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No Legitimate Business Purpose for FLP Precludes Analysis of Discounts

Estate of Jorgensen v. Commissioner, 2009 WL 7920771 (U.S. Tax Ct.)(March 26, 2009)

The Jorgensen estate could not persuade the U.S. Tax Court to find a single legitimate (non-tax) business purpose for its family limited partnership (FLP).

One FLP, two FLP. In 1995, Colonel Jorgensen and his wife funded an FLP with roughly $500,000 of marketable securities. They each became limited partners (LPs) along with their six grandchildren. The colonel and his two children were named general partners. The stated purpose of the FLP was to “pool certain assets and capital for…investing in securities.” When the colonel passed away in 1996, his estate attorney recommended that the widow transfer all of their brokerage accounts into the FLP, so that “hopefully your limited partnership interest…will qualify for the 35% discount.” The attorney also recommended that she form a second FLP, funded with some $1.8 million in marketable securities. After she died in 2002, the IRS audited the two FLP”s and assessed nearly $800,000 in deficiencies. The estate appealed.

Looking for a legitimate, significant nontax purpose. The Tax Court looked at whether the widow “had a legitimate and significant nontax reason…for transferring her property,” which would be sufficient to keep the FLP’s from being valued fully as part of her gross estate. The court found the following:

1. **No active management.** There were no books and records, no formal meetings or minutes. The widow’s only “activities” were to make cash gifts to amily members and pay taxes and other personal expenses out of the FLP.
2. **No financial education or family unity.** The family let the investment adviser make most decisions and the promotion of family unity was “no more than a theoretical purpose.”
3. **No investment philosophy.** The “perpetuation of a ‘buy and hold’ strategy for marketable securities is not a legitimate or significant nontax reason for transferring the bulk of one’s assets to a partnership.”
4. **No benefit to pooling of assets.** Transferring the investment accounts directly could have accomplished the same gift-giving purposes as the FLP’s, without adding any significant expense or oversight, and might have incurred less.

5. **Spendthrift tendencies continued unabated.** The FLPs did nothing to protect the LP's, in particular the profligate son, against his own tendencies. The widow's son borrowed a total of almost $170,000 from the FLPs, but made only two interest payments, and his mother later forgave one of the loans, without reporting it as a gift.
6. **Giving equal gifts.** Facilitating and simplifying gift giving, alone, is not a legitimate nontax purpose.

The court found that I.R.C. Sec. 2036(a)(1) pulled the FLP assets back into the value of the wife's gross estate.

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