2004

Family Limited Partnership Update

Farhad Aghdami

Repository Citation
http://scholarship.law.wm.edu/tax/107

Copyright c 2004 by the authors. This article is brought to you by the William & Mary Law School Scholarship Repository.
http://scholarship.law.wm.edu/tax
FAMILY LIMITED PARTNERSHIP
UPDATE

Farhad Aghdami
Williams Mullen
Two James Center
1021 East Cary Street – Suite 1700
Richmond, Virginia 23219
804.783.6440 (v)
804.783.6507 (f)
aghdmai@williamsmullen.com
FAMILY LIMITED PARTNERSHIP
UPDATE

Farhad Aghdami
Williams Mullen
Richmond, Virginia

I. BACKGROUND AND HISTORY.

A. Valuation Discounts in the Family Context.

1. For many years, the Internal Revenue Service (the “Service”) challenged valuation discounts, in the context of a family, because of the theory of family attribution - i.e., minority interests held by a family should be aggregated to form a controlling block because the family is more likely to act as one unit. The Service consistently lost on this issue. See, e.g., Propstra v. U.S., 680 F.2d 1248 (9th Cir. 1982); Estate of Bright v. U.S., 658 F.2d 999 (5th Cir. 1981); Estate of Andrews v. Commissioner, 79 T.C. 938 (1982); and Estate of Lee v. Commissioner, 69 T.C. 860 (1978).

2. In Rev. Rul. 93-12, 1993-1 C.B. 202, the Service abandoned the family attribution theory. Rev. Rul. 93-12 involved a gift by a 100% shareholder of a corporation of 20% of his stock to each of his five children. The Service ruled that the family’s control of the entity would not be considered in valuing the 20% interests. The Service stated:

For estate and gift tax valuation purposes, the Service will follow Bright, Propstra, Andrews and Lee in not assuming that all voting power held by family members may be aggregated for purposes of determining whether the transferred shares should be valued as a part of a controlling interest. Consequently, a minority discount would not be disallowed solely because a transferred interest, when aggregated with interests held by family members, would be a part of a controlling interest. This would be the case whether the donor held 100% or some lesser percentage of the stock immediately before the gift.

B. Use of Family Limited Partnerships and LLCs.

1. The family limited partnership (FLP) concept is fairly simple. The client contributes assets to a limited partnership in exchange for both general and limited partnership interests. The bulk of the initial capital contribution typically would be assigned to the limited partnership interests. For example, the partnership agreement might assign 1% of the initial capital contribution to the general partnership interests and the remaining 99% to
the limited partnership interests. The client then gifts the limited partnership interests to his issue (or to trusts for their benefit) while retaining the general partnership interest.

2. An FLP is a very attractive estate planning tool because it permits the donor/parent to significantly discount the value of gifts to the donee/children that might not be discountable if made outright.

3. Two discounts generally are available: a lack of marketability discount and a minority discount. A lack of marketability discount reflects the fact that the partnership agreement will restrict the sale or transfer of the partnership interests so that there is no ready market for those interests.

4. A minority discount reflects the inability of the limited partner to compel partnership distributions or to compel liquidation to obtain his share of the assets which the partnership owns. It also reflects the inability of the limited partner to control partnership investments.

C. IRS Initiates Attacks On Family Limited Partnerships. In 1997, the Service initiated its attack on FLPs and LLCs through a series of Technical Advice Memoranda. See, e.g., TAM 9842003 (July 2, 1998); TAM 9736004 (June 6, 1997); TAM 9735003 (May 8, 1997); TAM 9730004 (Apr. 3, 1997); TAM 9725002 (Mar. 3, 1997); TAM 9723009 (Feb. 24, 1997); TAM 9719006 (Jan. 14, 1997). The TAMs involved situations where (a) liquid assets, such as marketable securities, were transferred to a limited partnership or LLC; (b) the transferor was elderly; and (c) the transfer was carried out by third parties (such as children) as agents under a power of attorney or as trustees.

D. The Service’s Arguments. The Service has advanced the following arguments in challenging the use and validity of FLPs, each of which will be discussed in greater detail, below:

1. Disregarding the entity.

2. Code § 2703.

3. Code § 2704.

4. Gift upon formation.

5. Code § 2036.


7. Indirect gifts.
II. TAXPAYER VICTORIES.

A. Disregarding the Entity.

1. **The Service's Argument.** The Service claimed that the formation of an FLP should be treated as a single testamentary transaction and therefore disregarded for transfer tax purposes. The Service cites the Tax Court case of *Estate of Murphy v. Commissioner*, in which the court held that a minority interest discount was not applicable to stock of a closely held corporation owned by the decedent although the decedent owned slightly less than 50% of the stock at her death. T.C. Memo 1990-472. At the urging of her accountant, Mrs. Murphy had transferred a 1.76% interest to her children 18 days before her death specifically to reduce her interest below 50%.

2. **Church v. United States** 268 F.3rd 1063 (5th Cir. 2001), aff'g per curiam 85 AFTR2d 2000-804 (W.D. Tex. 2000) suggests that threshold for a validly formed partnership is extremely low. The taxpayer formed a limited partnership two days before her death.
   a. The corporate general partner had not been formed prior to her death, the limited partnership certificate had not been filed with the state, and assets had not been validly transferred to the partnership. Mrs. Church transferred $1.5 million of assets (real estate and marketable securities) to the partnership; her partnership interests were valued at $617,600.
   b. The Service argued that Church did not effectively convey the securities to the partnership before she died. Alternatively, the Service also argued that Church made a taxable gift when forming the partnership, represented by the difference between the value of the assets she contributed and the value of the partnership interest she received.
   c. The District Court ruled in the estate’s favor, rejecting the government’s arguments. As to the securities, the court found that Church did not hold legal title; she had an equitable beneficial interest because legal title was held by a brokerage house. Further, the court found that Church clearly expressed her intent to relinquish her beneficial interest when she executed the partnership agreement. On the gift issue, Judge Garcia wrote that the government’s argument “confuses the market value of the assignee interest passing at death with the value of the Partnership interest Mrs. Church received in return for her contribution. The two interests are not comparable. More importantly, the Government ignores the fact that this was a pro rata partnership that did not
confer a financial benefit on, or increase the wealth of, any partner.” Furthermore, the court found that there was no donee and no gratuitous transfer. Judge Garcia also held that the partnership was not a sham as the government contended, finding that the partnership had bona fide business purposes and was not formed to reduce estate taxes. The court noted that Church did not have the unilateral right to amend or revoke the partnership agreement and that the partners had no express or implied agreement that Church could continue to use or possess partnership property within the meaning of Code § 2036.


