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ADVANTAGES AND DISADVANTAGES OF FLPS (PART 3 OF 3)

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Family Limited Partnerships (FLPs) are designed to protect your assets from frivolous lawsuits and unwanted creditors. FLPs also reduce your estate taxes at death. They have been around longer than LLCs and are therefore battle- tested to shield your assets from outsiders and to pass them on to the next generation. If you own rental units, mutual funds, businesses, and other assets, consider putting them inside FLPs. You see, we spend five to seven days a week working and accumulating assets without spending an hour to protect them from attacks and seizures. One frivolous lawsuit could wipe out your estate. One nasty divorce among your kids could transfer assets to unintended beneficiaries, such as your beloved in-laws. There goes your life-long provision for your retirement, children, and grandchildren. With that in mind, let's discuss 10 pluses and minuses of Family Limited Partnerships (FLPs).

Advantages of FLPs:

1. Family Limited Partnerships shield assets from lawsuits. They make the assets less attractive to creditors who can only get charging orders to entitle them but not to receive shares of the general partners.
2. FLPs protect assets from divorces and keep them within family bloodlines by restricting the titling of assets, timing the gifting of shares, and having buy-sell provisions among the partners.
3. You reduce estate taxes by gifting shares (along with resulting future appreciation) to beneficiaries
4. You reduce income taxes by shifting revenues to children with lower tax brackets.
5. You can reduce beneficiaries' capital gains by electing to step up bases of assets upon a partner's death.
6. A 1% general partner (GP) can control the timing and amount of distributions to avoid transferring assets to irresponsible children who may just blow their inheritance through inappropriate behavior.
7. Avoid probate. Transfer properties at your death privately and inexpensively. You decide who gets what. In a probate, a judge decides who gets what. Skip probate and avoid administrative and legal fees.
8. FLPs facilitate transfers of real estate to your beneficiaries. It is rather easy to transfer partnership shares. It is cumbersome to create and record new deeds with the County every single year.
9. FLPs avoid fractionalizing titles. Imagine a house owned by five limited partners whose ownerships are fractional that keep changing every year. FLPs avoid that by owning realty 100% (it is the ownership inside the partnership that keeps changing).
10. FLPs are flexible to changing conditions. They adapt to situations (add new beneficiary or sell a rental) with simple amendments to the partnership agreement.

Disadvantages of FLPs:

1. You have to pay for the formation of a Family Limited Partnership.
2. You have to pay an annual franchise fee to the State of California—whether or not you make a profit.
3. It may create discord among family members especially if the younger generation with varying financial needs have differing ideas on the timing and amounts of distribution.
4. A new FLP may not be able to qualify for refinancing on account of its lack of credit history.
5. FLPs cannot be funded with S corporation stocks, an ideal way of escaping income taxation (TIP: Create a regular C corporation, a separate entity with liability protection).
6. Partners could be subject to tax on pre-contribution appreciation if the FLP is funded primarily with marketable securities (TIP: Investment assets should be more than 80% of total partnership assets).
7. You may lose step up of basis upon the death of a partner (TIP: Elect to step up inside bases of assets).
8. The IRS could challenge the existence of the FLP if it is set up just before the general partner's death.
9. Creditors could challenge if it is set up just before or after lawsuits are served or bankruptcies are filed.
10. It may be difficult to distribute funds to a general partner without also distributing to other partners.