BESSEMER TRUST

Estate of Howard V. Moore v. Commissioner, T.C. Memo. 2020-40

April 2020

FLP Assets Included in Estate Under Section 2036(a)(1); Application of Section 2043 Consideration Offset Regarding Section 2036 Transfer; Formula Transfer to Charitable Lead Trust Not Respected; Loans Not Respected as Bona Fide Debt; Deduction Not Allowed for Attorney's Fee for Estate Administration

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Synopsis

In a pre-death planning context beginning in late 2004, after contracting to sell a farm for about $16.5 million the decedent transferred a 4/5ths interest in the farm to an FLP in return for a 95% limited partnership interest. A Management Trust (with two children as co-trustees) was the 1% general partner, but the decedent exercised practical control over the FLP and caused transfers of $2 million of the sale proceeds to himself, $2 million to his children (who gave notes for their transfers), and $500,000 to a grandson as a gift.

The decedent subsequently gave $500,000 to an Irrevocable Trust (for his children) and several weeks later transferred his 95% limited partnership interest to the Irrevocable Trust for a $500,000 cash downpayment and a $4.8 million note (the gift and sale amount represented a discount of just over 50% for the FLP interest).

The decedent's revocable trust provided a formula bequest to a charitable lead trust in an amount to "result in the least possible federal estate tax." In addition, the Irrevocable Trust provided that the trustee would distribute to the revocable trust "the value of any asset of this trust which is includible in my gross estate."

Following the decedent's death at the end of March 2005, the charitable lead trust apparently was funded with a substantial amount under the revocable trust's formula transfer. An IRS examination resulted in this case alleging additional gift and estate taxes.

Not surprisingly, the court determined that the farm was included in the gross estate under §2036(a)(1). The bona fide sale for full consideration exception in §2036(a) did not apply because no businesses required active management, the children did not actually manage sale proceeds in the FLP, no legitimate creditor concerns existed, and the "whole plan" involving the FLP had a "testamentary essence." The decedent retained enjoyment or possession of the assets transferred to the FLP under §2036(a)(1) (at least by implied agreement) because, although he kept sufficient assets for personal needs, he instead "scooped into FLP assets to pay personal expenses," and his relationship to the assets remained unchanged after the transfer to the FLP.

The court followed up on the discussion of §2043 in *Estate of Powell v. Commissioner* with its own lengthy analysis, but on the facts of the case the application of §2043 had little practical impact.

The court refused to allow any additional charitable deduction under the formula transfer provision in the Irrevocable Trust as a result of the inclusion of the farm in the gross estate because (1) specific wording in the formula limits any transfer, and (2) the charitable amount was not ascertainable at the decedent's death but depended on subsequent events (the IRS audit and tax litigation). The *Christiansen* and *Petter* cases were distinguished because they merely involved valuation issues to determine what passed to charity, but in this case the charity did not know it "would get any additional assets at all."

The court also determined that (1) the $2 million transfers to the children in return for notes were actually gifts (with a detailed review of factors considered in determining whether bona fide debt exists), (2) additional gift taxes resulting from those gifts must be included in the gross estate under §2035(b) because the gifts were made within three years of death, and (3) a flat fee of $475,000 for attorney's fees was not deductible because the evidence did not establish what services were performed for the fee and that it was necessarily incurred in the administration of the estate. *Estate of Howard V. Moore v. Commissioner,* T.C. Memo. 2020-40 (April 7, 2020, Judge Holmes).

Basic Facts

1. **Background.** Mr. Moore's story is one of a compelling rise from poverty. He grew up in a home thatched out of arrowweed, left school after the eighth grade, became a "land leveler" in a local economy with so little cash that he was often paid with some of the land that was leveled, and slowly assembled over 1,000 acres that were consolidated into what became Moore Farms. He endured a long battle with alcoholism and had a dysfunctional family (including one son leaving for many years after he had borrowed a tractor belonging to one of his brothers, who then fired shots at the tractor, causing thousands of dollars of damage).

   At age 88, Mr. Moore negotiated with potential buyers about selling the farm property, but before completing the sale he had a serious heart attack and was told he had less than six months to live. In December 2004, while in hospice care in the hospital, he worked with an estate planning attorney who developed an estate plan, focused primarily on Mr. Moore's stated goals of maintaining control and eliminating estate tax. As part of that plan, he created various trusts and a family limited partnership on December 20, 2004, four days after leaving the hospital.

2. **Trusts.**

   a. **Living Trust**. Mr. Moore transferred all of his real and intangible personal property to a revocable trust (the "Living Trust"). On Mr. Moore's death, the trust provided for a formula transfer to a charitable lead trust of a fractional part of the trust assets to result in the "least possible federal estate tax." After paying expenses, claims, taxes, and specific distributions of personal property and real estate, the balance was left to the "Children's Trust" for the benefit of Mr. Moore's four children.

   b. **Charitable Lead Annuity Trust**. It is not clear from the opinion when the charitable lead trust (the "Charitable Trust") was funded. The Living Trust contained a formula transfer to the Charitable Trust of a sufficient amount to minimize estate taxes so it may only have been funded under the formula transfer in the Living Trust following Mr. Moore's death. By the time of trial, the trust had distributed $2.5 million, ultimately passing to various charities. The opinion is confusing about the funding following Mr. Moore's death, though, because it reports that the estate tax return claimed a deduction for a transfer to the Charitable Trust of $4,745,671, but the IRS determined that only $516,000 had been transferred to the Charitable Trust following Mr. Moore's death.

   c. **Children's Trust**. The "Children's Trust" apparently was created under the Living Trust following Mr. Moore's death. It directed specific distributions of certain property among the four children in trust, with the remaining assets being held in equal shares in trust for the four children.

   d. **Family Management Trust**. The only asset of the irrevocable "Management Trust" was a 1% general partner interest in the family limited partnership ("FLP") described below. The trustees were two of Mr. Moore's children. The trust assets were to pass to the four children following Mr. Moore's death.

   e. **Irrevocable Trust**. The "Irrevocable Trust" was for the benefit of the four children. One son was the trustee. Following Mr. Moore's death, the trust was directed to "distribute an amount equal to the value of any asset of this trust which is includible in my gross estate for federal estate tax purposes" to the Living Trust to be distributed in accordance with its terms (i.e., under the formula distribution to the Charitable Trust and to the Children's Trust). As discussed below, Mr. Moore funded this trust in February 2005 from the Living Trust with $500,000, and several weeks later he transferred all of his interest in the FLP to this trust.

f. **Family Limited Partnership**. The FLP was created with initial nominal contributions so the Management Trust held a 1% general partnership interest, and the limited partnership interests were held by Mr. Moore (95%) and by the four children (collectively 4%). The FLP was funded in early February 2005 with a 4/5ths interest in Moore Farms and with a separate farm, and in late February with $1.8 million from an investment account held by the Living Trust. (The farm properties are collectively referred to as the "farm" below, but references to the farm properties are not clear in the opinion. Four-fifths of Moore Farms and all of the separate farm (called "Doval Farms") were transferred to the FLP, but the rest of the opinion just referred to "Moore Farms," and "Moore Farms" was included in the estate under §2036. Whether that included all of the farms owned by the FLP is not clear in the opinion.)

3 **Sale of Farm**. Meanwhile, Mr. Moore had been engaged in negotiations with a prospective buyer of the farm, and before or shortly after his transfer of a 4/5th interest in the farm to the FLP there was a contract to sell the farm for about $16.5 million. That sale closed very shortly after his transfer to the FLP. (**Observation**: The opinion is not clear about the exact timing, suggesting in some references that the transfer and sale occurred on the same day and in other references that they were separated by up to five days.) Upon closing of the sale, the FLP transferred its 4/5ths interest in the farm (and the Living Trust transferred its remaining 1/5th interest) to the buyer, with Mr. Moore being allowed to continue living on and to operate the farm property for the short remaining balance of his lifetime.

