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Preferred partnership freeze: A useful estate planning vehicle

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Preferred partnerships or limited liability companies (LLCs) are useful and versatile estate planning vehicles that are well suited to act as multi-generational family investment vehicles.

From an estate planning perspective these partnerships are sometimes referred to as “freeze partnerships”, because they provide a structure that enables one class of partnership interests, typically held by a senior family member, to be “frozen” in terms of rights to a limited fixed rate of return, thereby enabling future appreciation in excess of the fixed rate to inure to the benefit of the other class of partnership interests, typically held by the younger family members or trusts for their benefit.

Low real estate values, coupled with a low interest rate environment, enhance the usefulness of the freeze transaction.

The Partnership freeze can be particularly useful to a real estate owner that has low basis property held in a partnership (or LLC) and a significant negative capital account (as a result of prior years’ depreciation deductions and refinancing) and is interested in a basis step-up that occurs at death, if the asset is owned at that time.

The senior member contributes a low value LLC interest to a newly formed partnership or LLC (the freeze partnership) in exchange for a preferred interest entitling the senior member to a fixed cumulative annual preferred return and a liquidation preference equal to the value of the contributed asset.

The junior family members, or trusts for their



benefit, contribute assets to the freeze partnership in exchange for a “common” or residual interest, which entitles them to partnership cash flow above the preferred return and appreciation above the preferred interest’s liquidation preference.

As with many estate freeze techniques, such as grantor retained annuity trusts (GRATs) or installment sales to grantor trusts, the freeze partnership is an attractive estate planning technique in that the older generation retains a steady income flow and protection of capital, while the younger generation captures upside growth. An added feature of the freeze partnership is that the senior member has retained a preferred “frozen” interest in the asset so that at death the income tax basis of the preferred interest is stepped up to its fair market value

(likely equal to the liquidation preference.) This eliminates a negative capital account, which provides a significant benefit.

The partnership freeze is a complex transaction which requires careful consideration of various income and gift tax issues.

If carefully structured, it can be accomplished without incurring income or gift tax liability.

It must also involve an independent appraiser to determine the appropriate coupon rate on the preferred partnership interest and value of such interest.

At MWE, family business planning is a highly specialized discipline. We understand the complexity of devising a succession strategy that will sustain a business enterprise into the future, while protecting the personal wealth and financial well-being provided by the owner’s life’s work.

We are experts at navigating the sensitive interpersonal dynamics that often define a company’s character, to arrive at an ownership and management infrastructure that capitalizes on the strengths of individual family members and other key executives active in the business. Simultaneously, the planning process must also provide equitably for other family members.

As tax and business planning specialists, we are able to ensure that the transfer of assets is properly structured for maximum financial benefit to all parties, utilizing sophisticated planning strategies designed to meet the particulars of an individual’s circumstances.

The planning process involves the implementation of an interim estate plan that ultimately evolves into a final plan which provides flexibility, and accommodates unforeseen contingencies or revisions.

Since 1946, MWE has mastered the finer details of successful family business transitioning and estate planning. Our approach encompasses a disciplined and focused process that results in a comprehensive plan that successfully synthesizes the owner’s business, personal and family priorities, and achieves consensus among the stakeholders and other family members.

“We call this turning vision into value. You’ll call it one of the best family business decisions you’ve made.”

The experts who comprise our Family Business Practice Group represent the highest

standards of achievement in the field. Many are active in leading professional associations and serve on specialized committees in order to remain current with new industry trends and developments.

Whatever the circumstances, MWE has the expertise to help devise and implement the right solution.

As business succession, estate and retirement planning consultants, we will apply our experience and body of knowledge to arrive at solutions that successfully integrate the dynamics of business and family, for the full benefit of all concerned parties.

We call this turning vision into value. You’ll call it one of the best family business decisions you’ve made.