

FCG VALUATION CASE E-FLASH

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Issue 12:2

CITATION:

Estate of Charlene B. Shurtz, Deceased, Bonnie K. Case, a.k.a. Bonnie Cathleen Case, Executrix, v. Commissioner, T.C. Memo. 2010-21, Docket No. 6076-07, February 3, 2010

COMMENTS:

As with *Estate of Black v. Commissioner* (133 T.C. No. 15), *Estate of Shurtz* shows that proper financial and legal planning can be invaluable to the taxpayer. Additionally, actively managing operations and properly administering the partnership contributed to a favorable ruling. The case is another clear victory for use of the FLP in estate planning.

OVERVIEW:

With proper estate planning, the Estate was able to avoid paying tax on an estate valued at more than \$8.7 million dollars.

- Transfers of assets (including LP interests and timberland) from the gross estate to a FLP were:
 - bona fide sales
 - for full and adequate consideration and
 - therefore not includable in the gross estate.
- Only the fair market value of the Decedent's interest in the FLP, rather than the fair market value of the assets contributed to the FLP, was includable in her gross estate.
- The FLP entities were created for legitimate and significant nontax reasons:
 - protection from litigious environment
 - preservation of the family business
 - management efficiency in an actively managed entity
- Because there was no estate tax deficiency, the Estate was not liable for an addition to tax under 6651(a)(1).

THE FACTS:

Charlene B. Shurtz (the "Decedent", or "Ms. Shurtz") engaged in sophisticated estate planning between 1993 and her death in January 2002. The Decedent created or was a partner in two FLP entities - C.A. Barge Timberlands LP ("Timberlands LP") and Doulos LP (the "Partnership") - as well as several trusts as part of her estate planning.

Timberlands LP was formed to consolidate the multiple undivided interests in timberlands owned by Ms. Shurtz's family. The Decedent also owned one-third of the stock in the general partner of Timberlands LP as well as a 16 percent limited partnership interest.

Additionally, the family wished to avoid the litigious atmosphere it believed existed in Mississippi at that time. Based on advice from a tax attorney, several of the partners in Timberlands LP formed limited partnerships in which to hold their Timberlands LP interests. As restricted by ownership transfer provisions of the partnership agreement, a judgment creditor would be entitled only to the distributions from Timberlands LP rather than being able to seize the underlying timberland.

Ms. Shurtz also wanted to gift interests in the timberland that she owned separately from that of Timberlands LP. Based on her experience with multiple undivided interests, the formation of Timberlands LP, and her attorney's advice on asset protection, Ms. Shurtz and her husband ("Reverend Shurtz") created a second limited partnership, Doulos LP, in November 1996. The Decedent owned a one percent general partnership interest and a 98 percent limited partnership interest, while Reverend Shurtz owned a one percent general partnership interest.

Although reduction of estate tax liability was a goal when Doulos LP was formed, the Partnership was also formed to provide for asset protection and to provide for heirs of the Shurtzes.

The Partnership Agreement required consent from the general partner to accept a substituted limited partner and required interests transferred as a result of death, divorce, or legal judgment out of the Shurtz family to be offered back to the Partnership for repurchase.

Between 1996 and 2000, Ms. Shurtz transferred 26 separate 0.4% limited partnership interests to her children and trusts for her grandchildren as annual exclusion gifts. As a result, Ms. Shurtz owned a one percent general partnership interest and an 87.4 percent limited partnership interest in Doulos LP when she died. Reverend Shurtz still held his 1 percent general partnership interest, and the remaining 10.4 percent limited partnership interests were divided among the children and grandchildren.

The Partnership maintained capital accounts, issued Schedules K-1, and filed taxes on Form 1065 for the partners. Although distributions were not always pro-rata, Doulos LP always made up the unequal distributions in later years. Additionally, partners paid partnership expenses out of personal bank accounts, but were always reimbursed.

The Partnership held annual meetings, usually combined with the annual meetings of Timberlands LP. During the Timberlands LP meetings, timberland strategies, expansion, and capital expenditures were some of the topics discussed and meeting minutes were retained. Because Doulos LP owned an interest in Timberlands LP and because the Partnership owned timberland directly, these discussions were relevant to the growth and success of Doulos LP.

Upon Ms. Shurtz's death, her estate was divided into a unified credit trust, trusts qualifying for the marital deduction, and deductible expenses. As a result of the planning, the Decedent's advisers believed that no estate tax was due.

DISCUSSION:

IRC § 2036(a) requires estates to include assets from the value of the gross estates except in certain instances ("except in the case of a bona fide sale for an adequate and full consideration in money or money's worth"). In particular, § 2036(a)(1) includes in gross estates "the possession or enjoyment of, or the right to the income from, the property" which the decedent (in general) enjoyed even if a transfer of the property had taken place.

The estate of Ms. Shurtz argued that the formation of Doulos LP was for legitimate non-tax reasons, including, but not limited to:

- protection of a family business from a litigious atmosphere and
- management efficiency.

Because the estate was left to a unified credit trust and marital trust, the taxpayer asserted no taxable estate existed. Additionally, the estate maintained the transfers were for full and adequate consideration and, therefore, § 2036(a)(1) did not apply.

The IRS rejected the estate's arguments and believed that Ms. Shurtz retained control, use, and benefit of the transferred assets under § 2036(a) and /or § 2035(a). Additionally, the IRS contended that the value of the marital deduction should be based on Ms. Shurtz interest in Doulos LP.

CONCLUSION:

The court agreed with the Estate's contention that Doulos LP was formed for significant non-tax reasons. In particular, the court believed that preservation of the family business and management efficiency were legitimate concerns of the Estate. Therefore the creation of the Partnership and contributions of assets were for legitimate and significant non-tax reasons. Accordingly, the bona fide sale exception was met.

The court also believed that the full and adequate consideration component was met for the following reasons:

- Contributors received partnership interests equal to the interests contributed,
- Capital accounts were properly created and maintained for each partner,
- Distributions were debited properly for amounts received by each partner, and
- Legitimate and significant non-tax reasons for the establishment of the Partnership existed.

Because the court ruled a bona fide sale for full and adequate consideration had taken place, the fair market value of the assets contributed to Doulos LP was not includable in the Decedent's gross estate. Accordingly, § 2036(a) (1) or (2) considerations (i.e., control, use and benefit of transferred assets) were not addressed by the court.

Additionally, the court determined that the value of the partnership interests in Doulos LP (rather than the fair market value of assets contributed to the Partnership) was includable in the gross estate. Because of the preceding, the marital deduction calculated under § 2056 was computed using the fair market value of the partnership interests passed to Reverend Shurtz.

Lastly, there was no estate tax deficiency and no tax due from the Estate. As a result, the Estate owed no addition to tax under § 6651(a)(1).

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