4. **Transfers**. Mr. Moore made various transfers over the next couple months. Some of the transfers were, as the court put it, "quite complex."

- The attorney was paid the $220,000 balance of his $320,000 design fee (80% came from the FLP and 20% from the Living Trust; Mr. Moore had paid $100,000 upfront).
- Mr. Moore directed the FLP to transfer $500,000 to each of his four children in return for a five-year note bearing interest at a rate of 3.6% from each of the children. (The mid-term applicable federal rate for February 2005 was 3.83%. Rev. Rul. 2005-8, 2005-1 C.B. 466.) The notes had no amortization schedule, no payments were made, no efforts were made to collect the notes, and the court ultimately did not respect the notes. In addition, a grandson also received $500,000 as a gift (he did not give a note to the FLP).
- The FLP distributed $2 million to the Living Trust, which was used to pay various expenses, including Mr. Moore's income tax attributable to the sale of the farm. Mr. Moore's daughter thought this was a loan from the FLP (the estate claimed a $2 million debt deduction and treated the loan as a receivable of the FLP), but there was no further evidence that it was a loan and the Living Trust never repaid the FLP.
- In late February, the Living Trust transferred $500,000 to the Irrevocable Trust (treated as a $125,000 gift to each of the four children).

- "A couple weeks later," in early March 2005, the Living Trust transferred its entire limited partnership interest in the FLP to the Irrevocable Trust in return for $500,000 cash (the cash that had been given to the Irrevocable Trust) and a note for $4.8 million. (Footnote 9 of the opinion says that the purchase price was based on an $11.5 million net asset value of the FLP minus a 53% discount, resulting in a purchase price of $5.3 million. That math does not work precisely if Mr. Moore still owned a 95% interest in the FLP at his death. $5.3 million/(.95 x $11.5 million) = .485, reflecting a 51.5% discount. If we assume that the Living Trust owned all of the partnership, $5.3 million/$11.5 million = .46, reflecting a 54% discount.)

5. **Mr. Moore's Death**. Mr. Moore died at the end of March 2005. Mr. Moore was a resident of Arizona, and his personal representative and trustee was also a resident of Arizona when the petition was filed. If the case is appealed, it would be appealable to the Ninth Circuit Court of Appeals.

Issues

The court said that it had to decide the following issues.

1. Is the value of the farm included in the gross estate under §2036 despite its sale by the FLP?
2. If so, does the subsequent transfer of the Living Trust's interest in the FLP to the Irrevocable Trust remove that value from the gross estate?
3. Can the estate deduct the $2 million ostensible debt from the Living Trust to the FLP, "*future* charitable contributions," and $475,000 in attorney's fees?
4. Were the $500,000 transfers to each of the children loans or gifts?

Interestingly, whether the transfer of the limited partnership interests for $5.3 million (reflecting a 53% discount) was a gift (with resulting penalties and interest) was not an issue addressed by the court.

Opinion

1. **Value of Farm is Included in Gross Estate Under §2036**. A three-part test is applied for determining whether §2036(a)(1) applies to a transfer to an FLP – (1) a transfer of assets was made to an FLP, (2) the transfer was not a bona fide sale for adequate and full consideration, and (3) the decedent retained an interest or right in the transferred property (citing *Estate of Bongard v. Commissioner*, 124 T.C. 95, 112 (2005)).

   a. **Bona Fide Sale for Full Consideration Exception to §2036 Not Satisfied**. "[I]n the context of a family limited partnership, a sale is *bona fide* only if the record establishes the existence of a legitimate and significant nontax reason for creation of the family limited partnership and the transfer of assets to it. <u>Estate of Bongard</u>, 124 T.C. at 118."

      - **Motive**. The estate maintained that Mr. Moore's "principal reason for forming the FLP and transferring his interest in Moore Farms to it was to bring his family together so that they could learn how to manage the business without him." After discussing prior cases that had found that the bona fide sale exception was satisfied (*Mirowski*, *Stone*, and *Bigelow*), the court summarized that "the transfers that we've found were motivated by genuine nontax purposes were of businesses that required active management." (The court also acknowledged that the bona fide sale requirement could also be satisfied by "[t]he desire to consolidate marketable assets and manage them as a family asset for continuing investment purposes," citing *Purdue*.) The *Moore* facts did not meet that standard:

> In these cases, there was no business to run. Moore sold Moore Farms just five days after he transferred four-fifths of it to the FLP. [But see the Observation in Item 3 of the Basic Facts Section above.] What's more, we find that he knew a month before the sale closed that he would sell it. This means as a practical matter that there was no farm for Moore's children to manage together. The only assets left in the FLP for Moore's children to manage were liquid, and they didn't even actually manage them. Other than the FLP's startup meeting, the children have never met to make and review investment decisions. They have an investment adviser who handles that for them, and there simply is no business to run.

- **Creditors. The estate argued that the FLP would function as a protection from** creditors. The court suggested that asset protection could never meet the bona fide sale exception, but in any event, Mr. Moore had no legitimate concern with creditor claims.

> While protection from creditors can be considered a legitimate–though not significant–nontax reason to form an FLP, see Estate of Mirowski …, there is no credible evidence that Moore or any of his children had a legitimate concern with possible creditor claims.

- **Other Factors**. The FLP was planned when death was imminent as "part of an attempt to avoid federal gift and estate taxes." The court would not "ignore the testamentary essence of the whole plan," as evidenced by the absence of bargaining, negotiating, or questioning. The plan was implemented unilaterally by Mr. Moore.
- **Adequate and Full Consideration Requirement Not Addressed**. Footnote 16 of the opinion observes that because the transfer to the FLP did not meet the "bona fide" requirement, the court did not need to discuss whether it was made for full consideration.

b. **Retained Enjoyment**. The court addressed, as what it called "an alternate holding," whether Mr. Moore retained "possession or enjoyment" of the assets transferred to the FLP. (**Observation**: This was not an "alternate" holding; a decedent's retention of possession or enjoyment of transferred assets is an integral requirement for §2036(a)(1) to apply.)

The court found that Mr. Moore "had, at the very least, an implied agreement to retain possession or enjoyment of the farm property upon the transfer of four-fifths of Moore Farms to the FLP and even after the sale of the entire farm." Factors mentioned by the court to support this finding include the following:

- **Continued Occupancy**. "We've held time and time again that a decedent's continued occupancy of property after its transfer to an entity is evidence of an implied agreement.
- **Use of Sale Proceeds in FLP "As His Own."** Mr. Moore retained outside the FLP sufficient assets for his personal needs, but he "didn't use them. Instead, he scooped into FLP assets to pay personal expenses."

- **Relationship to Assets Remained Unchanged.** Mr. Moore's relationship to his assets remained unchanged; he kept control over the FLP assets. Although two children were co-trustees of the Management Trust that was the general partner of the FLP, the "children typically did things because Moore asked them to, and giving them nominal 'power' was no different from Moore's keeping that power." An implicit understanding existed that Mr. Moore "would continue to use his assets as he desired and that his relationship with them changed formally, not practically."

c. **Conclusion as to §2036(a)(1) Inclusion**. Because Mr. Moore "retained possession or enjoyment of the farm, and because his transfer of part ownership to the FLP lacked a substantial nontax purpose, the value of Moore Farms should be included in the value of the estate under section 2036(a)(1)." As discussed below regarding the application of §2043, apparently the court is including 100% of the farm in the gross estate under §2036, not just the 4/5ths transferred to the FLP.

