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WEALTH PLANNING GUIDE FOR FAMILIES WITH LARGE ESTATES

How to Reduce Taxes, Receive Lifetime Income, Pass Your Entire Estate to Your Heirs, Help Your Favorite Charity… and More!

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How to Transfer Assets to Family Members and Pay the Lowest Amount in Taxes. Introducing the

Family Limited Partnership

What is a Family Limited Partnership?

The Family Limited Partnership (FLP) is a limited partnership created to transfer ownership of assets to family members with a minimum of tax consequences. The FLP is designed to lower the value of your investments and assets (for estate tax purposes) while still allowing you to maintain full control of your estate inside the limited partnership. It works particularly well to transfer a family business, real estate or an investment portfolio to the next generation. It helps to reduce estate taxes -- and to reduce the risk that assets would need to be sold to pay those taxes.

Here's how it works: Senior members of a family convey a family business, investment portfolio or real estate to the Family Limited Partnership. Typically, the senior family members will own the limited partnership initially. In most cases, though not all, the senior family members will begin a gifting program to make gifts of partnership interests to younger family members. The senior family members retain control of the partnership. The FLP allows elder family members to introduce younger members to the family business and investments, while limiting their liability.

Two Types of Partners

In FLPs, two types of partners are involved: The General Partners, who control the partnership -- and Limited Partners, who earn a share of the profit but cannot exercise control.

The general partner is usually an entity, such as a Corporation or a Limited Liability Company, owned by you and your spouse. Usually, though not always, you will gift partnership interests to the children. The general partners control the day-to-day operations of the FLP and make investment decisions. Also, they can receive a management fee based on a percentage of the FLP's income.

Limited partners, which would usually be you, your children and maybe even grandchildren, own an interest in the FLP. They share part of the income from the FLP, calculated on the number of shares they own. But they have almost no control. When the heirs dissolve the FLP, the partnership's property will pass to each limited partner based on their number of ownership shares.

5 Important Ways You Benefit

Discounted Value: By conveying into the FLP income-producing assets, such as rental property, the assets' value can be discounted 25% or more. This is due to factors such as the lack of marketability of -- or the minority interest in -- the partnership shares. Gifting small interests in FLP assets during your life is an effective way to use a person's $2,000,000 federal transfer tax applicable exclusion amount.

More specifically, the limited partnership shares can be discounted from the value of the underlying assets because (1) virtually no market exists for the shares, (2) the shares cannot be sold to someone else, (3) the limited partners have almost no control in the partnership, and (4) there may be no income from the FLP because the partnership pays the general partner for managing the business.

Limited Liability: In an FLP, the general partners can be personally liable for the acts of the partnership, but the limited partners are not subjected to such liability. Limited Partnership statutes are written to give the limited partners limited liability for partnership activities. More important, if a limited partner is personally sued, the creditor cannot take his share of the partnership assets. Rather, the creditor is limited to a Charging Order. This remedy is of very limited benefit to the creditor. Thus, creditors usually try to avoid Charging Orders.

Unified Credit: FLPs often allow you to give your heirs more than the maximum $2,000,000 (for 2008) unified credit ($4,000,000 per couple). This is because a gift of FLP assets of $1,000,000 may be appraised at a much lower figure. This means, due to discounting, you may be able to gift substantially more to your children, who still qualify to receive the gift free from both income and estate taxes.

Protection Against Creditors: As a rule, creditors do not want shares of a Family Limited Partnership because (1) those shares can exert no control in the partnership, and (2) they may have to pay taxes on income they don't receive. If the FLP earns income, each general and limited partner must report his share of the earned income on his personal tax return, even if the general partner does not distribute the income. This means the partners must pay income tax on money they have not received. (Creditors hate this!)

Intangible Asset: FLPs are considered an intangible asset. This means the odds are good that only your state of residence will impose any inheritance tax on partnership interests. This is important for people who own real estate in several states.

In The Beginning…

…you and your spouse own shares as both general and limited partners. As time passes, you may gift your limited partner interests to your children and grandchildren, using your $12,000 per year gift exclusion. In some instances, gifts will not be made. However, this will not necessarily limit the effectiveness of the FLP. Substantial discounts will still be available. As majority owners of the general partner entity, you can give away 99% of the FLP limited partnership interests and still retain control, to the exclusion of limited partners.

