PARTNERSHIPS AS A FAMILY PLANNING TOOL

I. What is a Family Limited Partnership?

A family limited partnership (FLP) is a limited partnership, specially designed for members of a family to own, which holds family assets. Which design features a family (and their estate planning counsel) uses or does not use depend on the family's particular situation.

One design feature that is common to all FLPs (and most limited partnerships for that matter) is the use of a limited liability entity as the general partner. There are many reasons for this, primarily involving liability and control issues. The general partner can be a corporation or a limited liability company (LLC). In addition, the corporation or LLC may be formed in a foreign jurisdiction (e.g., Nevada). So, while FLPs usually have entities for general partners, which entity is used and in which jurisdiction it is formed will also depend on the family's particular situation.

II. Reasons to Form a Family Limited Partnership

Purposes that may dictate which design features will be built into a limited partnership are:

III. ASSET PROTECTION

A. Liability Rules Affecting Partnership and Partners

1. Inside Liabilities

Most people are familiar with the protection from business liabilities that a corporation affords its owners. Absent a valid reason to "pierce the veil" of a corporation, a corporation's shareholders have no personal liability for the acts and obligations of the corporation.

A general partnership provides no owner protection for the partnership's liabilities. But, a limited partnership (LP) does for its limited partners (so long as they do not, by their participation in their capacity as limited partners, become liable as a general partner). [A limited liability partnership (LLP) also provides its partners protection from certain of the partnership's liabilities; but this discussion will not attempt to discuss the differences and similarities between an LP and an LLP.]

The general partner's liabilities for the partnership's business activities can similarly be limited by having a corporation, limited liability company (LLC), or other liability limiting entity serve as the general partner.

Thus, an LP can be constructed that provides its owners protection from the business's liabilities in a fashion virtually identical to that enjoyed by corporate shareholders.

2. **Inside Liabilities**

While the creditors of a partnership (whether it is a general or limited partnership) can reach the partnership's assets (and the assets of the general partners if partnership assets prove insufficient), partnership law limits the ability of the creditors of the partners to seek satisfaction out of partnership assets. Normally, a creditor must seek satisfaction of a personal judgment against a partner out of his interest in partnership assets by obtaining a charging order against that interest. The charging order allows the creditor to receive all distributions paid by the partnership on the charged partnership interest. It does not, by itself, however, require the partnership to make distributions, particularly where the partnership agreement does not require the partnership to make those distributions.

To obtain greater rights than merely the receipt of whatever distributions might be made, the creditor must foreclose on the interest. Under partnership law, however, an assignee of a partnership interest, even one who becomes an assignee by judicial foreclosure or other action, does not acquire all the rights of a partner. Under partnership law, he or she may not cause a dissolution of the partnership, even with a court order, unless the partnership is terminable at the will of the partner whose interest the creditor was assigned or, if the partnership is for a term of years or particular undertaking, when the term has expired or the undertaking has been completed.

The tax law treats a partner (and a partner's assignee) little differently from a sole proprietor. All partnership tax attributes are allocated to the partners who report them on their individual tax returns.

B. **Fraudulent Transfer Rules**

One exception to the above described partnership rules takes the form of the fraudulent transfer rules. These rules provide that a creditor can pursue a debtor's assets when they have been fraudulently transferred to another. Thus, if a person made a fraudulent transfer of assets to a family partnership, a partner's creditor could extract those assets from the partnership in spite of the partnership rules regarding debt collection.

1. **Insolvency**

A debtor's transfer is fraudulent on an existing creditor whose claim arose before the transfer if:

- ♦ the debtor made the transfer without receiving a reasonably equivalent value in exchange for the transfer, and
- ♦ the debtor was insolvent at that time or became insolvent as a result of the transfer.[1]

A debtor is considered insolvent if the sum of the debtor's debts are greater than the fair market value of all of the debtor's assets.[2] A debtor's assets do not include property encumbered by a valid lien (to the extent of the lien) and property generally exempted from execution under non-bankruptcy law.[3]

Under these rules, you must be solvent before and after organizing an FLP. If not, your existing creditors may void the transfers to the FLP if they can show that the partnership interest received for the assets was not of reasonably equivalent value to the assets transferred to the partnership. Therefore, you should confirm that you will be solvent before and after organizing your FLP.

