

FAMILY LIMITED PARTNERSHIPS UNDER § 2036 AND CHECKLIST

by

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This handout is not intended to be and should not be used as a substitute for specific legal advice, since legal opinions may only be given in response to inquiries regarding specific factual situations. If legal advice is required, the services of a qualified attorney should be sought.

I. INTRODUCTION

A. What is a Family Limited Partnership?

A family limited partnership ("FLP") is a limited partnership business entity created under state law through an agreement between an individual and his or her family members. A "family" limited partnership is the same as any other limited partnership under the law except that the partners are related.

Limited partnerships have a general partner that can be a person or entity which controls the day to day operation and management of the partnership and which is generally liable to third-parties for the acts of the partnership. Because of the general partner's liability to third-parties, general partners are typically not individuals whose personal assets may be put at risk due to third-party claims; instead, general partners are typically entities like limited liability companies or corporations that shield their owners from personal liability.

In a common FLP, the general partner is a limited liability company ("LLC") or corporation owned by certain family members, usually the children of a wealthy parent who desires to create the partnership for business and/or tax reasons. The wealthy parent is usually the sole or substantial owner of all of the limited partner interests in the partnership. The parent's children are often the owners of the LLC general partner and may also initially own some part of the limited partner interests; however, it is more common for the children to become limited partner owners over time through gifts from the parent. A 99%:1% or 90%:10% ownership ratio of the FLP between the limited partners and the general partner(s) is not unusual. Precise ownership sharing ratios are determined by the value of assets contributed by the general and limited partners to the FLP to obtain their ownership interests in the FLP.

Sometimes the wealthy parent contributes all of the assets to the FLP by (1) creating the general partner LLC by contributing some assets to the LLC which in turn contributes such assets to the FLP for a general partner interest; and (2) by contributing assets directly to the FLP in exchange for the limited partner interests. After contribution, the parent then gifts his or her ownership interests in the LLC and/or limited partner interests to children to bring them into the partnership as owners.

Assets most commonly contributed to a FLP are real estate, farming operations, marketable securities, and ownership interests (i.e., stock) of a closely held business.

An arrangement similar to a FLP can be created with a LLC where the manager of the LLC (who could be an individual or another entity) manages the LLC and the wealthy parent owns non-managerial units in the LLC.

B. Why Use a FLP?

A FLP is generally created for one or more of the following reasons:

1. Minimize gift and estate taxes on the transfer of wealth to younger family generations
2. Protection of assets from creditors
3. Provision for transitional and successor ownership of a family business
4. Move necessary management of assets to other family members
5. Protection of family wealth in the event of divorce or a family member's desire to transfer family assets outside of the family
6. Strength and leverage by pooling assets (i.e., pooling all family owned stock in one entity for voting power)

By far the most popular reasons used by planners and clients in establishing FLPs is the valuation discounts such partnerships potentially provide to reduce gift and estate taxes on the transfer of a wealthy parent's assets to his or her children. When valuing a parent's ownership interest in a FLP for purposes of making a lifetime gift of a limited partner interest or in determining the parent's taxable estate at death, certain discounts to the value of that interest, supported by a professional appraisal, can apply to reduce the value and provide tax savings. A lower value to a gift of a partnership interest allows a parent to make a larger gift to a child on a gift-tax preferred basis. A lower value to any remaining partnership interest owned by a parent at death equates to a lower estate tax liability.

The two (2) principal discounts that apply to FLP interests are lack of control discounts and lack of marketability discounts. Valuation discounts are determined from the perspective of the recipient of the transfer, such as a child, and not by the transferor, such as the wealthy parent. A lack of control discount may apply if a limited partner has no management or control over the FLP (which limited partners by definition do not have), cannot force the liquidation of the partnership, and cannot compel distributions of partnership assets. A lack of marketability discount for a partnership interest may apply if there is no real public market in which the interest may be sold due to such factors as a restriction in the FLP's partnership agreement on the transfer of the interest, or a right of first refusal to acquire the interest by the FLP and/or its partners if it is transferred, or other restrictions in the partnership agreement that would make a reasonable third-party reticent to acquire the interest.