Here's How It Works

Example: John and Mary Jones own $5,000,000 in rental property or a closely held business. With conventional tax planning, they could shield only $3,000,000 from estate taxes after they die. This means they would face an estate tax of about $1,800,000, so their heirs would receive only about $3,200,000 of their $5,000,000 estate.

John and Mary can reduce their estate before they die by using lifetime gifts. Both John and Mary can gift $12,000 to each of their children every year, tax-free. If they have three children, they could give away $72,000 per year, lowering their estate's value.

The Jones, however, also face the problem of increasing asset value. If their estate today is worth $5,000,000, their assets will probably increase in value faster than they gift it to their heirs. If their assets grow at the rate of 5% per year, in just 15 years their estate will double, increasing their estate tax. So even if they give away $72,000 per year, their estate will grow faster than they can give it away.

If John and Mary own real estate or a business, gifting to their heirs could pose problems. For example, making gifts in $72,000 increments is hard because few rentals or businesses are worth exactly $72,000. In addition, if the children own the real estate, they could face personal liability.

Now -- if John and Mary set up a Family Limited Partnership, they could transfer their $5,000,000 business into the partnership with no tax consequences. Let's assume there are 2,500 shares, so each share would represent $2,000 of the business value. Since the limited partners' shares are discounted, the value of each share might be only $1,400. In this way, because of the discounted value, every year John and Mary could each give away seven shares, rather than five. This will pass $14,000 of assets with no estate or gift tax liability.

This means if John and Mary each make the maximum tax-exempt gift to each of three children, they can gift $84,000 worth of assets each year, rather than only $72,000. What's more, the children would benefit from protection against creditors and limited liability. And even if the parents have given the children 99% of the value in the business (or real estate), as general partners, they still retain complete control.

Further, when the parents pass away, the discounts should further reduce the size of the estate. For example, in John and Mary's case, with a 30% discount, the $5,000,000 estate would be valued at $3,500,000. The tax on this estate would be about $1,100,000. That is an estate tax savings of $700,000.

Because of its many benefits, the Family Limited Partnership is one of the hottest tools in estate planning and asset protection. Parents can protect their assets from liability for a child's car accident. They can shield their assets from lawsuits arising from renters and rental property. They can safeguard their assets from disputes that result from their business.

In today's lawsuit-happy world, NO business owner should be a sole proprietor because his assets are there for the taking. Every business owner must have a high level of asset protection, not only for his children, but also for himself and his spouse. And in the event the husband and wife ever divorce and remarry, the children's assets are still protected.

I urge you to look at how a Family Limited Partnership will protect your assets -- and help you transfer assets to your children and grandchildren, while paying the lowest amount in taxes.

How to Receive Lifetime Income, Reduce Taxes, Help Charity and Pass Your Entire Estate to Your Heirs. Introducing the

Charitable Remainder Trust-PLUS

If you own a highly appreciated asset (such as stocks, real estate or a business) -- and if you'd like to sell the asset, I recommend that you consider a Charitable Remainder Trust (CRT).

A Charitable Remainder Trust allows you to donate your property to charity -- lower your income and estate taxes -- and help a charity that is important to you. Plus, with the money you save, you can buy a life insurance policy that replaces the asset you transferred from your estate so your children don't lose any of their inheritance.

Here are answers to your questions:

"What is a Charitable Remainder Trust?"

A Charitable Remainder Trust is simply an Irrevocable Trust into which you transfer your highly appreciated asset. The trustee (Trust manager) sells the asset at full market value and pays no capital gains tax on the sale. Then the trustee invests the proceeds in other assets. The CRT pays you and your spouse an income for the rest of your lives. After you and your spouse die, the remaining Trust assets go to the charity you selected. (When you set up the Trust, you can name one or several charities to receive your assets, as long as they are charities that qualify with the IRS. You can also retain the right to change the charitable beneficiaries, as long as they are also qualified charities.)

Since you are donating the asset to charity, you reduce your income taxes now. And since you transferred the asset out of your estate, when you die, your heirs pay no estate taxes on that asset.

“What types of assets are best suited to a Charitable Remainder Trust?”

You benefit the most when you donate assets that have greatly increased in value while you have owned them. These include real estate, stocks, other securities, and businesses. In most cases, you cannot donate real estate that has a mortgage against it. You may benefit enough from this arrangement to justify paying off the loan in full.