2. **Fraudulent Intent**

A debtor's transfer is fraudulent on a creditor whose claim arose within a reasonable time before or after the transfer if:

- ♦ the debtor made the transfer with the actual intent to hinder, delay or defraud his creditors, or
- ♦ without receiving a reasonably equivalent value in exchange for the transfer and the transfer inhibited the debtor's ability to pay debts as they became due.[4]

[1] § 24.006 Tex. Uniform Fraudulent Trans. Act.
[2] § 24.003(a) Tex. Uniform Fraudulent Trans. Act.
[3] § 24.002(2) Tex. Uniform Fraudulent Trans. Act.
[4] § 24.005(a) Tex. Uniform Fraudulent Trans. Act.

The factors used to determine whether a debtor made a transfer with "actual intent" to defraud a creditor include:

- ♦ Whether the transfer was to a related party.
- ♦ Whether the debtor retained control of the property after the transfer.
- ♦ Whether the transfer was concealed.
- ♦ Whether before the transfer was made the debtor had been sued or threatened with suit.
- ♦ Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the assets transferred.
- ♦ Whether the debtor was insolvent or became insolvent shortly after the transfer was made.
- ♦ Whether the transfer occurred shortly before or shortly after a substantial debt was incurred.[5]

Under these rules, it will be extremely difficult for someone with existing debts (or soon to be asserted debts) to avoid or hinder the collection of those debts by organizing an FLP.

3. **Statute of Limitations**

A creditor must generally bring a TUFTA fraudulent conveyance action within 4 years after the transfer occurred.[6]

4. **Conclusion**

The fraudulent transfer rules teach us that if you desire one of the effects of the FLP to be family wealth preservation:

- ♦ you need to form the FLP as soon as possible,
- ♦ you need to be solvent before and after the organization of the partnership, and
- ♦ you cannot use the family partnership to avoid existing or soon to be existing debts.

[5] § 24.005(b) Tex. Uniform Fraudulent Trans. Act
[6] § 24.010 Tex. Uniform Fraudulent Trans. Act.

So, proceed diligently but cautiously.

C. Using the Family Limited Partnership to Preserve Assets from Creditor's Claims

The formation of An FLP can frequently take advantage of the interplay of these various rules. An FLP must be structured to meet the demands of each family's situation. Generally, the structure involves the formation of a limited partnership owned in large part by the limited partners and to a much smaller degree by a corporate or LLC general partner. The partners contribute the assets they desire to protect to the partnership in proportion to their interests in the partnership. The persons with the assets to protect own, in their individual capacity, limited partnership interests. The general partner is at least 35% owned by persons who will not be liable for the debts or liabilities of the persons with the assets to protect.

Because the general partner will have control of the management of the limited partnership (and, therefore, have control of distributions from the partnership, transfers of partnership interests, and the termination of the partnership), you must not allow a creditor to gain voting control over a general partner. For example, the general partner could take the form of an LLC, membership interests of which cannot be voted by assignees, such as creditors or purchasers at foreclosure. Or, if a husband and wife will be the limited partners, their children, or trusts for their children, might own or vote more than 50% of the votes of the general partner. The ownership interests might also be subject to restrictions on transfer and other arrangements limiting the amount of control that may be exercised by third persons or interlopers.

The general partner would have to have enough capitalization to make its own contribution to the limited partnership. The general partner would also have to have enough capitalization to prevent it’s “corporate” veil from being pierced.