B. Code § 2703.

1. Statutory Language. Under Code § 2703(a), for purposes of estate, gift, and generation-skipping transfer taxes, the value of any property is determined without regard to any right or restriction relating to the property. Code § 2703(b) states that a right or restriction will not be disregarded if the following requirements are met:

   a. The right or restriction is a bona fide business arrangement;

   b. The right or restriction is not a device to transfer the property to the natural objects of the transferor’s bounty for less than full and adequate consideration in money or money’s worth; and

   c. At the time the right or restriction is created, the terms of the right or restriction are comparable to similar arrangements entered into by persons in an arms-length transaction.

2. The Service’s Argument. The Service argues that the use of a partnership structure to hold assets is, in and of itself, a restriction with respect to the property and should be disregarded. The Service also argues that the exceptions to Code § 2703(b) should not apply because the use of a partnership is a “device to transfer property” for a less than full and adequate consideration.

3. Strangi I, 115 T.C. 35 (2000), the decedent’s son-in-law, acting pursuant to a power of attorney formed a family limited partnership funded largely with marketable securities. The decedent owned a 99% limited partnership interest and 47% of the corporate general partner. The Court found that the decedent retained effective control over the partnership. Nevertheless, the Court ruled that the decedent formed a valid partnership and that Code
§ 2703(a)(2) did not operate to disregard the limited partnership. See also, Church, 268 F3d 1063 (5th Cir. 2001).

4. However, consider a recent District Court case from the Western District of Pennsylvania, Smith, 94 AFTR2d 2004-5283 (W.D.Pa. 2004) which held that Code § 2703(a) applied to a provision in a limited partnership agreement which restricted the transferability of the interest. The Court, however, held that the question of whether the taxpayer could avail itself of the exception found Code § 2703(b) was a question of fact that required further inquiry. The Court granted partial summary judgment on the Code § 2703(a) issue, but deferred on the Code § 2703(b) issue.

C. Code § 2704.

1. Statutory Language. Code § 2704(b) provides that an “applicable restriction” on the right of a donee to liquidate his or her interests may be disregarded for gift and estate tax purposes, thereby increasing the value of the gift or the size of the federal gross estate. An “applicable restriction” is a limitation on the ability to liquidate or dissolve the entity (in whole or in part) that is more restrictive than the limitations that would apply under the state law generally applicable to the entity in the absence of the restriction.

2. The Service’s Argument. The Service contended that under Code § 2704(b) any limitations on the right to liquidate the interests that were more restrictive than the state’s default rule would be disregarded.

3. Kerr v. Commissioner, 292 F.3d 490 (5th Cir. 2002), aff’g 113 T.C. 443 (1999). The Tax Court held that a couple transferred limited partnership interests, not assignee interests, to two grantor retained annuity trusts (GRATs), but that they were entitled to apply liquidity discounts in valuing those interests because Code § 2704(b) did not apply. The Fifth Circuit affirmed that the Tax Court properly held the dissolution and liquidation provisions in the partnership agreements were no more restrictive than the limitations under Texas law, and weren’t applicable restrictions.

4. Harper v. Commissioner, T.C. Memo 2000-202 (2000). The analysis employed by the Tax Court in Kerr was adopted by Judge Wells in Harper, a family limited partnership case involving marketable securities, where the decedent’s revocable trust held 99% limited partnership and her two children collectively held a 1% general partnership interest.
D. Gift Upon Formation.

1. The Service's Argument. The Service has argued that, if valuation discounts are appropriate in valuing limited partnership interests, the value that is “lost” by the taxpayer is a deemed gift of an equivalent amount to the other partners. For example, assume a taxpayer gifts an asset having a value of $1,000,000 to an FLP. The 99% limited partnership interest is discounted by 35%. The Service argues that the reduction in value of the taxpayer’s 99% limited partnership interest, as compared to its aliquot share of the underlying assets, constitutes a gift of $350,000, an amount equal to the amount of the reduction. See, e.g., Estate of Trenchard v. Commissioner, T.C. Memo 1995-232 (1995) and Estate of Bosca v. Commissioner, T.C. Memo 1998-251 (1998).

2. Taxpayer Arguments.

   a. The gift tax is an excise tax on the privilege of transferring property; it is an excise tax on the transfer, not on the subject of the gift. Treas. Reg. §§ 25.2511-2 and 25.2511-1(h)(1). Before the gift tax can be assessed, a transfer and a transferee must exist. On creation of a partnership, no person becomes a transferee, and without a transferee, there is no basis for the assessment of the gift tax.

   b. Value appears and disappears and that fact does not mean that a transfer has occurred from one person to another. If A, B, and C each contribute $100 to form a corporation and receive 1 share of stock in return, the value of A’s stock is presumably valued at less than $100 because A does not possess the right to liquidate the corporation and receive a return of his investment. This diminution in value does not mean that A has made a taxable gift to his children, B and C. There is no transfer to B and C. B and C’s shares are also valued at less than $100.

3. The Service has been largely unsuccessful with respect to the gift upon formation argument. See, e.g., Jones v. Commissioner, 116 T.C. 11 (2001), Church v. United States 268 F.3rd 1063 (5th Cir. 2001), Kerr v. Commissioner, 292 F.3d 490 (5th Cir. 2002), Shepherd, 115 TC 376, aff’d 283 F3d 1258 (11th Cir. 2002) and Strangi I, 115 T.C. 35 (2000).
III. CODE § 2036.

A. Statutory Provisions. Code § 2036(a) provides as follows:

The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death —

1. the possession or enjoyment of, or the right to the income from the property, or

2. the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.


1. The Service has been most successful under Code § 2036(a)(1) involving the retention of “possession or enjoyment” of property. Retention of possession or enjoyment may take place by express or implied understanding, and need not be under a legally binding agreement.

2. The Service has been successful in cases where the following “bad facts” were present:

   a. Most of a decedent’s assets were transferred to the partnership, without sufficient assets remaining outside of the partnership for the decedent’s needs.

   b. The decedent’s continued occupancy of a residence transferred to the partnership without contemporaneous payment of rent.

   c. Commingling of personal and partnership assets.

   d. Disproportionate distributions.

   e. Use of partnership funds for personal expenses.

   f. Timing of distributions, where partnership distributions were based on the decedent’s personal needs.

