RECENT DEVELOPMENTS CONCERNING THE ESTATE TAX INCLUSION OF TRANSFERS TO A FAMILY LIMITED PARTNERSHIP

Brent B. Nicholson[*]

I. INTRODUCTION

In February, 2010 the taxpayer in *Estate of Shurtz v. Commissioner*[1] successfully challenged the Internal Revenue Service's attempt to include the value of underlying assets transferred to a family limited partnership (FLP) in the decedent's gross estate. The Tax Court decision is the most recent example of the tug of war between taxpayers and the Service, arbitrated by the tax and United States appellate courts, over whether lifetime contributions made to a FLP are included in a decedent's estate at their full date of death value or, rather, the discounted value of the fractional partnership interest owned at death.

* J.D., C.P.A. (inactive); Associate Professor of Legal Studies, Bowling Green State University.

1. 99 T.C.M. (CCH) 1096 (2010).

The tool the Service uses to argue in favor of full estate inclusion is section 2036(a) of the Internal Revenue Code.[2] That section draws into a decedent's estate the value of assets transferred during life over which the decedent retained a lifetime interest or control, or retained the power to direct the enjoyment of the property.[3] The United States Supreme Court has referred to section 2036 as reaching "transfers that were essentially testamentary."[4] While the very validity of the FLP was initially challenged by the Service,[5] its emphasis has now shifted to argue the estate tax inclusion under section 2036.[6] The courts have steered a middle course between capitulation to the Service's position and a blanket rejection of it. The *Shurtz* case is the latest iteration of this ongoing dispute which is largely fact dependent.[7] Nevertheless, the case law has developed an increasingly well-defined path that taxpayers can follow. After a brief examination of the statutory and regulatory background, this paper will summarize the significant cases prior to *Shurtz*,[8] the significant cases in the last year,[9] discuss the facts and holdings of *Shurtz*,[10] and then outline the coordinates that have emerged to guide taxpayers[11].

II. THE STATUTORY AND REGULATORY BACKGROUND

The intent of section 2036(a) is to, "prevent parties from avoiding the estate tax by means of testamentary substitutes that permit a transferor to retain lifetime enjoyment of purportedly transferred property."[12] Section 2031 is the broad inclusionary provision of the

---

2. 26 U.S.C § 2036(a).

3. *Id.*

4. United States v. Estate of Grace, 395 U.S. 316, 320 (1969) ("inter vivos transfers that were testamentary in nature"), *quoted in* Estate of Bongard v. Comm'r, 124 T.C. 95, 118 (2005) and *Estate of Shurtz*, 99 T.C.M. (CCH) at *17-18.

5. "[T]he government has challenged family limited partnerships on a number of theories, the broadest of which is simply to disregard the partnership for tax purposes on grounds that it lacked economic substance or a business purpose." Brant J. Hellwig, *On Discounted Partnership Interests and Adequate Consideration*, 28 VA. TAX REV. 531, 538 (Winter, 2009) (citations omitted). *See also* BNA Tax Management Portfolio No. 812-3rd, A-18. ("In 1997 and 1998, the National Office issued seven Technical Advice Memoranda in which it refused to recognize family limited partnerships, and, in one case, an LLC for transfer tax purposes.").

6. *See Estate of Shurtz*, 99 T.C.M. (CCH) 1096.

7. *Id*.

8. *See infra* notes 20-80 and accompanying text.

9. *See infra* notes 81-191 and accompanying text.

10. *See infra* notes 192-235 and accompanying text.

11. *See infra* Section VI.

12. Strangi v. Comm'r, 417 F.3d 468, 476 (5th Cir. 2005), *quoted in Estate of Shurtz*, 99 T.C.M. (CCH) at *17.

estate portion of the tax code which broadly describes the gross estate.[13] More specific instances of includable property are described in Sections 2032-46. Because of its importance to the topic discussed herein, it is worthwhile to quote section 2036(a) in its entirety:

> Sec. 2036. Transfers with Retained Life Estate
>
> (a) General Rule.—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 the 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.[14]

In the context of the family limited partnership the argument of the Service is that a decedent that has transferred property to an FLP but taken an interest as a general and/or limited partner falls within the terms of the above provision under either sub-paragraph (a)(1) or (a)(2), or both. If the retained interest is present the argument shifts to whether the decedent's transfer qualifies for the parenthetical exception for bona fide sales for adequate and full consideration.

The Regulations issued in support of section 2036(a) provide only incremental guidance.[15] Of relevance to the FLP is Treas. Reg. § 20.2036-1(c), which provides that an interest included under 2036 includes the value of the entire transferred property.[16] This is where the point of conflict between the Service and taxpayers occurs—the Service seeks to include the entire date of death value of the property transferred whereas the taxpayer argues that only the date of death value of the partnership interest is included (under section 2031), and that value is

13. Section 2031 provides, "The value of the gross estate . . . shall be determined by including . . . the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated." 26 U.S.C. § 2031(a).

14. *Id.* § 2036(a)(1)-(2).

15. 26 C.F.R. § 20.2036-1.

16. *Id.* § 20.2036-1(c).

discounted to reflect marketability and minority discounts.[17] Those discounts collectively are often asserted to be as high as 35-50% and, given the substantial values of the assets typically involved, may generate millions of dollars in estate tax savings.[18] The Regulations also provide, "An interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, express *or implied*, that the interest or right would later be conferred."[19] The following section details the recent application of the section 2036 language in some specific cases, leading to the *Shurtz* decision in early 2010.

III. THE CASE LAW BACKGROUND

The cases involving the impact of section 2036(a) on the inclusion in a decedent's estate of assets contributed to an FLP during life have been numerous over the last five years.[20] At this point, it seems that the legal rules for the area are fairly well-settled, but the factual applications cause disputes.[21] This section will explore the more noteworthy recent cases in the area, specifically the appellate court decisions in *Kimbell*[22]

---

17. The discount for marketability reflects the fact that there is no ready market for sales of the partnership units. The minority discount, often referred to as a lack of control discount, reflects the fact that a potential buyer would discount the value of the interest because they would be acquiring an interest that did not exert control over the entity and would theoretically be subject to control by majority interest(s). Further, in the context of a limited partnership, a limited partner has only limited rights to participate in management.

18. Hellwig, *supra* note 5, at 534-36.

19. § 20.2036-1(c) (emphasis added).

