Limited Partnership and Family Limited Partnerships

A ***limited partnership*** (LP) is a separate legal entity created by a partnership agreement among two or more people. The LP also will be required to file a ***certificate of limited partnership formation,*** which can be costly. Partners then transfer money and property to the partnership in exchange for a partnership interest.

Limited partnerships are characterized by a two-tiered system of management and ownership; general voting partners and limited non-voting partners. Any or all partners can hold limited partnership interests, which carry no right to control the partnership but enjoy limited liability. Only partners with general partnership interests control the management of the business and are fully liable.

Limited partnerships generally function in the same way as general partnerships. Income is not taxed to the partnership, but to the individual partners. The same basis, distribution, and liquidation rules apply. The only difference is that self-employment tax is only applicable for guaranteed payments such as a management fee for general partners.

A ***family limited partnership*** (FLP) is a limited partnership in which ownership is restricted to family members. Parents, who set up the partnerships, are usually the general partners. Over time parents can transfer limited partnership interests to the next generation. The on-farm successor may also transition into a general partner with management capabilities.

There are usually no taxes incurred when changing your assets into a limited partnership for a partnership interest. Giving general or limited partnership interests to the next generation may have tax implications if an amount larger than the annual $12,000 exclusion per person is transferred. General partners may keep as little as one percent of the partnership interests and still retain control of the business. In that case, limited partners would have 99 percent of the tax liability, so discuss these options with all family members before transferring partnership interests.

Since an FLP is limited to family members, the interests are very difficult to sell. This may cause problems for generational successors who do not wish to be a part of the family business. Dissolving the partnership may cause liquidation of some business assets to pay off ownership interests. There are benefits as well. Because there is essentially no market for limited partnership shares, they may be appraised at a substantially lower price, enabling much more of the business to be transferred to heirs tax-free. In 2008, the first $2 million of a person's estate is tax-free. If their limited partnership shares are worth $2.5 million but are discounted to $2 million, the family will not have to pay estate tax on half a million dollars.

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