
**FLPs - Don't Leave Home Without One
(But Leave Your Home Outside of it)**

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I. Consider Appropriateness of Partnership

1. Keep your potential future audience in mind

- Consider what you write – *email*, memo to file regarding reasons for partnership formation, time records (for attorneys/accountants), letters, etc.
- The IRS, a judge, or even a jury may eventually be reviewing documents written during the planning stages
- Consider and document all substantive non-transfer tax reasons that fit the situation; avoid a template laundry list

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I. Consider Appropriateness of Partnership

2. Consider whether clients are ready for a partnership

- Sophistication of clients
- Willingness to comply with Partnership Agreement's terms
- Willingness to pay professional fees over time

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I. Consider Appropriateness of Partnership

3. Evaluate potential assets

- "Risky" assets should be segregated from other assets
- No retirement plans, IRAs, etc.
- No stock in S-corporations
- Contributions of stock in closely-held corporations require analysis of § 2036(b)

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I. Consider Appropriateness of Partnership

3. Evaluate potential assets (cont'd)

- Refrain from contributing personal use assets
- Retain enough assets outside Partnership to support lifestyle
- Secure appraisals of hard to value assets
- Review transfer restrictions on assets to be contributed; obtain appropriate consents, if necessary

See, e.g., Estate of Harper v. Comm'r, 83 T.C.M. (CCH) 1641 (2002);
Estate of Strangi v. Comm'r, 115 T.C. 478 (2000), rev'd, 293 F.3d 279 (5th Cir. 2002);
Estate of Strangi v. Comm'r, 85 T.C.M. (CCH) 1331 (2003), aff'd, 417 F.3d 468 (5th Cir. 2005).
See Estate of Stone v. Comm'r, 86 T.C.M. (CCH) 551 (2003).

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I. Consider Appropriateness of Partnership

3. Evaluate potential assets (cont'd)

- Ensure sufficient cash is contributed to the Partnership to fund maintenance of Partnership's real estate or other non-liquid assets
- Consider income tax issues related to contribution of assets subject to debt (margin debt, mortgages, etc.)
- Analyze investment company rules

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I. Consider Appropriateness of Partnership

4. Evaluate potential partners

- Consider whom to involve
- Consider health of partners
- Encourage meaningful contributions by partners

See, e.g., *Estate of Stone v. Comm'r*, 86 T.C.M. (CCH) 551 (2003) (good health);
Estate of Strangi v. Comm'r, 115 T.C. 478 (2000), *rev'd*, 293 F.3d 279 (5th Cir. 2002) (bad health);
Estate of Strangi v. Comm'r, 85 T.C.M. (CCH) 1331 (2003), *aff'd*, 417 F.3d 468 (5th Cir. 2005).
But see *Estate of Bongard v. Comm'r*, 124 T.C. 95 (2005).

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I. Consider Appropriateness of Partnership

5. Engage/consult with advisors who have experience in this area

- Involve attorney/accountant sooner rather than later
- Avoid “kit partnerships”

See *Estate of Strangi v. Comm'r*, 115 T.C. 478 (2000), *rev'd*, 293 F.3d 279 (5th Cir. 2002);
Estate of Strangi v. Comm'r, 85 T.C.M. (CCH) 1331 (2003), *aff'd*, 417 F.3d 468 (5th Cir. 2005).

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II. Partnership Formation

1. Consider separate counsel for some (or all) participants

- Discuss terms of Partnership Agreement
- Read and understand terms of Partnership Agreement

See *Estate of Stone v. Comm'r*, 86 T.C.M. (CCH) 551 (2003).

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II. Partnership Formation

2. Counsel Partners to discuss partnership terms

- management structure
- compensation to be paid to managers
- investment policy
- expected distributions
- transfer restrictions on partnership interests
- term of Partnership

But see Schutt v. Comm'r, 89 T.C.M. (CCH) 1353 (2005).

