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# ESTATE PLANNING CHOICE OF WEALTH MANAGEMENT ENTITY: THE LIMITED PARTNERSHIP AS AN ALTERNATIVE TO THE TRUST

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## I. INTRODUCTION

The substantial and steady increases in the amount a taxpayer can transfer free of federal estate, gift, and generation skipping transfer taxes<sup>1</sup> makes transfer tax planning irrelevant when counselling more than 99.9% of Americans.<sup>2</sup> Traditional estate planning structures set in place at a time when the estate tax impacted many more Americans may no longer achieve a client's current estate planning goals. The seismic shift in the estate planning paradigm requires estate planners rethink use of planning structures in light of shifting client objectives. Evaluated in terms of these shifting objectives, the limited partnership may prove just as nimble as the trust in reacting to altered goals of affluent clients who desire continued management

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1. See Rev. Rul. 93-12, 1993-1 C.B. 202. Limited partnerships grew in popularity as an estate planning tool following issuance of Revenue Ruling 93-12, which signaled the ability to take minority interest discounts for interests held in a family limited liability entity. From 1987 through 1997, the aggregate transfers, both during life and at death, that an individual could pass free of federal estate and gift tax totaled \$600,000, based on a unified credit amount of \$192,800. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 401(a)(2)(A), 95 Stat. 172 (codified as amended at I.R.C. § 2010(b) (2018)). The Taxpayer Relief Act of 1997 ushered in a gradual increase in the amount an individual taxpayer could pass free of Federal estate and gift tax from \$600,000 to \$675,000. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 501(a)(1)(A), 111 Stat. 788 (codified as amended at I.R.C. § 2010(a) (2018)). Congress again enacted increases in 2001 from \$1,000,000 to \$3,500,000 effective as of 2009. The Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 521(a), 115 Stat. 38 (codified as amended at I.R.C. § 2010(c) (2018)). In 2011, Congress retroactively increased the amount to \$5,000,000 as of 2010, with inflation adjustments beginning in 2012. Most recently, in 2017, Congress temporarily increased the amount from 2018 through 2025 to an inflation adjusted \$10,000,000. Act of Dec. 27, 2017, Pub. L. No. 115-97, § 11061(a), 131 Stat. 2054 (codified as amended at I.R.C. § 2010(c)(3) (2018)).

2. *Tax Policy Center Briefing Book: Key Elements of the U.S. Tax System*, TAX POLICY CENTER, URBAN INSTITUTE AND BROOKINGS INSTITUTION, <https://www.taxpolicycenter.org/briefing-book/how-many-people-pay-estate-tax> (last visited Feb. 15, 2020); see also INTERNAL REVENUE SERV., PUB. NO. 5332, ESTATE TAX RETURNS FILED FOR WEALTHY DECEDENTS, FILING YEARS 2008-2017 (2018).

as assets pass to the next generation. This Article explores the continued viability and new role the limited partnership can take in estate planning.

Many clients formed limited partnerships as an estate planning vehicle to minimize estate tax. Limited partnerships, if created to achieve a significant non-tax motive, have historically yielded sizeable valuation discounts, thereby minimizing estate tax.<sup>3</sup> With the goals of many affluent clients shifting from estate tax savings to income tax savings, some professionals have counselled clients to dissolve existing limited partnerships. Eventual modification of the partnership agreement, as opposed to dissolution of the limited partnership, however, may prove the better strategy.

Closer scrutiny of limited partnership characteristics important to non-tax succession goals indicates some clients may prefer the limited partnership to using the more traditional structure of a trust. Differences in investment duties, income taxation, and ease of amending terms, when compared to a trust, can make the limited partnership a favored choice for clients who wish to provide a flexible wealth management vehicle as assets transfer to the next generation. The limited partnership, with its characteristic use of an entrenched general partner, mimics the trust in ways important to the continued management of assets, and yet at the same time it provides ability to simplify and lower the costs of ongoing administration. The latest version of the Uniform Limited Partnership Act,<sup>4</sup> (“ULPA”) in fact, was crafted with estate planning uses in mind.<sup>5</sup> Not surprisingly, when tested against primary planning goals of affluent clients for whom the estate tax has become irrelevant, specifically continued management

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3. See, e.g., *Lappo v. Comm’r*, 86 T.C.M. (CCH) 333 (2003) (allowing a 15% minority interest discount, and a 24% lack of marketability discount); *Adams v. U.S.*, 218 F.3d 383, 387-88 (5th Cir. 2000) (allowing a 20% minority interest discount for assignee’s lack of control, a 10% portfolio discount for poorly diversified assets and a 35% lack of marketability discount for lack of a ready market).

4. UNIF. LTD. P’SHP ACT (amended 2013) [hereinafter ULPA].

5. UNIF. LAW. COMM’N, THE UNIFORM LIMITED PARTNERSHIP ACT: A SUMMARY (2019), <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=BA658bd6-ac05-be85-fc99-178fd09f21da&forceDialog=0> [hereinafter SUMMARY]. The Summary, provided as part of the legislative enactment kit, indicates: ULPA (2001) was drafted for a world in which limited liability partnerships (LLPs) and limited liability companies (LLCs) can meet many of the needs formerly met by limited partnerships. Therefore, ULPA (2001) targets two types of enterprises that are largely beyond the scope of LLPs and LLCs . . . . Second, ULPA (2001) addresses the modern needs of estate planning arrangements, so-called “family limited partnerships.” In addressing these concerns, this act assumes that people utilizing it will want both strong centralized, entrenched management, and passive investors or limited partners with little capacity to exit the entity. As a result, the act’s rules, and particularly its default rules, have been designed to reflect those assumptions. *Id.*; see also ULPA Prefatory Note.

oversight, creditor protection, and income tax minimization, the limited partnership reveals itself as a viable estate planning entity. After taking into account the benefits of simplified administration duties and administrative costs associated with the limited partnership, the limited partnership may evolve to find a niche as a viable wealth management strategy for those clients who have no ongoing estate tax planning concern.

This Article takes a closer look at the limited partnership as an alternative to the trust. After summarizing the shift in client perspective and objectives in part two, this Article analyzes specific characteristics of the limited partnership important to achieving those goals in comparison to the trust; in part three, it reveals the general partner, much like a trustee, can provide management of partnership assets and determine the timing and appropriateness of distributions to interest holders. The limited partnership, further, can provide some protection of assets from the immediate reach of a limited partner's creditors. It also can minimize income tax burdens when compared to a trust. The limited partnership can meet these client preferences and, at the same time, avoid certain downsides of trusts, such as more stringent investment duties and hurdles faced in trust modification. The analysis reveals that the characteristics of the limited partnership, as compared to a trust, make it a viable choice for affluent clients.

## II. OVERARCHING CLIENT GOALS IMPACTING ENTITY CHOICE

Clients often come to an estate planning conference with some generalized estate planning goals. Most have a clear idea of who they wish to inherit the use of their property but may not have a set understanding of how to address issues of children from a prior marriage or special needs a child may have. Many come to the conference with a desire to minimize the portion of their estate used to pay taxes. Some specifically want to protect assets from a beneficiary's creditors. The choice of planning strategy should strive to maximize these goals to the greatest extent possible.

### A. MEETING CLIENT OBJECTIVES

In addition to estate tax minimization for those who must pay it, the following are among the most typical planning goals voiced by clients:

- Provide for multiple beneficiaries, including spouse and children, from present and prior marriages;
- Assist beneficiaries with asset management;

- Control timing and amounts of distributions made to beneficiaries;
- Protect assets from a beneficiary's creditors; and
- Obtain an income tax basis step-up for appreciated assets on decedent's death.

Both lifetime trusts and those trusts funded on the death of the client can meet some or all of these goals. Use of limited liability entities, in particular the limited partnership, can also assist a client in meeting these goals. The appropriate choice depends on how a client weighs and balances these goals and the associated administrative costs in using the entity as a wealth management vehicle.

The planner should consider benefits and costs attendant with each choice—trust and limited partnership—given the client's circumstances and assets. In addition to the planning goals listed by the client, the following are additional factors to weigh in assessing the appropriateness of the entity used in transferring wealth:

- ability to modify or amend terms of the governing instrument;
- ability to limit fiduciary duties of care and management;
- ability to allow flexibility in investment choices; and
- ability to minimize any ongoing state income tax burden.

Some of these goals can best be addressed through the use of trusts, others may be achieved by forming a limited partnership or other limited liability entity.<sup>6</sup> Because its drafters designed the most recent version of the limited partnership specifically for use in estate planning, whereas the limited liability company was designed with general business needs in mind, this article focuses on the limited partnership as the alternate choice of entity for wealth management to the trust.

Very generally, for clients whose goals include the desire to provide multi-generational protections and tailored decision making, the trust remains the optimal entity to achieve these goals. For clients who prefer minimal administrative interventions and yet some control over timing of distributions, the limited partnership may provide an excellent cost-effective choice to achieve family succession planning. The limited partnership allows greater opportunity for streamlining income tax planning decisions, increasing investment flexibility, and easing procedures to amend the governing agreement. These last can tip the choice in favor of the limited partnership for some clients.

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6. ULPA Prefatory Note. The most recent version of the ULPA includes as part of the limited partnership default rules those anticipated preferences of clients who wish to use the entity to minimize estate tax costs. This is not the case with the Uniform Limited Liability Company Act. For this reason, the following analysis concentrates on comparing trusts and limited partnerships formed under the ULPA.

## B. KEEPING IT SIMPLE

In assessing advantages and disadvantages of estate planning strategies, most clients prefer adherence to the adage, “keep it simple.” Clients shy away from the complexity of trust administration and legal restrictions imposed on trusts. Their questions tend to proceed in a similar fashion when considering whether to put a trust in place. Commonly voiced questions of clients include:

- Can the terms of the trust be changed if our family circumstances change?
- Can I require the trustee not to sell my assets?
- How much is this trust going to cost me and my family in the future?
- If the client is a litigator by trade: Can I exculpate the trustee to avoid litigation fees for breach of fiduciary duty claims?

