

*Premier analysis of federal legislative and regulatory developments for the nation's 2,000 most advanced life insurance planners, focusing on business, estate, qualified and nonqualified retirement planning.*

**Counsel**

*Buchanan Ingersoll & Rooney PC*    *PricewaterhouseCoopers*  
Gerald H. Sherman                      William Archer  
Stuart M. Lewis                            Donald Carlson  
Deborah M. Beers

Keith A. Mong                                *Ricchetti, Inc.*  
Steve Ricchetti  
Jeff Ricchetti

**AALU**

David J. Stertz, *Chief Executive Officer*  
Marc R. Cadin, *Senior VP of Legislative Affairs*  
Chris Morton, *Vice President of Legislative Affairs*  
Tom Korb, *Vice President of Policy & Public Affairs*  
Sarah Spear, *Director of Policy & Public Affairs*  
Anthony Raglani, *Asst. Dir. of Policy & Public Affairs*

*Federal Policy Group*  
Ken Kies  
Matthew Dolan

*Arnold & Porter LLP*  
Martha L. Cochran  
David F. Freeman, Jr.

2901 Telestar Court, Falls Church, Virginia 22042  
Toll Free: 1-888-275-0092 Fax: 703-641-8119  
[www.aalu.org](http://www.aalu.org)

AALU Bulletin No: 10-45

April 21, 2010

Subject: **General Estate and Gift Tax Developments: January 2010**

1. **Gifts of Limited Partnership Interests Do Not Qualify for § 2503(b) Annual Exclusion**

Major References: [Price v. Commissioner, T.C. Memo. 2010-2 \(January 4, 2010\)](#)

Prior AALU Washington Reports: 03-69

2. **Canadian Resident's Retirement Plan Assets Are Not Subject to U.S. Estate Tax**

Major References: [CCA 201003013](#)

3. **Amount Paid in Settlement of Will Dispute Is Not Eligible for Federal Estate Tax Charitable Deduction**

Major References: [TAM 201004022](#)

Prior AALU Washington Reports: 00-100

MDRT Information Retrieval Index Nos.: 2500.00; 7400.021; 7400.022; 7400.024

**SEE THE CIRCULAR 230 DISCLAIMERS APPENDED TO  
THE CONCLUSION OF THIS WASHINGTON REPORT.**

*This Washington Report summarizes a few of the more important cases and rulings in the estate and gift tax areas which were decided or reported by the courts and the Internal Revenue Service in January of 2010, and on which we have not previously reported in Bulletins on insurance-related estate and gift tax matters.*

## Cases

1. *Price v. Commissioner, T.C. Memo. 2010-2 (January 4, 2010)*

*In a memorandum decision, the Tax Court ruled that gifts of limited partnership interests to the donors' children were not eligible for the gift tax annual exclusion in the years at issue because the partnership agreement restricted the donees' access to the income and capital of the partnership so severely that their interests could not be viewed as "present" interests in property.*

Walter M. Price started his own company, Diesel Power Equipment Co. (DPEC), in 1976, which eventually distributed and serviced about 40 lines of power equipment and had about 90 employees. Mr. Price and his wife, Sandra K. Price ("Taxpayers"), had children who had no career interest in the business. Consequently, Taxpayers decided in the late 1990s to sell the business as part of a careful financial plan which involved first placing the DPEC stock in a limited partnership.

On September 11, 1997, Taxpayers formed Price Investments Limited Partnership (the partnership) as a limited partnership under Nebraska law. Price Management Corp., a Nebraska corporation, was its 1-percent general partner. The Walter M. Price Revocable Trust and the Sandra K. Price Revocable Trust were each 49.5-percent limited partners. Mr. Price was president of Price Management Corp., and Taxpayers, through revocable trusts, held the shares in Price Management Corp.

When the partnership was formed, its assets consisted of the DPEC stock and three parcels of commercial real estate leased under long-term leases to DPEC and another equipment company. On January 5, 1998, the partnership sold the DPEC stock and invested the sales proceeds in marketable securities.

During 1997 through 2002 each Taxpayer gave each of their three adult children interests in the partnership. In each year except 1997 and 2001 the partnership made cash distributions in equal amounts to each child.

