

CARE AND FEEDING OF FLP'S, WHAT NOW?

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**ADVANCED TAX LAW COURSE
September 18 – 19, 2003
Dallas, Texas**

Chapter Three

The information set forth in this outline should not be considered legal advice, because every fact pattern is unique. The information set forth herein is solely for purposes of discussion and to guide practitioners in their thinking regarding the issues addressed herein. Nonlawyers are advised to consult an attorney before forming limited partnerships.

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I. INTRODUCTION.

For many years, the family limited partnership has been used as a vehicle to own and manage family property or family business enterprises in a custom designed entity to fulfill the family's desires. In the past few years, the family limited partnership has come under intense scrutiny from the IRS as they view the family limited partnership as primarily a discount tool for the estate planning practitioner. Due to the focus by the IRS and practitioners on the discounts in family limited partnerships it has become increasingly important for practitioners and clients to properly maintain family limited partnerships by observing the formalities of the partnership and truly treating it as a viable operating business entity. As outlined below, there are several key aspects that should be observed and maintained to protect the viability of an operating family limited partnership and to prevent its existence from being disregarded by the IRS and the courts. These aspects also reflect the specific information and documentation often requested by the IRS in the course of an estate tax audit. (*See Attachment #1.*) It is clear from these questions that, in order to give your client the best chance of success, the formalities of the partnership need to be observed, multiple business purposes for the formation/operation of the partnership should be established and the client should operate and manage the partnership in a professional manner as he or she would their other entities. **However, *Strangi v. Comm'r* (TC Memo 2003-145) now raises serious questions as to whether gifts of limited partnership interest will be respected and not included in the decedent's estate under Section 2036(a) even in the situation where the client has done a perfect job of following the partnership formalities in formation and operation.**

II. FORMATION ISSUES.

A. Compliance with Filing Requirements:

1. A limited partnership should file a certificate of limited partnership with the applicable Secretary of State's office prior to commencing business or funding the partnership. (*See* Section 2.01 of the Texas Revised Limited Partnership Act "TRLPA"). Additionally, if the limited partnership is engaged in business in another state, the limited partnership should register as a foreign limited partnership in the applicable state.
2. A federal tax identification number for the partnership must be obtained upon formation by filing IRS Form SS-4.

B. Partnership Agreement Among the Partners:

The partners should enter into a written limited partnership agreement to govern the terms of their relationship. The limited partnership agreement should contain certain key provisions, including but not limited to, setting forth the partnership interests of the partners (general and limited), the required capital contributions of the partners, the term of the partnership, management and voting issues with respect to activities of the partnership, transfer and buy/sell restrictions regarding partnership interests and withdrawal rights of a partner. Each partner should sign the partnership agreement. Additionally, if buy/sell restrictions are to be applicable to a spouse's interest, a spousal consent should be signed by the applicable spouse.

C. Bank Accounts/Brokerage Accounts:

The general partner should open an account in the name of the partnership with the cash contributed to the partnership at the time of its formation. Additionally, in the event the limited partnership will hold publicly traded securities, the applicable broker should open

up a brokerage account, separate from the partners, for the limited partnership to hold the publicly traded securities.

D. Following Formalities of the Partnership Agreement and State Law:

1. All of the partners should contribute their capital when, and in the amount, required under the partnership agreement. As a general rule, a partner's contribution of capital should match up with how the partners are allocated profits and losses under the partnership agreement.
2. If a partner is transferring real estate subject to a lease to a partnership, the lease must be amended or assigned so as to reflect the partnership as the lessor. Furthermore, a partnership that receives a contribution of real estate from its partner(s) should properly document such transfer by executing warranty deeds and filing the deeds in the deeds records of the applicable county clerk's office.
3. If the property contributed to the partnership is agricultural use property and has previously received an agricultural use exemption, a new agricultural use exemption application needs to be filed by the partnership. The new application must be filed by the partnership prior to May 1 of the year following the year the partnership received the property. The application must be filed with the chief appraiser for the appraisal district where the property is located. (*See* Section 23.43 of the Texas Tax Code.)

E. Business Purpose.

While the IRS has been unsuccessful in attacking limited partnerships for a lack of business purpose, it is unknown what impact strong business purposes will have on the IRS's handling of a case and the court's decision involving other legal issues. It is recommended that the practitioner and his or her clients develop a plan for the partnership that is consistent with normal third party or business operational issues. This can include purposes such as combining fractional interests of real estate, obtaining limited liability from real estate ownership, or combining investment assets of multiple parties to obtain better diversification and/or availability of professional investment managers. Most of these items can be documented in correspondence between the legal counsel and his or her client, as well as meetings of the partners regarding the operations of the partnership. Annual partnership planning meetings can serve as a useful tool for the partners' reviewing, documenting and implementing the business plan and purposes that were expressed prior to the formation of the partnership.

F. Distribution Plan.

If it is anticipated the partnership will be making distributions to its partners shortly after the formation of the partnership, the distribution plan should be discussed by all parties prior to the formation of the partnership and structured as one of the overall purposes of the partnership.

G. Contributions by Other Partners.

Contributions by other family members (or third parties) of more than nominal amounts add credibility to the structure of the partnership. Contributions by children, children's trusts, or grandchildren's trusts, to an investment partnership of the parents in order to take advantage of professional money managers makes good business and investment sense. A partnership is about multiple people coming together with a common purpose to pursue business or investment activities. Having multiple partners contribute to the partnership is consistent with that philosophy.

H. Percentage of Assets Transferred to Partnership.

In some of the cases discussed later in this outline, substantially all of the assets of the decedent were transferred to a partnership and sometimes, the decedent has no control over the right to withdraw the assets. In the real world, how many 70 and 80 year old people would transfer almost all of their assets to an entity that has a term 20 to 30 years past their life expectancy and in which they did not control the right to withdraw the assets? Sufficient assets should be maintained outside the partnership in order to duly provide security and income to the client. Additionally, personal assets should not be transferred to a partnership. In both *Harper* and *Strangi* (discussed in **Article IV** below) the court commented on the fact that 94% and 98%, respectively, of the decedent's assets were transferred to the partnerships. In both cases, this was one of the factors that influenced the court of the decedent's retention of control over the assets for Section 2036 purposes.

III. OPERATION ISSUES.

A. Partnership Formalities.

1. General Operational Issues.

- a. The partnership bank account should be used in the partnership's operations to deposit income earned by the partnership and to pay partnership expenses. Partnership income should not be deposited in the individual partner accounts and personal expenses of a partner should not be paid by the partnership out of its funds.
- b. The general partner should review and abide by the provisions of the partnership agreement concerning management responsibility.
- c. Prior to taking substantial and unusual actions on behalf of the partnership, the partners should discuss the transaction at a meeting (including the limited partners), and such meeting should be evidenced by partnership meeting minutes. The transaction could involve the borrowing of a substantial amount of money or the selling of a valuable piece of real estate. Additionally, where a vote of the limited partners is necessary, the voting requirements of the partnership agreement should be complied with by the general partner.
- d. An annual informational meeting of all of the partners of the limited partnership is recommended. If the limited partnership has a corporation or a limited liability company that is a general partner, such general partner should have meeting minutes pertaining to acts that it, as a general partner, will perform on behalf of the limited partnership.
- e. The limited partnership should keep and maintain its records at its principal place of business. (*See* TRLPA Section 1.07(a).) Any partner or assignee of a partnership interest may, on written request stating the purpose, examine and copy the applicable records. (*See* Sections 1.07(d) and (e).)

f. For example:

“FOUNDER FAMILY INVESTMENTS, L.P.

By: _____
James Founder, President of Founder Management, LLC,
General Partner”

- g. The general partner should carefully follow the terms of the partnership agreement relating to distributions. As a general rule, distributions should be distributed pro-rata. If there are uneven distributions, the capital accounts of the partnership will not match the profit and loss allocations, and the IRS may attempt to recharacterize such transactions as a deemed gift of proceeds from one partner to another.
- h. If the real estate or other assets of the partnership are used by a partner or other family member, such use should be documented by a lease or other occupancy arrangement. The lease should be at fair market value and the rent and other terms of the partnership should be complied with like any other third party.

2. Tax and Bookkeeping Compliance:

- a. Annually, the partnership must provide to each partner, information necessary to complete such partner’s federal income tax return, i.e. the partnership must provide an IRS Form K-1 to each partner.
- b. Annually, the partnership must complete and file a partnership tax return (IRS Form 1065) on or before the 15th day of the 4th month following the date its tax year ends (i.e. April 15 for calendar-year partnerships).
- c. As a general rule in a family limited partnership, the income should be allocated in accordance with partnership capital. In the event there is a special allocation in the partnership agreement, the allocation should be reviewed carefully by the accountant and/or practitioner for the partnership. IRC Section 704(e)(2), applies to family partnerships where a gift of limited partnership interests has taken place and provides that the amount of the individual’s distributive share of the partnership income is subject to two restrictions: (1) the donee’s share must be determined by the allowance of reasonable compensation for the donor’s services rendered to the partnership; and (2) the share of the income allocated to the donee must not be proportionately greater than the share of the donor attributable to the donor’s capital. The effect of this rule is to limit income allocated to the donee to that earned by his share of the capital. Thus, the partnership’s total income should first be reduced by reasonable compensation for the donor partner, if applicable, and then the remaining income can be allocated among the partners in proportion to their capital accounts.
- d. Partnership accounting records must be kept on behalf of the partnership. Depending on the size of the partnership, financial statements should be prepared at least annually and in many situations, quarterly. Additionally, the partnership’s accountant should keep track of each partner’s capital accounts, distributions of capital and allocation of profits.

