Estate of Jorgensen, T.C. Memo. 2009-66

Section 2036 Applied to Creation of FLPs; Equitable Recoupment Allowed to Adjust for Prior Income Tax Overpayments in Light of Increase in Basis Attributable to Increased Gross Estate Value

April 2009

Steve R. Akers
Bessemer Trust
300 Crescent Court, Suite 800
Dallas, Texas 75201
214-981-9407
akers@bessemer.com

Synopsis:

The Internal Revenue Service won another §2036 marketable securities FLP case. Some of the facts were not terrible — the decedent retained assets for her day-to-day living expenses. However, other facts were pretty bad — (1) there was no evidence of why one FLP was created but contemporaneous attorney correspondence referred only to estate tax savings as the reason for creating the second (and much larger) FLP, (2) the decedent had control of the FLPs' checkbooks even though she was not the general partner, and (3) she in fact wrote checks out of the partnership accounts for personal purposes (including for making annual exclusion cash gifts). Particularly notable aspects of the §2036 analysis include:

- This is yet another case where the court pointed to post-death payments of estate taxes as reflecting an implied agreement of retained enjoyment of partnership assets to trigger §2036;
- In rejecting the "bona fide" transfer defense, the court found "especially significant that the transactions were not at arm's length and that the partnerships held a largely untraded portfolio of marketable securities;" and
- In dictum, the court observed that §2036 applied even as to assets attributable to partnership interests that the decedent gave to her children and grandchildren more than three years prior to her death, reasoning that the decedent "retained the use, benefit, and enjoyment of the assets she transferred to the partnerships."

In addition, under the equitable recoupment doctrine, the Tax Court allowed an offset in the estate tax liability for the "overpayment" of income taxes, where a refund of the income tax was barred by limitations and where the prior income tax payments did not reflect the increased bases as a result of the increased value included in the decedent's estate under §2036.

The case is appealable to the Ninth Circuit Court of Appeals.

Basic Facts:

1. In mid 1995, Mr. and Mrs. Jorgensen ("H and W") contributed about $450,000 (equally from each) of their $2 million portfolio of marketable securities to an FLP (JMA-I). H and the son and daughter of H and W were general partners, but H made all decisions regarding the formation and operation of the FLP. (There was no testimony as to why JMA-I was created; W's estate later argued "that tax savings could not have been the primary factor in forming the partnerships because discounts were not used in valuing Colonel and Ms. Jorgenson's gifts of partnership interests in 1995 through 1998." However, the court noted that discounts were claimed in H's estate after his death.)
2. H died in late 1996. JMA-I was valued with a 35% discount, and H's bypass trust was funded with an interest in the partnership.
3. In late January 1997, while administering H's estate, the estate planning attorney recommended in a letter that W transfer her brokerage accounts to JMA-I, to qualify for the valuation discount and to facilitate making annual gifts, saying "[t]his is important if you wish to reduce the amount of your own estate, which will be subject to estate taxes." The attorney wrote another letter to W the following day, again recommending that she transfer the brokerage accounts of her and H's estate to JMA-I to qualify for the 35% discount, which would result in estate tax savings of $338,487.50, concluding that "there can be no discount if the securities owned by you continue to be held directly by you."

4. The attorney subsequently had discussions with the son, the daughter and her husband (but not W), and the decision was made to form a new FLP (JMA-II). A letter from the attorney to W in May 1997, said that the purpose of creating a new partnership was to have the new partnership own high basis assets, while JMA-I would hold low basis assets, and W could make future gifts from JMA-II (which would hold high basis assets).

5. JMA-II was formed in July 1997. W contributed about $2.1 million of her marketable securities (including assets bequeathed to her from H's estate), and about $500,000 of marketable securities from H's estate. W received about an 80%, and H's estate held about a 20% interest in the new partnership. The two children were general partners. The children and grandchildren (and the son-in-law) were listed as limited partners in the partnership agreement, but they did not contribute anything.

6. In 1995, 1996, and 1998, W gave about 30.6% of JMA-I to her children and grandchildren collectively. In 1997 and 1998, she gave about 6.0% of JMA-II to her children and grandchildren. (Footnote 4). [Observe: These gifts ended up being made more than three years prior to W's subsequent death; she also made gifts in 1999, but the facts stated in the opinion do not indicate whether the 1999 gifts were more than three years prior to her death.]

