ACTEC *Amicus* Brief in *Strangi v. Commissioner of Internal Revenue*

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Editor's Note: The authors, members of an ad hoc group from ACTEC's Estate and Gift Tax Committee under the leadership of Mil Hatcher, prepared and filed this *amicus* brief on July 15, 2004, in *Strangi v. Commissioner,* 85 T.C.M. (CCH) 1331 (2003), now before the 5th Circuit. As did the College's *amicus* brief in the recently decided case of *Kimbell v. United States,* 2004 WL 1119598 (5th Cir. 2004), this brief in *Strangi* addresses I.R.C section 2036 issues in the family limited partnership setting. The text of the brief is printed on the following pages and is available on the ACTEC website, with links to the significant authorities cited. The brief in *Kimbell* is also available on the website and was included in the Summer 2004 issue of the *ACTEC Journal.*

Case No. 03-60992

**IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT**

**ALBERT STRANGI, DECEASED,
ROSALIE GULIG, INDEPENDENT EXECUTRIX
Petitioner - Appellant
v.
COMMISSIONER OF INTERNAL REVENUE
Respondent - Appellee**

ON APPEAL FROM UNITED STATES TAX COURT

**BRIEF FOR AMICUS CURIAE IN SUPPORT OF NEITHER PARTY
ON BEHALF OF
AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL**

INTEREST OF THE *AMICUS CURIAE*

The American College of Trust and Estate Counsel (the "College") is a professional association of lawyers with a current membership of approximately 2,600 from throughout the United States. Members, including both practicing attorneys as well as academicians, have been elected by their peers on the basis of their professional reputation and their demonstrated exceptional skill and ability in probate, trust, and estate planning law, and on the basis of their substantial contributions to these fields through lecturing, writing, teaching, and bar activities. The College has no "client" in this matter, although many of its members who are practicing attorneys represent clients who may be impacted by the Court's decision.

Family limited partnerships and other family controlled entities have been used extensively, not just as estate planning vehicles, but also as relatively flexible investment management vehicles. The issues to be decided in this case are important to the predictability and stability of the tax treatment of such family controlled entities. This Court's decision in *Kimbell v. United States,* 2004 WL 1119598 (5th Cir. 2004) (*"Kimbell"*) has contributed significantly to the resolution of important issues under Section 2036(a), but several extremely important issues remain unresolved. The policies of the College provide for the filing of an *amicus curiae* brief only sparingly and only where the issues are of special significance, such as those in *Kimbell* and those now before the Court in this case. The College believes that, by filing this *amicus* brief, it can provide a perspective not available from either of the parties.

SUMMARY OF THE ARGUMENT

This *amicus* brief is being filed by the College to express its extreme concerns about the legal standards relating to Section 2036(a) that were announced by the Tax Court in *Estate of Strangi v. Comm'r,* 85 T.C.M. (CCH) 1331 (2003) (*"Strangi 2"*).

The College believes that the determinative issue in regard to whether the decedent retained the "right," alone or in conjunction with one or more other persons, to designate the persons who would possess or enjoy the transferred property or the income therefrom within the meaning of Section 2036(a)(2), or the "right" to the income within the meaning of Section 2036(a)(1), should be whether there were sufficient fiduciary constraints under state law to prevent any power held by the decedent to control or otherwise participate in partnership or corporate general partner distribution decisions from rising to the level of a "right" within the meaning of the statute. *See U.S. v. Byrum,* 408 U.S. 125 (1972) (*"Byrum"*). The subjec-

tive likelihood of enforcement of those fiduciary duties, as determined by the Tax Court in *Strangi 2,* is not an appropriate standard for determining whether a power is a "right" within the meaning of the statute. Also, as determined by the Supreme Court in *Byrum,* the decedent's "control" is not an appropriate standard.

The College also believes that the ability of all of the partners to dissolve a partnership should not constitute the retention of a right, in conjunction with other persons, to designate who would enjoy the transferred property within the meaning of Section 2036(a)(2), as the Tax Court determined in *Strangi 2.*

In regard to the applicability of the exception under Section 2036(a) for a "bona fide sale for an adequate and full consideration in money or money's worth", the College endorses the principles set forth in this Court's analysis in *Kimbell v. U.S.,* 2004 WL 1119598 (5th Cir. 2004) (*"Kimbell"*). The potential applicability of the "bona fide sale for an adequate and full consideration" exception under Section 2036(a) requires a two-part analysis:

> (1) First, whether the decedent received "adequate and full consideration" for his capital contributions to the partnership should be based on whether (1) the partnership interests received for his contributions were proportionate to the value of his contributions relative to the value of the contributions of all partners, (2) the value of the decedent's contributions was properly credited to his capital account, and (3) upon the dissolution of the partnership, the decedent would be entitled to a distribution from the partnership equal to his capital account. *Kimbell,* 2004 WL 1119598 at 9, *citing, Estate of Stone v. Comm'r,* 86 T.C.M. (CCH) 551, 580 (2002). Presumably, similar principles should apply if the decedent received equity interests in the corporate general partner proportionate to his contributions relative to the contributions of all shareholders. The determination of whether the decedent received "adequate and full consideration" should be based upon an objective inquiry under which transactions between family members should be treated no differently than transactions between non-family members. The value of the equity interests received does not necessarily have to equal the value of the assets contributed. Subjective considerations, such as the decedent's testamentary intent or tax savings motives, are not material to the adequacy of the consideration. 2004 WL 1119598 at 5.
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> (2) Second, in determining whether a sale is "bona fide," the issue should not be whether the parties negotiated at arm's length but instead should be whether the transferor actually parted with the property supposedly transferred and actually received the consideration to which he was entitled by reason of the sale (that is, whether the transfer or the consideration received was real and not a sham). *Id.* at 7. Although transactions involving family members require heightened scrutiny to confirm the absence of a sham transfer or a disguised gift, the requirements for a bona fide sale between family members are the same as those for a bona fide sale between non-family members. The determination of whether a transaction is bona fide or is a sham or disguised gift is not based on subjective intent but instead requires an analysis of objective factors, including (a) whether the parties have respected the *partnership formalities,* (b) whether there have been *operational abuses,* and (c) whether the partnership was formed for *"substantial business and other non-tax reasons." Id.* at 9. The fact that the contributions by other partners are de minimis or that management remains in the same hands is immaterial. *Id.* at 10.

The College endorses the objective and generally understandable standards set forth in *Kimbell* for applying the bona fide sale exception. The College believes that such standards properly reflect this Court's precedent in *Wheeler v. U.S.,* 116 F.3d 749 (5th Cir., 1997) (*"Wheeler"*), statutory language, legislative history, and common sense while at the same time denying protection under the bona fide sale exception for truly abusive transactions. The College's chief concern is that the above-quoted phrase "substantial business and other non-tax reasons" be construed and applied consistently with this Court's and the College's strong preference for an objective and "bright-line" test." For example, the College assumes that the word "substantial" in this context is not intended to import a quantitative measure but is instead intended to examine whether the "business and other non-tax reasons" are objectively "real, actual, genuine, and not feigned" and are thus "bona fide." *See Kimbell,* 2004 WL 1119598 at 6.

In addition, the College assumes that the phrase "business and other non-tax reasons" encompasses investment objectives as well as objectives relating to an operating "business." Both Section 7701(a)(2) and Regulation § 301.7701-1(a)(2) define a partnership, for transfer tax as well as income tax purposes, as an unincorporated organization through or by means of which any business *or "financial operation"* is carried on. For income tax purposes, the term "partnership" is similarly defined to include either a business or "financial operation," and provision is made for all partners to *elect out* of the income tax provisions for partnerships in accordance with the Regulations if the partnership is availed of "for investment purposes only." Section 761(a). Regulation § 1.701-2(a), the partnership

income tax anti-abuse provision, directly equates investment activities with business activities by specifying that "Subchapter K is intended to permit taxpayers to conduct joint business *(including investment)* activities through [a partnership]..." (emphasis added). In Revenue Ruling 75-523, 1975-2 C.B. 257, the IRS held that, under Section 761, "a partnership may be availed of for investment purposes only, and need not be engaged in the active conduct of a business." In the same published ruling, the Service also indicated that, for purposes of Section 7701 of the Code, "an investment club is considered to have an objective to carry on business." Because the Code, Regulations, and published IRS rulings thus consistently view an investment purpose as interchangeable with a business purpose, at least for purposes of determining whether a partnership has a "business purpose," the College believes that an investment purpose is, and therefore should be treated as, a "business reason" for purposes of analyzing whether *Kimbell's* bona fide sale requirement has been satisfied.

The College is expressly refraining from taking any position in regard to questions of fact, including any possible implied agreement to retain enjoyment under Section 2036(a)(1), and any application of facts to the appropriate legal standards for the other issues. Therefore, no position is being taken as to which party should prevail.

Despite taking no position on which party should prevail, the College strongly believes that the legal standards used by the Tax Court in *Strangi 2* are in error and should be repudiated for the following reasons:

(1) The use of family controlled entities such as limited partnerships and corporations for various purposes, including investment management and preservation of family assets, is widespread, including by College members.

(2) Most legal advisers, including College members, and their clients, want to design and use such family controlled entities within known rules and boundaries, and believed that they had done so until *Strangi 2* raised unexpected questions.

(3) Rules and boundaries are most useful for that purpose when they are objective and understandable.

(4) While it is natural that both the Government and taxpayers invoke as many arguments as they reasonably can, including novel legal interpretations, to sustain the positions they hold in litigation, it is extraordinarily disturbing and disruptive when novel legal interpretations are announced by courts, especially in dicta or as extraneous alternative grounds for a decision. Such announcements rarely produce the objective and understandable rules and boundaries that both taxpayers and the Service need.

(5) In particular, the Section 2036(a)(2) analysis of *Strangi 2* extends that statute in a fundamental way far beyond what the language, history, previous judicial construction, and even previous IRS construction of that statute have been commonly understood to require or permit. Unfortunately, this Court's decision in *Kimbell* has not resolved the confusion regarding this issue.

