THURSDAY, MAY 4 **10:00 a.m. – 11:45 a.m.**

BUSINESS PLANNING GROUP: DRAFTING FAMILY LIMITED PARTNERSHIP AGREEMENTS; PLANNING CONTROL OF BUSINESS ENTITIES; COMMENTS ON SELECTED S CORPORATE ISSUES

GROUP AND PROGRAM CHAIR:

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SPEAKERS:

SELECTED RECENT DEVELOPMENTS

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S Corporation and Other Developments

Business Planning Group Meeting at the Spring 2006 Symposia

of the

Real Property, Probate & Trust Law Section

of the

American Bar Association

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S Corporation Family Attribution Rules

The Business Planning Group of the Probate & Trust Division of the Real Property, Probate & Trust Law Section (RPPT) prepared comments on the S corporation family attribution rules referred to below.[1] The Section adopted these comments and submitted them to Congress.

PL 109-135, the Gulf Opportunity Zone Act of 2005, adopted the approach that our comments suggested and eliminated the requirement of an election referred to in the prior e-mail below.

Code § 1361(c)(1) now provides.

(1) Members of a family treated as 1 shareholder.

> (A) In general. For purposes of subsection (b)(1)(A), there shall be treated as one shareholder—
>
> > (i) a husband and wife (and their estates), and
> >
> > (ii) all members of a family (and their estates).
>
> (B) Members of a family. For purposes of this paragraph —
>
> > (i) In general. The term "members of a family" means a common ancestor, any lineal descendant of such common ancestor, and any spouse or former spouse of such common ancestor or any such lineal descendant.
> >
> > (ii) Common ancestor. An individual shall not be considered to be a common ancestor if, on the applicable date, the individual is more than 6 generations removed from the youngest generation of shareholders who would (but for this subparagraph) be members of the family. For purposes of the preceding sentence, a spouse (or former spouse) shall be treated as being of the same generation as the individual to whom such spouse is (or was) married.
> >
> > (iii) Applicable date. The term "applicable date" means the latest of—
> >
> > > (I) the date the election under section 1362(a) is made,
> > >
> > > (II) the earliest date that an individual described in clause (i) holds stock in the S corporation, or

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[1] Principal responsibility was exercised by Douglas W. Stein, of Barris, Sott, Denn & Driker, PLLC, Detroit, Michigan, a member of the Group, and by Steven B. Gorin, of Thompson Coburn LLP, St. Louis, Missouri, Chair of the Group. Also participating in the preparation of the comments were W. Birch Douglass, III, of McGuireWoods LLP, Richmond, Virginia, and Sydney S. Traum, of counsel to Levey, Airan, Shevin, et al, Coral Gables, Florida. Reviewing these comments on behalf of the Section's Committee on Governmental Submissions was Louis A. Mezzullo of McGuireWoods LLP, Richmond, Virginia.

(III) October 22, 2004.

(C) Effect of adoption, etc. Any legally adopted child of an individual, any child who is lawfully placed with an individual for legal adoption by the individual, and any eligible foster child of an individual (within the meaning of section 152(f)(1)(C)), shall be treated as a child of such individual by blood.

Our work has simplified (at least this aspect of) the rules governing millions of S corporations across the country.

Our task force was concerned how this works when a person who is a beneficiary of a trust owns the stock through another trust or otherwise and how this inter-relates with the family attribution. However, no double counting occurs:[2] For the 100 shareholder limit, see, Reg. § 1.1361-1(m)(4)(vii)(third complete sentence). For the family attribution rule, see, e.g., 2004 Blue Book (General Explanation of Tax Legislation Enacted in the 108th Congress), p. 189, footnote 321.

Sales to Irrevocable Grantor Trusts

Letter Ruling 200603040 could affect how we structure sales to irrevocable grantor trusts.

Under Code § 678(a), a beneficiary may be treated as an owner of a trust under the grantor trust rules. Code § 678(b) provides, "Subsection (a) shall not apply with respect to a power over income, as originally granted or thereafter modified, if the grantor of the trust or a transferor (to whom section 679 applies) is otherwise treated as the owner under the provisions of this subpart other than this section." In other words, the grantor's taxation under the grantor trust trumps the beneficiary's taxation under the grantor trust rules. However, Code § 678(b) refers to a "power over income". Therefore, some concern has been expressed whether Code § 678(b) applies only to the grantor trust treatment with respect to the trust's income, not with respect to the trust's corpus. Most people believe that Code § 678(b) applies to the trust income and corpus, but that concern is still a nagging one.

Due to the concern about whether Code § 678(b) applies to corpus, the author has avoided giving beneficiaries withdrawal rights on gifts made to a trust when the grantor's being the sole owner is important. This is especially a concern in a sale to an irrevocable grantor trust, because avoiding gain on the grantor's sale to the trust is often a key element to the transaction.

Letter Ruling 200603040 held, "Because Trust is a grantor trust under § 677 with respect to Grantor, it is a grantor trust in its entirety with respect to Grantor notwithstanding the powers of withdrawal held by Spouse that would otherwise make her an owner under § 678." Thus, presumably a sale could be made to the irrevocable grantor trust in the ruling, notwithstanding the beneficiaries' withdrawal rights.

[2] The author thanks for this analysis Kenneth N. Orbach, Professor of Accounting, School of Accounting, Florida Atlantic University, Boca Raton, FL, with whom the author served on an American Institute of Certified Public Accountants task force that created a checklist for trusts owning stock in S corporations.

Steve Akers[3] observed:

> Despite arguments from the literal statutory language (the exception in section 678(b) refers to a power over income, but a Crummey withdrawal power is a power over corpus), various rulings have indicated that the grantor trust provisions will "trump" a section 678 power attributable to a person holding a Crummey withdrawal right that lapses. E.g., PLRs 200011054; 9309023; 9321050. (See also PLR 9141027, but in that ruling the spouse also had an inter vivos power of appointment of principal.) This issue was raised in a PLR request that was discussed by Jonathan Blattmachr at the 2005 Heckerling Institute and the IRS said (during discussions in 2004) that this issue was "in a state of flux." A recent PLR held that where a Crummey withdrawal power was held by the grantor's spouse, the trust was still a grantor trust as to the grantor "notwithstanding the powers of withdrawal held by Spouse that would otherwise make her an owner under §678." PLR 200603040. It is not clear whether this PLR signals that the issue is no longer "in a state of flux" with the IRS or whether the IRS might rule differently if the power were not held by the grantor's spouse (the ruling gave no hint that it would be different if someone else held the withdrawal power).

Thus, a tax advisor might still consider obtaining a private letter ruling before using withdrawal rights in a sale to an irrevocable grantor trust.

[3] Steve R. Akers, RPPT's Vice Chair in charge of its Probate & Trust Division and also a Managing Director of Bessemer Trust Company.

BUSINESS SUCCESSION PLANNING – CHANGING THE GROUND RULES

by

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Closely held family-owned businesses constitute a significant portion of business enterprises in the United States. Perpetuating the family business is a common goal of many families. A critical issue in achieving this goal, and developing a successful transition to the next generation, is determining who will control the business. That is, who should own (or control) a majority of the corporation's voting stock. Limiting control to a single shareholder or small shareholder group is generally preferred in family businesses.

Selecting the appropriate successor, however, is not enough to assure a successful business transition. The founder must also plan for the potential conflict which inevitably will arise between family members. Conflict can significantly harm the health of the family business and, perhaps more importantly, damage family relationships. The origins of conflict are infinite. Inherent in all majority/minority shareholder relationships is the conflict that results from a majority shareholder's ability to effectively control the corporation. This is particularly so in closely held family corporations where minority shareholders commonly have no ready market to sell their stock outside the family. Conflict can push minority shareholders to the breaking point if the majority shareholder attempts to "freeze-out" a minority shareholder from management or the economic benefits of the family business. Personality clashes, the uniqueness of family relationships, differing expectations on operating the family business and the founder's selection of the controlling shareholder itself all can lead to problems.

Minority shareholders are afforded various statutory and judicial rights. Absent modification in a corporation's governing documents or a shareholders' agreement, these rights operate as the ground rules which govern the relationship between the majority and minority shareholders. Unfortunately, in most cases, these rules, if unchanged, do little to reduce conflict in a family corporation or to protect minority shareholders from majority oppression. This article will provide an overview of these rules and suggestions on how to alter them to protect minority owners, increase communication between shareholders, and reduce conflict.

Shareholder Management Rights

The inherit conflict between majority/minority shareholders stems primarily from the hierarchical structure of corporations which affords minority shareholders little say in corporate operations. Most state corporate statutes generally reflect traditional corporate theory which recognizes three distinct roles in corporate governance. Shareholders elect a board of directors.

The board sets corporate policy, elect officers who manage day to day operations of the corporation, and oversee management of the corporation.

Shareholder Voting Rights

While shareholders have the right to elect directors, there are few other corporate actions which require shareholder approval. Under most state corporate statutes, shareholder approval is typically needed only for certain amendments to the corporation's articles of incorporation and bylaws, to participate in a merger or other reorganization, to sell all or substantially all of the corporation's assets outside the ordinary course of business, and to voluntarily dissolve. Even when shareholder approval is required, the majority shareholder generally has the power to determine the outcome. Consequently, since majority shareholders can typically elect the entire board, minority shareholders are essentially removed from participation in setting corporate policy or selecting the individuals who will run the business on a daily basis.

How Shareholders Act

Shareholders may take action at a duly held meeting of the shareholders and, in most states, by unanimous written consent of the shareholders.

1. Shareholder Meetings

All shareholders have the right to participate in shareholder meetings. Corporations must generally hold annual shareholder meetings for the purpose of electing directors and addressing other business which may become before the shareholders. Some states do not require a corporation hold regular (or annual) meetings unless required by the articles of incorporation or bylaws but allow shareholders holding a minimum percentage of the voting power of all the corporation's shares to demand a meeting if a regular meeting has not been held for more than a specified period. See Minn. Stat. § 302A.431. The Model Business Corporation Act (the "Model Act") contains a similar provision for close corporations (i.e., a corporation which elects this status and has 50 or fewer shareholders) and does not require an annual meeting be held unless a shareholder delivers a timely written request for the meeting. Model Act §23. Corporations must hold special shareholder meetings if called or demanded by specified persons (e.g. certain officers, one or more directors, or shareholder's holding some minimum percentage of the corporation's voting power).

Unfortunately, most closely held corporations do not hold annual meetings. It is not uncommon for closely held corporations to go years without holding an annual meeting. Failure to hold shareholder meetings deprives a family corporation of a valuable forum for discussion and the opportunity for minority shareholders to debate, take issue with the actions of the majority shareholders, and to make relevant inquiries about the corporation's business. Open communication, particularly in family corporation, is critical to the success of any business. Lack of communication can lead to misunderstanding and, in turn, mistrust and a breakdown in family relationships. Rather than simply holding an annual meeting, most family businesses would benefit from holding more frequent meetings and permitting minority shareholders the right to demand, and compel, that annual and periodic meetings be held.

2. *Action by Written Consent*

Instead of holding a shareholder meeting, many shareholders appoint directors and take other shareholder action by written consent. The Model Act and most state corporate statutes permit shareholders to act by unanimous written consent as to any action required or permitted to be taken at a shareholder meeting. Model Act §7.04. Some states go one step further and allow, if authorized by the articles of incorporation, the written consent to be signed by shareholders holding the requisite voting power needed if the action was taken at a shareholder meeting. See Minn. Stat. §302A.441.

Shareholder action by written consent can be a useful and efficient means for shareholders to act, particularly when action is needed in short order and there is limited, or insufficient, time to hold a shareholder meeting. However, unanimous written consents prevent full and open discussion and debate and should be used only out of necessity when needed in extraordinary situations. Authority to use non-unanimous written consents is generally not recommended for family owned businesses because they permit a majority shareholder to take action without any input from minority shareholders and can used as a tool to freeze-out minority shareholders out of management discussions.

Right to Inspect Records

Virtually all state corporate statutes grant shareholders the right to inspect certain corporate books and records upon reasonable notice. The inspection right is important to allow minority shareholders to monitor actions of the majority shareholders and to effectively participate in shareholder meetings. In most states, however, the right to inspect records is not absolute nor available to all corporate records. Under the Model Act, each shareholder is entitled to inspect, after giving notice, only basic corporate documents such as a corporation's articles of incorporation and bylaws (and amendments thereto), shareholder resolutions (and written consents) for the past three years, communications to shareholders during the past three years, annual financial statements (which are required to be furnished to shareholders), names and business addresses of the current directors and officers, and board resolutions dealing with the creation of shares if shares issued pursuant to such resolutions are outstanding. Model Act §16.02(a).

Other corporate books and records, such as excerpts of board and committee meetings, accountings records and interim financial statements, may be inspected only for a proper purpose (described with reasonable particularity) and then only to the extent the records are connected with the purpose. Model Act §16.02(b). A proper purpose is one typically reasonably related to the person's interest as a shareholder. Model Act §16.02(b) (Official Comment). For example, assessing the competence of management and reviewing communication with other shareholders for various purposes such as encouraging a shareholder's of approval of a specific transaction or a corporate changes are relevant to a person's interest as a shareholder, but merely a disagreement with management is not.

In family corporations, it may be beneficial to alter default rules to allow shareholders greater access to corporate and accounting records to foster open communication and allow minority owners a greater opportunity to monitor majority shareholder actions. Founders should consider giving minority shareholders access to monthly or quarterly financial statements, annual budgets periodic comparisons to budgets, and business plans.

Methods to Provide Minority Shareholders Greater Management Rights

Minority shareholders can be afforded greater participation in corporate operations by various means including one or more of those means discussed below. How great a role minority shareholders should have in a family corporation depends on various factors and is unique to each family. These factors include (1) a minority shareholder's knowledge of the family business, (2) whether a minority shareholder is employed by the family corporation, (3) the personal relationship between the majority and minority shareholders, (4) any special business, financial, or legal skills of a minority shareholder, (5) the experience and skill of the majority shareholder, (6) whether the majority shareholder was selected by the founder, and (7) whether the founder desires to protect certain aspects of the business (e.g., to engage in a specific type of business or remain located in a specific geographic community). As a general guideline, only minority shareholders who are active in, or knowledgeable about, the family business should be granted an expansive voice in the business. Non-active minority shareholders and those not knowledgeable about the family business should usually have only limited rights to participate in management, but may be granted authority to serve as a "check" on the majority shareholder's power and to protect objectives of the founder.

1. Board Representation

Under normal voting for directors, majority shareholders can elect the entire board. One means to provide to minority shareholders a greater voice in the family corporation is to grant them a right to appoint one or more directors to act as a "watchdog." There are various means to provide minority shareholders board representation, including cumulative voting, multiple classes of stock, voting agreements, or shareholder agreements. The benefits of minority board representation will depend, in part, on the corporation holding regular and periodic directors' meetings. It is at the directors' meetings that the minority shareholder appointee is afforded an opportunity to discuss and debate corporate policy. Therefore, if minority board representation is desired, it should be coupled with a requirement for quarterly or more frequent board meetings. Furthermore, the board should act by unanimous written consent only when necessary. Non-unanimous written consent, even if permitted under the state corporate statutes, should not be used because it can be used as a tool for the majority shareholder dominated board to freeze-out the minority shareholder appointee.

(a) Cumulative Voting. Cumulative voting, an alternative to normal voting for directors, is generally a poor method to grant minority shareholders representation on the board representation. Under the Model Act and most state corporate statutes, it is permitted only if the corporation explicitly "opts-in." Model Act §7.28. Under cumulative voting, each shareholder is typically permitted to cast a total number of votes equal to the number of shares owned multiplied by the number of directors to be elected. Minority shareholders can aggregate their

votes to elect to a single director or distribute them among two or more candidates. However, the number of shares it takes to ensure that minority shareholders may appoint a director depends on a complex formula which takes into account various factors including the number of voting shares present and the number of board seats open for election. Changing the number of outstanding shares or the number of directors of the board changes the minimum number of shares required to elect one director. Moreover, shareholders may be required to give timely notice of their intent to vote cumulatively and cumulate their votes in the correct manner or it will fail.

(b) Agreements and Multiple Classes of Stock. A more precise method to provide minority shareholders board representation is through the use of multiple classes of stock, which grant each class the right to appoint a specific number of directors or a shareholder agreement or voting agreement. Most state corporate statutes and the Model Act allow shareholders to predetermine the desired board composition. See Model Act §7.32.