3. Miscellaneous Formalities:

- a. The partners should avoid co-mingling of personal assets with partnership assets.
- b. The partners should not borrow money from the partnership or loan money to the partnership without signing a promissory note and complying with the terms of the partnership agreement and the applicable state law.
- c. The partnership should not guarantee or pledge business assets of the partnership for personal obligations of the partners. However, if a guarantee or pledging of partnership assets on behalf of a partner is undertaken, all of the partners should consent to such action taken by the partnership. Furthermore, the partnership should receive a fee, i.e. a guarantee fee, from the applicable partner for such partnership services.
- d. In the event the partnership is operating under an assumed name, the partnership should file an assumed name certificate with the Secretary of State's office and with the county clerk of the county in which the partnership's principal office is located.
- e. Partnership stationery (reflecting the partnership's legal name) should be prepared and used in the business operations of the partnership.
- f. In the event the Partnership has multiple limited partners, consider quarterly or semi-annual reports to the limited partners to update them on actions taken, business plan revisions and ongoing partnership philosophy.

B. Gifts of Partnership Interest/Proper Documentation.

If senior members of a family desire to transfer a limited partnership interest to their descendants or trusts for descendants, such gift should be properly documented as to the amount of the gift and the date of the gift.

The documents that should be prepared to reflect the gifts of limited partnership interest by the limited partners are as follows:

1. An assignment document to reflect the amount of limited partnership interest being assigned by the donor to the applicable family members. Such assignment document should be dated and signed by the applicable donor. (*See Attachment #2.*)
2. An acknowledgment signed by the donee accepting the limited partnership interest and agreeing to accept and abide by the terms of the applicable partnership agreement. (*See Attachment #3.*)
3. In the event the partnership interest being transferred is an assignee interest and the applicable partners of the partnership agree to admit the assignee as a substituted limited partner, the applicable consenting partners should sign an acknowledgment to that effect. (*See Attachment #4.*)
4. The partnership agreement should be amended to reflect the new limited partners and the partnership interest adjustments resulting from the gift of a limited partnership interest. One method to simplify amending an agreement when

partnership interests change by reason of gifts, etc., is to provide in the partnership agreement that an Exhibit will be prepared and signed by all of the partners if the partnership interests change. (See **Attachment #5**.)

C. Death of an Individual General Partner.

Upon the death of an individual general partner of a family limited partnership, certain issues must be reviewed and dealt with by the practitioner. The issues to be addressed include:

1. Does the death of an individual general partner cause the dissolution of the limited partnership under state law?

TRLPA Section 8.01(3)(A) provides that, if upon an event of withdrawal of a general partner, i.e., death, there remains at least one general partner and the partnership agreement provides that the business of the limited partnership shall be carried on by the remaining general partner(s), the partnership shall continue. In the event after the death of an individual general partner, there is no remaining general partner, or the partnership agreement does not provide for the continuation of the partnership after the death of an individual general partner, all of the remaining partners (or the percentage specified in the partnership agreement) may agree in writing to continue the business of the partnership. Additionally, if there is no remaining general partner, the remaining partners must agree to the appointment of a new general partner(s). Such reconstitution must be done within ninety (90) days after the event of withdrawal, i.e. death, of the individual general partner.

In the event there is no remaining general partner after the death of the general partner, or the partnership agreement does not provide for the continuation of the business of the partnership after the death of the general partner, the partnership should be reconstituted so that proper discounting, i.e. lack of marketability and minority interest, may be taken regarding the valuation of limited partnership interest that is attributable to the deceased partner. Partnership meeting minutes should be prepared to evidence the reconstitution of the partnership and the appointment of the new general partners, if applicable, and the minutes should be signed by the partners whose consents are needed to reconstitute the partnership. If there are several general partners the family partnership agreement should provide for an automatic reconstitution.

2. Upon the death of a general partner, what happens to the deceased partner's general partnership interest?
 - a. For simplification purposes, the partnership agreement should provide that such deceased partner's general partnership interest should be converted to a limited partnership interest. If the partnership agreement does not provide for such result, TRLPA Section 6.02(b) provides that the remaining general partner(s), or if there are no remaining general partners then the limited partners may, at the option of a majority in interest of the limited partners in a vote that excludes any limited partner's interest held by the withdrawing, i.e. deceased, general partner:
 - i. Convert the general partner's interest to that of a limited partner;
or

- ii. Pay the withdrawn general partner in cash, or a secured bond approved by the court, the value of the deceased general partner's partnership interest.
 - b. If the partners vote to convert such general partnership interest to a limited partnership interest pursuant to the Texas Revised Limited Partnership Act, or the partnership agreement provides that the general partner's partnership interest converts to a limited partnership interest, certain documents will need to be prepared.
 - i. An amendment to the partnership agreement reflecting the conversion of the general partnership interest to a limited partnership interest. (See **Attachment #6.**)
 - ii. An amendment to the certificate of limited partnership, which will need to be filed with the applicable Secretary of State's office to reflect the new general partners of the limited partnership.
- 3. If a new general partner is appointed by vote of the partners or is named as a successor general partner in the partnership agreement, how will the new general partner acquire his general partnership interest?
 - a. In the event the new general partner is an existing limited partner, such partner could convert a portion of his limited partnership interest, i.e. one percent (1%), to a general partnership interest. Another method to acquire the general partnership interest is by a direct contribution of capital to the partnership equal to one percent (1%) of the value of the underlying assets of the partnership.
 - b. In either situation, the partnership agreement would need to be amended to reflect the new general partner in the manner outlined in **Section II.C.2** above. The new general partner should also evidence his agreement to abide by the terms and conditions of the partnership agreement in the amendment.
 - c. Finally, as mentioned above, any change in the general partners of a partnership requires the certificate of limited partnership to be amended and filed with the applicable Secretary of State's office. If a new general partner is needed, consideration should be given to adding a corporation or a limited liability company as a general partner for continuity purposes. Furthermore, in the event an individual general partner dies and there remains only one individual general partner, consideration should also be given to adding a new general partner (preferably an entity) so that the partnership may continue if the remaining general partner dies.

IV. RECENT IMPORTANT CASES.

A. Formation Cases

- 1. *Church v. U.S.*, 85 A.F.T.R. 2d 2000-804 (W.D. Tex., January 18, 2000); *aff'd*. 268 F.3d 1063 (July 18, 2001). The *Church* case involved a limited partnership in Texas. Mrs. Church died on October 24, 1993, "at the age of about 72." In October of 1993, Mrs. Church and her two children signed a partnership agreement which resulted in the formation of a Texas limited partnership. The

purpose of this partnership was to consolidate the undivided interests in the family's ranch and to protect Mrs. Church's assets from judgment creditors in the event of a catastrophic tort claim against her. Mrs. Church served as a limited partner in the partnership. The family LLC, which was owned 50-50 by her children, was designated as the general partner of the limited partnership, even though it had not been formed as of the date of the partnership agreement. Each limited partner contributed its interest in the ranch. Additionally, Mrs. Church contributed approximately \$1,000,000 in securities that were held in a brokerage account. The partnership agreement allocated the profits and losses of the ranch operations in proportion to the interest contributed by the limited partners. However, 99% of the taxable income from the securities was specially allocated to Mrs. Church after expenses. The limited partners conveyed their interest in the ranch to the partnership pursuant to Special Warranty Deeds signed on October 22, 1993. Mrs. Church's son assigned her securities to the partnership under power of attorney that she had executed in 1992. Two days after the transactions, on October 24, 1993, Mrs. Church died suddenly and unexpectedly of heart failure, although she had been diagnosed in 1990 with breast cancer. The finalization of the partnership formation was not completed prior to Mrs. Church's death. Indeed, the Certificated of Limited Partnership was not filed until October 26, 1993 and the corporate general partner of the partnership was not actually organized until March 1994. Even given the fact that the partnership formation was not finalized by the time of Mrs. Church's death, the court determined there was a business purpose for the partnership, namely, the desire to preserve the family ranching enterprise. The court determined that Mrs. Church's death was largely irrelevant in the outcome of the case. The court's opinion reflects several factors that went into the determination that her death was unexpected, including the fact that she was "living a normal life at the time of her death" and that she had "purchased new clothing before her death, which is not the act of one on her deathbed." The court determined that Section 2036 and 2038 did not apply to this case as "there was no gratuitous transfer in the formation of [the limited partnership]." Additionally, the court determined that Mrs. Church did not own the assets she contributed to the partnership on the date of her death, instead she held a partnership interest. As no valuation evidence was presented by the IRS at the trial, the court accepted the estate's valuation (a discount of over 57%) and determined that the estate was entitled to a refund of the additional estate taxes paid after notice of deficiency from the IRS. The 5th Circuit affirmed this decision without a written opinion in July 2002.

2. *Shepherd v. C.I.R.*, 115 T.C. 376 (October 26, 2000), *affd.* 283 F.3d 1258 (February 28, 2002), *reh'g denied*, 2002 WL 1277034 (May 20, 2002). The *Shepherd* case deals with family partnership issues in the gift tax context rather than the estate tax context. Though dealing with a general partnership, the *Shepherd* case offers guidance on important formation issues for all partnerships, limited or general. Mr. Shepherd transferred stock and a 100% fee interest in timber land subject to a long term lease to a newly formed family partnership of which he was a 50% owner and his two sons were each 25% owners. On August 1, 1991, Mr. Shepherd executed the partnership agreement. On August 2, 1991, his sons executed the same document, which created a general partnership under Alabama state law. In the partnership agreement, Mr. Shepherd was listed as the managing partner. Furthermore, the partnership's net income and losses were to be shared 50% by Mr. Shepherd and 25% by each of his sons in accordance with their partnership interests. On August 1, 1991, Mr. Shepherd and his wife executed two deeds to transfer the leased land into the partnership. On August 30, 1991, the deeds conveying the lease land to the partnership were recorded. On September 9, 1991, Mr. Shepherd transferred the stock into the partnership. His two sons did not make any contributions to the partnership.