Even upon learning the answer to these questions, the prospect of paying 40% in estate tax often encourages clients to move forward with intricate estate tax planning. For those clients whose cost-benefit analysis no longer includes payment of estate tax, yet who still wish to provide for management and control of family assets, a limited partnership may achieve estate planning goals with more tolerable costs and fewer disadvantages than a trust.

The susceptibility of trusts to a number of increased administrative costs, in comparison to the limited partnership, makes the limited partnership an option worth considering as a primary estate planning vehicle for those clients whose estates fall within the expected inflation adjusted basic exclusion amount.<sup>7</sup> Some of the administrative costs unique to trusts include, (1) the possibility of federal income taxation at compressed rates,<sup>8</sup> (2) the possibility of exposure to multiple state taxing jurisdictions assessing income tax,<sup>9</sup> (3) the likelihood of litigation for failure to diversify the trust’s investment portfolio and

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7. I.R.C. § 2010(c) (2018). The basic exclusion amount is the aggregate amount an individual can transfer without paying estate or gift tax. *Id.* The basic exclusion amount for years 2018 through 2025 is \$10,000,000, as that amount is adjusted for inflation. The 2020 inflation adjusted basic exclusion amount equals \$11,580,000. Rev. Proc. 2019-44, 2019-47 I.R.B. 1093. Absent further action by Congress, the basic exclusion amount in 2026 reverts to an inflation adjusted \$5 million, essentially halving the basic exclusion amount as of 2026. I.R.C. § 2010(a)-(c).

8. Compare I.R.C. § 1(j)(2)(E) (addressing taxable income of a trust or estate in excess of \$12,500, as adjusted for inflation, at the highest individual rate for tax years 2018 through 2025), with *id.* § 1(j)(2)(A) (addressing taxable income of married individuals filing jointly in excess of \$600,000, as adjusted for inflation to the highest individual rate for tax years 2018 through 2025).

9. See N.C. Dep’t of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 2213, 2221-22 (2019) (acknowledging the possibility of trust income subject to state income taxation in multiple states).

failure to treat beneficiaries impartially,<sup>10</sup> and (4) the difficulty and delay incurred in responding to changed circumstances.<sup>11</sup> Limited partnerships, for the most part, can minimize these administrative costs. The ability to minimize administrative costs goes a long way to keeping it simple for the client.

### C. CHOOSING AN APPROPRIATE WEALTH MANAGEMENT ENTITY

Neither the Uniform Limited Partnership Act nor the Uniform Limited Liability Company Act require the carrying on of a business or a business purpose, and this opens the door for use of these entities as an estate planning vehicle.<sup>12</sup> The default rules applicable to a limited liability company can be changed to mimic the default rules of the limited partnership. In fact the flexibility in entity structure means each of the three entities—the limited partnership, the limited liability company and the trust—for the most part, can achieve most client objectives with carefully crafted drafting.<sup>13</sup> To the extent entity default rules mirror client objectives, the more likely it is the client will be able to gage the outcome of a matter in light of case law interpreting the default rule. Thus, the limited partnership may prove preferable to the limited liability company in light of its specific design to achieve estate planning goals.<sup>14</sup> One factor in “keeping it simple” is to choose the entity with default rules most closely aligned to client preferences.

## III. COMPARING ENTITIES GIVEN PRIMARY CLIENT OBJECTIVES

Control, tax savings, and creditor protection goals often drive estate planning choices for clients. The client engages in estate planning principally to control and direct transfer of assets on death. The extent of control a client wishes to exert, however, varies among clients. With regard to tax savings, few clients would make the choice to

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10. See generally UNIF. TR. CODE § 803 (amended 2010) (addressing the duty of impartiality); UNIF. PRUDENT INVESTOR ACT §§ 3, 6 (1995) (discussing the duty of impartiality and duty to diversify); ACTEC FIDUCIARY LITIGATION COMMITTEE, FIDUCIARY REMEDY AND DAMAGES SURVEY: 50 STATE DAMAGES (2018). Partners owe duties of loyalty and care to one another, but investment choices are not circumscribed by duties under the ULPA. ULPA § 409(a)-(c).

11. See generally UNIF. TR. CODE §§ 410-412 (setting forth procedures for modification of trusts); UNIF. DECANTING ACT (2015). Partners in a limited partnership agreement may amend by the requisite vote required by the partnership agreement without further procedures.

12. ULPA § 110(b); UNIF. LTD. LIAB. CO. ACT § 108(b) (amended 2013).

13. ULPA § 105 (noting that except for specified matters, default rules may be changed); UNIF. LTD. LIAB. CO. ACT § 105 (except for specified matters, default rules may be changed); UNIF. TRUST CODE § 105 (amended 2010).

14. See SUMMARY, *supra* note 6.

increase the tax burden born by beneficiaries. The tax saving focus for 99.9% of Americans since 2010 has shifted primarily to income tax savings, as opposed to estate tax savings. Creditor protection, like tax savings, proves to be an objective most clients would prefer to achieve if given the choice. Obtaining a client's objectives, however, often involves trade-offs among these three principal objectives. For example, in some cases, the greater the control granted a beneficiary, the less creditor protection that can be obtained.<sup>15</sup> Likewise, the more control exerted by the donor over the beneficiary's actions, the higher the tax burden that can result.<sup>16</sup> The following discussion evaluates the ability of the limited partnership to achieve the primary goals of control, minimization of tax burden, and creditor protection, shared by most clients, in comparison to the trust, which has served as the historic entity for achieving these three client objectives. It then compares the ability to simplify and minimize administrative costs associated with the trust and limited partnership.

#### A. MATCHING THE CLIENT'S Control Objectives

Discerning a client's objectives for controlling future use of assets by beneficiaries drives in part the decision as to choice of wealth management entity. A number of questions can help explore the client's objective to control succession of assets. Why does the client want to avoid outright gifting? Is it to provide management and investment oversight? Is it to control the timing of distributions? Is it to control the purposes to which the beneficiary will put distributions? Is the client comfortable with the beneficiary having discretion to make distribution decisions? Does the client prefer a professional manager to make key decisions? Does the client wish for distributions to be made equally among children? Does the client desire to divide the use of assets to allow a spouse to use the life interest and children the remainder interest? For how many generations does the client wish to exert control? As can be gleaned from the following comparisons, the more control a client wishes to exert in the answers to these questions, the more likely the trust is the best choice of entity. Along those same lines, the more willing the client is to place discretion in the hands of

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15. For example, a beneficiary who holds a presently exercisable general power of appointment can exert essentially owner-like control of the assets subject to the power of appointment. As a result, the Uniform Power of Appointment Act § 501 (2013), allows a creditor to reach assets subject to the general power of appointment.

16. For example, if the trustee exercises discretion over distributions, and chooses to retain income and not make a distribution to the beneficiary, the retained income likely becomes subject to a higher tax rate due to the compressed income tax rate schedule applicable to trusts. See I.R.C. § 1(j)(2)(E) (2018).

the beneficiaries to make decisions in the future, the more likely the limited partnership provides an alternative to the trust.

### 1. *Controlling Distributions*

Clients explore trusts and other wealth management vehicles for the purpose of controlling use of the assets over a period of time. The trustee of a trust and the general partner of the limited partnership serve in a fiduciary capacity with powers to determine distributions. Appropriate distribution standards depend in large part on the amount of control a client desires to assert over receipt of the assets. The ability to design and target distribution standards to achieve various objectives differs between trusts and limited partnerships.

#### a. Trusts

Trusts flexibly accommodate the grantor's preferences for timing and purpose of distributions. The grantor can provide for wholly discretionary distributions, on the one hand, and more circumscribed distributions, on the other, by specifying the date distributions are to be made and the purposes for which they are to be used (i.e., for support or education). The choices made by the client about the timing of distributions and the standard for distributions often depend on the needs of the beneficiary.

Historically, for those clients with the objective to minimize estate taxation, the estate tax code drove the choice of distribution standard in many situations. For example, if a client wishes to name a beneficiary as trustee, distributions to that beneficiary and those to whom the beneficiary owes a duty of support must be limited to an ascertainable standard relating to health, education, support, or maintenance in order to avoid an adverse estate tax result for the beneficiary.<sup>17</sup> Similarly, if a beneficiary serves as trustee, in order to provide the trustee-beneficiary creditor protection, an ascertainable standard must also be used.<sup>18</sup> Alternatively, if a client wishes to name a professional trustee, wholly discretionary distributions may provide the best protection against a beneficiary's creditors, other than exception creditors carved out by state statute, which typically include children and a former spouse.<sup>19</sup>

Trusts can also accommodate the need to provide for a surviving spouse and children of a prior marriage. One type of trust, known as the qualified terminable interest property trust ("QTIP trust") achieves both an estate tax marital deduction and division of the use

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17. See I.R.C. § 2041(b)(1)(A) (2018).

18. See UNIF. TRUST CODE § 504(e) (amended 2010).

19. See *id.* § 504(b).

of trust assets as between the surviving spouse and other trust beneficiaries. QTIP trusts require that all income passes to the surviving spouse with no distributions of principal to anyone other than the surviving spouse during his or her lifetime.<sup>20</sup> On the death of the surviving spouse, the client's children or other named beneficiaries receive what remains for distribution as remainder beneficiaries.

The estate planner can tailor the distribution standard employed in a trust to meet specific planning goals and client preferences. For clients no longer concerned about incurring federal estate tax or obtaining a marital or charitable deduction, the options for designing distribution standards become broad indeed, limited only by the planning goals undertaken and the desire to obtain creditor protection for the person serving as trustee.

