



## Family Limited Partnership Developments—Time for a Checkup

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Family limited partnerships have long served as proper tools for structuring family-owned businesses and activities. Such arrangements protect assets, educate beneficiaries about a business and pass on existing businesses and interests of a client to the client's desired beneficiaries—often with estate and gift tax savings in the form of lower taxable gift or estate values on the interests transferred. Because of these tax savings, the IRS has targeted family limited partnerships for scrutiny. Recent

decisions both clarify the validity and impact of these entities and raise gift and estate tax concerns.

### IRS Attacks through PLRs (Private Letter Rulings)

Initially, the IRS released a series of technical advice memoranda/private letter rulings challenging tax savings claimed through the use of a family limited partnership (FLP). In these rulings<sup>1</sup>, the IRS

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claimed that the FLP was formed solely or primarily to reduce federal transfer taxes and/or depress the value of assets passing via the FLP and should be disregarded as a sham transaction.

The IRS also disregarded any claimed discount on the value of the FLP interests transferred by a decedent under IRC § 2703(a)(2). The IRS concluded that the “property” transferred was the underlying FLP assets, not the FLP interest. The IRS disregarded discounts on the value of these underlying assets based on restrictions in the FLP agreement and concluded that the IRC § 2703(b) exception did not apply to an FLP. Inter-family transactions were presumed not to be arm's length because the discounts in value proved that the transfer of assets to the FLP was not a *bona fide* arm's length transaction for full and adequate consideration.

The IRS asserted that IRC § 2704(b)(1) prohibited any discount in the value of the FLP interests. The IRS concluded that restrictions on withdrawals by partners and transfers of FLP interests under an FLP

agreement constituted “applicable restrictions” more restrictive than applicable state law that are disregarded in valuing FLP interests.

Finally, the IRS held that an indirect taxable gift to other FLP partners must result if the value of FLP interests transferred by a founder was less than the net asset value of assets contributed to the FLP, since this difference could not simply “disappear.” The transfer of assets to an FLP for a less valuable FLP interest could not be a *bona fide* arm’s length sale. Hence, the transaction must constitute a part-gift, part-sale transaction.

## Case Law—Setbacks for the IRS

A series of Tax Court and federal court decisions rejected these IRS arguments. The courts denied that an FLP arrangement constituted a testamentary transfer, lacked economic substance and should be disregarded *per se*.<sup>2</sup> Where the FLP is validly formed under state law, a willing buyer of the FLP interests would have no reason to disregard the existence of the FLP. Thus, the IRS cannot simply disregard a validly formed FLP.

The courts also rejected arguments to disregard the FLP under IRC § 2703(a)(2) and to ignore restrictions on the sale of FLP interests under the FLP Agreement.<sup>3</sup> By enacting IRC § 2703, Congress did not intend to ignore validly formed entities and treat partnership assets as if directly held by the holder of an FLP interest. Since IRC § 2703(a)(2) did not apply, the IRC § 2703(b) safe harbor need not apply.

Further, the courts rejected arguments under IRC § 2704(b) to disregard restrictions on partner withdrawals and transfers of FLP interests in valuing such interests.<sup>4</sup> A provision in an FLP agreement restricting withdrawals of partners or transfers of FLP interests does not constitute an “applicable restriction” on the ability of the

FLP to liquidate and does not impose a more restrictive provision on FLP liquidation than exists under applicable state law.

The courts generally declined to find a taxable gift upon formation of the FLP. Either the founder received all FLP interests in return for the contributed property, or the founder received a capital account for its FLP interest equal to the full value of the property contributed to the FLP by the founder, negating any gift on formation.<sup>5</sup>

Nonetheless, the IRS often succeeded in reducing the amount of the discount applied to the value of FLP interests, typically based upon deficiencies asserted in the appraisals supporting the lack of control/minority interest and lack of marketability discounts claimed.<sup>6</sup>

## IRS Success?—IRC § 2036(a)(1)

Recently, the IRS has found some success under IRC § 2036, at least based on certain similar fact patterns. The full value of assets transferred by a founder to an FLP is retained in the founder’s taxable estate, despite the validity of the transfer and the FLP under state law.

