

Abstract: Often, the best time taxwise to start transferring ownership is long before the owner is ready to give up control of the business. This article explains how a family limited partnership can help owners enjoy the tax benefits of gradually transferring ownership yet allow them to retain control of the business.

Could an FLP help your business succession plan?

One of the biggest concerns for business owners is succession planning — transferring ownership and control of the company to the next generation. Often, the best time taxwise to start transferring ownership is long before the owner is ready to give up control of the business.

A family limited partnership (FLP) can help owners enjoy the tax benefits of gradually transferring ownership yet allow them to retain control of the business.

How it works

To establish an FLP, you transfer your ownership interests to a partnership in exchange for both general and limited partnership interests. You then transfer limited partnership interests to your children or other beneficiaries.

You retain the general partnership interest, which may be as little as 1% of the assets. But as general partner, you can still run day-to-day operations and make business decisions.

Tax benefits

As you transfer the FLP interests, their value is removed from your taxable estate. What's more, the future business income and asset appreciation associated with those interests move to the next generation.

Because your children hold limited partnership interests, they have no control over the FLP, and thus no control over the business. They also can't sell their interests without your consent or force the FLP's liquidation.

The lack of control and lack of an outside market for the FLP interests generally mean the interests can be valued at a discount — so greater portions of the business can be transferred before triggering gift tax. For example, if the discount is 25%, in 2019 you could gift an FLP interest equal to as much as \$20,000 tax-free because the discounted value wouldn't exceed the \$15,000 annual gift tax exclusion.

There also may be income tax benefits. The FLP's income will flow through to the partners for income tax purposes. Your children may be in a lower tax bracket, potentially reducing the amount of income tax paid overall by the family.

Some risks

Perhaps the biggest downside is that the IRS scrutinizes FLPs. If it determines that discounts were excessive or that your FLP had no valid business purpose beyond minimizing taxes, it could assess additional taxes, interest and penalties.

The IRS pays close attention to how FLPs are administered. Lack of attention to partnership formalities, for example, can indicate that an FLP was set up solely as a tax-avoidance strategy.

Not for everyone

An FLP can be an effective succession and estate planning tool but, as we've taken pains to explain, it's far from risk free. Please contact us for help determining whether an FLP is right for you.

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