Mr. Shepherd filed a 1991 gift tax return reporting gifts to his two sons of interests in the leased land and bank stock taking a 15% minority discount of the unified credit. The IRS determined instead there was a deficiency in the appraisal report, valuing the land interest transferred \$239,000 higher than as reported, resulting in a gift tax deficiency of over \$160,000.

Mr. Shepherd argued that his gifts to his sons were not completed before August 2, 1991 and that the gifts of the interests in land represented two separate gifts of minority partnership interests and that the stock gifts constituted indirect enhancement of those partnership gifts. Consequently, Mr. Shepherd felt a thirty-five percent (35%) marketability and minority discount should be applied and that his gifts, as reported on the gift tax return, were actually overvalued. While agreeing with the petitioner that the gift was not completed until August 2, 1991, the court disagreed that the gifts of stock and leased land represented two separate gifts of minority partnership interest, determining that such a result “would require [the court] to recognize the existence . . . of a one-person partnership.” Instead, the court determined that the property transferred was an interest in land and bank stock rather than a partnership interest and that these transfers were indirect gifts to the sons even though the transfer was made to the partnership. In the end, the court allowed a fifteen percent (15%) discount on both the land and stock transferred.

B. Operational Cases.

1. *Schauerhamer v. C.I.R.* T.C. Memo 1997-242 (May 28, 1997). The decedent, Mrs. Schauerhamer and her husband, together with their three (3) children, jointly managed a closely-held company in Utah. In 1983, when her husband passed away, Mrs. Schauerhamer took over the business and managed the rental properties. In November 1990, Mrs. Schauerhamer was diagnosed with colon cancer; the next month she met with an attorney regarding restructuring her business affairs. On December 31, 1990, Mrs. Schauerhamer again met with the attorney to discuss her business affairs and at that time executed multiple limited partnerships. On May 13, 1991, the Certificate of Limited Partnership for these partnerships were filed with the Utah Department of Commerce. For each of the partnerships Mrs. Schauerhamer created, she served as the general partner together with one of her children and held a limited partnership interest as well. She was also named the managing partner for all three partnerships. On December 31, 1990, Mrs. Schauerhamer transferred some of her business assets to the partnerships and executed thirty-three (33) assignments of limited partnership interests, eleven (11) per partnership. On January 1, 1991, she executed an additional thirty-three (33) assignments. Later, in 1991, Mrs. Schauerhamer transferred additional business assets to the partnerships.

Until Mrs. Schauerhamer’s death, partnership funds were commingled with funds from other sources. Instead of depositing partnership funds into the partnership bank account, which was created, Mrs. Schauerhamer deposited the money into a joint account she held with her son. The estate provided no records to account for partnership assets as separate from non-partnership funds. Mrs. Schauerhamer paid both personal and partnership expenses from the same joint account. The sixty-six (66) \$10,000 gifts of limited partnership interest were not reported on the 706 return for Mrs. Schauerhamer’s estate and her children acknowledged at the trial that the partnerships constituted a way for Mrs. Schauerhamer to assign interests in partnership assets to her children.

In light of all the facts of the case, the court held that the value of the assets in the partnerships were to be included in Mrs. Schauerhamer's estate under 2036(a)(1). The court determined that the accountant's testimony that Mrs. Schauerhamer did not spend partnership income was not conclusive because it was based upon an evaluation of the partnership bank statements rather than any personal knowledge of the accountant. In considering the accountant's testimony, the court determined that while the ending balance at the time of the decedent's death showed that there was more income in the account than would be attributable to the partnership alone, there was no record to show that in the interim, partnership assets had not been used and then replaced with income from other sources. Consequently, the court determined that the "facts establish an implied agreement" between Mrs. Schauerhamer and her children that she would continue to enjoy the assets that were transferred regardless of the accounting shown.

2. *Estate of Reichardt v. C.I.R.*, 114 T. C. 144 (March 1, 2000). Mrs. Reichardt died in 1991, leaving a life estate in her sizable separate property estate to her husband. As part of his life estate, Mr. Reichardt had the right to sell or dispose of assets without providing any accounting for a replacement of such assets. In June of 1993, Mr. Reichardt was diagnosed with terminal cancer; he died on August 21, 1994. Around the same time as his diagnosis, Mr. Reichardt and his son met with an accountant to discuss planning for Mrs. Reichardt's estate. On June 17, 1993, Mr. Reichardt executed a new will and power of attorney, formed a revocable living trust and created a family limited partnership. Mr. Reichardt and his children were appointed as co-trustees of the living trust, which served as the general partner of the family limited partnership. Under the terms of the trust, Mr. Reichardt was to receive the net income from the trust as well as corpus of the trust assets for his health, support, maintenance, and welfare. On June 21, 1993, the certificate of limited partnership for the family limited partnership was filed with and approved by the Texas Secretary of State. Subsequently, Mr. Reichardt transferred all of his property, except for his car, personal effects, and a small amount of cash, to the partnership. Mr. Reichardt executed Deeds on behalf of his wife's estate to transfer the family home and additional real estate into the trust, which then in turn transferred the assets into the partnership. In June and August of 1993, Mr. Reichardt transferred investment accounts into the trust and then again into the partnership, along with an outstanding note obligation and cash.

During the time prior to his death, Mr. Reichardt commingled partnership and personal funds and used the partnership checking account as his personal checking account. Additionally, no bank accounts were ever opened for the trust. In July and August of 1993, Mr. Reichardt deposited over \$20,000 of partnership funds attributable to rental income on some of the partnership real estate into his personal checking account. Mr. Reichardt continued to live in his family home and paid no rent to the partnership even though this property had been transferred into the partnership. Additionally, Mrs. Reichardt's sister continued to manage properties that she had controlled before their transfer into the partnership. The CPA made adjusting entries into the partnership records to classify items as income for the partnership. However, in no way did the decedent's, or any other person's relationship to the partnership assets change after the partnership acquired them.

In light of all these facts, the court found that there were implied agreements between Mr. Reichardt and his children, including that he would have lifetime right to all income of the partnership, and that he would retain all use of personal assets even though they were transferred into the partnership. The court found

that these implied agreements were suggested by the fact that nearly all of his assets were conveyed to the partnership and that his children, even though they were co-trustees, did nothing to keep him from possessing and enjoying any of the assets, including the family home, during his lifetime. The court found that the adjusted entries provided by the CPA in 1993 and 1994 were “a belated attempt to undo the decedent’s commingling.” Based on these facts the court applied Section 2036(a) and included the value of all of the assets transferred to the partnership Mr. Reichardt’s estate.

3. *Knight v. C.I.R.*, 115 TC 506 (November 30, 2000.) The *Knight* case, rather than dealing with an estate tax audit, deals with similar issues arising in a gift tax context. Mr. and Mrs. Knight formed a family limited partnership in 1994 and gave interests in it to trusts they established for their adult children. At the time of trial, both Mr. and Mrs. Knight were in excellent health. Assets transferred into the partnership included two family residences and a ranch property. From 1984 until the time of trial, their son lived at the Dallas property, rent free and their daughter, except for a two year period from 1995 until 1997, lived in the Addison property rent free from 1993 until the date of trial. The Knights managed the ranch and homes prior to the partnership formation in 1994 and paid all the real estate taxes and insurance on those properties as well. The Knights met with a CPA in 1993 and 1994 to discuss estate planning. The CPA explained to them that if they placed their assets in limited partnerships, they could claim discounts for transfer of limited partnership interests if supported by a professional appraisal. Additionally, the CPA suggested that they form a trust to help protect their assets from creditors and then use a limited partnership to “add another layer of protection for those assets.” In 1993 and 1994, the Knights sought additional tax and estate planning advice from their attorney. In December 6, 1994, the Knights opened an investment account in the name of their family limited partnership which was created on December 28, 1994. On December 12, 1994, they opened a checking account for the partnership and transferred \$10,000 to it from their personal account. On December 15, 1994, the Knights transferred over \$550,000 in a bond fund to the partnership. On December 28, 1994, the Knights signed the documents to create their partnership, conveyed the ranch, the real property in Dallas and Addison to the partnership, created a management trust to serve as the partnership’s general partner and each transferred one-half of a partnership unit to the management trust. Additionally, on that same date they created trusts for their two adult children, signed codicils in their wills to change their bequest from their children to the trusts, and then each transferred a 22.3% interest in the partnership to each child’s trust, leaving them each with a 4.9% interest in the partnership as limited partners.

The Knights were the only trustees of the management trust; they decided which assets to buy and sell, paid all partnership expenses and handled all records of the partnership transactions. The trust itself never maintained a checking account, however the partnership has paid the management trust expenses. The Knights signed all the checks drawn on the partnership checking account, however the partnership kept no records, prepared no annual reports and had no employees. The Knights’ children and their individual trusts have not participated in the management of the partnership. The partnership has never borrowed or lent money, has never conducted any business activity and has not prepared any financial statements or reports. Additionally, the partnership did not rent the real property to third parties and received no rents from the Knights’ children who were living in the properties. A large amount of the partnership assets were used for personal purposes before and after the Knights formed their partnership. In addition to allowing their children to live rent free on the partnership property, the partnership paid the utilities on the property (even during the time of the

daughter's absence) and paid all real property taxes and insurance premiums on the properties. More than 70% of the partnership's annual expenses is attributable to the expenses of the Addison and Dallas properties. After its transfer to the partnership, the Knights continued to operate the ranch and, in December of 1998, entered into an oral pasture lease on the ranch between themselves as individuals and themselves as the trustee. Under this lease, the Knights paid \$1500 to the partnership as rent.