IRC § 2036(a) provides that:

the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money’s worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death:

- (1) The possession or enjoyment of, or the right to the income from, the property, or

- (2) 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.

Several tax court decisions have found, based on somewhat similar fact patterns, that an implied agreement existed between the FLP, the other partners and the deceased founder, that the founder would continue to have the right to use, possess or enjoy the FLP assets and income therefrom.

For example, *Estate of Strangi v. Comr.*, T.C. Memo. 2003-145 (filed May 20, 2003) (*Strangi II*), involved a Texas limited partnership (SFLP) and a Texas corporation (Stranco) created by the decedent’s attorney-in-fact. Stranco received the sole 1 percent general partner interest in SFLP, and the decedent received the sole 99 percent limited partner interest in SFLP, pro rata based on assets contributed. Stranco and the decedent received capital accounts in SFLP equal to the full value of the assets they contributed. The decedent transferred real property, insurance policies and other passive assets (substantially cash and marketable securities) to SFLP. All formation documents were executed and signed by all directors, all formalities of formation were respected and SFLP and Stranco were validly formed under state law. The decedent had a terminal illness at the time of creation of SFLP and Stranco, and died slightly more than two months after their formation.

Following remand from the Fifth Circuit<sup>7</sup>, the tax court held that IRC § 2036(a)(1) applied to include the full value of the assets transferred to SFLP in the decedent’s estate. The tax court found at least an implied agreement permitting the decedent’s continued possession or enjoyment of the FLP assets and income therefrom. The tax court identified several facts supporting this finding, including that:

- the SFLP agreement contained no provisions precluding the decedent from designating himself as recipient of income from Stranco and SFLP;
- the formation of Stranco and SFLP, though valid, did not preclude retention of economic benefit by the decedent in his property transferred to SFLP;
- the fact that the decedent transferred almost all of his assets (98%);
- the assets contributed to SFLP were cash, securities and other passive assets, rather than an actively operating business;
- the lack of liquid assets held by the decedent following the formation and funding of SFLP to pay reasonably expected expenses (including estate taxes and expenses, bequests, care costs, etc.);
- the decedent continued to live in the residence (even though rent was charged for one year, this rent was not paid until two years after the decedent's death);
- evidence of pro rata distributions to the partners was not determinative of a non-2036(a)(1) arrangement, since Stranco only held a one percent interest in SFLP;
- SFLP assets were used to pay the decedent's personal expenses (surgery for the decedent's nurse, and estate taxes, expenses and bequests under the decedent's will), without objection by Stranco shareholders;
- the finding of an overall testamentary arrangement, "more resembling one man's estate planning than an arm's length joint enterprise" or business involving multiple parties (based in part on the type of assets contributed, the largely unilateral formation and operation of the arrangement, and the decedent's age and health at formation of SFLP);
- the "crucial" characteristic that vir-

tually nothing beyond formal title changed in the decedent's relationship to his assets following formation and funding of SFLP and Stranco, with the attorney-in-fact retaining control over all distributions; and

- loans and credit extended by SFLP were for the decedent's children and attorney-in-fact's spouse, never to third parties.

The tax court concluded that the exception to IRC § 2036 for bona fide sales for full and adequate consideration did not apply in this case, since the decedent's attorney-in-fact unilaterally prepared and executed the arrangement without any sale or meaningful bargaining from any other interested parties. In addition, based on *Harper*, no sale for full and adequate consideration occurred upon formation, since SFLP did not resemble a functioning business and the decedent merely "recycled" the same value through his limited partner interest, receiving a more than 99 percent interest in the same assets he contributed to SFLP.<sup>8</sup> Finally, the tax court distinguished prior cases finding IRC § 2036(a) inapplicable to partnership arrangements since, unlike the facts of those cases, SFLP held no actual operating business and accomplished no genuine pooling of interests or assets between unrelated parties.

Other tax court decisions applying IRC § 2036(a)(1) to FLP arrangements involve similar, or even more egregious, fact patterns.<sup>9</sup> While the application of IRC § 2036(a)(1) gives reason for pause, recent cases also applying IRC § 2036(a)(2) to an FLP are of more concern.