(c) Number of Directors to Appoint. Founders typically desires the minority shareholders to appoint a particular portion of the board. To protect the desired board composition, the number of directors comprising the board should be set and limitations should be placed on the majority shareholder from increasing the number of directors and reducing the minority's representation on the board. If the number of board members is increased, the minority shareholders appointment rights should increase as well.

(d) Limitations. While minority board representation can increase a minority shareholder's participation in setting corporate policy, albeit indirectly, alone it does little to limit the majority shareholder's control of the corporation. The board will typically continue to be dominated by the majority shareholder and the minority shareholder appointee will usually be unable to block the decisions of the majority shareholder appointees. If the founder desires to alter the balance of power, minority board representation should be coupled with one or more veto powers.

2. Veto Rights

Veto powers are a common method to provide minority shareholders a greater voice in management and to protect them from majority oppression. It serves as a "check" on the majority shareholder's power. While veto rights may prevent a majority shareholder from taking certain actions without a minority shareholder's consent, they do not give minority shareholders a right to compel action. To achieve affirmative control, shareholders can agree in advance, typically in a shareholders' agreement, on certain corporate actions or policies. Common methods to create veto powers are to (1) increase director and/or shareholder voting requirements, (2) require shareholder approval of board actions, and (3) increase shareholder and/or director quorum requirements. Veto powers, however, may not be absolute and the minority shareholders may have a duty not to act arbitrarily. See e.g., *Smith vs. Atlantic Properties, Inc.*, 422 N.E.2d 798 (Mass. 1981).

(a) Higher Voting Requirements – Supermajorities

Under most state corporate statutes, shareholders take action by the affirmative vote of the shareholders holding a majority of the voting power present at a duly held meeting. Directors typically act by a majority present at a duly held meeting. The ability of the shareholders and directors to act can be increased to a specified percentage of all the shareholders or directors, as the case may be. The percentage should be high enough to allow a specific shareholder or a group of shareholders, or a minority shareholder board appointee, to have the ability to block actions. However, due to the tendency to create deadlock, unanimous voting requirements are not recommended and are usually invalid.

Perhaps more important than determining the voting percentage, is determining whether the supermajority vote requirement should apply to all director or shareholder actions or only specific transactions. The answer differs based on the dynamics of the family, the objective of the supermajority requirement, and the role the founder desires the minority shareholders to have in the business. If the founder has specifically selected an individual to have control, the increased voting requirement should only apply to significant activities. This will act as a check on the majority shareholder's authority and assure that specific objectives of the founder are carried out. For example, a founder who desires the family corporation to stay in existence, remain located in a particular geographic area, or engage in a specific business may limit the veto right to actions that deviate from the given objective.

(b) Board Action Subject to Shareholder Approval

Supermajority voting requirements are not the best tool to provide minority shareholders a check on the majority shareholder's power to control the corporation. As discussed above, few corporate actions need shareholder approval. Moreover, even though a director appointed by minority shareholders may block a board action, the minority director appointee, like all directors, has a fiduciary duty to act in the best interests of the corporation and all shareholders. In other words, the director cannot act solely in the best interests of the minor shareholder. An effective way to shift power to the minority shareholders is to limit the board's authority to act on specific matters without the prior approval of some supermajority of the shareholders. For example, board actions which may require shareholder approval include: any amendment to the articles of incorporation which would adversely affect rights of existing shareholders; confessing a judgment against the corporation, incurring a debt, or making a capital expenditure in excess of a specific amount; selling assets outside the ordinary course of business; participating in merger or similar transaction; investing in another entity; transactions with employees and shareholders; or issuing stock to any person. The right to block issuance of additional shares is often needed to protect the veto powers of minority shareholders. Issuance of additional stock can dilute a minority shareholder's interest in the corporation to the extent a supermajority vote or quorum is negated. Statutory preemptive rights may also protect against dilution by granting existing shareholders the right to purchase a pro rata share of any new shares offered by the corporation. However, preemptive rights can be difficult to work with and only benefit minority shareholders if they have the economic means to acquire additional shares.

(c) Higher Quorum Requirements

Another means to provide minority shareholder a veto power is to increase quorum requirements for board and shareholder meetings to something greater than a majority. Like unanimous voting requirements, unanimous quorum requirements are not recommended and are invalid in most states. Higher quorum requirements also serve to provide greater director and shareholder participation in the decision making process. However, because quorum requirements apply to all director's and shareholder's meetings, the appropriate percentage needed for a quorum should be carefully considered to prevent one or more of the directors or shareholders from creating deadlock**.**

Protecting Against Economic Freeze-Out

In addition to majority shareholders power to eliminate minority participation in management, they can freeze-out minority shareholders from the economic benefits of equity ownership. There are numerous techniques to economically freeze-out minority shareholders including failing to pay dividends, eliminating employment opportunities for minority shareholders or selectively reducing their salaries, siphoning corporate profits through excessive compensation to corporate insiders and corporate agreements and leases with the majority shareholders and their affiliates, and a corporation's preferential redemption of a majority shareholder's stock without a corresponding offer to buy the minority shareholder on a prorate basis.

State Law Protections Against Freeze-Outs

Most states attempt to protect minority shareholders from oppression by imposing a fiduciary duty on the majority shareholder and providing shareholder dissolution rights and dissenters' (or appraisal) rights.

1. Fiduciary Duty of Shareholders

In most states, a majority shareholder in a closely held corporation has a fiduciary duty to both the corporation and the shareholders, to act in the best interest of all shareholders. This generally requires the majority shareholder to exercise their power in good faith and in a manner that does not oppress or "freeze-out" the minority owners. For example, in Minnesota shareholders have a duty to act in an honest, fair and reasonable manner. Minn. Stat. §302A.751 Subd. 3a. Breach of the shareholder duty usually gives rise to a direct action on the injured shareholder's behalf, as opposed to a derivative action on behalf of the corporation. However, not all acts of self interest by a majority shareholder constitute a freeze-out. See e.g., Wilkes v. Springside Nursing Home, 353 N.E. 2d 657 (Mass. 1976).

A critical factor is whether the conduct in question produces a benefit to the corporation or merely the majority shareholder. In the latter case, the majority shareholder may need to demonstrate why the conduct was fair and reasonable. However, some courts have required the minority shareholder to prove the challenged transaction was not fair if it was approved by disinterested directors or the noncontrolling shareholders after full disclosure. For these reasons, it may be advisable to obtain disinterested director approval of all significant majority shareholder transactions with the corporation and actions which could freeze-out minority shareholders. This is particularly true when the majority shareholder desires to terminate a minority shareholder's employment.

Compensation is often a significant component of a minority shareholder's economic benefit from stock ownership. If the termination is not coupled with a buy-out of shares, many courts have found the minority shareholder is excluded from the benefits of their investment, and therefore, the termination constitutes oppression. The reasonable expectations of the parties is an important factor in determining if the termination constitutes oppression. It is not surprising, therefore, that cases have generally favored the majority shareholder when the termination is coupled with a contractual obligation to buy-out the minority shareholder's shares. The courts in these cases essentially defer to the parties' reasonable expectations as contained in the agreement requiring buy-out upon termination. In some states, any written agreement, including employment and shareholder agreements, among shareholders or among shareholders and the corporation, are presumed to reflect the parties' reasonable expectations as to its subject matter. Minn. Stat. §302A.751, Subd. 3a.

2. Dissolution Rights

Most state corporate statutes contain some type of voluntary or involuntary dissolution provisions. These statutes provide oppressed minority shareholders an exit strategy from the corporation in the absence of a contractual buyout arrangement. Under the Model Act, upon petition of a shareholder, a court may dissolve a corporation if (1) the directors are in a deadlock which the shareholders can't break and the corporation has suffered, or is threatened to suffer irreparable injury or the corporation's affairs can no longer be conducted for the advantage of the shareholders generally, (2) the directors or those in control have acted, are acting or will act in a manner that is illegal, oppressive or fraudulent, (3) the shareholders are deadlocked and have not been able to elect directors for two annual meetings, or (4) the corporate assets are being misapplied or wasted. Model Act §14.30(2). Oppression is a common ground for dissolution by petition of minority shareholders who do not have contractual exit rights. The Minnesota legislature expanded these grounds to include actions by the board or those in control that are unfairly prejudicial toward one or more shareholders in their capacity as a shareholder or director of a non-public corporation or officers and employees of a closely held corporation. Minn. Stat. §302A.751.

Many courts have been reluctant to dissolve the corporation to remedy an oppressed minority shareholder when buyout at fair value the injured shareholder's shares would be an adequate remedy. Model Act, §14.34 (2000) (Official Comment). Consequently, some courts have interpreted their state dissolution statute to include buyout as an alternative remedy. The Minnesota legislature has expanded the permissible remedies to "any equitable relief it deems just and reasonable" including buy-out of the injured shareholder's shares. Minn. Stat. §302A.751.

The Model Act takes a slightly different approach to buy-outs. It creates a defensive mechanism for the corporation and other shareholders to avoid the risk of dissolution by granting the corporation and other shareholders the right to elect to purchase the petitioning shareholder's shares. Model Act §14.34(a)-(b). If the election is timely made and the parties are unable to agree on a purchase price in 60 days, the court must determine the fair value of the shares. Model Act §14.34(c) and (d). Unlike Minnesota and other states, under the Model Act, neither the petitioning shareholder nor the court may initiate the buyout.

3. Dissenters' Rights

All state corporate statutes and the Model Act grant shareholders the right to dissent from specific corporate actions and be paid the fair value for their shares. Thus, dissenters' rights (or appraisal rights), allow minority shareholders an exit if they disagree with the certain decisions of the majority shareholders. Since the actions which trigger the appraisal rights vary by state, these rights provide a limited escape valve. Under the Model Act, appraisal rights are triggered by certain mergers, share exchanges, sale of all or substantially all the corporation's assets, certain amendments to the articles of incorporation affecting shareholder rights and conversion of the corporation to a nonprofit or unincorporated entity. Model Act §13.02(a).

4. Method to Prevent Freeze-out

While remedies are available to the oppressed minority shareholders in most states, they often require litigation. In most family corporations, litigation can significantly and permanently scar family members and eliminate any chance of healing wounds caused by the oppressive act. Instead of relying solely on state law remedies, family corporations may be better served by trying to minimize the majority shareholder's ability to economically freeze-out the minority shareholders. Some methods to do so include:

(a) Mandatory Distributions. Providing for mandatory distributions if the corporation's cash flow and/or earnings exceed a specified level. This is particularly useful to provide an economic return to minority shareholders not employed by the corporation. In the case of S-corporations, mandatory distributions should be required to enable minority shareholders to pay income taxes attributable to their distributive share of the corporation's income. Mandatory distributions have drawbacks. They can limit a corporation's working capital and in the case of C-corporations result in double taxation.

(b) Employment Agreements. Employment of a minority shareholder can be memorialized by an employment agreement which sets forth the shareholder's length of employment and compensation. To protect against the majority shareholder from siphoning profits through excess compensation, a minority shareholder's employment agreement may provide for salary increases in proportion to other key employees, including the majority shareholder. Liquidated damages or severance pay may be provided in the event the minority shareholder's employment is terminated without cause.

(c) Exit Strategies. A mechanism to redeem the stock of a minority shareholder should be created. For example, minority shareholders active in the family business may have a buy-out tied to termination of employment, disability and other events. For non-active shareholders, the corporation could have a "call right" to buy-out the minority

shareholder's shares after a specified period and the minority shareholder could be granted a "put right" to require the corporation to buy-out its shares after a specified period.

(d) *Disinterested Director*. Many times, a family member is inclined to act differently in front of outsiders. Having a disinterested director on the board may encourage a more business focus approach by family board members. Moreover, the disinterested director can provide necessary objectivity, and in some cases, serve as a tiebreaking vote in the event of management or shareholder deadlock.

Conclusion

A successful business transaction requires more than simply determining an appropriate successor. It requires an environment and ground rules that minimize conflict between family members and protect minority shareholders from oppression. Founders must be mindful that default corporate rules which govern the relationship between shareholders do little to reduce conflict. These rules should be altered to meet the expectations of the various parties and ensure the desired board composition or balance of power is obtained. Founders must also understand the impact these changes will have on themselves, their long term objectives for their businesses, and the long term relationships within their families.

PROTOTYPE
LIMITED PARTNERSHIP AGREEMENT
WITH
COMMENTARY

A Project
of the
Business Investment Entities, Partnerships,
LLC's, and Corporations Committee
of the
Business Planning Group

Section of Real Property, Probate and Trust Law

American Bar Association

2nd Draft
February 10, 2006

LIMITED PARTNERSHIP AGREEMENT OF[1]

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THE LIMITED PARTNERSHIP INTERESTS IN ________________________________ (THE "INTERESTS") ARE SUBJECT TO THE RESTRICTIONS ON TRANSFER SET FORTH IN SECTION 6 OF THIS AGREEMENT. THE INTERESTS HAVE BEEN ACQUIRED FOR INVESTMENT AND HAVE NOT BEEN REGISTERED UNDER (i) THE [STATE ACT], IN RELIANCE UPON THE EXEMPTION PROVIDED IN SECTION _____________ OF THE [STATE ACT], (ii) UNDER ANY OTHER STATE SECURITIES LAWS, OR (iii) UNDER THE FEDERAL ACT. NEITHER THE INTERESTS NOR ANY PART THEREOF MAY BE OFFERED FOR SALE, PLEDGED, HYPOTHECATED, SOLD, ASSIGNED OR TRANSFERRED AT ANY TIME EXCEPT IN COMPLIANCE WITH THE TERMS AND CONDITIONS OF SECTION 6 OF THIS AGREEMENT AND (i) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE [STATE ACT] OR IN A TRANSACTION THAT IS EXEMPT FROM REGISTRATION UNDER THE [STATE ACT] OR THAT IS OTHERWISE IN COMPLIANCE WITH THE [STATE ACT], (ii) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER ANY OTHER APPLICABLE STATE SECURITIES LAWS OR IN A TRANSACTION THAT IS EXEMPT FROM REGISTRATION UNDER SUCH SECURITIES LAWS OR THAT IS OTHERWISE IN COMPLIANCE WITH SUCH SECURITIES LAWS, AND (iii) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE FEDERAL ACT OR IN A TRANSACTION THAT IS EXEMPT FROM REGISTRATION UNDER THE FEDERAL ACT OR THAT IS OTHERWISE IN COMPLIANCE WITH THE FEDERAL ACT.

This LIMITED PARTNERSHIP AGREEMENT OF ________________________ is entered into and shall be effective, as of the Effective Date, among the Persons whose signatures appear below, and such additional Persons as are hereafter admitted as Partners of the Partnership.

SECTION 1
FORMATION

1.1 Formation of Partnership. The Partners hereby form the Partnership pursuant to the provisions of RULPA, and, except as provided in this Agreement to the contrary, the rights and obligations of the parties shall be as provided under ________________ law.[2] This Agreement may be executed in one or more counterparts, each of which shall be deemed an original, but all of which together shall constitute one and the same instrument.

1.2 Partnership Name. The name of the Partnership shall be ___________________________, and all business shall be conducted in such name or in any other name or names that are selected by the General Partner.

1.3 Partnership Office. The principal place of business shall be at ________________________. The General Partner may also establish other offices of the Partnership as the General Partner may determine.

1.4 Registered Agent and Registered Office. The registered agent of the Partnership shall be ________________________ and its registered office shall be located at _____________________________, or at such other place as the General Partner may determine.

1.5 Partners' Names and Addresses. The Partners of the Partnership and their addresses are as set forth in Schedule A.

1.6 Term. The Partnership shall exist from and after the Effective Date and shall continue thereafter until the Partnership is dissolved, liquidated, and terminated as provided herein.

1.7 Business and Purpose.[3] The business and purpose of the Partnership is to (a) invest the capital and undistributed income of the Partnership for the common benefit and profit of the Partners in the conduct of such activities and businesses as the General Partner deems appropriate; (b) to provide for the control, ownership, preservation and management of the Partnership Property; (c) to reduce the administrative and other costs associated with management of the Partnership Property; (d) to govern the transfer of a Partner's Interest in the Partnership as a result of a failed marriage; (e) to protect the Partnership Property from claims of future creditors of the Partners; (f) to avoid undue fractionalization of interests in the Partnership Property; (g) to provide flexibility in business planning not available through other types of entities; (h) to promote knowledge of and communication regarding the Partnership Property among the Partners; and (i) to facilitate the administration and reduce the costs associated with the disability of a Partner or the probate of a Partner's estate.

