

April 1, 2008
Issue 89

FLP/FLLC PLANNING CHECKLIST

The IRS continues to attack the application of valuation discounts to interests in family limited partnerships (FLPs) and family limited liability companies (FLLCs), mainly from an estate tax standpoint. From various federal court cases since 2000, the following lessons can serve as a planning checklist to help to counter attacks by the IRS against estate tax valuation discounts:

- Have a legitimate and significant non-tax reason for creating the FLP or FLLC,
- Give strong consideration to not being the general partner or managing member,
- Avoid the implied understanding that your access to the assets you contribute to the FLP or FLLC will be unchanged,
- Do not transfer virtually all of your assets to the FLP or FLLC,
- Do not form the FLP or FLLC when you are very elderly, in poor health, or terminally ill,
- Document contentious family relationships,
- Avoid the power to remove the general partner or the managing member,
- Do not pay your personal expenses directly from the FLP or FLLC,
- Make pro rata distributions to all of the partners and members,
- Carry out the non-tax reasons for creating the FLP or FLLC,
- Avoid contributing property to the FLP or FLLC that is subject to a debt,
- Avoid placing personal assets in the FLP or FLLC,
- Have regular board meetings and keep records of the minutes,
- Adhere to the terms of the FLP or FLLC agreement,
- Obtain the best qualified independent appraisal possible in valuing interests in the FLP or FLLC that you transfer,
- Have separate books and bank accounts for the FLP and the FLLC, and
- Be careful when using the FLP or FLLC as a source for the payment of estate tax for a deceased partner or member.

From the standpoint of lifetime transfers of interests in FLPs or FLLCs and the gift tax, the IRS has achieved a degree of success under the *indirect gift theory*. The IRS will try to apply this theory if contributions are made to the FLP or FLLC, those contributions are not allocated to the contributor's capital account, and the contributor makes gifts of the interests in the FLP or FLLC shortly thereafter. Under that scenario, the IRS argues that an *indirect gift* of the fair market value of a proportionate share of the contributed assets is being made rather than a gift of a potentially discountable interest in the FLP or FLLC. To combat this argument, contributions should be allocated to the contributor's capital account, and there should be reasonable "breathing room" between the contribution and the subsequent gift of the interest in the FLP or FLLC.

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