20. A somewhat less than exhaustive list would include: Estate of Bigelow v. Comm'r, 503 F.3d 955 (9th Cir. 2007); Estate of Korby v. Comm'r, 471 F.3d 848 (8th Cir. 2006); Estate of Abraham v. Comm'r, 408 F.3d 26 (1st Cir. 2005); Kimbell v. United States, 371 F.3d 257 (5th Cir. 2004); Thompson v. Comm'r, 382 F.3d 367 (3d Cir. 2004); Estate of Murphy v. United States, No. 07-CV-1013, 2009 U.S. Dist. LEXIS 94923 (D. Ark. Oct. 2, 2009); Keller v. United States, No. V-02-62, 2005 U.S. Dist LEXIS 25819 (S.D. Tex. Sept. 20, 2005); Estate of Black v. Comm'r, 133 T.C. 340 (2009); Estate of Bongard v. Comm'r, 124 T.C. 95 (2005); Estate of Miller v. Comm'r, 97 T.C.M. (CCH) 1602 (2009); Estate of Malkin v. Comm'r, 98 T.C.M. (CCH) 57938 (2009); Estate of Jorgensen v. Comm'r, 97 T.C.M. (CCH) 1328 (2009); Estate of Hurford v. Comm'r, 96 T.C.M. (CCH) 422 (2008); Estate of Mirowski v. Comm'r, 95 T.C.M. (CCH) 1277 (2008); Estate of Rector v. Comm'r, 94 T.C.M. (CCH) 567 (2007); Estate of Erickson v. Comm'r, 93 T.C.M. (CCH) 1175 (2007); Estate of Rosen v. Comm'r, 91 T.C.M. (CCH) 1220 (2006); Estate of Schutt v. Comm'r, 89 T.C.M. 1353 (2005).

21. *See Estate of Erickson*, 93 T.C.M. (CCH) 1175; *Estate of* Black, 133 T.C. 340; *Estate of Bongard*, 124 T.C. 95; *Estate of Rosen*, 91 T.C.M. (CCH) 1220; *Kimbell*, 371 F.3d 257; *Estate of Shurtz*, 99 T.C.M. (CCH) 1096.

22. 371 F.3d 257.

and *Bigelow*[23] and the Tax Court decision in *Estate of Bongard*.[24] Those cases will be discussed in chronological order.

Based on the language of section 2036(a), there are two prongs that must be satisfied in order to be within the parenthetical exception to the inclusive sweep of the Section.[25] That is, to escape 2036, the lifetime transfer by the decedent must be a bona fide sale and it must be for adequate and full consideration in money or money's worth.[26] The prongs are facially independent but clearly related.[27]

A. *Kimbell v. United States*[28]

The Service assessed an estate tax deficiency based on the failure to include the full value of property Ruth Kimbell had transferred to a limited partnership in exchange for a limited partnership interest.[29] The estate paid the tax and sued for a refund in district court, which granted a summary judgment in favor of the government.[30] On appeal, the Fifth Circuit reversed.[31]

In brief, Mrs. Kimbell's living trust joined with her son, his wife, and a family limited liability company (LLC) to form the R.A. Kimbell Property Co., Ltd., limited partnership.[32] The living trust (effectively Mrs. Kimbell) contributed $2.5 million in various assets, including oil and gas interests and royalties, in exchange for a 99% limited partnership interest.[33] The LLC was the 1% general partner so Mrs. Kimbell effectivelycontrolled 99.5% of the limited partnership because of her interest in the LLC.[34] She retained approximately $450,000 outside the partnership.[35] The partnership agreement included a detailed and lengthy recitation of the purposes of the partnership along with

23. 503 F.3d 955.
24. 124 T.C. 95.
25. 26 U.S.C. § 2036(a).
26. *Id.*
27. As stated in Bigelow v. Commissioner, 503 F.3d 955 (9th Cir. 2007), "[t]he validity of the adequate and full consideration prong cannot be gauged independently of the non-tax related business purposes involved in making the bona fide transfer inquiry . . . . In this context we must consider the 'bona fide sale' and 'adequate and full consideration' elements as interrelated criteria." *Id*. at 969.
28. 371 F.3d 257 (5th Cir. 2004).
29. *Id*. at 260.
30. *Id*.
31. *Id*. at 270.
32. *Id*. at 259.
33. *Id*.
34. *Id*.
35. *Id*.

several restrictions on the transfer of interests, limitations on the ability to withdraw, and the procedure for replacement of the general partner.[36] At Mrs. Kimbell's deaths the Internal Revenue Service sought to include the full value of the assets transferred to the limited partnership in her estate while the estate included only the discounted value (based on lack of marketability and control) of her partnership interest.[37] The focus on appeal was whether Mrs. Kimbell's transfers were bona fide sales for adequate and full consideration.[38] The circuit court found the transactions to be so.[39]

Relying on its own and the only circuit court decision at the time, *Wheeler v. United States*,[40] the court held that, while subject to greater scrutiny, family transactions were not automatically invalid.[41] The inquiry was to be one based on objective facts.[42] Tax motives did not preclude a good faith finding although tax motives alone would not satisfy the exclusion.[43] A transaction was bona fide if there was an actual parting of ownership in exchange for an actual conferral of a partnership interest.[44] A transfer was for adequate and full consideration if the exchange was "roughly equivalent."[45]

Here, the court said, the transaction was bona fide because there were substantial business and nontax reasons for the transfer, Mrs. Kimbell retained significant assets outside the limited partnership, the assets in the limited partnership consisted, at least in part, of working assets that required active management, and partnership formalities were observed.[46] It was not, in short, a sham, a dodge, or mere "recycling of value" even under the more rigorous standards accorded a family transfer.[47]

Adequate and full consideration was present due to the fact that the partnership interest received was proportionate to the assets contributed, contributions were properly reflected in the partner's capital accounts, and at dissolution assets were to be distributed consistent with capital

36. *Id*. at 259-60.
37. *Id*.at 260.
38. *Id*. at 261-69.
39. *Id*. at 269.
40. 116 F.3d 749 (5th Cir. 1997).
41. *Kimbell*, 371 F.3d at 263, 265.
42. *Id*. at 263-64.
43. *Id*. at 264 ("[T]ax planning motives do not prevent a sale from being 'bona fide' if the transaction is otherwise real, actual, or genuine." (citing *Wheeler*, 116 F.3d at 769-70)).
44. *Id*. at 265.
45. *Id*.
46. *Id*. at 267-68.
47. *Id*. at 269.

account balances.[48] Notably, and in contrast to the district court, the circuit court did not find it incongruous that assets with a particular value on the date of contribution could thereafter have a substantially reduced value by virtue of their presence in a partnership.[49] According to the circuit court, the reduced value reflected the trade-off for benefits gained (efficient management, preservation of assets, appreciation, and shelter from liability), and the fact that the fair value of the partnership interest needed to reflect discountsfor marketability and control.[50]

B. *Estate of Bongard v. Commissioner*[51]

This 2005 Tax Court regular decision was a significant opinion in the section 2036/family limited partnership jurisprudence and is frequently cited as authority.[52] The particular facts of this highly complex case are of less significance than the guidelines the court advanced for these type cases. What follows is a greatly simplified synopsis of those facts.

The relevant entities in the case were the Bongard Family Limited Partnership (BFLP) in which decedent owned a 91.28% limited partnership interest and WCB Holdings, and a limited liability company in which decedent owned an interest and which, in turn, owned a portion of BFLP.[53] The general partner of BFLP was an irrevocable trust established by the decedent.[54] The issues in the case surrounded the inclusion of closely held stock (where Bongard was CEO and the only director) that Bongard transferred to WCB Holdings and his subsequent transfer of certain WCB Holdings units to BFLP.[55] The court held the transfers to WCB to be within the section 2036 exception but those to BFLP were not.[56] It further found that Bongard had retained a sufficient

48. *Id*. at 266, 269.