SECTION 2
CAPITAL CONTRIBUTIONS AND ACCOUNTS

2.1 Initial Capital Contributions. The initial Capital Contributions and the opening Capital Account balances of the Partners and the initial Percentage Interests of the Partners are as set forth in Schedule A. The opening Capital Account balance of a Partner is equal to the agreed upon net fair market value of such Partner's initial Capital Contribution. The initial Percentage Interest of each Partner shall be based upon the ratio of total capital contributed to the Partnership in cash and value of contributed property credited to each Partner relative to the total capital contributed to the Partnership in cash and value of contributed property credited to all Partners pursuant to this Section. The value of any property contributed to the Partnership shall be adjusted for all purposes of this Agreement to reflect any value determined in a final valuation report obtained or accepted by the Partnership in connection with the contribution.

2.2 Subsequent Voluntary Contributions. Except as provided in Section 9.3(e), no Partner shall be obligated to make any additional Capital Contribution. Upon the approval of the

General Partner, a Partner may make a voluntary additional Capital Contribution. If a Partner makes an additional Capital Contribution, other than in the context of additional Capital Contributions made by all of the Partners in proportion to their respective Capital Account balances as of the date of such contribution, such payment shall be credited to the contributing Partner's Capital Account and the Percentage Interest of each Partner shall be adjusted. The adjusted Percentage Interest of each Partner shall be based upon a ratio of the Capital Account of each Partner relative to the aggregate Capital Accounts of all Partners, taking into consideration any adjustments the General Partner has made to each Partner's Capital Account in accordance with the last paragraph of the definition of "Capital Account" set forth in Section 12.

2.3 Capital Accounts. A separate Capital Account shall be maintained by the Partnership for each Partner in accordance with Code Section 704(b). In the event that a determination is made by the General Partner that it is necessary to modify the manner in which the Capital Accounts, or any debit or credit thereto, is accounted for in order to comply with Treasury Regulation Section 1.704-1(b), the General Partner may make such modification, provided, however, that such modification shall not have a material effect on the economic agreement among the Partners.

2.4 Return of Capital Accounts. No Partner shall have the right to demand or to receive the return of any part of such Partner's Capital Account or to demand or to receive any distributions from the Partnership, except as specifically provided in this Agreement. Except as provided in Section 9.3(e), no Partner shall be liable to the Partnership or any other Partner for the return of any Partner's Capital Account.

2.5 No Interest or Priority. No Partner shall have the right to interest on such Partner's Capital Account and no interest shall be paid to any Partner. No Partner shall be entitled to priority over any other Partner with respect to distributions or allocations, except as expressly provided in this Agreement.

2.6 Loans to the Partnership. No Partner shall be required to lend any funds to the Partnership. Any Partner may, but shall not be obligated to, advance funds to the Partnership to pay any expenses or obligations of the Partnership, in the discretion of the General Partner. Any payment, advance or transfer accepted by the Partnership from a Partner, or for which a Partner has the right to reimbursement, which is not an agreed Capital Contribution shall be deemed a loan, shall not be treated as a Capital Contribution for any purpose, and shall not entitle such Partner to any increase in the Percentage Interest in the Partnership. Any such advances shall be made in exchange for a demand promissory note of the Partnership and shall bear interest at the Partner Loan Rate. The Partnership shall make payments on such advances from the operating cash flow of the Partnership at such times, in such amounts, and in such a manner as the General Partner may determine in the General Partner's discretion to be in the best interest of the Partners and the Partnership; provided, however, that the unpaid accrued interest and principal balance of such advances shall be immediately due and payable in full upon a Financing or Sale of any Partnership Property, unless waived in writing by the lending Partner.

2.7 No Obligation of Partners to Fund. No Partner shall be obligated to fund, advance or lend monies which may be necessary to pay operating deficits, if any, incurred by the Partnership during the term of the Partnership except as explicitly set forth in this Section 2.

SECTION 3
ALLOCATION OF INCOME, LOSSES AND DISTRIBUTIONS

3.1 Allocation of Income, Loss, Gain, Deductions and Credits.[4] The Partnership's Net Profit or Net Loss, as the case may be, and all items of income, gain, loss, deduction and credit of the Partnership for each Fiscal Period shall be allocated as of the end of each Fiscal Period to each Partner, based upon each Partner's varying Interest in the Partnership during the Fiscal Period. Such allocation represents the apportionment of such items among the Partners for bookkeeping purposes and for calculation and adjustment of Capital Accounts.[5] Such allocations shall also be effective for income tax purposes, except to the extent tax allocations are explicitly provided in this Section to be made separately from book allocations. Any Partner allocated a certain proportion of income, loss, gain or credit shall be allocated a like proportion of all items comprising such income, loss, gain or credit, except as expressly provided in this Agreement.[6]

(a) Income, Loss, Gain and Credit, Generally. All income, loss, gain and credit shall be allocated among the Partners in accordance with their Percentage Interests at the time of such allocation. If the Percentage Interests of the Partners are adjusted in accordance with Section 2.2, with the result that the Percentage Interests of the Partners are different at (i) the date on which certain items of revenue or expenditures are accounted for and allocated under this Section and (ii) the date such items are actually received or paid in cash, then the allocations under this Section 3.1 shall be appropriately adjusted as of the later of the dates described in (i) and (ii) to cause the overall allocation to be consistent with the actual economic benefits of such revenue or burdens of such expenditures.

(b) Partner's Minimum Gain Limitation. In the event that by reason of the reductions to be made to a Limited Partner's Capital Account pursuant to Treas. Reg. Section 1.704-1(b)(2)(ii)(d)(4), (5), or (6), such Limited Partner would have an Adjusted Capital Account Deficit at the end of any Partnership Fiscal Period, then such Limited Partner shall be specially allocated items of Partnership gross income and gain in the amount of such excess to eliminate such Adjusted Capital Account Deficit as quickly as possible.

(c) Qualified Income Offset. In the event a Limited Partner unexpectedly receives any adjustment, allocation or distribution described in Treas. Reg. Section 1.704-1(b)(2)(ii)(d)(4), (5) or (6), which has not otherwise been taken into account in determining such Limited Partner's Adjusted Capital Account Deficit, if any, then items of Partnership gross income and gain shall be specially allocated to such Partner in an amount and manner sufficient to eliminate such Limited Partner's Adjusted Capital Account Deficit as quickly as possible. This Section 3.1(c) is intended to constitute a "qualified income offset" under Treas. Reg. Section 1.704-1(b)(2)(ii)(d) and shall be interpreted consistently therewith.

(d) Minimum Gain Chargeback. If during any Partnership Fiscal Period there is a net decrease in a Partner's share of "minimum gain," as defined in Treas. Reg. Section 1.704-2(g), each Partner who would otherwise have an Adjusted Capital Account Deficit at the end of such year shall be specially allocated items of Partnership gross income and gain for such year (and, if necessary, subsequent years) in an amount and manner sufficient to eliminate such Adjusted Capital Account Deficit as quickly as possible. The items to be allocated shall be determined in accordance with Treas. Reg. Section 1.704-2(j). This Section 3.1(d) is intended to comply with the minimum gain chargeback provisions of Treas. Reg. Section 1.704-2(f) and shall be interpreted consistently therewith. If any Limited Partner personally guarantees Partnership indebtedness at any time which is deemed a capital account restoration obligation pursuant to Treas. Reg. Section 1.704-1(b)(2)(ii)(c), and, if during any Partnership Fiscal Period there is a net decrease in such Partner's deemed capital account restoration with respect to such guarantee, special allocations of gross income and gain shall be made as provided in this Section 3.1(d) to eliminate such Partner's Adjusted Capital Account Deficit.

(e) Reallocation of Special Allocations Mandated by Treas. Reg. Section 1.704-1(b) and Section 1.704-2. If a special allocation is made of any item of Partnership income, gain, deduction, loss or credit by reason of Section 3.1(b) through Section 3.1(d), inclusive, a special allocation of items of Partnership gross nonrecourse and other deductions to a Limited Partner and gross income and gain to the General Partner shall be made in order to restore the Partner's Capital Accounts to the Partner's relative Percentage Interests as quickly as possible within the limitations of Treas. Reg. Section 1.704-2 regarding nonrecourse deductions allocable to the Limited Partners.

(f) Special Allocations for Contributed Property. In accordance with Code Section 704(c) and applicable Treasury Regulations, income, gain, loss and deduction with respect to any property contributed to the Partnership shall, solely for tax purposes, be allocated among the Partners so as to take into account any variation between the adjusted basis of such Property to the Partnership for federal income tax purposes and the value ascribed to it under this Agreement. In addition, if the value of any Partnership Property is required to be adjusted pursuant to the provisions of Code Section 704(b) and the Treasury Regulations thereunder, subsequent allocations of income, gain, loss and deduction for tax purposes with respect to such asset shall take account of any variation between the adjusted basis of such asset for federal income tax purposes and its adjusted value, in the same manner as under Code Section 704(c) and the applicable Treasury Regulations. Any elections or other decisions relating to such allocations shall be made by the General Partner in any manner that reasonably reflects the purpose and intention of this Agreement without regard to the adverse tax consequences to the other Partners. Allocations pursuant to this Section 3.1(f) are solely for purposes of federal, state and local taxes, as appropriate, and shall not affect, or in any way be taken into account in computing, any Partner's Capital Account or share of profits, losses, other items or distributions pursuant to any provision of this Agreement.

(g) No Shift of Recapture Responsibility. In making the allocation among the Partners of gain or profit, the ordinary income portion, if any, of such gain or profit caused by the recapture of cost recovery, depreciation, amortization or any other deductions shall be allocated among the Partners who were previously allocated related deductions in proportion to the amount of such deduction previously allocated to them, notwithstanding that a Partner's share of profits, losses or liabilities may increase or decrease from time to time. Nothing in this Section 3.1(g), however, shall cause the Partners to be allocated more or less gain or profit than would otherwise be allocated to them pursuant to this Section 3.

3.2 Assignees and Allocations. The Partnership shall not be required to deal with any Person by reason of a Transfer by a Partner of his, her or its Interest, except as specifically provided in this Agreement. Any payment by the Partnership to the one shown on the Partnership records to be entitled thereto as of the date of such distribution shall acquit the Partnership of all liability to any other Person who may be interested in such payment. In the case of the assignment of any Limited Partner's Interest during any Fiscal Period (whether such assignment results in the assignee becoming a substituted Limited Partner), all allocations under this Section 3 with respect to such Interest in respect to such Fiscal Period shall be further allocated between the assignor and the assignee in proportion to the number of months during such Fiscal Period that each was the holder of such Interest, determined by reference to the date the assignment thereof became effective pursuant to Section 6, without regard for the date, amount, or recipient of any distributions made with respect to that Partnership Interest. Allocations, however, are subject to the following: (i) the transferor and transferee may agree to an allocation based on the results as of the record date of the Transfer and agree to reimburse the Partnership for the cost of making and reporting their agreed allocation; (ii) the Transfer of the Partnership Interest may cause a termination of the Partnership within the meaning of Code Section 708 and thus require an allocation based on the results as of the date of the Transfer; or (iii) Code Section 706 and the Treasury Regulations thereunder may require certain different allocations.

3.3 Distributions to Partners.[7] The Distributable Cash or other assets of the Partnership may be distributed by the Partnership to the Partners, at such times and in such amounts as the General Partner may reasonably determine, in proportion to the Partners' Percentage Interests. Any assets distributed in kind to a Partner shall be distributed at the fair market values of such assets at the date or dates of distribution, or, at face value of an installment obligation received upon Sale of Partnership Property.

3.4 Withholding. The Partnership shall withhold and pay over to the applicable taxing authorities all taxes or withholdings, and all interest, penalties, additions to tax, and similar liabilities in connection therewith (hereinafter "Withheld Taxes") to the extent that the Partnership determines that such withholding and/or payment is required by any law, rule, or regulation, including, without limitation, _________________ of the [state statute]. The Partnership shall determine to which Partners such Withheld Taxes are attributable. All amounts withheld pursuant to this Section 3.4 with respect to any allocation or distribution to any Partner shall be treated as amounts distributed to such Partner pursuant to this Section 3.4 for all purposes of this Agreement.

3.5 Distributions upon Liquidation. Section 9 governs all distributions in liquidation of the Partnership.

SECTION 4
PARTNERSHIP MANAGEMENT

4.1 Rights and Authority of the General Partner.[8] The General Partner shall have the full power, right and authority to manage the Partnership business in all matters and shall have the sole and exclusive power on behalf of the Partnership to control the conduct of the Partnership business. Each Partner hereby grants to the General Partner all the necessary and appropriate powers and authority, which shall be exercised consistent with its fiduciary duties to the Partners and the Partnership, to carry out the purposes and conduct of the business of the

Partnership, subject only to rights of the Partner to vote on specific matters as provided in this Agreement and limitations of the authority of the General Partner as provided in Section 4.2, including the following:

(a) To manage the business of the Partnership and to hold, maintain, manage and dispose of any or all Partnership Property, on such terms deemed by the General Partner to be in the best interest of the Partners and the Partnership;

(b) To enter into any contracts appropriate for the character of the Partnership business including, but not limited to, management contracts for the operation and management of the Partnership business, service contracts with accountants, attorneys and/or investment advisors, on such terms and for such compensation as the General Partner shall reasonably determine;

(c) To file and publish all certificates, statements or other instruments required by law for formation, certification and operation of the Partnership in all appropriate jurisdictions;

(d) To call informational meetings of the Partners when deemed desirable by the General Partner;

(e) To make decisions as to accounting principles, methods and elections, whether for book or tax purposes. Such decisions may be different for book purposes than for tax purposes, although it is contemplated that to the extent practical the Partnership will maintain its books utilizing the same elections and principles used for tax purposes;[9]

(f) To make any and all decisions relating to the terms of any Sale of any or all Partnership Property and to execute all instruments in connection therewith;

(g) To institute, defend, or engage in legal proceedings of any nature whatsoever relating to the Partnership, including proceedings for reorganization, composition, arrangement or relief from Partnership obligations or submit to arbitration;

(h) To delegate any authority of the General Partner to other Persons under the supervision of the General Partner;

(i) To take any necessary and appropriate action to acquire any properties on behalf of the Partnership and to enter into any appropriate contracts, agreements, leases, or arrangements in connection therewith, including without limitation, the negotiation and execution of a mortgage of same upon such terms and conditions and at such rates at the discretion of the General Partner;

(j) To obtain insurance, in such amounts and against such risks, on behalf of and for the protection of the Partnership and the Partners, and to enter into split-dollar agreements with respect to life insurance policies owned by or insuring the lives of one or more Partners and the owners, trustees and beneficiaries of entities that are Partners;

(k) To invest and reinvest Partnership Property in any property, real, personal or mixed, wherever located. Examples of authorized investment include commodities, gold, silver and other precious metals, works of art, antiques, foreign currencies, coins, jewels, postage stamps, rare books, heavy equipment, boats, vessels, airplanes, commercial real estate, residential real estate leaseholds, oil, gas, mineral, timber and other interests in natural resources, breeding animals, life insurance, annuities, securities of domestic and foreign corporations and investment trusts, bonds (taxable and non-taxable), debentures, preferred stocks, common stocks, securities of new ventures, interests in a common trust fund, futures contracts (both regulated and unregulated and covering foreign and domestic commodities, indices and instruments), spot contracts, claims, puts, calls, straddles, short or long contracts, any form of option agreement (regulated or unregulated), hedge funds, mortgages, and mortgage participations. This list shall not preclude investments not listed;

(l) To cause the Partnership to enter into a joint venture, general or limited partnership, limited liability company, or other business or investment relationship with any other Person which the General Partner deems advisable, to structure any joint venture, partnership, limited liability company, or other business or investment relationship agreement entered into by the Partnership in any way the General Partner deems advisable, and to cause the Partnership to register as a limited partnership that is also a limited liability partnership (also sometimes known as a limited liability limited partnership);

(m) To borrow money or obtain Financing from any lending institution or other Persons including any one or more of the Partners and, if security is required therefor, to mortgage or otherwise encumber any part or all of the Properties in carrying on the normal, day-to-day business of the Partnership, and including borrowing to pay amounts due to Partners, and to prepay, in whole or in part, increase, modify, consolidate, or enter any note, loan, mortgage or other security instrument, all on such terms as the General Partner deems to be in the best interest of the Partnership, subject to any applicable restrictions imposed by any agreement to which the Partnership is subject;

(n) To lease all or any portion of the Properties without limitation as to the terms thereof; and

(o) To establish and maintain Reserves.

