Legacy M&A ADVISORS LLC

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

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Introduction
Many people who own small businesses have heard the term "Family Limited Partnership" (FLP) at least once or twice and have some grasp of what the idea concerns. 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, an FLP is a limited partnership or a Limited Liability Company (LLC) that is utilized largely in estate planning offering some benefits to the users, with some substantial downsides.

The Basics of a Family Limited Partnership
An FLP 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 another, while allowing the grantor/general partner to keep control over the assets. The FLP differs from a trust in that it provides for additional 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 FLPs niche in estate planning is a little less established, but not devoid of advantages.
The Limited Partnership (the LP portion of FLP) is a legitimate business entity set up 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 are personally held assets.

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A CASE STUDY

INTERESTING APPRAISAL

A Court of Appeals reversed and remanded a Tax Court ruling that was favorable to the IRS. In the case, the taxpayer donated a façade conservation easement to The National Architectural Trust. In order to get the deduction, she had to have a qualified appraisal of the property. The appraisal rules are quite clear on their requirements. First, the appraisal must specify its method to be used to determine fair market value. Second, the appraisal must provide the basis for the valuation such as comparables, statistical sampling, or other.

In this case, the market data was sketchy at best, so the "before and after method" was used. The Tax Court originally ruled against the taxpayer stating that the appraisal qualified on the first test, but disqualified on the second test. The before and after method did not have comparable and reliable statistical samples. Therefore the taxpayer lost at Tax Court. On appeal she won, because the Appellate Court reasoned that the lack of data went to the persuasiveness of the data, not the qualification or basis of the appraisal overall. Therefore, the taxpayer won.

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Cover Story

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 can be largely absolved by having the general partner shares owned through an S Corporation or a Limited Liability Company.

Advantages

While the tax benefits of the FLP are substantial, the non-tax benefits cannot be overlooked. Not only are the nontax benefits important for the family business, making an effort to achieve the nontax benefits is important to gain the tax benefit advantages as well.

Consolidation of management is a benefit of the FLP structure. Instead of setting up separate trusts, separate bank accounts, and separate brokerage accounts, the FLP can use one central account. The consolidation also has the effect of reducing investment expenses and unifies the investment as well. Unifying the investment, in the manner of an FLP, also provides longevity to the investment insofar as the FLP can be operated to provide greatest return.

The FLP also provides the benefit of creditor protection. Assets involved in businesses, especially a closely-held business owned by a minority non-voting shareholder, are often not attractive to creditors or potential ex-spouses

A professional business appraiser is required to be retained when valuing an FLP. An FLP, as most businesses, is not a simple asset to value. Houses, cars, antiques, items for donation must be valued by a qualified appraiser. Closely-held businesses, including FLPs, are often so intangible in nature and unique that a simple valuation by a nonprofessional is not sufficient. Because of the complexity, differences, and unique nature of each business, an appraisal by a professional appraiser is needed. The appraiser will appraise the business using a variety of methods that may be advantageous to your estate tax position.

One benefit of the FLP is the ability to use marketability and minority shareholder discounts upon valuation. The professional appraiser can assign discounts for lack of marketability and lack of control. For an FLP, combined discounts for lack of control and marketability can total from 20-40%.

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

- **…the terms Family Limited Partnership and FLP do not appear in the Internal Revenue Code or any of the accompanying regulations.**
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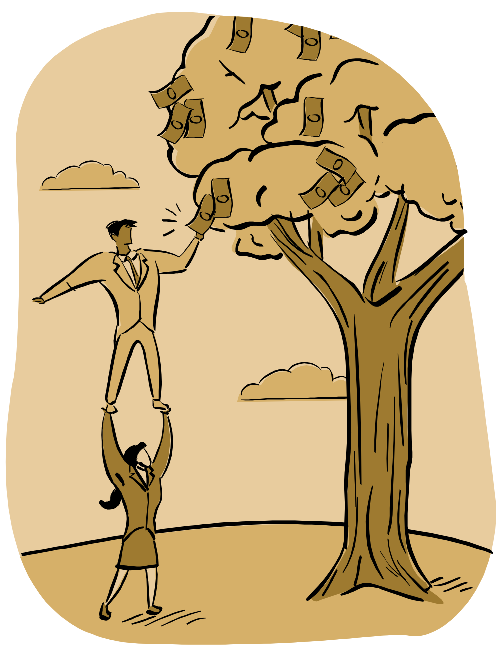

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A CASE STUDY CONTINUED:

Editor's Comment: I don't expect the reader to understand the full complexity of this case. The point of this case is to demonstrate to the reader that not all valuations are straight forward. All valuations and appraisals present challenges. This one was pretty tough. In its market, it had no reasonable comparables and no hard and fast statistics to go on. Under these conditions, the IRS would argue that no appraisal could ever be qualified. Recognizing the intent of the law, the Appellate Court recognized the impossibility of the situation and allowed the report to go through. Score one for the taxpayer!

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HOW SOON SHOULD YOU START WORKING WITH A BUSINESS BROKER/M&A ADVISOR?

A business owner who is thinking about selling his business sometime in the next few years recently asked me: "How soon should I begin working with a business broker?" My response was: "Probably a lot sooner than you think!"

The most common mistake I see business owners make when it comes time to sell their business <u>is waiting too long</u>. It's been said that most business owners spend more time planning their annual vacation that preparing for the sale of their business – and some don't even take an annual vacation!

In many cases, to maximize the selling price the seller may need to clean up some aspects of the business and its financial records which can take 6-12 months, and sometimes longer.

The sales process itself, including analyzing and recasting the company's financial records, preparing the necessary marketing materials, identifying and screening qualified buyers, negotiating the letter of intent, completing due diligence and financing, and closing the deal for a small- to mid-sized company can take up to 12 months, and sometimes longer.

Frequently the buyer will want the seller to stay on for several months – often 6-12 months, and in some cases for much longer - to assure a smooth transition and to maximize employee and customer retention.

Adding it all up, If you'd truly like to maximize the selling price of the business you've spent a great part of your working life building, you need to start <u>at least 2-3 years in advance</u> of the date you'd like to completely retire from it..

Contact me directly if you'd like a <u>free</u> copy of my white paper entitled, <u>Value Drivers To Maximize the Selling Price of Your Business</u>.

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

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Frequently Asked Questions…

Q: As an employer, am I required to pay my employees sick time, vacation, and otherwise supply them with paid time off?

A: Under the Fair Labor Standards Act, there is no employer requirement to give employees paid time off. At the same time, states may vary on their time off requirements for employees, but generally there is no paid time off requirement.

Q: Where is the best place to store estate plan documents?

A: The best place to store estate plan documents is in a location where others a) know of, b) can get into when the time arises, and c) is secure. Storing the documents in a safe deposit box that a friend knows of can be a good place as long as that friend knows where to get the keys at. The location would be known, able to be opened, and secure. Hiding documents in a book or in a safe that nobody knows of or does not have the combination renders the documents useless to both you and those that are trying to help you.

Q: I have recently had my business valued. The value between what I believe the value should be and what is calculated are completely different. Why is this?

A: There could be any number of reasons for this dilemma. Valuations are based upon assumptions, figures provided, and calculations based upon them. The numbers, assumptions, and calculations may not necessarily reflect the value of the business to an owner. There are methods and procedures available to improve the value of a business to a willing buyer. It is with these improvements, a business' value can be augmented.