II. Section 2036 Challenges by the IRS

Because of the potentially large discounts to the value of assets contributed to a FLP, the IRS has looked upon FLPs with disdain and has repeatedly challenged FLPs for decades in gift and estate tax audits where the value of the discounts and lost tax revenue due to discounts are significant and where the facts are favorable to an IRS attack. In the early 2000s, the IRS began to successively challenge FLPs under Internal Revenue Code ("Code") § 2036. This Code section provides that there is included in the taxable estate of a decedent all property transferred by a decedent during his lifetime over which he has retained (1) the possession or enjoyment of, or the right to receive

income from, the property or (2) the right (either alone or in conjunction with any person) to designate individuals who may possess or enjoy the property or the income therefrom. Section 2036 further provides that this general inclusion rule does not apply to property transferred in a "bona fide sale for an adequate and full consideration in money or money's worth."

A. *Strangi*

The pinnacle case for § 2036 arguments is *Strangi v. Commissioner*, 417 F.3d 468 (5th Cir. 2005). This case began its life as an IRS FLP estate tax audit which was challenged by the decedent's estate in the United States Tax Court, and which was ultimately resolved in favor of the IRS on appeal by the decedent's estate to the United States Court of Appeals for the Fifth Circuit ("Fifth Circuit") (Idaho is under the federal court jurisdiction of the 9th Circuit Court of Appeals). In the case, Albert Strangi, on his deathbed, transferred approximately 98% of his assets including his personal residence into an FLP. Strangi retained ownership of 99% of the FLP, and the other 1% was owned by a corporate general partner in which he also had a 47% ownership interest. The general partner corporation was managed by Strangi's son-in-law, who was also Strangi's agent under a durable power of attorney. Strangi continued to live in the house he had transferred to the FLP. The records of the FLP indicated that rent was shown as being owed by Strangi to the FLP for use of the FLP residence, but no rent was paid to the FLP until two years after his death. Strangi had not retained sufficient assets outside of his interest in the FLP to meet his living expenses, and most of his expenses after his creation of the FLP were paid with non-pro rata distributions from the FLP. Additionally, Strangi's estate taxes were paid by a non-pro rata distribution from the FLP. The FLP never made any investments or conducted any active business after its formation. The IRS challenged the decedent's estate's valuation discount to the decedent's limited partnership ownership interest in the FLP.

Under a § 2036(a)(1) analysis, the Fifth Circuit stated that:

a transferor retains "possession or enjoyment" of property, within the meaning of § 2036(a)(1), if he retains a "substantial present economic benefit" from the property, as opposed to "a speculative contingent benefit which may or may not be realized". *United States v. Byrum*, 408 U.S. 125, 145, 150, 33 L. Ed. 2d 238, 92 S. Ct. 2382 (1972). IRS regulations further require that there be an "express or implied" agreement "at the time of the transfer" that the transferor will retain possession or enjoyment of the property. 26 C.F.R. § 20.2036-1(a).

The court found that payments made prior to Strangi's death, the continued use of the transferred house, and the post-death payment of various debts and expenses were "substantial" and "present" benefits, as opposed to "speculative" or "contingent." The court then found that an implied agreement between Strangi and the FLP existed for his continued use of assets transferred to the FLP by virtue of the FLP's payment of his expenses during and after his death, his continued use of his residence transferred to the FLP, and the fact that outside of distributions from the FLP, Strangi had no other

significant assets to live on. The court held that of all of the assets Strangi transferred to the FLP would be included in his taxable estate under § 2036(a)(1).

The estate argued that even if § 2036(a)(1) applied, the bona fide sale for adequate and full consideration exception to 2036 applied. The court first addressed the adequate and full consideration requirement for the exception and noted that "so long as assets are transferred into a partnership in exchange for a proportional interest therein, the 'adequate and full consideration' requirement will generally be satisfied, so long as the formalities of the partnership entity are respected" (i.e., standard partnership accounting to credit contributions and partner capital accounts was utilized). The IRS conceded that such had been the case with the formation of the Strangi FLP. The court next addressed the bona fide sale aspect of the 2036 exclusion and held that a bona fide sale exists if it serves an actual, not theoretical, substantial business or other non-tax purpose as determined by an objective inquiry reviewing the facts at the time the sale, or in this case the FLP creation, occurred. Strangi's estate argued that several factors, including deterring potential tort litigation by a former housekeeper, deterring a potential will contest by step-children, and permitting centralized, active management of working interests owned by Strangi, were all sufficient non-tax reasons to create the FLP. In a facts and circumstances analysis, all of the estate's reasons were defeated, mainly because the FLP never took an active role in managing or doing anything once assets were transferred into it. The court concluded that no exception to § 2036 applied. Because the court found that § 2036(a)(1) applied to cause estate tax inclusion of Strangi's FLP assets, it did not review the Tax Court's holding that estate tax inclusion also applied under § 2036(a)(2).