#### b. Limited Partnerships

Limited partnerships cannot match the flexibility provided by trust law in the design of distribution standards. The general partner, however, can control timing of distributions and determine the amount of distributions.<sup>21</sup> The general partner, unlike a trustee, is not given discretion to make differing allocations among partners.<sup>22</sup> Variations in distributive shares must instead appear in the partnership agreement. The partnership agreement can provide for partnership interests with different economic rights, but once the general partner determines a distribution is appropriate, the general partner makes distributions according to the economic rights as specified in the agreement.<sup>23</sup>

The drafter can craft preferred interests to match a donor's preference for treating holders of certain limited partnership interests differently from holders of other interests. For example, preferences may require distributions be made first to the class of partnership interests to be transferred to and owned by the surviving spouse. Preferred interests can also be designed to ensure certain owners receive distributions before others and in differing amounts. In addition, voting preferences can allow certain owners of limited partnership interests to have more control than others should the client wish to provide vot-

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20. I.R.C. § 2056(b)(7).

21. ULPA § 503(b). The discretion of the general partner to make distributions is limited. A general partner may not make distributions without bearing personal liability for the amount distributed to the extent that partnership assets are insufficient to pay the limited partnership's creditors or to the extent that the distribution would cause partnership income to be insufficient to meet partnership debts as they come due in the ordinary course of business. See ULPA §§ 504(a), 505.

22. See generally *id.* § 503.

23. See *id.* § 503(a).

ing rights to limited partners on certain issues.<sup>24</sup> Preferences can also be scheduled to convert on the death of the original beneficiary. The ability to tailor economic benefits and management preferences in a limited partnership allows the client to designate benefits received by holders of the varying interests and to designate the amount of management control exercisable by interest holders.

If it is important to the donor's plan, the spousal preferred interests can carry preferential rights to achieve a marital deduction. For couples whose assets do not exceed the applicable exclusion amount, it is not necessary to qualify property passing in trust for the marital deduction unless the planning goal is to obtain a second step-up in basis on the survivor's death.<sup>25</sup> Clients, who no longer need to claim a marital deduction to avoid payment of estate tax until the survivor's death, can be more creative in the division of property as between spouse and children. It is possible to divide interests by carefully designing separate classes of limited partnership interests with varying economic rights. These rights can protect the spouse by providing distributions that first satisfy preferred rights held by the surviving spouse, and only if those rights have been fully satisfied do other limited partners receive any portion of the distribution.<sup>26</sup> Absent estate tax concerns, the applicable elective share statute, not the need to qualify for the marital deduction, now serves as the primary constraint in designing an estate plan for an affluent married client with assets under the basic exclusion amount.<sup>27</sup> The limited partnership offers an excellent vehicle to meet the requirements of the elective share statute as it can ensure ultimate transfer of assets through enforcement of buy-out provisions in favor of the client's children and grandchildren.<sup>28</sup>

The estate tax planning strategies, developed to freeze the value of a client's estate by having the client retain preferred interests and other preferences in relation to limited and general partnership interests, caused Congress to enact estate tax anti-abuse provisions in

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24. *Id.* § 303(a). The current ULPA allows limited partners to vote on issues without losing the benefit of the limited liability shield. *Id.* A client can also provide for differences in voting rights of the general and limited partners without triggering adverse tax consequences. *See* I.R.C. § 2701(a)(2)(B) (2018). These provisions allow the client to provide a voice in certain management issues to owners of limited partnership interests.

25. I.R.C. § 1014(b)(10).

26. Although I.R.C. § 2701 may apply to such rights, the rights can be structured as a qualified payment to alleviate estate and gift tax concerns, or if there is no concern regarding estate tax, the rights can be structured otherwise. *See id.* § 2701.

27. Elective share statutes typically require a client to transfer a certain portion of the client's assets to the surviving spouse at death. *See* UNIF. PROB. CODE §§ 2-201-2-214 (amended 2019)

28. *See infra* notes 38-42 and accompanying text.

1990.<sup>29</sup> The anti-abuse provisions directly address valuation of interests retained and transferred by a donor in the context of entities, trusts, and buy-out agreements. Careful structuring of a limited partnership can nevertheless achieve substantial estate tax planning goals despite the anti-abuse rules.<sup>30</sup> In planning for the 99.9% of clients with no estate tax worries, the planner need not necessarily adhere to the roadmap for achieving estate freezes provided by the anti-abuse rules, although given the political nature of the size of the basic exclusion amount, it is always a good idea to keep in mind and accommodate the strictures of the anti-abuse provisions to the extent feasible in light of client objectives.<sup>31</sup>

Although trusts offer flexibility in designing standards for distributions, some clients prefer the ability of a limited partnership to define distributions in terms of economic interests. The general partner, like the trustee, can control timing of distributions. Like a trustee, the general partner can also exercise discretion over the amount distributed. Once the general partner exercises discretion to make a distribution, however, each interest holder receives an amount as defined by the limited partnership agreement. The certainty of how distributions will be divided among owners of partnership interests can be attractive to clients who hesitate to place too much discretion in the hands of the fiduciary.

The limited partnership provides an alternative for more tailored standards when the client objective is to obtain creditor protection or flexibility to amend.<sup>32</sup> The use of wholly discretionary standards in trusts has increased of late to accommodate client objectives of creditor protection and flexibility for a trustee to modify trust provisions as necessary to achieve tax planning and other objectives of beneficiaries in the future. Wholly discretionary standards take control from the client and place it with a trustee. This shift in control concerns some

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29. See I.R.C. §§ 2701–2704.

30. See, e.g., N. Todd Angkatavanich & Johnathan A. Mayer, *A Tale of Three Freezes*, N.Y. ST. SOC'Y CERTIFIED PUB. ACCT. (Aug. 1 2018), <http://www.nysscpa.org/most-popular-content/a-tale-of-three-freezes#sthash.Uu4F5qpg.dpbs>; William T. Kriesel, *Accomplishing Estate Planning Goals through the Use of Partnership Income Tax Rules*, CPA J. (May 2017), <https://www.cpajournal.com/2017/05/29/accomplishing-estate-planning-goals-use-partnership-income-tax-rules/>; Christopher Pegg & Nicole Seymour, *Rethinking I.R.C. § 2701 in the Era Of Large Gift Tax Exemptions*, 87 FLA. B.J. 34 (2013).

31. In 2019, Senator Bernie Sanders introduced a bill to reduce the basic exclusion amount to its former \$3,500,000. For the 99.8 Percent Act, S. 309, 116th Cong. (2019).

32. The need to easily amend trust provisions without providing for representation of unidentified beneficiaries led to the adoption of the Uniform Decanting Act, which allows a trustee who holds discretionary powers to “decant” assets of a trust to a new trust with different provisions under certain circumstances. UNIF. TRUST DECANTING ACT §§ 11–12 (2015).

clients.<sup>33</sup> The limited partnership provides an avenue to achieve both the objective of obtaining a modicum of creditor protection and the ability to respond to future needs to modify terms without placing discretion wholly in the fiduciary.<sup>34</sup>

## 2. *Generational Planning*

Another aspect of control important to clients is the ability to control the use and distributions of family assets over the course of multiple generations. The prospect of using a client's exemption from generation-skipping transfer tax and future estate tax ("GST exemption") to protect property from federal estate tax over the course of multiple generations has made dynasty planning attractive to affluent clients.<sup>35</sup> The rule against perpetuities, in those states where it has not been repealed, dampens the ability to maximize the tax savings effect of GST tax planning. Those states without a rule that limits the time a trust for private beneficiaries can exist encourages planning for the purpose of maximizing use of the GST exemption.<sup>36</sup>

### a. Trusts

The trust, unlike the limited partnership, can provide for control over multiple generations and for effective use of the GST exemption. The client can allocate his or her GST exemption to protect trust assets from estate taxation for multiple generations. Trust terms can ensure longevity of the trust subject to any applicable perpetuities period. GST trusts typically provide for discretionary distributions, with principal not distributed retained in the trust for use by future generations. The terms of such trusts prevent inclusion in a beneficiary's gross estate for purposes of applying the federal estate tax.

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33. The desire of clients to avoid placing complete discretion in the hands of a fiduciary proved the impetus for the Uniform Directed Trust Act. The Act generally allows a person specified in the trust instrument to direct the trustee as to certain acts and decisions to temper discretion held by the trustee. UNIF. DIRECTED TRUST ACT (2017).

34. See *infra* notes 126-31 and 143 and accompanying text.

35. The GST exemption currently equals the basic exclusion amount. I.R.C. § 2631(c) (2018). This means for transfers made in 2020, a client can allocate up to \$11,580,000 of GST exemption to protect property held in a dynasty trust from further federal estate and gift taxation. *Id.* § 2010; Rev. Proc. 2019-44, 2019-47 I.R.B. 1093.

36. A majority of states have eliminated or modified the rule against perpetuities to allow for certain private trusts to continue beyond the time limit imposed by the rule against perpetuities. AM. COLL. OF TR. & ESTATE COUNSEL, THE RULE AGAINST PERPETUITIES: A SURVEY OF STATE (AND D.C.) LAW (2012). The survey indicates that as of March 2012: "A majority of states have eliminated the rule against perpetuities, either entirely or for certain types of trusts, or have adopted a very long fixed permissible period of the rule." *Id.* at 7.

## b. Limited Partnerships

A limited partnership alone cannot ensure longevity of planning in the same way that a trust can. Although a limited partnership, under the latest version of the ULPA, has unlimited duration,<sup>37</sup> the partnership may be dissolved under certain circumstances.<sup>38</sup> The limited partnership is subject to administrative dissolution if required state filings and fees are not kept current and to court ordered dissolution under certain circumstances.<sup>39</sup> If a client desires to control use of assets over multiple generations, the client should use a trust to achieve effective use of the GST exemption. A limited partnership proves an appropriate planning vehicle if a client wishes to place some control in the hands of the ultimate beneficiaries of the partnership interests to continue the benefits of the entity long term, but not necessarily for multiple generations.

