HOW NOT TO OBTAIN A FRACTIONAL OWNERSHIP VALUATION REDUCTION

MONDAY, FEBRUARY 07, 2011

If more than one person owns a fractional interest in property, the sum of the value of each part may be less than the whole for transfer tax purposes. For example, if Bill and Mary own a parcel of land worth $1,000,000 as 50/50 tenants in common, at Bill's death his interest is likely to be valued at less than $500,000 to reflect Bill's lack of control and costs of partition.

In a recent Tax Court case, a decedent during his lifetime transferred 1/5 interests in his ranch to each of his five children. HOWEVER, he retained the "full use, control, income and possession" of the ranch during his lifetime. At his death, his estate sought discounts in value for lack of marketability and control based on the children's fractional ownership.

Not so fast, opined the Tax Court. The entire value of the ranch was included in the decedent's estate under Section 2036, due to the decedent's retained lifetime interest in the ranch. The Court noted that in valuing property with a retained lifetime interest, the change in ownership is deemed to occur at the decedent's death. Thus, for this purpose, the children did not own an interest prior to death, and their interests could not give rise to a fractional interest valuation reduction to the decedent.

The result is as one would expect – to have ruled otherwise would have created a gaping whole in the estate tax regime that would allow for discounting of testamentary transfers simply by the creation of lifetime transfers with retained life estates.

Of course, if one of the children subsequently passed away while owning the ranch as co-owners with his siblings, then a fractional interest valuation adjustment would be more appropriate.

ESTATE OF AXEL O. ADLER, TC Memo 2011-28 (January 31, 2011)

Authored by Charles Rubin, Esq. Mr. Rubin is a Florida Bar Board Certified tax attorney with the firm of Gutter Chaves Josepher Rubin Forman Fleisher P.A. (www.floridatax.com) His practice focuses on protecting & enhancing individual, family & business wealth through: Planning to Minimize Taxes (U.S. & International) • Estate Planning, Charitable, Marital & Succession Planning • Business Structuring & Transactions • Trusts & Estates (Administration-Disputes-Drafting) • Creditor Protection. He can be reached at 561-998-7847 or at crubin@floridatax.com. This article was previously published at http://www.rubinontax.blogspot.com.