3. The “Bad Facts” cases are discussed in greater detail in Section IV, infra.

1. In Strangi, the Service argued under Code § 2036(a)(2) that the decedent retained a right in conjunction with other persons to designate the persons who will enjoy the property or the income therefrom.

2. Taxpayers and their counsel, up to that time, relied on the decision of the U.S. Supreme Court in Byrum to shield them from Code § 2036(a)(2).

3. Code § 2036(a)(2) and Strangi are discussed in greater detail in Section V, infra.

D. The Exception for a "Bona Fide Sale for an Adequate and Full Consideration."

1. Taxpayers have had mixed results in arguing that the exception for a "bona fide sale for an adequate and full consideration" should shield them from the application of Code § 2036.

2. The cases that have considered the bona fide sale exception are discussed in greater detail in Section VI, infra.

IV. THE "BAD FACTS" 2036(a)(1) CASES.


1. The decedent formed a separate limited partnership with each of her three children and transferred a substantial percentage of her interests in the limited partnerships to family members, using the annual exclusion to avoid taxable gifts. Afterwards, she deposited income from the partnerships in her personal account, in which she deposited income from other sources, and used the account to pay her personal expenses as well as partnership expenses.

2. The Service once again argued that the limited partnership interests should be disregarded based on its Code § 2703 analysis. However, the Tax Court decided that the transferred interests should be included in the decedent's estate under Code §§ 2036(a) and 2038 and decided the case in favor of the Service without invoking Code § 2703.

3. The Court found that there was an implied agreement that the decedent would retain the economic benefits of the property and, therefore, because the decedent had transferred property and retained the right to enjoyment of the income from the property until her death, the transferred limited partnership interests were includible in her estate under Code § 2036(a)(1). The Schauerhamer case points out the importance of complying with all the formalities under state law and the terms of the
operative agreements to ensure that the entity will be recognized under state law and the property transferred to the entity will not be includible in the transferor’s estate under Code §§ 2036(a) and 2038.


1. The Tax Court held that property transferred by an individual to a family limited partnership was includible in his gross estate because he retained possession and enjoyment of it, and the right to its income.

2. In June 1993, shortly after having been diagnosed with terminal cancer, Charles formed a revocable living trust and a family limited partnership. He appointed himself and his children as cotrustees and authorized each trustee to act on behalf of the trust. The trust was the partnership’s only general partner. Charles transferred all of his property (except for his car, personal effects, and a small amount of cash) to the partnership, including the property in which he had a life interest. He signed deeds individually and on behalf of his wife’s estate transferring property to the trust and then signed deeds as trustee transferring the property to the partnership. He deposited over $20,000 of partnership funds to his personal checking accounts. He lived in one property before and after he transferred it to the trust and partnership. No rent was paid to the trust or partnership for use of the residence. Charles gave each of his two children a 30.4% interest in the partnership on October 22, 1993. He died on August 21, 1994 and his estate did not include any of the assets transferred to the trust and partnership. It did include his 34.46% limited partnership interest and his 1% general partnership interest.

3. The Service determined that the assets transferred to the partnership should have been included in his estate.

4. The Tax Court noted that, for purposes of Code § 2036, a transferor retains the enjoyment of property if there is an express or implied agreement at the time of the transfer that the transferor will retain the present economic benefits of the property, even if the retained right is not legally enforceable. The Tax Court found that Charles did not curtail his enjoyment of the transferred property after he formed the partnership. It said that nothing changed except legal title. Charles managed the trust which managed the partnership. He was the only trustee to sign the articles of limited partnership, the deeds, the transfer of lien, and any document which could be executed by one trustee on behalf of the trust. He was the only trustee to open brokerage accounts or sign partnership checks. Furthermore, the Tax Court found that Charles commingled partnership and personal funds. He deposited some partnership income in his personal account and he used the partnership’s checking account as his personal account. He lived at the same property without paying rent before or after
he transferred it to the trust and to the partnership.

5. The estate maintained that Charles' fiduciary duties as a general partner and trustee precluded him from retaining enjoyment of the assets. The Tax Court disagreed. It said that these duties did not deter Charles from continuing to possess and enjoy the house in which he lived or the other assets he conveyed to the partnership. The court also stressed that the children, as co-trustees, did nothing to preclude him from doing so. This suggested to the court that Charles and his children had an implied agreement to allow him to continue to enjoy partnership property for life. The estate also argued the Charles received full and adequate consideration for the transferred property. The court disagreed, finding that the children gave nothing to Charles or the partnership when he transferred property to the trust.


1. The taxpayer formed a family limited partnership. However, the taxpayer failed to observe all of the formalities of the partnership, commingled funds, etc.

2. The Court reviewed four missteps by the taxpayer: (1) commingling of funds, (2) the delay in transferring assets to the FLP, (3) a history of disproportionate partnership distributions, and (4) the testamentary characteristics of the arrangement. The Court concluded that Code § 2036(a) applied and that all discounts should be disallowed.

3. The Tax Court's view of these cases is instructive: "Hence we are again met with an example of indifference by those involved toward the formal structure of the partnership arrangement and, as a corollary, towards the degree of separation that the Agreement facially purports to establish... we find equally compelling indicia of an implied understanding or agreement that the partnership arrangement would not curtail decedent's ability to enjoy the economic benefit of assets contributed to HFLP... decedent did not divest himself economically of the contributed assets... We additionally take note of decedent's advanced age, serious health conditions and experience as an attorney."


1. The decedent, received three significant properties from the estate of her deceased husband. The decedent's children, her guardians and guardians ad litem entered into a court-approved plan to rearrange the decedent's financial affairs to reduce estate taxes. The plan required that the three properties be transferred to three family limited partnerships, each having a corporate general partner the stock of which would be owned by a trust
for the decedent. The children were not to receive partnership income until the general partner had set aside sufficient sum to pay for the partnership’s administration and the support of the decedent. The corporate presidents (the decedent’s guardians ad litem), ran the partnerships, acting in a fiduciary capacity for the decedent, and they had complete discretion to determine how much money decedent needed from the partnerships to meet her needs. The decedent initially held a 98-percent limited partnership interest in two of the partnerships, the corporate general partners each held a one-percent interest, and one of the decedent’s daughters each held a one-percent interest. The decedent initially held a 99-percent limited partnership interest in the other partnership, and the corporation held the remaining 1-percent. The decedent later gave 30 percent limited partnerships to three of her children, two in exchange for cash transfers and the third in exchange for the settlement of certain claims.

