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## The Benefits of Family Limited Partnerships

**a** sset protection. Tax savings. Estate planning. Business owners need to plan for all three, and a family limited partnership (FLP) may help. Considering your business interests and potential tax exposure, it is important to develop strategies to protect your hard-earned assets and save money wherever possible. Let's take a look at the ways an FLP can help you minimize your liability, take advantage of tax savings, and plan your estate.

### *A Closer Look*

As you know, a partnership is created when two or more people join together to establish a trade, business, or profession, sharing in the profits and losses. In a general partnership, every partner is presumed to be the authorized agent of the partnership and of all other partners for all purposes within the scope and objectives of the business. As a result, all partners have unlimited liability.

A limited partnership consists of two or more persons with one or more general partners and one or more limited partners. A limited partner has no right to participate in the management and operation of the partnership business or to interfere in any manner with its conduct or control. There is no liability for the limited partner, in regard to the business, beyond his or her capital allocation.

A family limited partnership is an entity formed as a statutory limited liability partnership under state law in which the only partners are family members. FLPs must have business purposes and a fixed duration of years. Business owners establishing FLPs can act as general partners, hold many of the limited partner interests, and maintain 100% control of assets. Because only you and your family will own all FLP interests, the entity can be dissolved relatively easily.

FLPs also provide a measure of asset protection. Once assets are transferred to an FLP, the limited partners own partnership *interests*, rather than the assets themselves. Under many state partnership laws, the only remedy generally available to a creditor against a partnership interest is in the form of a **charging order** by a court. A charging order is considered a limited remedy, in that the creditor's interest against a partner is limited to distributions of income or principal made from the partnership.

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# Appraising Your Appraiser

**A**n appraiser is a professional who assigns value to your property based on formal methodology and standards generally practiced in the field of appraising. An appraisal can help you make informed financial decisions, as well as provide you with professionally prepared documentation should you need to validate your property's worth to a third party, such as an insurer.

## Hiring an Appraiser

Choosing a qualified professional involves time and preparation. Because appraisers tend to specialize in certain areas, such as antiques, coins, stamps, jewelry, silver, etc., you want to find someone with relevant expertise and a proven track record. For a referral, consider contacting the following professional organizations:

### International Society of Appraisers

[www.isa-appraisers.org](http://www.isa-appraisers.org)

206-241-0359

### Appraisers Association of America

[www.appraisersassoc.org](http://www.appraisersassoc.org)

212-889-5404

### American Society of Appraisers

[www.appraisers.org](http://www.appraisers.org)

800-272-8258

Other resources include libraries, museums, auction houses, and the Internet, as well as recommendations from friends and colleagues. Once you find someone with the necessary experience, conduct an interview to ensure his or her appraisal practices meet *your* standards, as well as generally accepted standards in the field. Consider asking the following questions:

#### 1. What are your work experience and education qualifications?

Ask for references and review the candidate's résumé, noting work

history, both formal and continuing education, and membership in professional organizations. Some professional organizations require that members pass examinations and comply with a code of ethics. Valuation should be based on standard appraisal principles and procedures acquired through formal training. Authenticating an item is just one aspect of the appraisal process.

#### 2. What is your area of expertise?

Make sure your candidate's expertise matches your needs. However, finding one person who is an expert in *all* areas may be difficult. The International Society of Appraisers recognizes over 220 areas of specialization. For items that exceed an appraiser's expertise, ask if the appraiser would be willing to consult with other qualified professionals.



#### 3. How much will the appraisal cost?

Appraisers may charge per hour, per diem, per item, or a flat rate. Other charges may include reimbursement for additional expenses, including travel and photographs. Consider avoiding any proposal that includes a "contingency fee" based on a sale or a fee based on a percentage of the valuation. Generally considered unethical, these types of appraisals could have tax consequences for you;

the Internal Revenue Service (IRS) rejects all appraisals performed under these conditions.

**4. How do you report your findings?** An appraiser generally prepares a signed, written report that documents the valuation of an item, including his or her evaluation methodologies and credentials.

## The Written Report

Keep in mind that at some point attorneys, judges, the IRS, estate executors, insurers, and trustees may base decisions on the appraisal. Therefore, it should be comprehensive and professionally prepared. The following key elements are generally included in an appraisal report:

**Statement of Purpose.** As discussed earlier, an appraisal has a variety of uses, which may include helping you assess your insurance needs or substantiate a tax deduction. The purpose of your appraisal and its expected use should be clearly noted.

**Description of Property.** This includes a physical description that details such features as the size, weight, color, age, material composition, origin, and condition of the appraised item, as well as the method of acquisition (often helpful for tax purposes). The appraiser also generally attests to an item's authenticity and notes the date it was viewed.

**Statement of Disinterest.** The appraiser should verify that no conflict of interest exists. If the report has been prepared for tax purposes, the appraiser must provide a tax identification number and also disclose if the IRS has ever disqualified him or her. The appraiser also generally includes an explanation of the applicable fee structure.

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# Assigning Your Life Insurance Policy

Getting approval for a loan can sometimes depend on one or two very important issues. For example, lenders often ask borrowers the question, “How will this loan be repaid in the event of your death?” Your answer may be to **assign** your **life insurance** policy. This useful feature of a life insurance contract can help provide necessary security for a lender.