The partnership agreement can, however, provide limitations to prevent a limited partner from transferring the partner's interest except to other family members. In this way, the partnership agreement can encourage limited partners to make subsequent transfers to children, grandchildren, and other family members of the client. The default rules of the ULPA help achieve this goal by restricting a limited partner's right to dissociate. A limited partner does not have the right to dissociate under the ULPA.<sup>40</sup> There are no provisions in the ULPA that would force the partnership to buy the limited partner's interest on dissociation. On dissociation, the limited partner would have no more than a transferee interest. To become a partner, a transferee of the limited partner's interest generally would need to obtain the unanimous consent of the partners or satisfy the provisions otherwise provided in the partnership agreement.<sup>41</sup> The partnership agreement, however, can change these restrictions under the ULPA. If appropriate, the partnership agreement can allow gratuitous transfer of partnership interests during life or at death to a limited class of transferees, including for example, descendants of a particular partner or former partner. On an attempted sale or other transfer by a limited partner of a transferee interest, the limited partnership agreement can require other partners be given rights of first refusal. Limitations on the transfer of a limited partnership interest can serve to maintain continued family control over assets.

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37. See ULPA § 110(c).

38. See generally *id.* § 801.

39. *Id.* §§ 801(a)(6)–(7).

40. *Id.* § 601(a).

41. *Id.* §§ 301(b)(1)–(3).

### 3. *Choosing Fiduciaries*

Clients must necessarily appoint a fiduciary to manage assets of the trust or limited partnership. Client choices for providing management services include professional managers, trusted family members, and trusted advisors, or a combination of these persons. Some clients prefer to appoint multiple fiduciaries to jointly make decisions. Both the trust and the limited partnership allow for an array of management choices.

#### a. Trusts

In deciding responsibility for trust management, clients typically appoint either a trusted family member or friend, or a professional trustee. Because both bring different expertise and perspective, some clients appoint co-trustees, one a professional trustee and the other a family member. Some clients instead divide trustee rights and responsibilities among more than one co-trustee. It has become popular of late to use a form of directed trust where an administrative trustee is subject to directions by another as to distributions or investment.<sup>42</sup> Generally, a directed trustee and the person provided authority to direct certain aspects of the trust are each subject to fiduciary duties.<sup>43</sup> The Uniform Directed Trust Act clarifies that trusts can also be designed to grant a person a non-fiduciary power of appointment not subject to fiduciary duties, which can be exercised at the discretion of the power-holder subject to the terms of the power granted.<sup>44</sup> The client, thus, has considerable flexibility in determining a trust's management design.

#### b. Limited Partnerships

The limited partnership's general partner exclusively manages the partnership.<sup>45</sup> Typically the general partner will own an interest in the partnership; however, the most recent version of the ULPA recognizes a limited partnership need not be formed for a business purpose and permits a general partner who does not acquire a transferable interest or make a contribution in exchange for the interest.<sup>46</sup> This provision, thus, accommodates appointment of an individual, family or non-family member, or a professional manager to serve as general partner. Similar to co-trustees, multiple persons may act

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42. See UNIF. TRUST CODE § 808 (amended 2010) (superseded by UNIF. DIRECTED TRUST ACT §§ 6–7 (2017)).

43. *Id.*

44. UNIF. DIRECTED TRUST ACT § 5(b) cmt. 1.

45. ULPA § 406(a).

46. *Id.* § 401(c)(1) cmt.

as general partners with disagreements resolved by a majority vote.<sup>47</sup> In addition, the partnership agreement may designate particular duties to one or more named general partners thereby allowing for division of duties similar to that which is accomplished by use of a directed trust. By allocating duties among persons serving as general partner, general partners obtain relief from performing duties assigned to other general partners.<sup>48</sup> With careful drafting, the limited partnership can provide for client preferences as to who will manage with much the same intricacy as can be achieved in appointing a trustee to manage a trust. Under the most current version of the ULPA, clients can achieve much the same preferences when appointing general partners as is achieved when appointing trustees.

The exclusive management rights of a general partner historically caused the general partner to bear personal liability for debts of the partnership. To avoid imposition of personal liability, planners structure the general partner as a corporation. The corporate form essentially provides the limited liability for the general partner otherwise absent from limited partnership statutes. Responding to the proliferation of limited liability entities, in 2001, the ULPA added limited liability provisions in the form of a limited liability limited partnership to protect general partners without the need to form a corporation to own the general partnership interest.<sup>49</sup> The limited partnership, thus, may provide limited liability protection for the general partner either through careful planning with a corporate general partner or by electing limited liability limited partnership status. The limited liability protection for the general partner bears similarity to that afforded a trustee for contracts and those torts for which the trustee is not personally at fault.<sup>50</sup> The limited liability limited partnership essentially provides the same liability protection to the fiduciary general partner as the trust provides the trustee.

#### 4. Resignation, Removal, and Succession

Clients exercise continued control over who manages family assets by setting forth a procedure to name successor fiduciaries. The Uniform Trust Code specifically acknowledges the ability of a trustor

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47. *Id.* § 406(a).

48. *Id.* Any division of duties, however, must not be manifestly unreasonable. *Id.* § 105(d)(2)(A). An example deemed by the comments to be reasonable is allocation of the management of each of three separate businesses to each of three separate general partners. *Id.* § 105(d)(2)(A) cmt.

49. *Id.* § 404(c) cmt.

50. UNIF. TRUST CODE § 1010 (amended 2010). Anticipating that the trustee may serve as a general partner of a limited partnership, the Uniform Trust Code further specifically provides trustee limited liability for actions taken as a general partner of a limited partnership, with trust assets footing the liability. *Id.* § 1011.

to provide for succession of trustees.<sup>51</sup> The ULPA does not directly address succession of general partners, however, it acknowledges that the partnership agreement can provide for another person to become general partner on dissociation of the initial general partner.<sup>52</sup>

a. Trusts

The language of trust law speaks in terms of resignation, removal, and appointment of a successor trustee. The trust can be drafted to allow resignation by the trustee, removal of a trustee by beneficiaries, and appointment by beneficiaries of a successor trustee. Absent specific provisions, statutory default rules generally require the trustee provide at least thirty-days' notice of resignation or otherwise obtain the court's approval,<sup>53</sup> with appointment of a successor trustee by the unanimous agreement of certain beneficiaries or, absent such appointment, by the court.<sup>54</sup> Courts may also remove a trustee for specified reasons.<sup>55</sup>

b. General Partners

The ULPA defines these same events in terms of dissociation, expulsion, and becoming a general partner. A general partner may dissociate, in other words, withdraw by giving notice to the limited partnership.<sup>56</sup> The partnership agreement may not change this power of a general partner to dissociate.<sup>57</sup> As to expulsion, while the partnership agreement may provide terms for expulsion, regardless of those terms a court may expel a general partner for materially breaching the agreement or a duty owed to the partnership, if done willfully or persistently.<sup>58</sup> On dissociation of a general partner, dissolution of the partnership may occur under certain circumstances absent a specific provision in the partnership agreement. Administrative dissolution by the Secretary of State and dissolution on order of a court that it is unlawful or not reasonably practicable to continue the partnership may not be varied by the partnership agreement.<sup>59</sup> If the client desires continuation of the partnership in the event a designated general partner no longer serves, the agreement should specifically provide for continuation of the limited partnership by allowing a

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51. *Id.* §§ 704–706.

52. ULPA § 604(a); *id.* § 603(a)(1).

53. UNIF. TRUST CODE § 705(a) (amended 2010).

54. *Id.* § 704(d).

55. *Id.* § 706.

56. ULPA § 604(a); *id.* § 603(a)(1).

57. *Id.* § 105(c)(11).

58. *Id.* §603(5)(B); *id.* § 105(c)(10).

59. *Id.* § 801(a)(6)-(7); *id.* §§ 105(c)(12), 105(c)(16).

successor to become a general partner.<sup>60</sup> The current ULPA specifically allows the partnership agreement to provide for the manner in which a person becomes a general partner after formation.<sup>61</sup> In drafting provisions to determine who may become a general partner and how this transition occurs, the limited partnership agreement could provide for successor general partners in a manner similar to that provided for successor trustees in a trust agreement.

### 5. Control Over Lifetime Transfers

Clients who decide to make lifetime transfers typically inquire whether they can act as trustee or general partner. Other planning objectives often cause clients to forgo naming themselves as fiduciary. In the alternative those clients seek to retain removal and appointment powers over the person serving as fiduciary.

#### a. Trusts

Donors, who undertake lifetime transfers in trust to minimize estate tax generally must refrain from serving as a trustee. When establishing a trust, although the donor can choose to serve as trustee, if the donor has discretion, as trustee or otherwise, regarding the timing of distributions or recipients of income or principal, the transferred assets remain subject to estate taxation in the donor's estate.<sup>62</sup> For federal gift tax purposes, retention of discretion over how and to whom distributions are made, regardless of the capacity in which this discretion is exercised, results in characterization of the transfer as an incomplete gift.<sup>63</sup> Donor retained interests in transferred property, like donor retained powers over property, cause gross estate inclusion of transferred assets.<sup>64</sup> Non-donor beneficiaries, who can exercise, as trustee or otherwise, distribution powers to benefit themselves, hold a power of appointment resulting in gross estate inclusion unless the discretion is subject to an ascertainable standard.<sup>65</sup> The goal of achieving estate tax savings, thus, essentially requires donor to forgo

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60. Keep in mind that, for estate tax purposes, however, any variation of the terms regarding dissolution may be disregarded in valuing partnership interests for wealth transfer tax purposes under I.R.C. § 2703. See *Estate of Cahill v. Comm'r*, 115 T.C.M. (CCH) 1463, at \*25–26 (2018). For those taxpayers no longer concerned about the possibility of paying estate tax, I.R.C. § 2703 should not pose a concern.

61. ULPA § 401(b)(1). The ULPA, specifically § 105, does not limit the ability of the partnership agreement to address the manner in which a person becomes a general partner. As a consequence, the limited partnership agreement could use provisions similar to those employed in designating successor trustees.

62. I.R.C. §§ 2036, 2038 (2018).

63. Treas. Reg. § 25.2511-2 (1999).

64. I.R.C. §§ 2036–2037.

65. *Id.* § 2041.

acting as trustee or naming a beneficiary to serve as trustee with discretionary powers of distribution.