4.2 Delegation of Authority to General Partner; Restrictions on Authority of the General Partner. All decisions made for and on behalf of the Partnership by the General Partner shall be binding upon the Partnership, and all power, authority and discretion of the Partners to act on behalf of the Partnership shall be vested exclusively in the General Partner, except where this Agreement explicitly requires the consent of a specified proportion of Partners to act. No action or decision taken or made by any Partner other than as explicitly provided in this Agreement shall bind the Partnership, and no Partner shall purport to take any action on behalf of the Partnership beyond such Partner's actual authority. Without the express written consent of the Majority of Interests, the General Partner shall have no authority:

(a) To do any act in contravention of this Agreement;

(b) To do any act that is not authorized under this Agreement and that would make it impossible to carry on the ordinary business of the Partnership;

(c) To confess a judgment against the Partnership;

(d) To admit a Person as a General or Limited Partner except as provided in this Agreement;

(e) To perform knowingly any act that would subject any Limited Partner to liability as a general partner under the laws of any jurisdiction; or

(f) To enter into any binding or enforceable financing agreement which would require a guaranty of any part of such Financing without the express consent of the Partners required to provide such guaranty.

4.3 Responsibilities of the General Partner. The General Partner shall have the responsibility and authority for the management of the Partnership business. The nature of such responsibilities, authority and duties are as follows:

(a) To take all the action which may be necessary or appropriate for the continuation of the Partnership's valid existence as a Limited Partnership under RULPA and under the laws of the State of _______________ or other jurisdictions in which the Partnership may do business;

(b) To prepare and cause to be filed on or before the due date (or any extension thereof) any federal, state or local tax returns required to be filed by the Partnership;

(c) To prepare and provide Partners with periodic reports as provided in this Agreement;

(d) To take such action and devote such time and energy as may be necessary for the proper and prudent management of the Partnership business;

(e) To take any and all reasonable action necessary and reasonably possible to assure that the Partnership complies at all times with the terms and provisions of the agreements to which it is a party; and

(f) To oversee the dissolution, liquidation and termination of the Partnership.

4.4 Compensation to and Reimbursement of the General Partner. The General Partner shall be compensated and reimbursed as provided in this Section 4.4.

(a) Compensation to the General Partner. The General Partner shall be entitled to compensation as may be approved by a Majority of Interests.

(b) Reimbursement to the General Partner. The Partnership shall pay all costs and expenses associated with: (i) carrying out the duties of the General Partner; (ii) oversight and management of the Partnership Property and (iii) the administration of the Partnership, including all accounting, documentation, professional, and reporting expenses, except to the extent the General Partner shall be obligated to provide (and is compensated for providing) such services under any separate written agreement with the Partnership. To the extent that it is reasonable and possible to do so, all Partnership expenditures should be billed directly to and paid by the

Partnership, but any Partner shall be reimbursed for any such expenses paid by a Partner. Such costs to be paid by the Partnership shall include, but shall not be limited to, any of the following expenses when properly incurred by the Partnership:

(i) Personnel Costs. All costs of personnel employed by the Partnership or directly involved in the business of the Partnership, including Persons who may also be employees of a Partner;

(ii) Professional Fees. Legal, accounting, brokerage, and other similar or related fees;

(iii) Management Expenses. Fees and expenses paid to independent contractors, leasing agents, consultants, on-site managers, and other agents; and

(iv) Accounting Expenses. Costs of bookkeeping, accounting, and audits, to the extent that the expense of such audits, if they occur, are Partnership obligations under this Agreement and costs relating to the preparation of budgets, preparing and mailing reports furnished to the Partners, cash flow projections, similar reports and Partnership federal and state tax returns.

The Partnership shall not reimburse the General Partner for items generally constituting direct overhead or administrative expenses of the business of the General Partner, which shall be paid by the General Partner from the General Partner's compensation and from sources other than the Partnership.

4.5 Indemnification; Liability of General Partner. The Partnership shall indemnify, defend and hold the General Partner harmless against any claim, liability or expense, including reasonable attorneys fees, incurred by the General Partner in connection with any acts or omissions relating to the organization, management, operation or liquidation of the Partnership, its business or Property, except liabilities, if any, which are specifically required under this Agreement to be paid by the General Partner from the General Partner's own funds without reimbursement. Notwithstanding the foregoing, the General Partner shall be liable for and shall not be indemnified for acts or omissions which constitute a breach of the General Partner's fiduciary duties to the Partnership or the Partners under applicable law, gross negligence, willful misconduct, intentional wrongdoing, or fraud against the Partnership.

4.6 Execution of Documents. Any deed, mortgage, bill of sale, lease, contract for deed, mortgage or other security interest, note, or other evidence of indebtedness, or other instrument purporting to convey or encumber the assets of the Partnership in their entirety or any portion of any real or personal property held in the name of the Partnership, or any other instrument, shall be signed on behalf of the Partnership by the General Partner and no other signature shall be required during the continuation or the liquidation of the Partnership. Any third party dealing with the General Partner in the ordinary course of business shall be entitled to rely on a representation by the General Partner of authority to conduct such dealing on behalf of the Partnership (but this Section shall not relieve the General Partner of any liability to the Partnership or the Partners without actual authority).

4.7 Restrictions on Limited Partners. The Limited Partners shall not take part in, or interfere in any manner with, the management, conduct or control of the Partnership business or Partnership Property, or the Sale, leasing or refinancing of Partnership Property, except as explicitly provided for in this Agreement. The Limited Partners shall have no right or authority: (i) to act for or bind the Partnership; (ii) to enter into any transaction on behalf of the Partnership; or (iii) to make any conveyance or alienation of the Partnership Property.

4.8 Reimbursement and Indemnification of Limited Partner. If any Limited Partner reasonably makes any payment in satisfaction of a Partnership obligation (whether a disputed or undisputed obligation), whether pursuant to a guarantee of such obligation, such Limited Partner shall be entitled to immediate reimbursement from the Partnership; provided, however, that, if such payment is made without the consent of the General Partner, the paying Partner shall be entitled to reimbursement only to the extent such Partner establishes the existence of an actual enforceable Partnership obligation to pay such amount to such creditor.

4.9 Excess Losses. Notwithstanding anything to the contrary contained in this Agreement, the liability of any Limited Partner for losses and obligations of the Partnership or otherwise with respect to the Partnership shall in no event exceed in the aggregate the amount of such Limited Partner's Interest in the Partnership.

4.10 Other Activities. Any Partner, General or Limited, and any entity in which any Partner has an interest, may engage in or possess an interest in any other ventures or businesses of any nature or description, independently or with others, without limitation, regardless of whether such other ventures or businesses compete with the business of the Partnership or any other Partner. No Partner shall have any duty to tender any business opportunity to the Partnership. Neither the Partnership nor any other Partner shall obtain any right to participate in any way in any such other venture, or the income or profits derived therefrom, by virtue of the existence of this Partnership.

SECTION 5
ACCOUNTING AND TAX MATTERS

5.1 Books and Records. The General Partner shall maintain accurate and complete books and records for the Partnership at the principal place of business of the Partnership. Records shall be kept in accordance with generally accepted accounting principles, consistently applied, or in accordance with such other accounting method as is customarily used by businesses similar to the Partnership. All Partners and their representatives shall have full access and the right to inspect, examine and copy such books and records during business hours at the expense of such Partner.

5.2 Financial Statements. The General Partner shall exercise its best efforts to deliver to the Partners within ninety (90) days after the end of each Fiscal Period accurate and complete financial statements, including a balance sheet and income and loss statement, a statement showing the Capital Account of each Partner, and Schedule K-1s reflecting the amounts of net income and net loss reportable for federal and state income tax purposes for each Partner. No financial statement need be audited.

5.3 Banking and Custody of Assets. The funds of the Partnership shall be kept in one or more separate bank accounts in the name of the Partnership in such banks or other federally insured depositories as may be designated by the General Partner or shall otherwise be invested in the name of the Partnership in such manner and upon such terms and conditions as may be designated by the General Partner, but such funds shall not be commingled with any other fund. All withdrawals from any such bank accounts or investments established by the Partners hereunder shall be made on such signature or signatures as may be designated by the General Partner. The funds and other assets of the Partnership may also be held in an account with such brokerage firms as may be designated by the General Partner.

5.4 Tax Matters Partner. The General Partner will serve as the Tax Matters Partner. The Tax Matters Partner (a) will represent the Partnership and its Partners before federal, state and local taxing authorities, and before courts of competent jurisdiction, in tax matters affecting the Partnership, the Partners in their capacity as Partners, or both; and (b) may execute agreements or other documents relating to or affecting such tax matters including (i) agreements or consents to extend the period of limitations on assessment of deficiencies with respect to "partnership items" or "affected items," as such terms are defined in Code section 6231, and (ii) other agreements or documents that bind the Partners with respect to such tax matters or otherwise affect the rights of the Partnership, the Partners, or both. The Partners will cooperate with, and do or refrain from doing anything reasonably requested by, the Tax Matters Partner to conduct such proceedings. The Tax Matters Partner may retain accountants, attorneys and other professionals to assist it in such matters. The Partnership will pay for or reimburse the Tax Matters Partner for all expenses incurred in performing the duties described in this Section.

SECTION 6[10]
TRANSFER OF PARTNERSHIP INTERESTS

6.1 Transfer of Partnership Interests.

(a) Transfers by Limited Partners. No Limited Partner shall Transfer all or any part of such Limited Partner's Interest to any Person without the prior or simultaneous written consent of the General Partner to any such proposed disposition, unless such transfer is an "Excepted Transfer" pursuant to Section 6.2 below, or the Limited Partner shall have complied with the provisions of Section 6.3 below, regarding rights of first refusal. A transferee of all or part of a Limited Partner's Interest may be admitted as a Partner only upon the approval of the General Partner, except as provided in Section 6.2 below, which may be granted or withheld in the sole and absolute discretion of the General Partner, and unless so admitted shall, any other provision hereof notwithstanding, have only the share of Partnership capital, Net Profit, Net Loss, allocations and distributions attributable to the Interest or portion thereof that is the subject of the transfer.

(b) Transfers by General Partner. The General Partner covenants and agrees that it will not Transfer all or any part of its Interest as General Partner to any Person without first having obtained the written consent of all of the Partners to any such proposed disposition. In the event the General Partner transfers full and complete ownership of all or any portion of its Partnership Interest as General Partner in compliance with the provisions of this Section 6.1(b), the Partnership shall continue, and the transferee of such interest shall be admitted to the

Partnership as a General Partner with the same interest in Partnership Net Profit or Net Loss, tax items, capital and distributions, the same obligations with respect to contributions to the capital of the Partnership, and the same rights and obligations to participate in the management of the Partnership, as the transferring General Partner had with respect to the transferred interest in the Partnership; provided, however, that any such transferee shall be subject to the terms and conditions of this Agreement and shall promptly execute and deliver to the Partnership such documents as may be necessary or appropriate, in the opinion of counsel to the Partnership, to reflect such transferee's admission to the Partnership as a General Partner and its agreement to be bound by all of the terms and conditions of this Agreement.

(c) Attempted Transfers in Contravention. Any attempted transfer of an Interest in contravention of this Section 6.1 shall be void and shall not bind or be recognized by the Partnership. Transfers restricted by this Section 6 shall include both voluntary and involuntary transfers and transfers by operation of law, except as otherwise expressly provided herein.

6.2 Excepted Transfers. Notwithstanding any other provision of this Agreement to the contrary, if

(a) any Interest of a Partner in the Partnership is transferred by gift, sale, as a result of the death or legal incompetency of a Partner, or upon distribution to a beneficiary of a trust that is a Partner, whether such distribution is by operation of law or otherwise; and

(b) the transferee is a Family Member, or, upon the death of any Partner, his or her duly qualified and acting personal representative, provided in the latter case that all Persons who are to receive any part of such Interest under the terms of such Partner's Will or under the applicable laws of intestate succession are Family Members;

the transfer shall be valid and the transferee shall become a substituted Limited Partner without the written consent of any other Partner. If the Interest transferred was that of a General Partner, the transferee may be admitted to the Partnership as a General Partner only with the written consent of all of the Partners, which they may grant or withhold in their sole and absolute discretion, and upon compliance with the document delivery requirements of Section 6.1(b) above. Upon the death of a Partner, unless all Persons who are to receive any part of such Partner's Interest under the terms of such Partner's Will or under the applicable laws of intestate succession are Family Members, the Partnership shall have the right, exercisable by delivering written notice to the personal representative of such Partner's estate within ninety (90) days of the appointment of such personal representative, to purchase such interest for the amount of such Partner's Capital Account at the time of his or her death.

6.3 Right of First Refusal on Sale of Interest.[11]

(a) If a Limited Partner shall receive a bona fide written offer (hereinafter referred to as the "Offer") for the purchase of all, but not less than all, of such Limited Partner's Interest for a consideration in cash or a combination of cash and promissory notes (such consideration to be expressed in U.S. Dollars), which Offer such Limited Partner (hereinafter referred to as the "Selling Partner") desires to accept, the other Limited Partners who have positive balances standing in their respective Capital Accounts on the date of the Offer (hereinafter referred to as the “Nonselling Partners"), shall have the first right and option, as hereinafter provided, to purchase all, but not less than all, of the Interest of the Selling Partner according to the terms of the Offer.

(b) The Selling Partner shall give the Nonselling Partners simultaneous written notice of the Selling Partner's receipt of the Offer, together with a copy of the Offer and a statement as to the identity of the real party in interest making the Offer. The Nonselling Partners shall have a period of thirty (30) days from the date of receipt of such written notice to exercise their respective options in writing to purchase all, but not less than all, of the Selling Partner's Interest at the purchase price and terms set forth in the Offer. Each Nonselling Partner shall have the right to purchase that proportion of the Selling Partner's Interest that such Nonselling Partner’s Capital Account balance on the date of the Offer bears to the total of the Capital Account balances of all of the Nonselling Partners as a group; provided, however, that if any Nonselling Partner does not commit to purchase such Nonselling Partner's full proportion of the Interest within said thirty (30) day period, the portion of such Nonselling Partner’s proportional share of the Interest which such Nonselling Partner fails to commit to purchase shall then be immediately reoffered in writing by the Selling Partner to those Nonselling Partners who did commit to purchase their respective full portions, such reoffer being subject to acceptance by said Nonselling Partners within ten (10) days after their receipt of the reoffer notice from the Selling Partner. The procedures set forth above shall be continued until either (i) the entire Interest shall have been accepted for purchase by the Nonselling Partners within the prescribed time limits; or (ii) the Nonselling Partners shall have failed to commit to purchase all of the Interest within the prescribed time limits.

(c) If the Nonselling Partners elect to purchase all of the Interest, then the closing for any such purchase shall take place at the Partnership's principal business office within thirty (30) days after the expiration of the last relevant option period, at a date and time designated in writing by the purchasing party(ies) to the Selling Partner at least five (5) days prior to such closing. If the Nonselling Partners fail to exercise their respective options granted in this paragraph, the Selling Partner may accept the Offer and dispose of the Interest pursuant to the Offer, which Interest shall at all times thereafter remain subject to the terms and conditions of this Agreement; provided, however, that if the Selling Partner does not accept the Offer within ten (10) days after the expiration of the last relevant option period, or if the closing of such sale does not take place within thirty (30) days after the expiration of the last relevant option period, the Selling Partner may not thereafter transfer any part of the Interest without having again complied with all of the provisions this Agreement.

SECTION 7
REMOVAL AND WITHDRAWAL OF GENERAL PARTNER

7.1 Removal of General Partner. A General Partner may be removed by a unanimous vote of all the Partners other than the General Partner for whom removal is being sought but only upon the occurrence of the following events:

(a) Bankruptcy and Similar Occurrences. The General Partner makes or attempts to make an assignment for the benefit of creditors; is adjudicated bankrupt or insolvent; files a petition or answer seeking for such Partner any debt reorganization, debt arrangement, debt composition, liquidation, dissolution or similar relief under any statute, law or regulation; files an answer or other pleading admitting or failing to contest the material allegations of a petition filed against such Partner in any proceeding of such nature; or seeks, consents to, or acquiesces in the appointment of a trustee, receiver, or liquidator of such Partner.

