

Understanding
LIMITED
PARTNERSHIPS

*How You Can Protect Your
Assets, Save Taxes, and More.*



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CONSULTATION**

THE TOOL OF THE FUTURE!



The Limited Partnership is the most popular tool used today for Asset protection, tax savings, and the reduction of a person's estate, all while being able to keep complete control of your assets.

Limited Partnerships when employed as a part of thoughtful business structuring are effectively used in three major situations:

1. As asset protection tools, Limited Partnerships top the list. The Limited Partnership we believe is without peer in asset protection planning
2. We often employ Limited Partnerships as a significant restructuring tool to spread income among a family and thereby affect a lower overall family income tax rate.
3. As a tool for thoughtful estate planning, few legal tools have the flexibility and control capabilities provided by the Limited Partnership.

The Following will briefly describe the advantages and disadvantages of the Limited Partnership. Generally the Limited Partnership helps reduce estate tax and settlement costs, protects family assets and provides for succession of ownership and control of property.

THE LIMITED PARTNERSHIP PROVIDES FOR MANAGEMENT AND SUCCESSION OF OWNERSHIP

The Limited Partnership has replaced the corporation as the preferred choice of entity to hold property and to pass it from one generation to the next. This is true for both tax and non-tax reasons. As far as tax

issues are concerned, a Limited Partnership rather than an “S” Corporation is a better choice for the taxation of interim and final distributions of appreciated property. In addition, a partner in a Limited Partnership may utilize partnership liabilities, thus allowing for more losses to be deducted.

Specific management of the family business assets by proper “Succession Planning” can also be accomplished with the Limited Partnership. The general partners control the assets of the partnership, to the degree outline in the partnership document, while the limited partners simply hold an interest without management authority in those assets.

Perhaps the use of the properly drawn Limited Partnership to manage family assets such as ranches and rental real estate may be the best way to maximize the chance the family business will survive to the next generation and not “self destruct.”

ESTATE TAX SAVINGS

A basic precept in estate and gift tax law is that, for tax purposes assets are valued at their “fair market value.” The Internal Revenue Code (the “Code”) and the Treasury Regulations generally define “fair market value” as that amount of money a willing buyer will pay a willing seller, neither being under any compunction to buy or sell, both with reasonable knowledge of the facts. As a corollary to succession-management planning, Limited Partnership interests, by definition, impact the legal ownership assets which, in turn, influence the values of those assets for estate and gift tax purposes.

A Limited Partnership interest owned by your child, for example may be worth less for gift tax purposes, than if your child actually received

direct interest in the underlying partnership assets. Common sense tells us that a willing buyer of your child's limited partnership interest would pay less for that interest if the buyer were unable to remove the managers of the assets (The general partners), must wait until the partnership ends to receive his or her share of the underlying partnership assets, cannot resell the purchased partnership interest to anyone except family members, and cannot pledge interest for a loan. These restrictions then lead to discounts in the value of the Limited Partnership interest to be gifted (or owned for death tax purposes) to the child.

The courts and the Internal Revenue Service ("IRS") recognize that discounts in valuation occur for partnership interests. In fact the IRS "Handbook" itself anticipates that discounts will be claimed by taxpayers. It is not, therefore, in the IRS view whether a discount exists, but, rather, the extent of the discount associated with the particular (minority) partnership interest. The courts have recognized the validity (based on common sense of discounts over the years.

Effective October 8, 1990, Congress added Chapter 14 to the code. Chapter 14 was designed to limit valuation discounts at death in family transfers by gift. Presently, Chapter 14 can be dealt with by having a proper business purpose for the Limited Partnership (i.e., management succession planning which, in our opinion, outweighs any tax benefit) and by careful drafting of the control issues. However, since this legislation is new, its full impact may not be known for years until after the courts have interpreted its meaning.

GIFTS OF PARTNERSHIP INTEREST

An annual gifting program can be utilized in which capital account interests in the limited partnership are given away instead of cash gift

of a present interest subject to the annual gift tax exclusion. By use of the Limited Partnership, one can make annual gifts while keeping control of the partnership assets. Individual gifts will also qualify for discounting as described above (see Revenue Ruling 93-13). This is extremely helpful in estate planning.

REDUCTION OF PROBATE COSTS

A Limited Partnership can be utilized with a revocable living trust to avoid probate costs of transferring title. The estate settlement cost savings can be significant. The usual situation which would facilitate this would be to have the family assets owned by the Limited Partnership and then the partnership interest transferred to the living trust.

