Vandenack Weaver Truhlsen S1-E33-Family Limited Partnerships with Lara Sass

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Welcome to today's episode of Vandenack Weaver Truhlsen law visionaries, a weekly podcast discussing updated legal, new news, as well as evolving methods of providing legal service. My name is Mary Vandenack, founder, CEO, and managing partner at Vandenack Weaver, LLC. I will be your host. As we talk to experts from around the country about closely held businesses, tax trust, and estates, legal technology, law firm, leaders, and wellbeing for lawyers. Before we start today's episode, I want to thank our sponsor. Here's a message from interactive legal.

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On today's episode. I have Laura Sass; Laura is an estate planning attorney in New York city serving high net worth clientele. We've talked on another episode about dynasty trust today. We're gonna talk about family limited partnerships in estate planning. Welcome back, Laura,

Mary, thank you for inviting me to participate on this episode. It's a pleasure to be back. I so enjoy listening to law visionaries and reading your articles. I must say the name of your podcast is very buffeting of you and I'm happy to once again, collaborate.

Well, thanks Laura. I appreciate you joining us for, and this is our high net worth planning series on a previous. I asked you to talk a bit about your practice. Is there anything you want to add today?

I spoke last episode about my background and passion for trust and estates. I will just add that as a mother of three girls, I truly understand that estate planning is not about clients serving themselves. It's about the family members and loved ones who will ultimately benefit. I believe that estate planning is a client's gift to their children or other loved ones so that they can have the best transition possible upon client’s possible incapacity and inevitable death. Today we're discussing an estate planning technique that I often utilize in my practice for business succession planning and to pass assets to the next generation. This is important, especially now when we're urging clients to consider using their remaining estate tax exemptions before the amounts are possible decreased in the near term.

So, as you noted, we're gonna talk about what is called family limited partnerships today. And that term gets used, but sometimes it's an LLC, a limited liability company rather than a partnership, but I think the family limited partnership term is the one that people ask me about, even though the actual legal structure might be a limited liability company at the end of the day, there's a variety. There are a variety of issues that impact which structure should be used for a particular project. We're not gonna go into all that detail today, but we're gonna consider what the term family limited partnership, whether it's a partnership or an LLC, me and generally regarding selecting it as a possible structure. So, can you explain the concept for us?

A family limited partnership or F L P is typically an entity that is created by a senior family member for purposes of transitioning a business or assets to family members using a family limited partnership can achieve savings for estate gift and income tax purposes and could provide a layer of asset protection.

So, what would the typical structure of a family limited partnership look like?

So, as you had mentioned, there are significant variations in structures that are very fact dependent, but off often a partnership might be created by a senior family member who might include a spouse or junior family member. As a partner, there will be a general partner that will continue to have a certain amount of control. There will be limited partners who will have less control, but an interest in the profits and capital of the partnership up. If an LLC is used instead of a general partner, you would have, what's called a manager. You would also often use voting and non-voting units.

So, let's say I'm senior family member. And I decide to create a family limited partnership and I've built a real estate empire. And so, I transfer some of my real estate into this family limited partnership. Now, what do I do?

So really the first issue is what you're funding. It will. So, for example, like you said, if you have a real estate investment and you have several office buildings, you'll want to transition those eventually to the next generation. So, funding that limited partnership with those buildings could be the first step.

So, I get something in, it could be their commercial real estate. We've seen investment assets can go in, you can put, put a business in theirs, any variety of things that you can put into the family limited partnership. How does this family limited partnership get used as an estate tax vehicle?

A very simple strategy might be that the senior family member uses annual exclusion gifts of interest in the family limited partnership. So she might transfer units of up to $15,000 in value to each of her junior family members each year, the units could be transferred either directly to those family members or into any one of a number of different types of trusts that layer in both control over disposition of the assets and asset protection.

And so, the annual exclusion for clarification means what so we can, it

Means it's a certain amount that someone who is a us person could gift to whomever they want every single year, it's $15,000. Um, and that could be cash. So, securities, business interests, FLP, et cetera.

And when they do that 15,000, they don't have to pay any gift tax,

Correct? No gift tax return needs to be filed. No gift tax needs to be paid. You don't use any of your lifetime exemption against estate tax.