The partners would then contribute the assets to be protected to the partnership. The limited partners would contribute their interest in those assets (*e.g.*, family business, investment assets, rental properties, etc.). In exchange, the limited partners would receive a proportionate interest in the partnership equal to the proportionate value of the assets they contribute. The general partner would likewise make a contribution to the partnership and receive a proportionate interest equal to the proportionate value of the assets it contributes. The partnership agreement would call for the partnership to continue for a specified term or undertaking. It would also give the general partner the maximum amount of discretion in determining when to make distributions to the partners and in what amounts. To the extent possible and reasonable, given the family's circumstances, partnership income would not be distributed, but accumulated or paid out to cover management and operating expenses.

The general partner would manage the operations of the partnership and receive a fee for its services. To perform these services, the general partner would employ the family members active in what is now the partnership's business or investment activities.

With this structure, if a limited partner incurs a liability subsequent to the formation of the partnership, his creditor may not seek satisfaction for the obligation out of the assets belonging to the partnership. Instead, the creditor may only proceed against the limited partners' interest in the partnership and/or the general partner. These assets have little or no value before the partnership's termination since the partnership will be making little or no distributions to its partners and the general partner will similarly be making little or no distributions (out of its small share of partnership income) to its owners. The creditors should not be able to force a termination of the partnership.

The general partner may, nevertheless, continue to receive a management fee for operating the partnership. This fee will allow it to continue to pay salaries to the persons it hires to manage the partnership's business and affairs. Therefore, the persons needed to operate the partnership's business and affairs will continue to receive compensation for those services without allowing a partner's or general partner owner's creditors from acquiring the assets owned by the partnership.

Because assignees of partnership interests become taxable upon the income generated by the partnership even if the partnership makes no distributions with respect to that income, an unwary creditor could stumble into a situation where he acquires an interest in a partnership which has no immediate value to him and also must pay tax on the income generated by the partnership without even receiving enough funds to pay that tax liability. This turn of events might allow the partners of the partnership to negotiate an arrangement with the creditor concerning the obligations of those partners.

IV. Estate and Gift Tax Planning

A. Valuation Discounts

FLPs can used to devalue a person's interest in his assets for transfer tax purposes. In valuing a person's assets for transfer tax purposes, the fair market value of the assets owned by the person governs. After the formation of an FLP, however, the asset belonging to the person would consist of a limited partnership interest and, possibly, an ownership in a corporation or LLC which was a general partner of a limited partnership. Just like a corporation, the value of ownership interests in those entities would not necessarily coincide with a proportionate value of the assets owned by those entities. In fact, the value of interests in those entities could be significantly less than the value of the assets belonging to those entities.

The precise nature and the various legal authorities governing the claiming and amount of the various discounts applicable when determining the discounts attributable to an ownership interest in an FLP are numerous and beyond the limited scope of this discussion. What follows is a general discussion of the attributes of an FLP that lead to discounts. However, you must keep in mind that designing (and operating) an FLP in a fashion such that these discounts are available is complicated beyond this brief discussion, and you should not rely solely on this discussion for the availability of valuation discounts for estate and gift tax purposes.

Where a decedent's estate has no right to cause the liquidation of the decedent's interest in a partnership, that interest in the partnership is worth less than the estate's proportionate ownership of the partnership itself. This remains true even when all the other interests in the partnership are owned by members of the decedent's family. Similarly, if a partner's estate cannot force a partnership to make a distribution to it of partnership profits, an interest in a profitable partnership might be worth less than the estate's proportionate ownership of the partnership owning the operations producing the profit (especially where the partnership had a history of not making distributions of profits).

To take advantage of these rules to reduce a person's estate tax liability, a partnership agreement should provide that the partnership will last for a term extending significantly beyond the life expectancy of the eldest generation (*e.g.*, fifty years). The partnership cannot be terminated before the end of that stated term unless all the partners (both limited and general) agreed to terminate the partnership sooner. If a general partner attempted to transfer its general partnership interest, that general partnership interest was converted into a limited partnership interest so the partner could not withdraw from the partnership. Liquidating or significant distributions can only be made upon the unanimous consent of all partners. No assignees of limited or general partnership interests have any rights to vote on the liquidation of the partnership or distributions by the partnership. And, the partnership makes it a practice to reinvest all cash generated to the extent it is not used to pay operating expenses (including management fees).

