

Family succession planning

Tools for teaching heirs about family assets and saving on estate taxes By Donald F. Zwilling

You know the importance of business succession planning, but have you ever thought of applying the process to your family affairs? It is important to teach heirs about financial affairs and save estate taxes in the process. Age is not the only criterion for innovative planning; size and complexity of family assets should also be considered. A family limited partnership (FLP) or limited liability company (LLC) can be a great tool. The term "FLP" will be used here to denote both entity forms.

We have all heard of FLPs, perhaps with varying degrees of enthusiasm or skepticism. They are only as effective as your financial discipline and the direction provided by your professional advisors. The IRS has challenged many estate and gift tax cases dealing with these planning techniques. Taxpayers have lost when there has been an abuse of purpose, structure or operation. But FLPs can be very successful if developed and maintained with a high degree of integrity.

Certain families (and certain family assets) are excellent candidates for an FLP. Individuals with taxable estates in excess of \$1.5 million are faced with estate tax rates of over 45 percent. Assets with a favorable income stream and potential appreciation are likely to fit into an FLP structure. Examples include rental property, investment portfolios and other intangible assets. Discounts of 15 to 40 percent from a taxable estate can reasonably be attained if the plan is followed properly.

The Purpose

With the maturity of a family's senior or wealthy generation, there may be a need to centralize family assets and their management. Teach heirs about these assets and their proper maintenance. Protection of assets from litigation is critical to preserving family wealth. And, yes, saving on estate taxes is a benefit of proper planning.

The Structure

For one significant asset, one FLP will be fine. If you have several types of assets (e.g. rental properties and an investment portfolio), a tiered structure can provide protection for each asset from the activities of another. This involves a parent FLP and subsidiary FLPs for each activity. The parent FLP



can initially be owned 50-50 by each spouse, or 100 percent by one. The individuals own partnership units of the FLP rather than hold direct ownership of the invested assets. The parent FLP owns the units of each subsidiary entity. These subsidiaries provide separation of liability from each entity's activities, yet the tax reporting is simple. One federal information return is required for the parent. However, each subsidiary is recognized for state and legal purposes.

Ownership of the FLP units can be in an individual's name or in a trust. For flexibility, there can be general and limited partners, as well as voting and nonvoting units. The FLP agreement can be either liberal or restrictive for items such as authority, partner admission, distributions, etc. Provisions cannot be more restrictive than state law. Larger discounts are generally attained with a more restrictive agreement. Do not invest all family assets into the FLP. Sufficient assets should be retained outside the FLP for standard living expenses and obligations.

The Operation

The FLP should be operated like a business, making sound decisions and instilling financial discipline among family members. Distributions should be pro-rata by ownership. After the death of one of the founders, continue operating the FLP and adhering to its objectives.

It is important to note that the IRS has won abusive cases where FLP founders have

comingled personal funds, or taken excess distributions based more on personal needs.

The Benefit

After funding the FLP, the founders can then consider gifting units to family members. A qualified appraiser should value the gifts, and appropriate discounts should be applied for lack of control and marketability.

- Assume the total value of FLP assets is \$1,000,000. Without an FLP, the estate tax on these assets could be \$450,000.
- The founders give 75 percent of the FLP units to heirs, yet they retain control.
- From the \$750,000 total value of the gifts, discounts of 30 percent (\$225,000) can be reasonably attained.
- Estate tax savings would be over \$100,000.

Remember, planning now can eliminate many challenges in the future.



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