II. Partnership Formation

3. Ensure that schedules to Partnership Agreement are complete

- Partnership Agreement should accurately set forth assets contributed to Partnership and ownership interests in Partnership

II. Partnership Formation

4. Prepare deeds and transfer documents prior to formation date

- Ensure transfer of title of all assets to Partnership
- Have parties sign transfer documents at the same time as Partnership Agreement and related formation documents
- Ensure that partners own assets to be contributed before Partnership is created

*See, e.g., Senda v. Comm'r, 88 T.C.M. (CCH) 8 (2006), aff'd, 433 F.3d 1044 (8th Cir.);
Shepherd v. Comm'r, 115 T.C.No. 30 (2000), aff'd, 283 F.3d 1258 (11th Cir. 2002).*

II. Partnership Formation

5. Promptly file for Employer Identification Number (EIN)

- Upon receipt of Certificate of Limited Partnership

See Estate of Thompson v. Comm'r, 84 T.C.M. (CCH) 374 (2002).

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II. Partnership Formation

6. Create Partnership bank/brokerage accounts in a timely manner

See Estate of Thompson v. Comm'r, 84 T.C.M. (CCH) 374 (2002).

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II. Partnership Formation

7. Involve an accountant specializing in partnership accounting

- Factors to consider
 - When changes in ownership interests occur
 - When to consider I.R.C. Section 754 elections
 - Protective claims
 - Audit procedures

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II. Partnership Formation

8. Ensure that partners receive interests in the Partnership in proportion to the fair market value of the assets contributed by each to the Partnership

- Correctly reflect the fair market value of the assets contributed in the respective partner's capital account

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II. Partnership Formation

9. Consider amortizing partnership set-up fees

- reimbursement to partner who initially paid

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II. Partnership Formation

10. If necessary, amend Partnership percentages as quickly as possible after formation

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II. Partnership Formation

11. Be prepared to produce documents in your file to the IRS, if necessary

- The best evidence of formation rationale often comes from the correspondence prepared in connection with the transaction
- Assertion of privilege may lead to negative inferences

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III. Partnership Maintenance

1. Consider filing tax returns for each year in existence

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III. Partnership Maintenance

2. File any annual/bi-annual registration statements required by relevant state authorities

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III. Partnership Maintenance

3. Comply with terms of Partnership Agreement

- Are periodic meetings required? At any meeting, consider taking minutes, even if not required by Partnership Agreement
- Are annual statements (other than tax returns) required?
- Are annual distributions required?
- Are payments on preferred interests required?

III. Partnership Maintenance

4. Comply with loan terms, if loans are made

- Generally, beware lending from the Partnership to family members
- Any loans made by the Partnership should comply with the terms of the Partnership Agreement
- Any loans should be properly documented
- Loan terms should be reasonable
- Payments should be made timely

See Estate of Thompson v. Comm'r, 84 T.C.M. (CCH) 374 (2002).

III. Partnership Maintenance

5. Make any distributions pro rata

- Ensure that all distributions are pro rata (proportionate to percentage interests in the Partnership)
- If you discover a non-pro rata distribution, consider a “make-up” distribution, perhaps with interest

III. Partnership Maintenance

6. Refrain from use of Partnership assets for Partners' personal obligations

- Personal use assets
- Partners' expenses
- Estate's needs

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III. Partnership Maintenance

7. If a partner dies or transfers an interest in the Partnership, consider whether to make a Section 754 election

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III. Partnership Maintenance

8. Avoid multiple transactions between partners and Partnership

- loans
- redemptions
- non-regular distributions
- non-pro rata distributions

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III. Partnership Maintenance

9. Review non-tax reasons stated for forming Partnership and follow them

- involvement of family members
- asset management

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IV. Transfers of Partnership Interests

1. Generally

- Ensure books and records of Partnership are in order
- Consider whether transfer triggers any rights of first refusal
- Keep track of changes in partnership interests
- Consider restating schedule or exhibit to Partnership Agreement that indicates ownership interests
- Consider keeping historical spreadsheet showing changes at each transaction

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IV. Transfers of Partnership Interests

1. Generally (cont'd)

- Document the transfer, to be executed by transferor and transferee
- Date the transfer document – effective date vs. date signed
- Review Partnership Agreement to determine how interest is to be valued
- Ensure that changes in percentage interests are reflected in books and records of Partnership
- Ensure that the Certificate of Limited Partnership is amended, if necessary

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IV. Transfers of Partnership Interests

2. By Gift or Sale

- Review Partnership Agreement to ensure compliance with terms
- Refrain from gift planning until Partnership is formed and operating
- Consider income tax issues (on sale)

See *Sendo v. Comm'r*, 88 T.C.M. (CCH) 8 (2006), *aff'd*, 433 F.3d 1044 (8th Cir.).