For affluent clients whose assets fall within the basic exclusion amount and are not anticipated to ever exceed that amount, tax planning goals no longer require a trade-off as between client control and income tax savings. A key income tax planning goal for clients, especially those with assets under the applicable exclusion amount, is to minimize gain and maximize any available depreciation deductions following death by obtaining a step-up in basis for appreciated property.<sup>66</sup> To obtain a basis step-up, the client's appreciated assets generally must either pass at death or, if assets are passed prior to death, be included in the decedent's gross estate.<sup>67</sup> Gross estate inclusion typically requires the client to retain control or rights to transferred assets.<sup>68</sup> Serving as trustee with discretion to determine when and to whom distributions will be made achieves the client's anticipated income tax planning goals.<sup>69</sup> Control of assets for 99.9% of clients now coincides with achieving income tax planning goals to obtain a basis step-up for appreciated assets. Traditional estate tax limits on clients serving as trustee no longer apply in the instance where the client has no estate tax worries.

#### b. Limited Partnerships

When initially conceived as an estate tax planning strategy, the beauty of the limited partnership was that it allowed the client to retain control over transferred assets and, at the same time, to achieve estate tax savings. The Internal Revenue Service initially acknowledged that fiduciary duties owed by the general partner to the limited partners proscribed the type of discretion that would cause gross estate inclusion.<sup>70</sup> Initial rulings cited the United States Supreme Court's decision in *United States v. Byrum*<sup>71</sup> as authority for the proposition that fiduciary duties owed by a controlling shareholder to minority shareholders in essence precluded the controlling shareholder from "promoting . . . personal interests at the expense of corporate interests."<sup>72</sup> Prior to the Tax Court's decision in *Estate of Strangi v. Commissioner*,<sup>73</sup> clients choosing to use the limited partnership to

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66. *Id.* § 1014.

67. *Id.* §§ 1014(b)(1), 1014(b)(9).

68. *Id.* §§ 2036–2038.

69. *Id.* § 1014(b)(9). Keep in mind, some items such as IRD are not eligible for a step-up despite inclusion in the gross estate. *Id.* § 1014(c).

70. See I.R.S. Priv. Ltr. Rul. 94-15-007 (Apr. 15, 1994); I.R.S. Priv. Ltr. Rul. 93-32-006 (Aug. 13, 1993); I.R.S. Priv. Ltr. Rul. 93-10-039 (Mar. 12, 1993).

71. 408 U.S. 125 (1972).

72. *United States v. Byrum*, 408 U.S. 125, 137 (1972).

73. 85 T.C.M. (CCH) 1331 (2003).

achieve estate tax savings often retained control by retaining ownership of the general partnership interest and carefully planning for succession of general partners. The Tax Court in *Estate of Strangi* distinguished the *Byrum* decision on the basis that duties in that case were owed to non-family member minority shareholders, whereas in *Estate of Strangi* the decedent and decedent's family stood on both sides of the transaction as a shareholder of the general partner and owners of limited partnership interests.<sup>74</sup> In order to avoid adverse estate tax consequences following the Tax Court's decision in *Strangi*, planners structure limited partnerships to preclude the donor from retaining direct or indirect control of the general partner. The substantial 2018 increase in the basic exclusion amount opens the possibility for the many donors who no longer face payment of estate tax to achieve tax planning goals and, at the same time, retain control of the general partner interests. For those clients who use the limited partnership as a technique to minimize estate tax, they may not serve as general partner or indirectly control the general partner, just as they are not able to serve or control who serves as trustee of a trust.

#### 6. Choice of Entity Based on Control Factors

The above discussion demonstrates that the trust and the limited partnership both achieve many of the most common client objectives for control and can be made to do so in similar ways. Critical differences lie in the inability of a limited partnership to achieve goals of generation-skipping transfer tax planning and tailoring distributional interests based on purposes such as those for support, health, and education. On the other hand, the limited partnership achieves more clearly defined economic rights based on preferred and non-preferred limited partnership interests. The ability of the limited partnership to parallel the trust in achieving many clients' control objectives opens the door for the limited partnership to find a continued niche in a world where 99.9% of clients will no longer use the limited partnership as an estate tax planning technique.

#### B. ACHIEVING THE CLIENT'S INCOME TAX PLANNING OBJECTIVES

With the wealth of more than 99.9% of Americans falling within the basic exclusion amount, income tax planning becomes the primary focus for many affluent clients. Income tax planning strategies aim to minimize tax on gains by obtaining a fair market value date of death basis, minimize ongoing federal income tax paid by the next generation on transferred assets, and reduce the incidence of state income

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74. *Estate of Strangi v. Comm'r*, 85 T.C.M. (CCH) 1331, at \*16-17 (2003).

taxation. The following evaluates the ability of the trust and the limited partnership to achieve these client objectives.

### 1. *Achieving a Fair Market Value Basis*

For certain assets, death can eliminate income tax on untaxed gain inherent in appreciated assets by providing a stepped-up basis to the date of death fair market value, sometimes referenced as “Section 1014 basis.”<sup>75</sup> The ability to pass assets with Section 1014 basis depends on the type of asset, as not all assets are eligible to receive a fair market value basis.<sup>76</sup> Assuming appreciating assets eligible for Section 1014 basis, when basis steps-up to fair market value at death, a sale at that value yields zero gain.<sup>77</sup> Optimally, assets would take a stepped-up basis not only on the client’s death, but again on the death of a beneficiary. Both trusts and limited partnerships require careful planning to achieve a basis step up in the hands of a beneficiary or donee limited partner.

#### a. Trusts

Assets owned by the client and eligible for a step-up in basis take a fair market value date of death basis on transfer by decedent at death to a trust.<sup>78</sup> In contrast, lifetime transfers of assets by a client to an irrevocable trust generally will not receive a fair market value date of death basis if trust assets are not subject to inclusion in the client’s gross estate for estate tax purposes.<sup>79</sup> The goal of planning strategies using irrevocable trusts, for the most part, has been to escape estate tax. With the shift in focus to income tax planning, it is

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75. I.R.C. § 1014 (2018).

76. I.R.C. § 1014 excludes from its purview property constituting a right to receive income in respect of a decedent. *Id.* § 1014(c). For example, a retirement plan that remains subject to income tax as withdrawals are made. In addition, property for which an alternate valuation election, special use valuation election, or conservation easement exclusion has been made take a basis prescribed by the election. *See id.* § 1014(a)(2)-(4). Certain appreciated property acquired by decedent by gift within one year of death does not receive a Section 1014 basis if the original donor is the beneficiary of the property. *Id.* § 1014(e).

77. Assets that have depreciated since purchase also take a fair market value date of death basis, resulting in a stepped-down basis. Ever the optimists, clients typically plan assuming appreciating assets.

78. I.R.C. § 1014(b)(1) (2018).

79. Assets transferred during life pass to the trust with a transferred basis under I.R.C. § 1015. *See id.* § 1015(a)-(b). Assets held in trust, however, can achieve a step-up in basis if included in the transferor’s gross estate at death, usually due to application of I.R.C. §§ 2036 through 2038. *See id.* § 1014(b)(9). In addition, certain community property can obtain a fair market value basis for both spouses’ community property interests, where decedent’s one-half interest is included in the gross estate. *Id.* § 1014(b)(6). QTIP trust property included in the survivor’s gross estate can also obtain a fair market value basis on the survivor’s death. *See id.* § 1014(b)(10).

important to consider whether powers of appointment or distribution can be used effectively to obtain a step-up in basis relative to the assets under their control or the distributed assets. New drafting techniques have developed to provide formula powers of appointment to beneficiaries for the purpose of maximizing the ability to obtain a Section 1014 step-up in basis.<sup>80</sup> Absent the beneficiary possessing a general power of appointment over property held in an irrevocable trust or an ability on the part of the trustee to distribute property to the beneficiary, it is difficult to achieve a step-up in basis for appreciated assets held in the trust on the subsequent death of the beneficiary. However, strategies like triggering the Delaware tax trap may achieve a step-up on exercise of a limited power of appointment by causing assets to be included in the gross estate, thereby triggering a fair market value basis.<sup>81</sup> Strategies also exist to achieve a step-up on the beneficiary's subsequent death.

#### b. Limited Partnerships

Limited partnership interests owned and transferred at death receive a step-up in basis.<sup>82</sup> In a limited partnership designed to obtain estate tax savings, fair market value of the limited partnership interests would likely take into account significant marketability and minority discounts.<sup>83</sup> Clients, however, prefer a basis calculated without adjusting for marketability and minority discounts. For those clients who are no longer concerned with minimizing estate tax, it should be possible to obtain an undiscounted fair market value basis for limited partnership interests. This is possible by providing decedent and decedent's personal representative the right, for a limited period of time beginning on the date of death, to put the limited partnership interests held by decedent to the limited partnership in exchange for a value based on the proportionate interest of undiscounted assets of the

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80. See *Trust and Estate Talk, Powers of Appointment: From Snoozy to Sexy*, AM. COLL. TR. & EST. COUNS. (June 2018), <https://actecfoundation.org/podcasts/powers-of-appointment/>.

81. I.R.C. § 1014(b)(9); see Richard W. Nenno, *Getting a Stepped-Up Income-Tax Basis and More by Springing — or Not Springing — The Delaware Tax Trap the Old-Fashioned Way*, 40 TAX MGMT. EST., GIFTS, & TR. J. 215 (2015); Jonathan G. Blattmachr & Jeffrey N. Pennell, *Using the 'Delaware Tax Trap' to Avoid Generation-Skipping Taxes*, 68 J. TAX'N 242 (1988).