HOW LIMITED PARTNERSHIP PROTECTS ASSETS FROM LAWSUITS

Under California Law, the rights of a creditor seeking to execute a judgment or tax lien against the ownership interest of a debtor in a limited partnership is restricted. California Corp. Code* 15674(a) provides that an assignee of a general partner, may become a limited partner if and to the extent that (1) the partnership agreement so provides, or (2) all partners consent.” The limited partnership agreement can provide that the creditor is not allowed to become a limited partner or liquidate the limited partnership. The creditor would only receive a charging order. A charging order is a court order requiring that distributions of cash and property with respect to the encumbered partnership interest be paid to the creditor until the judgment debt is discharged. This can also be avoided if the Limited Partnership holds non-income production property, such as real estate and stock of the family owned business which does not pay dividends.

Also, the general partner may be authorized to retain income as reasonable reserves.

If this is the case, all the creditor realizes from its charging order is an IRS Form K-1 at the end of each tax year and an income tax liability. If the spouse of a debtor holds his or her interest as separate property, and his or her conduct did not result in a judgment against him or her, the spouse's separate property interest may not be charges with a judgment debt against the debtor. In short, a Limited Partnership can make it extremely difficult for a creditor to obtain access to the assets with in the Limited Partnership.

While a Limited Partnership protects the assets of the limited partners, the general partner may still be liable. A number of businesses that choose to use a Limited Partnership format will obtain maximum protection for the general partner. If properly formulated, the shareholders of the "S" Corporation have their liability limited to the assets the have contributed to the corporation. Therefore, both the general partner and the limited partners are protected. A claim may be made that transfers to the Limited Partnership were intended to defraud a creditor. However, transfers made for legitimate business and estate planning reasons are lawful. The transfers that cause problems are those that are made without consideration while the transferor is insolvent. This raises a presumption of fraudulent intent. However, when transfer is made for consideration, as in the case of exchange of property for a Limited Partnership interest, such a transfer is made for a valuable asset and should be protected by the savings clause of Section 9 of the Uniform Fraudulent Transfers Act. Marital agreements and transfer should be recorded. Liability insurance should be acquired or continued.

The Uniform Limited Partnership Acts (RULPA 1976 AND ULPA 1985) which have been accepted totally or in part by all of the states provide in section 703 that an individual partner's judgment creditor can only go against his Limited Partnership interest by means of a charging order. The court may only "charge" the partnership interest owned by the limited partner for the benefit of a judgment creditor.

THE CHARGING ORDER

A charging order is a statutory creation and is the means by which a creditor who has obtained a judgment satisfies his judgment against a limited partner. The following are examples of statutes which make charging orders the means by which a judgment creditor satisfies his judgment.

CALIFORNIA CORPORATION CODE

On application to a court of competent jurisdiction by any judgment creditor of a partner, the court may charge the Limited Partnership interest of the partner with payment of the unsatisfied amount of the judgment with interest. To the extent so charges, the judgment creditor has only the rights of an assignee of the Limited Partnership interest. This chapter does not deprive any partner of the benefit of any exemption laws applicable to the partner's Limited Partnership interest."

A charging order is defined in American Jurisprudence, Partnership Section 391: "A court on application by any judgment with interest. To the extent so charged, the judgment creditor has only the rights of an assignee of the partnership interest. A partner is not deprived of any exemption laws applicable to this partnership interest."

THE CHARGING ORDER IS THE ONLY REMEDY

The charging order is the only means by which a judgment creditor can reach the partnership interest of a limited partner.

In a 1986 Florida case, the Court again emphasized: "...The Statutory charging order is the only means by which a judgment creditor can reach the debtor's partnership interest." *Atlantic Mobil Homes, Inc. v. LeFever*, Fla. Dist. Ct. App. 481 So. 2d 1002 (1986)

Similar language was used by a Minnesota Appellate Court in which a creditor as seeking satisfaction of his judgment. The court held, "...that charge order is the exclusive remedy for a judgment creditor of a Limited Partnership." *Chrysler Credit Corp. v. Peterson Heller.*, 342 N. W. 2d 170 Minn. App. (9184)

The Supreme Court of California, in *Baum v. Baum*, 51 Cal @d 610, 335 P.2d 481 (1959), also construed that state's partnership charging order statute and found that a charging order of a partnership interest replaced levies of execution as the remedy for reaching such interest. In upholding the rationale enunciated in *Sherwood v. Jackson*, 121 Cal. App. 354, 8 P.2d 943 (1932), the court in *Baum*, supra, determined that a creditor could not: "...levy attachment or execution on a partner's right in specific partnership property or on his interest in the partnership, but only, after first obtaining judgment, pursue the statutory remedy of seeking a charging order."

The decisions of other courts are in line with the reasoning enunciated in *Baum*. See, *Krauth B. First Continental Dev.*, Fla. App., 351 So. 2d 1106 (1977)

In a recent bankruptcy proceeding in Georgia, the bankruptcy court stated: "It is clear that the charge order is a substitute for execution,

attachment, levy and sale, or garnishment creditor of a limited partner.” matter of Smith, Bkrcty., 17 B.R. 541 (1982)

The above court also found that several courts, in other jurisdictions, have similarly analyzed the charging order.