Observation: Apparently, the court is combining two different transfers as triggering §2036 inclusion – (1) the transfer of 4/5ths of the farm to the FLP and the attributable portion of the sale proceeds, and (2) the sale of 1/5th of the farm directly to a third party and the retention of enjoyment of the sale proceeds attributable to that 1/5th. Whether the 1/5th interest is included in the gross estate under §2033 or §2036(a)(1) makes no difference in this case, but the opinion is not explicit in its analysis of why the 1/5th interest is included under §2036.

2. **Effect of Transfer of FLP Interests to Irrevocable Trust Not Addressed Directly**. The second issue for the court's review (as summarized by the court) was not discussed, at least directly, in the opinion. The opinion did not refer to any transfers from the FLP to Mr. Moore or other use of FLP assets by him after he transferred his limited partnership interest to the Irrevocable Trust (but Mr. Moore did continue to live on the farm itself for the remaining few weeks of his life). (**Observation**: Even if Mr. Moore retained no possession of enjoyment of FLP assets after the transfer of his limited partnership interest, a relinquishment of his retained interest within three years of his death would cause inclusion of the transferred assets under §2035(a)(2).)

3. **Application of §2043 Consideration Offset**. The court observed that prior to the *Powell* case in 2017, the analysis would end there regarding §2036 inclusion. The proceeds from the farm's sale would be included in the gross estate under §2036 and the value of the FLP attributable to the contribution would be excluded. "But then we decided Estate of Powell v. Commissioner, 148 T.C. 392 (2017). We discovered and analyzed there, apparently for the first time, section 2043(a) of the Code as it applies to family limited partnerships."

The court proceeded with an extended discussion of §2043, fortunately avoiding *Powell*'s doughnut and doughnut hole analogies, but applying a formula approach. The general formula applied by the court is:

Value in Gross Estate = Consideration (d/o/death) included under §2033 + FMV (d/o/death) of §2036 transfer – Consideration (d/o/transfer)

Mr. Moore's limited 95% partnership interest was valued at $5.3 million by the estate and at $8.5 million by the IRS. The opinion pointed out that the net value in the estate does not depend on which of these is correct because they net out in the formula.

In applying the facts to the formula, bear in mind that the opinion appears to treat all of the farm sale proceeds as includable under §2036, including both the 80% in the FLP and the 20% paid to the Living Trust.

Plugging the facts into the formula for the Moore estate, and taking into consideration that the values at the date of death and on the date of transfer to the FLP were roughly the same because the dates were within weeks of each other:

Value in Gross Estate = Consideration (d/o/death) included under §2033 + FMV (d/o/death) of §2036 transfer – Consideration (d/o/transfer) (the §2043 consideration offset)

Consideration (d/o/death) included under §2033 = *Either $5.3 million or $8.5 million for the 95% LP interest in the FLP + (0.2 x value of farm at date of death)* – money that left the estate between the time of the sale and Mr. Moore's death

+ FMV (d/o/death) of §2036 transfer = Value of farm at date of death

- Consideration (d/o/transfer) = *Either $5.3 million or $8.5 million for the 95% LP interest in the FLP + (0.2 x value of farm at date of death)*

Simplifying the equation (because the two items in italics above offset each other): Value in Gross Estate = Value of farm at date of death – money that left the estate between the time of the sale and date of death.

The opinion pointed out that further complexity would result if the distributions from the FLP to the Living Trust had not been fully spent. Example 5 in the opinion illustrates this phenomenon.

> *Example 5: Discounted Interest, But Not Simple*. Now assume the same facts as example 4 [which described the transfer of land worth $1,000 to a FLP in return for a partnership interest valued with a 25% discount for lack of control] except this time the FLP sells the land for $1000. Then, the FLP makes a distribution of $400 back to the aging father. Under the formula this produces a strange result. Included in the estate is $400 cash (section 2033), $450 for the FLP interest (section 2033),[20] $1000 for the transferred land (section 2036), less $750 (section 2043)–in all the estate now has a value of $1100. Had the aging man just sold the land he would have only $1000 in his estate.
>
> [20] $450 = $600 (what's left in the FLP after the $400 distribution) * 0.75 (to reflect the 25% discount).

The amount included under §2033 would be the date of death full **undiscounted** value of the remaining distribution proceeds plus the discounted value of the partnership interest, based on the value of partnership assets after the distribution. The §2043 consideration offset would be the **discounted** value of the partnership interest at the date of transfer. The net value included in the estate would increase as a result of the distribution in an amount attributable to the difference between the undiscounted value of the remaining unspent distribution proceeds and the discounted value of the FLP at the date of transfer attributable to the amount of the later distributed assets. Thus, in the court's example, the $100 increase in the value of the estate (from $1,000 to $1,100) is the 25% discount multiplied by the $400 distribution back to the father.

4. **Deductibility of Purported Loan to FLP and Attorney's Fees**.

   a. **Purported Loan to FLP Not Deductible**. Although the estate tax return reported the estate as owing $2 million to the FLP as the result of the "loan" of $2 million from the FLP to the Living Trust, the court found no evidence that the transfer was a loan. There was no promissory note, no interest charged or paid, no collateral, no maturity date, no payments made, and no demand for payments.

b. **Attorney's Fees Not Deductible**. A $475,000 payment for "administrative attorney's fees" was not deductible because of the absence of evidence that the "fees were necessarily incurred in the administration of the estate." The fee was a flat fee, there was no detail about the intricacy of the work or the time put in, and when asked to describe the work performed for the estate, the attorney "was vague and testified only that his work continues to this day." There were no claims against the estate and all of Mr. Moore's property was in the Living Trust "so it's unclear what administration [the attorney] is responsible for." (Prior to Mr. Moore's death, the attorney was also paid a $320,000 "design fee" for the structuring and implementation of the estate planning transfers.)

5. **No Charitable Deduction for Formula Transfer Attributable to Additional Value in Gross Estate Resulting From Estate Tax Audit**. Formula transfers to charity (to the Charitable Trust) were included in two places. (1) The Living Trust transferred to the Charitable Trust a portion of assets in the Living Trust sufficient to "result in the least possible federal estate tax payable as a result of my death." (2) The Irrevocable Trust (which owned the 95% limited partnership interest in the FLP) instructed the trustee to "distribute an amount equal to the value of any asset of this trust which is includible in my gross estate for federal estate tax purposes" to the Living Trust to be distributed in accordance with its terms (which included the formula charitable transfer described immediately above).

The IRS did not contest at least some of the charitable deduction claimed on the Form 706 for the formula amount left to the Charitable Trust based on values reported on the Form 706. Thus, the initial funding of the formula charitable transfer based on values of assets and deductions reported on the Form 706 was respected, at least in part. (See Item 11.b of the Observations Section below.)

The issue addressed by the court was whether an additional charitable deduction should be allowed as a result of "any increase in the value of Moore's estate" resulting from the estate tax examination and litigation. The court gave two reasons for denying "any charitable deduction for funds that might be transferred to the Charitable Trust under article 5, section 2 of the Irrevocable Trust": (1) a limitation based on the particular language of the trust agreement; and (2) a requirement that the charitable deduction must be ascertainable at a decedent's date of death.

a. **Particular Trust Language Limitation**. The literal language of article 5, section 2 of the Irrevocable Trust refers to transferring to the Living Trust "an amount equal to the value of any asset *of this trust* which is includible in my gross estate." (Emphasis in court opinion). The Irrevocable Trust owned the limited partnership interest, not the FLP assets. The additional amount included in the gross estate was an amount equal to the value of the farm transferred to the FLP, not the limited partnership interest itself. Therefore, the literal language of the Irrevocable Trust did not transfer any additional amount to the Living Trust.