IV. Transfers of Partnership Interests

3. At Death

- Review Partnership Agreement to determine character of interest passing – general partnership interest, limited partnership interest, assignee interest
- Review transfer to determine whether a lapse occurs under Chapter 14
- Review Partnership Agreement to determine whether Executor steps into the partnership shoes of the Decedent partner

IV. Transfers of Partnership Interests

3. At Death (cont'd)

- Consider maintaining the interest in the hands of the Executor, subject to estate administration, until a closing letter is received from the IRS
- Once IRS closing letter is received, document the transfer, to be executed by executor and beneficiary

IV. Transfers of Partnership Interests

4. By Redemption

- Review Partnership Agreement to ensure that Partnership is not prohibited from redeeming the interest
- Document the redemption, to be executed by Partnership management and the transferring partner
- Ensure that books and records of Partnership reflect decrease to transferring partner's interest and corresponding proportionate increase to all remaining partners' interests

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V. Transfer Tax Reporting

1. Obtain independent appraisal from qualified appraiser

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V. Transfer Tax Reporting

2. Encourage communication among appraiser, client, and advisors

- A good appraisal reflects a high level of communication
 - Bad legal facts + Good appraisal = Bad result
 - Good legal facts + Bad appraisal = Bad result
 - Both scenarios = Unhappy client

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V. Transfer Tax Reporting

3. Confirm with the appraiser the interest to be valued

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V. Transfer Tax Reporting

4. Consider whether to aggregate interests

- Interests held in marital trust may be valued separately

See *Beattie v. Comm'r*, ____ (SLP add here and add to list at end).

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V. Transfer Tax Reporting

5. Provide the appraiser access to client and assistance in due diligence process

- Will ensure that information is accurately conveyed
- May provide unique knowledge of family issues that can impact governance

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V. Transfer Tax Reporting

6. Promote defensibility of valuation reports

- Appraiser should conduct thorough due diligence
- Appraiser should have clear understanding of empirical data
- Appraiser should apply relevant comparative factors

- Appraisal should be well documented
- Appraisal should be readily understood

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V. Transfer Tax Reporting

7. Review appraisal closely for facts

- Distribution policy
- Partnership terms
- Assets
- Cash flow

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V. Transfer Tax Reporting

8. Encourage the client to live by factual information provided to appraiser

- Cash flow, distribution policy, etc.

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V. Transfer Tax Reporting

9. Beware of rounding on appraisals and tax returns

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V. Transfer Tax Reporting

10. Consider IRS Settlement Guidelines

- Goal: Consistency across different jurisdictions
- Issues addressed:
 - Discounts expected for various asset classes
 - Inclusion of assets under I.R.C. Section 2036 or 2038 transfers in gross estate
 - Determination of indirect gifts of assets
 - Applicability of accuracy-related penalties

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VI. Audit

1. Consider bringing in litigation counsel

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VI. Audit

2. Determine whether a document destruction policy exists; if so, suspend

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VI. Audit

3. Consider the burden of proof

- I.R.C. § 7491
 - comply with reasonable requests for documents, information, and interviews
 - maintain required records
 - not a partnership, corporation, or trust

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VI. Audit

4. Consider the impact of privileges

- Attorney-client privilege
- Work-product doctrine
- Tax Practitioner's Privilege – I.R.C. § 7525
- Waiver, generally
- Subject matter waiver

See *United States v. Frederick*, 182 F.3d 496, 500 (1999).

