



Valuation Insights & Updates

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RECENT FAMILY LIMITED PARTNERSHIP CASES: Astleford, Holman, Mirowski

Astleford v. Commissioner T.C. Memo. 2008-128, May 5, 2008 (*Multi-Level Discounting*)

This case involved three levels of discounting. There was an absorption discount (akin to a blockage discount) for the underlying property, a discount for the partnership Pine Bend Partnership that owned the land directly and the Astleford Family Limited Partnership (AFLP) which held the Pine Bend Partnership interests.

The IRS challenged the valuations of gifts of Astleford Family Limited Partnership (AFLP) limited partnership interests made by Jane Z. Astleford in 1996 and 1997. In particular, the IRS challenged the value of Minnesota farmland owned by AFLP, whether the 50% interest in the Pine Bend general partnership should be valued as a partnership interest or assignee interest, the proper discounts for lack of control and marketability to apply to the Pine Bend interest, and the proper discounts to apply to the gifted AFLP interests (All three levels of discounting).

The Court found discounting at all three levels to be warranted. First, the Court used the appraisal of the IRS but applied a 10% absorption discount which was midway between the amount asked for by Taxpayer and the IRS. The IRS then recognized a combined 30% discount for lack of marketability and lack of control for the 50% Pine Bend Partnership interest held in AFLP. The IRS urged the Court to disregard the 50% Pine Bend interest as merely an assignee's interest and not warranting any discounting. Lastly, the Court recognized a combined 17.47% Discount for Lack of Control (DLOC) and 21.23% Discount for Lack of Marketability (DLOM) was warranted to the AFLP interests.

This was obviously a nice win for the multi-tier discounting advocates. In the ruling the Court noted that tiered discounts have been both accepted and rejected depending on the portion of total assets represented by the lower level entity. In making its decisions the Court cited: *"The 50-percent Pine Bend interest constituted less than 16 percent of AFLP's NAV and was only 1 of 15 real estate investments that on Dec. 1, 1997, were held by AFLP, and lack of control and lack of marketability discounts at both the Pine Bend level and the AFLP parent level are appropriate."*

Holman v. Commissioner (130 T.C. No. 12, May 2008) (*Rejection of IRS Step transaction doctrine*)

In *Holman v. Commissioner*, the Court increased the value of the taxpayer's gifts of FLP units to his children because the FLP's restrictions on the transferability of the children's interests did not serve a

"bona fide business purpose" (victory for the IRS), but at the same time the Tax Court rejected the IRS' argument that the lack of control and marketability discounts should not have applied to the gifts. This resulted in a substantially lower value for the gifts than the IRS had originally calculated (victory for the taxpayer).

Notably the Court rejected the IRS's "step transaction doctrine" argument that the Discounts for Lack of Control and Marketability were not warranted due to the underlying asset, Dell Stock, and the brief time between formation, funding and gifting was six days.

Mirowski v. Commissioner, March 2008 (*Estate survives IRC 2036 "Bona fide Sale" Exception*)

In *Mirowski v. Commissioner* the U.S. Tax Court delivered a victory to taxpayers and appraisers when it found that a family limited partnership (FLP)—formed just days before the founder's death—was founded on legitimate, non-tax business purposes, sufficient to meet the exceptions under IRC Sec. 2036 and withstand an IRS attack. In making its decision the Court found: 1) no one expected the founder to die so quickly; 2) there was no provision to use the FLP assets to pay estate or gift tax liabilities (even though the latter were significant). Most importantly, Mrs Mirowski, the MVF LLC's founder and general partner, often cited that her family work together on the family business matters as the primary reason for funding the MVF LLC.

This case was won by the tax payer despite: 1) a testamentary transfer by proximity of the transfers to the date of death and (2) evidence of an implied or expressed agreement due to retention of insufficient assets by decedent outside of the MFV LLC and 3) the founder, Mrs. Mirowski stayed General Partner through her untimely death. Clearly the non-tax business reasons for the formation and operation of the LLC defeated the IRS attack under the IRC 2036 bona fide sale exception.

While the result was favorable for "good guys" in *Mirowski*, the opinion was based on Section 2036 exception (bona fide sale exception). Judge Chiechi's opinion observed a 'smell test' and Chiechi opinion did not believe that the family was just forming the LLC to generate estate tax discounts. Mrs Mirowski and her daughters were very contemplative, had a history of meetings with advisors before making decisions and taking actions. The only way to rationalize the various FLP/LLC Section 2036 cases is to recognize that the courts apply a 'smell test' to avoid allowing a valuation discount in what the Tax Court perceives as abusive cases involving paper shuffling (often immediately before death) just to generate a valuation discount.

Given the IRS's sustained efforts to disable FLPs as tax-planning devices, however, the Service may likely attack these FLPs when their founders die, to recover the full value of the assets under Sec. 2036. Before getting carried away with the favorable taxpayer result in *Mirowski*, observe that Section 2036 involves a 'smell test' and Judge Chiechi (who wrote this judicial opinion) did not believe that the family was just forming the LLC to generate estate tax discounts. The only way to rationalize the various FLP/LLC Section 2036 cases is to recognize that the courts apply a 'smell test' to avoid allowing a valuation discount in what the Tax Court perceives as abusive cases involving paper shuffling (often immediately before death) just to generate a valuation discount.

If you wish to discuss anything contained in this article, please do not hesitate calling Tony Garvy, CPA, CVA at (312) 324-0340 x2.