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Tax Valuation E-Flash

Estate of Thompson v. Commissioner, T.C. Memo. 2002-246, September 26, 2002

The IRS has successfully challenged the transfer of assets to two family limited partnerships under §2036(a).

Decedent, Theodore Thompson, died on May 15, 1995. In 1993, he had formed two family limited partnerships using the "Fortress Plan." He transferred substantially all of his investment assets (primarily cash, marketable securities, and loans receivable from family members) to these partnerships. Before forming the partnerships, the decedent and his children agreed that Mr. Thompson would be taken care of financially. The children also transferred assets to the partnerships, but generally structured these transfers so they would retain the income from these assets.

Decedent had a habit of making significant gifts to family members and his children had expressed concern that he would have access to funds to make these gifts. The partnerships

Before forming the partnerships, the decedent and his children agreed that Mr. Thompson would be taken care of financially.

made distributions to Mr. Thompson to cover the checks he wrote for these gifts. The partnerships also made distributions to Mr. Thompson to cover his personal expenses. The partnerships continued to make loans to family members and did not aggressively enforce repayment terms.

A 40% combined discount was taken from the underlying partnership asset values for gifts of partnership interests and for the estate. The IRS challenged the estate valuation claiming first that the partnerships lacked economic substance and should be ignored for transfer tax

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purposes. Alternatively, the IRS claimed that Mr. Thompson retained economic benefit and control of the assets he transferred to the partnerships and §2036(a) should apply. Finally, the IRS asserted that if the previous two arguments failed, the 40% discount was too high.

The economic substance issue and the §2036(a) issue had not been raised in the IRS notice of deficiency and the Tax Court determined, therefore, that the IRS had the burden of proof in these issues.

The Tax Court concluded that the partnerships did not lack economic substance. The partnerships and their corporate general partners were validly formed under local law and potential purchasers of the decedent's assets would not disregard the partnerships.

The Tax Court concluded, however, that §2036(a) should apply. At the time the assets were transferred to the partnerships, there was an implied agreement or understanding that Mr.

Mr. Thompson's transfer of assets to the partnerships was not a bona fide sale for full and adequate consideration.

Thompson would retain the enjoyment and economic benefit of the property he transferred. The plan to withdraw funds so Mr. Thompson could make annual cash gifts to family members was an indication of this. In addition, the transfer of the bulk of Mr. Thompson's assets would deprive him of the assets needed for his own support absent the implied agreement. The Tax Court also concluded that Mr. Thompson's transfer of assets to the partnerships was not a bona fide sale for full and adequate consideration.

The Tax Court said, "*Based on these facts, we conclude that nothing but legal title changed in the decedent's relationship to his assets after he transferred them to the partnerships...the full date-of-death value of the assets that decedent transferred from his trusts to the Thompson and Turner Partnerships is includable in his gross estate pursuant to 2036(a).*"