(6) Such "new law" is best created by statute (or by regulations pursuant to statutory authority), in a context in which the deliberative process (or the notice and comment process in the case of regulations) presents an opportunity to arrive at the needed objective and understandable rules and boundaries without the encumbrance of particular, sometimes difficult or extreme, facts.

(7) This is particularly true in a case such as this one where Congress has repeatedly visited, or declined to visit, the very subject matter that is the subject of the dispute. *See Wheeler,* 116 F.3d at 765-66.

(8) Therefore, however this Court rules on the underlying fact-bound merits of the case, it is important that it repudiate the destabilizing subjective standards used in *Strangi 2* for applying the "bona fide sale for an adequate and full consideration" exception of Section 2036(a), in determining the existence of "rights" within the meaning of Section 2036(a)(1) and (a)(2), and for finding that a dissolution power requiring the consent of all partners is covered by Section 2036(a)(2).

ARGUMENT

II. THE DECEDENT'S POWER TO PARTICIPATE IN THE DISTRIBUTION DECISION-MAKING PROCESS FOR AN ENTITY DOES NOT GENERALLY CONSTITUTE A RETAINED "RIGHT" TO INCOME FROM THE TRANSFERRED PROPERTY WITHIN THE MEANING OF SECTION 2036(a)(1) OR THE "RIGHT," ALONE OR IN CONJUNCTION WITH ANY PERSON, TO DESIGNATE THE PERSONS WHO WOULD BENEFIT FROM SUCH INCOME WITHIN THE MEANING OF SECTION 2036(a)(2).

The Tax Court in *Strangi 2* held that a retained power to participate in partnership or corporate general partner distribution decisions was a retained right, alone or in conjunction with any person, to designate the persons who would enjoy the property transferred to the entity or the income from such property within the meaning of Section 2036(a)(2). *Strangi 2,* 85 T.C.M. (CCH) at 1342. "Control" of such distribution

decisions was not required. *Id.* at 1341-1342. The Tax Court also "suggested" that such a power held by an equity holder in the entity amounted to a retained right to the income from the transferred property within the meaning of Section 2036(a)(1). *See id.* at 1336-37.

The Tax Court went so far as to determine that the decedent's power, in conjunction with all other partners, to dissolve the partnership is a "right" to accelerate present enjoyment of partnership assets within the meaning of the Section 2036(a)(2). *Strangi 2,* 85 T.C.M. (CCH) at 1341.

The decedent's estate argued in *Strangi 2* that, as in *Byrum,* any power the decedent had to participate in any distribution decision was restricted by fiduciary duties imposed by state law and thus was not a "right," as required by Section 2036(a)(1) and (a)(2). *Strangi 2* at 1342. This argument was rejected by the Tax Court, which distinguished *Byrum* on the ground that an independent corporate trustee, unrelated minority equity holders, and operating businesses were present in *Byrum.* *Id.* at 1342-43. In effect, the Tax Court applied a "likelihood of enforcement" standard. If all equity holders are family members, and the entity in question is not an operating business, enforcement is purportedly unlikely, and any intrafamily fiduciary duties should be ignored. *Id.* at 1343.

The College believes that the Tax Court's standards for applying Section 2036(a)(1) and (a)(2) are at odds with the Supreme Court decision in *Byrum,* with other judicial precedents following *Byrum,* with the IRS's own rulings, including at least one published ruling and one General Counsel Memorandum, and with basic fiduciary law. Because practitioners have relied upon these judicial precedents and IRS rulings for over 30 years, the estate and investment plans of literally thousands, if not tens of thousands, of taxpayers could be overturned if the Tax Court's holdings are sustained on appeal.

Furthermore, the Tax Court's holdings are inconsistent with Chapter 14, which includes express statutory remedies enacted by Congress to curb the perceived abuses potentially resulting from the use of family controlled entities, but which does not alter *Byrum's* fiduciary duty limitation on what constitutes a "right" within the meaning of Section 2036(a)(1) and (a)(2). *See Wheeler,* 116 F.3d at 767.

Byrum* and Other Judicial Precedents Preceding *Kimbell. In *Byrum,* the Government contended that a majority stockholder's retained voting *"control"* was tantamount to the power to accumulate income and thus amounted to a right within the meaning of Section 2036(a)(2) to designate who could possess or enjoy the income from the shares transferred to an irrevocable trust for the controlling shareholder's children. *Byrum,* 408 U.S. at 132 n. 4 and 135. The Supreme Court expressly rejected such a control standard. For a power to rise to the level of a "right," as required by Section 2036(a)(2), the power must be "ascertainable and legally enforceable." *Id.,* at 136. According to the Supreme Court, "the concept [of voting control] is too variable and imprecise to constitute the basis per se for imposing tax liability under § 2036(a)," apparently including Section 2036(a)(1) as well as Section 2036(a)(2). *Id.,* at 138 n. 13. As the Supreme Court concluded:

> The "control" rationale urged by the Government …would create a standard—not specified in the statute—so vague and amorphous as to be impossible of ascertainment in many instances.

