2010 CPAmerica International Tax Conference

Estate, Gift, and Fiduciary Taxes – Recent Developments
Part IV – Miscellaneous Updates
9:50 A.M. – 11:55 A.M.

By

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1. IMPORTANT ESTATE AND GIFT TAX NUMBERS

	2004	2005	2006	2007	2008	2009	2010
Gift Tax Annual Exclusion Under IRC § 2503(b)	$11,000	$11,000	$12,000	$12,000	$12,000	$13,000	$13,000
Non-Citizen Spouse Annual Gift Tax Exclusion under IRC § 2523	$114,000	$117,000	$120,000	$125,000	$128,000	$133,000	$134,000
GST Exemption	$1,500,000	$1,500,000	$2,000,000	$2,000,000	$2,000,000	$3,500,000	N/A
Special Use Valuation for Real Estate & Farms under IRC §2032A	$860,000	$870,000	$900,000	$940,000	$960,000	$1,000,000	N/A
Tax Deferral for Closely Held Businesses under IRC § 6166	$1,140,000	$1,170,000	$1,200,000	$1,250,000	$1,280,000	$1,330,000	N/A
Maximum Estate Tax Rate	48%	47%	46%	45%	45%	45%	N/A
Gift Tax Exemption	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000	$1,000,000

2. VALUATION

A. Lottery Winnings:

Non-transferable lottery winnings are considered a private annuity and must be valued using the Tables set forth in IRC § 7520. *Cook v. Commissioner*, 349 F.3d 850 (5th Cir. 2003); *Anthony v. United States*, 520 F.3d 374 (5th Cir.), cert. denied, 129 S. Ct. 115 (2008); *Gribauskas v. Commissioner*, 116 T.C. 142, 164 (2001); rev'd, 342 F.3d 85 (2nd Cir. 2003).

In the *Estate of Negron*, 553 F.3d 1013 (6th Cir. 2009), the Sixth Circuit Court of Appeals held that the present value of lottery winnings must be valued using the IRS annuity tables. It should be noted that the Ninth Circuit and Second Circuit have held that the IRS annuity tables need not be used in valuing lottery winnings for estate tax purposes where the lottery payments are nontransferable. *Estate of Shackleford*, 262 F.3d 1028 (9th Cir. 2001), aff'g, *Estate of Shackleford*, 84 A.F.T.R.2d 5902, (E.D. Cal. 1999); *Estate of Gribauskas*, 343 F.3d 85 (2nd Cir. 2003), rev'g, 116 TC 142 (2001).

The Tax Court and the U.S. District Court of Massachusetts have all held that lottery winnings must be valued using IRS annuity tables. See, *Estate of Cook*, 349 F.3d 850 (5th Cir. 2003); *Estate of Anthony*, 520 F.3d 374 (5th Cir.), cert. denied, 129 S. Ct. 115 (2008); *Estate of Gribauskas*, 343 F.3d 85 (2nd Cir. 2003), rev'g, 116 TC 142 (2001); *Estate of Cook*, T.C. Memo 2001-170; *Estate of Donovan*, No.Civ.A. 04-10594-DPW, 2005 WL 958403 (D. Mass. Apr. 26, 2005).

In *Negron*, three individuals won a lottery and were entitled to receive 26 payments when, in 2001, two of the winners died with 15 annual payments remaining. The lottery payments were not assignable and could not be used as collateral, but the State allowed the executor to receive a lump sum cash settlement in lieu of the remaining lottery payments. The state used a 9% discount rate, determined the present value of the remaining lottery payments, and made a payment accordingly. Naturally, each estate reported the amount received on the estate tax return.

The IRS, however, revalued the value of the annuity stream using a discount rate of 5% and 5.6%, respectively. The estate paid the tax due and filed a claim for refund with the U.S. District Court in Ohio. The District Court agreed with the taxpayer that a departure from the table was appropriate if the taxpayer could show (1) the value described by the IRS annuity table was unrealistic and reasonable, and (2) there is a more reasonable and realistic means by which to determine the market value. See, *Negron*, 502 F.Supp. 2d, 682 (DC Ohio 2007).