With respect to § 2036(a)(2), prior to the case reaching the Fifth Circuit the Tax Court had ruled that the assets Strangi contributed to the FLP would be included in his taxable estate under § 2036(a)(2) because he was a large owner of the corporate general partner of the FLP and could, through such ownership control the flow of FLP distributions to himself and others.

B. *Bigelow*

The United States Court of Appeals for the Ninth Circuit weighed in on the FLP issue in *Estate of Bigelow. v. Commissioner*, 503 F.3d 955 (9th Cir. 2007). In the case, Virginia Bigelow transferred 1/175th interest in her house to each of her three children, and transferred her remaining 98.2857 percent to a revocable trust. In 1992, Bigelow suffered a stroke. The next year, the trust exchanged the residence for other real property. In 1994, the trust and Bigelow's children formed a FLP. The trust contributed \$500 to the partnership in exchange for a 1% general partner interest; the trust and Bigelow's three children each contributed \$100 in exchange for one A, limited partner unit in the FLP; and the trust contributed the real estate for 14,500 B, limited partner units. The professed purpose of the partnership was to engage in the business of owning and operating residential real property.

The trust transferred the real property to the partnership, but not the liability for a loan and a line of credit totaling \$450,000, which were secured by the property, and for which the trust remained liable. However, the partnership made all the payments on the loan,

and did not adjust the trust's capital account for such payments as required by the partnership agreement. From 1995 to 1997 (when Bigelow died), funds were advanced and/or loaned (by undocumented and unsecured loans) from the FLP to Bigelow's trust 40 times. After the trust transferred the property to the FLP, Bigelow had been left with an insufficient amount of income to meet her living expenses or to satisfy her liability for the indebtedness. Bigelow's estate tax return reported a substantial discount to the trust's then remaining interest in the FLP which the IRS challenged under § 2036(a)(1).

At the Tax Court, the court held that the real property transferred to the partnership by Bigelow's trust was includible in her estate under § 2036(a)(1). The court found dispositive Bigelow's use of the FLP income to replace the income lost because of the transfer of her property to the FLP. The court concluded that such an income trade showed an implied agreement between Bigelow and her children that she would retain the right to the income from the property. Additionally, the court found that an implied agreement was also supported by the fact that the property continued to secure Bigelow's debts which gave her, not the FLP, the economic benefit of ownership of the property.

Addressing Bigelow's estate's argument that the adequate and full consideration and bona fide sale exception to § 2036(a)(1) applied, the court held that the transfer of property to the FLP was not made in good faith because the (1) the transfer left Bigelow unable to meet her financial obligations; (2) the parties' failed to respect the FLP partnership agreement as to properly documenting the debt of Bigelow, loans to her, and maintenance of capital accounts; and (3) management of the assets did not change by the transfer of the property to the FLP and thus there was no non-tax benefit to Bigelow. In sum, the court held that "a transfer made solely to reduce taxes and to facilitate gift giving is not considered in this context to be made in good faith or for a bona fide purpose."

On appeal, the Ninth Circuit affirmed the decision of the Tax Court. In its decision, the court followed the Fifth Circuit analysis of § 2036(a) under the Strangi opinion; however, the court held that merely contributing assets and receiving back a proportionate amount of partnership interests will not per se satisfy the adequate consideration test for limiting the scope of § 2036 and courts must also consider the non-tax reasons and benefits to the taxpayer derived from creating a FLP - this approach has not been followed by the Tax Court or other circuit courts. The court also stated that intra-family FLPs are to be reviewed through heightened scrutiny to ensure a true business purpose and operation.

