

WEALTH PRESERVATION AND ESTATE PLANNING ALERT

Annual Maintenance for Business Entities

by Jerome L. Wolf, Esq.

Recent estate tax case law indicates that the courts may not respect Family Limited Partnerships when the individuals involved in the transaction do not respect the formalities of the partnership at its inception, and thereafter. If not operated properly, any business entity, whether a corporation, a Family Limited Partnership, or limited liability company may be deemed a "sham" by a creditor or the IRS.

Accordingly, the purpose of this Alert is to reiterate the importance of properly maintaining the Partnership; and the following items are not exclusive, but are certainly crucial for the proper maintenance of the Partnership:

1. *Maintaining separate accounts for the Partnership and the General Partner to promote the business enterprises.* The Partnership has its own account and its own taxpayer identification number. The General Partner also should have its own account and its own taxpayer identification number. It is essential that you do not commingle your own assets in these entity accounts. It is also important that you do not use assets in these accounts for personal purposes. If you need funds to be distributed to you from either of these entities there are appropriate methods by which access to funds can be accomplished.

For all transactions by the General Partner, the Managing Member (or other authorized officer) of the General Partner will act (and sign, where applicable) in such capacity on behalf of the General Partner. Regarding any transactions on behalf of the Partnership, the Managing Member of the LLC serving as General Partner, will act as the General Partner on behalf of the Partnership.

It is important to remember that the General Partner and Partnership are business enterprises and should be treated as such. In that regard, assets in the General Partner and Partnership should never be used to satisfy your personal obligations and/or expenses.

Presumably you have retained assets outside the Partnership for purposes of satisfying personal expenses and daily maintenance needs. Retaining assets outside the Partnership is also beneficial from an asset protection perspective because it establishes a defense to an argument that a debtor has transferred all his assets to the Partnership.

2. *Distributions from and additions to the Partnership.* The goal of the Partnership is not to render its assets inaccessible to its partners. With exception of the annual mandated percentage distributions required under certain Partnership Agreements, the General Partner has the sole authority to determine when distributions should be made from the Partnership. However, such distributions should not be disbursed to any individual partner of your choosing. Distributions made from the Partnership should generally be made pro-rata to the partners in accordance with their respective partnership percentages. If you need disproportionate distributions, proper procedures can be implemented to redeem some of the partnership interest of the partner receiving such disproportionate distribution. If it is contemplated that distributions from the Partnership will be made on a regular basis, such distributions should not be linked to a partner's personal expenses or recurring obligations, including already existing patterns of gift giving.

Regarding additions to the Partnership, consider potential gift tax consequences which may arise by the resulting indirect increase in the value of a non-contributing partner's interest. Furthermore, if additional assets will be contributed to the Partnership, such contribution should be properly documented with the necessary paperwork and may adjust the number of units issued to each partner based upon which partners make contributions to the Partnership.

3. *Maintenance of Corporate Books and Records.* Pursuant to the Operating Agreement of the General Partner, an annual meeting of the members and managers of the General Partner should be held to elect officers and managers of the General Partner for the succeeding year and to discuss other entity business. On an annual basis, minutes should be prepared and signed by the General Partner's officer and should be maintained. Minutes of the General Partner that pertain to Partnership business, as well as minutes of the Partnership, should be sent to the partners of the Partnership when completed and a copy should also be maintained. If you hire a bookkeeper to maintain the General Partner and Partnership's books and records, the bookkeeper's fees should be paid from the General Partner or Partnership's bank account, as applicable.

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4. *Day-to-Day Partnership Business Maintenance of Partnership Books and Records and Establishment of Capital Accounts.* As previously mentioned, the overall management and control of the business and affairs of the Partnership is vested in the General Partner. Specifically, the General Partner is required to maintain records of all Partnership transactions. Although you should keep written documentation to reflect such transactions at the time they occur, we suggest that you prepare a written account of the Partnership activity as a whole on an annual basis. In that regard, it is probably best to prepare such written account at the end of each year so that you can reflect

all of the Partnership activity for the year in one accounting. In addition, after such written account is prepared, it should be sent to each partner of the Partnership.

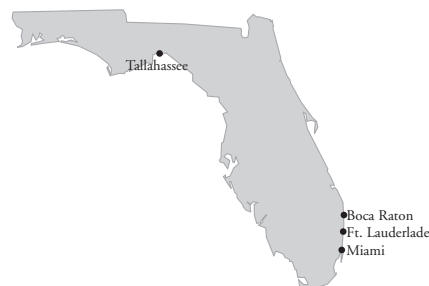
In conjunction with the preparation of the written account of the Partnership activity, as discussed above, we recommend that a Partnership meeting be scheduled and held on at least an annual basis. Such meeting should be attended by all of the partners, and should probably include your accountant, investment advisor and attorney. The meeting should be documented in the Partnership records. You should discuss Partnership business including, but not limited to, the investment policy for the succeeding year.