In *Bank of Bethesda v. Koch*, 408 A.2d 767 (1979), the Court dealt with the nature of charging order- that is, whether a charging order against a limited partner is a form of judicial assignment or form of attachment. Viewing neither alternative description as necessary nor especially desirable, the Court characterized a charging order as follows: “A charging order is nothing more than a legislative means of providing a creditor some means of getting a debtor’s ill-defined interest in a statutory bastard, surnamed partnership, but corporately protection participants by limited their liability as are corporate shareholders... Since the statutory offspring is unique, the rights of creditors against the charging order are neither fish nor fowl. It is neither an assignment nor an attachment. But like many questionable offspring it resembles both progenitors in some of their characteristics.”

CHARGING ORDER IS A RIGHT TO INCOME ONLY

A charging order gives the judgment creditor only a right to the income portion of the limited partner’s interest held by a debtor. The leading case to support this general principle of law in *Evans v. Galardi* 546 P.2d 313 (1976). The California Court held: “...that a limited partner has no interest in the partnership property by virtue of his status as a limited partner, and such assets are not available to satisfy judgment against the limited partner in his individual capacity.”

The court further held: "...that where the judgment creditor could not secure satisfaction of his judgment by attaching personal property of the debtor, the court would not make no exception to the general rule that a creditor has rights only to the income portion of a partnership..."

In a recent Florida case *Atlantic Mobil Homes, Inc.*, supra, the court also stated: "In order to proceed against a debtor/partner, a creditor must obtain a charging order pursuant to Florida Statutes Ann. Section 620.695, Florida Statutes (1985). Even then, the creditor cannot reach partnership assets but can only reach the debtor's share of profits from the partnership." A judgment creditor cannot unwind the partnership and force sale of the assets if the partnership is drafted correctly. Once a charging order has been obtained, there is not cessation of the debtor partner's status as a partner in all respects save his entitlement to receive profits and surplus. The judgment creditor who holds the charging order does not become the owner of the interest or a substituted limited partner; he is merely an assignee of the income interest held by the judgment debtor. Axelroad, "the Charge Order-Rights of a Partner's Creditor" 36 Ark. Law Rev. 90. (1982-83)

Pursuant to Section 27 of the Uniform Partnership Act and Section 702 of the Uniform Limited Partnership Act (1976) the assignee of a partner's interest does not become a substituted partner. Accordingly without inspection of the other partners Crane and Bromberg Law of Partnerships Section 44, 248 (1968)

A person who owns a partnership interest in a Limited Partnership owns a personal property right rather than a real property interest, *Matter of Havik Bkrty*, 14 B.R. 635 (1981). This personal property right entitled the partner to a pro rata share of the partnership profits and surplus *Reiter v. Greenberg*, 288 N.Y.S. 2d 57 (1968). However,

this does not mean a limited partner holds title to the assets of the partnership *Maxco v. Volpe*, 274 S.E. 2d 561 (1981).

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Since a limited partner has no rights in the partnership property other than his distributed share of the income, then the income becomes the only means with which to satisfy a judgment. The only way to reach that income is through a charging order. Most states codify the foregoing with the following language as reported from California R.U.L.P.A.: “(1) Nature of Partnership Interest ‘An interest in a Limited Partnership is a personal property and a partner has no interest in specific partnership property.’ (Corp. C. 15671. Both former Corp. C. 15518 and Revised U.L.P.A. section 701 provide that an interest in a Limited Partnership is personal property...)”

The lack of “power” and “control” by an assignee of a Limited Partnership interest is almost universally described in language such as in the California Case of *Kellis v. Ring app.*, 155 Cal. Rptr. 297 (1979), wherein the court held that an assignee had no right to interfere in the management of a Limited Partnership, stating: “while appellant has a right to receive the share of the profits or their compensation by way of income, or the return of his contributions to which his assignor would otherwise be entitled, he has no right to interfere in the management of the Limited Partnership.”

THE POISON PILL

The internal Revenue Service policy (set forth in Rev. Rule 77-137) presents a judgment Creditor with a “poison Pill”. THE JUDGEMENT CREDITOR UPON OBTAINING A CHARGE ORDER NOW MUST PAY INCOME TAXES ON THE UNDISTRIBUTED PROFITS OF THE PARTNERSHIP IN PROPORTION TO HIS INTEREST AS DETERMINED BY HIS CHARGING ORDER EVEN IF NO INCOME IS DISTRIBUTED BY THE PARTNERSHIP.