7. In 1999-2002, W gave 34.75% of JMA-II to her children and grandchildren collectively. (Discounts of 50% and 42% were applied in valuing some of the gifts. Gift tax returns were filed for 1999 and later years, but not earlier years.).

8. In 1998, W consulted with a different estate planning attorney about making gifts to utilize her lifetime gift exemption. In October 1998, the attorney sent W a letter observing the possibility of an audit of such a large gift "because JMA-II held only passive investments." The letter went on to state that W "had several nontax reasons for creating JMA-II, including: The ability to transfer assets without disrupting the recipient's initiative, cost savings from the pooling of assets, simplification of gift-giving, protection against creditors, protection in the case of divorce, and the education of younger family members." The court gave little weight to this letter, observing that it "was written well after the formation and funding of the partnerships by an attorney preparing for potential litigation with respect to the gift." In a footnote, the court observed that the Tax Court has previously recognized "that taxpayers often disguise tax-avoidance motives with a rote recitation of nontax purposes" (citing Hurford and Bongard).

9. Even though W was not a general partner, she was authorized to write checks on the partnership accounts. In October 1998, she wrote checks on JMA-I of over $30,000, primarily for making cash gifts. In late January 1999, W wrote a $48,500 check to her daughter from JMA-I to equalize a gift she had previously made to her son (she did not have enough cash in her personal account to make the cash gift to her daughter). (In April 1999, W deposited $30,000 plus $48,500 in the JMA-II account to "repay" the amounts she had withdrawn from JMA-I to make cash gifts, without explaining why the deposit was made to the "wrong" partnership account; there was no "indication that the error was corrected.")

10. In July 1999, the son borrowed $125,000 from JMA-II to buy a home. He did not make any payments on the loan for several years, and then just made several interest payments.

11. W also paid her 1998 estimated quarterly income tax payments of about $9000 from JMA-I. She paid about $6500 of H's estate administration expenses from JMA-II, but she later repaid that amount. W also paid H's estate income tax and various administration expenses and expenses regarding her gift tax returns, and some of her attorney's expenses from JMA-II (and those amounts were not repaid).

12. W died on April 25, 2002.

13. At the attorney's recommendation, the son repaid his $125,000 loan from JMA-II in January 2003. Also in January 2003, JMA-II paid $211,000 for W's federal and California estate tax liabilities.

14. In 2003-2006, the partnerships sold various assets that W had contributed to them. To compute the gain, the partnerships used W's "original cost basis in the assets, as opposed to a step-up in basis equal to the fair market value of the assets on Ms. Jorgensen's date of death under section 1014(a)." The partners reported the gain and paid the related income taxes. In 2008, the partners filed protective claims for refund of the income taxes, but the refund claim for the 2003 income tax payment was not timely.

Holdings

1. Section 2036(a)(1) Applied. All of the assets in JMA-I and JMA-II attributable to W's original ownership interests were included in her estate. The bona fide sale exception did not apply, and the court found an implied agreement of retained enjoyment in the partnership assets, even as to assets attributable to gifts of limited partnership interests made more than three years prior to her death (in dictum, reasoning that she retained enjoyment of all assets she had transferred to the partnerships).

2. Section 2038. The government also argued that §2038 applied. The court did not summarize the government's argument and refused to address the §2038 issue in light of the fact that the assets were included in the estate under §2036(a)(1).

3. Equitable Recoupment. An offset in the amount of additional estate tax due was allowed for the "overpayment" of income taxes, where the prior income tax payments did not reflect the increased basis as a result of the increased value included in the decedent's estate under §2036.

Court's Analysis

1. Burden of Proof. The court did not decide whether the burden of proof shifted to the government, because its resolution was based on a preponderance of the evidence rather than on whether either party met its burden of proof.

2. Section 2036 Overview. Section 2036 requires three elements: (1) an inter vivos transfer, (2) that was not a bona fide sale for full consideration, and (3) in which the decedent retained an interest or right described in §2036(a)(1) or (2) or (b). The transfer requirement is satisfied by W's voluntary contributions to the partnerships. The balance of the §2036 analysis addressed the last two elements.