C. *Mirowski*

In *Estate of Anna Mirowski v. Commissioner*, T.C. Memo 2008-74 (March 26, 2008), the Tax Court provided the taxpayer estate with a victory over the IRS. In the case, Anna Mirowski had a substantial investment portfolio of marketable securities, patents developed by her late-husband, and royalties payable on the patents. In May 2000, Mirowski and one of her children met with an advisor who suggested forming an LLC. Mirowski discussed this option with her attorney, who sent Mirowski and her daughters a draft of the operating agreement a few months later. Mirowski had meetings with her daughters once a year at their vacation home to discuss family finances and she planned to wait until the next family meeting in August 2001 (a year later) to discuss the LLC

operating agreement. However, in August 2001, Mirowski's daughters held the annual meeting with the attorney but without Mirowski. On Aug. 27, 2001, Mirowski received the final documents from her attorney and signed the articles of organization and the operating agreement to create the LLC. Funding of the LLC occurred simultaneously.

On Aug. 31, 2001, four days after creating the LLC, at the age of 74, Mirowski was admitted to the hospital for a foot ulcer which was an unexpected illness. During the first week of September 2001, Mirowski transferred the patents and her rights under the license agreement and \$62.5M of securities to the LLC. In early September, Mirowski also gifted a 16 percent interest in the LLC to each of three trusts, one for the benefit of each of her daughters, retaining a 52% interest in the LLC. After these transfers, she retained assets worth approximately \$10M in her name, \$3.3M of which was liquid. Mirowski was the general manager of the LLC.

On September 10, 2001, Mirowski's health deteriorated due to a sepsis infection related to the foot ulcer and she died the next day. On September 16, 2001, her daughters held a meeting and decided to continue the LLC and elected officers. The daughters held regular LLC meetings three to four times a year. In 2002, the LLC made distributions to Mirowski's estate totaling over \$36M to pay the estate and gift taxes and other obligations; the other members did **not** receive a proportionate amount of this distribution. The LLC has continued in existence.

For Mirowski's gift and estate tax returns, her daughters used distributions from the LLC to pay the taxes due. The IRS challenged the returns arguing that all of the assets transferred by Mirowski to the LLC should have been included in her taxable under § 2036.

The Tax Court concluded that the assets Mirowski transferred to the LLC were not includible in her estate under § 2036 because the bona fide sale exception applied. Based on Ms. Mirowski's daughters' testimony, the court found legitimate non-tax reasons as the crucial motivation for forming the LLC. Such reasons were: that family members could jointly manage family assets; to maintain the family's assets in a single pool to allow for certain investment opportunities that would not otherwise be available; and to provide for the Mirowski daughters and grandchildren on an equal basis. The court relied heavily on the Mirowski family history of meeting and planning together for business purposes and saw the LLC as a natural extension of that pre-existing practice. On the adequate and full consideration prong of the bona fide sale test, the court found that Mirowski had received a proportionate interest to the assets she had transferred to the LLC and her capital account was properly credited with the value of the assets contributed. The court further noted that the activities of the LLC did not have to rise to the level of a business under the federal income tax laws to be considered an active business.

The IRS argued that because Mirowski was the general manager of the LLC, she retained sufficient control to cause inclusion of assets under § 2036. The court countered that Mirowski's powers and discretion as the general manager and majority member of the LLC were limited by the LLC's operating agreement to prevent her from retaining the right to possess or enjoy the right to the income from the property. Under the operating

agreement all profits had to be distributed out pro rata within 75 days of the end of each operating year and capital proceeds had to be distributed to members in proportion to their interests. The court also found dispositive the fact that under the state law governing the LLC, Mirowski, as general manager, was subject to fiduciary duties to act in the best interest of the members.

The IRS argued that Mirowski had an implied agreement to continue to use and possess the assets she transferred to the LLC which would cause estate tax inclusion under § 2036. The IRS pointed to the fact that she did not retain sufficient assets outside of the LLC to pay her gift and estate tax liabilities. The court dismissed this argument as being just one factor to consider under an implied agreement theory and found that there was no overall intent or implied agreement for Mirowski to use the LLC for her living expenses or for any other purpose than its legitimate business purposes.

D. Jorgensen

In *Estate of Jorgensen v. Commissioner*, T.C. Memo. 2009-66 (March 26, 2009), Gerald Jorgensen and his wife Erma Jorgensen created a family limited partnership in 1995 called the Jorgensen Management Association (“JMA-I”). Mr. Jorgensen and his children were the general partners of the partnership and the Jorgensens, their children and some grandchildren were limited partners. The children and grandchildren received their limited partner interests through gifts from the Jorgensens from 1995 through 1998. The partnership agreement indicated that JMA-I was created to pool assets for investment purposes.