The Sixth Circuit reversed the Tax Court and adopted an arbitrary, capricious, and manifestly contrary to law standard stating that the IRS table must be used unless the parties seeking to depart meets a substantial burden of showing that, (1) the result of using the IRS annuity tables is so unrealistic and unreasonable that either some modification in the prescribed method should be made, or complete departure from the

method should be taken, and (2) a more reasonable and realistic means of determining value is available.

B. Limited Liability Companies and Limited Partnerships:

The companion cases of *Lappo v. Commissioner*, T.C. Memo. 2003-258 and *Peracchio v. Commissioner*, T.C. Memo. 2003-280 seem to be the governing cases when valuing limited partnership interests and limited liability companies, provided the entities have been maintained appropriately. In *Lappo*, the Court allowed a 15% minority interest discount and a 24% lack of marketability discount in a family limited partnership with active and passive real estate assets. In *Peracchio*, the Tax Court allowed a 6% minority interest discount and a 25% lack of marketability discount in a family limited partnership with passive investments.

In both cases, the minority interest was derived by examining valuations of closed end mutual funds, essentially conceding that a family limited partnership was nothing more than a closed end mutual fund. The Court simply checked Barons to determine whether the interest was trading at a premium or at a discount to the underlying assets in a closed end mutual fund and disregarded so-called outliers.

Note that both cases allowed a 24% and 25% lack of marketability discount, respectively. Also, the discounts are to be applied sequentially so that, in essence, the *Lappo* case resulted in a discount of approximately 35% while the discount in *Peracchio* resulted in a discount of approximately 30%. Note also that the IRS is trying to avoid discount cases by finding fault with the maintenance of the partnership and seeking estate tax includibility under IRC § 2036.

C. Valuation for Estate and Gift Tax Purposes
vs. Valuation for Domestic Relations Purposes – Are you kidding me!

In *Bernier v. Bernier*, 449 Mass. 774, 873 N.E.2d 216 (2007), the Massachusetts Supreme Judicial Court seemed to rule that the valuation of a closely held business for domestic relations purposes should differ significantly from the valuation of the same business for gift and estate tax purposes. Two questions presented to the Court were, (1) whether it would be proper to discount the value of an S-corporation by tax affecting income at the rate applicable for C-corporations where one spouse will receive ownership of all shares of the S-corporation after the divorce and the other will be required to relinquish all ownership in the business, and (2) whether the trial judge erred in discounting the fair market value of the S-corporation by applying keyman and marketability discounts.

The Court ruled that, at least for the domestic relations case, the trial judge erred in adopting the valuation of the husband's expert witness that tax affected the fair market value of the party's S-corporation at the average corporate rate applicable to a C-

corporation. In addition, the Supreme Judicial Court ruled that there should be no keyman discount nor should there be any marketability discount.

Prior to analyzing the discount issues, it is significant that the Supreme Judicial Court seemed to carve out an exception for divorcing couples where one of the parties will maintain and the other will be entirely divested of ownership of a marital asset after the divorce. In such a case, the judge must take particular care to treat the parties, not as arm's-length hypothetical buyers and sellers in a theoretical open market, but as fiduciaries entitled to equitable distribution of their marital assets.

The husband's expert set the fair market value at $7,850,000 while the wife's expert set the value of the corporation at $16,391,000. The husband's expert testified that the S-corporation earnings should be tax affected as though it were a C-corporation using an average corporate tax of 35%. His reasoning was that a person contemplating the purchase of an S-corporation would factor into his probable rate of return the tax consequences of the purchase. The wife's expert, on the other hand, argued that tax effecting would not be appropriate because an S-corporation, unlike a C-corporation, does not pay taxes at the entity level and, because no sale of the business was contemplated.

The husband's expert then discounted the fair market value of the supermarkets by applying a 10% keyman discount to the adjusted net income of the supermarkets to account for the undisputed fact that the husband was the most important figure in the operation and management of the supermarkets. He then applied an additional 10% discount to account for the lack of marketability if the S-corporation was a closely-held business. The wife's expert, however, testified that the husband planned to maintain ownership and control of the supermarkets after the divorce and, for this reason, keyman and marketability discounts should not apply.