**The Partnership Agreement.** The limited partnership agreement states that the partnership's primary purpose is to achieve a reasonable rate of return on a long-term basis with respect to its investments. The partnership agreement generally prevents any partner from withdrawing capital contributions. The partnership agreement also restricts transfer and assignment of partnership interests without the written consent of all partners, except that a limited partner may sell or otherwise transfer his or her partnership interest to a general or limited partner, or to a trust held for the benefit of a general or limited partner. Any assignment made to anyone not already a partner shall be effective only to give the assignee the right to receive the share of profits to which his assignor would otherwise be entitled (*i.e.*, an "assignee interest"), shall not relieve the assignor from liability under any agreement to make additional contributions to capital, shall not relieve the assignor from liability under the provisions of the partnership agreement, and shall not give the assignee the right to become a substituted limited partner.

The partnership agreement further provides that, in the event of any voluntary or involuntary assignment of a partnership interest, "the partnership and each of the remaining partners shall have the option to purchase the partnership interest for its fair market value" from the assignee. The agreement further provides that the partnership will terminate after 25 years but may be dissolved sooner if there is written consent or affirmative vote "by at least two-thirds (2/3) in interest of the partners."

Although partnership profits are shared by the partners according to their proportional partnership interests, such profits are to be distributed to the partners "in the discretion of the general partner except as otherwise directed by a majority in interest of all of the partners, both general and limited." The partnership

agreement states that neither the partnership nor the general partner has “any obligation” to distribute profits to enable the partners to pay taxes on the partnership’s profits.

**Taxpayer’s Gift Tax Returns.** On their gift tax returns for 2000, 2001, and 2002 each Taxpayer reported zero gift tax due after applying unified credits. Taxpayers attached to their gift tax returns valuation reports supporting the reported gift values. Each such valuation report indicates substantial discounts for lack of control and lack of marketability of the transferred partnership interests, stating: “Unless a partner owns or controls two-thirds of the partnership interests, his/her investment is illiquid until at least the scheduled termination date.”

**Disallowance of Annual Exclusions from Gift Tax.** The government disallowed annual gift tax exclusions for each transferred partnership interest for each year on the ground that the gifts were of future interests in property, and the Tax Court agreed with this determination. *See, e.g., Hackl v. Commissioner*, 118 T.C. 279, 294 (2002), *affd.* 335 F.3d 664 (7th Cir. 2003), discussed in our Bulletin No. 03-69.

Applicable Treasury Regulations provide that “[a]n unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain) is a present interest in property.”

In *Hackl v. Commissioner*, *supra*, the Tax Court held that gifts of units in a limited liability company (LLC) were gifts of a future interest that did not qualify for the annual exclusion. “The Court rejected the taxpayers’ argument that a gift that takes the form of an outright transfer of an equity interest in a business or property is necessarily a gift of a present interest.”

In *Hackl*, the Court held that to establish entitlement to an annual exclusion under section 2503(b), a taxpayer must --

establish that the transfer in dispute conferred on the donee an unrestricted and non-contingent right to the immediate use, possession, or enjoyment (1) of property or (2) of income from property, both of which alternatives in turn demand that such immediate use, possession, or enjoyment be of a nature that substantial economic benefit is derived therefrom. \* \* \*

Applying the methodology set forth in *Hackl*, the Tax Court concluded that Taxpayers failed to show that their gifts of interests in the partnership conferred upon the donees the immediate use, possession, or enjoyment of either the transferred property or the income therefrom.

As evidence of this lack of a right to immediate use or possession of either the property or its income, the Tax Court pointed to the provisions of the partnership agreement that (i) prohibit the donees from withdrawing their capital accounts, and (ii) prohibit partners from selling, assigning, or transferring their partnership interests to third parties or from otherwise encumbering or disposing of their partnership interests without the written consent of all partners.

The Court further determined that “the donees are not even properly characterized as limited partners in the partnership.” When the Taxpayers made their gifts, it was not clear that their children (the donees) became substituted limited partners. “[R]ather, the gifts were effective only to give each child a share of the profits to which the revocable trusts otherwise would have been entitled. Consequently, the donees lack the ability ‘presently to access any substantial economic or financial benefit that might be represented by the ownership units.’” [Citing *Hackl*.]