Mr. Jorgensen passed away in 1996. At his death a credit shelter trust was funded with his interest in JMA-I which was discounted by a flat 35%. In January 1997, the Jorgensen’s estate planning attorney initiated discussions with Mrs. Jorgensen recommending that she transfer additional securities to JMA-I so that her estate would also qualify for a 35% valuation discount when she passed away. The discussions culminated in the creation of a new limited partnership called JMA-II. JMA-II was owned approximately 80% by Mrs. Jorgensen as a limited partner, 20% with Mr. Jorgensen’s estate as a limited partner, and some initial gifts made by Mrs. Jorgensen to her children to make them the general partners. Children and grandchildren were listed as additional limited partners but they did not contribute anything to the partnership in exchange for their partnership interests.

JMA-I and JMA-II did not keep formal operating and accounting records.

From 1995 – 2002, Mrs. Jorgensen gifted about 30% of her interest in JMA-I and about 35% of her interest in JMA-II to her children and grandchildren on a discounted basis. In 1999, a new estate planning attorney, concerned with a potential audit of gifts made and later estate tax audit of JMA-II, provided Mrs. Jorgensen with a letter summarizing several non-tax, business and asset protection reasons why she created JMA-II.

Mrs. Jorgensen, as a limited partner, wrote several personal checks from the JMA-I bank account to make cash gifts to her descendants. She later re-paid the money to JMA-II

without explaining why the money was not given to JMA-I. In 1999, the Jorgensen's son borrowed \$125,000 from JMA-II to buy a house and made sporadic interest only payments on the loan. Mrs. Jorgensen also made required estimated tax payments from JMA-I and used JMA-II cash to pay her husband's final estate income taxes and administration expenses.

Mrs. Jorgensen died in 2002. On her estate tax return, discounts to the value of her remaining ownership interests in JMA-I and JMA-II were taken. Additionally, in the same month as the due date for her estate's estate tax return, Mrs. Jorgensen's son re-paid his \$125,000 loan to JMA-II. JMA-II paid Mrs. Jorgensen's estate tax bill of \$211,000. During 2003 – 2006, JMA-I and JMA-II sold various assets contributed to them by Mrs. Jorgensen and reported the income tax based upon the bases of the assets at the time of contribution to the partnership, rather than the step-up basis that would have applied had the assets sold been included in her taxable estate.

The IRS audited the estate tax return and denied all discounts to value arguing that the assets contributed by Mrs. Jorgensen to JMA-I and JMA-II, not just her ownership interest in the partnerships, were all included in her taxable estate under Code § 2036. The IRS also argued that the assets were includable in the estate under Code § 2038 (taxpayer had a retained right and power to alter the enjoyment of property transferred by taxpayer; also subject to a bona fide sale and adequate and full consideration exception), but the Tax Court did not address this argument because it agreed with the IRS on the § 2036 issue.

On appeal to the Tax Court, it held that Mrs. Jorgensen had indeed made "transfers" to the JMA partnerships under Section 2036 which requires that a lifetime transfer of assets first be made to trigger estate tax inclusion. The court next found that an implied agreement existed between Mrs. Jorgensen and the partnerships for her continued enjoyment of the assets as she continually used partnership assets for her own needs (i.e., gifts) and to pay her personal expenses and ultimately her estate tax liability. The court firmly concluded that 2036 would apply and pull back to her taxable estate all assets she contributed to the partnerships.

The court then analyzed whether the bona fide sale and adequate consideration exclusion to 2036 would apply. Under the bona fide sale prong of the exclusion, the court could not find a legitimate non-tax motive for the creation of the JMA partnerships. The court dismissed the need for management of assets as a non-tax reason because the assets were purely passive, Mrs. Jorgensen never managed them, and they did not need constant attention to make them productive. The court also dismissed reasons such as promoting financial education of children, preserving the Jorgensen's investment philosophy, spendthrift protection, and equalizing estate assets. The court also found that a lack of documentation of legitimate business reasons for creating the partnership at the time of formation and the lack of partnership formality throughout the life span of the partnerships showed no business purpose.

