Nelson v. Commissioner, T.C. Memo. 2020-81

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Gift and Sale of Partnership Interests Expressed as Dollar Amounts with Size of Transferred Interests Determined by Appraisals to be Completed Shortly after Transfers; Multi-Tiered Discounts; Lack of Control and Lack of Marketability Discounts

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Synopsis

This gift tax case determined the value of gifts and sales of interests in a limited partnership, the primary asset of which was 27% of the common stock of a holding company that owned 100% of eight subsidiaries (six of which were operating businesses). The gifts and sales were of limited partner interests having a specified dollar value on the transfer date "as determined by a qualified appraiser within ninety (90 days) of the effective date of the Assignment" (180 days in the case of the sale). An appraisal was prepared for the holding company, which was then used to prepare an appraisal for the transferred limited partner interests. The percentage limited partner interests that were transferred were based on those appraisals and documented in the partnership's records and used for preparing subsequent income tax returns.

The IRS took the position that the transfers resulted in additional gifts of about $15 million. The taxpayers first argued that the transfers were actually of interests worth a particular dollar value rather than of particular percentage interests. The court disagreed, observing that the clauses in the assignments "hang on the determination by an appraiser within a fixed period; value is not qualified further, for example, as that determined for Federal estate tax purposes."

> **Observation:** This is a practical approach that is often used in structuring assignments of hard-to-value assets. The IRS did not object to this type of assignment (determining the percentage interest transferred on the basis of an appraisal completed relatively soon after the transfer) as abusive, but merely proceeded to enforce the assignment as drafted and then value the interests so transferred.

The court ultimately determined that the 27% interest that the partnership owned in the holding company was valued using a 15% lack of control discount (slightly lower than the taxpayers' expert's position of a 20% discount but higher than the IRS's expert's 0% discount) and 30% for lack of marketability (agreed to by experts for both the taxpayers and the IRS). The holding company value was then used to determine the value of the limited partner interests, which the court determined using a 5% lack of control discount (compared to 15% by the taxpayer's expert and 3% by the IRS's expert) and a 28% lack of marketability discount (compared to 30% by the taxpayers' expert and 25% by the IRS's expert). The values determined by the court resulted in an additional gift value of about $4.5 million. *Nelson v. Commissioner*, T.C. Memo. 2020-81 (Judge Pugh).

Basic Facts

Founding of WEC. Mrs. Nelson's father founded a company providing gas compression equipment for the oil and gas industry in 1971. The company was successful and acquired various other businesses, many of which were related to the oil and gas industry. In 1990, Warren Equipment Co. (WEC) was organized as a Delaware corporation that served as a holding company owning 100% of six subsidiaries with operating businesses, a seventh subsidiary that provided administrative services to the businesses, and an eighth subsidiary that owned the real estate on which the various businesses operated. Mr. Warren died in 1999, and by 2008 WEC was owned primarily by his four children (including his daughter, Mrs. Nelson).

Creation of FLP. Mrs. Nelson transferred her shares, representing about 27% of the common stock of WEC, to an FLP on October 1, 2008. As the court described it, the FLP "was formed as part of a tax planning strategy to (1) consolidate and protect assets, (2) establish a mechanism to make gifts without fractionalizing interests, and (3) ensure that WEC remained in business and under the control of the Warren family." Mrs. Nelson's WEC stock comprised 99% of the value of the FLP's assets.

Mrs. Nelson and her husband were the sole general partners (collectively owning the 1% general partner interest), and Mrs. Nelson owned most of the limited partner interests (93.88%), with the balance of the limited partner interests being owned by custodianships and trusts for family members.

Both WEC and the FLP had transfer restrictions in their governing documents, but the appraisals did not seem to apply any reduction in the value of the stock of WEC or the partnership interests of the FLP by reason of the transfer restrictions (so no §2703 issue was raised).