INTERNAL REVENUE SERVICE REVENUE RULE 77-137

“A, a limited partner in a Limited Partnership formed under the Uniform Limited Partnership Act of a state, assigned the Limited Partnership interest to B. The agreement of the partnership provided, in part, that assignees of limited partners may not become substituted limited partners in the partnership without with written consent of the general partners. However, it also provided that a limited partner may, without the consent of the general partners, assign irrevocable to another the right to share in the profits and losses of the partnership and to received all distributions, including liquidating distributions, to which the limited partner would have been entitled had the assignment not been made. Under the terms of the assignment A, who was the nominal limited partner under local law, agreed to exercise and residual, powers remaining in A solely in favor of and in the interest of B.”

“Held, even through the general partners did not give their consent to the assignment, since B, the assignee, acquired substantially all of the

denomination and control over the Limited Partnership interest, for Federal income tax purposes B is treated as a substituted limited partner. Therefore, B. must report the distributive share of partnership items of income, gain, loss, deduction, and credit attributable to the assigned interest on B's federal income tax return in the same manner and in the same amounts that would be required if B was a substituted limited partner.”

This Revenue Ruling was affirmed in Jackson v. Commissioner, 91 81, 594 P- H Memo TC (1981), where the court held, “if and assignee is determined to be a partner for federal income tax purposes, he is liable for taxation as a new partner.” Also see A Willis, J. Pennell, P. Postlewaite, Partnership Taxation, section s.03, pp. 2 11(12) 3d ed. (1981)

PRACTICAL MATTERS IN GETTING STARTED

Keep in mind, as a general rule, that partners (general or limited) must not think of themselves as individuals, or appear to do business as individuals. Although you are partners, you are not the partnership- it is a separate entity and the distinction between you and your personal affairs and the partnership and its business affairs must be maintained.

The General partner should ensure that the following tasks are accomplished:

1- CERTIFICATES/STATEMENTS OF PARTNERSHIP

If your family partnership is a Limited Partnership, a certificate of Limited partnership (which lists the names and addresses of all partners, the address of the principal office and the agent for service of process) must be filed with the Secretary of State. Normally your

attorneys handle this at the time they prepare the partnership agreement. If the partnership owns real property, a certified copy of this Certificate of Limited Partnership must be recorded in each county in which real property is owned. Failure to properly file the Certificate of Limited Partnership will result in the partnership being classified as general partnership notwithstanding the terms of the agreement itself.

If your Limited Partnership is a general partnership, a statement of General Partnership (which lists the names and addresses of all partners) will be prepared and recorded in each County in which the partnership owns real property.

2- FICTITIOUS BUSINESS NAME STATEMENTS

You may file a Fictitious Business Name Statement with the County clerk of each county in which the partnership does business; however, if a Certificate of Limited Partnership or Statement of General Partnership is recorded in the county, a Fictitious Business Name Statement often is not filed. If the partnership does business under a different name, a Fictitious Business Name Statement should be file din addition to recording the certificate of Limited Partnership or Statement of General Partnership.

3- TRANSFERRING OWNERSHIP INTEREST TO PARTNERSHIP

When a partner contributes property to the partnership in exchange for an ownership interest in the partnership, the transaction should always be in writing (in some cases, such as with real property, it must be in writing). Normally, these documents are prepared by your attorneys at the time you establish the partnership; however, if any additional

property is to be contributed to the partnership, be sure to check with your attorneys to make sure it is properly documented and transferred.

4- AMENDING LEASES OR OTHER AGREEMENTS

If there are any agreements concerning property transferred to the partnership, such agreements must be amended to reflect the partnership's ownership. For Example, if a partner contributed a 10% ownership interest in real property to the partnership, and that property is leased to a third party; the lease must be amended or assigned to show the partnership as one of the lessors.

Documents to conform to this rule can be drafted for you by our office if you like.

5- PARTICIPATION AND MANAGEMENT

The donees should participate in the control and management of the business, particularly policy decisions, and not just perform ministerial acts. The IRS views this as evidence of the donees' control over their partnership interests. However, in a Limited Partnership, the donee limited partner must surrender control to the general partner and should not participate.

6- CONDUCT OF THE PARTNERSHIP BUSINESS

The following are suggestions for showing that donees are actual owners of their partnership interests. It is the first thing the IRS looks at, and compliance with these formalities can avoid further digging by an agent: (1) the partnership agreement shows that the donees are partners, (2) the partnership should comply with all state partnership and fictitious name as well as business registration statutes, (3) the donees (if general partners) in distributions of partnership property and

profits, and their existence should be noted in insurance policies, leases and other business contracts. The donees should also be recognized in written agreements, records and memoranda. If possible, the donee general partner should have an authorized signature for partnership bank accounts. In sum and substance, they should be treated the same as other partners and should be listed in any documents which show the composition of the partnership. The partnership agreement should be written and the partnership should file partnership returns.