During the trial, the trial judge awarded the husband the option to purchase the wife's 50% ownership interest in the supermarkets for $3,925,000, or one-half of the supermarket's total value of $7,850,000. In Bernier, the Supreme Judicial Court ruled that the S-corporation income should be tax effective relying upon the mechanics as set forth in *Delaware Open MRI Radiology Associates v. Kesseler*, 898 A.2d 290 (Del. Ch. 2006).

In determining the appropriate tax effect, the question was, if the S-corporation at issue were a C-corporation, at what hypothetical tax rate could it be taxed and still leave the shareholders the same amount in their pocket as they would have if they held shares in an S-corporation. In other words, the Judge asked what the effective corporate rate would be for the S-corporation shareholders, although the entity itself paid no corporate tax. Assuming a dividend tax rate of 15% and a personal income tax rate of 40%, the Court imputed a pre-dividend corporate tax rate of 29.4% to the S-corporation. The result was to leave the shareholder of an S-corporation with the same amount of money in his or her pocket as the shareholder of a C-corporation being taxed at a fictitious 29.4% corporate tax.

3. WHY SHOULD DISCOUNTS FOR INCOME TAX PURPOSES DIFFER FROM DISCOUNTS FOR ESTATE TAX PURPOSES?

In *Bergquist v. Commissioner*, 131 T.C. 8 (T.C. 2008), the IRS argued for a 64% combined valuation discount for a case involving a gift of shares in a closely held professional corporation to a charity. During the audit, the IRS disallowed any charitable deduction, but, at trial, argued that the corporation should be valued on a liquidation basis not on as an ongoing concern and the shares would be subject to a 45% discount for lack of marketability, a 35% minority discount, and a 5% lack of voting rights discount.

SPEAKERS COMMENT:
I recently brought this case to the attention of an IRS attorney challenging a discount reported in connection with a gift of a limited partnership interest containing real estate. The IRS attorney's response was that they need not follow anything the income tax group recommends. My client intends to pursue the deeper discount, although the IRS is willing to concede a 35% discount to "make the case go away." The case settled for a 40% discount.

4. ESTABLISHING A BUSINESS PURPOSE FOR FAMILY LIMITED PARTNERSHIPS

In the *Estate of Miller v. Commissioner*, T.C. Memo. 2009-119, the Tax Court ruled that the goal of carrying out a deceased spouse's investment philosophy was a significant non-tax business purpose for establishing a limited partnership.

In the *Estate of Mirowski v. Commissioner*, T.C. Memo 2008-74, the Tax Court ruled in favor of the estate on a § 2036 inclusion argument by the IRS. The Tax Court ruled that the decedent's transfer of assets to the LLC satisfied the bona fide sales exception because the decedent had legitimate and substantial non-tax purposes for the LLC. The Tax Court found three legitimate and significant non-tax purposes: (1) Joint management of the family assets by the decedent's daughters and eventually her grandchildren; (2) Maintenance of the bulk of the decedent's assets in a single pool of assets in order to allow for investment opportunities that would not have been available had separate gifts been made; and (3) Providing for each the decedent's daughters and eventually each of her grandchildren on an equal basis; and one legitimate, but not significant purpose for forming and funding the LLC: (1) Creating additional protection from potential creditors. It is significant to note that the LLC was formed on August 27, 2001, then on September 7, 2001, the decedent made three 16% interest gifts in the LLC to each of her daughters and then on September 11, 2001, the decedent died.

5. BAD FACTS MAKE BAD LAW / IRC § 2036

In the *Estate of Jorgensen v. Commissioner*, T.C. Memo. 2009-66, the Tax Court denied discounts for family limited partnership interests held by the decedent. The facts showed that the decedent had retained an implied use and enjoyment of the assets under IRC § 2036 by borrowing money to buy a home, making inconsistent interest payments, and generally commingling personal and partnership funds. The Court, however, held that the estate was entitled to equitable recoupment for income taxes paid. See, IRC § 6214(b).