49. *Id*. at 265 (citing Estate of Stone v. Comm'r, T.C.M. (CCH) 551 (2003)). The circuit court called the district court's and Service's position a "mixing apples and oranges." *Id*. at 266.

50. The estate took a combined discount of 49% for lack of control and marketability, which seems aggressive given Mrs. Kimbell's effective 99.5% interest in the limited partnership. *Id*. at 269-70.

51. 124 T.C. 95 (2005).

52. *See* Estate of Korby v. Comm'r, 471 F.3d 848 (8th Cir. 2006); Estate of Bigelow v. Comm'r, 503 F.3d 955 (9th Cir. 2007); Estate of Miller v. Commr, 97 T.C.M. (CCH) 1602 (2009).

53. *Estate of Bongard*, 124 T.C. at 98.

54. *Id*.

55. *Id*. at 96 (discussing transfers to WCB). *Id*. at 112-13 (discussing transfers to BFLP).

56. *Id*. at 125 (discussing transfers to WBC). *Id*. at 131 (discussing transfers to BFLP).

interest in the units transferred to BFLP to bring them within section 2036's inclusive effect.[57]

The court began its analysis with a review of the decisions to that time.[58] Synthesizing those cases the court said,

> In the context of family limited partnerships, the bona fide sale for adequate and full consideration exception is met where the record establishes the existence of a *legitimate and significant nontax reason* for creating the family limited partnership, and the transferors received partnership interests proportionate to the value of the property transferred . . . . The objective evidence must indicate that the nontax reason was a significant factor that motivated the partnership's creation . . . . A significant purpose must be an actual motivation, not a theoretical justification."[59]
>
> . . . .
>
> . . . [T]he bona fide sale exception in section 2036(a) is applicable only where there was *an arm's length transaction* . . . .
>
> . . . Was the transaction carried out in a way that the ordinary parties to a business transaction would deal with each other?"[60]

The court went on to indicate factors that would lead to a finding that a sale was not bona fide, including a taxpayer on both sides of the transaction, a lack of sufficient retained assets after the transfer, commingling of personal and partnership assets, and a failure to actually transfer the property.[61] On the facts of the case the court determined that the transfers of closely held stock to WCB Holdings were bona fide because they did have a legitimate and significant nontax purpose (facilitation of greater liquidity),[62] and were for adequate and full consideration because the resulting holdings in WCB were proportionate

---

57. *Id*. at 131. Specifically, Bongard retained the enjoyment of income from the transferred property bringing it within the terms of section 2036(a)(1). *Id*.

58. The court reviewed Estate of Harrison v. Comm'r, 52 T.C.M. (CCH) 1306 (1987); Estate of Harper v. Comm'r, 83 T.C.M. (CCH) 1641 (2002); Estate of Thompson v. Comm'r, 84 T.C.M. (CCH) 374 (2002), *aff'd*, 382 F.3d 367 (3d Cir. 2004); Estate of Strangi v. Comm'r, 85 T.C.M. (CCH) 1331 (2003); Estate of Stone v. Comm'r, 86 T.C.M. (CCH) 551 (2003); Estate of Hillgren v. Comm'r, 87 T.C.M. (CCH) 1008 (2004). *Estate of Bongard*, 124 T.C. at 114-18.

59. *Estate of Bongard*, 124 T.C. at 118 (emphasis added) (internal citations omitted).

60. *Id*. at 122-23 (emphasis added) (quoting Dauth v. Commissioner , 42 B.T.A. 1181,1189 (1940) regarding the meaning of that standard, and citing *Estate of Harper*, 83 T.C.M. (CCH) 1641 (2002) regarding the use of the arm's length standard.).

61. *Id*. at 118-19.

62. *Id*. at 122.

to the property transferred.[63] As to the transfers to BFLP, however, the court found that no asserted nontax reasons for forming BFLP were credible, but merely resulted in reshuffling the form of ownership to reap tax advantages.[64] There was no additional credit protection of the assets, no investment management employed, and no gifting of limited partnership interests to protect unified ownership of the underlying stock—thus the transfers were not bona fide.[65]

Having ascertained that the exception did not apply, Mr. Bongard was also found to have possessed a retained interest in the assets transferred (WCB units) to BFLP sufficient to pull them into his estate under section 2036(a)(1).[66] The retention was found in an implied understanding that Bongard would continue to control the transferred property by virtue of his 91% ownership of the limited partnership owning them and the fact that the partnership did and could do nothing but hold title to the stock without action by Mr. Bongard.[67] He effectively controlled the units despite the existence of the limited partnership.[68]

C. Estate of Bigelow v. Commissioner[69]

The decedent in this 2007 Ninth Circuit decision, like the decedent in *Bongard*, was found to have retained an implied section 2036(a) lifetime interest and did not qualify for the bona fide sale exception.[70] The result was not surprising given the facts.

Taxpayer's decedent's (Mrs. Bigelow) primary asset was residential rental property which she transferred to a limited partnership.[71] The property was collateral for two loans that remained in decedent's name.[72] Because she did not retain sufficient other assets outside the partnership for the debt service on the loans, the partnership ended up making the loan payments on her behalf, as well as making payments to decedent for living expenses.[73] As the issue of whether there was an implied agreement that Mrs. Bigelow retained the

63. *Id*. at 124.
64. *Id*. at 129.
65. *Id*. at 127-29.
66. *Id*. at 131.
67. *Id*. at 130-31.
68. *Id*. at 131.
69. 503 F.3d 955 (9th Cir. 2007).
70. *Id*. at 973.
71. *Id*. at 960.
72. *Id*.
73. *Id*. at 961.

income/benefits of the transferred property was a question of fact, the appellate court reviewed it only for clear error.[74] The Tax Court had found such an implied agreement and the Court of Appeals upheld it as not being clearly erroneous.[75] The more substantive portion of the opinion regards the potential application of the bona fide sale exemption.

The court first agreed with the Fifth Circuit's holding in *Kimbell* and the Third Circuit's holding in *Estate of Thompson v. Commissioner* that an intra-family transfer was not automatically lacking in good faith.[76] It also agreed that intra-family transactions should receive closer examination than non-family transfers and that an objective standard was utilized in making the good faith assessment.[77] The Ninth Circuit panel found that the transactions did not qualify for the exception due to: (1) the lack of assets retained for living expenses, (2) the lack of asset management needed or employed, (3) the failure of the partnership to assume the debt on the property when the property was transferred to it, (4) the lack of obedience to partnership formalities evidenced by the failure to charge decedent's capital account for the partnership's payments on the debt, (5) the lack of an identified and real liability threat, and (6) the lack of insulation from any potential liability because of Bigelow's revocable trust being both a general and limited partner of the partnership.[78] Given all of these deficiencies in the nontax reasons for creating the limited partnership, the court had little problem finding that the Tax Court had not erred in finding a lack of good faith.[79] The appellate court, like the Tax Court, concluded that the transfer was made to aid in gifting to decedent's children and grandchildren (a testamentary rather than a nontax purpose) and, in the process, take advantage of discounts in valuation.[80]

74. *Id*. at 964.