In the opinion of the court, the Knights have managed the investments and assets in the same manner as they did before they were transferred to the trust. The IRS argued that the partnership lacked economic substance and failed to qualify as a partnership under federal law. However, the Knights argued that their rights changed significantly when they formed a partnership and that it should be recognized for federal gift tax purposes. The court agreed with the Knights that the partnership must be recognized but reduced the discount taken on the gift tax return for minority interest and each of marketability of 15%.

4. *Estate of Thompson v. C.I.R.*, TC Memo 2002-246 (September 26, 2002.) The *Thompson* case deals with two partnerships, each between the decedent and one of his two children. The partnerships were put into place after the children had attended a financial planning seminar and had discussions on planning with financial planning practitioners. (The partnership plan in this case and in *Strangi* were "Fortress Plans".) In the estate planning letter detailing the family limited partnerships, the planning representative outlined the advantages to the program as:

- (1) lowering taxable value of the estate,
- (2) maximizing the preservation of assets,
- (3) reducing income taxes by having corporate general partner provide medical, retirement, and 'income splitting' benefits for family members, and
- (4) facilitating family in charitable giving . . . , while total control of all of the assets is retained by the directors of the Corporate General Partner.

Additional correspondence between the Thompson family and the tax advisors stated that additional advantages of the plan included maximizing the amount that passes to heirs and to "enjoy the benefit of discounting for gifts and estate tax valuation purposes." In 1993, Mr. Thompson, with his children, formed the two family limited partnerships and the two corporations, which served as their respective corporate general partners. In forming the partnerships, Mr. Thompson contributed the lion's share of the property to the partnerships. The assets contributed by his children into their respective partnerships included real property on which the children continued to live even after contribution to the partnerships.

As a part of these transactions, the parties involved agreed that Mr. Thompson would be taken care of financially and that he would continue to be able to access money in the partnerships to continue making gifts to his children and great-grandchildren. Evidence of these agreements were found in correspondence between the tax planning advisors and Mr. Thompson's children regarding distributions needed for Mr. Thompson to make gifts. For example, in 1993 both partnerships made distributions of \$40,000 to Mr. Thompson so that he could continue his Christmas gifts to family members, which distributions were reflected on Mr. Thompson's Schedule K-1s. In January of 1995, each partnership made distributions to Mr. Thompson in excess of \$45,000 to cover

checks written by Mr. Thompson to his children and grandchildren. In 1994 and 1995, Mr. Thompson also made gifts of interests in the partnerships thereby reducing his ownership in the same. In addition to making distributions for gifts, the partnerships distributed funds to pay for Mr. Thompson's personal expenses. Correspondence from Mr. Thompson's children reflect this, including a January 1995 letter written by Mr. Thompson's daughter to her brother listing his 1994 expenses and what accounts and assets could be used to cover these expenses. The court found that the investment strategies and treatment of properties by the parties did not change significantly after their contribution to the partnerships. For example, though in 1994, Mr. Thompson's daughter transferred her interest in her personal residence to the partnership, the property remained titled in her and her daughter's names. Correspondingly, Mr. Thompson's son contributed his ranch property to the partnership and entered into a lease with the partnership. However, he continued to maintain the ranch in the same manner as before the transfer and any income received from the ranch was paid directly to him, while the losses were claimed by the partnership. The rent paid by Mr. Thompson's son to the partnership was frequently used to pay the management fees of the corporate general partner, which in turn, paid a salary back to Mr. Thompson's son for his serving as president of the corporation. Additionally, the corporation paid for workers compensation insurance on Mr. Thompson's son and daughter-in-law to cover any injury or accident they suffered in their home as well as supplemental and health insurance. After Mr. Thompson died in 1995 (at the age of 97), both partnerships sold over \$340,000 of securities and in 1996 paid over \$240,000 to fund specific bequests set forth in Mr. Thompson's will. Additionally, the partnerships provided funds to pay Mr. Thompson's estate taxes.

In considering all of these facts, the court determined that Mr. Thompson retained enjoyment of the contributed property within the meaning of Section 2036(a)(1). One of the facts mentioned by the Court is that all of his investments, the majority of his assets, were contributed to the partnerships. Citing *Schauerhamer*, the court determined that the establishment of the partnerships was far more consistent "with an estate plan than with any sort of arms length joint enterprise between partners." Additionally, citing *Harper*, the court found that the family partnership was "a vehicle for changing the form which decedent held his property" and therefore, did not qualify for an exemption under 2036(a) as a bonafide sale for adequate and full consideration. Consequently, the court held that the full value of the assets (thereby ignoring the reduction of his partnership interests by his prior gifts) transferred by the decedent to the partnership, as well as new assets that "derived from" those assets, were includible in Mr. Thompson's estate.

5. *Harper v. C.I.R.*, T.C. Memo 2000-202 (June 30, 2000), *redetermined* T.C. Memo 2002-121 (May 15, 2002). On December 18, 1990, Mr. Harper created a revocable intervivos trust naming himself as original trustee and designating his children as successor trustees. The trust held marketable securities and mutual funds in addition to a note receivable. Mr. Harper reserved a life estate in the income and corpus of the trust and directed upon his death that the assets would be distributed 40% to his son and 60% to his daughter. On January 1, 1994, Mr. Harper, along with his two children, entered into a family limited partnership agreement under California law. Mr. Harper's children became the general partners of the partnership with interests of .4% and .6% respectively. The intervivos trust became the sole limited partner with an interest of 99% in the partnership. The trust contributed the marketable securities portfolio (about 94% Mr. Harper's total assets) to the partnership as its initial capital contribution. On July 1, 1994, the parties amended the partnership agreement, creating two classes

of limited partnership interest, Class A and Class B limited partnership interests, a portion of which the trust retained and a portion of which it transferred to Mr. Harper's children. Mr. Harper timely filed his gift tax return for 1994 reporting a gift of a .4% general partnership interest and a 24% Class B limited partnership interest gift to his son and a .6% general partnership interest and 36% Class B limited partnership interest gift to his daughter. Mr. Harper died of cancer on February 1, 1995. The Harper federal estate tax return filed in November 1995, reported a 39% Class A limited partnership interest in the partnership. In the original tax court memorandum, the court determined that the restrictions on liquidation of the partnership found in the partnership agreement were not more restrictive than the requirements under applicable state law. Additionally, the court found that the facts of the case were "indistinguishable from an issue in *Kerr*." Consequently, the court adopted the opinion of *Kerr* in the original *Thompson* opinion. The estate petitioned for a redetermination of the estate tax deficiency, which is found in the second tax court memorandum opinion.

The second tax court memorandum opinion considers at length the facts regarding the creation of the family limited partnership and whether Section 2036(a) applies to make the assets of the partnership includable in Mr. Harper's estate. Citing *Reichardt* and *Shauerhamer*, the court determined that a similar result was required in *Harper*. In reaching its conclusion the *Harper* court focused on the commingling of funds, the history of disproportionate distributions and the testamentary characteristics of the family limited partnership and found an implied agreement between the partners that Mr. Harper retain the economic benefits of the assets transferred. In fact, the court found that "the disregard here for the partnership formed to be equally egregious" as in *Reichardt* and *Schauerhamer*. The court uses the following terms in describing the parties treatment and understanding of the partnership structure:

1. "We are met again with an example of indifference by those involved toward the formal structure of the partnership arrangement and, as a corollary, toward the degree of separation that the Agreement facially purports to establish."
2. "This speaks volumes concerning how little the partners understood to have changed in the decedent's relationship to his assets as a result of the entity's formation."
3. "While we acknowledge that [the partnership] did come into existence prior to decedent's death and that some change ensued in the formal relationship of those involved to the assets, we are satisfied that any practical effect during decedent's life was minimal. Rather, the partnership served primarily as an alternate vehicle through which decedent would provide for his children at his death."
4. "Given the above, we place little weight on averments concerning change, during decedent's life, in the partners relationships to the contributed property."

Additionally, the court refused to find a bona fide sale for adequate and full consideration. Determining instead:

In actuality, all decedent did was to change the form in which he held his beneficial interest in the contributed property. We see little practical difference in whether the Trust held the property

directly or as a 99% partner (and entitled to a commensurate 99% share of profits) in a partnership holding the property.

Accordingly, the court included all the partnership property in Mr. Harper's estate under IRC Section 2036(a).

6. *Kimbell v. U.S.*, 244 F. Supp2d 700 (January 14, 2003, amended April 16, 2003)

The *Kimbell* case is a Texas Federal District Court Case involving a Texas limited partnership formed by Mrs. Kimbell on January 29, 1998. The limited partnership had two partners; Mrs. Kimbell's revocable trust as the 99% limited partner, and a Texas LLC as the sole general partner. The Texas LLC was owned 50% by Mrs. Kimbell's trust, 25% by Mrs. Kimbell's son and 25% by Mrs. Kimbell's daughter-in-law. The partnership had a term of forty years and was created at the time Mrs. Kimbell was 96 years old. She died two months after the partnership was created. The 99% limited partnership interest owned by Mrs. Kimbell's estate was valued on her estate tax return at \$1.257 Million. The IRS audited the estate tax return and valued the same limited partnership interest at \$2.463 Million. The estate paid the increase in tax and filed for a refund.