Gift and Sale of FLP Interests. About three months after the FLP was formed, Mrs. Nelson made a gift on December 31, 2008, of an interest in the FLP to a trust (the "Trust") for her husband and her four daughters of which her husband was the trustee (this was what has come to be referred to as a spousal lifetime access trust, or "SLAT"). The gift assignment provides:

> [Mrs. Nelson] desires to make a gift and to assign to * * * [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 * * *, as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.

Two days later, on January 2, 2009, Mrs. Nelson sold additional limited partner interests in the FLP to the Trust in return for a $20 million note. The note provided for 2.06% interest on unpaid principal, was secured by the limited partner interest that was sold, and required annual interest payments through the end of 2017 (suggesting that it was a 9-year note). (The interest rate was the mid-term AFR for January 2009, applicable for debt instruments over 3 years but not over 9 years). The Sale and Assignment document provides:

> [Mrs. Nelson] desires to sell and assign to * * * [the Trust] her right, title, and interest in a limited partner interest having a fair market value of TWENTY MILLION AND NO/100THS DOLLARS ($20,000,000.00) as of January 2, 2009 * * *, as determined by a qualified appraiser within one hundred eighty (180) days of the effective date of this Assignment * * *.

Appraisals of WEC and FLP Interests, Determination of Percentage Interests Transferred. Mrs. Nelson engaged Barbara Rayner of Ernst & Young to appraise the WEC stock owned by the FLP (which she determined to be $860 per share, or about $56.6 million). That value was then used by Roy Shrode to appraise the limited partner interests in the FLP, and he determined that a 1% limited partner interest was worth $341,000 and that the gift and sale equated, respectively, to transfers of 6.14% and 58.65% limited partner interests (rounded).

The partnership agreement was subsequently amended to reflect transfers of 6.14% and 58.65% limited partner interests to the Trust, and these ownership percentages were reflected on the Schedules K-1 for the FLP from 2008 through 2013, and proportional cash distributions from the FLP were based on those percentage ownerships of limited partner interests.

Gift Tax Returns. Mr. and Mrs. Nelson reported the 2008 gift by Mrs. Nelson as a split gift. Their 2008 Form 709s each reported a gift to the Trust "having a fair market value of $2,096,000 as determined by independent appraisal to be a 6.1466275% limited partner interest," and half of that amount was a gift by each spouse for gift tax purposes. The sale was not reported on the 2009 gift tax returns for the Nelsons.

The IRS selected the 2008 and 2009 gift tax returns for examination. A proposed settlement agreement was negotiated in the administrative appeals process. In light of those settlement discussions, the partnership agreement was amended to reduce the percentage interest owned by the Trust by 26.24%, from 64.79% to 38.55%, resulting in a proportional 40% reduction in the interest owned by the Trust). The settlement was never completed. (As discussed in Item 3 of the Observations, query if the family is much better off with the result of the *Nelson* opinion than if the settlement had been completed and the percentage ownership reductions had been required?)

IRS Appraisal Expert. The IRS engaged Mark Mitchell as its expert appraiser. (He has served as a valuation expert for the IRS in other cases, including *Hoffman v. Commissioner*, T.C. Memo. 2001-209, and *Grieve v. Commissioner*, T.C. Memo. 2020-8.)

Texas Residents. Mr. and Mrs. Nelson were residents of Texas when they filed their petitions (so the case is appealable to the Fifth Circuit Court of Appeals if it is appealed).

Court Analysis

1. Burden of Proof

The taxpayers argued that the burden of proof shifted to the IRS under §7491(a) because they produced credible evidence as to factual issues, but the court ruled that was moot because it resolved the issues on the basis of a preponderance of the evidence.

2. Transfers of Percentage Interests Based on Appraised Values Rather Than Transfers of Dollar Values Based on Values as Finally Determined for Gift Tax Purposes

The taxpayers argued that Mrs. Nelson transferred limited partner interests worth $2,096,000 and $20 million as finally determined for gift tax purposes, despite the language in the Assignment documents. They contended that this intent was evidenced by their subsequent actions to modify the purported transferred amounts to reflect settlement discussions with the IRS about the values of the limited partner interests.