75. *Id*. at 967.

76. *Id*. at 969. *See* Estate of Kimbell v. United States, 371 F.3d 257 (5th Cir. 2004); Estate of Thompson v. Comm'r, 382 F.3d 367 (3d Cir. 2004).

77. *Estate of Bigelow*, 503 F.3d at 969-70 (citing Estate of Bongard v. Comm'r, 124 T.C. 95 (2005); *Kimbell*, 371 F.3d 257; Estate of Korby v. Comm'r, 471 F.3d 848, 852 (8th Cir. 2006)). Ascertaining that this was Congress's intent in amendment section 2036(a) in 1976 (citing Wheeler v. Comm'r, 116 F.3d 749 (5th Cir. 1997)). *Id*. at n.5.

78. *Id*.at 970-72.

79. *Id*. at 973.

80. *Id*.

IV. THE RECENT DECISIONS

Over the last year or so, there have continued to be a flurry of decisions on the section 2036/family limited partnership front.[81] This section discusses those decisions.

A. *Estate of Jorgensen v. Commissioner*[82]

Jorgensen represents a taxpayer defeat, although, again, not an unexpected one given its facts. During Erma Jorgensen's lifetime she and her husband accumulated over $2 million in marketable securities, utilizing a conservative buy and hold strategy.[83] The Jorgensens, including their two children, formed a limited partnership with the children and Ms. Jorgensen's husband as the general partners.[84] Ms. Jorgensen and her husband contributed about a half million dollars to the partnership for half the limited partnership interests, the remainder going to children and grandchildren.[85] After her husband's death in 1996, Mrs. Jorgensen formed a second limited partnership, funding it with approximately $2.5 million of her assets and those of her late husband's estate—resulting in her ownership of slightly less than 80% of the limited partnership interest and her husband's estate with about 20%.[86] Again, the children were the general partners.[87] Gifts to the children and grandchildren over the years somewhat reduced Ms. Jorgensen's share of the partnership.[88]

The partnerships were classically mismanaged for the purpose of avoiding inclusion in Mrs. Jorgensen's estate (she died in 2002).[89] The deficiencies included: a passive "buy and hold" management of assets consisting only of marketable securities (not alone fatal, however), a failure to keep records, a checking account that went unreconciled, a failure to make pro-rata distributions as required, a mingling of partnership and personal accounts, a failure to file required gift tax

81. *See* Estate of Jorgensen v. Comm'r, 97 T.C.M. (CCH) 1328 (2009); Estate of Miller v. Comm'r, 97 T.C.M. (CCH) 1602 (2009); Estate of Roger Malkin v. Comm'r, 98 T.C.M. (CCH) 57938 (2009); Estate of Black v. Comm'r 133 T.C. 340 (2009); Estate of Murphy v. U.S., No. 07-CV-1013, 2009 U.S. Dist. LEXIS 94923 (D. Ark. Oct. 2, 2009).

82. *Estate of Jorgensen*, 97 T.C.M. (CCH) 1328.

83. *Id*. at *3.

84. *Id*. at *5-6.

85. *Id*.

86. *Id*. at *9.

87. *Id*.

88. Gift tax returns should have been filed as the gifts exceeded the $10,000 annual exclusion amount but were not. *Id*. at *10.

89. *Id*. at *12-17.

returns, withdrawals from one partnership repaid to the other, attorney bills that did not differentiate between partnership and personal services, payment of Mrs. Jorgensen's federal and California estate taxes from one of the partnerships, and, tellingly, letters that exposed the transparent attempt to use the partnerships for estate tax savings.[90]

Judge Haines had little trouble, or choice, in deciding that the property transferred by Mrs. Jorgensen to the partnerships had to be included in her estate under section 2036(a).[91] Citing *Bongard*,[92] the court found that there were no significant and legitimate nontax reasons for the creation of the partnerships.[93] The reasons cited by the taxpayer (more efficient management, financial education and family unity, perpetuation of a buy and hold investment strategy, and restraining of one child's spending habits) were found not to be credible.[94] In contrast, the Service's arguments that the partnerships were formed to provide the opportunity to utilize discounts, they failed to obey formalities of partnership operation, and the absence of an arm's length distance between taxpayers in the transactions compelled a finding that the transfers to the partnerships were not bona fide.[95]

Because Judge Haines did not hold the transfers to be bona fide, he proceeded under section 2036(a)(1) to examine if Mrs. Jorgensen retained an interest in the property transferred as of the date of her death.[96] Again, this was a relatively easy call. Mrs. Jorgensen took distributions from the partnership to make gifts to her grandchildren and substantial distributions were made to pay her estate taxes and other expenses.[97] This was done despite the fact that the partnership agreement required pro-rata distributions.[98] Based on these facts, the court found that there was an implied understanding that Mrs. Jorgensen retained the benefits of ownership of the transferred property.[99] Therefore, inclusion of the property's value was mandated under section 2036.[100]

---

90. *Id*.
91. *Id*. at *20-41.
92. Estate of Bongard v. Comm'r, 124 T.C. 95 (2005).
93. *Estate of Jorgensen*, 97 T.C.M. (CCH) 1328 ("[T]he transactions were not at arm's length and . . . the partnerships held a largely untraded portfolio of marketable securities.").
94. *Id*. ("[N]one of those alleged reasons are mentioned in contemporaneous documentation, and the estate has failed to establish that any of the reasons were significant and legitimate.").
95. The Service did not contest that the transfers were for adequate and full consideration. *Id.*
96. *Id*.
97. *Id*.
98. *Id*.
99. *Id*.
100. *Id*.

B. *Estate of Miller v. Commissioner*[101]

Miller is an interesting case because the Tax Court found two different estate tax treatments applicable to two different transfers to an FLP.[102] The first, made in 2002, qualified for the section 2036(a) bona fide sale exception, but the second, made in 2003, did not.[103] Although the transfers are similar, the difference between them and the resulting tax effect is instructive.