Nevertheless, the Court continued, “even if it were to be assumed . . . that the donees did somehow become substituted limited partners, it would not affect our conclusion that contingencies stand between the donees and their receipt of economic value for the transferred partnership interests so as to negate finding that the donees have the immediate use, possession, or enjoyment of the transferred property.”

On the issue of the right to income from the transferred property, the Court stated that the Taxpayers must demonstrate that: (1) The partnership would generate income at or near the time of the gifts; (2) some portion of that income would flow steadily to the donees; and (3) the portion of income flowing to the donees can be readily ascertained. The Court noted that, although the partnership generated steady income from rents, it did not flow steadily to the donees -- in fact, there were no distribution at all in 1997 and 2001.

“Pursuant to the partnership agreement, profits of the partnership were distributed at the discretion of the general partner, except when otherwise directed by a majority in interest of all the partners, both limited and general. Furthermore, the partnership agreement stated that ‘annual or periodic distributions to the partners are secondary to the partnership’s primary purpose of achieving a reasonable, compounded rate of return, on a long-term basis, with respect to its investments.’”

We note that planners sometimes lose sight of the forest for the trees. The taxpayers in *Price* undoubtedly entered into an extremely restrictive partnership agreement in order to obtain substantial discounts to the value of the transferred interests. They then tried also to take advantage of the gift tax annual exclusions which, in many such transactions, are relatively small in relation to the overall valuation of the gifted property. In some, although certainly not all, of such circumstances, it may be better to abandon the annual exclusion in favor of the discounts.

### Chief Counsel Advice

#### 2. CCA 201003013

***The IRS, in Chief Counsel Advice, has ruled that the value of an RRSP (registered retirement savings plan) - a form of Canadian retirement account - held by a Canadian who had never been a citizen or resident of the United States would not be includible in his estate for U.S. federal estate tax purposes. The RRSP held shares in Canadian mutual funds which, in turn, invested in the stock of U.S. corporations. The Canadian mutual funds were determined to be foreign situs assets not subject to U.S. estate tax.***

An RRSP is similar to an individual retirement account in the United States and is treated as a trust for U.S. income tax purposes. “Decedent” was a Canadian resident at the time of his death who was also a non-resident alien with respect to the United States. At the time of his death, Decedent’s RRSP held shares of Canadian mutual funds that, in turn, owned shares of U.S. corporations. Because he also owned U.S. real property, he filed a U.S. estate tax return as a nonresident alien. This return was subsequently audited, and the auditor requested technical advice from the IRS National Office.

As a nonresident non-U.S. citizen, Decedent’s gross estate for U.S. estate tax purposes should include only “U.S. situs” assets (such as his U.S. real property) pursuant to Internal Revenue Code section 2103. The issue presented to IRS Chief Counsel on audit of Decedent’s return was whether Decedent’s interest in the RRSP was a U.S. situs asset and thus includible in Decedent’s gross estate for U.S. estate tax purposes.

The IRS concluded, citing Rev. Rul. 82-193, that because of the “interest in or control over” the RRSP which Decedent possessed at the time of death, one must look through the RRSP to the asset(s) held by the RRSP to determine whether Decedent’s interest in the RRSP was a U.S. situs asset. As noted above, the assets held by the RRSP share in Canadian mutual funds that held stock in U.S. corporations. Revenue Code section 2104(a) provides that stock owned and held by a nonresident non-U.S. citizen is deemed property within the United States *only if issued by a U.S. corporation.*

The IRS therefore focused on whether the Canadian mutual funds in which the RRSP held an interest should be treated for U.S. tax purposes as corporations or as trusts. If they were corporations, then

the RRSP's interest in the funds would have a foreign situs for U.S. estate tax purposes. If the mutual funds were classified as trusts, then they might be "looked-through" so that the RRSP would be treated as directly holding the stock in the U.S. corporations. In that case, the assets of the RRSP would have a U.S. situs for U.S. estate tax purposes.