7- TRUSTEES AS PARTNERS

If the partnership is to be formed with minors, sometimes there are separate trusts (sometimes called 2503 (c) trusts) created for the minors' interest, and sometimes the partnership agreement creates a trust to hold the interest of the donees. Using a trust avoids the necessity of appointing a guardian for the minors. Furthermore, if a trustee is used, the IRS should recognize the trustee as a partner, provided the donor is not retaining unacceptable controls. The donor should not be the trustee (you should not personally have the power to do this), it is better to replace the trustee where it can be shown that the donor actively represents the interest of the beneficiary. Despite the advantages of using a trust, they involve special problems. If you intend minors to be donee partners, you need to discuss with your attorney more fully the implications and a ramification of creating trusts for them.

8- ALLOCATION OF FAMILY PARTNERSHIP INCOME

As a general rule, the income should be allocated in accordance with the partnership capital. Therefore, if you or any other partner own 10% of the income, the first exception to this rule occurs if the donor performs services for the partnership. If this is the case, partnership

income must be allocated to constitute reasonable compensation for those services before allocating the remainder according to the partnership and are the managing general partner (the donor), then you must be allocated a reasonable amount for your services. If you are hesitant or in doubt as to what constitutes a reasonable amount for your services, you might find out by questioning people who are compensated for the same type of services and see if your compensation agrees with theirs.

The second exception to the general rule is applicable where the portion of the partnership income allocated to donated capital is proportionately greater than the share of the donor attributable to the donor's capital. Therefore, if you allocated a disproportionately large portion of income to donated capital interest. This rule only applies to donated capital. There is no prohibition against a disproportionate allocation in favor of the other capital. Therefore, if you arbitrarily change the partnership agreement or start allocating income to someone who has been given his or her capital interest and its allocation is disproportionately large, you can expect it to be reallocated by the IRS. If you anticipate a change in the allocation of the income from that drafted in the partnership agreement, it should be something that you discuss with your attorney. In no event should you ever arbitrarily allocate a disproportionately larger share of income to yourself.

Normally, however, the partnership agreement (or attached schedules) set forth the percentages for allocation of income.

9- SPECIAL ALLOCATIONS

While special allocations are allowed under Code under the special situation of a family partnership and estate planning considerations, it

is mandatory that the terms of the partnership agreement be followed to the letter. The General Partner has a fiduciary obligation to follow the terms of the agreement; otherwise, he or she risks being sued by the other partners for a breach of that duty. As apart of the General Partner's fiduciary obligation, income must be distributed to the partners in proportion to their ownership interests (except as noted previously in this memorandum). Failure to follow the requirements may result in the IRS arguing that the donor has retained the right to all of the income of the gifted property and therefore all of the property will be included in the estate of the donor, notwithstanding those valid gifts of the limited partnership interests have been made. For this to happen, all that is required is that the IRS perceives an oral agreement among the family that the donor has the right to all the partnership income.

In short, with respect to the estate planning issues, the partnership agreement should achieve your desired goals, but if you amend the partnership agreement or change is in any way to give the donor more control, to set up a buy-sell agreement, or to change the allocation provisions, you need to contact your attorney before doing so. Small changes can have profound effects in the estate tax results of your partnership.

DISADVANTAGES

There are disadvantages to setting up a Limited Partnership. A Limited Partnership will have a cost to set up. Transferring assets to the partnership may also trigger a due on sale clause in mortgage. This should be examined before any transfers are made. Additionally, in some causes two separate appraisals may be necessary to properly value the gifts or partnership interest. For death tax purposes one appraisal is necessary.

REGARDING OPERATION OF FAMILY PARTNERSHIP

I. OVERVIEW

The objective in setting up your Limited Partnership is to achieve the desired goals of proper management of the business, succession planning, asset protection, and discounted values, as well as splitting income among family members. The tax goals will not be achieved if the partnership is not operated in the manner in which it is set up. The IRS may take the position that your family partnership does not exist for tax purposes. Therefore, it is very important that the partnership be operated in accordance with these instructions in order to achieve the desired goals. Throughout this discussion the person who sets up the partnership will be referred to as the “donor” and the other partners, usually the children, will be referred to as the “donees” (because they usually receive their partnership interest as gifts).

II. CAPITAL AS A MATERIAL-PRODUCING FACTOR

Code * 04(e) sets forth criteria for determining whether the donees are real owners of their interests. These criteria are listed below. No one criteria is by itself determinative but taken together the criteria can result in the partnership not being recognized for tax purposes. Although your partnership agreement should address all of these issues, it is important for the donor to see that they are carried out. Failure to follow the partnership agreement or to ignore the partnership may result in the partnership being treated as a sham. The following are certain controls which should not be abused by the partner in power.

III. DIRECT CONTROLS

1. Controls Over Distribution of Partnership Income

The person who set up the partnership (i.e., the donor) should not personally retain control over the timing of income distributions (such as where the person who set up the partnership is managing partner having such powers in a Limited Partnership). Also, the person who has set up the partnership should not arrange the transactions so that there are contractual restrictions on the current distribution of income (such as there the partnership agreement requires that all or a certain arbitrary percentage of income be accumulated for a period of time).