2. The Service stated that the value of the properties was includible in the decedent’s gross estate under Code § 2036(a), because the decedent had retained the lifetime income and beneficial enjoyment of those assets. The court stated that the decedent continued to enjoy the right to support and maintenance from all the income of the partnerships, because the decree that authorized the creation of the partnerships stated that the decedent’s needs for support were contemplated first from the partnership income, and only thereafter, could the children receive their proportionate shares of income from the partnerships. The decedent’s support needs were actually treated as an obligation of the partnerships. The court also noted that one of the decedent’s children admitted the existence of a pre-arrangement to maintain the status quo with respect to her mother’s financial situation.


1. The decedent became the limited partner of a family partnership. The decedent retained a 99.95 percent capital interest in the partnership and a 75-percent profits interest, and she gave her brother, Marc, the remaining interests as general partner. The decedent contributed seven properties to the partnership, though she did not actually change the title to the properties or formally assign to the partnership the leases on the properties for five months. The agreement allowed the decedent’s brother to act for the partnership without disclosing the existence of the partnership, and he did, in fact, do so. The partnership was “designed generally to be invisible to the public and to persons with whom the decedent and [Marc] Hillgren did business.” The partnership agreement stated that the partnership need not have a separate bank account, and that it could use the accounts of the decedent’s revocable trust and proprietorship. Initially, the partnership records included among its assets the decedent’s residence, and the partnership paid the mortgage and property taxes on that residence. An
adjusted journal entry posted after the decedent’s death removed the residence and related expenses from the partnership’s books. There were no minutes of meetings of the partners and the certificate of limited partnership was not filed with the Secretary of State until nearly two years after the decedent’s death. The decedent’s brother, as the general partner, had sole discretion regarding partnership distributions, and during the five months that the partnership existed during the decedent’s lifetime, all distributions were made to or for the benefit of the decedent; none were made to the brother. The distributions were made in amounts to enable the decedent to pay her living expenses, and she was dependent on the partnership cashflow to cover those expenses. The partnership also paid the costs of the decedent’s estate, including estate tax installments. The partnership assets were managed by a corporation all of whose business was managing properties owned by various entities controlled by the decedent’s family. The same person managed the properties before and after the formation of the partnership. The decedent and her brother did enter into a business loan agreement covering four of the seven properties held by the partnership. The agreement was a complex document that included a contract for services provided by decedent’s brother, who facilitated forbearance and extensions of other loans, an agreement for the brother’s personal guarantee of certain loans, an agreement extending a $1 million line of credit to the decedent, and a security agreement encumbering three properties. The business loan agreement gave the brother authority, for 29 years, to determine whether to sell any of four properties subject to the agreement, and granted him an irrevocable power of attorney for duration of her ownership of properties. The decedent’s estate reported the decedent’s 99.5 percent partnership interest at $2,266,000, based on an independent appraisal that claimed discounts for lack of control and marketability.

2. The Tax Court agreed with the Service that the value of the partnership assets should be included in the decedent’s gross estate under Code § 2036(a), with no discounts for the existence of the partnership itself. In particular, the court noted that: (a) the proximity of the creation of the partnership to the death of the decedent (five months), and the fact that the decedent had earlier attempted suicide and did, in fact, die by suicide, suggests that the transaction was testamentary in nature; (b) the management of the assets remained the same both before and after creating the partnership, suggesting an agreement to retain the beneficial enjoyment of those assets; (c) the argument that the partnership was created as a premarital asset protection device fails, because the decedent broke up with her boyfriend and apparent marriage candidate before the creation of the partnership [The court also noted that the estate made “inconsistent representations during discovery and during trial” regarding whether the boyfriend was even aware of the partnership.]; (d) there was no solid evidence that the decedent and her brother negotiated at arm’s
length over the terms of the partnership or the contributions of services to be made by the brother; (e) the decedent's brother was both general partner of the partnership and trustee of the decedent's revocable trust, that held the decedent's interest in the partnership; (f) the brother ignored the terms of the partnership agreement when "it suited him"; (g) funds were commingled; (h) the partnership form was ignored frequently; (i) the decedent's psychiatrist testified that the decedent had not expected that the partnership would change her relationship with her brother or her role in the management of the partnership assets; (j) the decedent had planned to transfer her residence to the partnership; (k) the decedent received all of the partnership income distributions. The court held, however, that the business loan agreement was a bona fide contract that would be taken into account by any buyer of the four properties to which it related. The business loan agreement, the court stated, restricted the control over those properties and reduced their marketability, justifying discounts of 55 percent for one property, 35 to 40 percent for three others, and an additional five percent for lack of voting rights.

V. CODE § 2036(a)(2) — STR ANGI


1. Decedent's son-in-law acting under a durable power of attorney, created a Texas family limited partnership and transferred to it most of the decedent's personal and investment assets. Decedent received a 99-percent limited partnership interest and 47 percent of the stock of the corporate general partner. Decedent's family owned 52 percent of the rest of the stock of the general partner, and an unrelated charity owned one percent of the stock. Decedent died two months later.

2. The Tax Court initially held that: (a) the creation of the partnership was not a taxable gift; (b) the partnership had economic substance; (c) the terms of the partnership agreement were not restrictions on the transfer the underlying assets, under Code § 2703(a)(2); and (d) the Service claim that the decedent had retained control over the transferred partnership assets was not raised in a timely manner. The Fifth Circuit affirmed the Tax Court on the substantive issues, but stated that the Service could argue the application of Code § 2036(a), because its motion was made early enough to prevent prejudice to the taxpayer.

3. On remand, the Tax Court held that the partnership assets transferred by the decedent were includible in his gross estate, because he had retained their beneficial enjoyment, under Code § 2036(a)(1). The court noted particularly that: (a) the decedent was in very poor health when he
established the partnership; (b) the partnership paid many of the
decedent’s personal expenses, including personal in-home health care,
surgery for the decedent’s care-giver, funeral expenses, estate
administration expenses, and related debts of the decedent’s estate, and a
specific bequest to the decedent’s sister (the court was not swayed by the
partnership having treated these expenses as advances and having made
corresponding distributions to the general partner, because the decedent’s
99.43-percent interest meant that no significant distributions were actually
made to anyone else); (c) the decedent continued to live in his residence
after transferring it to the partnership and the decedent only accrued rent
that was not actually paid for more than two years; (d) the decedent’s
99.43 percent interest made the arrangement seem testamentary, rather
than a true joint enterprise; and (e) the documents were forms provided by
a private group, with little, if any, input from other family members.