Under Florida tax law, Partnership interests owned by a Florida resident are exempt from the Intangible Personal Property Tax because the underlying intangible personal property owned by the Partnership will be reported by the Partnership. However, if the Partnership is not created under the laws of, or conducting business in, the State of Florida, the Partnership has no tax situs in Florida and hence no duty to report the tax. Regulations issued by the Florida Department of Revenue requires that all management and control, and the performance of functions consistent with management and control, must occur outside of Florida, and books, records and financial statements must show entries connected with ownership, management and control outside of Florida.

Regarding the day-to-day decision making with respect to Partnership business, no vote or consent of the limited partners would be required to authorize the General Partner to take any action on behalf of the Partnership. However, there are certain Partnership matters in which the limited partners would have a vote. Specifically, the limited partners have a right to vote upon the addition or substitution of the General Partner, the addition of new partners, the transfer or assignment of the General Partner's interest, the amendment of the Partnership Agreement and the dissolution of the Partnership. In other words, the limited partner has a "say" on those matters that have a substantial effect on the Partnership's business. In order for the limited partners to remain apprised of Partnership operations, the General Partner should provide the limited partners with financial information regarding the Partnership, such as a balance sheet, annual profit and loss statement and a copy of its Federal income tax return.

In addition, pursuant to the terms of the Partnership Agreement, each partner of the Partnership should have a separate capital account determined and maintained in accordance with the Internal Revenue Code and the Treasury Regulations promulgated thereunder. Your accountant should be able to assist you with establishing the appropriate capital accounts.

5. *Tax Matters/Annual Reports.* It is important that the Partnership and the General Partner remain active in its state of organization. Such active status should be maintained by the payment of appropriate registered agent fees and the satisfaction of any state requirements. If such tax is not paid on a timely basis,



the entity risks becoming delinquent or administratively dissolved. It is also important that you apprise your accountant that you have created a Partnership with a limited liability company as its general partner, as each entity must file an annual income tax return on Form 1065. Such returns are informational type returns whereby income flows through to the partners and members of the Partnership and General Partner, respectively.

Your accountant should also determine whether any state income or intangibles tax returns need to be filed.

If it is determined that the General Partner and/or Partnership is required to pay any annual taxes (i.e., real estate or intangibles tax), the appropriate entity should pay the respective tax. The partners of the Partnership or the member of the General Partner should never pay the taxes on behalf of the entity. Similarly, a partner's estimated and actual tax payments should be made by such partner, individually. The Partnership should never make a partner's estimated or actual tax payment on such partner's behalf.

6. *Issues Upon the Death of a Partner.* If a partner dies owning a limited partnership interest in the Partnership, such limited part-

nership interest would be included in that partner's gross estate for Federal estate tax purposes. Depending upon how the estate is structured, estate taxes may be due and payable at death. Any estate tax should be paid by the estate owing such tax. The Partnership should not pay the estate tax on behalf of the estate. Rather, the Partnership may make a distribution to such estate in advance of the due date of the tax and in excess of the actual amount needed to satisfy the tax liability. Alternatively, the Partnership would be able to loan money to the estate for such purpose. If a loan is made, it should be documented in the Partnership's books and records and the appropriate interest should be charged and paid.

Further, upon the death of a partner, assets of the Partnership should not be used to satisfy any bequests of such partner. Rather, the Partnership should make a distribution to the estate as suggested with the payment of estate taxes.

We suggest that you consult your professional advisor immediately upon the death of a partner and prior to making any distributions from the Partnership. There will probably be tax implications that need to be addressed concerning any such distributions.

CONCLUSION

It is critical that the Partnership formality be respected, and it is your responsibility to maintain the Partnership as such. Again, those cases in which the partnership was scrutinized were in circumstances where clients were (1) commingling entity assets with personal assets, (2) paying personal expenses from Partnership accounts, (3) distributing assets from the Partnership in a manner which disregarded the partner percentages, (4) disregarding the maintenance of entity records and (5) disregarding the creation and/or the maintenance of the appropriate entity accounts. If you avoid these pitfalls, your goals in creating the Partnership should be accomplished. ■

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Mr. Wolf has practiced in the areas of Trusts and Estates since the inception of his professional career on Wall Street. Since then, Mr. Wolf has spent his entire career in private law practice in New York City and then Florida.

Mr. Wolf has developed a statewide reputation as a knowledgeable practitioner through his participation as a speaker in the Florida Bar's Continuing Legal Education Program, as a panelist on programs sponsored by the Florida Attorney/Trust Officer Liaison Conference, and as a primary draftsman of revisions to Florida's trust law (Chapter 737, Florida Statutes). Mr. Wolf has been awarded an "AV" rating by Mar-

tindale-Hubbell and in May, 1993 was awarded the Annual Achievement Award by the Real Property, Probate and Trust Law Section of The Florida Bar for his outstanding effort and achievement on behalf of the Bar. In December 2005, Mr. Wolf was selected as one of the Top 100 Attorneys in the United States by Worth Magazine.

Mr. Wolf's major area of legal experience and expertise are Estates and Trust, Probate, Estate and Financial Planning. He is a Board Certified Estate Planning and Probate Lawyer by the Board of Legal Specialization and Education of The Florida Bar.

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