In *Estate of Malkin v. Commissioner*, T.C. Memo 2009-212, the Tax Court denied the discounts for the family limited partnership interests held by the decedent. The facts showed that the decedent retained for his life the possession and enjoyment of the stock he transferred to the family limited partnership and did not transfer the stock in a bona fide sale for adequate and full consideration in money or money's worth. The Tax Court held that because the decedent pledged the stock held in the family limited partnership to secure the decedent's personal loans, the decedent retained "the possession or enjoyment of" the stock transferred to the family limited partnership within the meaning of IRC § 2036(a)(1).

Note that IRC § 2036 provides two potential attacks by the Internal Revenue Service. First, IRC § 2036(a)(1) provides that the value of the gross estate will include the value of all property transferred, by trust or otherwise, under which the transferor has retained for his or her life the possession or enjoyment of or the right to the income from the property. If, in fact, the decedent transferred virtually all of his or her assets to a partnership before death and did not leave sufficient assets outside the partnership from which expenses could be paid, the IRS will conclude that there was an "implied" 2036(a) retained right to the income (even if distributions were not made to the decedent). In a case where distributions were made regularly to the decedent, the IRS will have an easy case showing that there was an implied right.

More problematic is the so-called 2036(a)(2) concern, which provides that the value of the gross estate shall include the value of all property to the extent of any interest to which the decedent has transferred under which he has retained for his life "the right, either alone or in conjunction with any person, to designate the persons who possess or enjoy the property or the income therefrom."

Does this mean that an individual who transferred 60% of the stock of a closely held S-corporation to three children (20% each) and retained 40% be required to include the entire value of the company, including not only the 40% retained, but also the amount transferred? This is the problem from so-called *Strangii II*, 417 F.3d 468 (5th Cir. 2005) which has settled down since the decision in *Kimbell*, 371 F.3d 257 (5th Cir. Tex. 2004). Out of concern over this section, it is recommended that decedents not have any ownership interest in the general partnership of a limited partnership.

6. MORE BAD FACTS MAKE MORE BAD LAW – PRIVATE ANNUITY

In the *Estate of Thelma G. Hurford*, T.C. Memo. 2008-278, the Tax Court ruled that partnership interests should be included in the decedent's estate at the undiscounted value of the underlying assets. The case was loaded with so-called "bad" facts.

First, despite the fact that the limited partnership interest had been sold in exchange for a private annuity, it was determined that only the first $80,000 payment was made and the children could not afford to pay the additional $80,000 per month and testified that their plan was to transfer back limited partnership interests and simply divide what was left over.

In addition, the evidence showed that the decedent comingled partnership funds with personal assets, property that, according to the schedule, was to be transferred into the partnership was never transferred into the partnership. Furthermore, the decedent had contributed a disproportionately large share of the assets in exchange for a substantially disproportionate share of the partnership. Bad facts make bad law to the point where the Tax Court ruled: "It is a truth universally acknowledged that a recently widowed woman in possession of a good fortune must be in want of an estate planner."

The Court also found that there was not adequate consideration in money or money's worth because there was no significant non-tax reason for the formation of the partnership. The Court found as a factual matter that none of the non-tax reasons listed for the creation of a limited partnership, such as dispute resolution, centralization of control, creditor protection, or maintaining family ownership were significant.

PLANNING NOTE:
This case was decided before the Miller case where the Tax Court ruled that the goal of carrying out a deceased spouse's investment philosophy is a significant non-tax business purpose for the limited partnership.

7. INDIRECT GIFTS USING FAMILY LIMITED PARTNERSHIPS

In *Holman v. Commissioner*, 130 T.C. 170 (T.C. 2008), the Tax Court rejected an indirect gift theory where gifts of a family limited partnership were made six days after the partnership was formed. The validity of the partnership was upheld when the taxpayers testified that their primary reasons for creating the partnership were long term growth, asset preservation, asset protection, and education.

