Estate of Bongard v. Commissioner, 124 T.C. No. 8, March 15, 2005.

<u>The Facts:</u> Wayne C. Bongard (decedent) established Empack, Inc., a manufacturer of electronics materials packaging, in 1980. The stock was owned by decedent and a trust for the decedent's children until 1996 when they transferred all of their Empack stock to a family-owned LLC - WCB Holdings, LLC (LLC). The next day, decedent formed Bongard Family Limited Partnership (BFLP) and transferred a significant amount of LLC equity to BFLP. Subsequent gifts and distributions followed up to Mr. Bongard's death on November 16, 1998. The IRS issued a notice of deficiency to the Estate on February 3, 2003, which, among other things, returned all of Empack's shares decedent had transferred to LLC under Sections 2035(a), 2036(a) and 2036(b) to the Estate.

<u>The Findings:</u> A split decision by the Court regarding the two transfers (LLC and BFLP). A summary of the findings regarding each entity is as follows:

<u>For the LLC</u>- The Court deemed the transaction as a bona fide transaction because of the following:

1. The Court viewed the creation of the LLC and pooling of all the Bongard family shares in Empack as a legitimate and significant nontax reason for entity formation. The Court said that the pooling of the shares would help raise capital for additional growth by increasing the potential market for Empack shares through positioning Empack to attract potential investors.
2. The parties received interests in the LLC proportionate to the number of shares transferred.
3. The decedent, as majority owner of Empack, received powers over the LLC similar to those that would have been agreed to among two unrelated parties.

Accordingly, the Court ruled that Section 2036 did not apply to the LLC and subsequent gifts were not pulled back into the Estate.

<u>For BFLP</u>- The Court reached the opposite conclusion and said that the bona fide sale exception did not apply for the following reasons:

1. The Court did not agree with the Estate's claim that BFLP was established to provide additional credit protection and to facilitate the decedent's postmarital agreement with his second wife. The Court stated that the formation of the LLC already served those purposes adequately.
2. The Court also stated that BFLP merely recycled the value of the assets because it "never diversified its assets during decedent's life, never had an investment plan, and never functioned as a business enterprise or otherwise engaged in any meaningful economic activity."
3. Accordingly, the Court ruled that there was not a legitimate and significant nontax reason for entity formation.

4. The Court also indicated that the transaction didn't alter decedents control of the units transferred to BFLP. Accordingly, the transaction was pulled back under Section 2036.

The Good News:

The taxpayer still received an effective discount of approximately 30% at the LLC level. Applying this discount to more than $120 million of undiscounted value resulted in a pretty substantial tax savings.

Parting Thoughts:

The Court seems open to both the pooling of assets and diversification/investment management as being legitimate nontax reasons for an entity.