3. Bona Fide Sale Exception Not Applicable.

    a. Purported Nontax Reasons Not Recognized. The court did not view any of the nontax reasons stated in the after-the-fact letter by the estate planning attorney as being "legitimate and significant nontax reasons." (The letter is quoted in Item 8 of the Basic Facts section of this summary.)

        - Management Succession. Prior cases (Kimbell and Mirowski) that recognized efficient management as a nontax reason involved assets requiring active management, unlike this portfolio of marketable securities in which there was very little trading after H's death. Also, the FLPs were not needed to manage assets for W's benefit because her revocable trust and power of attorney could have been used to provide management of her assets.

- Financial Education of Family and Promoting Family Unity. H made all decisions during his lifetime and did not teach his children about investing. The failure to involve his children suggests that promoting family unity was not "anything more than a theoretical purpose." In fact, the partnerships could cause family disunity between the son and daughter because of their different spending habits (the son was a spendthrift and the daughter was frugal).
- Perpetuate Investment Philosophy and Motivate Participation. The Schutt case, which recognized implementing a "buy and hold" investment philosophy as a legitimate nontax reason, was distinguished because that case (involving the duPont family) addressed retaining "stock traditionally held by the family" including stock held in trust after those trusts terminated. (Footnote 10). The "motivating participation" reason is unconvincing because H did not include the children in decisions and limited partners are precluded from participating in decision-making.
- Pooling of Assets. As to pooling for W's benefit: W had no involvement in managing the assets or in the decision to transfer assets to JMA-I, so pooling was not a significant purpose of JMA-I. There is no credible evidence that W wished to pool her assets in JMA-II.

  As to pooling for the benefit of children and grandchildren: There is little evidence that economies of scale or better service followed from pooling of assets. The children and grandchildren would have received the same attention from the investment advisor by just linking their accounts.
- Creditor Protection. Taxpayers asserted spendthrift concerns, particularly about possible divorces, unwise spending by minors, and the son's free spending habits. However, the son was the general partner and he accessed partnership assets by a loan. Like other prior cases that have rejected the creditor protection reason, the court emphasized that there were not any particular creditor problems, and this was just a theoretical concern.
- Providing for Children Equally and Facilitating Gift-Giving. Facilitating and simplifying gift-giving is not recognized as a significant and legitimate nontax reason (citing Bongard and Bigelow).

b. Factors Indicating Not Bona Fide. The court emphasized several reasons suggesting that the primary purpose of the partnerships was saving taxes.

- Contemporaneous Advice Referred to Tax Savings. Advice given at the time the partnerships were formed all pointed to tax savings is the reason. A letter offering purported nontax reasons over a year later was given little weight.
- Disregard of Partnership Formalities. No books and records were maintained. There were no formal meetings of partners and minutes were never kept. W and her children often failed to respect the partnerships, paying personal expenses and mingling personal funds with partnership funds. Financial dependence on the partnership for making cash gifts and various non-pro rata distributions are further evidence of the disregard of formalities.
- No Arms Length Transfers. "When a taxpayer stands on both sides of a transaction, we have concluded that there is no arm's length bargaining and thus the bona fide transfer exception does not apply." (Citing the Strangi and Harper Tax Court cases.)

JMA-I: H made all decisions regarding JMA-I, so transfers of assets to it were not made at arm's length.

JMA-II: W funded JMA-II through her revocable trust and as executrix of H's estate, and the decision was made largely by her children. "Considering that Ms. Jorgensen stood on both sides of the transaction, although in different roles, we conclude that the transfer of assets to JMA-I was not at arm's length."

- Conclusion. "We find *especially significant* that the transactions were not at arm's length and that the partnerships held a largely untraded portfolio of marketable securities." (emphasis added) [Observation: This is the first court case that applies this much importance to the "arm's length" factor.]

c. Full Consideration Conceded. The government did not repeat its argument from prior cases that there was not full consideration when the decedent received a limited partnership interest worth less than the value of assets that she contributed. [Observe: The government apparently is now conceding this issue (at least in Tax Court cases), and the court restated the proportionality test of Kimbell and Bongard.]