In two earlier cases, *Sheperd v. Commissioner*, 115 T.C. 376 (T.C. 2000), aff'd., 283 F.3d 1258 (11th Cir. 2002), and *Senda v. Commissioner*, T.C. Memo 2004-160, aff'd., 433 F.3d 1044 (8th Cir. 2006), the indirect transfer argument was made successfully. In *Senda*, the contributions to the partnership and the gifts were made the same day. In *Sheperd*, the contributions by the various parties were not allocated pro rata.

In *Holman*, the Tax Court did rule, however, that certain buy/sell provisions included in the partnership agreement were more restrictive than state law and could be disregarded for valuation purposes under IRC § 2703 as a device for transferring assets to the

transferor's family at less than fair market value. This was upheld on appeal, *Holman v. Commissioner*, 601 F.3d 763 (8th Cir. 2010).

In *Gross v. Commissioner*, T.C. Memo 2008-221, the Tax Court ruled that a gift made 11 days after formation was not an indirect gift of the underlying assets.

8. GOOD NEWS AND BAD NEWS! SINGLE MEMBER LLCs

Pierre v. Commissioner, 133 T.C. 24 (T.C. 2009) (PIERRE I):

First the good news! In *Pierre v. Commissioner*, 133 T.C, 24 (T.C. 2009), the Tax Court held that gifts of the taxpayer's interest in a single member LLC should not be disregarded and treated as a transfer of the underlying LLC assets. This appeared to be a significant victory since, for income tax purposes, the conversion of a single member LLC to a multi-member LLC was generally considered a purchase of the underlying LLC assets by the buyer and re-contribution to the LLC.

Pierre v. Commissioner, T.C. Memo 2010-106 (PIERRE II):

Notwithstanding this victory, the IRS urged the Tax Court to consider a so-called step transaction doctrine and disregard the LLC membership interests and to consider the gifts of the membership interest a gift of a pro rata share of the underlying partnership assets. The Tax Court bought it, hook, line and sinker!

The facts showed that the taxpayer had formed a single member LLC and transferred $4,250,000 of cash and marketable securities to the LLC in exchange for 100% of the membership interests. It should be noted that the taxpayer retained approximately $8,000,000 in other assets outside the partnership. Eleven days after formation, the taxpayer created a series of irrevocable trusts.

Twelve days after funding the LLC, the taxpayer transferred 50% of the LLC interests to each of the two irrevocable trusts, structuring the transaction as a gift of a 9.5% membership interest and a sale of 40.5%. The promissory notes contained interest at the rate of 6.09% and the LLC made distributions to the trusts each year pursuant to which the trusts were able to make the yearly interest payments to the taxpayer. No principal payments were ever made.

The court ruled that the step-transaction would be appropriate where the only reason a single transaction was done as two or more separate transactions was to avoid tax, noting that the gift and sale all occurred on the same day.

In valuing the gift and the sale of the membership interests, the taxpayer used a 36.55% valuation discount. The Court noted that no principal payments had been made despite eight years from the date of the sale. There also appeared to be considerable records maintained by the taxpayer's attorney, who initially recorded the transfers as two gifts of a 50% interest in the LLC rather than a sale.

The Court held that the taxpayer had made a gift of the 50% interest in the LLC, gifting the difference between the value of the promissory note and the value of the underlying assets.

Annual Exclusion Problems:

In *Fisher*, 105 A.F.T.R. 2nd 2010-1347 TC (Indiana, 2010), the U.S. District Court for the Southern District of Indiana held that a gift of an interest in a limited partnership would not be eligible for the annual gift tax exclusion under IRC § 2503(b).

Tenants-in-Common Valuation Discounts:

In *Ludwick*, T.C. Memo 2010-104, a married couple who owned residential property as tenants in common transferred their interests into two separate qualified personal residence trusts claiming a 30% valuation discount. The IRS suggested that 11% would be appropriate and the Tax Court determined that a 17% discount would be appropriate taking into account the cost to partition the property. In other tenancy in common cases, discounts have ranged between 20% and 55%. *LeFrak*, T.C. Memo 1993-526 (30% discount for lack of marketability and lack of control in partial interests in apartment buildings.); *Estate of Cervin*, T.C. Memo 1994-550 (20% discount for fractional interest in farm); *Estate of Williams*, T.C. Memo 1998-59 (44% discount for undivided one-half interest in real estate); *Estate of Baird*, 416 F.3d 444 (5th Cir. 2005) (55% for a fractional interest in timberland).

