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BASICS OF FAMILY LIMITED PARTNERSHIPS (FLP PART 2 OF 3)

By Victor Sy, CPA, MBA

You have just been sued. You suddenly realize a clear and present danger of losing your house, cars, business, rental units, and other hard-earned assets. Real estate properties are under your name and are therefore exposed to lawsuits and seizures. You might have discussed asset protection with your CPA or lawyer and even attended some seminars, but did not act on it. Read on and see if a battle-tested [Family Limited Partnership](#) (FLP for short) can help you.

Let's discuss the basic FLP structure - its formation, funding, and operation. Let's identify asset protection benefits and strategies when a partner is under creditor attack. We will enumerate 10 advantages and disadvantages of using FLPs in our next article.

The Basic Structure of a Family Limited Partnership (FLP):

- It is a limited partnership whose partners are members of the same family.
- In a typical situation, parents transfer assets to an FLP for the benefit of their children.
- Partnership shares are gifted to beneficiaries, preferably at \$13,000 per year, to avoid paying gift tax.
- A main objective is to shield assets from frivolous lawsuits and judgment creditors.
- Another objective is to reduce estate taxes by reducing the size of your assets.
- I like my clients keep assets within family bloodlines especially in cases where beneficiaries are divorced or die ahead of their spouses who could end up with your hard-earned assets.
- The FLP must have a valid business purpose (estate plan goals, improve returns on investments).
- Avoidance of creditor claims and other personal reasons are not valid business purposes.
- These assets are appropriate for FLP ownership: real estate, cash, stocks, businesses, and life insurance.
- These assets are not appropriate for an FLP: personal residence (loss of mortgage interests and deferral of gain from the sale of main home), personal properties with no investment purpose (furniture),
- S corporation stocks (doing so could terminate S status since partnerships cannot own S corporation stocks), qualified retirement plans (it may trigger distribution), and real estate with "due on sale" clause.

General Partners:

- The parents can keep 1% each as general partners and designate the 98% as limited partnership shares.
- The general partners still control the partnership, even if they only own 1% each.
- Creditors and plaintiffs can only try to attack that 1 or 2% share.
- They can continue to manage the properties, sell, refinance, buy, and do everything that they used to do.
- A regular corporation can be a general partner to restrict liability exposure of the GP (general partners).
- There is a risk that creditors can take control of that corporation, and with it, control of the partnership.

Asset Protection Benefits and Charging Orders:

- Partnership shares in an FLP are less attractive than real physical assets such as real estate and stocks.
- It transfers dangers from high-risk persons to low-risk partnership shares.
- By assigning 98% to limited partners and only 2% to general partners, you are shielding the shares of limited partners who cannot be reached by creditors to satisfy partner debts.
- Creditors' best tool against the general partner's shares is a charging order. It is not good enough. You see, a charging order merely entitles creditors to distributions. It is only a right to receive partnership income. That's all. It does not give them the right to seize or sell partnership assets. If there are no distributions, they get nothing. It is you, the general partner with a mere 1% share who decides if and when to distribute.
- Creditors who win a case cannot force an FLP to shell out cash. They cannot force it to liquidate either.