

Points of Law

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THANKS TO READERS

Thank you to the readers of the last edition of my newsletter. Your comments have confirmed that Death Angels are a common phenomenon. This issue discusses the continuing problems with valuation of FLP and LLC interests where the entity holds liquid/marketable assets. The two entity types can be considered the same for valuation purposes. Please feel free to call me to discuss subjects related to estate planning.

INTEREST VALUATION

IRS's lack of success contesting taxpayer Family Limited Partnership (FLP) interest valuation discounts contributes to an Anything goes attitude in FLP/LLC formation and management. The attitude is unfortunate because the battle is still on. Few realize that valuation discounts for passive liquid asset holding entities were denied nearly 60 years ago in Richardson v Comm'r 2 TCM 1039 (1943). That case, denied review by the Supreme Court, continues have validity even though various courts have announced that the IRS regulations require a hypothetical sale between hypothetical parties to establish fair market value of FLP interests. Other courts have determined that, under certain fact patterns, intrinsic value may be used as substitute for or equivalent of the hypothetical fair market value for FLPs that resemble non-business interest. See Estate of McMullen v Comm'r 56 TCM 507 (1988) and cases cited therein.

Practitioners know that discounts obtained for FLP/LLC interests, especially those with liquid assets, are considerably less generous than discounts for Areal businesses@ routinely not challenged by IRS. In an attempt to avoid fair market value discounts, IRS has tried various theories of law and has strongly contested the facts in a number of cases. The Estate of Strangi v

Comm'r 115 TC 478 (19***) is perhaps the high water mark for the taxpayer. In that case, which involved marketable assets, even though the court recognized that the FLP had no business purpose, fair market value discounts were allowed because the court felt compelled. The partnership was validly formed under state law, the assets had been properly transferred, and the is and ts dotted and crossed respectively.

IRS had argued, that the FLP was analogous to a trust and should be valued as one, but the tax court rejected the argument because IRS had not given timely notice of its intent to make the argument to the taxpayer. Trusts are valued at their intrinsic worth because they are a mere Aconcentration of wealth.@ The IRS argument contends that because an FLP with liquid assets is more a Aconcentration of wealth@ than a family business, it should be valued like a trust, not discounted to market value. IRS's litigation position is formally stated in Field Service Advice 200049003 (September 1, 2000).

SUPPORTING VALUATION

The most effective way to support a gifted FLP/LLC interest valuation continues to be starting the limitations clock by filing a gift return with adequate supporting information.

The courts are deciding interest valuations on facts. Often ignored steps that can increase the likelihood of the court finding facts that support higher interest valuation discounts include:

- Form the FLP/LLC now not later
- Engage in actual business

- Hold meetings, discuss business, and keep records
- Develop business reasons to hold marketable assets
- Minimize liquid assets not needed to run the business
- Maintain state filing status of the entity