4. Section 2036(a)(1) Implied Agreement of Retained Enjoyment.

a. Decedent Retained Assets for Living Expenses. The court acknowledged that W "retained sufficient assets outside the partnership for her day-to-day expenses."

b. Partnership Assets for Personal Expenses (Primarily to Make Gifts). W wrote various checks on the partnerships for her personal expenses and for expenses of H's estate administration. The court pointed primarily to her need for cash from partnerships to make cash gifts. (The court did not specifically mention payments of the partners' income taxes in this portion of the opinion.)

c. Post-Death Payments from Partnership. The court highlighted post-death distributions of $179,000 and $32,000 used to pay transfer taxes, legal fees, and other estate obligations. "The use of a significant portion of partnership assets to discharge obligations of a taxpayer's estate is evidence of a retained interest in the assets transferred to the partnership" (citing the Rosen, Korby, and Thompson Tax Court cases and the Strangi Fifth Circuit Court of Appeals case). [Observe: For some reason, the court did not cite the Erickson case, which seems to point almost exclusively to post-death payments as creating the implied agreement of retained enjoyment under §2036(a)(1).]

d. Substantial Amount Distributed in Non Pro Rata Distributions. The "actual use of a substantial amount of partnership assets" to pay pre-death and post-death obligations supports the finding of an implied agreement of retained enjoyment. Furthermore, even charging such distributions against the decedent's share of the partnership would not have helped: "This is true regardless of whether the distributions were charged against her percentage interest in the partnerships, and especially relevant considering that under the terms of the partnership agreements all distributions were to be pro rata."

e. Fiduciary Duties to Decedent Further Evidence of Implied Agreement. The son and daughter were general partners of the partnerships and were also co-trustees of W's revocable trust. As co-trustees, they had the duty to administer the trust solely for W's benefit, and their investment of trust assets in the FLPs in light of this fiduciary duty to W is further evidence of an implied agreement of retained enjoyment by W of assets contributed to the FLPs.

5. Section 2036 Applied Even As to Assets Attributable to Partnership Interests Given More Than Three Years Prior to Death. In objecting to one of the government's proposed finding of facts, the estate stated that if §2036 applied, it should only apply to assets that W held on the date of her death plus transfers made within three years. The court concluded (in footnote 13) that the estate waived or abandoned any claim that assets attributable to gifts of partnership interests made more than three years prior to her death should not be included under §2036 by failing to argue the issue beyond a vague assertion within an objection to a proposed finding of fact. In dictum, the court stated that even if the issue had not been waived, "we would not find that Ms. Jorgensen terminated a portion of her interest in the partnership assets. The record indicates that Ms. Jorgenson retained the use, benefit, and enjoyment of the assets she transferred to the partnerships." [Observe: The court reached that conclusion even though the decedent apparently never made payments from the partnership that exceeded her pro rata value of partnership assets. From a planner's perspective, this dictum may be the scariest aspect of this case, suggesting that assets attributable to partnership interests transferred long before the decedent's death could be brought back into the estate under §2036(a)(1) by finding an implied agreement of being able to access all partnership assets, even those attributable to interests that had been sold or given to other individuals.]

6. Equitable Recoupment. An amendment in 2006 to §6214(b) allows the Tax Court to apply the doctrine of equitable recoupment. The court analyzed the four elements of the equitable recoupment doctrine: "(1) The overpayment or deficiency for which recoupment is sought by way of offset is barred by an expired period of limitation; (2) the time-barred overpayment or deficiency arose out of the same transaction, item, or taxable event as the overpayment or deficiency before the Court; (3) the transaction, item, or taxable event has been inconsistently subjected to two taxes; and (4) if the transaction, item, or taxable event involves two or more taxpayers, there is sufficient identity of interest between the taxpayers subject to the two taxes that the taxpayers should be treated as one."

   a. Overpayment Barred by the Statute of Limitations. A refund of the income taxes for 2003 was barred by the statute of limitations, so the doctrine can apply with respect to the overpayment of income taxes in 2003.

   b. Overpayment Arose Out of A Single Transaction. This requirement was met because the same item that was included in the gross estate was the item that was sold and generated the gain that produced the income tax overpayment.