Observation: In one respect, this is nit-picking over words (and suggests that different drafting might have avoided the court's analysis), but in a broader respect this raises the same issue that has been referred to in the marital deduction context (at the death of the first spouse) as the "marital deduction mismatch" issue. An "amount" is included in the gross estate equal to the full undiscounted value of the farm, but all the trust owns to leave to charity is a discounted partnership interest. Indeed, footnote 23 of the opinion indicates that the IRS made an alternative argument that even if the formula clause is respected, "the Irrevocable Trust lacks the assets to donate a sum large enough to eliminate the estate tax." This issue is discussed in Item 11.f of the Observations Section below.

b. **Charitable Deduction Must be Ascertainable at Death**. A "much more general problem" is that charitable deductions cannot depend on actions of the decedent's beneficiary or executor, and the charitable deduction must be ascertainable at a decedent's date of death. Whether the Living Trust would get additional funds from the Irrevocable Trust to transfer to the Charitable Trust was not determinable at Mr. Moore's death, but only after an audit that ultimately resulted in additional property being included in the gross estate. "For the exception to apply, it would have to have been *almost certain* that the Commissioner would not only challenge, but also successfully challenge the value of the estate." (Emphasis added).

The court distinguished the *Christiansen* and *Petter* cases (in which, interestingly, Judge Holmes wrote the Tax Court opinions). In *Estate of Christiansen v. Commissioner*, 130 T.C. 1 (2008) (reviewed by the Court), *aff'd*, 586 F.3d 1061 (8th Cir. 2009), a sole beneficiary disclaimed all of the estate (under a fractional formula) in excess of a stated dollar amount, with the disclaimed assets passing to a charitable lead trust and foundation. In *Estate of Petter v. Commissioner*, T.C. Memo. 2009-280, *aff'd,* 653 F.3d 1012 (9th Cir. 2011), a gift was made of LLC units, with units up to a stated dollar value passing to trusts for the donor's children and the excess units over that stated value passing to charity. Although both of those cases recognized formula-based transfers to charity, the court reasoned that in those cases "the transfer itself was not contingent on the happening of some event… [V]alue was at issue, but not whether there would be a transfer to the donee at all." The court contrasted those situations with the *Moore* facts:

> Article 5, section 2 of Moore's Irrevocable Trust does not say that the Living Trust will receive a transfer of assets of unknown value. It says that whether the Living Trust will even receive a transfer of assets is unknown–contingent on an examination by the Commissioner. This is unlike Estate of Christiansen, where we *knew* the charity would get a transfer of assets, just not the value, or Estate of Petter, where we *knew* the charity would get some transfer of value, just not how much. Here, we *don't know* if the charity would get any additional assets at all. (Emphasis in original).

The court seems to draw a big distinction between formulas based just on the *value* of assets and formulas based on other issues, such as what assets are in the gross estate or the amount of allowable deductions.

c. **Unknown From Case Facts**. The court's actual holding is that no charitable deduction is allowed for funds that might be transferred from the Irrevocable Trust to the Charitable Trust under the formula transfer clause in the Irrevocable Trust. Even aside from a formula transfer from the Irrevocable Trust, the Living Trust itself made a formula transfer. Unless all of the Living Trust assets were originally allocated to the Charitable Trust under the Living Trust's formula charitable transfer, additional assets should have been transferred to the Charitable Trust directly from the Living Trust in an amount to result in the "least possible federal estate tax." The opinion does not directly address whether that transfer would be respected to qualify for a charitable deduction (but suggests that it would not).

Also, the opinion focused on not allowing an additional charitable deduction because of the inclusion of the farm in the gross estate. Would an additional charitable deduction be allowed for other reasons raised in the estate tax audit, such as disallowed deductions or gift tax paid within three years of death?

6. **Transfers in Return for Notes Not Respected as Loans, but Are Treated as Gifts**. Mr. Moore directed the FLP to transfer $500,000 to each of his four children in return for a five-year note bearing interest at a rate of 3.6% from each of the children. The notes had no amortization schedule, no payments were made, and no efforts were made to collect on the notes. The IRS asserted that these transfers "were gifts and not loans because they lack a legitimate debtor-creditor relationship." Various factors relevant in determining if a transfer creates a bona fide debt were summarized (citing *Estate of Rosen v. Commissioner*, T.C. Memo. 2006-115, as well as other cases). Even though the children signed notes and the debt was not proportionate to the children's ownership in the FLP (both of which weighed in favor of a bona fide debt), the court found it was "more likely than not" that these were gifts based on a variety of other factors:

   - The notes had no fixed payment schedule;
   - The children never made required interest payments;
   - The FLP never demanded repayment of the loans;
   - There was no evidence the children had the resources to repay the loans, and thin capitalization weighs against a finding of bona fide debt;
   - Repayment depending solely on earnings does not support a finding of bona fide debt;
   - The notes were not secured;
   - Comparable funding from another lender was unlikely;
   - The children did not set aside funds to repay the notes; and
   - Most important, Mr. Moore had listed a desire that each of his children *receive* $500,000 as one of his estate planning goals, and the attorney testified that the payments needed to be loans for tax purposes because "having [them] as a gift wouldn't be the best use of the tax laws."

   These transfers from the FLP to the children, totaling $2 million, were treated as gifts, and the additional resulting gift tax was included in the gross estate under §2035(b) because the gifts had been made within three years of death.

Observations

1. **Long Delay**. This Tax Court memorandum decision (not a reviewed opinion involving negotiations with all Tax Court judges) was long delayed. The trial was held March 26, 2012, the last brief was filed February 13, 2013, and the docket sheet reflects no other actions until the memorandum opinion was filed April 7, 2020–more than seven years later. Apparently, some of the issues in the case raised difficult issues for the court.

   Altogether, the Moore family had to wait ten and a half years from the filing of the Tax Court petition in September 2009 and over 15 years from Mr. Moore's death in March 2005 to reach this point, and the estate and the IRS still have to agree on the computations (and the opinion ended with an acknowledgement "that computations will be difficult").

2. **Death-Bed Planning.** Judge Holmes began his opinion by observing that after building a "thriving and very lucrative farm," the decedent's health went bad and he entered hospice care. "Then he began to plan his estate."

   This is the latest in a string of cases in which judges are understandably skeptical when planning is implemented on death's doorstep that would result in huge discounts (an approximately 53% discount in this case) for tax savings purposes and would not serve a legitimate and significant nontax purpose. The IRS viewed the decedent's estate plan "as nothing more than a last-minute, last-ditch effort to avoid paying tax." In that context, the §2036 result of this case is not at all surprising.

3. **Emphasis on Businesses Requiring Active Management to Satisfy "Legitimate and Significant Nontax Purpose" Requirement**. The opinion begins its analysis of the "bona fide" element of the bona fide sale for full consideration exception in §2036(a) by saying that "whether a transfer was *bona fide* turns on motive" and reiterating the legitimate and significant nontax reason test announced fifteen years ago in *Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005). (Some planners had believed that "bona fide" meant that a transfer occurred that was not a sham and represented something that really happened, but that position has been firmly rejected since 2005 in *Bongard*.) One sentence in the *Moore* opinion makes the observation that "[t]he desire to consolidate marketable assets and manage them as a family asset for continuing investment purposes is also a genuine nontax motive under section 2036. Estate of Purdue v. Commissioner, T.C. Memo. 2015-249." Other than that one sentence, the opinion emphasizes that active management by family member partners is a necessary element in order for a court to find the existence of a legitimate and significant nontax reason for the FLP. The opinion states that prior cases finding that the bona fide test was satisfied involved "businesses that required active management."

   The opinion also states that protection from creditors cannot be a "significant" nontax reason to form an FLP. (It says that creditor protection "can be considered a legitimate – though not significant – nontax reason to form an FLP.") It is startling to read that. If, because of wealth, background, profession, profile, reputation, personality, lifestyle, family connections, political history, or any other characteristic, a person is especially exposed to the threat of questionable claims by opportunistic claimants, then for that person protection against that threat is surely significant. For such a person, it appears that "significant" means almost the same thing as "legitimate."