The government filed a Motion for Partial Summary Judgment asserting that all assets transferred by Mrs. Kimbell to the partnership should be included in her estate pursuant to Section 2036(a). The Court reviewed the elements of 2036(a)(1) and 2036(a)(2) and concluded that under the "plain reading of Section 2036(a)" the property transferred to the partnership by Mrs. Kimbell would be included in the decedent's estate unless the property interest transfer qualified for one of the two exceptions to 2036(a)

The first exception reviewed by the Court was the bona fide sale exception which has two elements related to the transfer: (i) the transfer must be an arms length transaction, and (ii) the transfer must be for adequate and full consideration. The Court stated that in this case, the transfer failed both requirements as there was no evidence of an arms length transaction (the Court stated "one cannot find two parties, much less two parties conducting an arm's length negotiation leading to a bona fide sale") and there was not adequate and full consideration for the sale. In this situation, the Court held that adequate and full consideration did not include a transaction where Mrs. Kimbell transferred 99.5% of the assets into the partnership for a 99% limited partnership interest and a 50% ownership interest in the limited liability company general partner. The Court, relying on the *Harper* case (see above), ruled that all Mrs. Kimbell did was change the form of her ownership and that there was "only a recycling of value and not a transfer of consideration."

The second exception reviewed by the Court was what the Court called the "retained income or rights exception." The question addressed by the Court was whether or not there was an "express or implied agreement at the time of the transfer that the transferor will retain the present economic benefits of the property . . .". The limited partnership agreement allowed the general partner to be removed and replaced by a vote of 70% in interest of the limited partners (Mrs. Kimbell was the 99.5% limited partner). After the removal, a majority of the limited partners could elect a new general partner. Additionally, the general partner had sole discretion to decide on distributions of income from the partnership. Finally, the partnership agreement provided that the general partner did not owe a fiduciary duty to the partnership or any partner. Based on these terms in the partnership agreement, the Court determined that Mrs. Kimbell retained the right to control and direct income from the partnership because she

had the right to remove the general partner, elect a new general partner of her choice, distribute income with no standard for distribution and owe no fiduciary obligation to the partnership or the partners. Even if the partnership agreement provided a fiduciary obligation for the general partner to the partnership and its partners, the Court would not have changed its opinion due to the fact that Mrs. Kimbell owned 99.5% of the partnership. In the Court's words "assuming such fiduciary duties exist, to whom does a party which owns 99% of the partnership owe them? The fiduciary argument falls flat."

Kimbell is another in a line of cases where "bad facts" played a large role in the Court's decision. Ignoring the age of Mrs. Kimbell and the fact that she died two months after the partnership was formed, the structure of the partnership agreement and ownership of the partnership made it difficult to withstand an attack under 2036(a). The outcome might be different if the following facts are in place: (1) the general partner owes a fiduciary duty to the partnership and the partners; (2) the partnership agreement provides that the general partner cannot be removed and replaced by one partner for no reason, i.e. the general partner could only be removed for cause; (3) upon formation of the partnership, other parties contribute assets to the partnership so that one party is not the sole limited partner and the owner of 99.5% of the limited partnership; and (4) business or investment purposes, if possible, are established at the time of formation of the partnership.

C. *Strangi* Case.

Estate of Strangi v. Commissioner, 115 T.C. 478 (2000) aff'd in part, rev'd in part, *Estate of Strangi v. Commissioner* 293 Fed 3rd 279 (5th Cir., 2002), on remand *Estate of Strangi v. Commissioner*, T.C. Memo 2003-149 (May 20, 2003). The *Strangi* decision by a Tax Court judge (on remand from the 5th Circuit) represents the most wide ranging victory to date for the IRS in the family limited partnership area. The Court's opinion, which caused inclusion of a family limited partnership's assets in the decedent's estate under Section 2036(a)(1) and 2036(a)(2), calls into question the ability of a party to receive valuation discounts in a family entity, whether a limited partnership, limited liability company, corporation or other entity. It is unclear how far-reaching the Court's opinion will be, but clearly the opinion now invites additional litigation to determine where the lines will be drawn under Section 2036(a)(2). Interestingly, the Court ruled early on in its opinion that the assets of the partnership were includible in the decedent's estate under Section 2036(a)(1) consistent with the Court's opinions in *Estate of Reichardt*, *Estate of Thompson*, *Estate of Harper* and *Estate of Schauerhamer*. The Court's discussion regarding Section 2036(a)(2) is unnecessary to the outcome of *Strangi* but instead seems to be the Court's attempt to draw a line in the sand regarding family limited partnerships; however, in its broadness, the opinion potentially reaches far beyond family limited partnerships. In the discussion below, we will review the facts of the case and then the Court's discussion regarding 2036(a)(1) and 2036(a)(2). Finally, we will outline different commentators ideas on how *Strangi* should be handled in the drafting and implementation of the family limited partnerships.

Mr. and Mrs. Strangi moved to Waco, Texas in 1988 to be closer to their family after Mrs. Strangi began experiencing serious medical problems. Mr. Strangi appointed Mr. Gulig, his son-in-law, as his power of attorney holder in 1990. Mr. Gulig was an attorney in Waco, Texas. In December 1990, Mrs. Strangi died. During 1993, Mr. Strangi also experienced serious medical problems, including the removal of a cancerous mass from his back, a diagnosis of supra nuclear palsy and prostate surgery. Mr. Gulig had a close personal relationship with Mr. Strangi and began managing his affairs for him. On August 11, 1994, Mr. Gulig attended a seminar regarding the creation of family limited partnerships. On the next day, Mr. Gulig created a family limited partnership with a

corporate general partner pursuant to his power to act for Mr. Strangi under the power of attorney using “canned materials” from the seminar. Approximately 98% of Mr. Strangi’s wealth was transferred into the limited partnership in exchange for a 99% limited partnership interest. The assets transferred into the partnership included securities, life insurance policies, notes receivable, an annuity and real estate (including Mr. Strangi’s home). The corporate general partner was owned 47% by Mr. Strangi and 53% by his four children. Mr. Strangi and his four children were named as the five directors of the corporate general partner. After formation of the corporate general partner, the children gave an aggregate 1% interest in the corporate general partner (equivalent to .01% ownership interest in the partnership) to a charity. Formalities related to the formation of the partnership, the transfer of the assets, the receipt of contributions and the partnership operations were all properly documented.

After the formation of the partnership, there were a series of distributions from the partnership for personal matters related to Mr. Strangi. This included distributions to pay for back surgery of his caregiver, his personal nursing services, his funeral expenses, his estate expenses, specific bequests of his will, and finally, over \$3,000,000.00 of estate tax. When these distributions were made to Mr. Strangi, or a third party on his behalf, either a like distribution was made to the corporate general partner or adjusting journal entries were made on the books of the partnership. Finally, Mr. Strangi continued to live in his home after its contribution to the partnership and, although the rent was accrued on the books of the partnership, no rent was paid until January 1997, three years after Mr. Strangi’s death.

Section 2036(a)(1). Section 2036(a)(1) requires the inclusion of property in a person’s estate if a person transfers property and retains “possession or enjoyment of, or the right to the income from the property.” In prior “bad fact” cases (see case discussion above), the Service has been successful in arguing that a person transferred property into a partnership and retained the possession of or the enjoyment of the property, or the right to income from the property. In *Strangi*, the Court stated . . . “possession or enjoyment of transferred property is retained for purposes of 2036(a)(1) where there is an express or implied understanding to that effect among the parties at the time of the transfer, even if the retained interest is not legally enforceable.” In determining that the decedent in *Strangi* retained a right to the income, the Court was impressed by two factors. First, the general partner of the partnership had the sole discretion to determine distribution from the partnership. Second, the general partner hired Mr. Gulig (the decedent’s son-in-law who also held his power of attorney) to manage its day-to-day operations. In the Court’s opinion, Mr. Gulig had the power under his management agreement to control distributions of the partnership thereby giving him the same control over the distributions of the income from the assets as he previously had under the power of attorney with Mr. Strangi.

As to Mr. Strangi’s retention of possession or enjoyment of the property, the Court listed multiple factors in support of its decision that these powers were retained:

- (1) Approximately 98% of Mr. Strangi’s wealth, including his home, was transferred to the partnership.
- (2) Mr. Strangi maintained possession of his home after its transfer to the partnership without payment of rent. While the Court acknowledged rent was accrued, it did not view this as an arms length lease because the failure to pay rent by decedent was not enforced by the lessor.
- (3) Disbursements were made from the entity to Mr. Strangi for personal expenses. While the court acknowledged that like distributions were made to the corporate general partner, it felt that this was immaterial due

to the de minimis nature of the general partnership's ownership interest.

- (4) Partnership funds were spent because of specific needs of Mr. Strangi, including his caregiver's back surgery, funeral expenses, and estate administration debts. Some of the funds were spent directly by the partnership and while the partnership made accounting entries on its books treating those as distributions to Mr. Strangi (or his estate) from the partnership, the court said ". . . accounting adjustments do not preclude a conclusion that those involved understood that the decedent's assets would be made available as needs materialized."
- (5) The partnership formation and operation was substantially similar to Mr. Strangi's testamentary plan.

At this point of the opinion, the only difference between the Court's opinion and application of Section 2036(a)(1) to the decedent's estate from the cases discussed above, was that in *Strangi* the "proverbial i's were dotted and t's were crossed." Even ignoring the rest of the opinion and the application of Section 2036(a)(2), the *Strangi* opinion as to 2036(a)(1) stands for the proposition that more must be done in the set up and operation of the partnership than following the pure formalities.