You can freely assign your life insurance policy unless some limitation is specified in your contract. Your insurance company can furnish the required assignment forms. Through an assignment, you can transfer your rights to all or a portion of the policy proceeds to an **assignee** (lender). The extent to which these rights are transferable depends on the assignment *provisions* in the policy, the *intention* of the parties as expressed in the assignment form, and the *actual circumstances* of the assignment.

## Types of Assignments

There are two types of conventional insurance policy assignments:

1. An **absolute assignment** is normally intended to give the assignee every right in the policy that you possessed prior to the assignment. When the transaction is completed, you have no further financial interest in the policy.

The terminology of absolute assignments differs from contract to contract. In essence, it states that you transfer all rights, title, and interest in the policy to the assignee. Some insurance companies use an “ownership clause” to accomplish this transfer.

2. A **collateral assignment** is a more limited type of transfer. It is a security arrangement to protect the assignee by using the policy as security for repayment. After the debt is paid, the assignee releases his or her interest in the policy.

Usually, if the collateral assignment is still in force at your death, the assignee informs the insurance company of the remaining indebtedness, including interest, and receives that amount in a lump sum. Any excess proceeds are then payable to your named **beneficiary** in accordance with the beneficiary designation in your policy.

To fully protect the assignee, notice must be given to the life insurance company that the assignment has been made. If a company with no notice of assignment makes payment of the proceeds to another assignee or to a named beneficiary, the insurance company cannot be forced to pay a second time.

## Policy Provisions

Some typical policy provisions concerning assignments may include the following:

1. The assignment will not be binding until the original, or a duplicate thereof, is filed at the insurance company’s home office.
2. The insurance company assumes no obligation as to the effect, sufficiency, or validity of the assignment.
3. The assignment is subject to any indebtedness to the insurance company on the policy.

Thus, it is important to ensure that an assignment is made properly, regardless of whether it is absolute or collateral. For more information, consult your qualified professional advisors. ■

## appraising your appraiser

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**Method of Valuation.** An explanation of valuation methodology offers a basis for the appraiser’s conclusion. In general, appraisers make assessments based on such factors as replacement value, fair market value (FMV), or comparable sales. For example, an appraiser who is determining the value of a work of art may consider the prices of similar works of art. The appraiser often includes a market analysis that references historical performance and may also project future value.

**The Provenance.** In some instances, particularly with artwork, a history of ownership may be included. Further documentation, if applicable, might chronicle noteworthy exhibitions or publications.

**Statement of Value.** The report should clearly state a dollar amount representing the valuation of the appraised item, and it should be signed and dated by the appraiser. It is also standard practice for the

appraiser to include his or her credentials with a résumé.

## Stay Current

To keep up with changing market values, review an appraisal every three years. As your financial strategies change, make sure you base your decisions on the most up-to-date and accurate information regarding the value of your possessions. ■

## Plan Carefully When Choosing Your Executor

When writing your **will**, one important decision will be selecting an **executor**. Ideally, an executor will possess the tact of a diplomat and the administrative skills of a professional executive. The designated individual should be close enough to you and your family to faithfully carry out your wishes, yet also have the ability to act objectively should conflict arise among family members.

While any person you trust can be your executor, many people choose a spouse, close friend, or associate, who may also be a **beneficiary** of the estate. Large estates may require two executors—a personal representative to interpret your wishes and a professional representative or institution, such as your attorney or a bank, to make business or financial decisions, pay taxes, and maintain records.

An executor's job is to "wrap up" your financial affairs. The executor must identify and determine the value of the assets that are part of your estate. (**Trusts, life insurance policies, pension plans**, and some types of **jointly owned property** may fall outside the executor's authority.)



Certain assets may require an **appraiser**, whose fee is generally paid from your estate's assets, as are expenses for lawyers, accountants, and other professionals. An executor is also responsible for paying your

remaining debts, filing tax returns, and distributing whatever remains to your heirs.

Throughout this process, detailed records must be kept. Most **probate courts** will require a full and detailed account of all money received, spent, or held by your estate.

If you die *without* a will (**intestate**), the court will appoint an administrator to perform the executor's duties. Without a designated relative or beneficiary, the appointee is likely to be a civil servant or a creditor.

When choosing an executor, objectivity is essential. Be sure that the person you select is willing to accept the responsibility. It may be wise to choose an *alternate* executor to serve should your initial executor be unable to do so. If you have not yet selected your executor, consider choosing one *now* to minimize potential complications later. ■

## the benefits of family limited partnerships

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### Wealth Preservation

For estate planning purposes, an FLP can be a valuable tool because it allows you to give limited partnership interest to your children, but still retain control over the entity. Children, as limited partners, cannot transfer their partnership interest without your consent (as the general partner), and they have no personal

liability for partnership debt or obligations. Gifts of limited partnership interests to your children can generate substantial valuation discounts because they are minority interests and lack marketability.

While there are many advantages to establishing a family limited partnership, there are also disadvantages: There will be expenses for

establishing and maintaining an FLP; retained partnership interests appreciate in your estate until transferred; and gifts do not receive a step-up in basis.

As you can see, FLPs are complex, and proper planning is essential. For specific guidance, consult your tax and legal professionals. ■

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