4. The court also stated that the partnership assets could be included in the
decedent’s gross estate under Code § 2036(a)(2), because he controlled
their beneficial enjoyment. The court noted that the general partner could
(i) unilaterally determine partnership distributions, and (ii) could, acting
with the other partners, terminate the partnership and cause its assets to be
distributed. The court noted that Regulations § 20.2036-1(b)(3) taxes a
decedent with respect to powers that are exercisable only with the consent
of others.

5. The court also rejected the estate’s reliance on United States v. Byrum, 408
U.S. 125 (1972), because: (a) the control was vested in someone who was
the decedent’s son-in-law, his attorney, and his attorney-in-fact; (b) the
partnership held primarily investment assets, whereas the corporations in
Byrum were operating businesses whose ability to distribute dividends was
subject to business exigencies not relevant to the Strangi partnership; (c)
the other stockholders in Byrum were largely unrelated to the decedent; (d)
there was an independent trustee in Byrum, who could decline to distribute
to the beneficiaries any amounts distributed by the Byrum corporations;
and (e) the fiduciary duties held by directors and shareholders in Byrum
were not relevant in Strangi, because the few holders of other interests
were unlikely to enforce them.

VI. BONA FIDE SALE – FULL AND ADEQUATE CONSIDERATION EXCEPTION


1. The decedents, husband and wife, together created five family limited
partnerships, to hold various businesses and investments that the decedents
owned. The decedents had initially been drawn to the family limited
partnership as a means of settling disputes among their children regarding
the management of various assets, but their estate planning attorney had
later explained to them how these devices could also reduce their estate tax liabilities. They created the five partnerships, in consultation with their children. Each of their children became a general partner, together with the parents, in one or more of the partnerships, and participated actively in the operations of the partnership. The children each contributed their own assets to buy their shares of the partnerships, though some of these assets had originally been given to the children by their parents. The parents' attorney consulted with the attorneys for the children in selecting the terms of the partnerships, though the parents' attorney drafted the agreements.

2. After both parents died relatively close together, the Service asserted that the value of the partnership assets should be included in the decedents' estates under Code § 2036(a)(1), as a transfer with a reservation of beneficial enjoyment.

3. The Tax Court disagreed, and held that Code § 2036(a)(1) did not apply, because the decedents had transferred their assets to the partnerships in bona fide sales for adequate and full consideration. The court distinguished its contrary holdings in several other cases, noting that: (a) all of the partners transferred their own assets to the partnership in exchange for their proportionate interests, though some of those assets were the results of prior gifts from the decedents; (b) upon the termination or dissolution of each of the partnerships, the partners were entitled to distributions from each such partnership in amounts equal to their respective capital accounts; (c) each partner was represented in the decision-making by separate counsel; (d) the decedents retained enough assets outside the partnership to provide for their own needs and support; (e) creating the partnership was motivated at least partially by nontax business concerns; and (f) the decedents' children became general partners and participated actively in managing the partnerships. Cf. Estate of Reichardt v. Comm'r, 114 T.C. 144 (2000), Estate of Thompson v. Comm'r, T.C. Memo.2002-246; Estate of Harper v. Comm'r, T.C. Memo.2002-121; Estate of Strangi v. Comm'r, T.C. Memo.2003-145.


1. Ruth A. Kimbell died in March 1998 at the age of 96. When she died, Mrs. Kimbell held interests in three entities: (1) the R.A. Kimbell Living Trust ("Trust"), (2) the R.A. Kimbell Management Co., LLC ("LLC"), and (3) the R.A. Kimbell Property Co., Ltd. ("Partnership"). Trust was created by Mrs. Kimbell in 1991 and fully revocable by her before her death. Thus, its interests and Mrs. Kimbell's interests were treated as one for tax purposes. Mrs. Kimbell and David Kimbell were co-trustees, and David Kimbell was paid a monthly fee to manage Trust. LLC is a Texas limited liability company established in January 1998. It was owned 50% by
Trust, 25% by David Kimbell and 25% by his wife (Mrs. Kimbell’s daughter-in-law). David Kimbell was the manager of LLC. Partnership is a Texas limited partnership created on January 29 1998 (two months before Mrs. Kimbell’s death) by Trust and LLC, which contributed 1% of the capital of Partnership and was its general partner. Trust contributed 99% of the capital and yet was only a limited partner. Partnership had a term of 40 years (i.e., until Mrs. Kimbell would have been 136 years old). As Mrs. Kimbell had a 50% interest in LLC through her ownership of Trust and a 100% interest in Trust, her real interest in Partnership was 99.5%.

2. After Mrs. Kimbell died, David Kimbell, as her executor, filed estate tax returns with the Service, which audited them and found that the value of Mrs. Kimbell’s 99% interest in Partnership was $2.463 million, not $1.257 million as reported. David Kimbell paid the increased taxes and ultimately went to district court seeking a refund of $837,089, claiming that the Service had overvalued the estate.

3. At the District Court, David Kimbell argued that Mrs. Kimbell’s transfer of assets to Partnership was a bona fide sale for an adequate and full consideration in money or money’s worth. The district court disagreed. It said there was no credible evidence that Partnership’s formation was the product of an arm’s length transaction between unrelated parties. The court said that there weren’t even two parties because ownership interests in Partnership were held by two entities: 99% by Trust, which was wholly-owned by Mrs. Kimbell, and 1% by the LLC, which was 50% owned by Trust. The court said that even if Partnership resulted from a bona fide sale, David Kimbell didn’t establish that Mrs. Kimbell received adequate and full consideration for the sale. Mrs. Kimbell, through Trust, contributed 99% of the capital for Partnership and in return received a 99% interest in Partnership. Mrs. Kimbell received no consideration other than the interest in Partnership. David Kimbell, before becoming the general partner of Partnership, was already managing both Trust, where 99% of the assets of Partnership came from and LLC from where the other 1% came from (of which 0.5% were from Trust). David Kimbell argued that Mrs. Kimbell “irrevocably” transferred her assets to Partnership and thus qualified under the retained income or rights exception. The district court said that this argument didn’t fly. Mrs. Kimbell (through Trust), although formally a limited partner, owned 99% of Partnership, and an additional 0.5% of Partnership through her 50% interest in LLC. Under the partnership agreement, Mrs. Kimbell, as a limited partner with a 99% interest in Partnership, could at any time remove the general partner, and either appoint herself or someone she chose to be the new general partner, who could then distribute the income back to Mrs. Kimbell. Thus, Mrs. Kimbell retained the right to the income from the property. Accordingly,
the district court found the transfer to be includible in Mrs. Kimbell’s estate under Code § 2036.