(b) Judicial Determinations. Final judicial determination that the General Partner (i) was grossly negligent by failure to perform material obligations under the Partnership Agreement, (ii) committed a fraud upon the Partnership or the Partners, or (iii) committed a felony in connection with the management of the Partnership or its business.

Upon such removal of a General Partner, such General Partner's Interest shall be converted to that of a Limited Partner and, from that time forward, such removed General Partner shall receive only such allocations of income, loss, gain and distributions accorded to a Limited Partner. The removed General Partner shall be notified by registered mail of the removal, with such notice specifying the effective date of the removal. Removal of the General Partner shall be deemed to be an event of withdrawal by the General Partner, as defined in RULPA.

7.2 Effect of an Event of Withdrawal of General Partner. Upon an event of withdrawal by a General Partner pursuant to this Agreement or the provisions of RULPA:

(a) If there is a remaining General Partner, then the Partnership shall not dissolve but shall continue with the remaining General Partner continuing to serve in such capacity.

(b) If there is no remaining General Partner, the Partnership shall dissolve and its affairs shall be wound up, unless within ninety (90) days of withdrawal, a Majority of Interests (other than the withdrawing General Partner) agree to continue the business of the Partnership and the Majority of Interests appoints one or more General Partners, in which case the Partnership shall not dissolve.

In the event of withdrawal, a General Partner shall be liable to the Partnership for damages as provided for in ________________ of RULPA. Upon withdrawal, the General Partner shall be entitled to only those allocations of income, loss, gain and distributions accorded to a Limited Partner, and shall have only such other rights and shall be subject to such restrictions as are set forth herein.

SECTION 8[12]
DISSOLUTION

8.1 Dissolution. The Partnership shall automatically be dissolved and its affairs wound up upon the occurrence of:

(a) The decision of the General Partner to dissolve the Partnership and wind up its affairs;

(b) An event of withdrawal of the General Partner as defined in Section 7 followed by failure of the Partnership to continue under Section 7.2;

(c) The Sale of all Partnership Property and the receipt of the final payment of the purchase price; or

(d) The liquidation of the General Partner's Interest in the Partnership, if the remaining Partners do not elect a substitute General Partner in accordance with Section 7.2.

Thereafter, the Partnership shall be wound up and shall conduct no further business except for the activities necessary to its liquidation or to the completion of transactions previously commenced.

SECTION 9
WINDING UP AND SETTLEMENT

9.1 Sharing Income During Liquidation. Upon any dissolution of the Partnership, the Partnership shall expeditiously wind up its affairs. The Partners shall continue to share the Net Profit or Net Loss, as the case may be, during dissolution, including any gain or loss on disposition of Partnership Property in the process of liquidation, as provided in Section 3; provided, however, interest income on an installment obligation derived from the Sale of any Property, and any interest expense on any underlying indebtedness related thereto, shall be allocated among Partners in the proportion in which such installment obligation would be distributed to Partners if distributed pursuant to Section 3.3. For allocation purposes only, any Property distributed in kind in liquidation shall be valued and treated as though the Property were sold and the cash proceeds distributed; the difference between such fair market value of Property distributed in kind and its tax basis shall be treated as income or loss and shall be allocated among the Partners as provided for in Section 3.1. The fair market value of an installment obligation received upon Sale of Partnership Property shall be at face value.

9.2 Winding Up and Distribution. Upon the dissolution of the Partnership pursuant to this Section 9, the winding up of the Partnership business shall be carried out with due diligence consistent with the provisions of this Agreement.

(a) Appointment of a Liquidator. The General Partner, or if there is no General Partner, the Person designated in writing by a Majority of Interests, who shall be referred to as the "Liquidator," shall be responsible for taking all actions relating to the winding up and distribution of assets of the Partnership. The Liquidator shall have the right to exercise all of the powers granted generally to the General Partner in this Agreement in liquidation and winding up of the Partnership.

(b) Duties of the Liquidator. The assets of the Partnership shall be liquidated only to the extent determined to be appropriate by the Liquidator. The Liquidator shall proceed without any unnecessary delay to sell and otherwise liquidate the Partnership Property to be liquidated; provided, however, that if the Liquidator shall determine that an immediate Sale of part or all of the Partnership Property would cause undue loss to the Partners, the Liquidator may (but shall not be required to) defer the liquidation of the Partnership Property for a reasonable time in order to avoid such loss, except for such liquidation as may be necessary to satisfy the debts and liabilities of the Partnership to Persons and parties other than the Partners. The proceeds from the sale and liquidation of the Partnership Property, together with such assets as the Liquidator determines to distribute in kind, shall be distributed as provided in this Section 9.

(c) Pre-Liquidation Accounting. Upon the dissolution of the Partnership, the Liquidator shall, within thirty (30) days, prepare and immediately furnish to each Partner a statement setting forth the assets and liabilities of the Partnership as of the date of its dissolution. Promptly following the complete liquidation and/or distribution of the Partnership Property, the Partnership's accountants shall prepare, and the Liquidator shall furnish to each Partner, a statement showing the manner in which the Partnership Property was liquidated and/or distributed.

9.3 Distribution of Proceeds from Sale or Assets in Kind and Liquidation of Partnership Property. The net proceeds resulting from the Sale and liquidation of the Partnership Property, together with such assets as the Liquidator determines to distribute in kind, shall be distributed and applied in the following order of priority:

(a) Liabilities to Creditors and Expenses. To the payment of debts and liabilities of the Partnership, other than loans or other debts and liabilities of the Partnership to Partners or former Partners, and to the expenses of liquidation in the order of priority as provided by law.

(b) Reserves. To the setting up of any Reserves which the General Partner or the Liquidator deems reasonably necessary for contingent or unforeseen liabilities or obligations of the Partnership arising out of or in connection with the business of the Partnership; such Reserves may be paid to a bank or other designated agent to be held in escrow for the purpose of paying any such contingent or unforeseen liabilities or obligations and, at the expiration of such period as the Liquidator deems advisable, of distributing the balance of such Reserves in the manner hereinafter provided in this Section.

(c) Liabilities to Partners. To the payment of any unpaid loans, fees or other compensation, guaranteed payments, unreimbursed expenses, or other debts or liabilities of the Partnership to any Partners or former Partners, other than Capital Accounts, payable pro rata based upon such outstanding obligations until fully paid.

(d) Liquidating Distributions to Partners. To the Partners in proportion to their positive Capital Accounts, if any, after giving effect to all contributions, prior distributions, allocations and Capital Account adjustments for all taxable years, including the taxable year during which the final liquidating distribution occurs.

(e) Additional General Partner Contribution to Capital. Upon dissolution and at the time of final liquidation of the Partnership, the General Partner shall contribute to the Partnership an amount equal to the lesser of: (i) the deficit balance in the Capital Account of the General Partner, or (ii) the excess of 1.01 percent of the total capital contributions of the Limited Partners over the capital previously contributed by the General Partner. The General Partner shall determine the amount of any deficit contribution using its reasonable business judgment. Such amount shall be paid to the Partnership by the later of the end of the taxable year in question or ninety (90) days after the date of such liquidation. Such amount shall be available for distribution to Partners having positive Capital Account balances as provided in this Agreement.

This Section shall be interpreted and applied in conformity with Treasury Regulations section 1.704-1(b)(2)(ii)(b)(3).

The Partnership shall terminate when all of its assets shall have been applied and distributed in accordance with the provisions of this Section. The establishment of any Reserves in accordance with the provisions of this section shall not have the effect of extending the term of the Partnership, but any such Reserves shall be distributed in the manner provided in this Section upon expiration of the period of such Reserves.

9.4 Right of Offset. Should any Partner owe the Partnership any sums, including unpaid capital contributions, the Partnership is authorized to make an offsetting credit from any amounts otherwise payable to such Partner by the Partnership.

9.5 Retention of Books and Liquidation Accounting. Unless otherwise agreed upon, in the event of any winding up of the Partnership, the books and records of the Partnership shall be deposited with the accountants regularly employed by the Partnership and such books and records shall be retained for inspection and use by the Partners for a period of not less than seventy-six (76) months following the termination of the Partnership. Each Partner shall be furnished with a statement of the assets and liabilities of the Partnership as of the date of dissolution and the manner in which the assets have been applied and distributed.

9.6 Effect of Agreement. Until terminated by final distribution of all Partnership Property, the Partners and Partnership Property shall remain subject to this Agreement. All Partners from time to time shall sign all documents appropriate to cause the complete dissolution and liquidation of the Partnership.

9.7 Indemnification. The Liquidator will be defended and indemnified by the Partnership according to the same terms as apply to the General Partner as stated in Section 4.5.

SECTION 10
AMENDMENTS

No change or modification of this Agreement shall be valid or binding upon a Partner, nor shall any term or condition of this Agreement be considered waived by a Partner, unless the change, modification or waiver is in writing and is signed by such Partner. Notwithstanding the foregoing, an amendment to this Agreement solely by the General Partner shall be valid and binding on all Partners if its purpose is to (a) reflect the admission of a new Partner or the transfer of an interest in the Partnership (in either case in compliance with the other provisions of this Agreement), and it is signed by the Partners having the power to approve such admission or transfer and, as the case may be, the newly admitted Partner or the transferor and transferee Partners; (b) to add to the representations, duties, or obligations of the General Partner or surrender any right or power granted to the General Partner in this Agreement, for the benefit of the Limited Partners; (c) to cure any ambiguity, to correct or supplement any provision of this Agreement that may be inconsistent with any other provision of this Agreement, or to make any other provisions with respect to matters or questions arising under this Agreement that will not be inconsistent with the provisions of this Agreement; and (d) to modify the provisions of Section 3 or any other provisions of this Agreement if, in the opinion of counsel to the

Partnership and the General Partner, it is appropriate to make such modification to: (i) cause the allocations contained in Section 3 to have substantial economic effect in accordance with the final Treasury Regulations relating to Code Section 704, as most recently amended, or (ii) cause the provisions of this Agreement to comply with any applicable legislation or regulatory action effective after the date of this Agreement.

SECTION 11
MISCELLANEOUS

11.1 Entire Agreement. This Agreement constitutes the entire understanding between the Partners with respect to the Partnership, and all prior or contemporaneous agreements, understandings, representations and statements, oral or written, are merged into this Agreement.

11.2 No Third Party Beneficiary. The provisions of this Agreement, including Section 2 and Section 9, are not intended for the benefit of any creditor of the Partnership or any creditor of a Partner, and no such creditor shall obtain any right under any of such provisions.

11.3 Title to Partnership Property. All Partnership Property is owned by the Partnership as an entity, and no Partner individually has any ownership interest in Partnership Property. During the term of this Partnership, each Partner irrevocably waives any and all rights that he, she or it might have to maintain any action for partition of any Partnership Property, either as a partition in kind or a partition by sale.

11.4 Notices.

(a) Addresses. A Person may change his or her address for the purpose of this Section by notice to the General Partner in the manner provided in this Section. Each Person potentially entitled to notice pursuant to this Agreement has the responsibility for maintaining an accurate address in the records of the General Partner, and, if the other procedures specified in this Section are followed, a notice shall be effective if sent to the address shown in the records of the General Partner, regardless of the accuracy of that address.

(b) Procedures. A Person may effect a notice, approval or other communication required or permitted by this Agreement only by giving such notice in writing and delivering it, postage or charges prepaid, in person, by registered mail, by overnight delivery service, by electronic mail, or by facsimile transmission to the parties' respective addresses shown in the records of the General Partner. Same day delivery by messenger shall constitute personal delivery. Except as specifically provided to the contrary in other Sections of this Agreement, such notice shall be effective two days after properly mailed; one day after properly consigned to an overnight delivery service; upon the day of receipt of personal delivery; or, in the case of notice via electronic mail or facsimile transmission, on the day the sender receives electronic confirmation of receipt, provided (i) that if the receipt does not occur before 4 p.m., recipient's local time, on a business day, the notice will take effect on the next business day, and (ii) that on the day of transmission the sender sends via registered mail a copy of any notice sent via electronic mail or facsimile transmission (if the sender mails this copy at a later date), the notice will become effective two days after it is properly mailed.

11.5 Warranty of Authority. Each Person executing this Agreement on behalf of any Partner who is any type of corporation, partnership, limited liability company, trust or estate warrants that he or she is authorized by such entity to execute this Agreement, and that all necessary procedures and approvals of this Agreement have been complied with and obtained so that it is fully binding on the entity for which he or she is signing.

11.6 Joint Preparation. This Agreement is to be deemed to have been prepared jointly by the Partners, and any ambiguity shall not be interpreted against any Partner but shall be interpreted according to the application of the rules of interpretation for arm's-length agreements.

11.7 Binding Effect. This Agreement shall inure to the benefit of and shall be binding upon the Partners and their respective legal representatives, transferees, heirs, successors and assigns, subject to the limitations in this Agreement.

11.8 Severability of Provisions. Any provision of this Agreement which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of the prohibition or unenforceability without invalidating the remaining provisions hereof or affecting the validity or enforceability of the provision in any other jurisdiction, as far as possible and reasonable.

11.9 Counterparts and Copies. This Agreement may be executed in any number of counterparts with the same effect as if all of the Partners had signed the same document. All counterparts shall be construed together and shall constitute one agreement. A third party may rely upon a photocopy of this Agreement to the same extent as an original.

11.10 Construction. This Agreement shall be interpreted and construed in accordance with the internal laws of the State of __________________. All references to Sections and Sections refer to this Agreement, unless otherwise specifically stated. All Schedules or Exhibits that are attached hereto are hereby incorporated into this Agreement by reference. The Section and other headings herein (except for the definitions in Section 12) have been inserted for convenience of reference only and shall not control or affect the meaning or construction of any of the terms or provisions herein. As used in this Agreement, the singular shall include the plural, the plural shall include the singular, and the masculine, feminine or neuter gender shall each include both other genders, "will" and "shall" are mandatory words denoting an obligation to pay or perform, "may" is a permissive word denoting an option, and any form of the word "include" will be deemed to be followed by the phrase "without limitation," all as appropriate in the given context.

11.11 Investment Representations of Limited Partners.

(a) Each Limited Partner does hereby represent and warrant to the Partnership and to the General Partner that such Limited Partner has acquired his, her or its Interest for investment solely for his, her or its own account, with the intention of holding such Interest for investment, without any intention of participating directly or indirectly in any distribution of any portion of such Interest, and without the financial participation of any other Person in acquiring such Interest.

(b) Each Limited Partner does hereby acknowledge that he, she or it is aware that his, her or its Interest has not been registered

(i) under the Federal Act;

or

(ii) under any state securities laws. Each Limited Partner further understands and acknowledges that his, her or its representations and warranties contained in this Section 11.11 are being relied upon by the Partnership and by the General Partner as the basis for the exemption of the Limited Partners' Interests from the registration requirements of the Federal Act and from the registration requirements of applicable state securities laws.

Each Limited Partner further acknowledges that the Partnership will not and has no obligation to recognize any sale, transfer or assignment of all or any part of his, her or its Interest to any Person unless and until the provisions of Section 6 hereof have been fully satisfied.

(c) Each Limited Partner hereby acknowledges that prior to his, her or its execution of this Agreement, he, she or it has received a copy of this Agreement and a copy of the Certificate and that he, she or it has examined such documents or caused such documents to be examined by his, her or its representative or attorney. Each Limited Partner hereby further acknowledges that he, she or it or his, her or its attorney is familiar with this Agreement, with the Certificate, and with the Partnership's intention to invest and reinvest its assets in such manner as the General Partner determines, subject to the limitations set forth above. Each Limited Partner further acknowledges that he, she or it does not desire any further information or data relating to the Partnership, its assets or the General Partner. Each Limited Partner hereby acknowledges that he, she or it understands that the purchase of his, her or its interest in the Partnership is a speculative investment involving a high degree of risk and does hereby represent that he, she or it has a net worth sufficient to bear the economic risk of investing in the Partnership and to justify his, her or its investing in a highly speculative venture.

(d) Each Limited Partner hereby acknowledges and agrees that the legend reflecting the restrictions imposed on the transfer of his, her or its Interest pursuant to Section 6 hereof, under the Federal Act and under any state securities law shall be placed on the first page of this Agreement.