The court disagreed, looking to the plain language of the assignments, which transferred interests worth specified dollar amounts "as determined by a qualified appraiser within" 90 days for the gift and 180 days for the sale. The court contrasted the defined value cases that addressed transfers of property worth specified dollar amounts based on values as finally determined for gift or estate tax purposes (*Wandry*, *Hendrix*, *Petter*, *Christiansen*).

> Therefore, to decide whether the transfers were of fixed dollar amounts or fixed percentages, we start with the clauses themselves, rather than the parties' subsequent actions.
>
> …
>
> The transferred interests thus are expressed in the transfer instruments as an interest having a fair market value of a specified amount as determined by an appraiser within a fixed period. The clauses hang on the determination by an appraiser within a fixed period; value is not qualified further, for example, as that determined for Federal estate tax purposes.…
>
> … By urging us to interpret the operative terms in the transfer instruments as transferring dollar values of the limited partner interests on the bases of fair market value as later determined for Federal gift and estate tax purposes, petitioners ask us, in effect, to ignore "qualified appraiser * * * [here, Mr. Shrode] within * * * [a fixed period]" and replace it with "for federal gift and estate tax purposes." While they may have intended this, they did not write this. They are bound by what they wrote at the time. As the texts of the clauses required the determination of an appraiser within a fixed period to ascertain the interests being transferred, we conclude that Mrs. Nelson transferred 6.14% and 58.35% of limited partner interests in [the FLP] to the Trust as was determined by Mr. Shrode within a fixed period.

3. Valuation of WEC (Holding Company, 27 Percent of the Common Stock of Which Was the FLP's Primary Asset)

The six underlying operating company subsidiaries were valued separately by the taxpayers' expert. Three of the subsidiaries (involved in heavy equipment dealer operations) were valued on a net asset value method, which was common for that industry. One other subsidiary was valued using the income approach, and two other subsidiaries were valued using a combination of the income approach and market approach. The value of the subsidiary that owned the real estate was determined by a third-party appraiser. The administrative subsidiary (which provided administrative services to all of the businesses) was ignored for valuation purposes (agreed to by both the taxpayers' and IRS's experts). Those values were combined and the value of WEC's debt and preferred stock were subtracted to determine that WEC's common equity was worth $363.7 million on a controlling basis before discounts. The appraiser then applied lack of control and lack of marketability discounts in valuing the 27% of common stock of WEC that was owned by the FLP.

The taxpayers' expert applied a 20% lack of control discount. The IRS's expert used no lack of control discount, reasoning that the analysis of the underlying values of the subsidiaries resulted in noncontrolling interest values. Both experts agreed that a 30% lack of marketability discount was appropriate. The court ultimately determined that the minority interest that the partnership owned in the holding company was valued using a 15% lack of control discount and 30% lack of marketability discount.

The court primarily addressed two issues regarding the valuation of WEC. First, the experts disagreed as to whether the valuation of the various subsidiaries was of a controlling or noncontrolling value and therefore whether lack of control discounts should be applied in valuing the 27% of common stock of WEC that was owned by the FLP. The court concluded that the separate values of the subsidiaries reflected "at least some elements of control," but that "some discount should apply in valuing a minority interest in WEC common stock." The court reduced the lack of control discount from 20% to 15%.

Second, the taxpayer's appraiser used both the income approach (reflecting a value of $341.1 million) and market approach (reflecting a value of $269.8 million) to value two of the operating subsidiaries, concluding that the value of the two was "reasonably represented as $309.0 million." The court concluded that the evidence was not sufficient to support using a market approach to value those subsidiaries, suggesting that the undiscounted value of the two subsidiaries should have been $341.1 million rather than $309 million, but it is not clear how the court took that difference into consideration in concluding that the value of the WEC stock was $912 per share. (The taxpayers' expert valued the FLP's WEC stock at $860 per share, and the court's $912 per share number appears totally attributable to applying a 15% rather than a 20% lack of control discount [$860 x 85%/80% = 913.75, close to $912].)