4. **Active Involvement of Other Family Member-Partners**. At a minimum, the opinion points out the desirability of having other family members actively involved in planning, discussing (i.e., "negotiating") provisions about the partnership structure, having partner meetings, and being actively involved in decisions about the management of partnership assets.

   This is especially important if a purpose of the FLP is to facilitate the family's working together. Administer and manage the partnership in a way that is consistent with the stated purpose. The court observed:

   > Ronnie [one of Mr. Moore's sons] also testified during trial that because the family was–as he put it–"dysfunctional," the FLP was supposed to bring the family together. But if so, the FLP flopped. It doesn't seem as if there has ever been a second meeting of the partners. An investment adviser handles all investment decisions according to a set of "investment objectives." And neither Ronnie nor his siblings have vetoed any of the adviser's decisions.

5. **Retention of Possession or Enjoyment of Transferred Assets**. Cases have made clear that the retention of "possession or enjoyment" of transferred assets to trigger the application of §2036(a)(1) can be shown by an implied agreement. Planners have advised clients to retain assets outside the partnership for living expenses, so that no implication would arise that the decedent necessarily would be looking to use partnership assets for required living expenses. In this case, the court acknowledged that the decedent "kept sufficient assets for his personal needs," but the fact that the decedent then proceeded still to use assets of the partnership for personal expenses evidenced retained possession or enjoyment of the transferred assets. From a planning standpoint, be wary of actually using partnership assets (or partnership distributions) for personal purposes.

6. **Treating Sale of Decedent's Retained One-Fifth of Farm as §2036 Transfer; Use of Farm Property**. We are all very familiar with treating property contributed to an FLP or LLC as a §2036 transfer, with the transferred property (undiscounted) being included in the gross estate. In this case 4/5ths of the farm was contributed to the FLP and included in the gross estate under §2036(a)(1). But somewhat surprisingly, the remaining 1/5th interest that Mr. Moore retained in his Living Trust until the sale was treated as a transfer with retained enjoyment. Note — a sale to an unrelated party was treated as a §2036 transfer! The use of the sale proceeds could not have been the reason for that; sales to third parties typically are not considered as §2036 transfers no matter what the seller does with the sale proceeds. Typically the bona fide sale for full consideration exception would apply to third party sales. Clearly, there was a legitimate and significant nontax reason for selling the farm to a third party – it was to dispose of the farm. What was unusual in this case was that the decedent apparently contracted to continue living on the property, and to be in charge of making farm operations decisions, for the remainder of his very short life expectancy. (He lived about three months after the sale.) But even if that was treated as retained enjoyment, that would not explain why the bona fide sale for full consideration exception did not apply. Perhaps a small concession was made on the purchase price for the short period of time that the buyers agreed to allow their elderly neighbor to continue living on the property (though that seems unlikely and the court's opinion gives no hint of that). If such a price concession was made, that may have kept the full consideration requirement from being satisfied. But the court did not discuss why the bona fide sale for full consideration exception did not apply to the sale of the decedent's retained 1/5th interest in the farm.

   As a practical matter, it made no difference in this case whether the sale proceeds from that 1/5th interest was included in the gross estate under §2033 or §2036, but the complete absence of any analysis of treating a sale of property to a third party as a §2036 transfer is interesting, to say the least.

7. **Effect of Subsequent Transfer of All Interests in the FLP**. The court specifically listed as one of the four issues for consideration whether the subsequent transfer of the Living Trust's interest in the FLP to the Irrevocable Trust removed the value from the gross estate that was otherwise includable under §2036, but the court did not, at least directly, discuss that issue. Footnote 17 of the opinion merely states that because the value of the farm is included in the gross estate under §2036(a)(1) the opinion does not address "the subsequent transfer of the Living Trust's assets [i.e., the 95% interest in the FLP] to the Irrevocable Trust" and whether it "also triggers their inclusion under section 2036."

This is important because a way of defeating the inclusion of assets contributed to an FLP in the gross estate under §2036(a)(1) is to transfer all of the interest in the FLP so that the decedent has not retained an interest in the assets contributed to the FLP "for life or for any period not ascertainable without reference to his death." That may not work to avoid §2036 for two reasons: (1) the decedent continues to enjoy the transferred property even though he is no longer a partner, or (2) if, as in *Moore*, the transfer occurs in more than one step and is completed by the relinquishment of a retained interest described in §2036 within three years of death (§2035(a)(2)).

As to the first of those two reasons, interestingly, no distributions or transfers from the FLP appear to have been made after the decedent transferred his 95% interest to the Irrevocable Trust. However, Mr. Moore apparently did continue to make some use of partnership transfers that had been made to him prior to the date of the transfer of interests to the trust (including the payment of his income taxes attributable to his part of the pass-through income from the sale of the farm; the opinion states that Mr. Moore spent the $2 million that he received from the FLP "before he died, mostly on income tax that he owed on the sale of the farm," but because Mr. Moore died in late March less than two months after the sale on February 4, it is likely that the income tax had not been paid before the date of death).

Undoubtedly, the second reason also would apply. Section 2035(a)(2) would have caused the property contributed to the partnership to continue to be in the estate because the retained interest that would otherwise cause inclusion under §2036 was relinquished within three years of the decedent's death.

A few cases have recognized that a subsequent transfer of an interest in an FLP can prevent the inclusion of partnership assets under §2036. Value attributable to interests that have been transferred at least three years earlier should not be subject to §2036(a)(1) if no implied agreement of continued retained enjoyment exists (*see* the *Estate of Jorgenson*, *Estate of Kelly*, and *Estate of Rosen* cases).

8. **De Facto Trustee Discussion**. Several cases over the last several years have addressed situations in which a grantor effectively made all trust decisions, and have considered whether the grantor should effectively be treated as if he were the trustee. *E.g.*, *United Food & Commercial Workers Unions v. Magruder Holdings, Inc.*, Case No. GJH-16-2903 (S.D. Md. March 27, 2019) (ERISA case in which court looked to whether §678 applied to beneficiary's ability to withdraw assets as needed for health, education, support, and maintenance, but trustees never questioned whether withdrawn amounts were actually needed for those purposes; court reasoned that a "HEMS provision that exists only on paper cannot be said to restrict the power exercisable" by the beneficiary); *SEC v. Wyly,* 2014 WL 4792229 (S.D.N.Y. September 25, 2014) (failure to comply with fiduciary constraints regarding trust distributions caused a trust to be treated as a grantor trust for non-tax purposes).

   The court in *Moore* had a similar discussion in the context of concluding that Mr. Moore's relationship to the assets contributed to the FLP did not change after the transfer: "Moore's children typically did things because Moore asked them to, and giving them nominal 'power' was no different from Moore keeping that power."

9. **Section 2043 "Consideration Offset" Analysis**.

a. **Statutory Provision**. Section 2043(a) provides as follows:

> (a) In General.—If any one of the transfers, trusts, interests, rights, or powers enumerated and described in sections 2035 to 2038, inclusive, and section 2041 is made, created, exercised, or relinquished for a consideration in money or money's worth, but is not a bona fide sale for an adequate and full consideration in money or money's worth, there shall be included in the gross estate only the excess of the fair market value at the time of death of the property otherwise to be included on account of such transaction, over the value of the consideration received therefor by the decedent.

b. **Reliance on *Powell* §2043 Analysis**. The opinion says that the Tax Court "discovered" and first analyzed §2043(a) as it applies to family limited partnerships in *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017). In that case, the plurality opinion raised the issue on its own with no argument or briefing from any party. (Whether the IRS raised the §2043 issue in *Moore* is unknown.) The *Powell* case addressed the "double inclusion issue" when both the assets transferred to the partnership and the partnership interest itself are included in the gross estate. While reasoning that the reduction under §2043 for the value received when assets were transferred to the partnership avoids a double inclusion, the analysis in *Powell* acknowledged that double taxation (which it called "duplicative transfer tax") could result if the assets contributed to the partnership appreciated between the date of contribution and the date of death.