2. Limits on the Donees' Right to Dispose of Their Interest without Financial Detriment.

Your partnership agreement may restrict a partner's freedom to transfer their partnership interest or cause a liquidation of the venture. This is all right. The important point is that this can be done "without financial detriment." The partnership then will not be invalidated if it requires a partner to offer his or her interest to the partnership (or the other partners) at the same price as any bonafide offer from an outside party before accepting that offer. However, a provision giving the partnership the right to purchase a partner's interest for a set price which bears no relation to the interest's actual value could cause a partner financial detriment and would mitigate against a donee's real ownership for tax purposes. Your partnership agreement should be drafted to comply with these rules, but if the donor makes it difficult for one of the partners to be bought out this would be a problem recognizing the partnership as a valid one for tax purposes. You should consult with your attorney if you wish to make a change in the buy-out procedure.

3. Retention of Control over Essential Assets.

Your partnership agreement should be drafted so that the donor does not retain control over essential assets. For example, the donor should not lease essential assets to the partnership by a tenancy at will or short term lease. The Donor also should not retain the right to withdraw the essential asset which would cause the partnership to cease business, thereby rendering the donees' partnership interest worthless. If the donor wishes to engage in any of these types of controls or activities it is important that it is discussed with your attorney before doing so.

4. Retention of Management

It is acceptable for the person who set up the partnership to retain control by voting or management since it is consistent with ordinary business practices. The donor's control, however, must be subject to the donees' right to liquidate their interest without financial detriment. The donees will not be deemed to possess this right unless they are both independent of the donor and have sufficient maturity in understanding their rights to be able to exercise them. The partnership agreement will give the majority of the control to the person who set it up, but this becomes dangerous for tax purposes only to the extent that the other partners are immature and not independent of the donor. These factors should be analyzed in setting up your agreement. If you wish to change the agreement after it is operational, you should discuss your wishes with your attorney.

IV. INDIRECT CONTROLS

What cannot do directly, you cannot accomplish by indirect means. That is, the problem of retained controls cannot be avoided by retaining those controls indirectly through an entity controlled by the donor.

V. ACCOUNTANT

The general should retain an accountant who will assist you in setting up a partnership bookkeeping system, audit partnership records, and prepare the required tax returns.

VI. TAX IDENTIFICATIONS NUMBER

A federal tax identification number for the partnership must be obtained. The partnership must also provide to each partner (within 90 days of the end of each taxable year), information necessary to complete federal and a state income tax or information returns (usually IRS form K-1's). In addition, where there are 35 or fewer limited partners, a copy of the Limited Partnerships federal; and state returns for the year must be sent to each partner within the 90 days your accountant will normally prepare these returns and you can assist the accountant to make sure they are timely filed and sent to the partners.

VII. PROPERTY INCOME

Where property is owned by the partnership and others (e.g., real property owned by other family members along with the partnership), all income produced by such property must be paid to each owner according to the owner's respective interest. For example, if the partnership owns a 40% interest in property which earns \$100,000 per year from a lease, \$40,000 of the income must be paid to the partnership and the remaining \$60,000 must be paid to the remaining owner(s). Again, in order to maintain the existence of the partnership as a separate entity (and to validate any gifts that the partnership receive its respective share of property income and that the partnership receive its respective share of property income and that the partnership income and that partnership income actually be distributed in accordance with the partnership agreement.

VIII. REAL PROPERTY TAXES

It the partnership owns real property, the partnership is responsible for paying the property tax proportionate to its percentage interest. For example, if the partnership owns a 40% interest in property which is assessed \$1,000 for real property taxes, \$400 of this tax bill must be paid by the remaining owner(s). In order to maintain the existence of the partnership as a separate entity (and to validate any gifts of an ownership interest which have been made), it is imperative that the partnership pay its portion of such taxes.

IX. BANK ACCOUNT

The general partner should open an interest-bearing checking account is the name of the partnership with all cash contributed to the partnership at the time of its formation. (You will need to provide the bank with the tax identification number, and may also need to provide a copy of the Certificate of Limited Partnership or Statement of General partnership if requested.) For family partnerships which do not have numerous financial transaction, it is often easiest to make sure all income is deposited into one checking account and all expenses paid out of the one checking account so that the check register provides a record of all partnership transactions. (Of Course, excess funds may later be transferred to a savings or other investment account to obtain an increased interest rate.)

X. RECORD KEEPING

Clear accounting records must be kept of all partnership funds, partners' respective capital accounts, and distributions of profit and loss. The general partner should work with the accountant to set up system workable for your partnership. In the case of any Limited Partnership with more than 35 limited partners, the general partner

must send an annual report to each partner not later than 120 days after the close of the fiscal year; this should be prepared by the accountant.