Under these circumstances, once the partnership is formed, the parent's interest in the partnership is worth significantly less than the assets he or she transferred to the partnership. Because the parent, acting alone, no longer has the power to cause the partnership to liquidate or to make distributions to him or her, that interest has significantly less value to a transferee of the parent than the property contributed by the parent to the partnership (and any subsequent appreciation in the value of partnership assets or businesses). Thus, at any time after forming the partnership, the parent does not have the ability to make a transfer of the interest owned by the parent at the full liquidation value of the partnership. This results in a significant discount for transfer tax purposes.

B. Avoiding Trust Investment Rules

The trustee of a trust must abide by the investment rules that govern trust fiduciaries. The general partner of a limited partnership also owes fiduciary obligations to the other partners. However, the fiduciary investment standards imposed on a trustee of a trust are not as stringent as those imposed on a general partner. A general partner may make reasonable business and investment decisions based on business judgment. Since a trust fiduciary is not generally allowed to operate a business, similar investment or business decisions might not pass muster if made by a trust fiduciary.

C. Asset Management

1. Centralizing Management

The general partner of a limited partnership by law makes all management decisions. Particularly where the general partner is a corporation or manager managed LLC, the partnership's management is concentrated in the hands of the corporation's board of directors and officers or the LLC’s managers and officers.

2. Reducing Operational Costs

Where various family interests are fractured among several different entities and modes of ownership, they may not be able to take advantage of economies of scale available when assets are pooled in a single investment vehicle.

3. Can Make Gifts Without Giving Up Control

An FLP can provide significant transfer tax planning opportunities without requiring the elder generation to give up control over the investment of assets or the use of investment proceeds.

4. Planning Against Incapacity

The general partner of a limited partnership manages the partnership's affairs. If the general partner is a corporation or an LLC, you already have a body of law applicable to run the corporation or LLC (and, therefore, the partnership) if the principal owner of the partnership or general partner becomes incapacitated. You can provide additional planning through a shareholders' agreement for the corporate general partner or the regulations or operating agreement for the LLC general partner that specifies successor management in the case of incapacity.

5. Partnership Continues After Death

A limited partnership is not typically dissolved by the death of a limited partner. If you use a corporate or LLC general partner, a death will not terminate the general partner; so, you will not have a dissolution of the partnership by reason of the termination of the general partner's existence. Thus, the FLP can serve your children's estate planning needs to the same extent it served the yours without any additional complications (except, perhaps, extending the partnership's term, where necessary).

D. Keeping Assets in the Family

1. Buy-Sell Provisions

a) Partnership Level

The partnership agreement may contain transfer provisions that give the other partners (or the partnership) a right of first refusal and that allow the other partners (or the partnership) to acquire an interest transferred voluntarily or involuntarily to a non-family member or other undesirable outsider.

b) **General Partner Level**

Where a corporation serves as the general partner, the shareholders and the corporate general partner can enter into an agreement contain similar rights and restrictions.

2. **Arbitrating Family Disputes**

The general partner of a limited partnership manages its affairs. Limited partnership law limits the input that limited partners have regarding a limited partnership's affairs; and the limited partnership agreement can minimize this control even more. That leaves partnership (and, therefore, asset management) decisions in the hands of the general partner.

The general partner's owners can agree in advance on who will sit on the entity's board. This allows the family patriarch or matriarch to control the partnership's affairs during their lifetime.

On their death, the partnership can be governed according to corporate or LLC law, or the owner's agreement can specify a dispute resolution process. This can take the form of formal arbitration or mediation or of a buy-out provision.

3. **Protection from Failed Marriages**

Gifted limited partnership interests are separate property as are gifted shares in a corporation or interests in an LLC. Thus, divorce will not place interests in the family partnership or general partner into the hands of a family member's ex-spouse.

Additionally, the partnership agreement and any owner's agreement for the general partner may provide a right for the other owners or the entity to buy-back any ownership interests from an ex-spouse on a divorce (or on the death of the family member).