### IRS Success?— IRC § 2036(a)(2)

In addition to including SFLP assets in the decedent's estate under IRC § 2036(a)(1), in *Strangi II*, the tax court found that IRC

§ 2036(a)(2) also applied because, based on the facts, the decedent retained the right, in conjunction with the attorney-in-fact and other Stranco shareholders, to designate who enjoyed income from the partnership assets.<sup>10</sup>

The tax court rejected an argument based upon *United States v. Byrum*<sup>11</sup> that the fiduciary duties of the attorney-in-fact as manager of Stranco precluded application of IRC § 2036(a)(2). The tax court distinguished *Byrum*, stating that:

- no independent party held sole power over distributions from SFLP, instead the decedent's attorney-in-fact controlled distributions;
- the assets of SFLP were largely passive investments generating a predictable flow of income needing little meaningful fiduciary or substantive management, rather than an actual operating business subject to economic changes;
- in practice, the decedent's rights and control over SFLP assets exceeded the restrictions on his rights to the assets under the SFLP agreement;
- the decedent, acting together with his children, could liquidate SFLP, accelerating actual access of the decedent to the SFLP assets; and
- the vast majority of any alleged fiduciary duties ran to the decedent and to related parties rather than unrelated parties, save for the *de minimis* interest in Stranco of a charity that resulted in no meaningful oversight.

The tax court noted *Byrum* provided no basis for presuming that fiduciary obligations will be enforced in circumstances lacking the safeguards of business operations, meaningful independent interests or oversight and any genuine fiduciary impediments to the decedent exercising his rights regarding SFLP assets.<sup>12</sup>

Shortly before *Strangi II*, a federal district court found IRC § 2036(a)(2) applicable to assets transferred to a FLP. In *Kimbell v. United States*,<sup>13</sup> the court did not discuss specific assets contributed to the FLP, nor whether such assets constituted all or the majority of the decedent's available assets. Nonetheless, following an analysis similar to *Strangi II*, the court concluded that property contributed to the FLP by the decedent was included in the decedent's estate under IRC § 2036(a)(2). The decedent indirectly retained the power to remove and appoint the general partner under the FLP agreement as a result of his 99 percent limited partner interest, and therefore retained the indirect power to compel income and to appoint those who could receive income from the FLP.

The court rejected the claim, based on *Byrum*, that applicable fiduciary duties precluded finding the decedent retained the power to benefit from the income of the FLP. The court posited that the enactment of IRC § 2036(b) overruled *Byrum*, and also noted that the FLP agreement provided that the general partner owed no fiduciary duty to the FLP or to any partner. Finally, the court noted that, as the 99 percent partner, the decedent would owe such fiduciary duties largely to himself.

The court distinguished prior cases declining to find IRC § 2036(a)(2) applicable, because they involved multiple families pooling their assets. Unlike the dramatic change in the relationship of those families to the contributed assets by virtue of the limited partnership, in *Kimbell* the decedent's relationship to his assets was unchanged. The decedent's son was already co-trustee of the decedent's trust and was the manager of the limited liability company serving as the general partner of the FLP. Finally, the court rejected the bona fide sale exception to IRC § 2036(a), finding neither an arm's length transaction between unrelated par-

ties, nor adequate and full consideration, since the decedent's limited partner interest merely recycled the value of the assets he contributed.

## FLP Success?— Transfer/Bona Fide Sale Exception

*Harper*, *Strangi II* and *Kimbell* each allude to insufficient business operations or independent oversight of FLP's as a basis for rejecting the bona fide sale exception to IRC § 2036. However, two earlier decisions and a new tax court decision have declined to apply IRC § 2036 to an FLP, finding either no transfer of property or a bona fide sale for full and adequate consideration that preclude application of IRC § 2036.<sup>14</sup>

In *Church v. United States*,<sup>15</sup> the decedent and her children each contributed their undivided interest in a working ranch to an FLP in return for limited partner interests. Another family (Drake) also owned undivided interests in the ranch. The court accepted as valid the business reasons for forming the FLP—protection of the prop-

erty from creditors of individual partners, providing for centralized control of the property without potential interference from individual partners (based on past interference by one Drake family member that had to be bought out) and preparing for active cattle raising.

after signing the FLP agreement and prior to issuance of a certificate of formation for the FLP. The decedent's son subsequently executed the deed transfer and other documents the decedent would have signed. The formation of the corporation general partner and the re-titling of the securities account in the name of the FLP did not occur until approximately five months after the execution of the FLP agreement.