“Who should we name as trustee?”

You must make sure the Trust is managed correctly. Otherwise, you could lose the tax benefits and suffer penalties.

The best trustee is a person or corporation experienced with investments and accounting. You can serve as trustee. You can select a corporate trustee, such as a Trust Company or Bank. Or you can name the charity to manage the Trust, if they agree to provide this service. You should interview several potential trustees and look at their experience managing investments before you decide. Since you are relying on the trustee to make sure you have income the rest of your life, your decision is important.

“Can’t we just sell the asset and invest the money ourselves?”

Yes, but you’ll have to pay a significant tax bill, so you’ll receive less income. Here’s an example:

John and Mary Smith (ages 65 and 62) are planning to retire next year. Fifteen years ago they bought 20 acres of real estate for $200,000. Today, a city has grown to within one-half mile of the property, which is now worth $2,000,000. The Smith’s would like to sell the land so they can retire and use the money during their senior years.

If they sell the acreage, they would have a gain of $1,800,000 (its current value less what they paid for it). They would have to pay $360,000 in federal capital gains tax (20% of $1,800,000), which would leave them with $1,640,000.

If they invest the money and earn a 5% return, they would have a yearly income of $82,000. If their joint life expectancy is 22 years, they would receive a total lifetime income of $1,804,000 before taxes. Of course, they receive no tax deduction if they sell the real estate.

“How does a Charitable Remainder Trust make a difference?”

If they transfer title to the real estate to a CRT, the trustee will sell it for $2,000,000. But because the Trust does not pay any capital gains tax, the trustee can reinvest the full $2,000,000. The trustee invests the proceeds in assets that produce income. Now, the 5% return will generate a yearly income of $100,000. Before taxes, this will give them a total lifetime income of $2,200,000. That’s $396,000 more income than if they had sold the property themselves. Plus, they can take a charitable income tax deduction when the property is contributed to the Trust. This will result in additional income savings.

"How much money do we receive as income?"

You can choose to receive money in two ways:

Fixed Percentage: You can choose to receive a fixed percentage of the Trust assets every year. Under this method, the amount of your yearly income will vary based on how well the Trust's investments perform. At the beginning of each year, the Trust will be re-valued to determine the amount of income you will receive. Since the Trust assets grow tax-free, the Trust can quickly increase in value if the Trust is well managed and if the investment market is sound.

Fixed Amount: You can choose to receive a fixed amount of income every year. This means you get the same amount of income, regardless of how much money the Trust earns. As people grow older, they often like to know exactly how much money they will receive.

If the assets donated to the Trust are not readily marketable, the Trust may have trouble paying your income. Your lawyer can set up the Trust so it pays you a fixed percentage of the Trust's assets -- or the actual income earned by the Trust -- whichever is less. Your Trust can also include a provision that says during years when the income is higher, the Trust can pay you added income to make up for your losses during bad times.

The IRS requires that the money paid to you must be at least 5% -- and not more than 50% -- of the initial fair market value of the Trust's assets.

"Who can receive income from our Charitable Remainder Trust?"

You can receive income from the Trust for your lifetime. If you are married, the income goes to you or your spouse, as long as either of you lives.

In addition, the income can go to your children for their lifetimes -- or to any person or entity you wish, as long as the Trust meets certain legal requirements. A charity cannot receive income. Only the remainder interest goes to charity. If someone other than you or your spouse receives the money, you should realize that you are making a taxable gift upon funding the Trust which will use a portion of your lifetime exemption against transfer taxes. That person must follow IRS rules on gift and estate taxes. The Trust does not need to last for a person's lifetime, but may, instead, be set up for a specific number of years, up to 20.

"When do we start receiving income from the Trust?"

You can start receiving income now -- or you can choose to wait until a future date. Either way, you take the income tax deduction now, when you set up the Trust. The longer you wait to receive income, the more your Trust will likely be worth, which will increase the income you receive.

“How much of an income tax deduction do we receive?”

Your deduction is based on the amount of income you receive, the type and value of the asset, your ages (or the ages of the people receiving the income), and the applicable federal rate (AFR), which varies. A final factor is whether the charity chosen is a public charity or a private foundation. Some clients choose to create a private foundation to be the ultimate charitable beneficiary. (Our example is based on a 6.0% AFR.) As a rule, the higher the payout rate, the lower your deduction.