82. See I.R.C. § 1014(b)(1) (2018).

83. It is for this reason that some attorneys counsel clients who have limited partnerships in place for the purpose of minimizing estate tax to dissolve the partnership. The goal is to avoid a discounted fair market value basis. Before dissolving the partnership, the client may wish to consider putting in place a buy-out provision that would avoid this result.

partnership.<sup>84</sup> The contemplated buy-out provision should result in gross estate inclusion of the limited partnership interests at close to the undiscounted fair market value of the underlying partnership assets. Buy-out provisions based on such a formula should yield the desired higher value for the limited partnership interests.<sup>85</sup> The partnership can then make an election to correspondingly increase the inside basis of partnership assets to reflect the increase in the outside basis of the partnership interests.<sup>86</sup> By making the partnership tax election (“Section 754 election”)<sup>87</sup>, the increased Section 1014 basis of the limited partnership interests, the outside basis, benefits the basis of the underlying partnership assets, the inside basis. In this way, the limited partnership can imitate the trust in obtaining fair market value basis on death of the client, who is the initial transferor of assets to a trust.<sup>88</sup>

Use of a limited partnership allows for management of basis generally. A brief foray into the intricacies of partnership taxation is required to explain the ability to manage basis. The Section 754 election is of particular importance in this regard. For example, a non-liquidating distribution of cash to a partner will result in gain to that partner to the extent the cash exceeds the partner’s outside basis—the partner’s basis in her partnership interest.<sup>89</sup> If the partnership has made a Section 754 election, Internal Revenue Code Section 734(b)(1)(A) will provide for an increase in the inside basis of the partnership’s capital gain property.<sup>90</sup> As a result, the partnership, upon selling capital gains property, will recognize less gain or more loss.

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84. See Prop. Treas. Reg. § 25.2704-3(b)(5)(v), 81 Fed. Reg. 51413, 51423 (Aug. 4, 2016). Put rights were recognized for purposes of according value in these now withdrawn proposed I.R.C. § 2704 regulations. *Id.* Withdrawal rights, sometimes referenced as *Crummey* powers, in reference to the Ninth Circuit case upholding their viability, operate based on a similar principal of recognizing legally enforceable rights in determining tax consequences. See generally *Crummey v. Comm’r*, 392 F.2d 82 (9th Cir. 1968).

85. Buy-out provisions included to avoid applying discounts should not fall within the reach of I.R.C. § 2703 because that section targets provisions decreasing, as opposed to increasing, value. It focuses on agreements to sell “at a price less than the fair market value” and on “restrictions” to sell. I.R.C. § 2703(a)(1)-(2). Techniques used to achieve a step-up in basis would aim to achieve a fair market value basis and would allow, as opposed to restrict, sale.

86. See *id.* § 754. This election is known as the I.R.C. § 754 election. *Id.*

87. *Id.*

88. Keep in mind that the buy-out should only be provided to the client (the original donor) to assets to attain a step-up in basis on the client’s death. Allowing other partners a limited right to sell to certain persons or allowing the partner or partner’s estate a put right following death of the partner, although arguably yielding an increase in the date of death fair market value of the limited partnership interests, might result in creditors of the limited partner being able to force a sale at a similar price.

89. *Id.* § 731(a).

90. *Id.* § 734(b)(1)(A).

Similarly, as a general rule, a partner receiving a non-liquidating distribution of property other than cash will take a basis in the distributed property equal to the adjusted basis the partnership had in that property.<sup>91</sup> However, the partner cannot take a basis in the property greater than the partner's basis in her partnership interest.<sup>92</sup> Thus, if the distributee partner's outside basis is \$10.00 and the partnership's adjusted basis in the distributed property is \$30.00, the partner will take a \$10.00 basis in the property. If a Section 754 election is in effect, however, the \$20.00 of basis that was "stripped" from the property when distributed, will result in an increase of \$20.00 to the inside basis of the partnership in its remaining assets allocated pursuant to Internal Revenue Code Section 755 and the regulations thereunder.<sup>93</sup> Again, as a result of the increase in the inside basis of assets, the partnership will recognize less gain or more loss on the taxable disposition of those assets. If a Section 754 election is in effect, on a sale or exchange of a partnership interest or on the death of a partner, Internal Revenue Code Section 743 will, as a general rule, adjust the inside basis of partnership property so as to equate the transferee's outside basis with the aggregate of the partnership's inside bases in its assets. The adjustment is with respect to the transferee partner only. Obviously, where the transferee's basis—a Section 1014 basis in the case of a devisee of a partnership interest—is greater than the aggregate of the partnership's inside bases in its assets, a Section 754 election can prove most beneficial.

Despite this ability to manage basis in a limited partnership, as with an irrevocable trust, it is difficult to achieve a second step-up in basis on a beneficiary's death for limited partnership interests held by the beneficiary. A put right, as discussed above in reference to the client, would work similarly for donee limited partnership interests, but it would do so at the expense of other important client objectives, such as ongoing control and creditor protection. It is also important to acknowledge that the Tax Court decision, *Estate of Powell v. Commissioner of Internal Revenue*<sup>94</sup> has left it difficult at best to accurately predict what basis will result in the hands of the limited partner in a traditional estate tax effective limited partnership. In a split decision, with two judges concurring in result only, no clear holding left doubt as to whether the client's gross estate will include the limited partnership interests or the underlying partnership assets.<sup>95</sup>

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91. *Id.* § 732(a)(1).

92. *Id.* § 732(a)(2).

93. *See id.* § 734.

94. 148 T.C. 392 (2017).

95. *See* Elaine Gagliardi, *On The Family Limited Partnership in 2018: Powell, Cahill, and Income Tax Basis at Death*, LEXIS FED. TAX J.Q. § 1 (2018). This article pro-

## 2. Incidence of Federal Income Taxation

Tax rate directly impacts overall income tax burdens. Taxation of income received over the term of the trust or partnership is an important consideration. Overall tax burden proves somewhat difficult to predict given that effective rates for trusts depend in part on whether trust income is taxed to the trust or to the beneficiary. Effective tax rates for limited partnerships depend on the respective partners' rates.

### a. Trust Income Taxation Generally

The tax burden on income from assets held in trust depends on what trust tax regime applies. Trusts taxed as “grantor trusts” treat the grantor as owner of the trust for income tax purposes.<sup>96</sup> All other trusts are categorized as simple or complex trusts depending on whether all income is required to be paid to the beneficiaries.<sup>97</sup> For these trusts, distributions to beneficiaries carry with them trust income and deductions taxable to the beneficiary.<sup>98</sup> Income not distributed to beneficiaries remains in the trust, and as such, is subject to tax at the trust level on a much more compressed rate schedule. For simple trusts, where the trust terms require all income be distributed, only capital gains allocable to trust principal typically remain subject to taxation inside the trust. For complex trusts, including those where the trustee has discretion to distribute income and principal, both income and gains may be subject to taxation inside the trust. For the tax year 2020, trust taxable income in excess of \$12,950.00 is taxed at the highest 37% individual tax bracket.<sup>99</sup> The differences in income tax treatment require trustees be cognizant of the impact of distributions on overall income taxes and earnings of the trust.

### b. Limited Partnership Taxation Generally

Taxation of limited partnerships is reasonably simple in comparison to taxation of trusts. Absent an election under the check-the-box

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vides a complete analysis of basis in light of the Tax Court's opinion in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017). *See id.*

96. *See generally* I.R.C. §§ 671–679 (2018). Grantor trust status results in grantor bearing the tax burden on trust assets even though grantor has not retained any direct benefit from the trust assets. Some grantors want to preserve the option for grantor trust status to terminate. Fiduciaries, however, may be loath to take the step of turning off grantor trust status. Exercise of the power, granted in the trust instrument, to toggle grantor trust status on and off, thereby relieving the grantor of the income tax burden, may be subject to fiduciary duties owed by the person making the decision to toggle.

97. *See generally id.* §§ 651–652, 661–662.

98. *Id.*

99. *Id.* § 1(j)(2)(E); Rev. Proc. 2019-44, 2019-47 I.R.B. 1093, §§ 2-3.

regulations, the limited partnership generally is taxed as a partnership for purposes of the federal income tax.<sup>100</sup> The Internal Revenue Code taxes partnerships as complete pass-through entities. Partnership income, while determined at the partnership level, passes through to and is reported by the partner. Decisions on when, what, and how to distribute can also become complex and can impact income tax paid by a partner, but unlike trusts, partnership income is taxed solely at the partner level. The partnership avoids “trapping” income inside the entity and subjecting it to a higher rate, as can occur with trust income. Provided the partnership is substantively recognized for income tax purposes under Internal Revenue Code Section 704(e), income will be taxed at the various partners’ tax rates.<sup>101</sup>

The underlying policy of Section 704(e) prevents shifting the incidence of income tax liability to younger donee family members. Very generally, if capital is a material income-producing factor, a partner who owns a capital interest in the partnership will be recognized as a partner for income tax purposes.<sup>102</sup> The fact that a general partner controls decisions in a limited partnership is key in meeting the objective test used to evaluate the application of Section 704(e).<sup>103</sup> The donee, however, must have sufficient control over the partnership interest to be treated as the real owner.<sup>104</sup> Distributions of income to a donee partner will provide strong evidence the partner is exercising control of his or her interest.<sup>105</sup>

### 3. State Income Taxation Implications

State income tax rules often follow federal income tax rules for both trust and limited partnership tax purposes. Unlike with trusts, there is no need to determine a state’s taxing jurisdiction over a partnership because it is the partner who is taxed on income, not the partnership. The simplicity of this rule cannot be fully appreciated without comparing state income taxation of trusts.

#### a. State Taxation of Trust Income

Trust income subject to taxation inside the trust for federal purposes will likely also be subject to trust income taxation for state purposes. Tax rates imposed on trust income vary among states,

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100. See generally Treas. Reg. §§ 1.7701-1–1.7701-3 (2016).

101. I.R.C. § 704(e) (2018).

102. *Id.* § 704(e)(1).

103. Treas. Reg. § 1.704-1(e)(2)(ii)(d).

104. *Id.* § 1.704(e)(1)(iii).

