

PROTECTING YOUR ASSETS WITH THE FAMILY LIMITED PARTNERSHIP



Are you worried about being sued? Well, you should be. It is reported that there are 18 million lawsuits in the United States each year. However, that isn't the whole story. Have you ever heard of the "deep pocket" syndrome? The deep pocket syndrome means that the person claiming to have been harmed files a suit against anyone even marginally connected with the incident. The list includes the shopper who spilled the milk on the supermarket floor; the employee who failed to clean it up quickly; the supermarket that hired the employee, the designer of the "defective" shelf that held the milk and the manufacturer of the "defective" milk carton are all sued. This kind of lawsuit is done to ensure that the person with the money, or "deep pockets," is covered by the claim for damages.

As you can see, that means there may be as many as 50 or 60 million people who are actually sued each year. What can you do about it? You can create what many consider to be the premiere asset protection entity, the Family Limited Partnership, or FLP.

WHAT IS AN FLP?

An FLP is one of the most popular estate tax and asset protection planning devices. An FLP is simply a limited partnership similar to the real estate or business operating limited partnerships with which many are familiar.

HOW IS AN FLP FORMED?

The estate planning attorney prepares a limited partnership agreement for you. Once the FLP is properly formed, you transfer your business and investment assets into the FLP in return for:

General Partnership Interest — You receive general partnership interests. Generally, you only receive 2% of the total partnership interests in the form of general partnership interests. That means that you control all of the decision making for the FLP's activities. We find that control is very important to our clients.

Limited Partnership Interests — You receive the remaining 98% of the FLP in the form of limited partnership interests. Limited partnership interests do not give the limited partner any rights in partnership income or activities. While the general partners may not treat a limited partner unfairly, a limited partner essentially has no control or rights.

You are now the proud owner of your very own FLP. You are the 2% general partners and control the partnership. Now what happens? You will give your children some of your limited partnership interests. That means that the partnership has partners other than just you.

ENTER THE CREDITOR

If you are successfully sued, all the creditor receives is what is called a **charging order**. A charging order is a judgment against the partner that tells the partnership that any distributions of profit that would otherwise be made to the debtor partner must instead be paid to the creditor. The creditor has no power to interfere in partnership matters. The charging order is a very hollow victory. Because the general partners decide if profit is to be distributed to the partners, the general partners can withhold distributions from all of the partners and the creditor receives nothing.

WHAT DOES THE CREDITOR DO?

Obviously, the creditor does not just go away, but because the charging order provides so little leverage, creditors frequently settle the claim for less than face value. Those who might consider filing a unjustified lawsuit may change their minds when they realize that all they will receive is a hollow charging order.

WHAT HAPPENS TO THE MONEY IN THE FLP?

As general partner, you have complete control and access to the assets and income of the FLP. If you have given your children 10% of the FLP, they are entitled to 10% of any distributions that you decide to make, but they cannot force you to make any distributions.

SUMMARY

A properly designed and operated FLP is a formidable deterrent to unjustified lawsuits and a formidable negotiating advantage against a successful creditor. While an FLP should never be formed to defeat the interests of an existing creditor, the sooner you create your own FLP, the safer your family is from the "deep pocket" syndrome.

Note: If estate tax reduction is one of the other purposes of the FLP, additional restrictions may be required.