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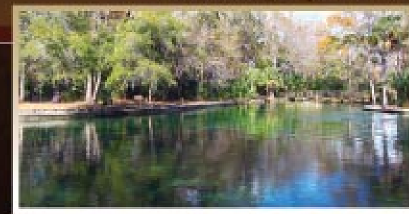

Serving Clients Throughout Central Florida

FAMILY LIMITED PARTNERSHIPS

The Family Limited Partnership (FLP) has been a popular business entity for wealth management, tax minimization and wealth transfer maximization. Under the right circumstances, FLPs traditionally helped taxpayers remain in control of their wealth even after transferring it to their loved ones. Additionally, many of these transfers were made at

a significant discount, thereby further leveraging wealth transfer tax savings. Not surprisingly, while FLPs have been employed as a planning panacea by taxpayers, FLPs have received additional scrutiny from the IRS and some courts in recent years.

Background

Simply put, a Family Limited Partnership is a Limited Partnership among family members. The FLP is often created by the wealth-owning generation, typically the parents. The FLP creators are initially both the General Partners (GPs) and the Limited Partners (LPs) at the time they contribute assets to the FLP. The lion's share of the contributed assets is thereafter assigned to the LPs shares. Even so, the GPs hold all of the management control over the Family Limited Partnership assets.

When the Family Limited Partnership assets generate income, the General Partners are entitled to compensation for their management services. Limited Partners enjoy an ownership interest only. They have few rights or powers and there are restrictions on the transferability of their Limited Partner interests. This lack of control (*minority interest*) and inability to transfer the Limited Partner interests freely (*lack of marketability*) reduces or *discounts* the value of the FLP assets. In turn, this discounting enables the parents to transfer more wealth (and the future appreciation of that wealth) via their Limited Partner interests to younger family members, yet retain lifetime control over that wealth.

Other benefits include income splitting and asset protection, since Family Limited Partnership income may be spread among multiple family members and creditors of the Limited Partners may be limited in their attempts to reach the underlying FLP assets.

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INSIDE

Family Limited Partnerships offer many benefits, both tax and non-tax. Our front-page article is a primer that explores why they are at once a taxpayer favorite... and a potential target of the IRS and some courts.

On page three we examine three strategies for protecting your hard-earned wealth: exempting your assets, limiting your liability, and transferring your risk. This article will inspire you to take specific actions today to protect your wealth tomorrow.

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IRS & Judicial Scrutiny

Given the powerful tax and wealth transfer benefits available through FLPs, it is easy to see why the IRS and some courts do not like them. First and foremost, an FLP must be created for a business purpose … not just for estate planning. For example, a valid business purpose may be *to maintain family ownership and control of assets while they are transferred between generations free from the claims of third-party creditors and probate*. Any planning with an FLP must begin with a solid business purpose in substance, as well as in form.

Like most legal arrangements that offer both tax minimization and wealth transfer maximization, FLPs are subject to an unwritten rule of law: *pigs live and hogs get slaughtered.* Some examples of hoggish behavior with FLPs include taxpayers who establish deathbed FLPs and/or taxpayers who transfer substantially all of their personal assets and means of financial support to their FLPs (i.e., leaving themselves no other source for income and sustenance). Result: If an FLP is found to be hoggish, then the entire value of the underlying

FLP assets may be included in the estate of the FLP creator by the IRS and some courts.

As you might imagine, in addition to the FLP's business purpose, the IRS has traditionally scrutinized the *valuation discounts* claimed by the taxpayer for the LP interests. Once these gifts are made, the taxpayer must ensure that any discounts attributed to the gifts are substantiated in writing by an appropriate valuation expert and that these discounts are reported on a timely gift tax return. Expert professional valuation assistance is critical to successful FLP planning, implementation and maintenance. It is money well spent.

Practical Considerations

FLPs are not for everyone. Between legal fees, valuation fees, required state filings and reports, and tax returns (for the FLP, the GPs and the LPs), FLPs may require a substantial commitment in time and resources.

For many taxpayers, however, the tangible rewards of FLPs far outweigh any potential risks.

Bottom line: Be sure to engage competent legal counsel.

Ask Yourself …

These Questions Regarding "Family Limited Partnerships."