Nonetheless, the court found no expectation of impending death and held that the execution of the FLP agreement validly formed the FLP. The court found the interests owning a majority of the ranch changed significantly as a result of the FLP. Further, the decedent could not unilaterally amend the FLP agreement or dissolve the FLP. The court found the FLP to be *bona fide*, and that each partner's interest was proportional to the capital contributed, therefore the decedent made no gratuitous transfer. Without a gratuitous transfer, IRC § 2036 could not apply.

In *Harrison v. Comr.*,<sup>16</sup> an incompetent testator's family used powers of attorney to set up an FLP. The tax court held that IRC § 2036 did not apply to include the underlying FLP assets in the testator's estate, noting that the testator retained no rights in the property transferred to the FLP.

Unfortunately, there is little direct analysis of IRC § 2036 in these decisions. However, in *Estate of Stone v. Comr.*,<sup>17</sup> the tax court thoroughly considered application of IRC § 2036(a)(1) to an arrangement involving multiple FLPs and concluded that assets transferred by the decedents (husband and wife) to the FLPs were not included in their respective estates. The tax court found that:

- the FLPs were formed for valid non-tax reasons to settle litigation between the decedents' children over their parents' assets and to

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erty from creditors of individual partners, providing for centralized control of the property without potential interference from individual partners (based on past interference by one Drake family member that had to be bought out) and preparing for active cattle raising.

involve the children in the active management of their parents' assets;

- substantial negotiation of the FLP agreements and funding occurred with respect to each child (rather than a unilateral imposition of the arrangement by the decedents or by the children);
- after formation, the FLPs were actively managed and operated by the children and not by the decedents;
- at no time were the assets or income of the FLPs commingled with the decedent's assets or income, nor did the decedents' make personal use of any FLP assets;
- at all times each FLP was respected by the partners as a separate entity;
- the FLPs were each formed by substantial contributions of assets from both the decedents and their children;
- partner capital accounts in the FLPs reflected the fair market value of assets contributed by each partner;
- the decedents consulted financial experts and were careful to retain sufficient liquid assets to maintain the decedents' existing standard of living and costs;
- FLP distributions were made on a *pro rata* basis in accordance with each FLP agreement.

Potentially "bad" facts of the case included that Stone was a general partner, as well as limited partner of each FLP; that the decedents gave the other children the property the children then contributed to the FLPs; that the decedents died approximately one year and two and one-half years, respectively, after the date of formation of the FLPs and that each FLP made distributions to each of the decedents' estates to fund payment of federal and state estate taxes (but only with respect to estate taxes on the value of that FLP interest held by each decedent at death and not with respect to tax on that decedent's entire estate).

The IRS again asserted that the transfers merely recycled value. The tax court noted that for IRC § 2036 to apply there must be a transfer of property by the decedent, other than a *bona fide* sale for adequate and full consideration. Because the FLPs were formed for substantial business purposes, resulted from substantial arm's length negotiations, had economic substance, accomplished a genuine pooling of property and services and actually operated as joint enterprises for profit with active participation by the children, the tax court found the transfers constituted *bona fide* sales for full and adequate consideration precluding application of IRC § 2036. Unlike *Strangi II*, *Harper* and similar cases,<sup>18</sup> value was not merely "recycled" since the decedents received *pro rata* FLP interests in return for the contributions made to the FLPs, the decedents' respective FLP capital accounts reflected the fair market value of all property they contributed and all FLP partners were entitled to distributions of their capital accounts on dissolution.<sup>19</sup>

## IRS Also Attacks Present Interest Gift Exclusion

The IRS has also argued to limit annual exclusion deductions applied to transfers of an FLP interest, finding success in the case of *Hackl v. Comr.*<sup>20</sup> Hackl formed Treeco, LLC, to start an active tree-farming business, but projected losses through the first five years of operations and did not realize any net profits.

