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Craig Smalley • May. 23, 2017

In the Estate of Nancy Powell (2017) 148 TC No. 18, shortly before her death, she transferred cash and securities to a limited partnership for a 99% interest in the partnership. The goal was to get it out of the taxable estate. Tax Court concluded that if she retained until her death her rights with regard to the transferred cash and securities, the value of those assets would be includible in the value of her gross estate to the extent required by Code Sec 2036(a) which says:

The value of the gross estate shall include the value of all property to the extent of any interest

The point of transferring assets to a limited partnership or a family limited partnership concerning estate tax is to remove the assets from the taxable estate and then PASS THEM to the next generation – not hold 99% interest in the limited partnership.

The first goal of a family limited partnership (FLP) is asset protection, which is defined as the safeguarding of personal wealth from lawsuits by future creditors. Those assets could be cash, securities, cars, homes, or anything worth protecting.

Creditors are also broadly defined and include actual creditors as well as identifiable probable creditors, such as litigants, soon-to-be ex-spouses, disgruntled business partners, or anyone who you know that has a claim against you, even if they do not yet know it. Creditors may even include government agencies such as the I.R.S.[1] The FLP effectively codifies asset protection as law.

The FLP basically provides a joint venture between family members. It is formed with the senior family members holding the partnership interests through a shell corporation as general partners, and then the children or grandchildren hold their interests as limited partners. The general partners are effectively in control of the partnership while the limited partners have none. The FLP is then funded with these assets. CAUTION: if not funded correctly, you can run into some gift tax issues.

A note needs to be added here about fraudulent conveyance. What that means is that the person forming the FLP is already under a lawsuit and puts their assets into something to protect them. The courts can see right through that and call it fraudulent conveyance.

Now let's discuss the estate tax reasons for this. Let's say the assets coming over are worth $5 million. This removes those assets from the taxable estate. First, the value

of a limited interest in the FLP is discounted. Once discounted, more FLP interests

one, or unless all general partners died and the FLP liquidated.

Another hint created here is a second reduction in value that is due to the fact that there is no ready market for buying and selling the assets. The Courts have repeatedly forced the IRS to recognize the validity of these discounts and it has been officially recognized in Revenue Ruling 93-12.

Let's say that an asset worth $1 million is put into the FLP. The IRS would give a 50% discount in the value of the limited interest in the FLP with a discount leaving the assets value at $500,000. If this is a husband and wife, they have a lifetime exclusion of $10.56 million due to portability. In effect, the $1 million asset is tax free, removed from the taxable estate, and provides asset protection.

Back to the case… On Aug. 8, 2008, Nancy Powell's son, Jeffrey Powell, acting on her behalf, transferred cash and securities to NHP Enterprises LP (NHP), a limited partnership, in exchange for a 99% limited partner interest. On that date, the transferred cash and securities were worth $10 million. NHP had been formed two days earlier on Aug. 6, 2008, when Jeffrey, as general partner, executed and filed with the Delaware secretary of state a certificate of limited partnership. NHP's limited partnership agreement gives him, as general partner, sole discretion to determine the amount and timing of partnership distributions. That agreement also allows for the partnership's dissolution with the written consent of all partners.

Also on Aug. 8, 2008, Jeffrey, purportedly acting under a power of attorney, transferred Nancy's NHP interest to a charitable lead annuity trust (CLAT), the terms of which provided an annuity to a charitable organization for the rest of Nancy's life. Upon her death, the CLAT's corpus was to be divided equally between Nancy's two sons.

Nancy died on Aug. 15, 2008. The Court concluded that Nancy had control over her

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