Id., at 137 n. 10.

In *Strangi 2,* the Tax Court expressly recognized the Supreme Court's rejection of a "control" standard. *See Strangi 2,* 85 T.C.M. (CCH) at 1340. Instead of using a "control" standard, the Tax Court in *Strangi 2* in effect held that any power to participate in a distribution decision, including a decision by the five member board of the corporate general partner to declare dividends or even a decision to dissolve the partnership requiring the consent of all partners, constitutes a right, when held in conjunction with other family members, to designate the persons who would enjoy the property transferred to the entity or the income therefrom within the meaning of Section 2036(a)(2). *Id.* at 1341-42. Furthermore, the Tax Court "suggested" that the decedent retained a "right to the income" from the transferred property within the meaning of Section 2036(a)(1). *Id.* at 1336-37.

In contrast to this standard in *Strangi 2,* the Supreme Court in *Byrum,* after rejecting a "control" standard for purposes of Section 2036(a), focused on whether the *de facto* power of a majority shareholder and directors of a closely held corporation to arrange for dividend payments was "ascertainable and legally enforceable" under state law in light of the fiduciary duties owed by such majority shareholder and directors to the corporation and to the other shareholders. *Byrum* at 138-142. In *Byrum,* such fiduciary duties were held to effectively constrain the exercise of the *de facto* powers held by the majority shareholder and directors, so such *de facto* powers were not *"rights"* within the meaning of Section 2036(a)(2) (and presumably Section 2036(a)(1)). *Id.* at 143.

The Tax Court in *Strangi 2* focused on whether any constraints imposed by state law were "illusory" because of the factual context of that case. *See Strangi 2.* 85 T.C.M. (CCH) at 1342-43. Thus, the Tax Court based its decision on the *likelihood of enforcement,* not

enforceability as the Supreme Court had specified in *Byrum.* This standard used by the Tax Court in *Strangi 2* is materially different from the Supreme Court's standard in *Byrum.*

In effect, the Tax Court has substituted a subjective facts and circumstances test to determine the likelihood of enforcement. This is in contrast to the relatively objective bright-line approach favored by the Supreme Court in *Byrum,* which expressly rejected a "control" standard as being "so vague and amorphous as to be impossible of ascertainment in many instances." *Byrum,* 408 U.S. at 137 n. 10. If the Supreme Court was concerned about the uncertainty resulting from a "control" standard, with its inherently factual and potentially subjective predicates, what would the Supreme Court's reaction be to a "likelihood of enforcement" standard, which is clearly factual and highly subjective? If the Supreme Court's goal in *Byrum* was to establish a relatively objective bright line test, as opposed to one which was "too variable and imprecise," the Tax Court's "likelihood of enforcement" standard would be a radical departure, not only from the general tenor of *Byrum* but also from the Supreme Court's requirement that a "right" must be "ascertainable" as well as "legally enforceable."

The Tax Court in *Strangi 2* rested its "likelihood of enforcement" standard on the absence of three facts present in *Byrum.* In *Strangi 2,* there were (1) no independent trustees, (2) no unrelated minority equity holders, and (3) no operating businesses. *Strangi 2* at 1343. The majority opinion in *Byrum,* however, strongly supports a finding that the cited factors were not determinative but were instead *alternative bases* or simply *additional factual reinforcement* of the Supreme Court's Section 2036(a)(2) holding.

The majority opinion in *Byrum* includes the following excerpt illustrating that the presence of an independent trustee with sole discretion over trust distributions was an *alternative basis* for holding Section 2036(a)(2) to be inapplicable:

> We conclude that *Byrum* did not have an unconstrained de facto power to regulate the flow of dividends to the trust, much less the "right" to designate who was to enjoy the income from trust property.

Byrum, 408 U.S. at 143. The reference to the absence of "an unconstrained de facto power to regulate the flow of dividends to the trust" is a reference to the Supreme Court's prior determination in the decision that the fiduciary duties owed by a majority equity holder and directors imposed restraints upon the de facto power of the decedent to influence dividend policy, thus negating the existence of a "right" within the meaning of Section 2036(a)(2). The fact that the independent trustee, not the decedent in *Byrum,* had sole discretion to make distributions was a second, separate basis for concluding that the decedent had no right within the meaning of Section 2036(a)(2), because the trustee, not the decedent, would designate who would enjoy the income from the property transferred to the trust.

In turn, the presence of unrelated minority equity holders and operating businesses merely provides reinforcement for the opinion in *Byrum* that there was not a "right" within the meaning of Section 2036(a)(2) because of the fiduciary legal constraints upon the decedent's exercise of his de facto power to control dividends. Supporting this conclusion is the following excerpt, rejecting the Government's contention that the decedent's retention of corporate control (through the retention of the right to vote the shares transferred to the trust) was tantamount to the right to accumulate income in the trust:

> This approach seems to us not only to depart from the specific statutory language,14 but also to misconceive the realities of corporate life.