The IRS noted that the mutual funds were organized in Canada as trusts. It also noted, however, that a mutual fund may be formed as a "trust" under Canadian law but nevertheless properly be classified as a corporation under the entity classification rules applicable Treasury regulations. The IRS concluded, "[b]ased on the information provided" (but without indicating what information was provided), that the Canadian mutual funds should be classified as foreign corporations for U.S. tax purposes. Thus, the IRS concluded that the assets held by the RRSP were stock in foreign corporations, a foreign situs asset, and therefore that no portion of the interest in the RRSP was includible in Decedent's gross estate for U.S. estate tax purposes.

We note that the "default classification" under the "check-the-box" rules of a foreign entity that does not elect otherwise (or makes no election) generally depends on whether or not its members/owners have limited liability. Thus, under these rules, a foreign entity will be classified as an association taxable as a corporation if all of its members have limited liability. (Treas. Reg. § 301.7701-3(b)(2)(i)(B).)

### Technical Advice Memoranda

#### 3. TAM 201004022

*The IRS National Office, in technical advice (TAM 201004022) ruled that a decedent's estate is not entitled to a federal estate tax charitable deduction for an amount paid pursuant to a settlement agreement with a charitable trust.*

Under the facts of the TAM, "Decedent" died on an unspecified date having executed a will and three separate codicils. Decedent had previously (*i.e.*, prior to his death) established "Charitable Trust."

Decedent devised a parcel of real property in trust to be held for the use of "Son" and Son's wife during their lifetimes. Upon the death of the last to die of Son and Son's wife, the trustee is to sell the property and add the proceeds to Charitable Trust. Decedent also bequeathed an amount (\$a) to be held in trust for the benefit Son. The trustee is to pay income from the trust in monthly or in other convenient installments, at least quarterly, to Son for his life. The trustee may also invade the principal of the trust, up to \$b, to pay for medical expenses. Upon Son's death, the trust income is to be paid to Son's wife. Upon Son's death if he is unmarried, or upon the death of Son's wife, the accrued interest and principal is to be paid over to Charitable Trust.

The will also provides for the establishment of similar trusts for the benefit other relatives. These trusts all provide income to the beneficiary for life with the remainder to be paid on termination to Charitable Trust.

Decedent's will provides that all expenses debts and taxes are to be paid out of the residue of his estate, but does not otherwise disposed of the residue. Nor do any of the codicils address the disposition of the residuary estate.

The will contains an *in terrorem* clause providing that if any person contests the will or elects to take against the will, that person will be considered to have predeceased the Decedent. Any share of the estate which such person or entity would otherwise receive would then be distributed to Charitable Trust.

Son claimed that as Decedent's sole intestate heir, he alone was entitled to the residuary estate. The Charitable Trust claimed that it was the lawful beneficiary of Decedent's residuary and that the omitted

residuary clause was the result of a scrivener's error, a position supported by Decedent's attorney in an affidavit. In addition, the Charitable Trust asserted that other extrinsic evidence indicated that Decedent intended that the residuary pass to Charitable Trust, including previous wills of the Decedent that had identified Charitable Trust as the residuary beneficiary. Decedent also had a history of making a large number of lifetime charitable transfers.

After several months of negotiations, Son and Charitable Trust settled the dispute and executed a settlement agreement. The settlement agreement provided that Son would receive \$c outright and free and clear of all expenses and taxes. The amount remaining after the \$c payment to Son and after payment of expenses and taxes (including taxes on the \$c distribution to Son) totaling \$d and was paid to Charitable Trust. The settlement agreement was approved by the local state court, without an evidentiary hearing.

The IRS National Office, in its analysis of whether the estate could deduct the \$d distribution paid to Charitable Trust, looked first to authorities under the marital deduction rules. Treasury regulations addressing the federal estate tax marital deduction provide that:

“[I]f as a result of the controversy involving the decedent's will, or involving any bequest or devise thereunder, a property interest is assigned or surrendered to the surviving spouse, the interest so acquired will be regarded as having passed from the decedent to the surviving spouse only if the assignment or surrender was a bona fide recognition of enforceable rights of the surviving spouse in the decedent's estate. If the assignment or surrender was pursuant to an agreement not to contest the will, it will not necessarily be accepted as a bona fide evaluation of the rights of the spouse.”