The tax court upheld the IRS denial of annual exclusion deductions under IRC § 2503(b)(1) related to LLC interests transferred, asserting that the gifts were not transfers of present interests in property. To qualify as a present interest gift, the interests transferred must confer a substantial present economic benefit by reason of use, possession, or enjoyment of property itself or income from the property. In this case, the LLC interests did not

convey a current substantial present economic benefit because:

- all distributions were subject to the manager's discretion;
- no distributions had been made, nor were any likely to be made since the business focused on a growth-only investment;
- members had no right to distributions except on dissolution, and while Hackl served as manager, only he could authorize a dissolution;
- transfer restrictions prevented any transfer of any LLC interest without the manager's approval; and
- members had no right to withdraw or receive their capital contribution from the LLC (unlike a Crummey withdrawal power where a recipient has an absolute right to withdraw under power granted).

## Summary

In light of the recent decisions regarding FLPs, the IRS is likely to continue to argue that stringent restrictions on transfers and growth-only assets jeopardize or prevent annual exclusion deductions for transfers of FLP interests. Using IRC § 2036(a)(2), the IRS may expand its use of IRC § 2036 beyond the "bad" fact patterns, and argue that any founder serving alone, or in conjunction with others (particularly relatives or controlled entities), directly or indirectly as a general partner of a partnership, managing member of a FLP, or trustee, has retained at least indirect control over FLP assets triggering inclusion of those assets in the founder's estate. This is particularly true if the entity holds only passive investments. Counsel who have formed such entities should consult with their clients for a careful review of the operations and documentation of the entity and additional planning changes as necessary. In light of the developing law, clients and counsel should establish a regular practice of meeting for checkups to review the operations



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- disbursements corresponding to the decedent's personal needs, including payment of estate expenses and estate taxes;
- distributions inconsistent with the FLP agreement;
- overall testamentary characteristics of the FLP arrangement indicating the relationship of the decedent to the assets remained unchanged during the decedent's lifetime (securities portfolio remained unchanged after transfer to the FLP, the unilateral nature of the arrangement more resembling one person's estate plan rather than arm's length transaction or joint enterprise between partners);
- commingling the decedent's personal funds and income with FLP funds and income; and
- the decedent's death a short time after forming the FLP