Section 2036(a)(2). Section 2036(a)(2) requires the inclusion of property in a person's estate if the decedent has transferred the property and retains ". . . the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." One exception to the application of 2036(a)(2) to a transfer of property is if the decedent received adequate and full consideration in a bona fide sale. The *Strangi* Court focused on the statute and regulations (20.2036-1(b)(3)) of 2036 in deciding that Mr. Strangi, acting in conjunction with the other corporate general partner's shareholders, could control the designation of the directors and therefore who would enjoy the benefit of the partnership property. Additionally, the Court decided that Mr. Strangi could act together with the other parties to effectively revoke the partnership and bring about a distribution of the partnership assets to the owners. Some commentators have called this a "banding together" theory and under the Court's opinion, if there are not additional factors, i.e. fiduciary duties, full and adequate consideration, etc., the ability of a decedent and his family members to come together and dissolve a partnership would cause inclusion of the partnership assets in the decedent's estate to the extent of his contributions to the partnership.

The Court then reviewed different constraints that would not cause inclusion in Mr. Strangi's estate under Section 2036(a)(2). The Court extensively analyzed *United States v. Byrum* 408 U.S. 125 (1972). In *Byrum*, the Court noted, distributions from the corporation were paid to a trust with an independent third party trustee who would ultimately make a decision regarding the distribution to the trust's beneficiaries. In *Strangi* there was no trust to receive the income that could be paid to the trust's beneficiaries, whether an independent trustee, or a trustee with a fiduciary duty regarding distributions. Secondly, the Court determined that there were no fiduciary duties equivalent to those recognized by the Court in *Byrum*. In *Byrum* there were unrelated third party owners of the corporation. While it is certainly unclear that there need to be unrelated third parties as members of the partnership in order for there to be fiduciary obligations, in *Strangi*, the decedent owned approximately 99.47% of the partnership through his ownership of the limited partnership interests and his ownership of the general partner, thereby making any fiduciary obligation to the other owners almost meaningless. The *Strangi* Court also noted that the decedent's interest was represented by his son-in-law, Mr. Gulig, acting under a power of attorney. In the Court's opinion, this caused Mr. Gulig to owe a higher high fiduciary duty to Mr. Strangi under the power of attorney than any duty he owed to the other owners as manager of the general partner.

Additionally, the 1% ownership in the corporate general partner by a charity was viewed as “amounting to no more than window dressing. A charity given a gratuitous 1% interest would not realistically exercise any meaningful oversight [over the operation of the partnership.]” Finally, the Court in contrast to prior positions taken by the IRS and other courts, argued that fiduciary duties owed among family members are not sufficient to override Section 2036(a)(2). The Court said “intra-family fiduciary duties within an investment vehicle simply are not equivalent in nature to the obligations created by the *United States v. Byrum, supra* scenario.” It is interesting to note that the Court refers to fiduciary duties “within an investment vehicle,” seemingly differentiating between an investment entity from other family entities.

Finally, the Court reviewed whether there was an exception to 2036(a)(1) or 2036(a)(2) under the bona fide sale for full and adequate consideration exception. The Court, as it did in the *Harper* case, found no bona fide sale because there was no negotiation among the parties; “canned materials” were used. Also, the Court determined that full and adequate consideration was not received for the property as there was a mere “recycling” of assets for a partnership interest. In a key point, the court distinguished *Estate of Harrison (Estate of Harrison v. Commissioner, T.C. Memo 1987-8)* and *Church* (see above) as both prior cases had involved contributions by other partners that were more than de minimis contributions; in each case there was “a genuine pooling of interest.” Arguably, if other family members make substantial contributions to a partnership such as a pooling of undivided interest in real property, contributions of substantial investment assets for professional asset management purposes, etc. the Court might be more inclined to recognize the satisfaction of the full and adequate consideration exception and possibly the obligation of fiduciary duties among the parties.

Commentators’ Thoughts

The *Strangi* case has been extensively analyzed and discussed by experts in the family partnership area. Some of the commentators have been brave enough to offer ideas to address the issues raised by the Court in *Strangi*. Some of the recommendations of the commentators are as follows:

1. Do not have the parent (or donor) own any interest in the general partner.
2. Give the general partner control over the distribution of funds from the partnership without requiring limited partners’ approval.
3. Give the general partner the right to liquidate the partnership without limited partners’ approval, i.e. do not allow the limited partners a right to vote on dissolution of the partnership.
4. Upon formation of a partnership, have other family members contribute substantial assets to the partnership so that there is a “pooling of assets” in the partnership. Gifts by the donor to the family members prior to the formation of the partnership in order to effectuate the pooling concept would probably not be respected.
5. If the parent (or donor) is the general partner of the partnership, or the manager of the entity’s general partner, make sure the successor is not also the power of attorney holder for the parent/donor.
6. Consider multiple classes of limited partnership interest with the class owned by the parent not having voting rights related to distributions or liquidation of the partnership. (This would have to be carefully structured to avoid arguments by

the IRS that there is a gift due to the lower value of the partnership interest retained by the parent/donor.)

All of the above ideas and concepts are valid. However, the implementation of these ideas is not easily accomplished. For example, very few donor/parents are comfortable giving up complete control of the general partner to their children or a third party, or giving up all rights regarding distributions from, or liquidation of the partnership. Additionally, in many situations, there is not sufficient independent wealth at the next generation to join in the contribution of assets to the partnership. Does this mean if you are unable to structure a new limited partnership, or restructure an existing limited partnership, along the guidelines mentioned above, that the family limited partnership is a failed proposition? Not necessarily.

In a majority of the cases discussed above, the Court was faced with incredibly bad facts in the formation and/or implementation of the partnership. Certain of the partnerships involved “canned materials” with little or any planning and discussion among the family members for a business purpose or other plan in implementing the partnership. The Court was left with little option but to disregard the entity as nothing more than a discount tool utilized just prior to the decedent’s death. We don’t know what the result would be if the family members had a plan regarding the formation and implementation of a limited partnership and the plan was followed in the formation and operation of the partnership. Until more cases (hopefully with better facts) are addressed by the Court, we are faced with a situation similar to that when Chapter 14 (Sections 2701-2704) was first enacted - ideas of what works and doesn’t work, but uncertainty until the Court fully addresses all of the issues. In the interim, all we can do is advise our clients on the changing environment and help them implement a plan that will best fulfill their purposes for the entity and (hopefully) withstand an attack from the IRS.

ATTACHMENT 1

SAMPLE IRS QUESTIONS

1. All documents relating to the creation of the partnership (including bills) from any attorney, accountant or firm involved in recommending the creation of the partnership agreement. If a claim is made that any of these documents are [sic] privileged, identify each privileged document by date, source, audience and reason for the privilege.
2. Original partnership agreement and all amendments thereto.
3. Articles of incorporation of the general partner if the general partner is a corporation.
4. All documents that were prepared to meet state law requirements on the formation and operation of the partnership (i.e., Certificate of Limited Partnership which has the filing date stamp on it and all amendments thereto; stamped copies of annual reports; supplemental affidavits on capital contributions, etc.).
5. All partnership financial statements and tax returns prepared and/or filed since inception.
6. All of the partnership's bank and other records (i.e., general ledger, cash receipts and disbursements journals, check registers, etc.) which reflect the amount and nature of all deposits and distributions, including distributions to partners, for the period since the partnership was formed to the date of death/current date.
7. Minutes of all partnership meetings; if none, indicate the dates of all the meetings and the business discussed.
8. Evidence showing how the value of each partnership asset was arrived at as of the date:
 - (a) it was contributed to the partnership;
 - (b) of each gift of a partnership interest; and
 - (c) of the death of the donor; provide all appraisals and supporting work papers obtained of the partnership's assets, including partnership interests and any discounts.
9. Evidence to substantiate all initial and subsequent capital contributions and the source of all contributions by partners other than the donor/decedent.
10. For each partnership asset, explain/provide:
 - (a) evidence that the partnership owns the asset (i.e., deeds, bill of sale, other title changes, and account statements);
 - (b) when the donor/decedent acquired the asset;
 - (c) how the asset was used by the donor/decedent since its acquisition and how the partnership has used the asset since (i.e., held for rent, personal residence, investment, etc.); and

- (d) who managed the asset prior to and after its contribution; explain in detail what the management consisted of and how it changed after the partnership was formed.
11. For each gift or transfer of a partnership interest, provide:
 - (a) evidence that the partnership interest was legally transferred under state law and under the partnership agreement;
 - (b) any assignment of partnership interest prepared;
 - (c) the terms of the assignment, if not indicated in a written assignment;
 - (d) the amount and source of any consideration paid;
 - (e) an explanation of how the amount of the consideration was arrived at.
 12. Indicate whether the partnership is currently in existence, and, if so, provide the current ownership interests.
 13. A statement describing the donor's/decedent's state of health at the time of the formation of the partnership and for the six-month period prior thereto, including a description of any serious illnesses. Please also provide the names, addresses and telephone numbers of all doctors who would have knowledge of the donor's/decedent's state of health during this period to the present and provide these doctors with authorization to respond to the Service's future requests for information, including a copy of the medical records, if necessary.
 14. A statement indicating the identity of the parties recommending the use of the partnership, when the recommendations were made, and the reasons set forth in support of the partnership.
 15. A "family tree" for the decedent going "up" from the decedent one generation and "down" from the decedent two generations.
 16. An explanation of how the partnership assets were managed before and after the contribution to the FLP.
 17. A statement as to who manages the FLP assets, their duties, and the approximate time devoted to the management activities. Also, include a description of the qualifications and expertise of the general partners of the FLP and an explanation of the specific duties performed in connection with managing assets both before and after they were contributed to the FLP.
 18. A statement as to the purpose for establishing the FLP. Include a description of the specific economic and other goals to be achieved through its creation and how the partnership was expected to meet those goals.
 19. A statement as to how the goals and purposes described above could not be achieved equally as well through the medium of a trust or through outright gifts of the underlying property.
 20. Where were the fees charged to create the entity deducted?