So, if I have an 11.7 million exemption and I give 15,000 to 10 beneficiaries, I have not used up any of my lifetime exemption.

None. It's like a freebie from the IRS

And we like freebies from the IRS

Love.

So, what about the senior family member who might be considering using his or her lifetime gift exemption

For that situation? And the senior family member might create an irrevocable trust. Again, there are multiple types of strategies, depending on the client's overall fact situation and objectives, a client who is in a position to use her estate tax exemption and give away 11.7 million in assets might gift that amount to an irrevocable trust without retaining any type of access to the assets. And that trust a client who desires instead, a stream of income might engage in a part sale part gift transaction with a trust. This strategy is often considered what's called an estate tax freeze. The client essentially converts an appreciating asset into a note receivable that won't grow in value in the client's estate.

We are going to take a brief break from our episode for a word from one of our sponsors, Carson, private client

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Okay, let's you our episode. So, when a client gives cash in the amount of 11.7 million to a trust for her beneficiaries, the value of the gift is clear, right? This is 11.7 million. And now we go to my real estate example and I instead transfer real estate into the family limited partnership. And then I am gifting units of this limited partnership interest. And let's say there's non-voting units. There are various discounts that I can apply. So, can you explain the concept of how discounts on those partnership interests create leverage when using a family limited partnership?

So, there are various types of discounts that could be applied in valuing a family limited partnership interest. Let's say that the value of the real estate inside the partnership is worth 15 million. However, the donor transfers a small percentage of non-voting interests in the family limited partnership. The recipient of the interest is unlikely to be able to readily sell those interests. So, you therefore forget what's called a lack of marketability discount. In addition, if the recipient owns only a minority interest, there may be a minority interest discount. There may also be a control premium allocated to the voting. So the bottom line here is that because of these various discounts, an asset inside an LLC that is worth 10 million, if not owned within the LLC may actually result in LLC interests that are worth something less than 10 million because of the structure. So as an example, discounting of even up to 35% is not uncommon. This provides an immediate estate tax advantage as opposed to a gift structure that doesn't allow for this type of discounting.

And those discounts are real and supported by the IRS, right? Because if let's say my dad who isn't currently living, but he puts a $10 million building in, into a family limited partnership and gives me non-voting units. And I have 1% the chance I can like sell that to somebody is slim to none

Precisely. And let's say for now that's something that is allowable by the IRS,

Right? That's a, that's an excellent point. Is there a disadvantage to the use of the family limited partnership?

When an asset is transferred to a family limited partnership, the partnership takes what's called a transferred or carryover basis when interests are transferred, the ability to get a step up and basis at death is therefore impacted. There are various elections that could be made to reduce this negative impact, but there is definitely a loss of the full benefit of the step up and basis that an asset owned by the decedent received if it's owned outright of at the time of death.

And I always explain to clients and PR some practitioners in terms of how that step up and basis works. And that is if I own some apple stock don't know what it's today. So, don't know if that's a good, but let's just say I own stock in company a, and I paid $1 for it and it's worth a thousand dollars. If I sell it the day before I die, I'm gonna have gain of $999. If instead that same stock I die the next day. And then my beneficiary sells the stock, their basis steps up to a thousand and so they sell it and there's absolutely no gain. And that's one of the things that we want people to look at when they start funding this. And as you noted, there's currently a lot of legislation being tossed around that may affect the best strategy to use and we'll need to keep monitoring and we'll update on those issues as they develop. Well, any last thoughts?

Yeah. I mean, I think what you just said is critically important. You know, we're, we're talking about STR structures that really do leverage the exemption amount, but there, there is proposed legislation that would significantly curtail or eliminate the use of these discounts in many estate planning contexts. So, it's important that clients pay attention to this sooner rather than later. Um, again, thank you so much for having today. It's been a pleasure

And thanks for joining me as we reach the end of our episode, I want to thank our sponsors, interactive, legal and Carson, private client. That's all for now. Thanks for listening to today's episode and stay tuned for our weekly releases.

Yeah.

A Hurrdat media production.