of any such entities and compliance with intended goals. ☞

#### Endnotes:

- 1 See, e.g., PLR 9723009; PLR 9725002; PLR 9730004; PLR 9735003; PLR 9736004; PLR 9802004; PLR 9804001; PLR 9842003.
- 2 See *Thompson v. Comr.*, T.C. Memo 2002-246 (Sept. 26, 2002); *W.W. Jones, II v. Comr.*, 116 T.C. No. 11 (Mar. 6, 2001); *Knight v. Comr.*, 115 T.C. No. 36 (Nov. 30, 2000); *Dailey v. Comr.*, T.C. Memo 2001-263 (Oct. 3, 2001); *Estate of Strangi v. Comr.*, 115 T.C. 478, 489-90 (2000) (*Strangi I*), *aff'd in part and rev'd on other grounds and remanded in part* 293 F.3d 279 (5th Cir. 2002); *Church v. United States*, 85 AFTR2d 2000-804, 2000-1 U.S.T.C. ¶ 60,369 (W.D. Tex. 2000), *aff'd* 268 F.3d 1063 (5th Cir. 2001).
- 3 See *Strangi v. Comr.*, 115 T.C. 478, 115 T.C. No. 35 (2000) (*Strangi I*), *aff'd in part and rev'd on other grounds and remanded in part* 293 F.3d 279 (5th Cir. 2002); *Church v. United States*, 85 AFTR2d 2000-804, 2000-1 U.S.T.C. ¶ 60,369 (W.D. Tex. 2000), *aff'd* 268 F.3d 1063 (5th Cir. 2001).
- 4 See *W.W. Jones, II v. Comr.*, 116 T.C. No. 11 (Mar. 6, 2001); *Knight v. Comr.*, 115 T.C. No. 36 (Nov. 30, 2000); *Kerr v. Comr.*, 113 T.C. 449, 474 (1999), *aff'd* 292 F.3d 490 (5th Cir. 2002).
- 5 See *W.W. Jones, II v. Comr.*, 116 T.C. No. 11 (Mar. 6, 2001); *Strangi v. Comr.*, 115 T.C. 478, 489-90 (2000) (*Strangi I*), *aff'd in part and rev'd on other grounds and remanded in part* 293 F.3d 279 (5th Cir. 2002); cf. *Shepherd v. Comr.*, 115 T.C. 376, 389 (2000) (founder formed FLP with sons and funded FP with real property and stock; gift on formation because sons received capital accounts in FLP based on value of property contributed to FLP by founder).
- 6 See, e.g., *W.W. Jones, II v. Comr.*, 116 T.C. No. 11 (Mar. 6, 2001); *Strangi v. Comr.*, 115 T.C. 478, 115 T.C. No. 35 (2000) (*Strangi I*), *aff'd in part and rev'd on other grounds and remanded in part* 293 F.3d 279 (5th Cir. 2002).
- 7 In *Estate of Strangi v. Comr.*, 115 T.C. 478 (2000) (*Strangi I*), *aff'd in part, rev'd and remanded in part*, 293 F.3d 279 (5th Cir. 2002), the tax court found that the limited partnership (SFLP) was validly formed under state statutes and must be respected as a separate entity, rejecting the various IRS arguments that IRC § 2703 applied to the SFLP agreement to value the other partnership interests at zero (as discussed above), that the transfer of property and assets to SFLP constituted a taxable gift, and that the decedent's interest in SFLP and Stranco should be valued using the IRS' calculation of applicable valuation discounts based upon lack of marketability and lack of control. However, the tax court raised the possibility that IRC § 2036(a) could apply to include the full value of the assets transferred to SFLP and

Stranco in the decedent's estate. The tax court denied as untimely an IRS motion to add the § 2036(a) argument as an additional grounds for inclusion of the SFLP assets in the decedent's estate. On appeal, the Fifth Circuit upheld the tax court's conclusions on the substantive issues mentioned above, but allowed the IRS leave to add the § 2036(a) argument as a ground to include the SFLP assets in the decedent's estate.

- 8 Contrast the tax court's finding in *Strangi II* that full and adequate consideration was lacking, due to the "recycling" of value through SFLP, with its conclusion in *Strangi I* that there was no gift on formation of SFLP because Strangi retained control over the entity and received a capital account equal to the fair market value of assets he contributed. Where a founder contributes all or nearly all of the assets of an FLP and such assets are not an operating business, the founder will face both gift on formation and 2036(a) inclusion arguments. To maximize the chances of rebutting such arguments, the founder's capital account should be credited with the fair market value of all assets contributed by the founder and the founder should relinquish even indirect control over the FLP. Less than a complete separation from the FLP assets may not be sufficient to successfully avoid both horns of the dilemma. See *Estate of Bischoff v. Commissioner*, 69 T.C. 32 (Oct. 20, 1977) (the mere power to affect the timing of the enjoyment of property is sufficient to attract a tax under IRC §§ 2036(a)(2) and 2038(a)(1)), citing *United States v. O'Malley*, 383 U.S. 627 (1966); *Lober v. United States*, 346 U.S. 335 (1953).
- 9 See *Thompson v. Comr.*, T.C. Memo 2002-246 (Sept. 26, 2002), *Estate of Harper v. Comr.*, T.C. Memo 2002-121 (May 15, 2002), *Reichardt v. Comr.*, 114 T.C. No. 9 (Mar. 1, 2000), and *Estate of Schauerhamer*, T.C. Memo 1997-242 (May 28, 1997), all involving FLP arrangements and activities with the result that the assets transferred by the founder to the FLP were included in the founder's estate under IRC § 2036(a)(1), with similar facts including:
  - funding of the FLP with all or nearly all of the decedent's total assets;
  - indirect, and sometimes direct, evidence indicating that all parties agreed FLP assets would finance the decedent's personal needs;
  - no change in investment holdings after contribution to the FLP;
  - continued personal use of residences or property after contribution to the FLP, with rent never paid or paid only after-the-fact;
  - the decedent's actual control of FLP accounts without significant roles by other partners;
  - lack of documentation of FLP activities similar to an actual operating business;
  - disproportionate disbursements from the FLP to the decedent;

