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Estate of Virginia A. Bigelow v. Commissioner, No. 05-75957 Tax Ct. No. 4066-02 Opinion

The Facts: This case was brought before the United States Court of Appeals for the Ninth Circuit on June 5, 2007, in Pasadena, California. The Estate of Virginia A. Bigelow appealed the United States Tax Court's decision to uphold a deficiency in the Estate's federal estate tax return. (See original case below) The Estate had two main arguments for the Court to consider: (1) Did the Tax Court err in finding that there was an implied agreement that the decedent would retain enjoyment of, or derive income from the Padaro Lane property, and (2) Did the Tax Court err in concluding that the "bona fide sale for an adequate and full consideration" exception under Section 2036(a) did not apply to the transfer of the Padaro Lane property from the trust to the Spindrift family partnership?

The Findings: In response to the first argument of the Estate, the Circuit Court upheld the Tax Court's decision that there was an implied agreement between the decedent and the FLP that decedent would retain an economic benefit from the transferred asset (Padaro Lane property) because the property continued to secure the debt for which decedent was personally liable and the Partnership, in fact, continued to make the monthly loan payments on decedent's behalf when decedent's monthly income did not meet her monthly obligations. Without the additional $2,000 a month payment from the FLP, decedent would have been left impoverished and unable to meet her obligations and because of this decedent was deemed to have retained economic benefit of the property.

In response to the Estate's second argument, the Circuit Court concluded that the Tax Court correctly found that an inter vivos transfer of the Padaro Lane property was not executed for any legitimate, significant non-tax related business purpose. The Court ruled that the record supported the finding that the Partnership was formed to facilitate the transfer of the Padaro Lane property to the decedent's children and grandchildren as a testamentary substitute which allowed an advantage of lowering the gross estate by applying discounts for lack of marketability and control. Thus, the Circuit Court ruled that the Tax Court did not err when it ruled the transaction was not a bona fide sale for

adequate and full consideration under section 2036's parenthetical exceptions, upholding all of the Tax Court's original findings.

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The Facts: Ms. Bigelow established a Trust in 1991 and transferred her residence to it. The Trust exchanged the residence for other real property in 1993. An FLP was formed in 1994 with the Trust and the decedents' children shortly after Ms. Bigelow suffered a stroke and began living in an assisted-living facility. The Trust contributed the real property it owned for a general partner and limited partner equity interest and the children each contributed a nominal amount of cash for a limited partner equity interest. Ms. Bigelow died on August 8, 1997. She owned a 45% limited partner equity interest and her Trust owned a 1% general partner equity interest. On her Estate tax return, the 45% limited partner equity interest was valued at approximately $135,000 (or a 37% discount from the underlying appraised value) and the 1% general partner equity interest was valued at approximately $20,000 (or a 35% premium above the underlying appraised value).

The Findings: The Tax Court ruled that Ms. Bigelow's transfer of real property to a FLP and subsequent gifting were includable in the decedent's estate under Section 2036(a) for the following reasons:

1. Financial records showed that decedent's expenses exceeded her income by $2,700. Furthermore, there were several transfers from the FLP to Ms. Bigelow's Trust to help support her. In addition, the Partnership made the payments on the loan on the real property (even though the loan was never transferred from the Trust to the Partnership when the real property was). Accordingly, the Court ruled that there was an implied agreement between decedent and her children to retain the right to the income from the property.

2. The Court also ruled that the decedent continued to retain enjoyment of the property during her lifetime because enjoyment includes present economic benefits and the Partnership continued to pay the loans on the property.

3. The Court ruled that the transfer of the real property to the FLP was not made in good faith for several reasons including:

    a. Before the property was transferred to the FLP, decedent met her financial obligations. After the transfer, she no longer received rent from the property but remained liable for both the mortgage loan and line of credit on the property. Accordingly, this left her unable to meet her financial obligations.
    b. The Partnership did not properly maintain records of partnership capital or the partners' capital accounts including errors in balance sheet liabilities and errors in preparation of Partner K-1's. Accordingly, the parties failed to respect Partnership formalities.

c. The transfer did not provide and had no potential to provide any nontax benefit to decedent because management of the assets did not change as a result of the transfer and there was no pooling of assets. Furthermore, the Court stated that the decedent did not receive any additional legal protection from creditors upon transferring the property to the limited partnership because the decedent's Trust was the sole general partner.

The Estate asserted that the transfer was a bona fide sale for full and adequate consideration and relied upon Kimbell v. U.S. No. 03-10529, Fifth Circuit, May 20, 2004 (Kimbell) for their support. However, the fact pattern of Kimbell was much different than this case for the following reasons:

1. In Kimbell, the asset was entirely parted with whereas in this case, the debt obligation was retained by the Trust and the FLP continued to pay on the debt.
2. The general partner in Kimbell was an LLC that provided additional liability protection whereas the general partner in the case was the Trust that did not provide any liability protection.
3. Kimbell also retained sufficient assets outside the Partnership to support herself and did not have to make continuous transfers between the Partnership and her personal assets. (Ms. Bigelow transferred funds between her Trust and the FLP 40 times from April 1995 to August 1997).

<u>Parting Thoughts:</u>

Again, this is another bad facts case victory for the IRS. FLP's are still a viable planning tool provided there is no retained income and enjoyment and there are sufficient nontax reasons to qualify for the bona fide sale exemption.