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Using Family Limited Partnerships...in Guernsey

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Inheritance tax ("IHT") rules in the UK have put increasing pressure on the use of trusts as a tool for family tax planning. Since 2006, trusts designed to benefit the children of a settlor have been subject to an immediate 20% IHT charge on the initial capital above the threshold of £325,000 and an ongoing charge of 6% on the value of the trust assets every 10 years.

Enter the family limited partnership ("FLP"). FLPs are attracting interest from tax advisers in the UK because they offer similar levels of flexibility of management and asset protection over subsequent generations as trusts, but allow lifetime gifts without the charges to IHT. Limited partnerships - a partnership of usually one general partner and multiple limited partners - have been around for many years and have long been used as tax-transparent investment vehicles. The general partner manages the investments, holds the assets on behalf of the partnership, and has unlimited liability for the losses of the limited partnership (although usually a limited company is used as general partner to provide continuity and to restrict losses). The limited partners contribute capital to the limited partnership in return for partnership interests which give them rights (subject to the overall distribution policy and any discretion of the general partner) to distributions of profits or capital growth. Limited partners have liability only to the extent of their capital contributions but may not have any part in the management of the partnership if they are to retain such limited liability.

In an FLP, the family elder or donor usually controls the general partner and thereby directs the investment strategy and distribution policy. The limited partnership agreement can allow for the limited partnership to be wound up after a certain period, on the occurrence of a trigger event (such as the death of the donor), or provide for continuity of the general partner and the structure. The limited partnership agreement and the articles of incorporation of a corporate general partner can set out a family investment strategy and a management mechanism that can be maintained over multiple generations. The board of directors of the general partner can be constituted by family elders or by independents.

The children, as limited partners (whether as individuals, or through limited companies or trusts) will receive distributions. As a partnership is a contractual relationship, it can be tailored to fit the requirements of a particular family group. The general partner may be given discretion to distribute profits to one limited partner without benefiting others or to defer rights to profits until a certain date or trigger event. Transfers of partnership interests will usually be restricted to existing partners or other family members.

FLPs do not attract the initial nor the ongoing IHT charges levied on trusts and will remain clear of IHT charges if the donor remains alive for seven years from the time of making his contribution to the FLP. FLPs are tax transparent - that is, each partner is taxed individually depending on their residence / domicile on receipts from the FLP. There will be no Guernsey taxes levied save for on certain types of income which are sourced in Guernsey.

Guernsey's regulatory environment is such that an FLP will usually be outside the scope of Guernsey's collective investment scheme regulation and a Guernsey general partner will only require licensing if it takes a fee for managing the FLP. Long-standing experience and professional expertise in administering limited partnerships means Guernsey is ideally placed to serve the UK's growing demand for wealth planning schemes which use FLPs.

This article can only provide a general review of this area and is not intended to constitute legal advice. Legal advice should be taken with regard to individual circumstances. References to UK taxation are based on our understanding; we are not qualified to advise on UK tax law.