In 2001, Valeria Miller, at age eighty-six, established a family limited partnership with her son as general partner, and herself (as trustee of her revocable living trust) and her children as limited partners.[104] Mrs. Miller owned 92%, her children collectively owned 7%, and the general partner 1%.[105] The general partner had sole management authority.[106] Securities were not actually transferred to the partnership until April, 2002 and constituted 77% of Mrs. Miller's net worth.[107] Further transfers of roughly $1 million were made in May, 2003, after Mrs. Miller suffered serious injury in a fall.[108] She died on May 28, 2003.[109] The partnership interest of Mrs. Miller was included in her estate after taking a 35% discount.[110] The limited partnership made distributions to the estate to enable payment of the estate tax.[111]

The Tax Court found the April 2002 transfers to be bona fide transfers for adequate and full consideration.[112] The Court cited "legitimate and substantial nontax business reasons" for creating the partnership: active management of the contributed securities consistent with the investment philosophy of her deceased husband.[113] The active management consisted of the general partner's charting of stocks and trading based on that activity—spending about forty hours a week doing

101. Estate of Miller v. Comm'r, 97 T.C.M. (CCH) 1602 (2009).
102. *Id*. at *43.
103. *Id*.
104. *Id*. at *6-7.
105. *Id*. at *8-9.
106. *Id*. at *9.
107. *Id*. at *12.
108. *Id*. at *16.
109. *Id*.
110. *Id*. at *28-29. The court did not indicate the nature of the discount, but presumably it was for lack of marketability and/or lack of control. *Id.* at 29. In any event, the Service did not contest the amount of the discount, claiming that the discount issue was moot since they argued that the full value of the property transferred was includable. *Id.*
111. *Id*. at *19.
112. *Id*. at *32.
113. *Id*.

so.[114] Additionally, the court cited Mrs. Miller's general good health and retention of sufficient assets outside the partnership for her living expenses.[115] The fact that the partnership paid her trust's margin account did not negate a finding of good faith.[116] There was no discussion of the adequacy of the consideration requirement.[117]

As for the May 2003 transfers, the court reached a different conclusion.[118] With respect to those transfers, the significant difference was Mrs. Miller's rapid decline in good health resulting from her fall.[119] As a result, the court concluded that the sole reason for those transfers was a desire to reduce her taxable estate.[120] The fact that distributions from the estate were used to pay Mrs. Miller's estate tax liability demonstrated that she had depleted her estate with the transfers, which, in turn, was evidence that she retained the possession, enjoyment, or income from the transferred property.[121] That triggered inclusion in her estate of the May 2003 transfers under section 2036(a)(1).[122]

C. *Estate of Malkin v. Commissioner*[123]

The estate in this case was assessed an estate tax deficiency of $6.1 million along with gift tax deficiencies for three years totaling nearly $11.5 million.[124] The decedent, Roger Malkin, was the general partner of two family limited partnerships with himself and two trusts (for his two children) as limited partners of each.[125] One FLP (MFLP) contained stock, and the other (CRFLP) contained stock and decedent's interests in four family LLC's that he and his son either totally owned or controlled.[126] Mr. Malkin transferred $16.8 million of stock to MFLP in exchange for a general partnership interest and about a 98.5% limited

114. *Id*. at *33.
115. *Id*. at *36.
116. *Id*. at *37-38.
117. *See id.*
118. *Id*. at *38.
119. *Id*.
120. *Id*. at *39 (citing Estate of Erickson v. Comm'r, 93 T.C.M. (CCH) 1175 (2007) and Estate of Rosen v. Comm'r, 91 T.C.M. (CCH) 1220 (2006) for the proposition that the age and health of the transferor and the proximity of the transfers to the decedent's death were relevant to the good faith assessment).
121. *Id*. at *41.
122. *Id*. at *41-42.
123. 98 T.C.M. (CCH) 57938 (2009).
124. *Id*. at *2.
125. *Id*. at *3.
126. *Id*.

partnership interest.[127] Shortly thereafter, Malkin as general partner, and the trustees of the limited partners collateralized a personal loan to Malkin with assets of MFLP, which Malkin then personally guaranteed.[128]

Malkin established CRFLP a little over a year after MFLP but, after a diagnosis of pancreatic cancer.[129] Initially, Malkin owned all general and limited partnership interests but sold the limited partnership units to two trusts in exchange for a 10% down payment plus a promissory note for the remainder.[130] Malkin then transferred personal funds to the trusts to make the down payment.[131] He later transferred 80,000 shares of stock to CRFLP—shares that had recently been pledged on a personal loan to Malkin from Morgan Guaranty.[132] The Internal Revenue Service sought inclusion of the property transferred to both FLP's arguing that there was an express or implied agreement with the trustees for Malkin to retain the benefits of the property.[133]

Judge Halpern tackled the section 2036(a)(1) issue first.[134] He found that there was an implied agreement that Malkin would retain the benefits of ownership of the stock transferred to the FLP's bringing the transfers within the purview of section 2036(a)(1).[135] Despite the stock's presence in the partnership it was still used to benefit Malkin by its use as collateral for his personal indebtedness.[136] His control over the assets was diminished little by their presence in the partnership.[137] Having determined that Malkin retained the necessary benefit of the transferred property to trigger section 2036(a)(1), the court turned to a consideration of whether the transfers met the bona fide sale for adequate and full consideration exception.[138]

---

127. *Id*. at *8-9.

128. *Id*. at *11.

129. *Id*. at *12.

130. *Id*. at *14. Malkin paid for the partnership interests with his ownership interests in several LLC's which he and his son owned. *Id*.

131. *Id*.

132. *Id*. at *15.

133. *Id*. at *19. The Service's position was based on the use of the assets of both limited partnerships to secure the debts of Malkin. *Id*.

134. *Id*.

135. *Id*. at *21.

136. *Id*. at *22. ("Decedent applied all the . . . stock he transferred to FLP's toward the discharge of *his* obligations." (emphasis added) (citing Estate of Bigelow v. Comm'r, 503 F.3d 955 (9th Cir. 2007) in support)).

137. *Id*. at *24.

138. *Id*. at *25.

The court's conclusion was that there was not a bona fide reason for the transfers.[139] Most importantly, the transfers were said to have had no nontax purpose,[140] and there was no centralized management benefit, as asserted, because Malkin was the only one to contribute assets to the partnerships.[141] Management was therefore centralized in him both before and after the transfers.[142] Neither of the children nor their trusts contributed to the partnerships.[143] The fact that one of the children also owned stock in the closely held business but did not transfer it to the partnerships undermined the argument that the FLP was created to prevent the sale of stock.[144] Finally, the court said the passive holding of the stock reinforced the lack of nontax motivation for the transactions.[145]

D. *Estate of Murphy v. United States*[146]

This late 2009 U.S. District Court decision involved the substantial business and investment holdings of Charles Murphy and the entities he and his family created to hold and manage those assets.[147] Murphy formed the entities, a limited partnership and limited liability company, in concert with two of his four children for the purpose of managing and preserving family assets and transferring them to later generations.[148]

Prior to his death in 2002, Charles Murphy was a 49% owner of the limited liability company that was the general partner of the limited partnership, and two of his four children were each 25.5% owners.[149] He was 77 and in good health at the time of their creation.[150] Mr. Murphy and the two children contributed assets primarily consisting of stock of three companies with which Mr. Murphy had been actively involved.[151] The contributions were made both by Mr. Murphy individually and as trustee of certain revocable family trusts, and totaled approximately $90