4. Discounted Value of Limited Partner Interests

The taxpayers' expert began with using the appraised value of WEC and adding the other FLP assets and making adjustments for lack of control and lack of marketability discounts to value the transferred limited partner interests.

a. Lack of Control Discount.

Both experts based their lack of control discounts on the lack of control discounts in the case of what they viewed as comparable closed-end funds. The taxpayers' expert concluded that a 15% lack of control discount applied.

The IRS's expert analyzed 30 closed-end funds but reasoned that the FLP was not comparable to any of them. Without explaining the expert's reasoning, the opinion states that "[h]e determined that there would be almost no possibility of a lack of control disadvantage for a minority owner of [the FLP] except 'under certain circumstances, the precise nature of which cannot be exactly determined with reference to empirical/market data.'" He applied a 5% discount "to account for that remote possibility," which he reduced by another 2% because of the low probability that the FLP "would undertake any significant change in its operating profile," resulting in a 3% lack of control discount.

The court stated that none of the closed-end funds were comparable, and rejected both experts' analyses. The court found the IRS's expert's explanation of how he arrived at his discount unconvincing, but then seemed to adopt that expert's analysis, concluding that "we do agree with him that the possibility of a lack of control disadvantage for a minority owner is remote. We therefore adopt a 5% lack of control discount …"

Observation: Neither the expert (so far as the opinion reveals) nor the court explained *why* "the possibility of a lack of control disadvantage for a minority owner is remote."

b. Lack of Marketability Discount.

The taxpayers' expert relied on certain studies of sales of restricted stock and sales of private, pre-IPO stock in applying a 30% discount.

The IRS's expert similarly examined several studies of sales of restricted stock and pre-IPO stock, but involving more recent data, and also used "quantitative models that looked at the role of liquidity premiums in calculating the value of a forgone put option on the basis of the Black-Scholes model." Applying that analysis, he concluded that the approximate range of discounts was 20% to 35%, and used 25% "because 25% was approximately equal to the mid-point of these two ranges."

Observation: The actual average, or arithmetic mean, of 20% and 35% is 27.5%, and the geometric mean is approximately 26.5%, neither of which would have been difficult to compute.

The court reasoned that prior cases had disregarded the studies that had been used by the taxpayers' expert and that the IRS's expert's analysis was more thorough. Without explanation, the court found as reasonable the IRS's expert's reasoning that the FLP's lack of marketability discount "should be incrementally lower than WEC's [lack of marketability] discount because the marketability of WEC shares was considered in computing the WEC discount."

Observation: What??? If the subsidiary businesses were fairly marketable resulting in low marketability discounts for them, the marketability discount for the intra-family FLP that was controlled by the parents had to be even lower? Why are those two marketability discounts tied to each other? That reasoning would seem to suggest that the lack of marketability discount for partnerships owning marketable securities should be zero. Perhaps the court has a reasonable justification for approving this statement, but the opinion does not describe that reasoning.

The IRS's expert provided "no support for his conclusion that 25% is appropriate other than his claim that 25% was equal to the median of the ranges," which the court observed was really 28%. Therefore, the court used a 28% marketability discount.

5. Conclusion

The court ultimately determined that the 27% interest that the partnership owned in the holding company WEC was valued by using discounts of 15% for lack of control (slightly lower than the taxpayers' expert's position of 20%) and 30% for lack of marketability (agreed to by experts for both the taxpayers and the IRS). The holding company value was then used to determine the value of the limited partner interests, which the court determined by using discounts of 5% for lack of control (compared to 15% by the taxpayer's expert and 3% by the IRS's expert) and 28% for lack of marketability (compared to 30% by the taxpayers' expert and 25% by the IRS's expert).

The fair market values of the gift and sale transfers, as compared to the anticipated amounts, are as follows.