105. *Id.* § 1.704-1(e)(2)(iv)-(v).

sometimes significantly, ranging from 2.9% to 13.3%.<sup>106</sup> Changing the situs of the trust can sometimes lead to substantial overall income tax savings after considering both federal and state tax costs.<sup>107</sup>

Because of differences among state laws, trust income may be subject to income taxation in more than one state or may avoid state income taxation all together with careful planning. The leading commentator on planning to minimize state taxation of trust income, Richard Nenno, warns that failure to take state income taxation into the planning equation may lead to claims for malpractice or breach of fiduciary duty.<sup>108</sup> Nenno's exhaustively detailed analysis highlights that in 2017, eight states did not tax non-grantor trust income: Alaska, Florida, Nevada, New Hampshire, South Dakota, Texas, Washington and Wyoming.<sup>109</sup> The planning matrix, however, is not as simple as ensuring trust situs in one of these states.

States that impose income tax on trust income do so on the basis of a variety of factors including, for testamentary trusts, the testator's or trustor's state of residence, the trust situs for administration purposes, the location of trust assets, the residence of the trustee, and the state of residence of the beneficiary or beneficiaries.<sup>110</sup> It is not always possible to control these factors, especially the residence of the beneficiary, due to the ease of moving to a different state. Given the differences between state income tax jurisdictions, it is possible that more than one state will tax trust income.<sup>111</sup> It is also possible to avoid state income taxation of a trust with careful planning. The law continues to evolve as states grapple with the constitutionality of imposing taxes based on some or all of these factors.

The United States Supreme Court, in *North Carolina Department of Revenue v. Kimberley Rice Kaestner 1992 Family Trust*,<sup>112</sup> limits the ability of states to tax trust income based solely on residence of the beneficiary. The *Kaestner* decision addressed the constitutionality of North Carolina's claimed jurisdiction to tax income of a non-grantor trust. North Carolina taxes the income of non-grantor trusts that "[are] for the benefit of" its residents.<sup>113</sup> The Court begins by noting:

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106. See Richard D. Nenno, *Minimizing or Eliminating State Income Taxes on Trusts*, WILMINGTON TRUST 1, 3 (May 2018), [https://www.wilmingtontrust.com/repositories/wtc\\_sitecontent/PDF/Minimizing-or-Eliminating-State-Income-Taxes-on-Trusts.pdf](https://www.wilmingtontrust.com/repositories/wtc_sitecontent/PDF/Minimizing-or-Eliminating-State-Income-Taxes-on-Trusts.pdf).

107. See *id.* at 8.

108. *Id.* at 2.

109. *Id.* at 6.

110. *Id.* at 6-10.

111. See N.C. Dep't of Revenue v. Kimberley Rice Kaestner 1992 Family Tr., 139 S. Ct. 2213, 2221-22 (2019) (acknowledging the possibility of trust income subject to state income taxation in multiple states).

112. 139 S. Ct. 2213 (2019).

113. *Kaestner*, 139 S. Ct. at 2217.

The North Carolina courts interpret this law to mean that a trust owes income tax to North Carolina whenever the trust's beneficiaries live in the State, even if—as is the case here—those beneficiaries received no income from the trust in the relevant tax year, had no right to demand income from the trust in that year, and could not count on ever receiving income from the trust.<sup>114</sup>

The opinion of the Court, delivered by Justice Sotomayor, pointedly limits the opinion's reach: "We hold that the presence of in-state beneficiaries alone does not empower a State to tax trust income that has not been distributed to the beneficiaries where the beneficiaries have no right to demand that income and are uncertain ever to receive it."<sup>115</sup> To be subject to state income taxation, the trust must have a "minimum connection" with the state.<sup>116</sup> For the beneficiary to have the requisite minimum connection, the taxing authority must show "the in-state beneficiary's right to control, possess, enjoy, or receive trust assets."<sup>117</sup> The court further indicated in the course of its opinion that in-state residence of a trustee, in-state administration of the trust, and distribution of income to an in-state resident beneficiary also demonstrate the necessary minimum connection for the state to tax trust income.<sup>118</sup> For a holding intended by the court to be narrow, the opinion offers substantial guidance as to when a state may exert taxing authority over a trust. Given the mobility of beneficiaries, to avoid state taxation by states who tax on the residency of a beneficiary, the trust should use wholly discretionary beneficial interests. For clients, who prefer to avoid placing discretion in a non-family member trustee, it may be difficult to avoid the possibility of multiple states asserting jurisdiction to tax income of the trust.

#### b. State Taxation of Partnership Income

For clients who wish to avoid the complex planning needed to minimize state income taxation of trusts, the limited partnership offers a comparatively simple solution. The partnership is not a tax paying entity. Partnership income is passed through to partners, reported on the partners' personal tax returns, and taxed at the level and rate applicable to the partners. None of the income is susceptible to being trapped and taxed at the entity level. In an investment limited partnership, one that does not operate an active business, a beneficiary living in one of the several states without an individual income

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114. *Id.*

115. *Id.* at 2221.

116. *Id.* at 2219-20.

117. *Id.* at 2221.

118. *Id.* at 2220.

tax could avoid state income taxation altogether on partnership income taxed to the partner. The simplicity of partnership taxation has great appeal for clients.

### C. ATTAINING CLIENTS' Creditor Protection Objectives

Clients often choose to place property in trust, as opposed to making outright transfers to beneficiaries, for the primary purpose of protecting the trust assets from creditors. Clients especially express creditor concerns if the intended beneficiaries practice a profession susceptible to malpractice lawsuits. Other clients may simply not have confidence in the beneficiary's ability to manage money. These concerns encourage clients to use a trust or a limited liability entity to protect family assets from creditors.

#### 1. Trusts

Most states allow a client to protect trust assets from a beneficiary's creditors by including spendthrift provisions in the trust agreement. Essentially, a spendthrift clause protects assets until such time as a distribution is due or discretion to distribute exercised.<sup>119</sup> The Uniform Trust Code limits effectiveness of spendthrift provisions and allows children, spouses, and former spouses to reach trust assets despite a spendthrift provision.<sup>120</sup> It also exempts claims by the United States or a state government from application of the spendthrift provision.<sup>121</sup> Discretionary trusts also provide protection from creditors regardless of whether the trust includes a spendthrift clause, because a creditor may not compel an exercise of discretion.<sup>122</sup> Again, an exception is made for protection, support, and maintenance payments for a child, spouse, or former spouse.<sup>123</sup> Some states have not adopted exceptions from the spendthrift rules for children, spouses, or former spouses. Thus, while spendthrift provisions can provide some protection for a beneficiary's assets until distributed to the beneficiary, the protection is not complete.

A minority of states have also enacted domestic asset protection trust legislation allowing a trust to protect assets from a trustor's creditors. Except in those states which have enacted domestic asset protection trust legislation, typically a trustor's creditors can reach the maximum amount the trustor could receive under the trust as-

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119. See UNIF. TRUST CODE § 502 (amended 2010). The comment to § 502 confirms this reading.

120. *Id.* § 503.

121. *Id.*

122. *Id.* § 504.

123. *Id.*

suming a maximum exercise of discretion in favor of trustor.<sup>124</sup> From a policy perspective, the Uniform Trust Code chooses not to allow an individual to avoid creditors by placing assets in trust for their own benefit.

## 2. Limited Partnerships

Family limited partnerships can provide some creditor protection for partnership assets. Creditors of a limited partner may not access the assets of the limited partnership to satisfy a partner's debt owed to the creditor. It makes sense that assets of the partnership be preserved to pay debts owed to creditors of the partnership, and those assets should not be available to pay debts of the individual partners. The partner's partnership interest, however, does not benefit from similar protection from the partner's creditors. A partner's creditor can reach the partner's transferable interest in the partnership by obtaining a charging order.

Under ULPA, the charging order is the exclusive remedy for the partner's individual creditors to satisfy debts owed by the partner to the creditor from the partner's partnership interest.<sup>125</sup> A judgment creditor can apply for the court to enter a charging order against the partner's interest in the limited partnership. A charging order amounts to a lien on the partner's transferable interest.<sup>126</sup> It requires the partnership pay any distribution directly to the judgment creditor and not to the partner. In much the same way a creditor cannot force a trustee to make a discretionary distribution, the creditor cannot force the partnership to make a distribution.<sup>127</sup> The court can order the foreclosure of the charging order if distributions will not satisfy the debt within a reasonable time. The purchaser at the foreclosure sale only has the rights of a transferee—the right to receive distributions when made.<sup>128</sup> In a partnership for a term, as opposed to one “at will,” the transferee is not able to ask the court for dissolution of the partnership and must wait until the end of the partnership term to receive any distribution of the value of the underlying partnership assets.

Courts can issue orders to enforce a charging order. The current version of ULPA does not speak to what terms may be included in the charging order or in the order enforcing it. Earlier versions precluded a court ordered dissolution of a term partnership until the end of the

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124. *Id.* § 505.

125. ULPA § 703(g).

126. *Id.* § 703(a).

127. *See id.*

128. *See id.* § 703(c).

term. The comments to ULPA, but not the Act itself, specify what the Act means when it grants courts the ability to make those orders necessary to effectuate the charging order. The comments provide a narrow reading precluding the court from interfering with the decision to make a distribution.<sup>129</sup> Some courts have not felt bound by similar comments to ULPA to limit a court's ability to interfere with management decisions.<sup>130</sup> The comments to the Act contemplate that a court would not have authority to order dissolution of the partnership in order to comply with the charging order, but the Act does not specifically limit orders to enforce a charging order. If courts follow the directive of the comments to ULPA, a charging order provides considerable protection in much the same way as a spendthrift clause or discretionary trust.

Neither the trust nor the limited partnership can provide fool-proof protection from a beneficiary's or partner's creditors. Both provide some protection, but the limited partnership, unlike the trust, provides an option to buy out the creditor and thereby protect underlying family assets. This proves especially beneficial when the client wishes to protect a specific asset. The limited partnership provides options for the family to protect that asset through a buy-out arrangement.