11.12 Power of Attorney. Each Limited Partner does hereby irrevocably constitute and appoint the General Partner as his, her or its true and lawful agent and attorney-in-fact, in his, her or its name, place and stead, to make, execute, consent to, swear to, acknowledge, record and file:

(a) A Certificate of Limited Partnership under the applicable laws of the State of ____________________ and under the applicable laws of any other jurisdiction in which the General Partner deems such filing to be necessary or desirable;

(b) Any and all amendments or modifications to said Certificate which may be deemed necessary or appropriate by the General Partner to reflect any amendment or modification to this Agreement made in compliance with Section 10. Any amendments to this

Agreement of Limited Partnership which may be adopted pursuant to this Agreement or which may be required by RULPA, including amendments which may be necessary in the judgment of the General Partner for the purpose of conforming the provisions of Section 3 to the requirements of any Treasury Regulations promulgated under Code Section 704 regarding allocations of profits and losses, required for the admission, substitution, retirement or other withdrawal of a Limited Partner, for the reflection of the change of the capital contribution of any Limited Partner, or for the continuation of the business of the Partnership, provided that amendments required for the purpose of admitting a new Limited Partner shall be signed by such new or contributing Limited Partner.

(c) Any fictitious name or assumed name certificate or other instrument or amendment thereto which may be required to be filed by the Partnership.

(d) All certificates and other instruments which may be required to effectuate the dissolution and liquidation of the Partnership pursuant to the provisions of this Agreement.

It is expressly understood, intended and agreed by each Limited Partner for himself, herself or itself, and his, her or its successors and assigns, that the grant of the power of attorney to the General Partner pursuant to this Section 11.12 is coupled with an interest, is irrevocable and shall survive the death or legal incompetency of the Limited Partner or the assignment of his, her or its interest in the Partnership, but in the case of an assignment, for only so long as necessary to effect the admission of the substituted Limited Partner.

11.13 Arbitration.[13]

(a) Any controversy, dispute or claim arising out of or relating to this Agreement or any transaction hereunder shall be settled by a single arbitrator appointed in accordance with this Section 11.13. This agreement to arbitrate shall be specifically enforceable under the prevailing arbitration law of the state in which the arbitration is convened.

(b) The arbitration shall be conducted in accordance with the Commercial Arbitration Rules of the American Arbitration Association (the "AAA") then in effect. The party desiring the arbitration (the "Claimant") shall give to the other party or parties (the "Respondent") written notice of the Claimant's desire to arbitrate, specifying the questions to be arbitrated and naming an arbitrator agreeable to the Claimant. Within a reasonable time thereafter, not exceeding thirty (30) days, the Respondent shall give in like manner written notice, specifying any additional questions to be arbitrated and either agreeing to the arbitrator named by the claimant or naming an alternate arbitrator. If the parties are unable to agree on an arbitrator within thirty (30) days thereafter, the parties shall immediately notify the AAA and the AAA shall appoint the arbitrator in accordance with its then existing rules for appointment of an arbitrator from the AAA's National Panel of Commercial Arbitrators. The arbitration shall be conducted in the state in which the Respondent is domiciled at the time the arbitration is convened. The award rendered by the arbitrator shall be final, and judgment may be entered upon the award in any court having jurisdiction of the matter.

(c) For the purpose of enforcing any arbitration award granted herein or enforcing any other provisions or rights hereunder, the parties hereby agree and consent to in personam jurisdiction in the courts of the State of _____________ or the domicile of any party at the time of such enforcement, at the selection of the Person instituting such enforcement.

(d) As a part of the arbitration award and in addition to such other relief as may be granted, the prevailing party in the arbitration proceeding shall be entitled to the costs of arbitration, including reasonable attorneys' fees as determined by the arbitrator, together with any costs, including reasonable attorneys' fees as determined by the court, incurred by the prevailing party in court enforcement of the arbitration award after it is rendered by the arbitrator. If any party voluntarily dismisses a claim or counterclaim, the other party shall be considered the prevailing party with respect to such claim or counterclaim.

SECTION 12
DEFINED TERMS

Defined terms used in this Agreement shall, unless the context otherwise requires, have the meanings specified in this Section 12.

"Adjusted Capital Account Deficit" means the deficit balance, if any, in a Limited Partner's Capital Account increased by the amount of the Limited Partner's share of minimum gain as defined by Treas. Reg. Section 1.704-2(g) and any additional amounts which such Partner is obligated to restore or deemed obligated to restore by Treas. Reg. Section 1.704-1(b)(2)(ii)(c), and decreased by the items described in Treas. Reg. Sections 1.701-1(b)(2)(ii)(d)(4), (5) and (6). The foregoing definition is intended to comply with the requirements of Treas. Reg. Section 1.701-1(b)(2)(ii)(d).

"Agreement" means this Agreement of Limited Partnership, as amended from time to time, together with accompanying Schedules or Exhibits, as executed by the General Partner on behalf of the Partnership and Limited Partners of the Partnership either individually or by the General Partner as attorney-in-fact.

"Book Depreciation" for each Fiscal Period means an amount computed for such period with respect to the depreciable assets of the Partnership in the manner provided in Regulations Section 1.704-1(b)(2)(iv)(g)(3).

"Capital Account" means , with respect to any Partner, the capital account maintained for such Partner, and such capital account, as of any particular date, shall be:

(a) The amount of cash plus the agreed upon net fair market value (as of the date of contribution) of any other property that has been contributed by such Partner to the Partnership as of such date; plus

(b) The aggregate amount of the Partnership's Net Profit that has been allocated to such Partner as of such date pursuant to Section 3.1 hereof and the last paragraph of this definition of "Capital Account"; minus

(c) The aggregate amount of the Partnership's Net Loss that has been allocated to such Partner as of such date pursuant to Section 3.1 hereof and the last paragraph of this definition of "Capital Account"; minus

(d) The sum of all distributions of cash and the agreed upon net fair market value (as of the date of distribution) of any other property that has been distributed to such Partner by the Partnership as of such date.

The provisions of this Agreement relating to the maintenance of Capital Accounts are intended to comply with Regulations Section 1.704-1(b) and shall be interpreted and applied in a manner consistent with such Regulation. In the event that any Interest is transferred in accordance with the terms of this Agreement, the transferee shall succeed to the Capital Account of the transferor to the extent it relates to the transferred Interest.

The General Partner shall determine the gross fair market value, as of each Valuation Date, of each asset owned by the Partnership at the opening of business on such Valuation Date, and shall adjust the book value of each such asset to equal such gross fair market value. The Partnership shall be deemed to have sold all of its assets for such values as of such Valuation Date. Any gain or loss deemed to have been realized by the Partnership as a result of such deemed sale of its assets shall be treated as an additional item of Net Profit or Net Loss, as the case may be, and shall be allocated to the Partners as provided in Section 3.1 hereof.

"Capital Contribution" means the total amount or value of cash and property contributed by each Partner to the Partnership as an equity investment in the Partnership pursuant to Section 2.1 or as an Additional Capital Contribution pursuant to Section 2.2 or Section 9.3(e).

"Certificate" means the Certificate of Limited Partnership of the Partnership.

"Claimant" means the person desiring arbitration under Section 11.13.

"Code" means the Internal Revenue Code of 1986, as amended from time to time (or any corresponding provisions of succeeding law).

"Distributable Cash" means only that cash held by the Partnership at the end of the Fiscal Period after reasonable reserves of cash have been set aside by the General Partner, subject to the duties imposed by Section 4, for working capital and other cash requirements, including current and reasonably projected expenses, current and reasonably projected investment opportunities, and reasonably anticipated contingencies. For purposes of this definition, any of the Partnership Property which is contributed to the Partnership by the Partners, any borrowed funds, and any cash generated upon the sale of any of the Partnership Property, including Partnership Property which is purchased with borrowed funds and including the cash attributable to appreciation in value, shall be considered as necessary for investment purposes.

"Distributions" means any and all cash and or property distributed by the Partnership to any Partner in his, her or its capacity as a Partner pursuant to Section 3.1.

"Effective Date" means the date on which the Certificate of Limited Partnership is filed with the _____________ Secretary of State.

"Family Member" means (a) _______________, [his spouse], their descendants and any trust created and existing for the primary benefit of any one or more of any such Persons, and (b) a trust established for the primary benefit of a spouse of a descendant of _________________, where such spouse does not possess a power of appointment or other power of disposition over the property in such trust, other than a power exercisable only in favor of descendants of _______________, and where the remainder interest in such trust shall in all events be distributed to Persons described in the immediately preceding clause (a) or in this clause (b).

For purposes of this definition, references to descendants shall be deemed to include only persons who prior to that time were born in wedlock, born out of wedlock to parents who subsequently married each other, [born out of wedlock to a descendant of ____________, who acknowledged to the General Partner by signed written instrument making express reference to this provision that such person is his or her natural child], or legally adopted before reaching the age of majority.

"Federal Act" means the United States Securities Act of 1933, as amended.

"Financing" means any loan(s) obtained by the Partnership secured by Partnership Property, whether as original or subsequent financing for any Partnership Property other than from Capital Contributions by the Partners.

"Fiscal Period" shall mean the fiscal year of the Partnership. The Fiscal Period shall end on the last day of the calendar year.

"General Partner" means __________________________ and any successor-in-interest to any General Partner Interest transferred pursuant to this Agreement.

"Interest" means the entire ownership interest of a Partner in the Partnership at any particular time, including the right of such Partner to any or all benefits to which a Partner may be entitled as provided in this Agreement, together with the obligations of such Partner to comply with all of the terms and provisions of this Agreement. A Partner's Interest shall constitute such Partner's entire interest in the Partnership and shall include, but not be limited to, such Partner's Capital Account.

"Investment Activity" means the actual or contemplated investment by the Partnership in a single business enterprise which is operated as a single unit, regardless of the nature of such Partnership Investment. For example, the Partnership may hold common and preferred stock and debt of a single business organization, and the cumulative amount of Partnership Property invested in such business organization shall be considered to be a single "Investment Activity". Similarly, contiguous parcels of real estate may be owned as a single Investment Activity, although separately described for real estate title purposes.

"Limited Partner" means each Limited Partner identified as such on Schedule A, and each assignee of any part of a Limited Partner's Interest in the Partnership; provided, however, that such assignee shall not be entitled to any substantive rights of a Limited Partner unless such assignee is admitted as a substitute Limited Partner as provided in Section 6.

"Liquidator" has the meaning ascribed to it in Section 9.2.

"Majority of Interests" means an affirmative vote by Partners entitled to vote owning a majority of the Percentage Interests of all General and Limited Partners at the time of the vote.

"Marketable Securities" means stock, bonds or similar financial assets which are readily tradable in an established securities market (which may include over-the-counter markets or by specific local market-makers as well as established financial assets exchanges).

"Net Profit" or "Net Loss" of the Partnership, as the case may be, for each Fiscal Period shall be an amount equal to the Partnership's taxable income or loss for such period as determined under Code Section 703(a), except that

(a) such Net Profit or Net Loss shall be computed as if items of tax-exempt income and nondeductible, noncapital expenditures (under Code Section 705(a)(1)(B) and 705(a)(2)(B)) realized and incurred by the Partnership during such period were included in the computation of taxable income or loss;

(b) Book Depreciation for such period shall be taken into account in computing such taxable income or loss in lieu of any amortization, depreciation or cost recovery deductions to which the Partnership is entitled for such period;

(c) gain or loss resulting from any disposition of property with respect to which gain or loss is recognized for federal income tax purposes shall be computed by reference to the book value of such property as adjusted pursuant to the definition of "Capital Account" above, notwithstanding that the adjusted tax basis of such property differs from its book value as so adjusted; and

(d) items that are required to be specifically allocated under Code § 704(c) shall not be taken into account in computing such taxable income or loss.

"Partner" means any General or Limited Partner, and any additional or substitute General or Limited Partners which are explicitly permitted by this Agreement.

"Partner Loan Rate" means either (i) the rate agreed upon between the Partnership and a Partner to whom money is owed, if such rate is a commercially reasonable rate, or (ii) in the absence of such an agreed rate, a floating interest rate equal to two percent (2%) over the rate published from time to time by the bank or other financial institution where the Partnership's primary operating accounts are maintained at its prime or reference rate, calculated at the varying rates in effect from time to time, compounded annually. If the Partner Loan Rate would exceed the maximum rate allowed by law, then the Partner Loan Rate shall instead equal such maximum rate.

"Partnership" means the limited partnership created and governed by this Agreement.

"Partnership Property" or "Property" means all property owned by or for the benefit of the Partnership, regardless of whether such property is owned in the name of the Partnership or the name of a nominee on behalf of the Partnership.

"Percentage Interest" of any one or more Partners is defined in Section 2.1, and, if adjusted, in Section 2.2.

“Person” includes any individual, partnership, corporation, trust, organization or other entity, unless the context requires otherwise.

“Regulations” means the Income Tax Regulations, including Temporary Regulations, promulgated under the Code, as such regulations may be amended from time to time (including corresponding provisions of succeeding regulations).

“Removed Partner” means any Partner who is removed as Partner and whose Interest is purchased, forfeited or converted to a Limited Partner in accordance with Section 7.

“Reserve(s)” means the amount of cash from the total amount of Capital Contributions, or from Partnership debt or operations from time to time retained by the Partnership in its Reserve account for the purpose of maintaining amounts reasonably deemed sufficient by the General Partner for working capital and to pay the costs and expenses incident to the ownership and operation of the business of the Partnership. The Reserve may be increased or decreased from time to time pursuant to Section 4.1.

“Respondent” means the party or parties not the Claimant with regard to arbitration under Section 11.13.

“RULPA” means the ____, as amended from time to time (and any corresponding provisions of succeeding law).

“Sale” means any transaction whereby the Partnership transfers any of its rights or interest in any Partnership Property to a third party except for transfers for the purpose of renting Partnership Property or providing a mortgage or other security interest on any Partnership Property as security for Partnership debt.

“State Act” means the ____, as amended.

“Transfer” means any sale, transfer, mortgage, assignment, gift, pledge, hypothecation or other disposition of a Partnership Interest, whether voluntary, involuntary or by operation of law.

“Valuation Date” means any date designated by the General Partner, provided that on such date either:

(a) a contribution is made to the capital of the Partnership by one or more Partners under Section 2.2 hereof or by a Person being admitted as a Partner, other than contributions made by all of the Partners in proportion to their respective Capital Account balances as of such date; or

(b) a distribution of cash or other property is made by the Partnership to one or more Partners other than a distribution made to all of the Partners in proportion to their respective Capital Account balances as of such date.

“Withheld Taxes” has the meaning ascribed to it in Section 3.4 hereof.

IN WITNESS WHEREOF, the undersigned partners have set their hands and seals as of the Effective Date.

GENERAL PARTNER:

______________________	____________________________(SEAL)
Date	Print Name: ______________________

LIMITED PARTNERS:

______________________	____________________________(SEAL)
Date	Print Name: ______________________
______________________	____________________________(SEAL)
Date	Print Name: ______________________

SCHEDULE A

Partners

Partner Name and Address:	Initial Capital Contribution	Opening Capital Account Balance	Initial Percentage Interest
General Partner:			
[General Partner Name & Address]	[Description of Contribution]	[$____________]	[____%]
Limited Partners:			
[Limited Partner Name & Address]	[Description of Contribution]	[$____________]	[____%]
[Limited Partner Name & Address]	[Description of Contribution]	[$____________]	[____%]
			100.00%

COMMENTARY

Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended (the "Code").

[1]Choice of Entity. This is a prototype of a limited partnership agreement to use as an investment vehicle for the consolidation, management and transfer of family wealth. It is contemplated that the general partner would be an entity, either a corporation or a limited liability company, owned by family members, and the limited partners would be family members, trusts for the benefit of family members, or some combination of both.

Many practitioners use limited liability companies with voting and nonvoting membership interests as an alternative to the more traditional two entity structure contemplated here. Although there is nothing wrong with such an approach, the limited partnership approach may have more universal appeal because of state law issues. For instance, some states treat partnerships more favorable than limited liability companies for income tax, intangible tax and franchise tax purposes. Moreover, some practitioners choose a partnership over a limited liability company because there is a more established body of law in the partnership area.

Because operating agreements for limited liability companies are similar to partnership agreements, many of the provisions of this prototype document could be adapted easily for use with an LLC. In addition, the commentary to the various provisions applies whether the entity is an LLC or limited partnership.

[2]State of Formation. Because of § 2704(b), it is important to form the limited partnership in a state where the limited partnership act provides that partners who withdraw, voluntarily or on account of death, are not entitled to liquidation of their partnership interest, nor does such an event cause dissolution of the partnership. Moreover, if a limited liability company is used as the general partner, it should be formed in a state where the limited liability company act provides that the withdrawal of a member, voluntarily or on account of death, does not cause a dissolution of the LLC.

