FAMILY PARTNERSHIPS

The family partnership is an often overlooked planning technique with some important advantages, and it is a technique frequently used as a means of shifting income from parents to children or other family members. It may also be used to "freeze" the value of an individual's estate by shifting future growth in various assets to other family members. In addition, it is also often used to fractionalize the individual's interest in business assets or real estate to create valuation discounts.

Family partnerships can hold almost any type of assets, however they are most commonly used to hold family business interests or real estate. There are several requirements of a family partnership:

1. Capital must be a material income-producing factor. Personal service businesses generally do not qualify since the business must require substantial inventories or substantial investment in plant, machinery or other equipment.

2. If the family partnership was created by gift, the donor must be paid reasonable salary for services rendered to the partnership before profits can be allocated among the partners.

3. The income of the partnership must be allocated, in proportion to each partner's capital investment.

4. All partners in the partnership must actually own a "capital interest" in the partnership. A capital interest consists of ownership of the assets of the partnership, which is distributable to the partner upon his or her withdrawal from the partnership or upon liquidation of the partnership.

Now that we've reviewed the requirements, let's examine some of the benefits of this technique.

1. The family partnership allows intra-family income splitting, thus shifting the income tax burden from a high income tax bracket (the parents) to a lower tax bracket (children or other family members).

2. Sometimes partnerships (particularly limited partnerships) afford certain controls not available in other business forms such as a corporation. In a family limited partnership, for instance, the parents as the general partners make the decisions, while the children as limited partners have a specified interest and share in any income or profits. This keeps the control and decision-making with the parents.

3. Family partnerships offer the ability to transfer ownership interests without loss of control. Every year the parents can simply modify the partnership agreement to convey additional interests to the children. This allows the children to be brought into the business at whatever pace the parent feels they are ready to handle.

Of course, this brief article is no substitute for a careful consideration of all of the advantages and disadvantages of this matter in light of your unique personal circumstances. Before implementing any significant tax or financial planning strategy, contact your financial planner, attorney or tax advisor as appropriate.

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