IRC § 2036

The *Estate of Hurford*, T.C. Memo 2008-278, is a lesson in what should not be done in connection with estate planning with family limited partnerships. The facts of *Hurford* are fairly straight forward and estate planners will see every day.

The facts showed that the decedent died suddenly in April, 1999, and was worth over $14,000,000 consisting of 2,000 acres of farm and ranch lands, stocks, bonds, stock options, two residences, and phantom stock issued through "Hondoyle" of which he was president prior to his death. Prior to his death, he had set up a typical pourover Will and a revocable trust, which broke down into a so-called marital share and a by-pass share.

Following death, $650,000 was allocated to the by-pass share and the balance was allocated to the marital QTIP share. The marital share provided that all income would be made payable to the surviving spouse and principal was payable for health, support and maintenance. The decedent's wife was named as executor of the estate and trustee of both the marital share and the family share. The family share also provided that distributions of principal could be made to the spouse, but limited to an ascertainable standard.

Following the decedent's death, the trusts were administered properly (at least initially), until January of 2000 when the wife learned she had cancer and her prognosis was very poor. A new attorney was retained who recommended estate planning with family limited partnerships. Three limited partnerships were created, one to hold cash, stocks and bonds, another to hold Hondoyle phantom stock, and the third to hold the farm and ranch properties.

The wife, together with the marital share and the by-pass share, was to transfer their interests in the properties to the FLP in exchange for limited partnership interests in the limited partnerships. The children were to receive small shares in the FLP, although they did not contribute any assets to the FLP. The plan was for the wife to sell the interests she had received in the FLPs to her children in exchange for a private annuity. The general partner of each partnership was a limited liability company, in which the wife and the children received a 25% interest.

The plan went awry because of sloppy paperwork. The Court found that: "The agreements of limited partnership showed an "unsteady drafting ability to even an untrained eye." This included distributing the FLP interests in the marital trust and family trust to a non-existent trust and naming the same LLC as general partner on the signature page of each FLP (even though three separate LLCs were formed to serve as the general partner of the respective three limited partnerships).

The wife then liquidated her IRA and transferred these assets to the FLP. She was the sole signatory on the account and withdrew funds from the FLP for her personal use. Insofar as funding is concerned, the Court found that the assets were not transferred to the FLP in a timely manner, they were commingled with the wife's own assets at times, and paperwork was not properly handled. The court also found that, when the wife transferred all of her interest in the FLP to her children, it was dependent on the annuity payments for support. The composition of the FLP assets did not change and the wife added and withdrew funds from the FLP as though it were her own, even though she had "sold" the accounts to the children.

The Court noted that the FLP did not have any business and they were created primarily to reduce taxes by discounting asset values. The Court also determined that the family ignored the terms of the marital trust and the family trust costing the family significant assets noting that the wife, in effect, exercised a general power of appointment by distributing all of the assets of the family trust to herself and selling them to the children as part of the proceeds of the annuity.

PLANNING NOTE:
Be sure the assets are contributed to the partnership before the gifts are, in fact, made remembering that it takes time for securities to be re-titled in the name of the partnership.

9. PARTNERSHIPS AS A BUY/SELL AGREEMENT

In *Holman v. Commissioner*, 601 F.3d 763 (8th Cir. 2010), the Eighth Circuit Court of Appeals affirmed the Tax Court in finding that IRC § 2703(b) applied for purposes of valuation. IRC § 2703(b) usually applies to a buy/sell agreement and provides that certain buy/sell agreements may be disregarded for valuation purposes. Specifically, a restriction will be disregarded unless, (1) the restriction is a bona fide business arrangement, (2) the restriction is not a device to transfer property to other family members for less than full and adequate consideration, and (3) the terms are similar to those entered into by persons in an arm's length transaction. The Eighth Circuit determined that the partnership which held only Dell stock, was not a bona fide business arrangement and therefore denied any discounts attributable to a partner's restricted ability to sell its interests.