XI. RECORDS REQUIRED TO BE KEPT AT PRINCIPAL OFFICE

The partnership is required to keep the following records at the address of the principal office listed on the Certificate of Limited Partnership (or statement of General Partnership):

1. A current list of the full name and last known business or residence address of each partner set forth in alphabetical order, together with the contribution and the share in profits and losses of each partner.
 2. A Copy of the Certificate of Limited Partnership (or statement of General Partnership and all certificates of amendment thereto, together with executed copies of any powers of attorney pursuant to which any certificate has been executed.
 3. Copies of the partnerships federal, state, and local income tax or information returns and reports, if any, for the six most recent taxable years.
 4. Copies of the original partnership agreements and all the amendments thereto.
 5. The partnership's book and records as they relate to the internal affairs of the partnership for at least the current and past three fiscal years. These records will include all agreements and important documents, such as notices given to the partners, deed, leases, and contracts.
- Each Partner has a right to inspect each of these documents upon reasonable request.

XII. AVOID COMMINGLING

It is imperative that no personal funds or affairs of an individual partner (general or limited) are mixed with funds or affairs of the partnership. For instance, you should not use the partnership's checks to pay your personal and household bills, or vice versa. You should not borrow money from the partnership or loan money to the partnership without signing a promissory note and complying with the terms of the partnership agreement and California law.

XIII. MANAGEMENT RESPONSIBILITIES

In a Limited Partnership, only the general partners have management authority and it is imperative that they review and abide by the provisions of the partnership agreement concerning the management responsibilities of the general partner. The limited partners do not have management authority. In a general partnership, all partners do not have management responsibilities, although such responsibilities may be delegated to one managing partner. In any event, all management decisions on operations of both limited and general partnership agreement as well as general partnership law.

Where there are any substantial, unusual, or peculiar transactions, it is advisable that they be taken only after notifying all partners and holding a meeting to discuss any such matters (such as selling the real property owned by the partnership). Similarly, if other partners are concerned about your actions, there are provisions under California Law, whereby they may call a meeting of all partners to discuss the matter.

XIV. PARTNERSHIP NAME

Whenever a transaction involves the partnership, the partnership name (and not your individual name) must be used, if the partnership owns a

majority interest in property, all contracts, accounts, utilities, and other similar related matters should be transferred into the partnership name.

Whenever signing on behalf of the partnership, the general partners should never sign it in their own names (even “John Smith, General Partner of the Smith Family Partnership” is improper), the general partners below the Partnership name; e.g.:

THE SMITH FAMILY LIMITED PARTNERSHIP A California Limited Partnership	
By _____ Mary Jane Smith, General Partner	By _____ John Doe Smith, General Partner

(Be sure to check your partnership agreement and certificate of Limited Partnership or Statement of General Partnership to see how many general partners are required to sign on each document.)

XV. PERSONAL GUARANTEES

Some creditors, banks, and other entities may require you sign a “Personal or Continuing Guarantee.” or to co-sign notes or contracts individually in addition to the signature of the partnership. Sometimes you cannot avoid this if you need the loan or other agreement. But keep in mind that by signing such a guarantee, or by co signing, you become personally liable if the partnership should consult with your attorney to determine if there is any other estate planning ramifications to your guarantee.

XVI. OWNERSHIP INTEREST AND ASSIGNMENT

An interest in a Limited Partnership is personal property and a partner has no interest in specific partnership property. Only a Partner has a partner’s right to participate in the management of Limited Partnership

assets. A partnership interest may be assigned to another, in whole or part, except as provided in the partnership agreement (normally, your family partnership agreement will restrict assignment or partnership interest to persons outside of your family). An assignment of partnership interest will not dissolve the partnership. But control of that asset must be transferred into Limited Partnership. However, if you anticipate that any of the assets which the partnership will acquire will some how result in the donor having indirect control, then this needs to be reviewed and analyzed before it is implemented. Also, keep these requirements in mind in your future management of assets and designation of entitles (e.g., trusts) to own your assets if any such assets are likely to be assigned to the Partnership at a future date.

However, keep in mind that under the rules of taxation of California real property, if the partnership owns real property and if 50% or more of partnership interest is assigned or transferred, this will result in a “change in ownership” of the real property and will result in reassessment of the value of the real property (finally resulting in increased real estate taxes).

XVII. ADDITION OR SUBTRACTION OF PARTNERS

If new partners are added to the partnership, or if a partner withdraws, dies, or assigns the partnership interest to another, the Certificate of Limited Partnership must be amended and the amendment filed with the Secretary of State. A certified copy or the filed amendment must also be recorded in each county in which real property is owned by the Limited Partnership. (If the partnership is a general partnership, the Statement of General Partnership must also be amended and recorded.) If a fictitious Business Name Statement has been filed, that must similarly be amended.