Your tax deduction is usually limited to 30% of your adjusted gross income. Still, it can vary from 20% to 50%, depending on how IRS defines the charity and the type of asset. If you cannot use the full deduction the first year, you can carry it forward for up to five years.

“How much control do we have over the Trust?”

When you set up the Trust, you put instructions into the Trust that the trustee must follow. Then, for as long as you live, your trustee controls the Trust assets. If you are not satisfied with your trustee, you can retain the right to change trustees. And, of course, you can also choose to act as trustee yourself. In addition, you may be able to change the charity that receives your assets, without losing your tax advantages.

Even so, the reason you receive so many benefits from the Trust is because after you set it up, you cannot change your mind. The Trust is irrevocable. That’s why it’s important that you understand the Trust -- and decide, with the help of a Trust attorney, that this decision is right for you.

“If we donate the asset to charity, what do we leave to our children?”

If you have a large estate, the asset you place into your Charitable Remainder Trust may be only a small part of your assets. On the other hand, if you want to replace the value of the asset for your children’s benefit, you can do this quite easily.

You use the money you saved on income taxes -- and part of the income you receive from the Trust -- to fund an Irrevocable Life Insurance Trust. The trustee of your Life Insurance Trust buys enough life insurance to replace the full value of the asset for your children and other heirs. Life insurance is often a low-cost way to replace the asset for your children because one premium dollar buys several dollars of insurance. Plus, the life insurance proceeds avoid probate and income taxes.

“Why do we need an Irrevocable Life Insurance Trust?”

When you die, the Life Insurance Trust keeps the insurance proceeds out of your estate so you do not pay estate taxes on the life insurance. The Trust also lets you control when your children receive the money, such as at different times or all at once.

“What do we lose by setting up a Charitable Remainder Trust?”

To gain the benefits of the Trust, you give up two things: You give up the asset you put into the Trust (in exchange for many benefits, such as lifetime income). And you give up the ability to revoke the Trust. Still, if the trustee is not performing to your satisfaction, you can change trustees.

And you can also change the charity that receives your asset. But you cannot cancel or revoke the Trust because a Charitable Remainder Trust is, by definition, irrevocable.

That's why it's important that you understand the Trust and -- with the help of a skilled, experienced attorney -- make sure this decision is right for you. Thousands of people set up Charitable Remainder Trusts each year because they want future lifetime income and the many tax benefits. The decision to set up a Charitable Remainder Trust should not frighten you, but you should realize it's an important decision that will affect you and your family.

Summary

Here's how the Charitable Remainder Trust and the Irrevocable Life Insurance Trust work together.

You start with a highly appreciated asset. Your lawyer creates a Charitable Remainder Trust -- PLUS the Irrevocable Life Insurance Trust. You name a trustee to manage the Trust. Then you transfer the asset into the Trust -- and the trustee sells the asset at fair market value. The trustee then invests the proceeds from the sale, generating income for the Trust, from which you receive income for life.

Tax Benefits: You receive a charitable income tax deduction beginning the year you transfer the asset to the Trust. This reduces your current income taxes. Since your asset is going to charity, the trustee pays no capital gains tax on the sale. And since you have transferred the asset out of your estate, when you die, your heirs pay no estate taxes on this asset.

From the money you save in taxes, you fund the Life Insurance Trust. The trustee buys life insurance that will replace the full value of the asset in your children's inheritance. In this way, your children actually receive more money because they do not have to pay capital gains and estate taxes on the asset. Plus, the life insurance proceeds avoid probate, as well as income and estate taxes.

Also, the charity benefits now because it knows it will receive your gift in the future. As a result, it can lay the groundwork for how it intends to use the money, so everything is in place when your gift goes to the charity.

The Charitable Remainder Trust benefits you, your children and your favorite charity. If you own highly appreciated property and would like to convert it to future income, I invite you to call me.

You're Invited to Call or E-mail.

"If you have questions or concerns about asset protection, estate planning, probate, business planning, charitable giving or tax law, please don't hesitate to call. You're welcome to contact me at any time without cost or obligation. I'll be happy to help you in every way." -- *Anthony*

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