§ 2704(b)(1) provides that for purposes of the gift and estate tax, if there is a transfer of an interest in a corporation or partnership to (or for the benefit of) a member of the transferor's family, and the transferor and members of the transferor's family control the entity immediately before the transfer, any "applicable restriction" shall be disregarded in determining the value of the transferred interest. Under § 2704(b)(2), the term "applicable restriction" means any restriction that effectively limits the ability of the corporation or partnership to liquidate if (i) the restriction lapses after the transfer of the interest or (ii) the transferor or a member of the transferor's family, either alone or collectively, has the right to remove the restriction after the transfer.

§ 2704(b)(3) provides a significant exception to § 2704(b)(2). The term "applicable restriction" does not include any restriction imposed by federal or state law. In other words, a restriction on the ability to liquidate the entity may only be disregarded if it is more restrictive than the limitations that would apply under the state generally applicable to the entity in the absence of the restriction in the partnership agreement. Thus, it is important to form the entities in jurisdictions where "bare state law" backs up liquidation and dissolution provisions of the agreements for § 2704(b) purposes.

[3] Partnership Purpose. The length and detail of a purpose clause varies greatly from practitioner to practitioner. Some prefer a one sentence general statement while others go into explicit detail that my go on for a page. Neither approach is right or wrong. This prototype employs a compromise. The actual reasons for creating the partnership, however, are more important than what the agreement says. Although if you choose to detail the reasons in the partnership agreement, the stated reasons should be consistent with the actual purposes and not simply a list of possible partnership purposes.

This is important to fall within the exception to §2036 for bona fide sales for adequate and full consideration in money or money's worth. In interpreting this section, the Tax Court in Estate of Bongard (124 T.C. No.8 (2005)) required legitimate and significant non-tax purposes. The 5th Circuit and 3rd Circuit Courts of Appeals may require more than a mere non-tax purpose. In Estate of Kimbell (371 F. 3d 257 (5th Cir. 2004)) and Estate of Turner (382 F. 3d(3rd Cir. 2004)), it seems as though these courts required a business purpose although in the case of the 5th Circuit the threshold for establishing a business purpose may be very low.

[4]Allocations in General. In order to understand the prototype limited partnership agreement's general approach to tax allocations, we must understand first the default rules governing the taxation of partnerships set forth under Subchapter K of the Code. With an understanding of the default rules under the Code, we can understand better the specifically enumerated rules that are incorporated in the prototype document. We also can more easily understand the implications of a partnership agreement's departure from the default rules, when variations from the default rules may be adopted in particular circumstances.

A partnership generally is treated as a pass-through entity for income tax purposes. Thus, a partnership usually is viewed by the Internal Revenue Code as an aggregation of its assorted partners. This is known as the "aggregate approach" to partnership taxation. However, a partnership is treated, for some income tax purposes, as a separate entity, distinct from its partners. This is called the "entity approach" to partnership taxation. Thus, for purposes of allocating items of income, loss, gain, deductions and credit, as set forth in Section 3 of the prototype partnership agreement, sometimes the aggregate approach will be adopted and sometimes the entity approach will be adopted. Let us look briefly at the default rules.

§ 701 sets forth the aggregate approach that is generally taken for income tax purposes. The very title of § 701 states it clearly: "partners, not [the] partnership, [are] subject to tax." The Code section goes on to say that individuals "carrying on business as partners shall be liable for income tax only in their separate or individual capacities." The general aggregate approach is evidenced by the tax returns that are required to be filed by a partnership each year. A partnership does not file its own income tax return but instead files only an informational return, a Form 1065. On the Form 1065 the partnership calculates the gross income of the partnership and allocates that income to its partners. The partnership will report the income allocated to its various partners on Forms K-1, one of which is issued annually to each partner.

Unfortunately, the seemingly straightforward aggregate approach adopted in § 701 does not tell the full story. § 703 generally requires the income of a partnership, with some exceptions, to be computed separately, in the same manner as for an individual. Thus, § 703 takes the entity approach for purposes of determining the taxable income of the partnership as a whole. But there are exceptions to the entity approach also mentioned in § 703. Certain items, such as short- and long-term capital gains and losses, charitable contributions and other items described in § 702(a), must be separately stated by the partners and not the partnership, and certain deductions, such as the personal exemption, are not allowed to be taken by the partnership but instead are allowable only to the partner level. See § 703(a).

In summary, the general rule is that when it comes to paying the actual tax liability of a partnership and its partners, the aggregate approach prevails. That is, each partner is responsible for his or her payment of tax, not the partnership itself. However, the entity approach often prevails for purposes of computing actual items of income, loss, gain, deductions and credits. And there are several exceptions to the entity approach set forth in § 703.

But how should a partnership allocate its items of income, gain, loss, deductions and credits among its partners for tax purposes? § 704(a) tells us the answer to that question: unless otherwise provided under the Internal Revenue Code, "a partner's distributive share of income, gain, loss, deduction, or credit shall … be determined by the partnership agreement." Seemingly, then, all kinds of special allocations of items of income, gain, loss, deductions and credits could be specifically set out in the partnership agreement. And it is often the case that commercial partnership agreements will establish "exotic" allocations of these items. However, this prototype limited partnership agreement is not so much concerned with special income tax allocations that may affect the timing and/or amount of recognition of gain or loss by the partners. Instead, the prototype agreement is concerned primarily with family financial and estate planning, so no special tax allocations are included. With the exception of preferred partnerships, discussed briefly below, most estate planning partnerships do not contain special tax allocation provisions that are unusual or inconsistent with default federal tax rules.

Thus, it would seem as though it should not be necessary for the typical estate planning partnership to include a lengthy and complicated tax allocation section if it merely reflects the default rules (and their myriad exceptions) set out in the Code. Some practitioners adopt this approach in their partnership agreements. These agreements simply state, in effect, that allocations of income, loss, gain, deductions and credit are to be made pro rata among the partners, in accordance with their respective ownership interests in the partnership. They also state that, to the extent that the Internal Revenue Code requires an exception to the general pro rata approach to allocations, those exceptions should apply. This approach to drafting results in a partnership agreement that has fewer pages and is more easily understood by the client. For clients who may have never read a partnership agreement before, the simple approach may be best.

The prototype agreement takes a different tack, however. Thus, while there are no special tax allocations contained in the agreement, the prototype "walks through" the default rules and their many exceptions. Thus, Section 3.1 states that the partnership's Net Profit or Net Loss, and all items of income, gain, loss, deduction and credit for each Fiscal Period of the partnership are to be allocated at the end of each such period according to each partner's Interest in the partnership. Each partner's Capital Account also is to be adjusted accordingly for each item so allocated. The agreement provides that allocations of these items for book purposes should be similarly made for tax purposes, except as otherwise explicitly provided in the agreement. If there is a change in the partners' Percentage Interests in the partnership during the year, the allocations should reflect the actual economic benefits or burdens realized. See Section 3.1(a) of the prototype agreement.

Sections 3.1(b) through (g) set out the many exceptions to the straight pro-rata rule otherwise adopted in the agreement and by Subchapter K. These sections, dealing with the exceptional rules governing a partner's minimum gain, qualified income offset, minimum gain chargeback, the special rules of Treas. Reg. § 1.704-1(b) and § 1.704-2 (relating to the "substantial economic effect" of tax allocations), the special rules of IRC § 704(b) (relating to contributions of built-in gain property), and the shifting of recapture responsibility among partners, all provide exceptions to the general pro rata rule. As a practical matter, these special tax provisions will become relevant only if there will be indebtedness or significant partnership losses. In the context of a family limited partnership, it is likely that no significant debt or loss will be associated with partnership operations. Therefore, some practitioners choose to omit these provisions from their partnership agreements in the interests of clarity and simplicity, as discussed above.

On the other hand, some practitioners believe it is better to set out these exceptions explicitly. After all, it is impossible to predict with certainty what the actual operations of the partnership will be in the years to come. Therefore, it may well be that these provisions will become relevant some time in the future, even if it is unlikely that the special tax allocation requirements of the Code will be triggered by unanticipated partnership activities. Also, some practitioners feel that including these provisions will make the agreement resemble more closely ordinary commercial partnerships, which will nearly always set out these provisions. By drafting the estate planning partnership similarly, it may help to establish the business "validity" of the entity, which is always necessary for estate tax purposes. Why, these practitioners believe, make a distinction between commercial partnerships and family limited partnerships? By including similar language in both types, FLPs are not singled out by their simplicity.

So is it necessary to go into excruciating detail about the various exceptions to the general pro rata approach to allocations, as set forth in Section 3? There is no right or wrong answer to one approach versus another. It is simply the case that some practitioners prefer to provide an explicit list of the various tax allocation rules and their exceptions, while others prefer to take a more streamlined approach to make it easier for the client (and themselves) to understand. Certainly, the prototype's decision to include the additional language is better for practitioners, as it is always easier to delete unwanted material than to remember to add language that was not included in the prototype.

[5] Maintenance of Capital Accounts. Notwithstanding what approach is adopted by the draftsman, it is imperative for the practitioner to emphasize to the client the need for the partnership to maintain accurate capital accounts. Annually, a beginning and ending capital account must be shown for each partner, reflecting the economic operation of the partnership over the course of the year. The capital account of each partner effectively represents each partner's equity or investment in the partnership. Allocations of items of income, loss, gain, deduction and credit, if done on a pro rata basis, must be maintained with respect to each partner so as to reflect the actual economic activity of the partnership. The capital accounts of each partner also will reflect any distributions made to a partner from the partnership.

By maintaining these capital accounts strictly, the business activities of the partnership will be properly reflected and the integrity of the entity will have the best chance of being respected. Often, families have been tripped up by the courts viewing a partnership as a head-of-the-family's "personal pocketbook", where the assets and activity of the partnership appear to serve only the needs of the main partner, typically in the senior generation. The IRS's main line of successful attack against family limited partnerships has been to utilize § 2036(a)(1), where the assets of the partnership are deemed to be fully includible in the decedent's estate because the decedent is deemed to have possessed or enjoyed the right to income from partnership property. By maintaining capital accounts of the partnership in accordance with the terms of the partnership agreement, the separateness of the entity is maintained and has a far greater chance of being respected by the IRS.

[6] Preferred Partnerships. Finally, it should be noted that this discussion of tax allocations presumes, and the prototype agreement reflects, that there will be no special tax allocations in the agreement. Most estate planning partnerships do not contain special tax allocation provisions. However, preferred partnerships, explicitly sanctioned by § 2701, are a special estate planning "freeze" technique that creates a preferred class of partnership interests. The preferred partnership interest will have a preferential right to partnership net cash flow, payable annually. This preference, similar to preferred stock in a corporation, will be respected for estate planning valuation purposes only if the preferred interest enjoys a cumulative net cash flow preference. Therefore, if a preferred limited partnership is desired to be created, the special rules set forth in the Regulations under § 2701 should be consulted, and the allocation provisions in the document may be adjusted accordingly

[7] Distributions. In determining whether distributions of cash or other assets from the partnership should be made in the discretion of the general partner or instead by mandatory distributions as required under the terms of the partnership agreement, it is important to review the client's facts and circumstances while also considering the estate and gift tax implications. Specifically, it is important to consider (i) the possible application of Section 2036; (ii) the impact on valuation discounts obtained on the value of the interests gifted; and (iii) the ability to obtain annual gift tax exclusions of the interests gifted. Also, if it is determined that some distributions should be mandatory, should the amount of the distribution to be distributed be determined in the discretion of the general partner or otherwise? And should prorata distributions be required?

§ 2036(a)(2) is applicable if a decedent transferred property to his or her lifetime and retained the right "either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom." In the typical FLP scenario, the parents establish the partnership, gift the limited partnership interests to their children and the parents (or parent) are the general partners. In this situation, if the general partners have the discretionary right to determine the amount and timing of the distributions of cash or other assets, rather than the distributions being mandatory under the terms of the partnership agreement, then an argument could be asserted that the general partners (who have transferred interests to the limited partners, their children) have retained the right to designate the persons who shall enjoy the income from the property, which was transferred. This is particularly the case if prorata distributions are not required.

In fact, this argument was raised by the Internal Revenue Service and was initially successful in Kimbell v. United States, 2003-1 USTC ¶60,455 (N.D. Tex. 2002). The district court for the Northern District of Texas (although its decision was vacated by the 5th Circuit, which held that the transfer satisfied the bona fide sale exception and therefore did not consider the application of § 2036(a)(2)) held that § 2036(a)(2) was applicable because the decedent retained the right to determine who was to enjoy the income from the property. In that case, the decedent at the time of her death owned a 50% interest in the 1% general partner and a 99% limited interest. Even though the decedent was not solely in control of the general partner, because the partnership agreement permitted the limited partners that held 70% or more of the limited partnership interests to remove the general partner and appoint themselves, this right of removal and appointment in the partnership agreement, was significant for the court to apply § 2036(a)(2).

In other words, the court held because the decedent was able to control (although indirectly by the removal of the general partner and appointment of herself) the distributions from the partnership, § 2036(a)(2) was applicable. In Kimbell, the court treated the decedent as having the power over distributions held by the general partner even though she was not serving as general partner at the time of her death. The troubling aspect about § 2036(a)(2) inclusion is that its application does not depend on "bad facts" surrounding the operation of the partnership. In deciding whether or not § 2036(a)(2) was applicable, the court focused on the structure of the partnership arrangement as opposed to a failure on the part of the partners to respect the partnership form.

As an argument against the application of § 2036(a)(2), the Kimbell estate tried to argue that the decedent's ability to control the partnership was limited by her fiduciary duties, as articulated in Byrum v. United States. However, the Kimbell court held that because the partnership agreement specifically absolved the general partner of any fiduciary duties to the other partners, the standard for application of the fiduciary duty as set forth in Byrum was not applicable. In addition, the fact that there were no other partners to whom duties could have been owed, other than the 50% owners of the 1% general partner, in these circumstances did not help the Kimbell estate's argument in this respect.

Although the District Court's decision in Kimbell was vacated by the Fifth Circuit, which held that the bona fide sale exception was satisfied, it is important to consider the possible application of § 2036 particularly if the bona fide sale exception is not satisfied or if there is a split in the circuit courts' decisions.

The following are options, which could be considered in avoiding the application of § 2036(a)(2):

An alternative to the possible argument of a § 2036(a)(2) application, which clients are fairly receptive to implement, is for one parent to be the transferor of the limited partnership interests and the other to be the general partner. As an example, both parents could make contributions to the partnership in the necessary amounts so that mother receives a 1% general partnership interest and father receives the 99% limited partnership interests. Father then makes gifts of the limited partnership interests to the children (or children's trusts). Then mother, as the general partner, is able to retain control of the "family assets" while father is the transferor of the interests. Unlike § 672(e), which treats the grantor as holding the powers of the grantor's spouse, § 2036 does not have a similar provision. Therefore, if one spouse is able to retain control of the partnership and the other spouse is the transferor of the limited partnership interests then § 2036 should not be applicable.

Another simple alternative, although not necessarily agreeable with many clients, is to structure the partnership so that neither parent is a general partner nor would they have any interest, however small, in an entity that serves as the general partner. In this alternative the application of § 2036(a)(2) is avoided if the parent, the transferor, is neither the general partner nor does the parent control the general partner. In such a case, the distributions from the partnership could be within the discretion of the general partner and not raise an inclusion issue.

Another issue to consider in determining the distribution standard is the impact it may have on the valuation discounts that can be obtained. If a partnership agreement requires mandatory distributions of cash or other assets to the partners, it could impact the amount of the valuation discounts obtained for the gifted limited partnership interests. In general, when valuing the limited partnership interests that are gifted, an appraiser will begin with the fair market value of the underlying assets of the partnership and reduce that amount by the applicable discounts, which typically include lack of marketability and minority interest. The discount for lack of marketability is certainly warranted when a limited partner's return on her investment is subject to the discretion of the general partner to make distributions of cash or other assets from the partnership. In that situation, the limited partner is able to obtain cash or other assets from the partnership only in the discretion of the general partner. Therefore, if the general partner is able to determine when and whether distributions are to be made, the value of the limited partnership interests should have less value.

On the other hand, mandatory distributions of cash or other assets to the partners from the partnership in accordance with the agreement would enable a partner to receive an immediate return on her investment. This return would likely increase the value of the limited partnership interest and therefore reduce the amount of the discounts applicable to the valuation of the interest.

