THE ESTATE PLANNER

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Understanding the ins and outs of an FLP

A family limited partnership (FLP) is an estate planning tool with various benefits. These include centralized management of family assets, the ability to transfer wealth without ceding control, reduced gift and estate taxes, income tax savings, and asset protection. Let's take a closer look at how an FLP works.

An FLP in action

To take advantage of an FLP, you form a limited partnership to transfer a family business, real estate, investments or other assets. Initially, you receive a *general* partnership interest of 1% or 2% and *limited* partnership interests totaling 98% or 99%. You then sell or gift the limited partnership interests to your children or other family members.

As a general partner, you retain management control over the partnership assets, even though you've transferred most of the assets' value to other family members. The significant benefit here is that an FLP removes wealth from your estate while the federal gift and estate tax exemption is at a record high without immediately parting with control over that wealth.

> ***Transferring FLP interests to family members removes the value of the underlying assets from your taxable estate.***

Limited partners, on the other hand, have minimal control over the partnership, and their ability to sell their interests to nonfamily members is, generally, highly restricted by terms of the partnership agreement. This allows the older generation to consolidate management of family assets and keep them in the family.

Reduce transfer tax

Transferring FLP interests to family members removes the value of the underlying assets from your taxable estate. Although interests transferred for no consideration (or for consideration that's less than full fair market value) are taxable gifts, they're generally shielded (in whole or in part) from federal gift tax by the federal gift and estate tax exemption. For 2025, the exemption amount is $13.99 million for individuals or $27.98 million for married couples filing joint tax returns.

Beware the kiddie tax

As noted in the main article, a family limited partnership (FLP) benefit is the ability to shift income to family members in lower tax brackets. But beware: the "kiddie tax" may thwart this strategy. This tax — which applies to children 18 or younger and full-time students between 19 and 23 — provides that a child's unearned income (such as investment income) over a specified threshold is taxed at the parent's marginal rate. Currently, the threshold is $2,700.

There are a couple of exceptions to the kiddie tax. It doesn't apply to adult children who are married and file joint returns with their spouses. And it doesn't apply to children 18 or older if their earned income exceeds half their support needs.

If the kiddie tax applies, the first $1,350 of a child's unearned income is tax-free, the next $1,350 is taxed at the child's rate and any unearned income above $2,700 is taxed at the parent's marginal rate. (These thresholds are adjusted annually for inflation.)

In addition, because limited partnership interests possess little control over the partnership and are challenging to sell, their value for gift tax purposes is generally discounted substantially due to their lack of control and marketability. This allows the older generation to give away even more wealth tax-free.

Reduce income tax

A properly structured and operated FLP allows you to shift income to your children or other family members in lower tax brackets. An FLP is a pass-through entity for income tax purposes. In other words, there's no entity-level federal tax. Instead, the FLP's income (deductions, credits and other items) is passed through to the individual partner, who reports his or her share on a personal income tax return.

So, for example, if you're in the 35% tax bracket and transfer FLP interests to family members in the 10% or 12% bracket, the tax savings can be substantial. Remember, however, that your ability to shift income to certain children may be limited. (See "Beware the kiddie tax" above.)

Provide asset protection

Transferring assets to an FLP can place them beyond the reach of certain creditors. Generally, an FLP's assets are protected against claims by the limited partners' personal creditors. In most cases, those creditors are limited to obtaining rights to distributions, if any, received by a limited partner. In addition, limited partners' personal assets held outside the FLP are generally shielded against claims by the FLP's creditors.

General partners don't enjoy the same protections. Still, they may be able to limit their personal liability by forming a corporation or limited liability company to hold their general partnership interests.

A versatile tool

FLPs are more complex and costly to set up and operate than other estate planning tools. But given the variety of benefits an FLP offers, it's worth consideration as part of your overall estate plan. Contact your estate planning advisor to help you determine if an FLP is right for you.

Health care directive terms defined

A comprehensive estate plan has many objectives. They include ensuring your assets are passed on to your loved ones according to your wishes while minimizing gift and estate taxes. Another equally important objective is to communicate your preferences in advance for medical care in the event you're incapacitated and can't express your wishes. To that end, including advance health care directives in your estate plan is critical.

One problem: There's often disagreement about the legal names given to those directives and their optimal use, depending on your jurisdiction. Here are a few health care directive-related terms you should be familiar with:

Living will. A living will is a legal document establishing criteria for prolonging or ending medical treatment. It indicates the types of medical treatment you want (or do not want) in the event you suffer from a terminal illness or are incapacitated.

