

USING YOUR ESTATE PLANNING FAMILY LIMITED
PARTNERSHIP FOR INCOME TAX PLANNING

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Using the family's estate planning family limited partnership for income tax planning, not only upon the death of a partner, but also while the partner is living. **Two Objectives:**

- (1) Returning appreciated assets for inclusion in a decedent's gross estate!**
- (2) Increasing basis in appreciated assets that will be sold while living**

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The partnership income tax rules, as originally enacted in 1954, are complex and became even more difficult over the years as Congress added rules designed to reduce or eliminate what it perceived as manipulation of the rules in Subchapter K of the Internal Revenue Code.

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- The partnership mixing bowl rules under §§ 704(c)(1)(B) and 737.
- § 731(c), marketable securities treated as cash.
- Special allocations and capital accounts under § 704(b).
- Assignment of income under § 706
- Partnership anti-abuse rules Treas. Reg. § 1.701-2.
- Mandatory decrease in the basis of partnership assets upon the death of a partner under § 734(b)(2) and (d).

The treatment of partnerships becomes even more complex when one has to integrate the partnership rules with the income tax treatment of trusts and the estate tax “string” rules under § 2036.

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Income tax basis planning near death

Should Senior retain appreciated assets for inclusion in Senior's gross estate, eliminating built-in gain under the income tax at a cost of the 40% estate tax on the value of the appreciated asset?

The effective income tax rates can be greater than the 40% estate tax rates for ordinary income assets and slightly below the 40% estate tax rate for capital gain assets.

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Income tax basis planning

Factors to consider:

1. Encumbered assets.
2. Ability to depreciate the tax-free step-up in basis at death.
3. The extent of Senior's pre-death basis for the appreciated asset.
4. Step-up for first spouse to die, and no estate tax using the credit shelter trust and the marital deduction.
5. Couples net worth exposed to estate tax is less than their combined \$5,000,000 exemptions.

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