Byrum, 408 U.S. at 138-39. Immediately following this excerpt was a discussion of the economic vicissitudes of operating businesses and governance considerations relating to closely held businesses with unrelated minority equity holders. This discussion, although addressed, of course, to the facts of *Byrum,* was consistently framed in the context of the legal restraints on the exercise of a majority shareholder's and directors' powers by reason of fiduciary duties imposed by state law. Therefore, this discussion is fully consistent with the initial indication in the above excerpt that the Government's control contention "seems…to depart from the specific statutory language." Significantly, footnote 14, which appears immediately following the above-cited reference to the departure from the specific statutory language, concludes as follows:

> [T]his case concerns a statute written in terms of the "right" to designate the recipient of income. The use of the term "right" implies that restraints on the exercise of power are to be recognized and that such restraints deprive the person exercising the power of a "right" to do so.

Bryum at 139 n. 14.

The restraints in *Byrum* are fiduciary duties imposed by state law. In *Byrum,* the focus was on state

law. Although the factual context of this analysis of state law involved operating businesses and unrelated minority shareholders, there is no indication in *Byrum* that the outcome would have been different if state law had imposed similar fiduciary constraints in the context of an investment entity with only related equity holders, which is the case for many family controlled entities.

In two Tax Court cases decided more than 20 years prior to *Strangi 2,* the Government litigated the issue of whether *Byrum's* fiduciary duty limitation applied in an intrafamily setting. In both *Estate of Gilman v. Comm'r,* 65 T.C. 296 (1975), *aff'd,* 547 F.2d 23 (2d Cir. 1976), which involved a corporation, and *Estate of Cohen v. Comm'r,* 79 T.C. 1015 (1982), which involved a Massachusetts business trust, the Government's argument that family members are not likely to enforce fiduciary duties imposed by state law was rejected, and Section 2036(a)(2) was held not to apply by reason of *Byrum's* fiduciary duty limitation.

The Tax Court's finding in *Strangi 2* that *Byrum's* fiduciary duty limitation should not apply in an intrafamily setting is nothing more than a reincarnation of the old family attribution notion that was repudiated in valuation cases in this Court (and others) and was ultimately abandoned by the Government. *See Estate of Bright v. U.S.,* 658 F.2d 999 (5th Cir. 1981) *en banc;* Rev. Rul. 93-12, 1993-1 C.B. 202 (1993). The Government's family attribution argument should similarly be rejected in a Section 2036(a)(2) context. Families simply are not inherently the harmonious monoliths portrayed by the Government, and fiduciary duties owed by one family member to another are not illusory, as evidenced by the volumes of fiduciary litigation among family members witnessed by members of the College.

The College believes that the only potential explanation for an unfavorable Section 2036(a)(2) decision in *Strangi 2,* properly using *Byrum* fiduciary duty limitation standards, would relate to the discretionary standards for partnership distributions which are unique to the limited partnership agreement in question. *Byrum's* fiduciary duty limitation would not protect against the applicability of Section 2036(a)(2) if, under state law (taking into account the terms of the governing instruments), there were not sufficient fiduciary constraints imposed on the power of the decedent, alone or in conjunction with other persons, to make distribution determinations. Whether there were sufficient fiduciary constraints is a combined question of state law and fact that is unique to this case and thus does not require or permit deviation from the Supreme Court's generally applicable legal standard. Therefore, the College takes no position on this narrower, case-specific issue other than to encourage this Court, if it holds for the Government under Section 2036(a)(2) because of this discretion, to clarify that *Byrum's* fiduciary duty limitation is not applicable because of the parties' effective waiver of the duties that would have otherwise applied and not because of the subjective likelihood of enforcement standard proposed by the Government.

Kimbell. Although this Court's decision in *Kimbell* provides objective and generally understandable standards for important issues under Section 2036(a), it leaves unresolved the standards to be applied in determining whether the decedent retained a "right" to income from the transferred property within the meaning of Section 2036(a)(1) or a "right," alone or in conjunction with other persons, to designate the persons who would possess or enjoy the transferred property or the income therefrom within the meaning of Section 2036(a)(2).

Kimbell could be construed as applying a "control" standard to determine if any such "right" existed. *Kimbell,* 2004 WL 1119598 at 12. An alternative explanation, however, is that even assuming *arguendo* that the lower court's "control" standard was appropriate, the decedent in *Kimbell* did not possess the requisite voting power for control.

As noted previously, the Supreme Court in *Byrum* expressly rejected a "control" standard as being "too variable and imprecise to constitute the basis per se for imposing tax liability under § 2036(a)." 408 U.S. at 138 n. 13. In light of this holding, the College assumes that *Kimbell* did not adopt a "control" standard but instead was emphasizing that the Government would not have prevailed on the issue of whether the decedent in that case had the requisite control even if a "control" standard had been used.