	Value of Transfer Anticipated by Taxpayers	Value of Transfer (and Increase in Value) Asserted by IRS	Value of Transfer (and Increase in Value) Determined by Court
Gift	$2,096,000	$3,522,018 (+$1,426,018)	$2,524,983 (+$428,983)
Sale	$20,000,000	$33,607,038 (+$13,607,038)	$24,118,933 (+$4,118,933)
Total	$22,096,000	$37,129,056 (+$15,033,056)	$26,643,916 (+$4,547,916)

At the 45% gift tax rate that applied in 2008 and 2009, the additional gift tax is about $2,000,000, assuming the spouses had previously utilized all of their available unified credit amounts with prior lifetime gifts. But a comparison of the amounts in the above table shows that this is only about 30% of what the IRS was demanding, making the case, in effect, a 70% taxpayer victory.

Observations

1. Not a Rejection of Defined Value Clauses

The court's refusal to treat this as a transfer of a dollar amount based on values as finally determined for gift tax purposes might on first blush be viewed as a rejection of a defined value transfer. That is not the case. The transfer was of a defined value of interests not as finally determined for gift tax purposes but as determined by a qualified appraisal that would be completed shortly after the date of the transfer.

2. Importance of Using Grantor Trusts With Defined Value Transfers

The facts of *Nelson* illustrate the importance of using grantor trusts with defined value transfers. If the amount transferred depends on values as finally determined for gift tax purposes, the amounts actually transferred may not be determined for years. In the meantime, income tax returns are filed, reflecting the anticipated amounts that were transferred. In *Wandry v. Commissioner*, T.C. Memo. 2012-88, the government argued that "if petitioners prevail it will likely require the preparation and filing of numerous corrective returns." A much preferable planning design is to make the gifts and sales to grantor trusts. Even if the ownership percentages change as a result of a gift tax audit, all of the income and deductions will have been reported on the grantor's income tax return in any event, and no corrective returns should be necessary (unless the parties wish to file corrected entity level returns to make clear the appropriate sharing of profits and losses of the entity's owners).

In *Nelson*, the taxpayers attempted to make adjustments in the percentages that were transferred on the basis of settlement discussions with IRS appeals. The *Nelson* court's analysis indicates that adjusting the percentage interests transferred was not appropriate. But if the percentage interests transferred had changed, no amended income tax returns would have been needed because the transfers were made to the Trust, which was a grantor trust (if for no other reason, because the grantor's spouse was a beneficiary of the trust), so all of the income was reported on Mrs. Nelson's income tax return, whether the interests were owned by Mrs. Nelson or by the Trust.

3. Potential Disadvantage of Defined Value Clauses

This case illustrates a potential disadvantage of using defined value clauses. This case did not involve a defined value clause, so the percentage interests transferred did not have to be adjusted to reflect the values determined by the court. Instead, the donors made additional taxable gifts and may have had to pay additional gift taxes. The court ultimately determined that the taxpayers made additional gifts of about $4.5 million. Even if they had previously used all of their unified credit with prior gifts, at a 45% gift tax rate, the additional gift taxes would have been about $2 million (plus interest).

As a result of the settlement discussions with IRS Appeals, the taxpayers attempted to adjust the percentage interests transferred from 64.79% (for the gift and sale) to only 38.55%. If that had been the effect of the assignment clauses, the parties would have decreased the Trust's interest in the FLP (with underlying assets of over $60 million) by 26.24%, or a reduction of the Trust's value by about $15.7 million, without counting subsequent appreciation and income. The family in retrospect may be delighted that they "lost" their argument that the assignments were defined value transfers. They may be happy to pay an additional $2 million of gift tax in order to keep in the Trust an additional $15.7 million, plus untold subsequent appreciation and income (unreduced by income tax because the grantor pays it) that has accumulated in the Trust during the intervening eleven years, which amount could now be many multiples of $15.7 million.