E. **Avoiding Probate**

Since the FLP is specifically designed not to terminate at death, the partnership's assets remain in the partnership at death. Thus, the assets placed in the limited partnership no longer require probate proceedings at death to pass title. The assets subject to probate are an interest in the limited partnership and an interest as or in the general partner. These assets are personal property, subject to probate in the decedent's state of domicile. Thus, probate becomes greatly simplified.

If the client owns real estate in many different states and that real estate is placed in one or more limited partnerships, you have avoided probating those assets in states other than the decedent's domicile.

F. **Simplifying Annual Giving**

Upon formation of the FLP, all (or most) of the family's assets are held in the form of interests in the limited partnership or interests in the general partner. These property interests may be transferred with an assignment and (before the assignee is approved as a limited partner) a consent to substitution of the assignee as a limited partner. The transfer is then reflected on the partnership's records. Nothing more need be done.

You may be able to use a formula gift to make sure that the gift does not exceed the annual exclusion. Recent case law affects the use of the annual exclusion on gifts of limited partnership interests; so, you should consult with us before you actually make an annual exclusion gift of partnership interests.

G. **Flexibility**

Many estate planning techniques involve "irrevocable" actions: ILITs, outright gifts, or other irrevocable trust techniques. The FLP may be revoked (provided you can get the family and non-family members to agree to liquidation). In addition, partnerships, in general, are highly flexible vehicles. You can usually liquidate a partnership in-kind without incurring an income tax cost. This is not true of corporations.

H. **Charitable Giving Tool**

Limited partnership interests may be given to charitable beneficiaries without giving up any significant control over partnership operating decisions. In fact a charitable owner can serve as a non-family member owner to better assure asset protection and discounts. Thus, making a charitable beneficiary a partner in a family partnership can fit quite nicely into both a client's transfer tax planning and charitable giving.

V. **Income Tax Planning**

A. **General Income Tax Rules.**

1. **Taxation of Partners, not Partnership**

A partnership is not subject to federal income tax. Rather, its partners and their assignees are liable for federal income tax in their separate capacities. Thus, each partner and assignee will take into account in computing his federal income tax liability each year his share of all Partnership income, gain, loss, deduction, credit, and tax preference (or item thereof), without regard to whether he has received or will receive any distribution from the partnership and without regard to any contributions made or to be made by him to the partnership. Accordingly, a partner or his assignee can receive an allocable share of taxable income or gain from the partnership that must be reported on his personal income tax return without receiving any distribution from the partnership with which to pay the tax. For example, even if the partnership retains income as working capital or for additional acquisitions or uses it to repay partnership debt, a partner or assignee must report his full distributive share of all partnership income (including the income retained as working capital or used to repay the debt).

The taxable income of the partnership will be computed as if the partnership were an individual; but items which may affect a partner's tax liability are separately stated rather than aggregated with the other items used to compute the partnership's taxable income. Elections affecting the computation of taxable income derived from the partnership will be made by the partnership. Thus, each partner will have allocated to him his share of the partnership's net income or loss computed under the partnership's method of accounting, taking into account any partnership tax election. Each partner's share will be computed using the allocation provisions of the partnership Agreement. Similarly, each partner will have allocated to him an equivalent share of any partnership items that must be accounted for separately.

The partnership's net income or loss and its items of income, gain, loss, and deduction will be characterized for federal income tax purposes at the partnership level. The character of income, gain, loss, and deduction can affect its treatment under federal income tax laws. For example, a taxpayer can currently deduct loss from a passive activity only from net income from other passive activities. Similarly, a taxpayer may deduct losses attributable to investments that generate investment or portfolio income only from investment or portfolio income. Additionally, a taxpayer may deduct capital losses only from capital gains and $3,000.00 per year of ordinary income and gains. Thus, the circumstances in which the partnership's net income or loss or other tax items arose will have a bearing on each partner's computation of his tax liability.