A "control" standard would also be at odds with the well-established, long-standing principle that a power retained by the decedent, even as sole trustee of a trust which the decedent established, to make trust distributions pursuant to a reasonably definite external standard enforceable under state law, such as for support, maintenance, health or education of one or more specified beneficiaries, is sufficiently constrained to avoid being a "right" within the meaning of Section 2036(a)(2). In at least three instances, the IRS has acquiesced to such a reasonably definite external standard limitation on what constitutes a "right" under Section 2036(a)(2). *See United States v. Powell,* 307 F.2d 821 (10th Cir. 1962); *Estate of Ford v. Comm'r,* 53 T.C. 114 (1969); *Estate of Budd v. Comm'r,* 49 T.C. 468 (1968); *Estate of Pardee v. Comm'r,* 49 T.C. 140 (1967), *acq.* 1973-2 C.B. 3; *Estate of Kasch v. Comm'r,* 30 T.C. 102 (1958), *acq.* 1958-2 C.B. 6; *Estate of Wier v. Comm'r,* 17 T.C. 409 (1951), *acq.* 1952-1 C.B. 4 (partially withdrawn in regard to another issue in 1966-2 C.B. 8); *Jennings v. Smith,* 161 F.2d 74 (2d Cir. 1947); and *Estate of Frew v. Comm'r,* 8 T.C. 1240

(1947), *acq.* 1947-2 C.B. 2. Cf. Revenue Ruling 73-143, 1973-1 C.B. 407.

IRS Rulings. In Revenue Ruling 81-15, 1981-1 C.B. 457 (1981), the IRS expressly acknowledged that *Byrum* imposed a fiduciary duty limitation on the applicability of Section 2036(a)(2). The ruling then analyzed the extent to which the enactment of Section 2036(b) (which is expressly limited to the retained right to vote shares of stock of a controlled corporation) affects the holding in *Byrum.* To the extent that Section 2036(b) does not apply, especially in the case of a transfer of nonvoting stock or a transfer of a minority block of stock by a majority stockholder, the ruling, relying on explicit legislative history, concluded that "the effect of *Byrum*…is not changed by the enactment of section 2036(b)".

In Gen. Couns. Mem. 38,984 (May 6, 1983), which in effect was an acquiescence to the Tax Court's decision in *Estate of Cohen,* 79 T.C. at 1015 (1982), the IRS conceded that *Byrum's* fiduciary duty limitation applied to a Massachusetts business trust in which the decedent was a trustee and in which only family members were equity holders.

In a series of private letter rulings in the early to mid 1990s (at least some of which expressly involved intrafamily settings), the Service acknowledged that the *Byrum* fiduciary duty limitation applied to partnerships, as well as corporations and Massachusetts business trusts, because the general partner's distribution decisions were subject to fiduciary constraints under state law. *See* Priv. Ltr. Rul. 9026021 (March 26, 1990), Tech. Adv. Mem. 9131006 (April 30, 1991), Priv. Ltr. Rul. 9310039 (December 16, 1992), Priv. Ltr. Rul. 9415007 (January 12, 1994), and Priv. Ltr. Rul. 9546006 (August 14, 1995).

The Tax Court in *Strangi 2* correctly notes that these private letter rulings have no precedential force under Section 6110(k)(3). *Strangi 2,* 85 T.C.M. (CCH) at 1343. Inexplicably, however, the Tax Court does not cite Revenue Ruling 81-15, even though that published ruling remains outstanding and even though the IRS is obligated to respect its published rulings. *See Rauenhorst v. Comm'r,* 119 T.C. 157 (2002); *McLendon v. Comm'r,* 135 F.3d 1017 (5th Cir. 1998). Also not cited was Gen. Couns. Mem. 38,984 (May 6, 1983), even though a General Counsel Memorandum may be entitled to more deference than private letter rulings. *See Morganbesser v. U.S.,* 984 F.2d 560 (2d Cir. 1993).

Rauenhorst and *McLendon* represent not only controlling precedent but also sound policy. Taxpayers should be able to rely upon published IRS rulings, as this Court held in *McLendon.*

Legislative History. Congress has considered family controlled entities, including partnerships, on several occasions since *Byrum* was decided in 1972. Although a taxpayer's retained voting rights in a 20% or more family controlled *corporation* were addressed by the adoption of Section 2036(b), the balance of *Byrum's* fiduciary duty exception to Section 2036(a)(2) remains intact from a legislative perspective.

When Congress enacted Chapter 14 in 1990, it specifically adopted an approach of treating the gift as complete at the time of the transfer or relinquishment of voting or liquidation rights. Generally, gift or other transfer tax consequences were to be determined at that time through use of special valuation rules designed to take into account the likelihood that related parties would not exercise rights in an arm's length manner. In taking this approach and by simultaneously repealing Section 2036(c) retroactively to its enactment in 1987, Congress consciously decided to abandon the inherently testamentary approach briefly adopted when Section 2036(c) was passed. *See Present Law and Proposals Relating to Federal Transfer Tax Consequences of Estate Freezes, Before the Senate Joint Comm. on Taxation,* 101st Cong. 27-28 (2d Sess. 1990) (prepared by the Staff of the Joint Committee on Taxation). *See also* Informal Senate Report on S. *3209,* 136 Cong. Rec. S15,680 (daily ed. Oct. 18, 1990) (statement of various committees to the Budget Committee).