Specifically, Section 9.3 of the Agreement provided that the partnership had an option to purchase at an appraised value any partnership interest assigned in a manner that is prohibited by the Agreement but that is otherwise lawful and that the purchase price can be paid out over a five year period at a specific interest rate with a 10% down payment. In the Tax Court, experts testified that such a provision would not be found in a traditional business partnership.

Since IRC § 2703(b) applied, the partnership units should be valued without regard to any restriction on the right to use or sell the partnership interest within the meaning of IRC § 2703(a)(2). The Donors claimed discounts of slightly over 49% from net asset value. The Tax Court allowed a lack of marketability discount of 12.5% and minority interest discounts of 4.63% to 14.34%, all as asserted by the Commissioner's expert.

10. CAPITAL GAIN TAX DISCOUNT

In *Jelke v. Commissioner*, 507 F.3d 1317 (11th Cir. 2007), cert. denied, 129 S.Ct. 168 (2008), the Eleventh Circuit Court of Appeals agreed with the Tax Court that built-in capital gains should be allowed in computing the value of a corporation. In Jelke, the C-corporation owned appreciated securities. Interestingly, the Eleventh Circuit Court of Appeals concluded that the valuation must be based upon an assumption that the corporation will be immediately liquidated, thereby incurring an immediate capital gains tax. As a result, there should be a dollar-for-dollar reduction to take into account the built-in capital gains. This is similar to the Fifth Circuit in *Dunn v. Commissioner*, 301 F.3d 339 (5th Cir. 2002).

11. PRIVATE SPLIT-DOLLAR ARRANGEMENTS

- Private Letter Ruling 200910002 (3/6/2009)

In Private Letter Ruling 200910002, the Internal Revenue Service ruled that an arrangement between the grantors of an irrevocable trust with respect to the payment of premiums would not result in any gift by either the husband or the wife as the insureds. In the facts of this case, the husband and wife created an irrevocable insurance trust to hold a second-to-die policy in which neither the husband nor the wife could act as

trustee, and neither the husband nor the wife retained any power which would cause the trust assets to be included in their estate.

The trustees proposed entering into a private split-dollar arrangement where the trust would own the policy and pay a portion of the annual premiums equal to the insurance company's currently published rate for annual renewable term insurance generally available for standard risk and the insureds (husband and wife) would pay the balance.

The trust collaterally assigned certain rights to the husband and wife, namely (1) if the split-dollar agreement terminated on the death of the survivor of the husband and wife, the survivor's estate would receive the greater of the cash surrender value of the policy or the cumulative premiums paid by the husband and wife, and (2) if the split-dollar agreement terminated during the lifetime of the husband and wife, then the husband and wife are entitled to an amount equal to the greater of the cash surrender value of the policy or the premiums paid to date to the extent the cash value of other trust assets were available. (Note that this differs from earlier split-dollar arrangements where the amount to be repaid upon termination or upon death was the lesser of the cash value or the cumulative premiums paid.) See, also, Private Letter Ruling 200825011.

12. GENERAL POWERS OF APPOINTMENT

In Private Letter Ruling 200847015, the IRS ruled that a power held by a surviving spouse as trustee to withdraw income and principal to herself limited to health, support, and maintenance in the manner to which she was accustomed as of the time of her husband's death, would not constitute a general power of appointment.

One problematic issue in the ruling, however, was that if the trustee ever deemed it appropriate to do so, the trustee could spend amounts for a beneficiary's support, comfort, happiness, and welfare, if this was necessary to carry out the spirit and purpose of the spendthrift provisions. The IRS ruled that the decedent did not have a taxable general power of appointment because there was no indication that, at the time of the surviving spouse's death, she met any of the criteria that would trigger the spendthrift provision and the ability to exercise the non-ascertainable powers. Treasury Regulations 20.2041-3(b).

Powers in a spendthrift provision, which, by their terms, were exercisable only upon the occurrence during the decedent's lifetime of an event that did not, in fact, take place, was not a power in existence at the wife's death. For this reason, the wife did not possess a general power of appointment.