4. Support of Planning Alternative for Transferring Hard-To-Value Assets; 90 vs. 180 Days for Appraisals

As a practical matter, valuing hard-to-value assets on the date of the transfer is impossible. A formula transfer of a dollar value worth of a particular asset, based on an appraisal to be acquired within a specified term in the near future, is routinely used, and is not viewed by the IRS as abusive. By the time the gift tax return is filed, the appraisal will be at hand, and a specific number of shares or units that have been transferred pursuant to the formula will be known and listed on the gift tax return. *See* Rev. Rul. 86-41, 1986-1 C.B. 300 ("In both cases, the purpose of the adjustment clause was not to preserve or implement the original bona fide intent of the parties, as in the case of a clause requiring a purchase price adjustment based on an appraisal by an independent third party retained for that purpose").

The IRS apparently raised no objections to these assignments based on values as determined by appraisals within a short time after the transfers, and indeed simply proceeded to enforce the terms of the assignments.

Obviously, that approach provides no protection against gift taxes in the event of an audit. The key distinction of a classic defined value type of transfer is that the formula dollar value being transferred is based on values as finally determined for federal gift tax purposes.

The assignments in *Nelson* provided that the appraisal would be determined within 90 days for the gift transaction and within 180 days for the sale transaction. The gift and sale were made two days apart. Surely the plan was to use the same appraisals for both purposes. Why different time periods were allowed for obtaining the appraisals for the two different transactions is unclear. Perhaps the parties realized that, as a practical matter, obtaining an appraisal of a holding company that owned six operating subsidiaries and two other non-operating subsidiaries, and then subsequently using that appraisal to obtain an appraisal of the limited partner interests all within 90 days was not realistic. Or perhaps they did not want to extend the due date of the gift tax return (maybe in the hope of attracting less attention) and therefore needed the appraisal for the December 31 gift before April 15. Whether the appraisals were indeed obtained within 90 days is not addressed in the opinion. Even if the appraisals were obtained outside that window, they were used to determining the percentage interests that were transferred, and the IRS raised no objections about the specific time frame in which the appraisals were completed.

5. Partnership Respected by IRS Despite Being Created Shortly Before Transfers

The FLP was created only about three months before the transfers, but the IRS did not argue that the partnership should be ignored as simply an artificial device to produce more valuation discounts.

6. Transfer Restrictions Not Addressed in Appraisals, So No Section 2703 Issues Arose

Both the WEC corporate documents and the FLP agreement contained transfer restrictions, generally just allowing transfers to family members. For the corporation, shareholders could also sell their shares back to the corporation or other shareholders, and for the FLP, the partners could also sell interests with the approval of the general partners (who happened to be Mr. and Mrs. Nelson) or subject to a right of first refusal by the FLP and the other partners. None of the experts applied any valuation discounts because of the transfer restrictions. Therefore, no issues arose as to whether the restrictions should be disregarded in valuing the transfers under §2703.

7. Sale for Note Using AFR Was Respected

The sale in early 2009 in return for a note using the mid-term AFR that was secured by the limited partner interest that was sold was respected by the IRS. The IRS did not attempt to argue that the note's value should be discounted because the interest rate was less than a market interest rate.

Anecdotal indications are that the IRS has recently raised questions in some audits as to whether notes using the AFR in sale transactions should be discounted in value because of the interest rate. So far, there is no case law supporting that position. *But see* PLR 200147028, in which the IRS seemed to embrace a market interest rate standard when it ruled that partitioned and reformed trusts "will retain their GST tax exempt status … [i]f the trustee elects to make one or more loans to the beneficiaries … provided that such loans are adequately secured and subject to a market rate of interest." There is no indication in the ruling whether the taxpayers who had requested the ruling had included that proviso on their own or if perhaps the IRS had required them to add it. (The ruling states that the taxpayers had asked a court to grant that discretion and the court had agreed, but it doesn't indicate whether that request had been made at the suggestion of the IRS after the ruling request had been submitted).

Most planners use the applicable federal rate, under the auspices of §7872, as the interest rate on notes for intra-family installment sales. Section 7872 addresses the gift tax effects of "below-market" loans, and §7872(f)(1) defines "present value" with reference to the "applicable Federal rate." Using §7872 rates would seem to be supported by the position of the IRS in a Tax Court case and in several private rulings.