ATTACHMENT 2

STATE OF TEXAS §
 §
COUNTY OF TARRANT §

ASSIGNMENT OF LIMITED PARTNERSHIP INTEREST

JAMES FOUNDER, Donor, in consideration for the love and affection that he has for his children, hereby gives, transfers, and delivers a 15% Limited Partnership Interest in Founder Family Investments, L.P., a Texas limited partnership, to the following Assignees in the amounts indicated:

James Founder, Jr., as his sole & separate property	5%
William Founder, as his sole & separate property	5%
Carol Founder, as her sole & separate property	5%

Effective the _____ day of _____, 200_.

James Founder

DONOR

STATE OF TEXAS §
 §
COUNTY OF TARRANT §

ASSIGNMENT OF LIMITED PARTNERSHIP INTEREST

SALLY FOUNDER, Donor, in consideration for the love and affection that she has for her children, hereby gives, transfers, and delivers a 15% Limited Partnership Interest in Founder Family Investments, L.P., a Texas limited partnership, to the following Assignees in the amounts indicated:

James Founder, Jr., as his sole & separate property	5%
William Founder, as his sole & separate property	5%
Carol Founder, as her sole & separate property	5%

Effective the _____ day of _____, 200_.

Sally Founder

DONOR

ATTACHMENT 3

ACCEPTANCE OF LIMITED PARTNERSHIP TERMS AND CONDITIONS

Each of the undersigned hereby consents to the assignment of a 10% Limited Partnership Interest to him or her, as his or her sole & separate property, from James Founder and Sally Founder (5% from each donor) and agrees to accept and abide by the terms and conditions of the Founder Family Investments, L.P. Limited Partnership Agreement, as amended.

Effective the ____ day of _____, 200_.

James Founder, Jr.

William Founder

Carol Founder

ATTACHMENT 4

CONSENT TO ADMISSION OF SUBSTITUTED LIMITED PARTNERS

The undersigned, being the General Partner and a Super Majority Interest of the Limited Partners of Founder Family Investments, L.P., a Texas limited partnership, hereby consent to the admission of the following Assignees as a Substituted Limited Partners in Founder Family Investments, L.P., pursuant to and in accordance with the terms and conditions of the Founder Family Investments, L.P. Limited Partnership Agreement, as amended.

James Founder, Jr., as his sole & separate property	10%
William Founder, as his sole & separate property	10%
Carol Founder, as her sole & separate property	10%

Effective the ____ day of _____, 200_.

GENERAL PARTNER:

Founder Management, LLC

By: _____
James Founder, President

LIMITED PARTNERS:

James Founder

Sally Founder

ATTACHMENT 5

EXHIBIT "C"

Effective the _____ day of _____, 200_, pursuant to the provisions of Paragraph 7.1 of the Limited Partnership Agreement of Founder Family Investments, L.P., certain Limited Partners of the Partnership transferred by gift a portion of their Limited Partnership Interests to new Limited Partners. The Partners and the Partners' Partnership Interests after the gifts are as follows:

Name GENERAL PARTNER	Partnership Interest After Gift
Founder Management, LLC	1%

Name LIMITED PARTNERS	Partnership Interest After Gift
James Founder	34.5%
Sally Founder	34.5%
James Founder, Jr.	10%
William Founder	10%
Carol Founder	10%

GENERAL PARTNER:

Founder Management, LLC

By: _____

James Founder, President

LIMITED PARTNERS:

James Founder

Sally Founder

James Founder, Jr.

William Founder

Carol Founder

ATTACHMENT 6

**[OPTIONAL – IN THE EVENT AN INDIVIDUAL GENERAL PARTNER
SHOULD DIE AND A LIMITED LIABILITY COMPANY
(OR OTHER ENTITY) IS NOT USED AS A GENERAL PARTNER]**

**FIRST AMENDMENT
TO THE
LIMITED PARTNERSHIP AGREEMENT
OF
FOUNDER FAMILY INVESTMENTS, L.P..**

This First Amendment (“First Amendment”) to the Limited Partnership Agreement of Founder Family Investments, L.P. (“Agreement”) dated effective _____, 200_, is made and entered into by and among the undersigned persons serving as Limited Partners (the “Limited Partners”), Sally Founder, as General Partner (the “General Partner”) and James Founder, Jr. (“Successor General Partner”)

WHEREAS, prior to the execution of this First Amendment, James Founder (with a 1% general partnership interest) and General Partner (with a 1% general partnership interest) were both general partners of Founder Family Investments, L.P., a Texas limited partnership (the “Partnership”);

WHEREAS, James Founder died on September 1, 200_;

WHEREAS, pursuant to Paragraph 16.5 of the Agreement, upon the death of James Founder, his 1% General Partnership Interest converts to a Limited Partnership Interest;

WHEREAS, pursuant to Paragraph 15.6 of the Agreement, the General Partners and a Majority in Interest of the Limited Partners desire to admit the Estate of James Founder as a Substituted Limited Partner holding a 1% Limited Partnership Interest;

WHEREAS, pursuant to Paragraph 16.4 of the Agreement, the Limited Partners and remaining General Partner desire to appoint James Founder, Jr. as a general partner of the Partnership;

WHEREAS, the Successor General Partner desires to become a general partner of the Partnership;

WHEREAS, the Successor General Partner, General Partner and Limited Partners desire for the Successor General Partner to convert a 1% Limited Partnership Interest in the Partnership held by the Successor General Partner into a 1% General Partnership; and

WHEREAS, the Limited Partners, the General Partner, and the Successor General Partner desire to amend the Agreement in certain respects more fully described herein.

NOW, THEREFORE, for and in consideration of the mutual promises, covenants and undertakings described herein, the Limited Partners, the General Partner and the Successor General Partner hereby agree to amend the Agreement as follows:

1. Subparagraph 3.3(a) is hereby amended in its entirety as follows:

“(a) The names and addresses of the General Partners of this Partnership are:

James Founder, Jr.
123 Founder Street
Fort Worth, Texas 76109

Sally Founder
123 Founder Street
Fort Worth, Texas 76109

There are no other General Partners of this Partnership and no other person has any right to take part in the active management of the business affairs of the Partnership except as otherwise provided in Article XI.”

2. Paragraph 7.1 is hereby amended in its entirety to read as follows:

“The interests of the Partners in the Partnership (the “Partnership Interests”) are as follows:

<u>General Partners:</u>	<u>Partnership Interests:</u>
James Founder, Jr.	1%
Sally Founder	1%
 <u>Limited Partners:</u>	
Sally Founder	34%
Estate of James Founder	35%
James Founder, Jr.	9%
William Founder	10%
Carol Founder	10%”

3. The Estate of James Founder hereby acknowledges receipt of a copy of the Agreement, agrees to accept and be bound by the terms and provisions of the Agreement as a Substituted Limited Partner.
4. The Estate of James Founder is hereby admitted as a Substituted Limited Partner of the Partnership with respect to the 1% Limited Partnership Interest which was converted from a General Partnership Interest effective September 1, 200_.
5. The Successor General Partner hereby acknowledges receipt of a copy of the Agreement, and agrees to accept and be bound by the terms and provisions of this Agreement as a General Partner.
6. The undersigned persons agree that the Successor General Partner shall obtain a General Partnership Interest from converting a 1% Limited Partnership Interest, he currently holds, to a 1% General Partnership Interest and that such Successor General Partner shall be admitted as a General Partner.
7. The above-described Agreement is incorporated herein by reference and all of its original terms shall apply to all parties hereto except as such terms are modified by this First Amendment. By executing this First Amendment, all parties hereto expressly agree to abide by all terms and conditions of the Agreement as modified herein.

IN WITNESS WHEREOF, this First Amendment has been executed as of the date set forth above.

SUCCESSOR GENERAL PARTNER:

James Founder, Jr.

GENERAL PARTNER:

Sally Founder

LIMITED PARTNERS:

Sally Founder

James Founder, Jr.

William Founder

Carol Founder

Sally Founder, Executor of the
Estate of James Founder

110556v3

ATTACHMENT 7

FIRM LETTERHEAD

**THIS DOCUMENT IS INTENDED TO BE PROTECTED BY THE
ATTORNEY-CLIENT AND WORK PRODUCT PRIVILEGES**

October 10, 2003

«ClientNames»
«Address1»
«Address2»
«CityStateZip»

Re: Your Family Limited Partnership

Dear «SalutationLine»:

As you are probably aware, the family limited partnership has been the focus of intense scrutiny from the IRS in recent years as the IRS views the family limited partnership as a tool used by estate planning practitioners solely for the purpose of discounting the value of their clients' estates. Although the discount on the family limited partnership is an added benefit, there are several other reasons to utilize a family limited partnership such as (i) minimizing state franchise taxes, (ii) providing management control to the parent generation, (iii) providing continuity of management through a pre-determined management scheme, (iv) providing a means of consolidating family wealth and training family members in the management and investment of such family wealth, (v) providing limited liability for the limited partners, and even in some situations, (vi) providing marital property protection. The IRS, in auditing a family limited partnership, would first attempt to determine whether the partnership is treated by the family members as a legitimate, separate business entity with a valid business purpose. As a part of this review, the IRS would normally review whether or not the partnership formalities have been followed by the family members. **It has been our experience that some of our clients are still unfamiliar with the operational aspects and formalities of limited partnerships.** The purpose of this letter is to provide you with a concise list of some of the more critical formalities which should be adhered to as you operate and manage your family's limited partnership.