In enacting Chapter 14, Congress specifically considered voting rights. Nonlapsing rights with respect to proportional interests, such as those in *Strangi 2,* were expressly excepted from the new special valuation rules. *See* Sections 2701(a)(2)(C), 2704(a). Even under the testamentary approach of repealed Section 2036(c), inclusion in the gross estate was not required if the only difference in the transferred and retained interests related to voting or managerial powers. *See* Notice 89-99, 1989-2 C.B. 422, 428 (1989). *See also Present Law and Proposals Relating to Federal Transfer Tax Consequences of Estate Freezes, Before the Senate Joint Comm. on Taxation,* 101st Cong. at 21.

It is difficult to reconcile the *Strangi 2* standard under Section 2036(a)(2) with this legislative history, which clearly indicates that the non-lapsing voting rights of retained equity interests should not generally pose any estate or gift tax problem under Section 2036 or Chapter 14. Needless to say, Congress has been aware of *Byrum,* and it has the power to reverse *Byrum's* fiduciary duty limitation, but it has chosen not to do so in more than 30 years since that decision. As the Supreme Court noted in *Byrum,* courts should be loath to depart from long-standing principles on which taxpayers have relied when the departure could have far-reaching consequences:

> When a principle of taxation requires re-examination, Congress is better

> equipped than a court to define precisely the type of conduct which results in tax consequences. When courts readily undertake such tasks, taxpayers may not rely with assurance on what appear to be established rules lest they be subsequently overturned.

Byrum, 408 U.S. at 135.

III. A PROVISION IN A LIMITED PARTNERSHIP AGREEMENT WHICH PERMITS THE PARTNERSHIP TO BE DISSOLVED AT ANY TIME WITH THE CONSENT OF ALL PARTNERS SHOULD NOT CONSTITUTE THE RETENTION OF A SECTION 2036(a)(2) RIGHT, IN CONJUNCTION WITH OTHER PERSONS, TO DESIGNATE THE PERSONS WHO WOULD PRESENTLY ENJOY THE ASSETS TRANSFERRED TO THE PARTNERSHIP.

In *Strangi 2,* the decedent, the corporate general partner, and all shareholders of the corporate general partner had the power, together, to dissolve the partnership in question. The Tax Court held that this amounted to a Section 2036(a)(2) retained right in the decedent, in conjunction with other persons, to accelerate receipt of the partnership assets and thus to designate the persons who would presently enjoy the assets transferred to the partnership. *Strangi 2,* 85 T.C.M. (CCH) at 1341.

Judicial precedents (including Supreme Court precedents), Regulations, and legislative history all demand that Section 2036(a)(2) cannot apply to a unanimous dissolution power, because important elements of Section 2036(a)(2) are missing. There is no "enjoyment" of transferred property at stake, and in any event the decedent's ability to affect the alleged "enjoyment" does not rise to the level of a "right."

Section 2036(a) Analysis. In *Byrum,* the Supreme Court expressly rejected the notion that the power to liquidate the corporations in question in that case could be a retention of the transferred property for Section 2036(a)(1) purposes. The Supreme Court found it "well settled that the terms 'enjoy' and 'enjoyment,' as used in various estate tax statutes,…connote substantial present economic benefit…. [T]he power to liquidate…is not a *present* benefit; rather, it is a speculative and contingent benefit which may or may not be realized." *Byrum,* 408 U.S. at 145, 149-150 (emphasis added). Thus, the Supreme Court held that the controlling shareholder had not retained "present enjoyment" of the transferred property within the meaning of Section 2036(a)(1). *Id.* at 150.

If the power of a controlling shareholder in *Byrum* to determine whether and when the controlled corporations would be liquidated was insufficient present economic benefit to constitute retained enjoyment for purposes of Section 2036(a)(1), the power of a partner in *Strangi 2* to participate in a partnership liquidation decision requiring unanimity must likewise fall short of a right to designate the persons who would presently enjoy the property for purposes of Section 2036(a)(2). The fact that the opinions addressed different paragraphs of the same statute should make no difference. As the Supreme Court explicitly stated, "the terms 'enjoy' and 'enjoyment,' *as used in various estate tax statutes,*…connote substantial present economic benefit." *Byrum,* 408 U.S. at 145 (emphasis added). Surely, if the power to allegedly benefit *personally* from a liquidation (Section 2036(a)(1)) has no adverse tax consequences, the power to merely benefit *others* by a liquidation (Section 2036(a)(2)) should not. Viewed another way, if the power does not create a right to present enjoyment in the holder of the power, then it cannot create present enjoyment in others either.

In addition, for the reasons discussed previously, the College believes that the fiduciary duties owed by the partners to each other and to the partnership under applicable state law would generally prevent the *de facto* power of the partners, acting in conjunction with each other, to dissolve the partnership from rising to the level of a "right," as required by Section 2036(a)(2).