In *Frazee v. Commissioner*, 98 T.C. 554 (1992), the IRS urged, as its primary position, that the interest rate under §7872 (rather than the interest rate under §483 or any other approach), should apply for purposes of determining the gift tax value of a promissory note in the context of a sale transaction. Whether the §7520 rate or some other market rate should apply was not strictly before the court, because the IRS proposed using the lower §7872 rate. However, the court analyzed §7872 and concluded that it applied for purposes of valuing a note given in a seller financed sale transaction:

> Nowhere does the text of section 7872 specify that section 7872 is limited to loans of money. If it was implicit that it was so limited, it would be unnecessary to specify that section 7872 does not apply to any loan to which sections 483 or 1274 apply. The presence of section 7872(f)(8) signaled Congress' belief that section 7872 could properly be applicable to some seller financing. We are not here to judge the wisdom of section 7872, but rather, to apply the provision as drafted. 98 T.C. at 588.

The opinion concluded with an acknowledgement that this approach was conceded by the IRS in its position that §7872 applied rather than valuing the note under a market rate approach: "We find it anomalous that respondent urges as her primary position the application of section 7872, which is more favorable to the taxpayer than the traditional fair market value approach, but we heartily welcome the concept." *Id.* at 590. The concept is welcome, probably because rates under §7872 are objective and do not burden the court with the need for evidence, argument, and judgment.

The use of the §7872 rate for intra-family note transactions was subsequently approved in *True v. Commissioner*, T.C. Memo. 2001-167 ("We concluded in Frazee v. Commissioner, supra at 588-589, that section 7872 does not apply solely to loans of money; it also applies to seller-provided financing for the sale of property. In our view, the fact that the deferred payment arrangement in the case at hand was contained in the buy-sell agreements, rather than in a separate note as in Frazee, does not require a different result."), *aff'd on other grounds*, 390 F.3d 1210 (10th Cir. 2004).

Private letter rulings have also taken the position that using an interest rate that is equal to or greater than the AFR will not be treated as a gift, merely because of the interest rate that is used on the note. *E.g.*, PLRs 9408018; 9535026.

8. No Issue of "Equity" in the Sale Transaction

Although PLR 9535026 (which often is cited as the IRS's first approval of an installment sale to a grantor trust) does not refer to any "equity" in the trusts, such as other property to help secure the debt or property with which to make a down payment, it is well known that the IRS required the applicants for the ruling to commit to such an equity of at least 10% of the purchase price. *See generally* Michael Mulligan, *Sale to a Defective Grantor Trust: An Alternative to a GRAT*, 23 EST. PLAN. 3, 8 (Jan. 1996). (In PLR 9251004, the IRS had held that a transfer of stock to a trust with no other assets, in exchange for the trust's installment note, "must be considered a retention of the right to receive trust income" for purposes of §2036.)

In *Nelson*, a gift to the Trust believed to be $2,096,000 was followed by a sale of property believed to have a value of $20,000,000. That would have resulted in "equity" of only about 9.5%. No mention was made of that in the opinion, and it cannot be determined whether that was a part of the IRS's concerns about the transactions. Of course, after the gift component had been adjusted by the Tax Court to a total of $6,643,916 ($2,524,983 as the December 31, 2008, gift plus $4,118,933 as the additional gift at the time of the January 2, 2009, sale) and the sale component remained $20,000,000, this issue disappeared.

9. Multi-Tiered Discounts

The IRS did not question applying substantial discounts at both the level of assets owned by the FLP and also of interests in the FLP itself.