4. The Fifth Circuit said that for Mrs. Kimbell’s transfer to Partnership to qualify as a bona fide sale, it had to be a sale in which she actually parted with her interest in the assets transferred and the partnership/transferee actually parted with the partnership interest issued in exchange. For the sale to be for adequate and full consideration, the exchange of assets for partnership interests must be roughly equivalent so the transfer does not deplete the estate. In addition, when the transaction is between family members, it is subject to heightened scrutiny to ensure that the sale is not a sham transaction or disguised gift.

5. The Fifth Circuit concluded that Mrs. Kimbell’s transfer was for full and adequate consideration because:

   a. The interest credited to each of the partners was proportionate to the fair market value of the assets each partner contributed to Partnership,

   b. The assets contributed by each partner to Partnership were properly credited to their respective capital accounts, and

   c. On termination or dissolution of Partnership the partners were entitled to distributions from it in amounts equal to their respective capital accounts.

6. The court in *Kimbell* noted with regard to the immediate decrease in value of the decedent's assets after the partnership was formed that, “The business decision to exchange cash or other assets for a transfer-restricted, non-managerial interest in a limited partnership involves financial considerations other than the purchaser's ability to turn right around and sell the newly acquired limited partnership interest for 100 cents on the dollar. Investors who acquire such interests do so with the expectation of realizing benefits such as management expertise, security, and preservation of assets, capital appreciation, and avoidance of personal liability.”

7. The sale was “bona fide” in *Kimbell* because:

   a. The transferor actually parted with his interest in property transferred in exchange for a partnership interest. Put differently, the transferor did not use partnership assets in the same way both before and after the transfer.
b. Mrs. Kimbell retained sufficient assets outside of the partnership for her support. Partnership formalities were followed, and partnership assets were not used for personal expenses.

c. There were significant nontax reasons for the arrangement (and therefore it was not a disguised gift or sham). These included: (a) protection of Mrs. Kimbell from personal liability in connection with working oil and gas interests; (b) partnership assets could continue intact, and could be passed down to family members without being broken up; and (c) the arrangement provided centralized management and a mechanism to appoint successors to the decedent's son, who was currently managing the partnership.


1. The Third Circuit Court of Appeals held that the estate of an individual who transferred $2.8 million in securities and other assets to two family limited partnerships in exchange for pro-rata partnership interests had to include the full date of death value of the transferred assets under Code § 2036.

2. In 1993, Theodore Thompson, his daughter Betsy T. Turner, and her husband George Turner, formed the Turner Partnership and Turner Corporation. Mr. Thompson contributed $1,286,000 in securities, along with notes receivable from Betsy's children totaling $125,000, in exchange for a 95.4% limited partnership interest in the Turner Partnership. George contributed $1,000 in cash and real property valued at $49,000 in exchange for a 3.54% limited partnership interest. Turner Corporation, the sole general partner, held the remaining 1.06% interest. Shares in Turner Corporation were issued to Mr. Thompson (490 shares or 49%), Betsy (245 shares or 24.5%), George (245 shares or 24.5%), and an unrelated tax-exempt entity (20 shares or 2%). Mr. Thompson and his son Robert Thompson formed the Thompson Partnership on April 30, 1993, and the Thompson Corporation on April 21, 1993. Mr. Thompson contributed $1,118,500 in securities, along with notes totaling $293,000, in exchange for a 62.27% limited partnership interest. Robert contributed mutual funds worth $372,000, and a ranch property appraised at $460,000 in exchange for a 36.72% limited partnership interest. Thompson Corporation, as general partner, held the remaining 1.01% interest. Mr. Thompson and Robert each held 49% of Thompson Corporation and an unrelated third party held the remaining 2% interest. As of July 1993, Mr. Thompson, then age 95, had transferred $2.8 million in assets—$2.5 million in the form of marketable securities—to the Turner and Thompson Partnerships. He retained $153,000 in personal assets, and received an annual income of $14,000 from two annuities and Social Security. At the
time of transfer, he had annual expenses of $57,202, and an actuarial life expectancy of 4.1 years.

3. The Turner Partnership assets consisted primarily of marketable securities contributed by Mr. Thompson, which the partnership continued to hold in his brokerage account with minimal post-transfer trading. The Turner Partnership engaged in several business transactions, although none produced economic gains. The Turner Partnership also made loans to members of the Turner family. Although the partnership formally charged family members interest on these loans, interest payments were often late or not paid at all, and loans were frequently reamortized. But the partnership never pursued enforcement action against any of its debtors nor made loans to anyone outside the Turner family. Like the Turner Partnership, most of the Thompson Partnership assets consisted of marketable securities contributed by Mr. Thompson and Robert Thompson and there was little post-transfer trading. In 1993, each partnership made cash distributions of $40,000 to Mr. Thompson which he used to provide holiday gifts to family members. In 1995, the Thompson and Turner Partnerships made cash distributions to him of $45,500 and $45,220 respectively. During the same time period, he made gifts of interests in both partnerships to individual family members. In March 1995, the Thompson Partnership distributed $12,500 to Mr. Thompson to pay for some personal expenses.

4. Mr. Thompson died on May 15, 1995. On May 27, 1995, the Turner and Thompson Partnerships respectively sold $347,000 and $350,000 in securities to partially fund bequests in his will and pay his estate taxes. Mr. Thompson’s estate tax return reported that he held a 87.65% interest in the Turner Partnership and a 54.12% interest in the Thompson Partnership valued at $875,811 and $837,691 respectively, and that his shares in Turner Corporation and Thompson Corporation were worth $5,190 and $7,888 respectively. The estate calculated these values by applying a 40% discount rate to the net asset value of the partnerships and corporations for lack of control and marketability.

5. In January 1999, the Service issued a notice of deficiency in the amount of $707,054, adjusting the taxable estate from $1,761,219 to $3,203,506 after disallowing the claimed discounts. The estate went to Tax Court. In an amended answer to the estate’s petition, the Service contended that the full fair market value of the assets transferred by Mr. Thompson to the partnerships should be returned to his gross estate under Code § 2036(a) because he retained control and enjoyment over the transferred assets during his lifetime.