13. RESTRICTED MANAGEMENT ACCOUNTS

It was thought that an IRA could be discounted by causing the IRA to enter into a so-called restricted management account. In Revenue Ruling 2008-35, the Internal Revenue Service determined that a restricted management account must be valued for

gift and estate tax purposes without any discount for the restrictions imposed by the restricted management agreement.

14. INCOME IN RESPECT OF A DECEDENT

● IRC § 691(c)

In Private Letter Ruling 200744001, the IRS addressed a question as to whether a contract to sell real estate entered into before death, but not closed before death, would be income in respect of a decedent or would the property receive a so-called step up in basis. In the Letter Ruling, the evidence showed that the decedent's revocable trust had signed a contract with a specific closing date, but, prior to that time, a gas pipeline was discovered, which significantly delayed the closing and created a number of issues that needed to be taken care of with the decedent's heirs.

In relying on Rev. Rul. 78-32, which held that, in the case where, prior to death, a decedent had entered into a binding contract to sell real estate, had substantially completed all of the substantive perquisites of consummation of the sale, and was unconditionally entitled to the proceeds of the sale at the time of death, gain would be realized from the sale and such gain would be income in respect of a decedent under IRC § 691(a), but, in this case, found that significant efforts were needed in order to consummate the deal and that the closing had been delayed several times.

15. GRANTOR TRUSTS

● IRC § 675(4)(C)

In Revenue Ruling 2008-22, the IRS ruled that a grantor of an irrevocable trust who held a so-called IRC § 675(4)(C) power to reacquire trust property in a non-fiduciary capacity by substituting for other property of an equivalent value would not be required to include the assets in the grantor's estate under either IRC § 2036 or IRC § 2038. Some concern still remains that the IRS did not rule as to the includibility of the trust assets under IRC § 2042 (life insurance incidents of ownership) so it is recommended that another Section be used to create a grantor trust if the trust contains any life insurance.

In the facts of the ruling, the grantor was prohibited from serving as a trustee and the power of substitution was held in a non-fiduciary capacity.

This ruling follows the *Estate of Jordahl v. Commissioner*, 65 T.C. 92 (T.C. 1975), acq. in result, 1977-2 C.B. 1, where the Tax Court held that the power of substitution held in a fiduciary capacity, would not result in estate tax includibility under either IRC § 2036 or IRC § 2038. It was unclear for many years as to whether the power to substitute property held in a non-fiduciary capacity would be deemed to cause estate tax includibility. As to life insurance, consider a IRC § 674(c) power by a trustee, none of whom is the grantor and no more than half of whom are related or subordinate parties who are subservient to the wishes of the grantor to add to the beneficiary or beneficiaries or to a class of beneficiaries designated to receive the income or corpus.

Another option is to use a IRC § 675(2) power to give an independent person, which enables the grantor to borrow the corpus or income directly or indirectly, without adequate interest or without adequate security. Finally, consider IRC § 675(3), by simply loaning money to the grantor, in which case the trust would be considered a grantor trust, unless the grantor has completely repaid the loan, including any interest before the beginning of the taxable year and the loan was without adequate interest and without adequate security.

Transfers to Children – Gift, Loan or Resulting Trust

In *In reEstate of Dimond*, 759 NW.2d 534 (S.D. 2008), the Trial Court ruled that the transfer of $25,000 by a mother to her son was presumptively a gift and that the presumption could be rebutted only by clear and convincing evidence. The Supreme Court reversed the Trial Court finding that the "clear and convincing evidence" was too substantial a burden, but agreed that transfers of property or money from a parent to a child are presumptively gifts.

In this case, the son died, at which point the mother claimed that the transfer to the son was a loan and not a gift. This transfer also could be considered a resulting trust. A resulting trust usually will exist when one person pays the purchase price for property and places title to the property in the name of another. In such a case, there will be a presumption of a resulting trust on the property in favor of the party who paid the purchase price. One situation exists where title to the property is placed in the name of a child, in which case a presumption arises that the transfer was a gift. See, *Vanhoof v. Vanhoof*, 997 So.2d 278 (Ala. 2007).