Discounts at multiple levels of interests owned by partnerships were allowed in *Astleford v. Commissioner*, T.C. Memo. 2008-128. The court in *Astleford* allowed full lack of control and marketability discounts at both the subsidiary level and the parent level. The cases cited by the court suggest that this is appropriate when there are minority interests being valued at both levels. Footnote 5 of the *Astleford* opinion cites four Tax Court and Tax Court memorandum cases that have allowed multi-level discounts where there were minority interests in both levels. (*Estate of Piper, Janda, Gow,* and *Gallun*.) However, footnote 5 also identifies cases that have refused to apply multi-level discounts where minority interests in subsidiaries were a significant portion of the parent entity's assets (*Martin*) or for a subsidiary that was the parent's "principal operating subsidiary" (*Estate of O'Connell*). The multi-tiered discounts were not questioned in *Nelson* even though both of those conditions (addressed in *Martin* and *Estate of O'Connell*) were applicable.

Grieve v. Commissioner, T.C. Memo. 2020-28 (March 2, 2020), rejected on procedural and prudential grounds the approach offered by the taxpayer's expert at trial for the taxpayer to apply tiered discounts that would have resulted in a value considerably lower than the value reported on an appraisal attached to the gift tax return. The court explained that it had found no justification for using a net value significantly lower than the value to which the taxpayer had previously admitted on the appraisal attached to the gift tax return (without any specific criticism of the multiple-tiered discounting approach).

10. Split Gift Election for Gift to SLAT

Mrs. Nelson made a gift to the Trust on December 31, 2008, and Mr. Nelson consented to making the split gift election with respect to that gift. The effect of the split gift election is that the transfer is treated as having been made one-half by each of the spouses for gift and GST tax purposes (meaning that the consenting spouse's gift and GST exemption could be used), but not for estate tax purposes. Because the election does not treat the spouses as making equal transfers to the trust for *estate* tax purposes, Mr. Nelson could be a beneficiary of the trust without causing estate inclusion under §2036(a)(1) and Mr. Nelson could serve as trustee without risking estate inclusion for him under §23036(a)(2) or §2038.

The case has no discussion of any problems with the split gift election (other than to note that any resulting gifts are made one-half by each of the spouses). A potential problem, however, with making the split gift election for a transfer to a SLAT is that split gift treatment is not allowed if the consenting spouse is a beneficiary of the trust unless the spouse's interest in the trust is ascertainable, severable and de minimis, so that the gift amount by the spouse is the amount of the transfer other than the spouse's severable interest (because one cannot make a gift to himself or herself). *See* Rev. Rul. 56-439, 1956-2 C.B. 605; *Wang v. Commissioner,* T.C. Memo. 1972-143 (no split gift election allowed where consenting spouse's interest in trust receiving gift assets was not ascertainable); *Robertson v. Commissioner,* 26 T.C. 246 (1956) (gift splitting allowed for full amount transferred); *see generally* D. Zeydel, *Gift-Splitting — A Boondoggle or a Bad Idea? A Comprehensive Look at the Rules,* 106 J. TAX'N 334 (June 2007). Interestingly, Letter Ruling 200130030 allowed gift splitting for the full amount of the transfer without discussing the value (in particular, that it had no value) of the donee spouse's severable interest.

While the *amount* that can qualify for gift splitting may be limited for gift purposes, the regulations appear to provide that if any portion of the transfer qualifies for gift splitting, a full one-half of the transferred amount shall be treated as having been transferred by the consenting spouse for GST purposes. Reg. §26.2652-1(a)(4).

For a more complete discussion of the relevant cases and letter rulings, see Item 5.k.(3) in the December 2012 "Estate Planning Current Developments and Hot Topics" found here and available at www.bessemertrust.com/for-professional-partners/advisor-insights.

Gift splitting should be allowed in full if:

- Distributions of both income and principal to the donee-spouse are subject to an ascertainable standard of distribution under §2514, preferably a standard based upon the spouse's accustomed standard of living;
- The trustee must consider other resources available to the spouse before exercising its discretion to distribute income or principal to the spouse; and
- The resources that are, and are expected to be, available to the spouse for the remainder of his or her lifetime are sufficient to meet the spouse's living expenses, such that the likelihood that the trustee will need to exercise its discretion to distribute income or principal to the spouse is so remote as to be negligible.