you receive the distribution. Otherwise, the distribution, taken before the statutory distribution age, can be taxed and subject to a 10% penalty.

Q: I have an employee claiming 11 exemptions. Must I report this to the IRS?

A: No. In the past, employers were obligated to send the IRS the employee's W-4 form when employees claimed over 10 exemptions or claiming complete exemption from withholding. This requirement has been eliminated.