The ability to satisfy the requirement for the annual gift tax exclusion is another issue to be considered in determining the standard for distributions. If the client is making gifts of the limited partnership interests and expecting that the gifts will qualify for exclusion under § 2503(b), then the gift must be of a present interest. Reg. 25.2503-3(b) defines a present interest as an "unrestricted right to the immediate use, possession or enjoyment of the property or the income from the property." The issue of whether the receipt of an interest in a family limited partnership qualifies for the annual exclusion was considered in Hackl, 118 TC No.14, in which the court made a highly technical analysis of what constitutes a present interest for annual exclusion purposes.

The Tax Court relied heavily on the Supreme Court case of Fondren v. Commissioner, 324 U.S. 18 (1945). In that case the Supreme Court held that to qualify as a present interest, a gift must confer on the donee not just vested rights but a substantial present economic benefit by reason of the use, possession, or enjoyment of either the property itself or income from the property. The Tax Court stated that in cases such as this the taxpayer must establish that "the transfer in dispute conferred on the donee an unrestricted and noncontingent right to the immediate use, possession or enjoyment (1) of property or (2) of income from property, both of which alternatives in turn demands that such immediate use, possession or enjoyment be of a nature that substantial economic benefit is derived therefrom." In reviewing the operating agreement and the facts and circumstances of the operation of the limited liability company, the Tax Court concluded that the interests transferred did not satisfy this test. However, when the 6th Circuit Court of Appeals affirmed this decision, it focused on the non-transferability of the interests in the entity rather than the distribution issue.

[8] Reserved for commentary discussing authority of General Partner.

[9] § 754 Election. The prototype agreement grants to the general partner the discretion to make or not make a § 754 election. This commentary discusses basis adjustment on the death of a partner. It does not discuss basis adjustment as a result of a transfer by sale or exchange, although the same rules apply. Nor does the commentary discuss the situation where a transfer on the death of a partner triggers a substantial partnership built-in loss (more than $250,000). The "substantial built-in loss" rules were added as § 743(c) by the American Jobs Creation Act of 2004 to curb manipulation of the § 743(b) rules which were being used to transfer or duplicate losses among partners in sales or exchanges through failure to make the § 754 election. A transfer as a result of the death of a partner generally does not present the same opportunity for loss transfer or duplication abuse as a transfer by sale or exchange. Nor does the commentary mention, other than here, that a § 754 election requires a downward adjustment as to the bases of partnership assets which have declined in value.

Under § 742, the basis of a partnership interest acquired other than by contribution is determined under §s 1011 et seq. Therefore, says Reg. 1.742-1, the basis of a partnership interest acquired from a decedent will be the fair market value of the interest at date of death increased by the successor partner's share of partnership liabilities and reduced to the extent value is attributable to income in respect of a decedent (IRD). For example, A is an equal partner in Partnership ABCD which has assets the total FMV/inside basis of which $96,000/$60,000 is broken down as follows: cash, $24,000/same; accounts receivable, $12,000/0; 1245 property, $40,000/$20,000; and capital assets, $20,000/$16,000. A dies. Under § 742, 1014(a) and 1014(c), A's successor takes an outside basis in A's partnership interest of $21,000 (1/4th of $96,000 minus 1/4th of the $12,000 of accounts receivable which is IRD). Under § 706(c)(2), if A died after January 1, 1998, the partnership taxable year would close with respect to him (only), in which case, his distributive share of partnership income earned prior to death would be included in his estate. Such share is not IRD. Thus, in the above example, if A had earned $2,000 prior to death, A's successor would take an outside basis in his partnership interest of $23,000. If the partnership has a § 754 election in effect or a § 732(d) election were made, A's partnership interest would obtain an $8,000 inside basis adjustment ($23,000 minus $15,000) which would be allocated $2,000 to the income earned prior to death, $5,000 to the 1245 property and $1,000 to the capital asset.

In the case of a transfer of a partnership interest as a result of the death of a partner, § 754 permits the partnership in its discretion to make an election to adjust the inside bases of partnership properties. The election is made "in accordance with Regulations prescribed by the Secretary." The Secretary has adopted Reg. 1.754-1 which says, basically, that the election (i) applies until it is revoked; (ii) must be made by the partnership, rather than the executor, on the Form 1065 for the taxable year in which the transfer or distribution occurs (unless the entity already has an election in effect, in which case, a new election does not have to be filed); and (iii) must contain a statement that sets forth the name and address of the partnership making the election, is signed by one of the partners, and declares that the partnership elects under § 754 to apply the provisions of § 734(b) and § 743(b). An extension of time to make the election may be requested under the provisions of §1.9100-1. There is no official form of election. The executor should request that the partnership make the election if it would benefit the estate. Because the election will require the partnership to keep a separate set of books with respect to the estate's and the estate's successor's interest, the partnership may decide not to make the election or, as a condition of making it, may require the estate to reimburse the partnership for the costs incurred as a result of making the election. A partnership having an election in effect may revoke the election with the approval of the district director for the internal revenue district in which the partnership return is required to be filed pursuant as set forth in Reg. 1.754-1(c).

Unless a § 754 election is in effect, the bases of partnership properties in connection with the transfer of a partnership interest on the death of a partner are not adjusted. § 743(a). If a § 754 election is in effect, § 743(b) says the bases of partnership properties must be adjusted. Beware, if a Sec. 754 election is in effect, on the death of a partner the transferee must notify the partnership in writing, within one year of death, under penalties of perjury. The notice must include various items of information, including the fair market value of the partnership interest on the estate tax valuation date. Reg. 1.743-1(k)(2)(ii).

When a § 754 election is in effect, § 743(b) says that the partnership shall increase adjusted basis of partnership property (inside basis) by the excess of the basis of the transferee partner in his interest in the partnership (outside basis) over his proportionate share of the adjusted basis of the partnership property."

For example, if Partner A had contributed property in which he had a basis of 20 (tax free under § 721), thus giving the partnership an inside basis of 20 and Partner A an outside basis in his interest in the partnership of 20, and Partner A dies when his outside basis has appreciated from 20 to 100, Partner A's outside basis is stepped-up from 20 to 100 pursuant to § 1014(a), in which event, if a partnership 754 election is in effect, 743(b) mandates a corresponding increase from 20 to 100 in the inside basis of partnership property. The increase constitutes an adjustment to the basis of partnership property with respect to the transferee partner only. No adjustment is made to the common basis of partnership property.

If Partner A's governing instrument allocates the partnership interest to a marital trust, for example, the basis increase of 80 constitutes an adjustment to the basis of partnership property with respect to the marital trust only. Following the transfer, the marital trust will have an adjusted outside basis of 100 in the partnership interest and the partnership will have an adjusted inside basis of 100 in the marital trust's share of partnership property, but the partnership's adjusted inside basis for those partnership properties is special and personal to the marital trust for the purpose of thereafter calculating its income, deduction, gain and loss. One negative consequence of the § 754 election, obviously, is that the partnership will immediately incur recordkeeping, accounting, appraisal and other administrative expenses in connection with the basis adjustment, and thereafter will have to keep a separate set of books for the transferee marital trust.

Note, if Partner A had contributed property in which Partner A had an adjusted tax basis of 20, thus giving the partnership an inside basis of 20 and Partner A an original outside basis in his interest in the partnership of 20, and Partner A dies when his outside basis has appreciated not from 20 to 100, but rather from 20 to 70 because of a 30% valuation discount, Partner A's outside basis is stepped-up from 20 to 70, not from 20 to 100, pursuant to § 1014(a) and, if a § 754 election is in effect, Partner A's successor's share of inside basis of partnership property is stepped up from 20 to 70, not from 20 to 100. The greater the discounts taken, the lower the estate tax, but the lower the estate tax, the lower the adjusted basis and therefore the greater the potential capital gain.

Next question becomes: The bases of which partnership properties are adjusted to what extent? § 743(c) says that the allocation of basis among partnership properties where § 743(b) is applicable shall be made in accordance with the rules provided in § 755. § 755(a) first states a general rule: Any increases in adjusted basis shall be allocated in a manner which has the effect of reducing the difference between the fair market value and the adjusted basis of partnership properties. § 755(b) gets more specific: In applying § 755(a), such increases in adjusted basis attributable to (i) capital assets and § 1231 property and (ii) "any other property" of the partnership shall be allocated to partnership property of like character. Reg. 1.755-1 details the process. For a simple example of how this works, see the above example.

Warning, while the execution and filing of the § 754 election is easy, and the determination of the overall § 743(b) basis adjustment not that difficult, § 755 allocations can be very, very complicated. After dividing all of the partnership properties into the two classes, the overall § 643(b) adjustment is allocated ratably between the two classes in relation to the net amount of appreciation (or depreciation) in each class. If one class has appreciated and the other has declined in value, the upward adjustment must be allocated entirely to the appreciated class and a downward adjustment must be allocated to the class that has declined in value. Next, § 755 requires that the adjustment allocable to each of the two classes be further allocated within the class according to the net appreciation or depreciation of each asset. When the smoke clears, the adjustments will increase (or decrease) the successor partner's inside bases in partnership properties so that they equal his outside basis.

Not all is lost if the partnership refuses to make a § 754 election. Under Sec. § 732(d), a distributee partner who acquires her interest upon the death of a partner (or by sale or exchange) may elect, with respect to distributions of partnership property within two years after date of death to treat the bases of the partnership property as if the § 743(b) adjustments had taken place. As a result, the distributee partner will take the § 743(b) adjustment and § 755 allocations into account in determining the basis of the distributed property under § 732(a) and (c).

[10] Reserved for commentary to Section 6 regarding transfers of partnership interests.

[11] Transferability Issues. Section 6.3 of the prototype agreement provides a mechanism for a Limited Partner to sell his Interest while giving the other Limited Partners the ability to protect themselves from a sale to an undesirable party. It is important to provide a Limited Partner with the ability to sell his Limited Partner Interest for two reasons: (1) If it is anticipated that the Limited Partnership Interests will be the subject of annual exclusion gifts under § 2503(b) of the Code or (2) if it is important to ensure that any Limited Partner transferee be recognized as a partner for income tax purposes under § 704(e) of the Code.

In Hackl v. Comm'r, 118 TC 279 (2002), aff'd, 335 F.3d 664 (7th Cir. 2003), the Tax Court held that gifts of interests in a limited liability company were not eligible for the annual exclusion because the gifts did not confer on the donee a substantial present economic benefit. The fact that the donee of the limited liability company interests could not transfer or sell his or her units to third parties without the prior written consent of the manager of the limited liability company was one of the factors the Tax Court relied upon in reaching its conclusion.

In addition, in PLR 9751003 (August 28, 1997), the Internal Revenue Service held that gifts of limited partner interests did not qualify for the annual exclusion where the limited partner interests were not transferable by the donees. However, in PLR 199905010 (October 30, 1998) and PLR 199944003 (July 2, 1999), the Internal Revenue Service held that gifts of limited partner interests did qualify for the annual exclusion where they were transferable by the donees. Because Section 6.3 gives a donee of a Limited Partnership Interest the opportunity to obtain current economic benefit for his Interest via a sale of his Interest there is an increased likelihood that any gift to such donee will qualify for the annual exclusion.

With respect to partnerships in which capital is a material income-producing factor (which will generally be the case for family limited partnerships), § 704(e) provides that a donee of a partnership interest in such partnership will be recognized as a partner of such partnership for income tax purposes if the donee has a capital interest in the partnership and if he is the "real" owner of such interest. Treas. Reg. § 1.704-1(e)(1)(iii). To be recognized, the donee must have dominion and control over the partnership interest. Whether a donee is the "real" owner of a partnership interest must be determined from examining all the facts and circumstances. Treas. Reg. § 1.704-1(e)(2). One of the factors that will be considered in making the determination is whether there are any limitations on the right of the donee to liquidate or sell his partnership interest. Any limitation on a limited partner's right to liquidate or sell his interest will be considered a negative factor in determining whether the donee is the "real" owner of his partnership interest. Treas. Reg. § 1.704-1(e)(2)(ii)(b), (d); Treas. Reg. § 1.704-1(e)(2)(ix).

If it is not important that a transfer of a Limited Partner Interest qualify for the annual exclusion because the Interests, for example, will be the subject to unified credit gifts or transfers to a GRAT, then giving a Limited Partner the ability to sell his Interest will not be necessary. In addition, the same will be true if qualifying a transferee of a Limited Partner Interest as a Partner of the Partnership for income tax purposes is not important because, for example, the transferee is a grantor trust.

[12] Dissolution. Judge Cohen, in her reconsideration of Estate of Strangi v. Comm'r, 115 T.C. 478 (2000), aff'd in part and remanded in part, 293 F.3d 279 (5th Cir. 2002), on remand, T.C. Memo. 2003-145 ("Strangi II"), accepted the Internal Revenue Service's arguments for the inclusion of limited partnership assets in a decedent's estate based on I.R.C. §2036. She held not only that the partnership assets were fully includable without discount in the decedent's gross estate under § 2036(a)(1), but that alternatively this same result was appropriate under § 2036(a)(2).

The alternate holding was based on the decedent's ability to control two different aspects of the partnership, one of which was his ability to liquidate the partnership acting in concert with others. Under the partnership agreement, if all of the limited partners and the general partner agreed, a liquidation could occur. Also, the general partner could consent if its shareholders, including the decedent, voted in favor of it. Judge Cohen held that the decedent's retained right, which could be exercised in conjunction with others to cause a liquidation of the partnership, mandated inclusion of the partnership assets in his gross estate since he could therefore control the timing of the beneficiaries' enjoyment. Following this reasoning, this holding would apply even when a decedent retained only a small percentage of the partnership, as long as he could cast a vote.

Although this alternate holding appears to be clearly erroneous in light of U.S. v. Byrum, 408 U.S. 125 (1972), and the Service's own holding in Rev. Rul. 73-143, the 5th Circuit Court of Appeals did not comment on the alternative holding. The 5th Circuit affirmed Judge Cohen's analysis under § 2036(a)(1) and then concluded it did not need to address the § 2036(a)(2) analysis. This leaves a cloud around this issue that the Internal Revenue Service is attempting to exploit.

For this reason, in the model form limited partners do not vote on the issue of dissolution.

13 Alternative Dispute Resolution. Most states have a strong public policy in favor of alternative dispute resolution (ADR) processes, of which arbitration is one type (mediation being the main other). Because intra-family disputes can lead to litigation that can devastate family wealth, and because a partnership agreement like any commercial contract can contain reasonable provisions that mandate arbitration of disputes, the prototype agreement contains an arbitration provision. Note that arbitration is mandatory, not merely facilitative. Arbitration is required of all disputes, management and otherwise, that arise out of or relate to the Agreement or any transaction pursuant to it. The arbitration award will be final, binding and non-appealable. Awards are personally and locally enforceable. The "loser pays all" provision should deter frivolous claims. Mandatory arbitration serves to support a significant nontax reason for forming a family partnership. Note, too, that mediation, while a facilitative and not a mandatory process, should usually be pursued first, and only when that fails, should the disputants resort to arbitration.

Publicity can be avoided through arbitration if there is a confidentiality provision. The prototype agreement contains no such provision. Consider including the following: The Partners agree and acknowledge that they are or will become familiar with substantial and significant Confidential Information (as defined below) and that if any Confidential Information were made available to third parties or to the public, it could do serious and irreparable harm to the Partners and to the business of the Partnership. Accordingly, the Partners agree that they shall keep all Confidential Information confidential and shall not disclose such information to any third party other than professional advisors who need to know such information and who have been advised of the Partners' obligations hereunder and agree to abide by the terms hereof. The Partners shall use the Confidential Information solely in connection with the performance of their duties hereunder and for no other purpose. Upon the request of the Partnership, the Partners shall promptly deliver to the Partnership all tangible materials (whether provided by the Partnership or created by or on behalf of the Partner) containing Confidential Information, and shall not retain any copies, extracts or other reproductions of such materials. If a Partner shall be ordered to disclose any Confidential Information, the Partner shall provide the Partnership with prompt written notice thereof so that the Partnership may seek a protective order or other appropriate relief. In the event that such order or other remedy is not obtained, the Partner agrees to disclose only that portion of the Confidential Information that the Partner is advised by counsel is legally required to be disclosed. As used herein, "Confidential Information" shall mean all information, whether written or oral, tangible or intangible, of a confidential or proprietary nature concerning the Partnership and its assets, business and operations.