Addressing the adequate consideration (aka pro rata partnership interest in exchange for the value of assets contributed by a taxpayer to a partnership), the court noted that the

IRS conceded this point. Finding no bona fide sale/consideration exception to the application of 2036, the court ruled in favor of the IRS and included all assets of Mrs. Jorgensen contributed to the JMA partnerships, regardless of the fact that Mrs. Jorgensen had made partnership interest gifts (and hence part of the assets had been gifted) more than 3 years prior to her death.

On the taxpayer's equitable recoupment claim (equitable claim for income tax refund made outside of the applicable statute of limitations period), the Tax Court held that the estate had met the requirements for relief under the equitable recoupment doctrine and allowed the estate to use Mrs. Jorgensen's stepped up basis for the partnership assets sold in order to reduce the income tax liabilities and qualify for a tax refund. The requirements for establishing an equitable recoupment argument are: (1) the overpayment or deficiency for which recoupment is sought by way of offset is barred by an expired period of limitation; (2) the time-barred overpayment or deficiency arose out of the same transaction, item, or taxable event as the overpayment or deficiency before the Court; (3) the transaction, item, or taxable event has been inconsistently subjected to two taxes; and (4) if the transaction, item, or taxable event involves two or more taxpayers, there is sufficient identity of interest between the taxpayers subject to the two taxes that the taxpayers should be treated as one. *Menard, Inc. v. Commissioner*, 130 T.C. 54, 62-63 (2008).

III. Checklist

The string of cases from *Strangi* to the present provide several issues that should be considered when working with FLPs, including:

1. Facts and Legitimate Non-Tax Reasons for Formation. The cases are extremely fact sensitive. Make sure that several legitimate non-tax reasons for creating the FLP are well-documented at the time of FLP formation and that the actual operation of the FLP thereafter is consistent with those reasons.

The attorney-client privilege should be noted upon and used for documents where the estate and gift tax savings of a FLP are discussed with the client. Avoid cc's on such letters which could cause an inadvertent waiver of the privilege.

2. Business. The FLP must be treated as a fully functioning business and as if the owners were not related parties. Documented negotiations between FLP owners both before and after formation shows business purposes. Separate bank accounts, separate accounting records, timely filed state and federal tax returns, bona fide leases for real property as needed, and annual and more frequent meeting minutes are all required.
3. Proportionate Interests. Make sure that all percent ownership interests of the owners are proportionate to the value of the assets they contribute to the FLP. This is the easiest part to meet of the adequate and full consideration part of the bona fide sale exception to § 2036.

4. Sufficient assets and income to meet living expenses, taxes. Be certain that upon contribution of assets to a FLP that the wealthy parent maintains sufficient liquid assets outside of the FLP to meet his or her living expenses, personal debts, funeral expenses and estate taxes. If there are insufficient liquid assets outside of the FLP, a wealthy parent should consider the options of third-party loans, pro rata distributions from the FLP (but avoid the appearance of the parent commanding distributions at will), or borrowing from the FLP with a note, commercial rate of interest, and documented security (some commentators suggest using a Graegin loan from the case of *Graegin v. Commissioner*, T.C. Memo. 1988-477 (illiquid estate borrowed from closely related entity to pay estate taxes with note at high interest rate, balloon payment, and no prepayment option)).
5. No personal residences. Personal residences should stay outside of FLPs. Any personal use of a FLP property should be done under a lease at fair value rent.
6. Limit Control. The wealthy parent should not be the general partner of the FLP (or manager of an LLC) or else the IRS can argue § 2036 control issues and the IRS can challenge discounts taken because there is no true lack of marketability or minority interest issues if the wealthy parent is both the general and limited partner. If the wealthy parent must be such a person, limit the discretion he or she may have to control the use and possession of the FLP assets such as non-discretionary distribution of profits provisions in the partnership agreement.
7. Funding. Fund the trust within a short time of its creation which would be in keeping with the formalities of a operating a real business.
8. Avoid Indirect Gifts. The IRS has been successful in arguing under the step-transaction doctrine that gifts made to children within in a short time of, or contemporaneously with, the formation and funding of a FLP are actually gifts of the underlying assets and not of partnership interests.
9. Entity as general partner. A non-tax tip is to use an entity as the general partner to limit third-party liability to the general partner. If the wealthy parent is to be a member of the general partner entity, think again and avoid it, or if you must to do it, limit their control and discretion over the entity.
10. Diversify. A client may need more than one FLP to split assets for creditor protection. Additionally, having more than just marketable securities in a FLP will help to show that active management of the FLP assets, a legitimate business purpose, is truly necessary.
11. Children's Trusts. Consider using a trust as the holder of a child's interest in the FLP to provide spendthrift and creditor protection.
12. Appraisals. Make sure that at formation, the fair market value of contributed assets, particularly real estate, is established and that appraisals, as applicable, are done. Going forward, a current appraisal/valuation of the FLP assets as well as a separate appraisal of the value of a 1% limited partner interest in the FLP are necessary for gifting of limited

