

Sharing wealth with a family limited partnership

One way to transfer assets to other family members is to establish a lifetime gift-giving program. Currently, the **annual gift tax exclusion** allows you to give up to \$11,000 to each recipient every year without paying any gift tax (\$22,000 for joint gifts). And the unified estate and gift tax credit may provide tax shelter for additional transfers (up to \$1,000,000 in 2002).

Potential Problem: It can be difficult to transfer your wealth if you are the owner of a **closely held business**. However, you may be able to accomplish your objectives without losing control of the business by setting up a **family limited partnership (FLP)**.

The IRS gave its stamp of approval to this estate planning technique in a **new private letter ruling** (Ltr. Rul. 199944003).

How It Works: Typically, you transfer income-producing property (e.g., business assets or real estate) to the limited partnership. Since you are the sole general partner, you continue to maintain **complete control** over the partnership's assets. Then you give the limited partnership interests to your children (or other designated family members).

Note: As limited partners, your children have no direct say in the partnership's decisions. For example, when you transfer an interest in your company to the partnership, you still can run the day-to-day business operations without any direct interference from your children.

Of course, the transfers of the limited partnership units are subject to **gift tax**. But you can still take advantage of the annual gift tax exclusion and the unified estate and gift tax credit. Furthermore, the gift may be valued at a special discount - even if you effectively retain 100% ownership of the business.

Facts of the new ruling: A business owner and his wife created an FLP and named themselves as the general partners. Under the partnership agreement, the general partners retained broad powers over business affairs, including control over partnership distributions. The agreement also stated that the general partners had a strict fiduciary responsibility towards the limited partners and the partnership.

According to the ruling, this arrangement passes muster under the applicable state and federal laws. Each child received the immediate use, possession and enjoyment of the interest, including the right to sell it or assign it.

Bottom Line: The transfers to the FLP qualified for the annual gift tax exclusion.

Extra Tax Benefit: A gift of a minority interest in a closely held company is generally valued at a **discount** from the proportionate share of the full value. This special tax rule reflects the fact that minority shareholders cannot influence management decisions or force a sale or liquidation of the company. Also, keep in mind that a minority interest is generally not marketable.

*Nevertheless, a family limited partnership is **not for everybody**. You must consider all the relevant factors, including the applicable state laws, before you use this approach.*