This document doesn't take effect unless you're incapacitated. Typically, a physician must certify that you're suffering from a terminal illness or that you're permanently unconscious. Address common end-of-life decisions in your living will. This may require consultations with a physician.

Be aware that the requirements for a living will vary from state to state. Have an attorney experienced in these matters prepare your living will based on the prevailing laws.

Health care power of attorney. Comparable to a durable power of attorney that gives an "agent" authority to handle your financial affairs if you're incapacitated, a health care power of attorney (or medical power of attorney) enables another person to make health care decisions for you. This is also called a "health care proxy" in some states.

Choosing an agent is critical. You can't anticipate every situation that might arise — virtually no one can — where it's likely that someone will have to make decisions concerning your health. Therefore, the agent should be a person who knows you well and understands your general outlook. Frequently, this is a family member, close friend or trusted professional. If your first choice can't do the job, remember to designate a successor agent.

DNRs and DNIs. Despite the common perception, it's not a legal requirement for you to have a living will or an advance directive on file to implement a "do not resuscitate" (DNR) or "do not intubate" (DNI) order. To establish a DNR or DNI order, discuss your preferences with your physician and have him or her prepare the paperwork. The order is placed in your medical file.

Even if you already have a living will spelling out your preferences regarding resuscitation and intubation, it's still a good idea to create DNR or DNI orders when you're admitted to a new hospital or

health care facility. This can avoid confusion during emotionally charged times.

POLSTs. In some states, an estate plan may include a document known as a "physician order for life-sustaining treatment" (POLST) or a similar name. A POLST may be used by a person who has already been diagnosed with a serious illness.

This document doesn't replace your other directives. Instead, it complements them to ensure you receive the treatment you prefer in case of an emergency. Your physician completes the form based on your instructions and personal conversations.

If you're hospitalized, the POLST is posted by your bedside. If you're residing at a health care facility, it should be prominently displayed where medical or emergency personnel can easily view it.

Consult your attorney, physician and health care agent

Advance health care directives must be put in writing. Each state has different forms and requirements for creating these legal documents. Depending on where you live, you may need certain forms signed by multiple witnesses or notarized — or both. Contact an attorney for assistance if unsure of the requirements or the process.

Review your advance directives with your physician and health care agent to be sure you've accurately filled out the forms. Then let all the interested parties — including your attorney, physician, power of attorney agent and family members — know where the documents are located and how to access them.

Can your will be contested?

A no-contest clause can cause beneficiaries to think twice

Your will is meant to ensure that your final wishes are honored. However, it can sometimes be contested, potentially leading to lengthy legal battles and financial disputes among your heirs. Understanding when and why a will might be contested — and how to safeguard your intentions — can help prevent unnecessary complications for your loved ones.

Grounds for contesting a will

Not just anyone can challenge a will. Typically, only individuals with a direct financial interest in the estate have legal standing to contest it. This may include heirs, beneficiaries or those named in a previous version of the will but later removed.

Common reasons for contesting a will include lack of testamentary capacity, undue influence, fraud or the failure to meet legal requirements.

When a will is successfully contested, a judge may declare it invalid in whole or in part. This can result in the estate being distributed according to an earlier will or, in the absence of a valid prior document, under the state's intestacy laws. This process can be both time-consuming and emotionally taxing for all parties involved.

Add a no-contest clause

One way to deter challenges to your will is by including a no-contest clause, also known as an in terrorem clause. It penalizes beneficiaries who attempt to contest your will by disinheriting them if they challenge it and lose. This can be particularly effective in discouraging frivolous claims that could otherwise drain your estate's resources.

Most, but not all, states permit and enforce no-contest clauses. And even if they're allowed, the laws differ — often in subtle ways — from state to state, so it's important to consult state law before including a no-contest clause in your will.

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Some jurisdictions have different rules regarding which types of proceedings constitute a "contest." For example, in such jurisdictions, your heirs may challenge the appointment of an executor or trustee without violating a no-contest clause. In some states where a no-contest clause is generally enforceable, courts will refuse to enforce the clause if a challenger has "probable cause" or some other defensible reason for bringing the challenge. This is true even if the challenge itself is unsuccessful.

Suppose you live in a state in which no-contest clauses are strictly unenforceable. In that case, you might still choose to have one in case you: 1) move to another state that does enforce no-contest clauses, 2) own property — such as real estate — in another state where it's enforceable, or 3) decide to establish a trust that's governed by the laws of another state.