2. **Importance of Partnership Classification.**

The highest tax rate imposed on corporations exceeds the highest tax rate imposed on many individuals. Therefore, while partners will be responsible for paying the tax liability of the partnership, the taxes paid by the partners will, in many instances, be less than the taxes that would be imposed if the activities were conducted through a corporation paying taxes at the highest corporate income tax rate. Additionally, as a partnership, not a corporation, the income will be taxed only to the partners without first being subject to an entity level income tax.

3. Passive Loss Rules.

Limited partners are presumed to have passive interests in a limited partnership, generally causing all income and loss allocated to the limited partner to be classified as passive. This presumption may, however, be overcome where the limited partner spends more than 500 hours participating in the partnership's business, has materially participated in the partnership's activity for 5 out of the last 10 years, or has participated at any time during the last 3 years if the partnership's activity involves providing personal professional services.

4. **Distributions in Partial Liquidation.**

Generally, a partner will not recognize gain or loss for federal income tax purposes upon the receipt of a cash distribution from a partnership, although the distribution will reduce (but not below zero) the basis of his interest. Cash distributions in excess of basis, will result in the recognition of gain, which gain will generally be taxable in accordance with the rules governing a sale of a partnership interest.

5. **Liquidation of the Partnership.**

In the event of the liquidation of a partnership, the partners will continue to be allocated, and will pay tax on, any partnership income or gain during the taxable year of liquidation. The income or gain, as well as any other separately stated partnership income, gain, loss, or deduction (or items thereof) will be reflected in the partners' capital accounts and will cause an adjustment to the basis of their partnership interests.

Generally, a Partner will not recognize gain or loss upon the receipt of a liquidating distribution from the partnership. There are, however, numerous exceptions to this general rule. For example, if some of the assets of the partnership to be distributed consist of unrealized receivables or substantially appreciated inventory items and the distribution of those receivables and items is not made proportionately to all partners according to their capital interests in the partnership, the distribution will be treated as a sale of those items by the partnership, which sale may give rise to ordinary gains to the partnership and its partners.

Gain may also be realized to the extent that the cash received by a partner in liquidation exceeds the partner's tax basis for his Interest in the partnership at the time the distribution is made. Reduction in the amount of a partner's share of partnership debt is treated as a distribution of cash to the partner and may result in the recognition of a gain on the liquidating distribution without the receipt of any property with which to pay the resulting taxes. That gain would be capital gain, except to the extent treated as ordinary income because attributable to the partner's share of the partnership's "unrealized receivables" and "substantially appreciated inventory items".

Capital loss will be recognized in the event only cash, inventory items, and unrealized receivables are distributed, and only to the extent the adjusted basis for the partner's interest in the partnership exceeds the sum of money distributed and the partner's acquired basis for unrealized receivables and inventory items. Because of the restrictions on the deduction of capital losses, any capital loss recognized by a partner on liquidation of the partnership might not be available to offset gain recognized on sale of partnership property, to the extent any of that gain was treated as ordinary gain, or to offset any income from operations in the year of liquidation.

The basis of property distributed by the partnership to a partner in liquidation will be equal to the adjusted basis of the partner's interest in the partnership reduced by any money distributed in the liquidating distribution, except that unrealized receivables and substantially appreciated inventory may have a carryover basis. Where a partner receives a distribution of property from the partnership which is an unrealized receivable or an inventory item in the hands of the partnership, any gain or loss recognized by the partner on the disposition of that property is to be treated as ordinary gain or loss; except that in the case of distribution of inventory, this rule applies only for sales made within five years from the date of the distribution.

It might appear that all the various rules substantially restrict the ability to make liquidating distributions on a tax free basis. In practice, however, these rules have limited applicability and can frequently be avoided with proper planning. Therefore, a partnership also provides a unique vehicle for income tax planning and can allow liquidating distributions of partnership assets among partners on a tax-free basis. This can prove extremely advantageous to persons who have made their children their partners and later decide to retire from the partnership. The retirement can frequently be structured to provide a retirement income from the income generated by property distributed from a partnership the receipt of which is not taxed.