The *Moore* opinion notes that example scenarios applying §2043 in the FLP context "lead to what may seem odd results," but the court stated that it "must nevertheless apply the Code as it is written and interpreted in a Division Opinion." (A "Division Opinion" is more commonly referred to as a "T.C. opinion" – not, for example, a "memorandum opinion" – generally strengthened when an opinion, as in *Powell*, is "Reviewed by the Court." But see the discussion below.) However, the §2043 discussion in *Powell* was controversial among the judges in that case and did not clearly have the support of a majority of judges participating in that opinion (and is likely dictum because the discussion had no impact on the ultimate outcome of the case). The "plurality" opinion (which espoused the double inclusion analysis) was joined by only 8 judges (including Judge Halpern (who wrote that opinion) and Judge Holmes (who also wrote the *Moore* opinion) , each of whom is now a Senior Judge, not one of the 16 current "regular" Tax Court judges, and therefore will not be participating in future decisions for which he was not the trial judge), a concurring opinion (that expressly rejected the double inclusion analysis) was joined by 7 judges, and 2 judges concurred in the plurality opinion in result only. The concurring opinion, which rejected the double inclusion analysis, reasoned that the inclusion of the partnership assets in the gross estate under §2036 meant that the partnership interest itself was merely an alter ego of those same assets and should not also be included in the gross estate. That approach has been followed by the various FLP cases prior to *Powell* in which §2036 was applied, and the IRS has not made that argument in *any* other FLP cases even though substantial additional estate tax liability would have resulted in situations involving significant appreciation of partnership assets.

c. **Section 2043 Background**. The §2043 analysis was not actually "discovered" in *Powell*. The plurality opinion's summary of how §2043 applies in the context of §2036 FLP cases is similar to what Professor Jeffrey Pennell has been telling planners for decades. *See*, *e.g.,* Pennell, *Recent Wealth Transfer Developments*, ABA REAL PROP., PROB. & TR. LAW SECTION 14TH ANN. EST. PL. SYMPOSIUM, at 21-23 (2003).

In other contexts, the IRS has not used the double inclusion approach where doing so would result in unfair results. The IRS has previously ruled that life insurance proceeds received by a partnership should be not includible in the gross estate *both* under §2042 and under §2033 as to the decedent's partnership interest under the reasoning that "unwarranted double taxation" would otherwise result. For example, in Revenue Ruling 83-147, 1983-2 C.B. 158, the IRS refused to include life insurance proceeds payable to a partnership both as part of a partner's interest in the partnership and under §2042 as a result of incidents of ownership attributed to the decedent as partner of the partnership, because doing so would result in "unwarranted double taxation":

> In *Estate of Knipp v. Commissioner*, 25 T.C. 153 (1955), *acq. in result*, 1959-1 C.B. 4, *aff'd on another issue* 244 F.2d 436 (4th Cir. Cir), *cert denied*, 355 U.S. 827 (1957), a partnership held 10 policies on the decedent's partner's life, at his death…. The court found that the decedent, in his individual capacity, had no incidents of ownership in the policies, and held that the insurance proceeds were not includible in the gross estate under the predecessor to section 2042(2) of the Code. The Service acquiesces in the result of *Estate of Knipp* on the basis that in that case the insurance proceeds were paid to the partnership and inclusion of the proceeds under the predecessor of section 2042 would have resulted in the **unwarranted double taxation** of a substantial portion of the proceeds, because the decedent's proportionate share of the proceeds of the policy were included in the value of the decedent's partnership interest. See also section 20.2042-1(c)(6) of the regulations (which adopts a similar rule with regard to life insurance proceeds paid to or for the benefit of a corporation). (Emphasis added.)

A distinction regarding life insurance inclusion under §2042, however, is that §2043(a) refers to transfers under §2035-§2038 and §2041, but not transfers under §2042.

Similarly, the regulations regarding GRATs state that if the GRAT assets are included under §2036, the retained annuity interest payments that are payable after the decedent's death are not also included under §2033 "because they are properly reflected under this section." Reg. §20.2036-1(c)(1)(i).

Over the last 23 years, 22 cases have held that assets contributed to a family limited partnership or LLC were included in a decedent's estate under §2036, but *none* of those cases, other than *Powell*, included both the FLP assets and the FLP interest in the gross estate. Despite this long history of FLP/§2036 cases and other examples of avoiding double inclusion described above, the *Moore* opinion responds:

> Excluding the value of the partnership interest from Moore's gross estate might appear to be the right result because it would prevent its inclusion in the value of the estate twice. The problem is that there is nothing in the text of section 2036 that allows us to do this.

d. **Major Practical Impact—Appreciation, Depreciation, Distributions**. Applying the double inclusion with a §2043 consideration offset analysis (rather than simply including the §2036 amount in the gross estate) has a practical impact on the overall result primarily in situations in which (1) the assets contributed to the entity have appreciated or depreciated by the time of death, or (2) distributions from the entity have been made that are still owned by the decedent at death.

(1) **Impact of Appreciation**. If the assets that were contributed to the entity have appreciated prior to the date of death, footnote 7 of the *Powell* plurality opinion acknowledged that "duplicative transfer tax" would apply because the date of death asset value is included in the gross estate under §2036 offset only by the *date of contribution* discounted value of the partnership interest. The date of death value of the LP interest would also be included under §2033, so all of the post-contribution appreciation of the assets would be included under §2036 AND the discounted post-contribution appreciation also would be included under §2033.

The effects in different example situations are summarized in various scenarios:

(1) **No FLP**. Do nothing; continue owning assets directly

(2) **FLP/No§2036**. Create FLP and §2036 not apply

(3) **FLP/Simple §2036**. Create FLP and §2036 apply without double inclusion or §2043 analysis

(4) **FLP/Double Inclusion §2036**. Create FLP and §2036 apply with double inclusion and §2043 adjustment

Example. $10 million contributed to FLP; Assets appreciate to $12 million, 25% discount.

Under the double inclusion with §2043 adjustment approach:

Inclusion= FLP Interest (DOD)(§2033) + [§2036 Value (DOD) – FLP Interest (DOT)]

= ($12 million x 0.75) + [$12 million – ($10 million x 0.75)]

= $9 million + [$12 million – $7.5 million)]

= $13.5 million [OBSERVE: $1.5 million more than if no FLP transfer.]

Inclusion Comparisons:

Scenario	Inclusion
(1) No FLP	$12 million
(2) FLP/No §2036	($12M x 0.75) = $9 million
(3) FLP/Simple §2036	$12 million
(4) FLP/Double Inclusion §2036	$13.5 million

Observation: Double Inclusion §2036 vs. Simple §2036 (or No FLP) results in double taxation of $1.5 million of gross estate value.

As a result, more value would be included in the gross estate than if the decedent had never contributed assets to the FLP. Whether a court would actually tax the same appreciation multiple times (or whether the IRS would even make that argument) is unclear, but the *Powell* and *Moore* opinions do not even hint that a court would refuse to tax the same appreciation twice in that situation.

(2) **Impact of Depreciation**. Footnote 7 of the *Powell* plurality opinion also stated that a "duplicative reduction" would result if the assets depreciated after being contributed to the FLP. The analysis is not that simple though. If the assets have depreciated in value, a net reduction in value likely does not occur by having §2036 apply with the §2043 adjustment as compared to §2036 not applying. Section 2043(a) indicates that if §2036 applies the excess of the fair market value at the time of death over the value of consideration received is included in the estate, indirectly saying that the net amount included under a string statute is merely reduced to zero (a negative number cannot be created).