Alternatives to a no-contest clause

While a no-contest clause can be helpful, it's not the only tool to safeguard your estate. A revocable living trust can help avoid probate, making contesting harder. Keeping detailed records of estate planning decisions, including medical evaluations when necessary, can counter claims of undue influence or lack of capacity. Open communications with heirs can prevent surprises and reduce disputes after your passing. Finally, updating your estate plan regularly ensures that it reflects significant life changes such as a divorce, a second marriage or the birth of a child.

Another effective strategy involves neutral third parties, such as a professional fiduciary or corporate trustee, to oversee the distribution of assets. This can help remove potential conflicts of interest and ensure impartiality. Additionally, including a letter of intent to explain your decisions can clarify and reduce misunderstandings among beneficiaries.

Protect your estate planning wishes

Estate planning is complex, and the laws governing wills and no-contest clauses vary by state. Working with an experienced estate planning attorney or CPA can help ensure your estate plan is legally sound and designed to minimize the risk of disputes. Taking proactive steps now can help protect your legacy and provide peace of mind for your loved ones.

ESTATE PLANNING RED FLAG

You own property jointly with your child

There are specific estate planning strategies that, on the surface, may sound appealing. This includes owning property jointly with a child or other family member. However, these techniques can result in unwelcome outcomes that outweigh potential benefits.

To be clear, owning an asset with your child as "joint tenants with right of survivorship" offers advantages. Assets may include real estate, a bank or brokerage account, or a car. When you die, the asset automatically passes to your child without needing more sophisticated estate planning tools or going through probate.

However, owning property jointly with a child or other family member can result in unexpected outcomes. These include:

Transfer tax exposure. Adding your child to your property title may be considered a taxable gift of half the property's value. And when you die, half of the property's value will be included in your taxable estate.

Increase in capital gains tax. As a joint owner, your child loses the benefit of the stepped-up basis enjoyed by assets transferred at death, exposing him or her to higher capital gains tax.

Exposure to creditor claims. When your child becomes a joint owner, the property is exposed to claims from the child's creditors.

Loss of control over the assets. Adding your child as an owner of certain assets, such as bank or brokerage accounts, enables him or her to dispose of them without your consent or knowledge. And joint ownership of real property prevents you from selling or borrowing against it without your co-owner's written authorization.

Unintended consequences. If your child predeceases you, the assets will revert to your name alone, requiring you to devise another plan for their disposition.

Unnecessary risk. When you die, your child receives the property immediately, regardless of whether he or she has the financial maturity and ability to manage it.

The good news is that many of these outcomes can be mitigated or avoided with the help of your estate planning advisor. Using certain trusts may be the answer.

How open dialogue today can head off painful debate tomorrow

A son asks: "Why did my sister receive more than I did?"

A daughter asks: "Why was my brother chosen to run the family business?"

These kinds of uncertainties about your legacy can be avoided if you explain your thinking clearly before you no longer can. How can that be done?

Warren Buffett, billionaire and well-known investor, once wrote "Whether [parents] are of modest or staggering wealth, when your children are mature, have them read your [estate plan]."

This seems simple enough, yet many parents fail to talk to their children about money even as they are growing up. Fewer still discuss estate planning with their kids. According to the "State of Wealth," a 2024 study conducted by Fidelity Investments, more than half of Americans surveyed say their parents never discussed money with them. However, 82 percent of those surveyed say they "wish their parents had."

The goal for bringing adult children into the loop is to ensure they appreciate "both the logic for your decisions and the responsibilities they will encounter upon your death," Buffett explained, according to *Fortune*. Parents should then "listen carefully [to the responses] and adopt those found sensible." Make such reviews and discussions dialogues, especially if your children have a good relationship with each other.

There are exceptions to this general rule, however. For example, the level of transparency may vary when relations with one child are strained, especially if that child is fully or partially disinherited. While building a record of your wishes can help defend your estate plan against future challenges, letting an estranged family member know that they receive nothing would add unnecessary stress to your life. In this case, you may want to consider sharing your plans only with those you most trust. If you are unsure whether you should initiate such a discussion with your family, you are welcome to contact our office to discuss the pros and cons of such a strategy.

While estate and trust planning and administration are not issues of day-to-day living, your decisions in those areas now—and your attitudes—can affect the day-to-day lives of your beneficiaries later. Get in touch with us at any time to talk about questions you have about your plans and how to answer questions others, especially your children, might have.

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