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Estate of Roger D. Malkin et al. v. Commissioner; T.C. Memo 2009-212; September 16, 2009

The Facts:

Mr. Roger Malkin was the chairman and chief executive officer of Delta & Pine Land Co. (D&PL) from 1980 until his death in November of 2000. During the time in which he was employed, Mr. Malkin accumulated more than 1,000,000 D&PL shares and options. In 1997, Mr. Malkin decided he wanted to transfer approximately $16,000,000 worth of D&PL shares to his children. However, he did not want his children to sell the shares after they had received them. Mr. Malkin discussed this with his financial planner and an estate planning expert from Arthur Andersen. After a series of conference calls, Mr. Malkin decided to form an FLP to hold the D&PL shares and two trusts, one for each child, to hold limited partnership interests in the FLP. Mr. Malkin and his advisors then proceeded to establish a complicated estate plan involving the formation of two family limited partnerships (FLPs), four trusts (two for each of his children), four LLC's, two self cancelling installment notes (SCINs), additional sales with installment notes and various other gift transfers.

As a result of the transfers, Mr. Malkin was able to move approximately $20 million of D&PL stock from the estate into the two FLPs keeping in mind his stated objective of transferring the stock but not wanting his children to be able to sell it.

Mr. Malkin also had personal loans with Bank of America and Morgan Guaranty which he collateralized with the shares of stock he had previously transferred to the FLPs.

At the time of Mr. Malkin's death in 2000, the transfers to the FLPs, the SCINs and the loan owned to Morgan Guaranty for over $12 million rendered the estate insolvent.

The IRS reviewed Mr. Malkin's various transfers over the time frame in question and assessed deficiencies on the estate and the 1998, 1999, and 2000 gifts in the amount of nearly $17 million. The primary issues in the case were whether or not Mr. Malkin retained control of the shares of transferred stock under Section 2036(a) and whether the transfers of the stock to the created LLCs and FLPs created indirect gifts.

The Arguments and Findings:

The petitioners argued that there was no express or implied agreement with Mr. Malkin to retain economic benefits of the property he transferred to the FLPs. However, the Court concluded, after review of all pertinent facts, that because the D&PL stock had been pledged by Mr. Malkin as collateral on a personal loan, there was indeed an implied agreement as he retained the "right to use that transferred stock". Furthermore, because the decision to pledge said stock had been approved by both Mr. Malkin and the FLP trustees, but was not "a business decision made at arm's length" the D&PL stock was held to be an asset of the estate under Section 2036(a)(1) of the Code.

In addition, the Court determined that there was no significant nontax reason for using the stock as collateral even though the estate claimed there was a bona fide sale of the stock.

Furthermore, the Court determined that any claimed sale of a partnership interest "was a sham" and as a result, the transfer of shares of D&PL were essentially indirect gifts to the children and as a result the transfers were treated as gifts in each case.

The Court did permit the deduction of the nearly $13 million dollar debt to Morgan Guaranty, as a nonrecourse debt, but only to the extent of its collateral value.

Parting Thoughts:

Another case where putting the "cart ahead of the horse" came back to bite the taxpayer. Besides the 2036(a) issue, the decedent made indirect gifts because the chronological order of establishing the FLPs and creating the trusts, funding the FLPs or LLCs and then transferring the interests was not followed.