6. The Tax Court found that the family partnerships were validly formed and properly recognized for federal estate tax purposes but nevertheless
included the transferred assets in the estate under Code § 2036(a). The Tax Court found an implied agreement existed at the time of transfer that Mr. Thompson would retain lifetime enjoyment and economic benefit of the transferred assets. In support of this finding, the Court noted that both Betsy and George Turner had sought assurances from financial advisors that Mr. Thompson would be able to withdraw assets from the partnerships to make gifts to family members, and that the partnerships in fact made such distributions to him. The Tax Court also determined that the transfers did not qualify for the full and adequate consideration exception because the transactions were not motivated by legitimate business concerns. According to the Tax Court, the family partnership was a mere "recycling of value" and Mr. Thompson's receipt of a partnership interest in exchange for his testamentary assets was not full and adequate consideration.

7. After reviewing the record, the Third Circuit found no clear error in the Tax Court's finding of an implied agreement between Mr. Thompson and his family that he would continue to be the principal economic beneficiary of the contributed property, which was sufficient to trigger Code § 2036(a)(1). The Third Circuit stressed that, as the Tax Court had found, Mr. Thompson did not retain sufficient assets to support himself for the remainder of his life, as calculated at the time of transfer. It said that this fact supported the implied understanding with the children. The Third Circuit said that Mr. Thompson's *de jure* lack of control over the transferred property did not defeat the inference of an implied agreement under the circumstances of the case.

8. The Third Circuit also agreed with the Tax Court that there was no transfer for consideration within the meaning of Code § 2036(a). The Third Circuit stressed that neither partnership had engaged in any valid, functioning business enterprise. Although the partnerships did conduct some economic activity, these transactions did not rise to the level of legitimate business operations.

9. The Third Circuit also emphasized that the form of the transferred assets—predominately marketable securities—was significant to its holding. Other than favorable estate tax treatment resulting from the change in form, the Court said that it is difficult to see what benefit could be derived from holding an untraded portfolio of securities in a family limited partnership with no ongoing business operations. In short, the Third Circuit said that where the transferee partnership does not operate a legitimate business, and the record demonstrates that the valuation discount provides the sole benefit for converting liquid, marketable assets into illiquid partnership interests, there is no transfer for consideration within the meaning of Code § 2036(a).
10. The Third Circuit also concluded that there was no bona fide sale within the meaning of Code § 2036 because there was no discernible purpose or benefit for the transfer other than estate tax savings.

11. The Court implied that the case at hand was different from *Kimbell*, where the Fifth Circuit found that there was both full and adequate consideration and a bona fide sale for a transfer of assets to a family limited partnership where the transferred assets were working oil and gas interests and the transfer was motivated by a desire to achieve centralized management and protection from personal environmental liabilities.

VII. OTHER AREAS OF CONCERN.


1. In 1995 and 1996 Albert and Christine Hackl gave their children and grandchildren membership units in Treeco, a limited liability company that Albert formed to hold and operate tree farming properties. When Albert bought the timberland, he sought to provide investment diversification in the form of long-term growth and future income. The land he bought had little or no existing salable timber. Albert and Christine gave interests in the company to family members in 1995. The couple reported the gifts on their gift tax returns and elected to treat them as made one-half each by Albert and Christine under Code § 2513. They also treated the gifts as qualifying for Code § 2503(b)’s $10,000 annual exclusion. The couple continued the gifting program in 1996, but transferred membership units in Treeco to their minor grandchildren’s trust. The couple treated the 1996 gifts as they had the 1995 gifts. At the time of the gifts, Albert correctly anticipated that Treeco and several successor entities would generate losses and make no distributions for many years. The IRS disallowed the exclusions for 1996.

2. The Tax Court, deciding in the Service’s favor, noted that the dispute turned on whether the transfers amounted to gifts of a present or future interest. Because the gifts failed to confer substantial present economic benefit by reason of use, possession, or enjoyment of the property or the income from the property, the court concluded that they failed to qualify for the Code § 2503(b) exclusion. In reaching its decision, the court rejected the Hackls’ argument that when a gift takes the form of an outright transfer of an equity interest in property, no further analysis is needed or justified. The court held that to follow this logic was to sanction exclusions for gifts based only on “conveyancing form,” without inquiring into whether the donees received rights that differed from those that would have come from a traditional trust arrangement. In examining the facts and circumstances of the Hackls’ case, the court held that any economic
benefit the donees could have ultimately obtained from their receipt of Treeco units was future, not present.

3. The Tax Court based its decision primarily on the terms of the LLC Operating Agreement. The terms discussed by the Tax Court included the authority given to Mr. Hackl as manager, the inability of members to withdraw their capital accounts, the inability of members to sell interests to outsiders, and the inability of members to compel distributions. The Court concluded, "...the terms of the Treeco Operating Agreement foreclosed the ability of the donees presently to access any substantial economic or financial benefit that might be represented by the ownership units."


1. The donors (a husband and wife) created two FLPs (FLP I and FLP II). The donors signed the FLP I agreement on April 1, 1998. The partnership agreement provided that a .01% limited partnership interest was initially held in trust for each of the donors' three minor children. On December 28, 1998, the donors contributed 28,500 shares of MCI WorldCom stock to FLP I by transferring the stock from their joint brokerage account to the brokerage account of FLP I. By fax dated December 28, 1998, the donors informed their accountant that they had transferred stock to FLP I, and sought advice as to what percentage of partnership interests they should transfer to the children. On that same day, the husband gave each child (or trust for that child) a 29.94657% limited partnership interest in FLP I, and the wife gave each child (or trust for that child) a 0.0434% limited partnership interest in FLP I. The certificates of ownership reflecting the transfers were not prepared and signed until several years later.

2. The donors signed the FLP II agreement on December 17, 1999. As with FLP I, the partnership agreement provided that a .01% limited partnership interest was initially held in trust for each of the donors' three minor children. On December 20, 1999, the donors contributed 18,477 shares of MCI WorldCom stock to FLP II by transferring the stock from their joint brokerage account to the brokerage account of FLP II. By fax dated December 22, 1999, the donors informed their accountant that they had transferred stock to FLP II, and sought advice as to the percentage of partnership interests they should transfer to the children to maximize their annual gift tax exclusions and use all of their remaining unified credits. On Jan. 31, 2000, the donors gave to each child, in trust, an additional 4.5% limited partnership interest in FLP II.