139. *Id*. at *29-30.
140. *Id*. at *27.
141. *Id*. at *28.
142. *Id*.
143. *Id*.
144. *Id*.
145. *Id*.
146. No. 07-CV-1013, 2009 U.S. Dist. LEXIS 94923 (D. Ark. Oct. 2, 2009).
147. *Id*. at *2.
148. *Id*. at *12-14.
149. *Id*. at *12-13.
150. *Id*. at *21.
151. *Id*.at *14-15.

million.[152] The limited liability company was a 2.25% general partner, Mr. Murphy a 96.75% limited partner, with the other 1% was owned by the two children.[153] During the life of the partnership it also acquired real property which was actively managed.[154] At the time of Mr. Murphy's death he owned, among other assets, a 76% limited partnership interest (due to gifting) and the 49% interest in the general partner LLC.[155] Murphy's estate included his limited partnership interest at a discounted value, which was challenged by the Internal Revenue Service under section 2036.[156] The estate paid the $34 million deficiency plus $7 million of interest, then sued for a refund in federal court.[157]

Much of the opinion deals with the valuation issues, not directly relevant here.[158] In granting the refund the court determined that there was a bona fide sale due to the nontax motivations for forming the partnership: centralized management and operation of partnership business consistent with Murphy's investment philosophy.[159] Further evidence of the good faith nature of the arrangement was the retention of sufficient assets outside the partnership (to the tune of $130 million), separate legal representation for one of the children, and the lack of commingling between partnership and personal assets.[160] Citing *Kimbell* in refutation of an Internal Revenue Service argument, the court also reiterated that the presence of a tax motive did not, alone, preclude a finding of good faith.[161] The court, citing *Estate of Schutt,* also rejected both the assertion that the partnership's assets were not actively managed and that, if not, there could not be a bona fide transaction.[162]

---

152. *Id*.

153. *Id*. at *15.

154. *Id*. at *18-19.

155. *Id*. at *23-24.

156. The estate had valued the discounted interest at approximately $74 million while the Internal Revenue Service pegged the value at about $131.5 million. The value of the 49% LLC interest was valued by the estate at $706,000. The Service valued it at $1.9 million. Four pieces of artwork resulted in a difference in value of $233,000. The Service also claimed the estate overstated the amount of some deductions. *Id*. at *24-25.

157. *Id*. at *26.

158. *See id.*

159. *Id*. at *70-73.

160. *Id*. at *71.

161. *Id*. ("[T]ax advantages do not 'prevent a sale from being 'bona fide' if the transaction is otherwise real, actual and genuine.'" (citing Kimbell v. United States, 371 F.3d 257, 264 (5th Cir. 2004)).

162. *Id*. at *72. *See* Estate of Schutt v. Comm'r, 89 T.C.M. (CCH) 1353 (2005). In *Schutt*, the Tax Court held that heirs of the Dupont fortune had a legitimate and significant nontax motive for a

Adequate and full consideration was present as well since, under the test of *Kimbell*, Murphy's partnership interest was proportionate to the amount he contributed; the value contributed was credited to his partnership account; and distributions on dissolution of the partnership were to be consistent with each partner's capital account.[163] Thus, after applying the discounts for lack of marketability and control discussed earlier in the opinion, the court valued Murphy's limited partnership interest at $74.5 million rather the $131.5 million asserted by the Service.[164]

E. *Estate of Black v. Commissioner*[165]

This December 2009 Tax Court decision is noteworthy because it resulted in a taxpayer victory where the asset transferred to the limited partnership was stock which was passively held.[166] Nonetheless, the court found a significant and legitimate nontax purpose existed for forming the partnership, and that the transfer was made in good faith for adequate and full consideration.[167]

Samuel and Irene Black died within five months of each other in December, 2001 and May, 2002.[168] Between the two estates the Internal Revenue Service asserted estate tax deficiencies in excess of $200 million.[169] Mr. Black had been a long time employee and officer of Erie Indemnity Company and became its second largest shareholder.[170] His investment philosophy with respect to Erie stock was to buy it at every opportunity and hold it.[171] Over time, Mr. Black gifted Erie stock to both his son and grandchildren's trusts.[172] He became increasingly concerned, however, about the potential for sale of the stock by the grandsons when their trust interests matured and the possibility of his son losing a significant portion of the Erie stock through divorce.[173]

---

passive buy and hold investment strategy because of a desire to maintain family ownership of Exxon and Dupont stock, although the circumstances of that case were considered unique. *Id*.

163. *Estate of Murphy*, 2009 U.S. Dist. LEXIS 94923, at *73.
164. *Id*. at *74.
165. 133 T.C. 340 (2009).
166. *Id*.
167. *Id*.
168. *Id*. at 343.
169. *Id*. at 341.
170. *Id*. at 343-44.
171. *Id*. at 344.
172. *Id*. at 345.
173. *Id*.at 345-46.

In 1993, Black LP, a limited partnership, was formed with contributions of Erie stock from Mr. Black, his son, and the grandchildren's trusts.[174] Mr. Black and his son were the general partners; Mr. Black, his son, and the grandson's trusts were the limited partners.[175] At the time the partnership was formed, Mr. Black was over 90 years of age but active and in good health.[176] The reasons provided in the partnership agreement for creation of the partnership were to provide centralized management of the partnership assets, to restrict ownership of the partnership, to engage in the insurance business, and to handle investment in the Erie Indemnity Company, among other purposes.[177] Mr. Black was the managing partner until 1998, when his son took over that role.[178] The Erie stock was retained throughout the existence of the partnership, rising in value from $80 million to well over $300 million.[179] Mr. and Mrs. Black retained assets outside the partnership that, when coupled with their income, were adequate for their personal expenses.[180]

Judge Halpern rejected the Service's assertion that the transfers to the partnership were not bona fide,[181] i.e., that they did not have a significant and legitimate nontax reason; citing *Bongard,*[182] the Tax Court memorandum decision in *Schutt v. Commissioner*[183] and the Third Circuit decision in *Estate ofThompson v. Commissioner,*[184] and distinguishing the nine month old decision in *Jorgensen v. Commissioner.*[185]Those reasons included Mr. Black's reasonable fear of his son's disposal of Erie stock by sale or pledge pursuant to a divorce, and his like fear that his grandsons would liquidate some or all of their holdings as their trust interests terminated.[186] Neither of the grandsons, then in their twenties, was employed and neither was looking for work.[187] Judge Halpen described the Black family circumstances as "unique," like those in *Schutt*,but the courtestablished that Mr. Black's

174. *Id*. at 348.
175. *Id*.
176. *Id*.
177. *Id*. at 349.
178. *Id*. at 350.
179. *Id*. at 351.
180. *Id*.at 354-55.
181. *Id*. at 371.
182. Estate of Bongard v. Comm'r, 124 T.C. 95 (2005).
183. 89 T.C.M. (CCH) 1353 (2005).
184. 382 F.3d 367 (3d Cir. 2004).
185. 97 T.C.M. (CCH) 1328 (2009).
186. *Estate of Black*, 133 T.C. 340, at 369, 371.
187. *Id*. at 370-71.