XVIII. DISSOLUTION OF PARTNERSHIP

At the time the partnership is dissolved, final tax returns must be filed, and the partnership assets must be distributed according to the terms of the partnership agreement. If a Limited Partnership, a Certificate of Dissolution must be filed with the Secretary of State. You will need to work with your attorneys and accountants to properly comply with California Law in winding up the affairs of the partnership to value the underlying assets of the partnership. For Example, if the partnership consists of a ranch, a real estate appraiser must be engaged to determine the value of the ranch owned by the partnership. A second appraisal is also necessary to value the limited or general partnership interest that is given away by the donor or owned by the decedent.

If the conveyed property is rental real estate, the partnership is not entitled to the \$25,000 passive loss under Code * 469(in) (6) (c) from which an individual owner may benefit. In addition, if a home is transferred into the partnership, the owner will lose the ability under the code to sell the property and purchase another qualified property within 18 to 24 months and defer capital gains taxes, although the ability to make a 1031 exchange is still available. In addition, if a home is transferred into the partnership, the owner may lose their one time \$125,000.00 exemption from capital gains tax, and some expenditure for a residence may not be as beneficial as they would if the property was not being used for the owners use. There will be charged a transfer tax to transfer the property into the partnership in most counties in the state of California, but property taxes should not be increased under Taxation and Revenue code section 62.

Under California law, the Limited Partnership cannot engage in the banking or insurance business. The partnership should not own a qualified retirement plan or individual retirement account as the

homestead exemption; a residence should not be transferred to the Limited Partnership unless the homestead exemption is insignificant, or is on a lease hold.

Transfers to partnerships and trusts in California may result in a change of ownership which would step up the property tax basis of the property otherwise protected by Proposition 13. Proper planning may reduce (but not eliminate) the risk of a change of ownership for property tax.

Lastly, the estate and gift tax valuation issue may be subject to challenge by the IRS as described above.

WARNING

This packet must not be construed as legal advice by the reader. This information is only a brief outline of how a Limited Partnership can be an important part in some people's business structuring and estate planning plans. Actual business structuring and estate planning can only be recommended after analyzing your type of business, present material status, family structure, age, general health, present wealth and asset ownership, type of major assets owned, abilities, present tax levels, present structuring or estate planning already in effect, employee status, personal income needs and other important and vital information. Speak to your attorney before attempting to anything mentioned in this packet. Remember, there may be some tax consequences from the use of a Limited Partnership and there can never be any guarantee as to results with any entity.

BENEFITS: FISCAL YEAR, OWN TAX BRACKET, LIFE, HEALTH, DISABILITY, WORKERS COMPENSATION AND MORE.

CORPORATION
-VEHICLES
-INVENTORY

FAMILY LIMITED PARTNERSHIP
DANGEROUS ASSETS:
-VEHICLES
-OTHER HIGH RISK ASSETS

LIMITED PARTNERSHIP
SAFE ASSETS: HOME
C CORP, STOCK BUS.
EQUITY INVESTMENTS,
PERSONAL PROPERTY,
BENEFITS: ASSET
PROTECTION, TAX
STRUCTURING, AND
GIFTING

TRUST
OWNS: FLP ASSETS,
PERSONAL ASSETS, AND
PERSONAL VEHICLES
BENEFITS: NO
PROBATE, ELIMINATES
MOST ESTATE TAXES
AND YOUR ASSETS GO
WHERE YOU WANT THEM
TO GO.

HOMESTEAD

BENEFITS:
\$75,000 –
\$100,000
HOME PROTECTION

POWERS OF ATTORNEY

BENEFITS:
YOU CHOOSE WHO TAKES CARE OF YOUR
FINANCES AND MEDICAL DECISIONS WHEN
YOU CAN NOT.
THESE PREVENT THE COURT FROM
CHOOSING FOR YOU

Biography of
GREGORY R. BEYER, Esq.;



Gregory R. Beyer is a Practicing California Attorney and for over 20 years has had as the emphasis of his personal practice of law issues primarily revolving around Estate Planning, Elder Law, Medi-Cal Planning, Asset Protection Planning, and Business Structuring. Mr. Beyer was the Salutatorian, Parliamentarian, and Honor Graduate of his class, and is authorized to practice law before the courts of the State of California and Federal District Courts. He is a Certified Estate Planner in Legal Concepts (CEP-L) and one of a very few select Certified Senior Advisor Attorneys (CSA) in the United States. He has been listed in Who's Who and was President of the California Estate Planning Council for 2 terms. He is a member of the J. Reuben Clark Law Society and is a member of the National Association of Elder Law Attorneys. Mr. Beyer enjoys speaking on Elder Law and Estate Planning principles to small groups as well as a speaker for national legal seminar providers. The Law Offices of Beyer Pongratz and Rosen has been a member of the Lincoln Chamber of Commerce, the Rancho Cordova Chamber of Commerce and the United State Chamber of Commerce.