In summary, for Section 2036(a)(2) to apply to the power of all partners to dissolve a partnership, there must be a retained "right," in conjunction with other persons, to designate the persons who will "presently enjoy" the transferred property. *Byrum* indicates that these statutory requirements are not met by a mere power of dissolution. There is no "right," and there is no "present enjoyment." Therefore, for at least two separate and distinct reasons, Section 2036(a)(2) should not apply to a dissolution power.

Analogous Section 2038(a)(1) Authority. Persuasive analogous support is found under Section 2038(a)(1). This provision requires inclusion in a decedent's gross estate of an interest in property transferred by the decedent to the extent that the decedent (in any capacity), alone or in conjunction with one or more persons, held at death the "power" to alter, amend, revoke, or terminate the enjoyment of the transferred property. Because several statutory requirements under Section 2036(a)(2) do not apply to Section 2038(a)(1), the Section 2038(a)(1) requirements are generally easier to satisfy than the Section 2036(a)(2) requirements. *See* Rev. Rul. 70-348, 1970 C.B. 193, regarding the absence of any "retention" requirement under Section 2038(a)(1), and Pennell, *Federal Wealth Transfer Taxation* 281-282 (2003). Typically, then, if Section 2038(a)(1) does not apply to a particular situation, it is even less likely that Section 2036(a)(2) will apply.

In this context, *Helvering v. Helmholz,* 296 U.S. 93 (1935) (*"Helmholz"*) is relevant. The Supreme Court held that the predecessor of Section 2038(a)(1) did not apply to a power of all beneficiaries to terminate a trust pursuant to the terms of a trust agreement if that power to terminate added nothing to the parties' powers under applicable state law:

> This [Section 2038(a)(1) predecessor] argument overlooks the essential difference between a power to revoke, alter, or amend, and a condition which the law imposes. The general rule is that all parties in interest may terminate the trust. The clause in question added nothing to the rights which the law conferred. Congress cannot tax as a transfer intended to take effect in possession and enjoyment at the death of the settlor a trust created in a state whose law permits all the beneficiaries to terminate the trust.

Helmholz, 296 U.S. at 97.

The substance of the *Helmholz* decision was subsequently incorporated in Regulation § 20.2038-1(a)(2):

> [S]ection 2038 does not apply —
> (2) if the decedent's power could be exercised only with the consent of all parties having an interest (vested or contingent) in the transferred property, and if the power added nothing to the rights of the parties under local law….

This Regulation should apply to a power to dissolve a partnership that, consistently with state law, requires the consent of all partners.

Even in *Strangi 2,* the Tax Court did not find that the power to dissolve the partnership with the consent of all partners was a Section 2038(a)(1) power, presumably on the basis of Helmholz and Regulation § 20.2038-1(a)(2). By analogy, if such a unanimous dissolution power is not a Section 2038(a)(1) "power," it should also not be a Section 2036(a)(2) "right."

In *Estate of Tully v. United States,* 528 F.2d 1401 (Ct. Cl. 1976), the U.S. Court of Claims held that the mere *possibility* that the parties to a contract would alter or amend that agreement is too "speculative" to rise to the level of a "power." *Tully,* 528 U.S. 1401, 1404-05. Similarly, the term "power," as used in Section 2038(a)(1), "does not extend to *powers of persuasion,"* again because powers of persuasion are speculative. *Id.,* at 1404. Finally, "Congress did not intend the 'in conjunction' language of section 2038(a)(1) to extend to the mere possibility of bilateral contract modification." *Id.,* at 1405.

If the possibility of a contract revision does not give rise to a "power" for Section 2038(a)(1) purposes, it also should not give rise to a "right" within the meaning of Section 2036(a)(2). Similarly, if the "in conjunction" language of Section 2038(a)(1) does not extend to the mere possibility of a bilateral contract modification, the "in conjunction" language of Section 2036(a)(2) also should not extend to the possibility of a bilateral contract modification in the form of a dissolution of the partnership by agreement of all partners.

Legislative History. Congress specifically addressed liquidation restrictions when it enacted Chapter 14 in 1990. Section 2704(b) causes certain restrictions on liquidation involving transferred interests in family-controlled corporations or partnerships to be disregarded for valuation purposes if the transferor or any member of the transferor's family, either alone or collectively, has the right to remove the respective liquidation restriction. Section 2704(b)(1) and (2)(B)(ii). Expressly excepted from this general rule, however, is "any restriction imposed by state law." Section 2704(b)(3)(B). Also excepted is any liquidation provision that is not more restrictive than the rule that would apply under state law in the absence of any provision in the partnership agreement. *See* Regulation Section 25.2704-2(b).

There was no reason for Section 2704(b) to be adopted in 1990 if Section 2036(a)(2) already applied to a family-controlled partnership or other entity that could be liquidated or dissolved with the consent of all equity holders. Furthermore, Section 2704(b) clearly reflects Congress's desire not to impose a greater transfer tax liability on an equity interest in an entity because of a non-lapsing liquidation provision that is no more onerous than the default provision under state law.

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