- 10 The term "right" as used in IRC § 2036(a)(2) means "an ascertainable and legally enforceable power." See *United States v. Byrum*, 408 U.S. 125 (1972); *Estate of Trotter v. Comr.*, T.C. Memo 2001-250 (Sept. 21, 2001); *Estate of Wall v. Comr.*, 101 T.C. 300 (1993).
- 11 408 U.S. 125 (1972).
- 12 The tax court's conclusion, that it is only where unrelated third parties are involved that fiduciary duties actually limit the ability to designate persons to possess or enjoy the transferred property, conflicts with private letter rulings finding a donor's administrative powers do not automatically constitute a right or power to determine distributions triggering application of IRC § 2036(a). See, e.g., PLR 9415007, PLR 9131006 and PLR 8611004.
- 13 244 F. Supp. 2d 700 (N.D. Tex. 2003).
- 14 Three other tax court decisions involving family limited partnerships have been released with or since *Strangi II*, all upholding the validity of FLPs and the application of discounts for lack of control/minority interest and lack of marketability in FLP interests transferred. None of these cases discusses the application of IRC § 2036. See *McCord v. Comr.*, 120 T.C. No. 13 (May 14, 2003) (upholding a family limited partnership arrangement, finding IRC § 2704(b) inapplicable, and valuing the interest transferred only as an assignee interest applying reduced lack of marketability and lack of control/minority interest discounts without discussion of IRC § 2036. The tax court also considered claimed charitable deductions for partnership interests granted to charities pursuant to a formula (charity to receive the excess of total fair market value of transferred interest over a stated sum). After an intricate analysis of the discounts and expert opinions offered by both sides, the court held that it was not bound by the parties' determination of the amount and value of the gifted interest to the charity pursuant to the formula because the parties' formula referred to the "fair market value" of the property rather than the "fair market value as finally determined for gift tax purposes"); *Lappo v. Comr.*, T.C. Memo 2003-258 (Sept. 9, 2003); *Peracchio v. Comr.*, T.C. Memo 2003-280 (Sept. 25, 2003) (considering and applying appropriate lack of marketability and lack of control/minority interest discounts and expert opinions to FLP interests transferred without discussion of IRC § 2036).
- 15 *Church v. United States*, 85 AFTR2d 2000-804, 2000-1 U.S.T.C. ¶ 60,369 (W.D. Tex. 2000), *aff'd* 268 F.3d 1063 (5th Cir. 2001).
- 16 *Harrison v. Comr.*, T.C. Memo 1987-8 (Jan. 6, 1987).

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## Family Limited Partnership

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- 17 T.C. Memo 2003-309 (November 7, 2003). The tax court's approval in *Stone* of gifting assets to beneficiaries to facilitate substantial contributions by all partners in formation of the FLP may also present the opportunity to improve factual support for avoiding IRC § 2036 (at the expense of potential gift tax or unified credit use on the portion of any assets transferred as taxable gifts to beneficiaries).
  - 18 The tax court expressly rejected any claim by the IRS that the exception for a bona fide sale for full and adequate consideration could never apply where a transferor retains possession or enjoyment of, or the right to income from, the property transferred, as this argument would read the exception out of IRC § 2036 altogether.
  - 19 The tax court also found that the transfers to the FLPs by the decedents' children were bona fide sales for full and adequate consideration, rejecting the IRS' argument that because the children contributed property received as gifts from the decedents the children did not make transfers to the FLPs for purposes of IRC § 2036. The tax court noted that the children owned the property they contributed, that the decedents filed gift tax returns reporting the gifts to the children, and that the IRS had abandoned the substance over form argument it previously asserted.
  - 20 118 T.C. No. 14 (Mar. 27, 2002).
-