

Memo

To: Our Clients and Friends
From: Barry A. Nelson
Date: April 12, 2005
Re: Family Limited Partnerships

Two recent IRS tax court cases, Estate of Virginia A. Bigelow (T.C. Memo 2005-65) and Estate of Wayne C. Bongard (124 TC No. 8), filed on March 30, 2005 and March 15, 2005 respectively reflect the tax court's most recent application of Code Section 2036(a)(1) to Family Limited Partnerships. It is clear that the IRS is now focusing on whether there were significant non-tax benefits for establishing Family Limited Partnerships and transferring assets to them.

In Bigelow the estate argued that the Partnership provided asset protection from creditors, provided continuity of management of the property, and was more efficient to make gifts. The tax court did not agree with the three non-tax purposes based upon factual conclusions.

In Bongard, the estate contended that the non-tax reasons to create the Partnership included: to provide "another layer of creditor protection for the decedent", to make gifts, and to acquire, own, and sell stocks. The tax court concluded that the Partnership never diversified its assets during the decedent's lifetime, it never had an investment plan, it never functioned as a business enterprise, or engaged in any meaningful economic activity. The court indicated that there was no significant change in asset protection, and that the decedent did not make gifts of interest prior to his death.

Both of these cases should alert those who have Family Partnerships to review existing procedures to help substantiate the non-tax reasons for the Partnership. The Partners should meet periodically to review investments, long term decisions, distributions, etc., and the conferences should be documented through Minutes. It would appear beneficial that the person who initially created the Partnership pool his/her assets with other family members and that investment decisions be made by a consensus of the General Partners. If there is a corporate or LLC General Partner, its shareholders or members should meet periodically to establish the investment decisions for the Partnership, and such meetings should be documented. Furthermore, changes in the marketable securities and distribution plan help to reflect that the Partner who initiated the Partnership had a meaningful change in the investments initially contributed to the Partnership.

Based upon Bigelow and Bongard a significant change in the administration and management of the Partnership assets will help establish that there was more than merely a name change and a different "wrapper" around the assets. In this regard, children should actively represent their interests (preferably as General Partners, such as members or shareholders of the LLC or Corporate General Partner) rather than just comply with what their parents suggest based upon how Partnership assets were invested prior to the time of the Partnership contribution.

The IRS is keenly aware of these cases. Anyone who has a Family Limited Partnership needs to verify that their Partnerships are being operated in such a manner that their families can establish significant non-tax benefits for Partnership creation and operation.

If we can provide any assistance, please feel free to contact our firm.

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