In *Ahmanson Foundation v. United States*, 674 F.2d 761 (9th Cir. 1981), the court considered whether a marital deduction was allowable for property distributed to the decedent's spouse pursuant to a settlement agreement. Relying on *Commissioner v. Estate of Bosch*, 387 U.S. 456 (1967), the court concluded that a good faith settlement must be based upon an enforceable right under state law properly interpreted in order to qualify the property distribution as “passing” from the decedent for purposes of the federal estate tax marital deduction. See also PLRs 200032043 and 200032010, discussed in our Bulletin No. 00-100.

In summary, the National Office stated, “[t]he parties to a settlement are only entitled to federal estate tax deductions to the extent that they have an enforceable right under properly applied state law.” It determined that this was not the case in TAM 201004022.

The estate had argued that State law does not favor property passing by intestacy if there is a will. It also argued that, because the will in this case lacks a residuary clause, a court could not ascertain with certainty Decedent's intent from the four corners of the will, and therefore would be required to consider other evidence of intent, including the attorney's affidavit, Decedent's prior will, and the *in terrorem* clause, which designates Charitable Trust as the taker in the event that the clause becomes operative.

The IRS, however, disagreed with the estate interpretation of State law. “Under [State] case law, although, it is presumed that a testator who has executed a will intended to dispose of his entire estate and avoid intestacy, ‘[s]uch presumption, however, is met by an equally potent presumption that an heir is not to be disinherited except by plain words or necessary implication.’” The IRS also noted that, in several cases, the courts have declined to supply a missing residuary beneficiary simply to avoid a partial intestacy.

“In this case, the extrinsic evidence indicates that the residuary clause was erroneously omitted from the Decedent's will. However, the omission of the residuary clause does not create an ambiguity. Rather, the will is silent regarding the disposition of the residuary estate and under State law, in the absence of the residuary bequest, the residue passes by intestacy. No language in the will conflicts with the distribution of the residue under the [State] intestacy statute. \* \* \* Further, there is no evidence in the will that Decedent intended that the residuary pass to the Charitable Trust. The will

does provide for the distribution of certain trust remainders to Charitable Trust, and the Charitable Trust is the taker in the event the *in terrorem* clause becomes operative. However, we can not conclude that these provisions addressing bequests other than the residue, ‘expressly or by clear implication discloses the intention of the testator that the courts may carry it out.’”

Accordingly, the Revenue Service concluded, Decedent's estate is not entitled to a federal estate tax charitable deduction for the settlement proceeds paid to Charitable Trust.

Any AALU member who wishes to obtain a copy of any of the items discussed in this Washington Report may do so through the following means: (1) use hyperlink above next to “Major References,” (2) log onto the AALU website at [www.aalu.org](http://www.aalu.org) and enter the *Member Portal* and select *Current Washington Report* for linkage to source material or (3) email Anthony Raglani at [raglani@aalu.org](mailto:raglani@aalu.org) and include a reference to this *Washington Report*.

In order to comply with requirements imposed by the IRS which may apply to the *Washington Report* as distributed or as re-circulated by our members, please be advised of the following:

**THE ABOVE ADVICE WAS NOT INTENDED OR WRITTEN TO BE USED, AND IT CANNOT BE USED, BY YOU FOR THE PURPOSES OF AVOIDING ANY PENALTY THAT MAY BE IMPOSED BY THE INTERNAL REVENUE SERVICE.**

In the event that this *Washington Report* is also considered to be a “marketed opinion” within the meaning of the IRS guidance, then, as required by the IRS, please be further advised of the following:

**THE ABOVE ADVICE WAS NOT WRITTEN TO SUPPORT THE PROMOTIONS OR MARKETING OF THE TRANSACTIONS OR MATTERS ADDRESSED BY THE WRITTEN ADVICE, AND, BASED ON THE PARTICULAR CIRCUMSTANCES, YOU SHOULD SEEK ADVICE FROM AN INDEPENDENT TAX ADVISOR.**



---

*The mission of AALU is to promote, preserve and protect advanced life insurance planning for the benefit of our members, their clients, the industry and the general public.*

For more information about how AALU’s advocacy efforts help protect your business and the advanced life insurance marketplace, visit our website at [www.aalu.org](http://www.aalu.org), or call toll free 1-(888)-275-0092.