desire to hold and protect the Erie stock was the requisite legitimate and significant nontax reason for the transfer.[188] As for the adequate and full consideration requirement, the Service conceded that the interests granted in the partnersthip were proportionate to the assets transferred to it; and the court found that capital accounts were properly credited and proper adjustments made for distributions.[189] Adequate and full consideration was therefore present according to the *Bongard*criteria.[190] As noted earlier, the primary significance of the *Black* decision is its affirmation of the holding that, under the proper circumstances, the passive holding of securities can constitute a legitimate and significant nontax purpose and a give rise to a bona fide transfer of property, even in a family limited partnership.[191]

V. THE *SHURTZ* DECISION[192]

The decision in Estate of Charlene Shurtz, handed down on February 3, 2010, represents the latest word on the topic. Given the taxpayer's success, the case furnishes a current map of the touchstones necessary to make transfers to an FLP, preserve the discounts for the included limited partnership interest, and avoid inclusion of the transferred property in the transferor/decedent's estate.[193]

A. The Factual Setting

Charlene Shurtz died in January 2002, survived by her husband, Richard, and two adult children.[194] Family wealth came to Mrs. Shurtz and her siblings through timber interests in the state of Mississippi where she was raised, although she and her husband were residents of California at the time of her death.[195] She and Richard were philanthropic in outlook and had gifted nearly one million dollars to charities between 1989 and her death.[196]

In 1993, in an effort to consolidate fractured ownership interests in the Mississippi timber land, Mrs. Shurtz and her siblings formed a

188. *Id.*at 371.
189. *Id.* at 373-75.
190. *Id.* at 373.
191. *Id.* at 371.
192. Estate of Shurtz v. Comm'r, 99 T.C.M. (CCH) 1096 (2010).
193. *Id.*
194. *Id.* at *2.
195. *Id.* at *2-3.
196. *Id.* at *1-3.

limited partnership—C.A. Barge Timberlands, L.P. (Timberlands)—with a newly created entity, Barge Timberlands Management, Inc. (BTM) as the general partner.[197] Timberlands owned approximately 45,000 acres of land in Mississippi.[198] BTM owned a 2% general partnership interest and Mrs. Shurtz owned a 16% limited partnership interest as well as a one-third interest in BTM.[199] Shortly after forming Timberlands, Mrs. Shurtz formed a second limited partnership—Doulos, L.P. (Doulos)—to hold the Timberlands limited partnership interest along with an additional 748 acres that she owned and contributed.[200] The professed reasons for this second layer of limited partnerships were: (1) estate tax mitigation, (2) liability protection, (3) provision for heirs, and (4) to "provide for the Lord's work."[201]

The Doulos limited partnership was owned by Mrs. Shurtz as a 98% limited partner and a 1% general partner with her husband owning the other 1% general partner interest.[202] As a result of a gifting program to children and grandchildren, Mrs. Shurtz owned an 87.6% limited partnership interest and 1% general partnership interest in Doulos at the time of her death.[203] That interest was valued at approximately $6.1 million at death and the 1% general partnership interest at $73,500.[204] Her reported total gross estate was about $8.7 million.[205] The Internal Revenue Service assessed a deficiency of $4.7 million along with a $1.2 million penalty.[206] Its contention was that the estate should have included the entire value of the assets Mrs. Shurtz contributed to Doulos but was only entitled to a marital deduction for the value of her Doulos partnership interest.[207] The linchpin of the government's case was, of course, section 2036.[208] If the assets were not includible under that section, the marital deduction and penalty issues were moot.

197. *Id*. at *3-5.
198. *Id*. at *5.
199. *Id*. at *4.
200. *Id*. at *5-8.
201. *Id*. at *4-7.
202. *Id*. at *8-9.
203. *Id*. at *10.
204. *Id*. at *15.
205. *Id*. at *14-15.
206. *Id*. at *1.
207. *Id*. at *16.
208. 26 U.S.C. § 2036.

B. The Tax Court Opinion

Judge Jacobs began by reiterating the accepted decisional authority that cases that involve family related transactions are accorded a heightened examination because of the potential for mischief.[209] The bulk of the remainder of the opinion was focused on whether the transfers were a bona fide sale for adequate and full consideration.[210] If the exception to the general language of section 2036(a) was satisfied, the value of the assets transferred would be excluded from the gross estate.[211] The Court decided both the bona fide sale and full consideration issues in the affirmative.[212]

Judge Jacobs cited the 2005 *Estate of Bongard* decision, which established that in the case of FLP's the

> . . . bona fide sale for adequate and full consideration exception is met where the record establishes the existence of a legitimate and significant nontax reason for creating the family limited partnership, and the transferor's received partnership interest is proportionate to the value of the property transferred. The objective evidence must indicate that the nontax reason was a significant factor that motivated the partnership's creation. A significant purpose must be an actual motivation, not a theoretical justification.[213]

A bona fide sale for adequate and full consideration was said to mean an arm's length transaction as would be entered into by unrelated business parties.[214]

Judge Jacobs had little difficulty in finding valid, non-tax reasons for the creation of Doulos.[215] First, was the value of asset protection.[216] Shurtz's family viewed Mississippi as a "judgment jackpot" state and they were sincerely and legitimately concerned about significant asset

---

209. Judge Jacobs cited Estate of Bigelow v. Comm'r, 503 F.3d 955, 969 (9th Cir. 2007); Kimbell v. United States, 371 F.3d 257, 263 (5th Cir. 2004); Estate of Bongard v. Comm'r, 124 T.C. 95, 123 (2005). *Estate of Shurtz*, 99 T.C.M. (CCH) at *19.

210. *Id*. at *19-29.

211. § 2306(a).

212. *Estate of Shurtz*, 99 T.C.M. (CCH) at *27, *29.

213. *Estate of Bongard*, 124 T.C. at 118. Judge Jacobs also cited *Estate of Bigelow*, 503 F.3d at 969 and Estate of Korby v. Comm'r, 471 F.3d 848, 854 (8th Cir. 2006) for the same proposition. *Estate of Shurtz*, 99 T.C.M. (CCH) at *20-21.

214. *Estate of Shurtz*, 99 T.C.M. (CCH) at *21 (citing *Estate of Bongard*, 124 T.C. at 123 and *Estate of Bigelow*, 503 F.3d at 969).

215. *Id.* at *22-27.

216. *Id*. at *23-24.

loss through liability incurred on their vast holdings.[217] In addition, the Court found that management was facilitated through unified ownership by the partnership in light of the multiplicity of fractional interests in the property held by various family members.[218] Further, at least a significant portion of the limited partnership required active asset management and were not mere passive investments.[219] Evidence showed that the family engaged in a collaborative decision-making process.[220] Mrs. Shurtz did not make management decisions alone but was consulted about major actions.[221] Conceding that tax reasons were involved in the decedent's decisions to create the limited partnerships did not alone preclude a finding that there were significant nontax reasons as well and, thus, a bona fide transfer had occurred.[222]

The other major issue was whether the bona fide sale was for adequate and full consideration.[223] Again relying on the *Bongard* criteria, the Court found that, (1) Shurtz received a partnership interest commensurate to what she had contributed to the partnership, (2) the contributions were recorded in the contributor's partnership capital account, (3) distributions from the partnership resulted in a decrease in the recipients capital account, and, finally, (4) that there were the significant nontax reasons for creating the partnership.[224]

In light of his finding of a bona fide transfer for adequate and full consideration in money or money's worth, Mrs. Shurtz's estate did not include the value of the assets contributed to Doulos, L.P. but only the value of her partnership interest.[225] As that was also the value of her interest passing through the marital deduction, there was no estate tax deficiency and, thus, no penalty.[226] The *Shurtz* decision represented a significant victory for the taxpayer. But it was not without some potential concerns.