1. I would like to control (and perhaps obtain some income from) any assets transferred to my loved ones as long as I am alive. Yes No Not Sure
2. I am concerned that any divorces, lawsuits or bankruptcies of my loved ones might threaten my control of the assets I transfer to them. Yes No Not Sure
3. I understand the a Family Limited Partnership will attract IRS/judicial scrutiny, particularly if I am seeking to use it for tax minimization and wealth transfer maximization purposes. Yes No Not Sure
4. I have considered creating a Family Limited Partnership, but have never consulted with appropriate counsel regarding whether it is appropriate for me. Yes No Not Sure
5. I have created a Family Limited Partnership and have it thoroughly reviewed by qualified legal counsel from time to time, given the increasing scrutiny of such arrangements by the IRS and some courts. Yes No Not Sure

ASSET PROTECTION

Statistically and anecdotally, we all know that the number of divorces, lawsuits and bankruptcies is staggering. While no one believes lightning will strike them, wealth created through a lifetime of work, saving and investing can be lost overnight if these forms of man-made lightning do strike. To protect your assets from such disaster, proper risk management strategies should be given careful consideration. These strategies include *exempting your assets* from the claims of creditors and *limiting your liability* through legal entities and *transferring your risk* through insurance.

Exempting Assets

State and federal laws may exempt some of your assets from the claims of creditors. Depending on your state of domicile (i.e., your legal residence), the equity in your primary personal residence may be protected from creditors. Protection also may extend to your retirement funds and even the cash value of your life insurance.

Once you have identified the protected asset classes available to you under applicable law, it may be prudent to maximize your protection by converting non-exempt assets into exempt assets. For example, if the equity in your home is exempt from the claims of creditors under the laws of your domicile, then using non-exempt resources to pay off your mortgage may be a smart move.

Limiting Liability

Many entrepreneurs operate their businesses as sole proprietors rather than through a legal entity, such as through a Corporation or a Limited Liability Company. Whether their business is home-based or in the Fortune 500, these business owners are attracted by the informality of sole proprietorship. They also do not want to incur legal fees to create and maintain a legal entity. However, in addition to other advantages, conducting business through a legal entity may offer substantial risk management benefits.

While lawsuits brought against a sole proprietorship are really lawsuits against the owner's personal assets, lawsuits against a properly created and maintained legal entity are really lawsuits against the entity's assets. Nevertheless, the selection of an appropriate legal entity is critical for managing your risk.

Transferring Risk

When was the last time you reviewed the details of your liability insurance program with your insurance professionals? Are your policies current? Are the coverage limits adequate and are the deductibles reasonable? Have you scrutinized the policies for loopholes? Remember: the fundamental philosophy of any insurance coverage is to pay a premium you can afford to transfer a risk you cannot afford. Take time to understand both the risks you have retained and the risks you have transferred.

Closing Thoughts

Managing your risk, like avoiding lightning, requires that you make proper plans in advance of the storm. Take time today to protect your wealth tomorrow.

POCKET PROTECTORS
Tips to help you protect your pocket!

Valuation Experts

There are times when some or all of your assets must be valued with great accuracy. At such times, your best guess is just not good enough. For example, a rock-solid valuation is necessary to help withstand an IRS challenge to any *discounts* claimed on gifts of Limited Partnership interests. Additionally, if you are valuing a business for a buy-sell agreement between shareholders, a sale to a third party or for estate tax purposes, then an accurate valuation is essential.

Here are some resources to help you locate a valuation expert: the American Institute of Certified Public Accountants (www.aicpa.org or 888.777.7077), the National Association of Certified Valuation Analysts (www.nacva.com or 800.677.2009), the American Society of Appraisers (www.appraisers.org or 800.272.8258), and the Institute of Business Appraisers (www.go-iba.org or 954.584.1144).

"Wrinkles should merely indicate where smiles have been."
— Mark Twain

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In this ever-changing world, it can be difficult to predict the future. Fortunately, there are many steps that you may be able to take to protect your family or your business from unnecessary harm stemming from unforeseen events. With the guidance of an experienced lawyer, these steps can help you gain peace of mind in knowing that your family or your business will be protected throughout any contingency.

At the Law Office of Vincent J. Profaci, P.A., we understand how difficult it can be to resolve complex legal issues relating to the well-being of your family or business. With more than 20 years of experience and a detailed knowledge of many legal practice areas, our attorney works to provide the detailed and personalized advice you need to address your unique concerns and pursue the most favorable resolutions possible.

We encourage you to learn more about our attorney and firm by visiting the Web site **http://www.profacilaw.com** where you will have access to newsletter archives, a free subscription and a link to the Profaci Law Blog, located at **http://blog.profacilaw.com**.