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Estate of Erma V. Jorgensen, Deceased, Jerry Lou Davis, Executrix, and Jerry Lou Davis and Gerald R. Jorgensen, Co-Trustees, Petitioner vs. Commissioner of Internal Revenue, Respondent, T. C. Memo 2009-66, March 26, 2009.

The Facts:

Colonel Gerald Jorgensen passed away on November 12, 1996. He was survived by his wife Erma Jorgensen and his children Jerry Lou Davis and Gerald Jorgensen. Mr. and Mrs. Jorgenson were frugal and thrifty having been raised during the Great Depression. Prior to his death in November of 1996, Colonel Jorgensen made all financial decisions related to the family, their revocable trusts, signed in 1994, and of the family limited partnership named the Jorgensen Management Association (JMA-I), which was formed on May 19, 1995. JMA-I was funded by both Colonel and Mrs. Jorgensen who each contributed \$227,644 of marketable securities to the family limited partnership in exchange for a 50% limited partnership interest. The couple's children, Gerald and Jerry Lou, along with Colonel Jorgensen were the general partners. In addition, Gerald, Jerry Lou and their combined six children were all listed as limited partners and received their initial interests by gifts although no gift tax return was ever filed for these gifts.

After Colonel Jorgensen's death, the couple's estate planning attorney wrote to Ms. Jorgensen and recommended that the estate claim a 35% discount on Colonel Jorgensen's interest in JMA-I. The estate's interest in JMA-I passed into Colonel Jorgensen's family trust - which was funded with \$600,000 of assets including JMA-I interests valued using minority and marketability discounts. All amounts over \$600,000 were transferred to Ms. Jorgensen. In subsequent letters, the couple's estate planning attorney recommended that Ms. Jorgensen transfer her brokerage accounts into JMA-I and explained reasons for doing so including reducing the chance of an IRS audit on the 35% discounts previously taken by the estate and potential audit and tax savings on Ms. Jorgensen's own estate. No formal valuation of the estate's assets was completed.

Ms. Jorgensen never met personally with their estate planning attorney to discuss these issues. Instead, all financial decisions were made by the attorney, Gerald, Jerry Lou and Jerry Lou's husband. On July 1, 1997, JMA-II was formed to primarily hold high basis assets with the original JMA-I to hold basically low basis assets. On July 28, 1997, Ms. Jorgensen funded the partnership with \$1,861,116 in marketable securities. In addition, Ms. Jorgensen personally contributed another \$22,019 of marketable securities, money

market funds and cash to JMA-II in August of 1997 and acting, as executrix of Colonel Jorgensen's estate, transferred \$718,350 from his brokerage account that also consisted of marketable securities, money market funds and cash. Once all contributions were made, Ms. Jorgensen held a 79.6947% interest in JMA-II and Colonel Jorgensen's estate held a 20.3053% interest. Gerald and Jerry Lou were the general partners and Gerald, Jerry Lou and their children were listed as the limited partners. The children and grandchildren again received their interests in the partnership as gifts from Ms. Jorgensen. The value of the interests was determined using the value of the securities held by JMA-II on November 12, 1997 (although the interests were transferred in the summer of 1997). On the basis of their values in the summer of 1997, all gifts exceeded the \$10,000 gift tax exclusion so gift tax returns were therefore required, but none were filed.

Mrs. Jorgensen passed away on April 25, 2002, and Gerald and Jerry Lou filed her Form 706 Estate Tax Return and claimed discounts for both JMA-I and JMA-II.

The Arguments:

The IRS claimed that the discounts should be disallowed for several reasons including the following:

1. No Partnership books and records other than a checkbook were maintained for either Partnership;
2. Checkbooks were never reconciled;
3. The Partnership never held formal meetings or kept meeting minutes;
4. The Partnership and Ms. Jorgensen's funds were co-mingled and used interchangeably by Ms. Jorgensen at her discretion;
5. Partnership funds were used to pay Ms. Jorgensen's personal expenses; and
6. Partnership funds were used for Ms. Jorgensen's personal gifts to her children and grandchildren.

In addition, the IRS argued that neither Partnership had a valid non-tax purpose despite several arguments including, but not limited to; management of partnership assets, financial education of family members and promotion of family unity, and perpetuation of the Jorgensen's investment philosophy and motivating participation in the Partnerships presented by the petitioner.

The Findings:

The Court determined that inclusion under Sec. 2036(a) of the code is applicable when (i) there is a transfer of property, (ii) there is not a bona fide sale for full and adequate consideration and (iii) the decedent retains an interest in the gifted property as described under Sec. 2036(a). The Court determined that there were transfers of property; however since Ms. Jorgensen stood on "both sides of the transaction" there was no bona fide sale



for full and adequate consideration. In addition, the Court felt Ms. Jorgensen retained an interest in the gifted property as she continued to use Partnership assets to meet her needs.

Accordingly, the Court disallowed all discounts and assessed a deficiency of \$796,954 on the estate. However, because the children had received assets and paid income tax in the years 2003-2006 on sales of assets later included in the estate of Ms. Jorgensen, the Court determined that the estate was entitled to an offset for the income taxes paid by the children (as the basis in these assets was higher once valuation discounts were disallowed in this instance).

Parting Thoughts:

Colonel Jorgensen, who did most of the investing, adhered strongly to a buy and hold policy so there was never a significant amount of active trading and portfolio management. I found it interesting that in analyzing the business purpose of these Partnerships, the Court stated that “the mere holding of an untraded portfolio of marketable securities weighs against the finding of a nontax benefit for a transfer of that portfolio to a family entity”. The Court also stated that “the General Partners management of JMA-I’s and JMA-II’s portfolios of marketable securities was not active, therefore management succession was not a legitimate reason for Ms. Jorgensen’s transferring the bulk of her assets to the partnerships.”

Based on the above statements, it would appear that having an actively traded and managed diversified portfolio is the best way to help substantiate a nontax business purpose for Partnerships holding marketable securities.