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Family Limited Partnerships

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An FLP is nothing more than a limited partnership, created as a vehicle to transfer income and title to assets from the family head to other family member, rather than to a non-family business associate. When the owner of a business is in a high income tax bracket, this transfer can drastically reduce any personal liability and taxes.

In the case of an FLP, property with a high appreciation potential is the best type of contribution. It can be transferred in under a freeze-style transaction with all taxes deferred.

At first this may seem like a drastic surrender of your wealth to your children, but it’s not. Children as limited partners have no control over the assets. A parent or parents as 5% managing general partners have the control. They make the decisions in respect of cash distributions, including what salary is paid to the managers, meaning themselves, and what investments are made. Although the limited partners own the assets, they are inactive titleholders, forbidden by law to control those assets lest they jeopardize their partnership status and their limited liability.

An FLP offers the advantages of a precise agreement defining the parties’ rights, allows withdrawal of property with far fewer tax problems, and operates under no shareholder restrictions. It also allows you to effectively freeze the value of your own interest, which allows you to predict your tax liability while accruing future growth to your children as limited partners.

This means greater freedom of movement and flexibility all around.

Transferring real property to the partnership eliminates probate of property located in jurisdictions other than that of your donee’s residence at the time of your death. Most jurisdictions exempt partnership property from probate.

Since a partnership isn’t a taxable entity, making gifts to children or other family members through the medium of a fairly constructed partnership avoids the burden of double taxation to which personal net income is subjected in a corporation. A partnership is a flow-through vehicle so income will only be taxed once and, as discussed above, you will be able to freeze your interest for a predictable tax bill.

In summary, when formulated correctly, the FLP is an excellent means of shifting income, conducting a family business where the corporate form presents tax problems, maintaining control of assets while passing them on to others, estate planning, and insulating your wealth from creditor attacks.

A family limited partnership in itself doesn’t guarantee either increased income or absolute asset protection benefits. As with any asset protection structure, an FLP’s value comes from creation of the proper governance structure, continued good management of the underlying assets, and wise decisions during the life of the partnership. Additionally, the limited partnership offers an established tool, recognized in law, which can enable you to achieve your desired financial goals.

The province or the state of location for partnership formation should be chosen to maximize protection. Delaware and other US states with favourable partnership laws should be considered. Asset protection benefits accompany this choice.

The legal forms or identities of the partners themselves aren't important. For instance, a partnership interest can be transferred to, and owned by, an irrevocable trust, with spendthrift provisions created for the benefit of the children. Even the parents' partnership interest can be held by irrevocable trusts, offering yet another layer of protection.

Remember that this form of asset protection and family business ownership has been around for a long time. The pitfalls and ways to avoid them are documented above. There are no shortcuts, but there are many tangible rewards to the proper creation and operation of an FLP.

Invitation for Discussion:

If you would like to discuss this article in greater detail, or any other business law matter, please do not hesitate to contact one of the lawyers in the Tax group at Shea Nerland LLP.

Disclaimer:

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