A. Partnership Agreement.

Since the Limited Partnership Agreement (in conjunction with state law) is the governing document for the partnership, its terms and provisions should be consulted and strictly adhered to on each action or activity involving the partnership. Some of the more important terms and provisions of the agreement to be followed in the operation and management of the family limited partnership are as follows:

1. Contributions and Percentages. All contributions made to the partnership by its partners should match up with the partners' ownership percentages for purposes of profit and loss allocations pursuant to the agreement. If any disproportionate contributions are made, the consent of the other partners (in a percentage as set forth in the agreement) should be obtained, and the ownership percentages of all partners should be adjusted accordingly.
2. General Partner Management. The general partner(s) should carefully review and abide by the provisions of the partnership agreement concerning management responsibility.
3. Special Meeting and Minutes. Prior to taking substantial and unusual actions on behalf of the partnership, the partners (including the limited partners) should discuss the

transaction at a meeting, and such meeting should be evidenced by partnership meeting minutes. Such transactions could involve the partnership borrowing a substantial amount of money or selling a valuable piece of real estate or other partnership asset. Additionally, where a vote of the limited partners is necessary, the voting requirements of the partnership agreement should be complied with by the general partner.

4. Annual Meetings and Minutes. An annual informational meeting of all of the partners of the partnership is recommended. If the partnership has a corporation or a limited liability company that serves as general partner, such general partner should have corporate or limited liability company meeting minutes authorizing acts that it, as a general partner, will perform on behalf of the partnership.
5. Partnership Contracts. The partnership should only acquire assets and/or enter into contracts in the name of the partnership. The general partner(s) or the Managing General Partner, as applicable, should sign the contracts on behalf of the partnership in their representative capacity. For example:

“FOUNDER FAMILY INVESTMENTS, L.P.

By: _____
James Founder, President of Founder Management, LLC,
General Partner”

6. Amendments. Finally, any amendment to the terms of the partnership agreement must be made in writing and consented to by the applicable number or percentage of the partners as set forth in the agreement.

B. Compliance with State Law Filing Requirements.

To form your limited partnership, a Certificate of Limited Partnership was filed with the Secretary of State’s office in the state in which your partnership is organized (generally, Texas or Delaware), listing the name and address of the general partner(s) of your partnership along with the name and address of the partnership’s registered agent for service of process. Additional filings may also be required for your partnership, a few common ones are listed below.

1. Conducting Business in Other States. If your partnership conducts business in a state other than the one in which it was formed (the “domestic” state), it will need to file a Certificate of Authority or other similar document to register to do business in that state (a “foreign” state.)
2. Changes. In the event any change takes place involving the identity of the partnership’s general partner(s) (i.e. due to death, removal or addition), the identity or location of the partnership registered agent or, the principal office of the partnership, then an Amended Certificate of Limited Partnership (and an Amended Certificate of Authority, if applicable) would be required to be filed with the Secretary of State’s office of its domestic state and each foreign state where it is registered reflecting such change.
3. Annual Reports. Finally, the Secretary of State’s office of the domestic state or any foreign state(s) may require the limited partnership to file a report containing certain basic information about the partnership and its partners on a regular basis (e.g. annually.) In Texas, such a report may not be required to be filed more than once every four (4) years. Any annual reports requested of the limited partnership should be timely and

properly filed along with the appropriate filing fee (\$50 in Texas) in order to avoid the forfeiture of the partnership's authority to do business in such state.

D. Tax and Bookkeeping Compliance.

The primary tax and bookkeeping compliance items concerning the partnership are as follows:

1. Tax Returns.

- a. Annually, the partnership must provide to each partner, information necessary to complete such partner's federal income tax return, i.e. the partnership must provide an IRS Form K-1 to each partner.
- b. A partnership tax return (IRS Form 1065) must be completed and filed every year by the partnership on or before the 15th day of the 4th month following the date its tax year ends – April 15 for calendar-year partnerships.

2. Income Allocations and Distributions.

- a. As a general rule in a family limited partnership, the income should be allocated in accordance with partnership capital. In the event there is a special allocation in the partnership agreement, the allocation should be reviewed carefully by your accountant or legal counsel.
- b. The general partner(s) should carefully follow the terms of the partnership agreement relating to distributions. As a general rule, distributions from the partnership should be made pro-rata based upon the partners' ownership interests in the partnership. **This is a common mistake in the operation of the partnership.** If there are uneven distributions, the capital accounts of the partnership will not match the profit and loss allocations, and the IRS may attempt to recharacterize such transactions as a deemed gift of proceeds from one partner to another.

3. Books and Records.

- a. The partnership should comply with the laws of its home state regarding maintaining partnership books and records. If your partnership is a Texas partnership, it should keep and maintain its records at its principal place of business as required by Section 1.07(a) of the Texas Revised Limited Partnership Act. Any partner or assignee of a partnership interest may, on written request stating the purpose, examine and copy the applicable records (Sections 1.07(d) and (e) of the Texas Revised Limited Partnership Act.)
- b. Partnership accounting records must be kept on behalf of the partnership. Depending on the size of the partnership, financial statements should be prepared at least annually and in many situations, quarterly. Additionally, the partnership's accountant should keep track of each partner's capital accounts, distributions of capital and allocation of profits.

4. Taxes and Fees. Finally, Texas imposes no franchise tax upon limited partnerships; however, there is currently a \$200 annual franchise tax imposed by limited partnerships filed in Delaware. Any such annual taxes or fees should be timely paid by the partnership

from the partnership account in order to avoid the forfeiture of the limited partnership's standing in such state.

E. Miscellaneous Formalities/Instructions.

Other miscellaneous formalities and instructions regarding the operation and management of the partnership are as follows:

1. Partners and Partnership Issues.

- a. **The partners must avoid the co-mingling of personal assets with partnership assets.** The partners should not borrow money from the partnership or loan money to the partnership without signing a promissory note and complying with the terms of the partnership agreement and Texas law.
- b. The partnership should not guarantee or pledge business assets of the partnership for personal obligations of the partners. However, if a guarantee or pledging of partnership assets on behalf of a partner is undertaken, all of the partners should consent to such action taken by the partnership. Furthermore, the partnership should receive a fee, i.e. a guarantee fee, from the applicable partner for such partnership services.
- c. If a partner is transferring real estate subject to a lease to a partnership, the lease must be amended or assigned so as to reflect the partnership as the lessor. Furthermore, a partnership that receives a contribution of real estate from its partner(s) should properly document such transfer by executing warranty deeds and filing the deeds in the deeds records of the applicable county clerk's office.
- d. In the event the partnership has multiple limited partners, the general partner(s) should consider quarterly or semi-annual reports to the limited partners to update them on actions taken, business plan revisions and ongoing partnership philosophy.
- e. **If the real estate or other assets of the partnership are used by a partner or other family member, such use should be documented by a lease or other occupancy arrangement. The lease should be at fair market value and the rent and other terms of the partnership should be complied with like any other third party.**

2. Partnership Operational Issues.

- a. The partnership should have its own separate checking and/or brokerage account, and this account should be used in the partnership's operation to deposit all income earned by the partnership and to pay all expenses incurred by the partnership. Partnership income should not be deposited into individual partner accounts and personal expenses of a partner should not be paid by the partnership out of its funds.

- b. Partnership stationery (reflecting the partnership's legal name) should be prepared and used in the business operations of the partnership. If an assumed name is used by the partnership and on the partnership stationery such assumed name must be appropriately obtained by making the requisite filings at the state and local level.
- c. In the event the partnership is operating under an assumed name, the partnership should file an assumed name certificate with the Secretary of State's office and with the county clerk of the county in which the partnership's principal office is located.
- d. If the property contributed to the partnership is agricultural use property and has previously received an agricultural use exemption, a new agricultural use exemption application needs to be filed by the partnership. The new application must be filed by the partnership prior to May 1 of the year following the year in which the partnership received the property. The application must be filed with the chief appraiser for the appraisal district where the property is located (Section 23.43 of the Texas Tax Code.)

F. Gifts of Partnership Interests/Proper Documentation.

It is absolutely crucial that any and all gifts or transfers of partnership interests in the partnership be made in strict compliance with the terms of the partnership agreement and that the proper and required documentation be prepared and executed evidencing the gifts or transfers. **Please note that before any gifts or transfers of partnership interests are made, you should consult your tax advisor, attorney, or accountant as to the gift tax and partnership tax consequences resulting from such gift or transfer.** A summary of the documents involved in a partnership interest gift or transfer are as follows:

1. An assignment document to reflect the amount of limited partnership interest being assigned by the donor to the donee. Such assignment document should be dated and signed by the applicable donor.
2. An acknowledgment signed by the donee accepting the limited partnership interest and agreeing to accept and abide by the terms of the partnership agreement.
3. In the event the applicable percentage of partners agree to admit the donee as a substituted limited partner, the consenting partners should sign an acknowledgment to that effect.
4. The partnership agreement should be amended to reflect the new limited partner and the partnership interest adjustments resulting from the gift or transfer of a limited partnership interest.

We would like to take this opportunity to remind you that if you intend to make any annual exclusion or taxable gifts of limited partnership interests or other assets to be effective for this tax year, these gifts will need to be completed before midnight on December 31. If you desire our assistance in discussing the tax advantages and consequences with you regarding such gifts or in preparing the necessary documents to evidence such gifts, please contact us at your earliest convenience so that we may include such planning in our end of the year work schedule.

As stated above, this list is designed to aid you in the operation and management of your family limited partnership. It is not intended to be a comprehensive or exhaustive list of all partnership formalities as each partnership, along with its assets and operations, are unique. If you have any questions concerning the information contained in this letter or your family limited partnership, please do not hesitate to contact our firm. We will be happy to assist you, and we look forward to continuing our working relationship with you and your family.

Sincerely,