B. **Income Tax Planning Opportunities**

1. **Rate Splitting**

Each partner of a partnership is allocated his, her, or its proportionate share of partnership income. Each partner has his, her, or its own tax rate schedule. Thus, where various family members have differing income tax rates, the family partnership provides a means to allocate taxable income away from the higher bracket members to the lower bracket members. Also, where the general partner is a taxed as a corporation, you can also take advantage of its ride up the corporate tax rate brackets.

2. **Employee Benefits**

If you use a general partner that is a taxable corporation that employs various family members to manage and operate the partnership's affairs, you may provide the employees with various employee benefits. Generally, the employer may deduct employee benefits provided employees; but the employees do not have to include the benefit provided in their taxable income until they actually receive a benefit payment.

a) **Pension Benefits**

The general partner could adopt a pension plan for its employees. Pension plans containing ERISA governed trusts cannot be seized by the employer's or employees' creditors. Thus, a pension plan may provide asset protection for the assets it places in the plan in addition to the income tax benefits provided it and its employees.

(1) **Defined Benefit Plans**

This type of plan promises to pay an employee a benefit determined, usually under a formula, on the employee's retirement. Thus, contributions to the plan depend on actuarial computations of the amount necessary to provide that benefit.

These types of plans may provide a pension benefit with a current value in excess of $1.2 million. Thus, more than $1.2 million may be contributed to the plan in a tax deductible manner.

(a) **Pension Plan**

Typically, these types of plans are referred to as pension plans.

(2) **Defined Contribution Plans**

This type of plan promises to pay into an account, established on the employee's behalf, a determinable contribution, usually computed under a formula. Thus, contributions to the plan are fixed and the amount the employee receives at retirement depends on the value of the employee's account at retirement.

These types of plans are subject to limits on amounts that may be contributed each year; and employees are limited in the amounts of contributions that can be made on their behalf each year in a tax free manner.

(a) **Profit Sharing Plan**

This is the most popular form of defined contribution plan because it allows the employer the flexibility to decide each year how much to contribute to the plan.

(b) **Money Purchase Plan**

This plan imposes on the employer an obligation to contribute a fixed percentage of employee salaries each year. It is not quite as flexible as a profit sharing plan, but provides employees more security that something will be put aside for their retirement each year. With the new limits on salary that can be taken into account for determining contributions to defined contribution plans, you will see many employers adopting both a profit sharing plan and money purchase plan.

(c) **ESOP**

This plan is a profit sharing plan that invests principally in employer stock. Employers can contribute their stock to the plan, obtaining a tax deduction without a drain on cash. ESOPs may also purchase employer stock on extremely favorable tax terms to the employer and the selling shareholder.

b) **Welfare Benefits**

Welfare benefits encompass all benefits an employer may provide other than pension benefits. Typically, they would consist of some combination of the following.

(1) **Health Insurance**

An employer may provide its employees with health insurance benefits in a tax favorable manner. In effect, 100% of the premiums get deducted and employees include no amounts in their taxable income.

(2) **Medical Reimbursement**

If the employer complies with certain non-discrimination rules, it can not only provide health insurance to employees, it may pay all of its employees' medical expenses, taking a deduction for amounts it spends with no inclusion in the employees' taxable income.

(3) **Disability**

Disability insurance may be provided by an employer on the same basis as medical insurance.

(4) **Life Insurance/Death Benefits**

An in depth discussion of these benefits is beyond the scope of this outline. So, simply note that an employer can provide group-term life insurance, split-dollar coverage, and other forms of insurance and death benefits in a tax favorable manner.

(5) **Other Benefits**

Also beyond the scope of this outline; but, remember that there are numerous employee benefits that might also be provided in the proper circumstances.

VI. SUMMARY

To summarize, partnerships, particularly "family limited partnerships," are magnificent planning tools. Properly structured and used, a partnership, particularly a limited partnership, can provide protection against future creditor's claims and be a powerful tax saving and family and estate planning tool.