3. On their 1998, 1999, and 2000 gift tax returns, the donors reported the transfers as gifts of partnership interests to their children. The values of
the partnership interests were determined by multiplying the value of the transferred stock (as to which there was no dispute) by the percentage of the partnership interests transferred to the children, and then applying lack of marketability and minority interest discounts.

4. The Service conceded that the Jan. 31, 2000 gifts were gifts of partnership interests, not gifts of stock. But the Service argued that the December 28, 1998 transfer of stock to FLP I, and the December 20, 1999 transfer of stock to FLP II, coupled with the transfer of limited partnership interests to the donors' children, were indirect gifts of the stock to the children. Thus, the Service argued that the stock, not the partnership interests, had to be valued for gift tax purposes. According to the Service, "the transitory allocations to [the donors'] capital accounts, if such allocations even occurred at all, were merely steps in integrated transactions intended to pass the stock to the [donors'] children in partnership form."

5. The Tax Court agreed with the Service, saying that the donors had presented no reliable evidence that they contributed the stock to the FLPs before they transferred the partnership interests to their children. The court said that the donors were "more concerned with ensuring that the beneficial ownership of the stock was transferred to the children in tax-advantaged form than they were with the formalities of FLPs," and noted that the husband, as general partner, did not maintain any books or records for the partnerships other than brokerage account statements and partnership tax returns. The tax returns were prepared months after the transfers of the partnership interests, and thus were unreliable in showing whether the donors transferred the partnership interests to the children before or after they contributed the stock to the partnerships. The same was true of the certificates of ownership reflecting the transfers of the partnership interests, which were not prepared until at least several weeks after the transfers. And the letters that the donors faxed to their accountant after they had funded the partnerships did not establish—as the donors contended—that the donors first funded the partnerships and then transferred the partnership interests to their children. The faxes established only that the donors had funded the partnerships; they did not show what the partnership ownership interests were immediately before the funding, or how the stock was allocated among the partners' capital accounts at the time of the funding. The court concluded that the value of the children's partnership interests was enhanced upon the donors' contributions of stock to the FLPs. Thus, the transfers were indirect gifts of stock to the children.
VIII. LESSONS TO BE LEARNED.

A. What Should Planners Do About *Strangi*?

1. Estate planners need to pay careful attention to how partnerships are structured and administered, because Code § 2036(a) is a potent basis for the Service challenge. The decision in *Strangi* should not cause practitioners to doubt the general utility of this technique, in appropriate cases.

   a. First, this decision has been appealed to the Fifth Circuit, which affirmed the refusal of a district court to apply Code § 2036(a)(2) to a similar family limited partnership in *Church v. United States*, 268 F.3rd 1063 (5th Cir. 2001)(unpublished opinion). In addition, the Fifth Circuit adopted a bright-line, objective standard in *Kimbell*, which suggests it may do the same in *Strangi*.

   b. Second, the opinion of the Tax Court in *Strangi* was a memorandum decision, issued without review by the whole court. *Strangi*, therefore, represents the view of one judge, more than that of the entire court.

   c. Third, the Tax Court stated that its analysis was based on the "particular structure" of the *Strangi* arrangements. A different result might well occur if the partnership agreement required that all net earnings be distributed currently, if significant interests are given to other family members, and especially if significant interests were given to trusts controlled by independent trustees.

   d. Fourth, the Tax Court's rationale that Code § 2036(a)(2) applied even though the donor could direct the beneficial enjoyment of the partnership only with the consent of all of the other partners should not be read too broadly. Read literally, this would negate any discounts for intrafamily transfers, because the donees could always agree to return the gift to the donor, or to dispose of the gift as the donor wished. The court may have been more swayed by the fact that the donor gave away only .53 of one percent of the total partnership interests, and it might reach a contrary conclusion if there were very significant partnership interests transferred to others (including, hopefully, trusts with independent trustees).

2. Estate planners should consider the following steps to minimize or avoid the application of Code § 2036(a) to family limited partnerships:
a. The general partners should keep detailed contemporaneous records of their activities, and send copies to the limited partners (for information purposes, only).

b. Have partnership stationery, to assure that the general partner never acts in a different capacity.

c. Recite the non-tax business reasons for establishing the partnership.

d. Never pay personal expenses from the partnership assets, even if capital account adjustments are made.

e. Do not transfer personal use assets to the partnership or otherwise commingle personal and investment/business use assets.

f. Never put too much of the donor’s wealth in the partnerships; the donors should retain enough assets on which to live comfortably.

g. Limited partners should pay for their partnership assets with their own assets. If they do not have assets, the donors should make gifts and let the gifts gather some age, before creating the partnership.

h. Family members or trusts to whom the client wishes to pass the bulk of the partnership assets should themselves be general partners and participate in the operations of the enterprises.

i. All partners should be represented by counsel and consulted in the preparation of the governing instruments.

j. Consider a provision, like one used in the Stone documents, that precludes anyone voting for a general partner through a power of attorney (Contrast the emphasis in Strangi that the general partner’s son-in-law ran the partnership under a power of attorney).

k. Create and fund the partnership as early as possible, to minimize any appearance that it is testamentary in nature.

l. Have someone else hold all of the general partnership interests, to remove any right to control beneficial enjoyment.

m. Give or sell significant limited partnership interests to others, particularly including trusts with independent trustees.
n. Do not make distributions discretionary – either preclude distributions during the donor’s lifetime, or require distribution of all income.

o. Create two classes of general partnership interests, one of which has control over distributions, and the other which manages the partnership assets. The donor can then transfer the former, retaining the latter. For existing partnerships, there is a Code § 2035 issue.

p. Include a mix of assets, such as real estate, or, in the case of Kimbell, oil and gas interests, into the partnership. In Kimbell, the oil and gas interests only comprised 11% of the portfolio, but may have been the saving grace.

q. Document that the general partner is acting in a fiduciary capacity to the other partners; pare down or eliminate exculpatory language that benefits the general partner.

B. What Should Planners Do About Hackl?

1. Many planners consider Hackl as an aberrant case of bad facts creating bad law. Nevertheless, Hackl is a reported case that should not be ignored, especially if the nature of the underlying partnership assets will be slow to generate current income to the partnership.

2. Practitioners may want to consider granting a “put option” to the donee of a limited partnership interest in which the donee is entitled, for a limited period of time, to put the gifted interest back to the partnership (or the donor) in exchange for a cash payment equal to the fair market value of the gifted interest, taking into consideration all available valuation discounts.