SOUTH FLORIDA
ESTATE PLANNING LAW
INSIGHT AND COMMENTARY ON ESTATE PLANNING, WILLS, TRUSTS, PROBATE & TAXATION
PUBLISHED BY Law Offices of David A. Shulman, P.L.

Document hosted at JDSUPRA
http://www.jdsupra.com/post/documentViewer.aspx?fid=5af4ceae-a205-47eb-b6af-5eebcdc166f4

South Florida Estate Planning Law

Posted at 6:52 AM on March 27, 2009 by David Shulman

Estate of Jorgensen v. Commissioner: IRS wins another Family Limited Partnership Case due to the Taxpayer Doing Everything Wrong

In writing a blog, or in writing *anything*, the most important question is "Who is your audience?" So far, my posts have been aimed towards what I call "the sophisticated layman." I have been writing for the educated reader who is not an expert in matters regarding estate planning or tax, and is interested in learning more.

But every now and then there is "breaking news" in the estate tax world, that most laymen, sophisticated or not, probably would not be interested in, but would be of interest to estate planning and tax experts. This is one of those times.

Yesterday, the US Tax Court's issued its opinion in *Estate of Jorgensen v. Commissioner*, ruling that the entirety of assets transferred to a family limited partnership were included in the gross estate of a decedent under s. 2036(a)(1) of the Internal Revenue Code.

Like many other cases in which there is a complete victory for the Government, the most important lessons in this case for Estate Planning attorneys is "Don't do this."

More after the jump

THE FACTS OF THE CASE

The Decedent, Mrs. Erma Jorgensen, died on April 25, 2002. Her late husband was Colonel Jorgensen; her daughter was Jerry Lou and her son was Gerald. During their lives, the Colonel was responsible for managing the family's investments. He was actively involved in picking stocks, managing the family's money, and engaging in their estate planning. Mrs. Jorgensen was not interested in these matters.

From the decision:

> "On June 30, 1995, Colonel and Ms. Jorgensen each contributed marketable securities valued at $227,644 to JMA-I in exchange for 50-percent limited partnership interests. Gerald and Jerry Lou, along with their father, were the general partners. Colonel and Ms. Jorgensen had six grandchildren; three were Gerald's and three were Jerry Lou's. Gerald, Jerry Lou, and the six grandchildren were listed as limited partners and received their initial interests by gift. ***Neither Gerald, Jerry Lou, nor any of the grandchildren made a contribution to JMA-I, although each was listed in the partnership agreement as either a general or a limited partner.*** During his lifetime Colonel Jorgensen made all decisions with respect to JMA-I." Emphasis Added.

The Colonel died on November 12, 1996.

After his death, the Jorgensens' estate planning attorney, who Mrs. Jorgensen had little contact with during her husband's life, advised Mrs. Jorgensen to transfer her brokerage accounts to the FLP. The attorney wrote to her in a letter:

> Hopefully, this will allow your estate to qualify for the discount available to ownership of interests in limited partnerships and at the same time, facilitate your being able to make annual gifts to your children and grandchildren. This is important if you wish to reduce the amount of your own estate which will be subject to estate taxes.

And then again in a letter the following day:

> The reason for doing this is so that hopefully your limited partnership interest in JMA partnership will qualify for the **35% discount**. Instead of your estate having a value in various securities of about $1,934,213.00 it would be about $1,257,238.00. The difference of $676,975.00 would result in a potential savings in estate taxes to the beneficiaries of your estate of $338,487.50. Obviously, no one can guarantee that the IRS will agree to a discount of 35%, however, even if IRS agreed to only a discount of 15%, the savings to your children would be $145,066.00, and there can be no discount if the securities owned by you continue to be held directly by you. (Emphasis Added. Thirty five percent? No wonder they were audited)

The FLPs (there was a second one formed) did not operate a business, and were passive investments only. There were no books or records, just unreconciled checking accounts. Gerald took a $125,000 loan from the Partnership to buy a house, after learning to his shock and dismay that the money in the partnership wasn't his. Gerald testified that "it took a while to get my head around the fact that it wasn't just like a bank account you can get money out of." Gerald did not make any payments on the loan for two years, after which he made a payment of accumulated interest only. While Jerry Lou believed that if Gerald did not repay the loan, she would take it out of his partnership interest, the partnerships required that all distributions be pro rata.

During Mrs. Jorgensen's life, there was much mingling of her personal funds and the partnerships' assets. Mrs. Jorgensen died on April, 25, 2002. In August of that year, Jerry Lou sent her brother Gerald a letter stating, that their attorney:

> highly recommends that you pay back Jorgensen Management II Partnership the $125,000 you borrowed. You paid the interest in July for $7,625.00 so you are just about square. **He says it will clean up the Partnership and things will look much better should we get (and we probably will) audited in the upcoming months. * * * Guess we have to be real straight on who borrowed what etc. *so the partnership looks very legit.*** (Emphasis added).

The FLP paid Mrs. Jorgensen's $179,000 Federal estate tax liability and $32,000 California estate tax liability (as calculated by the estate).

Document hosted at JDSUPRA™
http://www.jdsupra.com/post/documentViewer.aspx?fid=5af4ceae-a205-47eb-b6af-5eebcdc166f4

THE COURT'S ANALYSIS

This was a clear slam dunk case for the IRS. There are so many bad facts here (and I didn't list a lot of them). The court had no problem deciding that the entire v
FLPs were included in Mrs. Jorgensen's estate of s. 2036(a). The Court took the effort of going through all of the prongs to show how the estate lost on e

The Court found that there was a "transfer" as that term is defined in 2036(a). The court stated that a transfer includes "any inter vivos" voluntary act of transferring property.

The transfers were **NOT** bona fide sales for adequate and full consideration

The Court had no problem finding that under the *Bongard* standard, the transfers were not bona fide sales for full and adequate consideration. There were no non-tax reasons for forming the partnerships. The Estate tried to argue that the reasons it formed the FLPs included

1. Management Succession
2. Financial Education of Family Members and Promotion of Family Unity
3. Perpetuation of the Jorgensens' Philosophy and Motivating Participation in the Partnerships
4. Pooling of Assets
5. Spendthrift Concerns
6. Providing for Children and Grandchildren equally

The Court did not buy any of those arguments, as the facts didn't seem to support them. Additionally, the Court found that Ms. Jorgensen retained the possession and enjoyment the property contributed.

The entire value of the assets transferred to the FLPs by her were included in her estate, a big win for the Commissioner.

The one silver lining for the taxpayer is that since the estate sold some of the assets after her death using a carryover and not a step up in basis, they were entitled to equitable recoupment of the taxes paid, even though the statute of limitations had expired.

Link to full text of the decision here.

Comments (0) Read through and enter the discussion with the form at the end

Law Offices of David A. Shulman, P.L
Fort Lauderdale, FL