Example. $10 million contributed to FLP; Assets depreciate to $6 million, 40% depreciation, 25% discount.

Under the double inclusion with §2043 adjustment approach:

Inclusion= FLP Interest (DOD)(§2033) + [§2036 Value (DOD) – FLP Interest (DOT)]

= ($6 million x 0.75) + [$6 million – ($10 million x 0.75)] but not less than zero

= $4.5 million + 0

= $4.5 million [OBSERVE: Applying §2036 has no impact; discount still allowed.]

Inclusion Comparisons:

Scenario	Inclusion
(1) No FLP	$6 million
(2) FLP/No §2036	$4.5 million
(3) FLP/Simple §2036	$6 million
(4) FLP/Double Inclusion §2036	$4.5 million

Observation: Double Inclusion §2036 vs. Simple §2036 – Double Inclusion §2036 has the same result as if no §2036 (25% discount is still permitted), but the Simple §2036 approach does not allow use of the 25% discount.

Thus, creating an FLP may result in lower estate inclusion than doing nothing, even if §2036 applies, if the assets should experience significant subsequent depreciation (40% depreciation in this example).

If an FLP is created, if §2036 applies under a double inclusion/§2043 adjustment approach, and if depreciation occurs, the net inclusion amount is the same whether or not §2036/2043 applies if the depreciation percentage is equal to or greater than the discount percentage in valuing the FLP interest. For example, using the example above, if the discount percentage for valuing a limited partnership interest is 25% and if the assets depreciate by 25% from $10 million to $7.5 million, the net inclusion under the double inclusion §2036/2043 approach is ($7.5 million) minus ($10 million x 0.75) or zero.

For an explanation (with examples) of the impact of appreciating and depreciating values, see Larry Katzenstein and Jeff Pennell, Estate of Moore v. Commissioner – *Discount Planning Debacle*, LEIMBERG INFORMATION SERVICES ESTATE PLANNING EMAIL NEWSLETTER #2790 (April 20, 2020).

(3) **Distributions**. The other practical impact occurs if distributions are made from the entity that are still owned by the decedent at death, illustrated by Example 5 in the *Moore* opinion, discussed in Item 3 of the Opinion Section above. A brief summary of that example follows—

Example 5 in *Moore* opinion: $1,000 land contributed to FLP that is sold, 25% discount, but §2036 applies, $400 distribution that is unspent.

Inclusion = Unspent distribution + FLP interest (§2033) + [§2036 Value (DOD) – consideration (DOT)]

= $400 + (remaining $600 x .75) + [$1,000 (land value) – ($1,000 x .75)]

= $400 + $450 + [$1,000 - $750]

= $1,100 (compared to $1,000 if no distribution is made)

Observe: Additional amount = Unspent distribution x 25% discount ($400 x 0.25 = $100).

Inclusion Comparisons:

Scenario	Inclusion
(1) No FLP	$1,000
(2) FLP/No §2036	$850
(3) FLP/Simple §2036	$1,000
(4) FLP/Double Inclusion §2036	$1,100

e. **Summary: Double Inclusion Analysis Going Forward in FLP Context**. Using the Double Inclusion §2036 approach rather than the Simple §2036 approach results in "unfair" double taxation if *appreciation* occurs and still allows the partnership discount if significant *depreciation* occurs. From a policy standpoint, the Simple §2036 Approach seems preferable.

The fact that eight (but less than a majority) of the judges in *Powell* and now *Moore* adopted the double inclusion analysis may embolden the IRS to take that position in future cases. But we do not yet know how a majority of the Tax Court judges would rule as to that issue.

In any event, the double inclusion analysis applied in *Powell* and *Moore* raises a risk that contributing assets to an FLP (or for that matter, any entity) may leave a taxpayer in a significantly worse tax position than if the taxpayer had merely retained the assets, if the assets appreciate between the time of contribution to the entity and the date of death.

10. **No Discussion of §2036(a)(2)**. The IRS argued, in the alternative, that the FLP assets should be included in the gross estate under §2036(a)(2). Footnote 17 of the opinion states that the court does not address the IRS's §2036(a)(2) arguments in light of the fact that the FLP's assets are included in the gross estate under §2036(a)(1).

11. **Formula Transfer Following Resolution of Estate Tax Examination Not Recognized**. The opinion addresses whether a "future" charitable contribution deduction should be allowed with respect to "any increase in the value of Moore's estate," particularly with respect to the transfer of additional funds from the Irrevocable Trust to the Living Trust. (That would include assets in the Irrevocable Trust includable in the gross estate, such as value attributable to the FLP, but would not literally include additions to the net estate value by the disallowance of a deduction for the attorney's fee or the inclusion of gift taxes attributable to an additional gift made within three years of death.)

    a. **No Impact on Defined Value Clause Cases**. Various cases have recognized the effectiveness of clauses leaving amounts to charity under formulas based on the valuation of hard-to-value assets. Defined value clauses use a formula to allocate assets that are transferred, with a certain value passing for family members and the excess that was transferred passing to another (non-taxable) person or entity (*see Succession of McCord*, *Hendrix*, *Estate of Christiansen*, *Estate of Petter*). *Moore* does not impact those cases, because its formula was based on determinations other than valuation (i.e., whether assets are included in the gross estate). The court carefully distinguished formulas based on valuation as compared to other issues impacting whether a transfer is made; indeed Judge Holmes authored the Tax Court opinions in the *Christiansen* and *Petter* cases approving defined value clauses involving formula charitable transfers.

       The defined value clause cases addressed, among other arguments, a public policy argument based on *Commissioner v. Procter*, 142 F.2d 824 (4th Cir. 1944), *cert. denied*, 323 U.S. 756 (1944). *Moore* has none of that type of discussion, and its refusal to recognize the formula clause was not based on any public policy concerns.

    b. **Confusion Regarding Charitable Deduction Based on Assets as Reported on Form 706**. The opinion is confusing as to the IRS's treatment of the charitable deduction and the court's ultimate determination of the allowable charitable deduction. The opinion indicates that the estate claimed a deduction for $4,745,671 on the Form 706 as filed, but the IRS determined that only $516,000 should be allowed. Presumably, the $4,745,671 reported on the Form 706 did not take into account the inclusion of FLP assets under §2036, but was based only on values as reported. The opinion does not address the discrepancy of the amount of allowable charitable deduction based on assets as reported on the estate tax return.

    c. **Formula Transfer Based on Determinations Following Estate Tax Examination; Distinction Between Valuation Issues and Other Issues**. The primary concern addressed by the court is that charitable deductions must be ascertainable at a decedent's date of death, and the Living Trust would get additional funds from the Irrevocable Trust (which could pass to charity under the formula transfer in the Living Trust) only after an audit and ultimate determination that additional value should be included in the estate. A problem with the "ascertainable at the date of death" argument in this context is that the *Christiansen* case allowed a charitable deduction under a formula disclaimer based on values as finally determined for estate tax purposes, and value changes determined in litigation following the estate tax examination in that case resulted in additional charitable deduction.

The Tax Court in *Christiansen*, in an opinion written by Judge Holmes, who (as noted above) decided the *Moore* case, reasoned as follows regarding the estate tax examination contingency argument:

> The transfer of property to the Foundation in this case is not contingent on any event that occurred after Christiansen's death (other than the execution of the disclaimer [which is recognized in charitable deduction regulations])–it remains 25 percent of the total estate in excess of $6,350,000. **That the estate and the IRS bickered about the value** of the property being transferred doesn't mean the transfer itself was contingent in the sense of dependent for its occurrence on a future event. Resolution of a dispute about the fair market value of assets on the date Christiansen died depends only on a **settlement or final adjudication of a dispute about the past, not the happening of some event in the future**. Our Court is routinely called upon to decide the fair market value of property donated to charity–for gift, income, or estate tax purposes. And the result can be an increase, a decrease, or no change in the IRS's initial determination. (Emphasis added.)