partner interests. Additionally, for estate tax purposes, discounts of remaining limited partner interests held by a decedent must be supported by a professional appraisal. There are no standard discounts that apply and you are asking for audit trouble if you arbitrarily pick a discount number.

If a FLP survives a § 2036 attack, the next battle with the IRS will be over the discounts utilized for the gift or estate tax return under audit. Some members of Congress have proposed legislation eliminating or limiting FLP valuation discounts but commentators feel that applying the limits to just FLPs and not all other truly legitimate business operations will not be sustainable.

13. Avoid non-pro rata distributions and payments. Non-pro rata distributions, guaranteed payments, and unsubstantiated loans to a wealthy parent and to other partners of a FLP are not allowed as they will almost always violate the express terms of the partnership agreement and will cause estate tax inclusion under § 2036. Loans would be the least offensive way to document such money transfers but the loans must be arms length transactions with a note, sufficient commercial interest rate (not lowest AFR), reasonable pay back terms, and security.
14. Three year look back under § 2035. Be very aware that in the *Jorgensen* case, the court included in Mrs. Jorgensen's estate assets that she had gifted, through gifts of partnership interests, more than 3 years before she died (under § 2035, transfers causing inclusion under § 2036 are limited to those transfers taking place within 3 years of a decedent's death). The court reasoned that the estate had failed to fully brief this issue and waived the argument that the 3 year limitation of § 2035 applied. In dicta, the court stated that even if the issue had been briefed, the more than 3 year inclusion would still have applied because Jorgensen never gave up possession or control of the assets gifted through the gifted partnership interests.
15. Post-death operations. Consider continuing to operate a FLP post-death of the wealthy parent until at least an estate tax closing letter is received or the audit period expires. Ongoing operations is a factor considered by the courts to point to legitimate business reasons for creating the FLP in the first place.
16. Protective Claims. As applicable, if an audit commences on a FLP, file timely protective income tax claims for refunds if assets could be pulled back into the estate and qualify for a stepped-up basis.
17. FLPs are not for everyone. FLPs are just one tool to use to minimize gift and estate taxes. Due to their potential complexity, requirement for relinquishment of wealthy parent's control over the FLP assets, and the need for maintenance, they may create an unwelcome intrusion in a client's life which will cause frustration to the client, the failure to operate the FLP correctly, and a potentially large gift and/or estate tax problem.
18. Appeals Guide. The IRS has published a guide for its appeals officers to use in reviewing FLP cases which can be found at: http://ftp.irs.ustreas.gov/pub/irs-utl/asg_penalties_family_limited_pships_finalredacted10_20_06.pdf.

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AREAS OF EMPHASIS

Estate planning including wills, trusts, charitable giving and complex estate tax planning
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Probate and administration of estates
Tax planning and dispute resolution

RELATED EXPERIENCE

Owner, McAnaney & Associates, PLLC, 2004-Present
Perkins Coie, LLP, Boise, Idaho, 2002-2004
Brassey, Wetherell, & Crawford, LLP, Boise, Idaho 1997-2001

PROFESSIONAL AND CIVIC ACTIVITIES

Idaho State Bar, Taxation, Probate and Trust Law Section
Boise Estate Planning Council, Director
Treasure Valley Estate Planning Council
Boy Scouts of America, Ore Ida Council, Director
Author ABA Sales and Use Tax Deskbook, Idaho Chapter (2002 – 2009 eds.)

EDUCATION

University of Washington School of Law, LL.M (Taxation), 2002
Texas Tech University School of Law, J.D., 1997
Brigham Young University, B.A., 1993

ADMITTED TO PRACTICE

Idaho State Courts
United States District Court for the District of Idaho
United States Court of Appeals for the Ninth Circuit

