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*Estate of Thelma G. Hurford, Deceased, Donor, Deceased, G. Michael Hurford, Independent Executor vs. Commissioner of Internal Revenue Service, Respondent, T.C. Memo 2008-278, December 11, 2008*

The Facts:

Mrs. Hurford's husband, Gary, was a petroleum engineer who worked for and eventually rose to the position of president of Hunt Oil Company in Texas. During his employment, Mr. Hurford accumulated many assets including phantom stock in Hunt Oil, a retirement plan, real estate and additional assets. As a perk to Mr. Hurford, Hunt Oil provided free accounting and legal services. Mr. Hurford's tax returns were prepared by KPMG and Mr. Hurford worked with attorney Mr. Santo Bisignano to create wills for himself and his wife, Thelma. The wills were mirror images of each other and both took a conservative approach to estate planning. Although Mr. Bisignano had suggested slightly more aggressive estate planning techniques such as irrevocable life insurance trusts (ILITs), grantor-retained annuity trusts (GRATs) and family limited partnerships (FLPs), Mr. Hurford chose to place the majority of his assets into two trusts, a bypass trust and a qualified terminable interest property trust (QTIP). The Hurford's wills stated that the property of whichever spouse died first would go into the two trusts with the exception of a home in Arlington, Texas, and any personal effects, which would pass to the surviving spouse. Upon his death in April of 1999, Mr. Hurford's estate was worth over \$14 million.

Mrs. Hurford initially continued working with Mr. Bisignano to settle Mr. Hurford's estate. In the summer of 1999, Mrs. Hurford also consulted with Mr. Bisignano on creating her own estate plan. Mr. Bisignano made some conservative recommendations that included making gifts of \$225,000 to each of Mrs. Hurford's three children (equaling the lifetime exemption amount of \$675,000 at that time) and creating two FLPs. One FLP would hold the farm and ranch properties and unify the land management within a single entity and the other FLP would hold Thelma's financial assets. Mrs. Hurford did not create FLPs with Mr. Bisignano, but did make the recommended gifts in February of 2000, the same month she was diagnosed with cancer.

In late January of 2000, Mrs. Hurford became dissatisfied with Mr. Bisignano for several reasons. Mrs. Hurford's oldest son Michael began to search for a new attorney and was recommended to Mr. Joe Garza. Mr. Garza had a very pleasing personality and quickly won the trust of the Hurfords. Mr. Garza outlined a very aggressive estate plan for Mrs. Hurford which included separating the existing trusts into three groups (i) cash, stocks

and bonds, (ii) the Hunt Oil Phantom Stock, and (iii) the farm and ranch properties. Then, he recommended creating three separate FLPs to receive each group of assets giving an interest in each to Mrs. Hurford and her three children. Finally, Mr. Garza recommended that Mrs. Hurford sell her and Mr. Hurford's interests in each FLP to her children (Michael, David and Michelle) through a private annuity agreement. Mr. Garza intended for the majority of the value of the estate to be transferred to the FLPs and, since Mrs. Hurford had been diagnosed with cancer, for the value paid under the private annuity to be a modest sum in comparison to the estate value.

The Hurford's agreed and Mr. Garza began to work on the plan. Mr. Garza assisted Mrs. Hurford in the creation of the FLPs and private annuity in April of 2000. Mrs. Hurford passed away less than a year later in February of 2001. During the existence of the plan, Mrs. Hurford received payments of \$80,000 per month under the terms of the annuity.

The Estate filed Form 706 and claimed Mrs. Hurford's taxable estate to be valued at \$846,666. The IRS audited both her gift tax return and estate tax return and assessed a deficiency of approximately \$9.8 million on her estate and \$8.3 million on gift tax returns, plus approximately \$3.6 million in penalties.

#### The Arguments:

The court's main issue for decision was what should have been included in Mrs. Hurford's taxable estate (were her transfers to the FLPs and private annuity valid under Sections 2035, 2036 and 2038)? In addition, the court was asked to decide (i) what was the effect of the QTIP election on Mr. Hurford's estate tax return, (ii) should the \$675,000 in gifts that Mrs. Hurford made in 2000 be excluded from her estate tax return, (iii) could the estate deduct \$45,000 in attorney's fees and (iv) was Mrs. Hurford's estate liable for negligence penalties?

Before the tax court, the estate's new attorneys claimed that there was a bona fide transfer and the combination of the FLPs and the private annuity should result in the elimination of the approximate \$18 million deficiency. The IRS countered that Mrs. Hurford had not made a bona fide sale under Sec. 2036(a) and had also retained enjoyment of the property.

#### The Findings:

The court determined that the Hurford's attorney, Mr. Joe Garza, had made multiple errors in the drafting of various documents and instruments (names were often incorrect and sometimes left off entirely), the funding of the trusts (properties were placed into incorrect FLPs and titled incorrectly and the number of properties was incorrect), in the determination of the value of the private annuity (no independent appraisals were completed and the value of the stock was not verified at the time the funds were transferred) and even in the documenting of his fees. As a result, there was not a fair market value transfer when the FLPs were funded and the calculation of the value of the

private annuity was incorrect from the start. In addition, the FLPs were not handled in a businesslike manner. Mrs. Hurford comingled personal funds with FLP assets and in essence treated the FLPs as though she still possessed personal ownership of the assets. Finally, the assets from the bypass trust were distributed to the first FLP, and the estate tax avoidance normally available for a bypass trust was also lost. Because the FLPs and private annuity were ultimately disregarded, all estate assets were taxable at full fair market value.

The small sliver of victory for the Hurford's was that, because the Hurford children serving as executor did rely on both Mr. Garza and CPAs for guidance, there was no negligence penalty imposed on the estate.

#### Parting Thoughts:

I knew it was going to be an interesting case right from the start when the beginning of the memorandum findings of fact and opinion by Judge Holmes begins with "It is a truth universally acknowledged, that a recently widowed woman in possession of a good fortune must be in want of an estate planner" and the memorandum ends with "She lost her life to the cancer. We must now decide how much of her estate will be lost to taxes."

The court openly criticized the Estate's attorney Mr. Garza for many errors, including sloppy drafting of key documents and making "egregiously false" statements on tax returns. He also declined to retain independent appraisals of the three FLPs, bragging to the Hurford heirs that he had "experience obtaining 50% discounts in settlements on estates with the IRS." I struggled to find any positive comments or support for the Estate's argument in the 80+ page summary. It was a "train wreck" from the start.

One last interesting piece of information from this case is that the court offered the following list of factors that, if present, will incline them to find that the transfer of property to an FLP was not motivated by a legitimate and significant nontax purpose:

1. The taxpayer's financial dependence on distributions from the partnership;
2. Whether the taxpayer comingled his/her own funds with partnership funds;
3. The taxpayer's delay or failure to transfer the property to the partnership;
4. The taxpayer's old age or poor health when the FLP; and
5. Whether the FLP functioned as a business enterprise or otherwise engaged in any meaningful economic activity.