#### D. CONSIDERING OTHER CHOICE OF ENTITY FACTORS

Both the trust and the limited partnership allow for obtaining client objectives of ongoing management and control of assets. Trusts prove more adept at ensuring control of assets over multiple generations and have increased flexibility when designing distribution provisions. Careful planning can minimize income taxation and provide creditor protection regardless of the entity chosen. The limited partnership, however, has the added advantage and simplicity of pass-through taxation. It also allows partners or the entity to buy the debt of a creditor in the event of a charging order and thereby protect underlying family assets. The ability of an entity to not only meet these primary client objectives, but to also meet other considerations regarding fiduciary duties of the trustee or general partner and the flexibility to provide for changed circumstances can tip the choice to one or other of the two entities.

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129. The comments to ULPA § 703 specifically cite the narrow reading by the Iowa Court of Appeals in *Wells Fargo Bank, Nat'l Ass'n. v. Continuous Control Sol., Inc.*, 821 N.W.2d 777 (Iowa Ct. App. 2012), as an appropriate interpretation. ULPA § 703(b)(1) cmt.

130. See *Law ex rel Robert M. Law Profit Sharing Plan v. Zemp*, 408 P.3d 1045 (Or. 2018).

### 1. Differences in Duties of Care

Trustees and general partners must adhere to fiduciary duties of loyalty and duties of care. The duty of loyalty requires the fiduciary to refrain from conflicts of interest and from use of the trust's or the entity's property or opportunities for personal gain.<sup>131</sup> The default rules of both entities hold the fiduciary to high standards of loyalty.<sup>132</sup> The primary differences in duties owed by a trustee and a general partner arise in regard to duties of care, specifically investment duties.

#### a. Trustee Duties

In exercising the duty of care when making investments, the trustee in many states must comply with what has become known as the prudent investor rule, set forth in the Uniform Prudent Investor Act, which has been incorporated by reference in the Uniform Trust Code, as Article 9. The Uniform Prudent Investor Act requires trustees to consider a number of factors in determining how to appropriately invest trust assets.<sup>133</sup> Diversification lies at the heart of the Uniform Prudent Investor Act.<sup>134</sup> The prudent investor rule requires that a trustee follow specific procedures and consider numerous factors in arriving at an appropriate investment plan. Failure to diversify assets, absent offsetting reasons for not doing so, can lead to a breach of duty.

#### b. General Partner Duties

In contrast, the duty of care owed by a general partner is governed by the overarching and more relaxed principles of the business judgment rule, which encourages a measure of risk taking necessary to operate a successful business. The duty of care under ULPA only requires the general partner to avoid grossly negligent acts, intentional wrongdoing, and knowing violation of law.<sup>135</sup> Given the relaxed standard applied in determining whether the general partner has ful-

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131. See UNIF. TRUST CODE § 802 (amended 2010); ULPA § 409(b); *see also*, UNIF. LTD. LIAB. CO. ACT § 409(b) (amended 2013).

132. The limited partnership agreement, while not able to eliminate the duty of loyalty, can modify it to allow certain conflicts if the partners deem it advisable. The Uniform Trust Code, unlike the ULPA, does not specifically prohibit modification or elimination of the duty of loyalty. The fiduciary nature of the trust relationship and the requirement that trust terms must be for the benefit of the beneficiaries, however, should preclude elimination of the duty of loyalty without the need to so specify. *See* UNIF. TRUST CODE § 105(b)(3). Comments to the duty of loyalty as set forth in the Uniform Trust Code, however, acknowledge that the trust agreement may modify the duty to allow specific transactions as not violative of the duty. *See id.* §§ 105, 802 cmt. The ULPA specifically allows for partners to agree that certain transactions do not amount to a breach of duty of loyalty. ULPA § 409.

133. UNIF. PRUDENT INVESTOR ACT § 2 (1994).

134. *See id.* § 3.

135. ULPA § 409(c). *See also*, UNIF. LTD. LIAB. CO. ACT § 409(c) (amended 2013).

filled the duty of care, it is more difficult to succeed in bringing a breach of duty of care claim, provided the general partner takes steps to be reasonably informed regarding investment decisions. In contrast, the prudent investor act, as was the case under predecessor statutes, imposes a higher duty of care regarding investment standards for trust assets. ULPA encourages more flexibility for the general partner to choose investments.

c. Use of Exculpatory Clauses

Exculpatory clauses may protect a trustee and a general partner in very similar fashion. The trust agreement, under certain circumstances, may exculpate a trustee for conduct, except for conduct undertaken with reckless indifference or bad faith.<sup>136</sup> The limited partnership agreement may exonerate a general partner for conduct, except conduct done in bad faith, wrongdoing done with intent, or for laws knowingly violated.<sup>137</sup> The critical difference in exculpation provisions as between trustees and general partners lies in the partners' ability to bargain for exculpation. In contrast, the Uniform Trust Code calls on courts to determine if the insertion of the exculpatory clause resulted from the trustee's abuse of a fiduciary or confidential relationship and, if so, to declare the clause invalid.<sup>138</sup> Even if found not to be a result of abuse of the relationship, a court must also find the clause fair and clearly communicated to the settlor of the trust to avoid invalidity. Similar language is not found in ULPA. A fiduciary, responsible for investment decisions, may prefer acting as a general partner to acting as a trustee, given the more relaxed duty of care standard applicable to limited partnerships.

2. *Differences in Ability to Respond to Changed Circumstances*

Passage of time brings changes in circumstances. The need to respond to changed circumstances often requires amending governing documents. Historically, it has been more difficult to modify a trust than to amend a partnership agreement. The need to keep up with continual change in the areas of taxation, creditor protection, and entity laws has generally increased the need for entities to flexibly adapt.

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136. UNIF. TRUST CODE § 1008(a)(1) (amended 2010).

137. Compare ULPA § 105(c)(8), with MODEL BUS. CORP. ACT § 2.02(b)(4) (amended 2016) (stating that relief from liability may be provided for acts other than intentional inflictions of harm or violations of law, or an inappropriate financial benefit or distribution).

138. UNIF. TRUST CODE § 1008.

## a. Trusts

Statutes giving heed to the principle of freedom of testation encourage deference to a testator's or trustor's intent. Historically, these statutes have required court intervention to amend or modify trust terms absent the consent of the settlor and all beneficiaries.<sup>139</sup> A trust, however, can be drafted with an eye towards easy modification. Judicious granting of powers of appointment in a non-fiduciary capacity can allow for appointment of assets in further trust, thereby allowing the power-holder to modify trust terms. Trustees holding wholly discretionary powers may, under certain circumstances, “decant” to a new trust. Many states have adopted what have come to be known as “decanting” statutes.<sup>140</sup> The advantage of the Uniform Trust Decanting Act is the ability to decant without the need to obtain representation of unknown or unascertained beneficiaries as must occur when a trust is reformed or modified. The Act provides for court approval of decanting to protect a trustee who remains subject to fiduciary duties when decanting.<sup>141</sup> State statutes set forth specific standards and procedures for modification of trusts or decanting.

## b. Limited Partnerships

Limited partnerships, in contrast, may be amended as provided in the partnership agreement.<sup>142</sup> The limited partnership agreement, thus, can specify the terms for amending the agreement. There is no requirement for court approval of an amendment. The provisions for amending the partnership agreement provide great flexibility. Clients may view this flexibility as a positive or negative, depending on the client's preference to exercise a greater or lesser degree of control over partnership terms. The advantage, however, is that amendment can occur without the need to obtain court approval or to meet the prerequisites for decanting. If the partnership agreement so provides, amending can even occur with fewer than all partners agreeing to the change.

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139. UNIF. TRUST CODE §§ 411-416 (amended 2010).

140. See *A Few Facts About the Uniform Trust Decanting Act*, UNIF. LAW COMM'N (Jan. 22, 2020), <https://www.uniformlaws.org/HigherLogic/System/DownloadDocumentFile.ashx?DocumentFileKey=639ebb5f-8668-f959-1c7e-94901abd9227&forceDialog=0>. A Uniform Trust Decanting Act approved in 2015 has been adopted by six states according to the Legislative Fact Sheet provided by the Uniform Law Commission.

141. UNIF. TRUST DECANTING ACT § 4 (2015).

142. ULPA § 105(a).

## IV. SUMMARY OF FACTORS IN CHART FORM

The family limited partnership compares favorably to the trust as a wealth management entity. Whether the limited partnership or the trust provides a more appropriate choice of entity depends on the client's specific needs and assets. The following chart evaluates the ability of each entity to achieve client objectives. A "✓" means the entity adequately achieves the objective, with a "✓+" meaning the entity has an advantage in achieving the objective. A "—" indicates the entity is not able to easily achieve the client objective without complex planning.

	TRUST	FAMILY LIMITED PARTNERSHIP
AVOIDING POSSIBILITY OF MULTIPLE STATE TAXATION	—	✓
ABILITY TO MINIMIZE FIDUCIARY DUTIES	✓	✓+
ABILITY TO AMEND AND MODIFY TERMS	✓	✓+
OPTION FOR DONOR/FAMILY MANAGEMENT	✓	✓
OPTION FOR PROFESSIONAL MANAGEMENT	✓+	✓
ABILITY TO REMOVE/REPLACE MANAGER	✓	✓
ABILITY TO TAILOR DISTRIBUTION STANDARDS	✓+	✓
ABILITY TO ASSURE CONTINUANCE OVER MULTIPLE GENERATIONS	✓+	—
ABILITY TO PROVIDE FOR MULTIPLE BENEFICIARIES	✓+	✓
ABILITY TO OBTAIN A STEP-UP IN BASIS	✓	✓
ABILITY TO PROVIDE CREDITOR PROTECTION FOR ASSETS	✓	✓

## V. CONCLUSION

In choosing a vehicle to meet clients' estate planning goals, planners should consider the effectiveness of the limited partnership in addition to the traditional trust. The limited partnership can achieve many important client objectives and, at the same time, avoid some of the administrative disadvantages of a trust. When appropriate, the latest version of the Uniform Limited Partnership Act makes room to appoint a professional financial manager as general partner. The effective repeal of the estate tax for more than 99.9% of Americans, in conjunction with recent changes to the Uniform Limited Partnership Act, makes the limited partnership a viable choice of estate planning entity for some clients.