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VI. Audit

5. Consider whether production of privileged information may help your case

- Beware subject matter waiver

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VI. Audit

6. Provide responses to the IRS that are true and correct, to the best of your knowledge

- Be precise

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VI. Audit

7. Keep in mind that anything stated or written at this stage can be treated as an admission

- Anything written to the appraiser or any expert is discoverable
- Educate your appraiser
- Beware spoliation of evidence

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VI. Audit

8. Produce responsive documents in your possession, custody, or control

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VI. Audit

9. Keep careful track of every document and electronic file produced to the IRS

- Bates-label documents; send copy to the IRS

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VI. Audit

10. Understand the IRS's broad subpoena power

- IRC § 7602(a)
- May examine or summon a laundry list of items and people
- For the purpose of "ascertaining the correctness of any return, making a return where none has been made, or determining the liability of any person for any internal revenue tax"
- Subpoena power is subject to privileges

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VI. Audit

10. Understand the IRS's broad subpoena power

Valuation: *Lappo v. Comm'r*, 86 T.C.M. (CCH) 333 (2003)

Valuation: *McCord et al. v. Comm'r*, 120 T.C. 358 (2003)

Defined Value Transaction: *Succession of McCord et al. v. Comm'r*, 461 F.3d 614 (5th Cir. 2006)

Valuation: *Peracchio v. Comm'r*, 86 T.C.M. (CCH) 412 (2003)

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VI. Audit

11. Go easy on process and tough on substance

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VI. Audit

12. File protective claims if necessary

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VI. Audit

13. Keep Partnership in place

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VI. Audit

14. If you're in an audit of an estate . . .

- Refrain from distributing Partnership interests held in the estate to the beneficiaries
- Save any estate audit expenses for deduction at the conclusion of the matter – on Form 4421
 - consider not taking expenses as deductions on estate's 1041s
 - advise Executor to consider keeping track of time spent on estate matters

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VI. Audit

15. Treat informal interviews as depositions

- Prepare witnesses as if for a deposition
- Have a court reporter present
- Conduct interview at advisor's office, rather than client's office

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VI. Audit

16. Treat a protest like a brief

VII. Relevant Cites

2036: *Estate of Bongard v. Comm'r*, 124 T.C. 95 (2005)
Work Product Doctrine: *United States v. Frederick*, 182 F.3d 496, 500 (1999)
Promissory Notes: *Estate of Graegin v. Comm'r*, 56 T.C.M. (CCH) 387 (1988)
Recycling of Value: *Estate of Harper v. Comm'r*, 83 T.C.M. (CCH) 1641 (2002)
2036: *Kimbell v. U.S.*, 244 F. Supp. 2d 700 (N.D. Tex. 2003), ___, 371 F.3d 257 (5th Cir. 2004)
2036: *Korby v. Comm'r*, 89 T.C.M. (CCH) 1150 (2005)
Valuation: *Laplo v. Comm'r*, 86 T.C.M. (CCH) 333 (2003)
Valuation: *McCord et al. v. Comm'r*, 120 T.C. 358 (2003)
Defined Value Transaction: *Succession of McCord et al. v. Comm'r*, 461 F.3d 614 (5th Cir. 2006)
Valuation: *Peracchio v. Comm'r*, 86 T.C.M. (CCH) 412 (2003)
2036: *Estate of Rosen v. Comm'r*, 91 T.C.M. (CCH) 1230 (2006)
2036: *Schatt v. Comm'r*, 89 T.C.M. (CCH) 1353 (2005)
Indirect Gift: *Senda v. Comm'r*, 88 T.C.M. (CCH) 8 (2006), ___, 433 F.3d 1044 (8th Cir.)
Indirect Gift: *Shepherd v. Comm'r*, 115 T.C.No. 30 (2000), ___, 283 F.3d 1258 (11th Cir. 2002)
2036: *Estate of Stone v. Comm'r*, 86 T.C.M. (CCH) 551 (2003)
2036: *Estate of Strangi v. Comm'r*, 115 T.C. 478 (2000)
2036: *Estate of Strangi v. Comm'r*, 293 F.3d 279 (5th Cir. 2002)
2036: *Estate of Strangi v. Comm'r*, 85 T.C.M. (CCH) 1331 (2003)
2036: *Estate of Strangi v. Comm'r*, 417 F.3d 468 (5th Cir. 2005)
2036: *Estate of Thompson v. Comm'r*, 84 T.C.M. (CCH) 374 (2002), ___, *Turner v. Comm'r*, 282 F.3d 367 (3rd Cir. 2004)
IRS Settlement Guidelines: ___

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