The Eighth Circuit affirmance in *Christiansen* also emphasized that a regulation about charitable lead trusts recognizes that references to values "as finally determined for Federal estate tax purposes" are sufficiently certain to be considered "determinable" for purposes of qualifying as a guaranteed annuity interest. Reg. §20.2055-2(e)(2)(vi)(a). 586 F.3d 1061 (8th Cir. 2009).

The *Moore* opinion draws a distinction between estate tax examinations and court determinations of value vs. other issues. A contingency based on ultimate determination of valuation issues is not a "transfer … contingent on the happening of some event." The court reasoned that in *Christiansen* and *Petter*, "we *knew* the charity clearly would receive assets, just not how much. Here we *don't know* if the charity would get any additional assets at all." (Emphasis in original.)

Under this approach, formula transfers to charity that depend on IRS or court determinations as to any issues other than values are suspect. The *Moore* opinion, however, offers no support for making a distinction between a court resolution of valuation issues vs. the resolution of other issues (such as §2036 inclusion) that impacts the amount passing to charity under a formula bequest. Both involve significant uncertainties about how the issues will ultimately be resolved, based on a set of facts that existed at the date of death. For example, the opinion cites *Estate of Marine v. Commissioner*, 97 T.C. 368, 378-79 (1991), *aff'd*, 990 F.2d 136 (4th Cir. 1993), in support of its position that charitable deductions must be ascertainable at the decedent's date of death. But in *Marine*, the personal representative could make bequests to compensate individuals chosen by the representative who contributed to the decedent's well-being, with no limit on the number of persons who could receive such bequests, which would reduce the amount that could pass to charity under the residuary estate. That is a contingency based on future events and exercises of discretion involving distributions to an unlimited number of non-charitable beneficiaries, far different from a court determination of the tax effects of facts as they existed at the date of death. A court determination of the tax effects of transactions that had occurred involving the FLP by Mr. Moore is something that "depends only on a settlement or final adjudication of a dispute about the past" (to quote Judge Holmes' reasoning in Christiansen). "It should make no difference whether inclusion as of the date of death is the trigger, rather than the value of the gross estate. Both cases turn on resolution of a dispute involving the ultimate size of the gross estate." Larry Katzenstein and Jeff Pennell, Estate of Moore v. Commissioner – *Discount Planning Debacle*, LEIMBERG INFORMATION SERVICES ESTATE PLANNING EMAIL NEWSLETTER #2790 (April 20, 2020).

If *Moore* is appealed, the appeal would be heard by the Ninth Circuit Court of Appeals (which also approved the *Petter* defined value clause case involving a formula charitable transfer).

d. **Contrast with Marital Deduction Formula Transfers**. Classic testamentary marital deduction formula clauses traditionally take into account a wide variety of factors, not just valuation issues, to leave enough assets to a surviving spouse in order to avoid or minimize federal estate tax (analogous to the "least possible federal estate tax" formula charitable clause in *Moore*). Adjustments in estate tax examinations or litigation are taken into consideration in applying the formula marital bequest. If the formula transfer in the *Moore* case had been to a surviving spouse or marital trust, presumably the formula bequest would have been respected, assuming sufficient estate assets were available to satisfy the formula bequest. *E.g.*, *Turner II* (discussed in Item 11.f below).

e. **Formulas Regarding Terms of Charitable Lead Trust**. Regulations acknowledge that the terms of a charitable lead trust may be determined under a formula, as long as the amount to be paid to charity is determinable.

> An amount is determinable if the exact amount which must be paid under the conditions specified in the instrument of transfer can be ascertained as of the appropriate valuation date. For example, the amount to be paid may be a stated sum for a term of years, or for the life of the decedent's spouse, at the expiration of which it may be changed by a specified amount, but it may not be redetermined by reference to a fluctuating index such as the cost of living index. In further illustration, the amount to be paid may be expressed in terms of a fraction or a percentage of the net fair market value, as finally determined for Federal estate tax purposes, of the residue of the estate on the appropriate valuation date, or it may be expressed in terms of a fraction or percentage of the cost of living index on the appropriate valuation date. Reg. §20.2055-2(e)(2)(vi)(a).

In particular, the regulation acknowledges that the annuity amounts can be based on values "as finally determined for Federal estate tax purposes." PLRs have recognized various formula structures for determining the terms of testamentary charitable lead annuity trusts in order to "zero out" the value of the remainder interest. *E.g.*, PLRs 199927031, 9840036, 9631021, 918040, 9128051, 8946022. Private rulings have approved clauses designed to limit the remainder interest in a charitable lead annuity trust to the amount of the testator's remaining GST tax exemption. *E.g.,* PLRs 200714009, 199927031, 984036. *See* Mary Hester, *Charitable Lead Trusts: The Time is Right*, 110 J. TAX'N 4 (Jan. 2009).

Those rulings do not recognize a formula that determines the *amount passing to* a charitable lead trust, as opposed to a formula that determines the *terms of* a charitable lead trust. Cases, however, such as *Christiansen* and *Petter*, have approved formulas that determine the amount that passes to charity, and there would seem to be no reason that a formula could not be used similarly to determine the amount that passes to a charitable lead trust. The issue raised in *Moore* is what types of such formulas will be recognized (in particular, whether formulas based on what assets are included in a decedent's gross estate after an estate tax examination will be recognized).

f. **Analogy to "Marital Deduction Mismatch" Issue**. The first rationale in *Moore* for not respecting the formula transfer provision in the Irrevocable Trust was that the clause directed the transfer to the Living Trust of any assets of the Irrevocable Trust that were included in the decedent's gross estate, but the Irrevocable Trust merely owned a limited partnership interest, not the FLP assets that were included in the estate under §2036. This raises the same issue that has been referred to as the "marital deduction mismatch" issue in the marital deduction context (at the death of the first spouse). An "amount" is included in the gross estate equal to the full undiscounted value of the farm, but all the trust owns to leave to charity is a discounted partnership interest. Footnote 23 of the opinion indicates that the IRS made an alternative argument that even if the formula clause is respected, "the Irrevocable Trust lacks the assets to donate a sum large enough to eliminate the estate tax."

This issue in the marital deduction context was summarized by the Tax Court in *Estate of Turner v. Commissioner*, 138 T.C. 306 (2012) (sometimes referred to as "*Turner II*").

> In some cases the Internal Revenue Service has taken the position that even when section 2036(a) applies, the marital deduction is measured by the value of what actually passes to the surviving spouse, which is a discounted partnership interest, and not by the value of the underlying assets. Estate of Black v. Commissioner, 133 T.C. 340, 342 (2009); Estate of Shurtz v. Commissioner T.C. Memo. 2010-21. This produces a mismatch between values for the gross estate inclusion and the marital deduction calculation. However, this type of mismatch is not present in this case: respondent allowed an increased marital deduction that he calculated on the basis of the value of assets transferred in exchange for the partnership interests that Clyde Sr. held at death, rather than on the basis of the discounted values of the general and limited partnership interests that Clyde Sr. owned at death, to the extent that they passed to Jewell [Clyde Sr.'s wife]. The estate recognizes that, and we leave this mismatch problem for another day.

g. **No Concern With Transfer Under Formula Even Though Not Respected for Tax Purposes**. A concern with some defined value clauses is that the clause may require a transfer (for example, to a spouse, a charity, or a retention by the grantor) according to the contract even though the transfer is not respected for tax purposes. That would not happen under the formula clause in the Living Trust in *Moore* because the amount left to charity under that clause was an amount that resulted in the least possible federal estate tax. The court determined that an additional transfer to charity would not reduce the estate tax, so the additional transfer presumably would not be made under the terms of the agreement.