As part of his factual recitation of the case, Judge Jacobs noted several items that could have led to a decision declining to apply section

217. *Id*. at *23.
218. *Id*. at *24-25.
219. *Id*. at *25-26.
220. *Id*. at *26-27.
221. *Id*. at *26. In this case about 16% of the Doulos assets required active management, the 748 acres contributed by Ms. Shurtz. *Id*.
222. *Id*. at *27.
223. *Id*. at *27-29.
224. *Id*. at *28-29.
225. *Id*. at *29.
226. *Id*. at *30.

2036.[227] Among those items was that, although Doulos maintained capital accounts for the partners, it did not maintain accounting records.[228] That was in violation of the partnership agreement.[229] The partnership also did not have a bank account until four months after its creation.[230] Mrs. Shurtz and her husband personally paid some of the partnership expenses.[231] Reimbursement for those expenses was not consistent although unreimbursed expenses were appropriately credited to their capital accounts.[232] Finally, not all distributions were proportional to the ownership interest.[233] The opinion did not indicate whether proportionate distributions were required by the partnership agreement, although they were apparently reconciled in later years.[234]

None of these items, in and of themselves, are particularly problematic. Taken together they reveal a casualness about the operation of the partnership that could have led some courts to question the authenticity of the limited partnership, had the other facts not been as strong as they were in this case. Judge Jacobs mentioned these failures in his discussion of the facts, but he did not cite them as being a factor in the outcome.[235]

VI. ANALYSIS AND CONCLUSION

After a number of years and nearly two dozen cases, the legal "lay of the land" in this area is reasonably clear. Courts reasonably and understandably look at family-related transactions with a skeptical eye. They seek assurance that transfers to a family limited partnership are made for reasons other than those that are purely or predominantly tax-motivated—though tax savings may permissibly be among the motives.[236] Among the recognized nontax reasons are: centralized management, liability protection, perpetuation of an investment strategy (even a buy and hold strategy), and preservation of assets.[237] Courts will examine those reasons for their consistency with what has actually transpired in the partnership operation. These reasons should be real,

227. *Id*. at *11-12.
228. *Id*. at *11.
229. *Id*.
230. *Id*.
231. *Id*.
232. *Id*.
233. *Id*. at *11-12.
234. *Id*. at *12.
235. *Id*. at *11-12.
236. *Id*. at *17 (citing Strangi v. Comm'r, 417 F.3d 468, 476 (5th Cir. 2005)).
237. *See id.* at *23-27; Estate of Black v. Comm'r, 133 T.C. 340 (2009).

realistic, and documented in the partnership agreement or in a separate memorandum. [238]

The amount of assets a transferor retains is relevant to the issues of whether the transfer was made in good faith and whether the transferor implicitly retained a sufficient interest to trigger section 2036(a)(1).[239] Obviously, the fewer assets retained to maintain the transferor's living expenses during the remainder of their life, the more likely they will need to tap into the transferred assets, including accessing assets needed to pay estate tax liabilities. In a similar regard, courts will look to see that if distributions were made to the transferor, whether they were pro rata to other partners.[240] Interests conferred by the partnership must be proportionate to the assets contributed, and other partners should likewise make contributions and receive proportionate interests.[241] The partnership agreement should specify that on dissolution assets will be distributed proportionate to ownership interests.[242] Partnership formalities need to be recognized and honored, and the commingling of personal and partnership assets avoided.[243] It is advantageous to a favorable taxpayer outcome if other partners are consulted regarding the creation of the partnership and any other related entities (such as an entity to function as the general partner); and, preferably, that those other partners have their own legal counsel.[244] It is also strongly preferable that, at the time the decedent made the transfers, they were in reasonable health, or at least that death was not in the near offing.[245] This issue bears on whether the transfers were, in reality, a disguised testamentary transfer and thus implicates the good faith nature of the transfers.

It should not be surprising that courts will examine these situations with rigor. In fact, it is almost more surprising that courts are willing to accept and recognize them for tax purposes in some cases. The potential for mischief is significant and the tax savings via discounts—as seen in nearly all the cases discussed—are often in the millions of dollars.[246]

238. *See Estate of Shurtz*, 99 T.C.M. (CCH) 1096; *Estate of Black*, 133 T.C. 340; Estate of Jorgensen v. Comm'r, 97 T.C.M. (CCH) 1328 (2009), at *42.

239. *See Strangi*, 417 F.3d at 19-21.

240. *See* Estate of Stone v. Commr, 86 T.C.M. (CCH) 551 (2003).

241. *See id.*

242. *See id.*

243. *See* Estate of Harper v. Comm'r, 83 T.C.M. (CCH) 1641 (2002).

244. *See Estate of Stone*, 86 T.C.M. (CCH) at *153-54.

245. *See* Estate of Erickson v. Comm'r, 93 T.C.M. (CCH) 1175 (2007), at *31.

246. *See* Estate of Shurtz v. Comm'r, 99 T.C.M. (CCH) 1096 (2010); Estate of Bongard v. Comm'r, 124 T.C. 95 (2005); Estate of Jorgensen c. Comm'r, 97 T.C.M. (CCH) 1328 (2009).

Other than the transaction costs, taxpayers often have little to lose in attempting these transactions—the assets would have been included and taxed at their full date of death value if no action had been taken; the same result that occurs in cases where the Internal Revenue Service successfully challenges the transfers to an FLP.

In all likelihood, taxpayers will continue to use the family limited partnership form to accomplish both tax and nontax purposes because of the substantial savings that can result when done successfully. It is far from risk-free, but taxpayers have had enough success in the courts to warrant the attempt. The courts have provided a trail to follow.[247] Certainly, the desired results can be accomplished if attention to the details is paid; but it is a device that is only worthwhile for high net worth individuals, advised by experienced and knowledgeable legal counsel. For it is also certain that, as surely as taxpayers will continue to engage in these arrangements, the Internal Revenue Service will continue to challenge them.

247. *See Estate of Shurtz*, 99 T.C.M. (CCH) 1096; *Estate of Stone*, 86 T.C.M. (CCH) 551; *Estate of Harper*, 83 T.C.M. (CCH) 1641; *Estate of Jorgensen*, 97 T.C.M. (CCH) 1328; Strangi v. Comm'r, 417 F.3d 468 (5th Cir. 2005).