Understanding the ins and outs of a Family Limited Partnership

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

An FLP in action

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

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

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

Reduce transfer tax

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

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

Reduce income tax

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

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

Provide asset protection

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

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

A versatile tool

Keep in mind that FLPs are more complex and costly to set up and operate than many other estate planning tools. But given the wide variety of valuable benefits an FLP offers, it’s worthy of consideration as part of your overall estate plan. Contact your estate planning advisor to help you determine if an FLP is right for you.

Sidebar: Beware the kiddie tax

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

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

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