The strategy, known as a family limited partnership (FLP), has helped many families decrease estate taxes. Such partnerships have proliferated during the last decade, allowing people to transfer large amounts of money and other property virtually tax-free to their heirs.

A family partnership can help reduce or even eliminate estate and gift taxes by transferring assets owned by a person into a partnership, typically formed with the children. For example, a parent could move property, such as stocks, bonds or shares in a family-owned business into a partnership. In some cases, a parent can become the general partner, with the kids as limited partners. In other cases, a child serves as the general partner.

For those with considerable assets, tax planning is crucial since taxes can take an enormous bite out of what is left to the heirs. This year, the top federal estate-tax rate is 46%. The first $2 million of a taxable estate is typically exempt from federal taxes. Under current law, the federal estate tax is scheduled to be phased out in stages in coming years and then disappear entirely in the year 2010, but then reappear the following year.

The FLP must be constructed properly to pass IRS muster. Things to look out for in a family limited partnership based on a recent court ruling: do not put all your assets, such as your house, into the partnership, do not try to exercise too much control over the assets in the partnership, do not use the partnership as a piggy bank to pay your rent and other personal bills, and do not set up the partnership so that it appears designed solely to dodge taxes.

If you need help with estate planning, please contact us.