

SUCCESSION PLANNING AND THE FAMILY LIMITED PARTNERSHIP SOLUTION

Representing closely held family businesses often involves counselling the founders with regard to developing a succession plan that involves the children. The potential transfer of power and authority within a family business is one of the greatest concerns of the owners. "Having your cake and eating it too" is the general theme of the founder who does not want to squander family assets or give up control of the enterprise. One solution and consideration to this dilemma is transferring minority ownership and retaining control through the use of a family limited partnership ("FLP").



An FLP is a type of planning vehicle in which most or all partners belong to a single family group. This strategy provides for asset protection as well as the transfer of ownership over time with the possibility of reducing estate taxes. The steps include the transfer of the business owner's interest in exchange for general and limited partnership interests in the FLP with the owners retaining the general partnership interest which could be for as little as 1% of the assets. As the general partner, the owner retains the ability to operate the day-to-day business and make decisions.

Upon the formation of the FLP, limited partnership interests may be transferred to the children or other family members by gift or sale. These transfers can occur all at once or over a period of time. As the transfers are executed, the value of the

FLP interests is removed from the owner's estate for federal estate tax purposes with the business's future income and asset appreciation being moved to the next generation.

This strategy allows for the gradual transfer of the business while the children are being mentored without them having control over the FLP or the business operation. In addition, the children do not have the ability to sell their limited partnership interests without the general partner's consent. From a tax perspective, the fact that the limited partnership interests are not controlling and do not have a market value, they are valued at a discount and future appreciation is moved to the next generation upon the death of the owners.

The discounted value of the limited partnership interest allows for a greater percentage of the business to be transferred with little or no gift tax implication provided that the value of the transferred interest is below the annual gift tax exclusion. Additional value may be transferred by using the lifetime gift tax exemption. The income tax implications are also favorable by using this planning technique because the children will be in a lower tax bracket.

Another benefit in using the FLP technique is that the FLP's assets typically are protected from creditors because they are not owned by the individual partners. Further, the general partner has the ability to limit distributions to the limited partners, which is a valuable feature from a credit protection perspective. If the family owns several businesses or real estate developments, each can be placed in a separate FLP, which protects each entity from exposure to lawsuits against the other entities. If there is a divorce, the FLP can be structured to require the interest of the family member returned to the FLP so as to retain the interest in the family.

The FLP may be amended or liquidated before its term expires generally with the consent of the partners which offers greater flexibility than an irrevocable trust and its terms will generally include dispute resolution provisions to avoid litigation. The most significant downside risks in using the FLP are that the IRS is always attempting to void the structure and they are a red flag for audit. For these reasons, it is critical that the FLP is administered in accordance with business formalities and have a business purpose.

For further information on FLPs, please contact PLDO Managing Principal Gary R. Pannone at 401-824-5100 or email gpannone@pldolaw.com. Attorney Pannone is annually selected by his peers for inclusion in Best Lawyers in America® in Metropolitan/Providence. For the last two years, he has been recognized as "Lawyer of the Year" in his business practice areas.



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Gary R. Pannone is the Managing Principal of Pannone Lopes Devereaux & O'Gara LLC. He has been representing closely held business owners for 30 years, specializing in the areas of business formations, corporate restructuring, mergers and acquisitions and corporate compliance. Attorney Pannone's practice also includes the representation of nonprofit organizations with respect to consolidations and mergers and acquisitions, and he serves on several boards and governance committees of nonprofit agencies. He is a frequent lecturer and published author in the areas of corporate compliance, board governance and best practices.

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