   c. Subject to Two Taxes Inconsistently. The court reasoned that the increased basis as a result of including additional value in the decedent's gross estate should result in decreased gain recognition. [Observe: The taxpayer may have been fortunate as to this element. The opinion indicated that the amount of the taxable gain in 2003 was computed based upon W's original basis rather than on a stepped-up basis under §1014. Based on the reporting position taken (i.e., not computing gain based on a stepped up basis under §1014), the amount of the 2003 income tax arguably is not inconsistent with an increase in the gross estate value. Furthermore, the facts do not make clear whether a §754 election was in effect for the partnerships; if not, there would not have been an increase in the "inside basis" of the partnership assets by reason of the death of a partner.]

   d. Sufficient Identity of Interest. The court reasoned that it does not matter that the grandchildren, who also paid some of the increased income tax, are not liable for the estate tax attributable to inclusion of additional value under §2036. "[T]he relevant caselaw does not indicate that the taxpayer who overpaid tax must be the one responsible for the related deficiency for equitable recruitment to apply."

e. Conclusion. "It would be inequitable for the assets to be included in the value of Ms. Jorgensen's gross estate under section 2036 on the one hand, and on the other hand for the estate not to recoup the income taxes her children and grandchildren overpaid on their sale of those very same assets but are unable to recover in a refund suit." The court allowed the recoupment of the overpayment of 2003 income taxes attributable to additional basis step-up allowed under §1014 because of the §2036 inclusion of partnership assets in the gross estate.

Observations

1. Cannot Avoid §2036 By Merely Retaining Assets for Living Expenses. Planners should not fall into the trap of thinking that by merely having a client retain sufficient assets for living expenses that §2036 (a) (1) can necessarily be avoided.

2. Non Pro Rata Distributions to Pay Decedent's Personal Expenses. The key item evidencing an implied agreement of retained enjoyment in this situation was the actual payment of personal expenses of the decedent (primarily to make cash gifts and also to pay post-death expenses) in a non-pro rata manner.

3. Post-Death Payments of Estate Taxes and Administration Expenses. The court pointed very explicitly to the payment of estate taxes and other administration expenses as evidencing an implied agreement of retained enjoyment. It would seem that the use of partnership assets after death is irrelevant as to the retained right to enjoy assets under §2036 "for life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death." However, there is a growing number of cases that have now looked at post-death partnership payments to trigger §2036(a)(1). The court quoted the Fifth Circuit's statement that "part of the 'possession or enjoyment' of one's assets is the assurance that they will be available to pay various debts and expenses upon one's death." Strangi, 417 F.3d at 477.

   Interestingly, the court did not cite the Erickson case, in which the only distributions from the partnership for the benefit of the decedent were the post-death payment of taxes. T.C. Memo. 2007-107. In Erickson, the court emphasized particularly that the partnership provided funds for payment of the estate tax liabilities. (The only liabilities mentioned in the case were gift and estate tax liabilities.) The court viewed that as tantamount to making funds available to the decedent. Although the disbursement was implemented as a purchase of assets from the estate and as a redemption, "the estate received disbursements at a time that no other partners did. These disbursements provide strong support that Mrs. Ericsson (or the estate) could use the assets if needed."

   What if there are non-liquid assets in the estate and insufficient liquid assets for paying all post-death expenses? John Porter's recommendations (from presentations at various seminars):

   (a) It is best is to borrow from a third party, but a bank may be unwilling to do that using only the partnership interest as collateral.

   (b) Borrow from an insurance trust or a family entity, secured by the partnership interest.

   (c) There are three options for utilizing partnership funds: redemption, distribution or loan. Erickson involved a purchase of assets and redemption but the court still held against the taxpayer. Pro rata distributions are a possibility, but if they are made on an "as needed basis" that plays into IRS's hands on the §2036 issue; the estate can argue that distribution for taxes are made all the time from partnerships, but usually income taxes. If the partnership assets must be used directly to pay taxes, John prefers borrowing from the partnership on a bona fide loan, using the partnership interest as collateral. It is best to use a commercial rate rather than the AFR rate (that looks better to the government as an arm's length transaction). Also, consider using a Graegin loan — with a fixed term and a prohibition on prepayment. The IRS is looking at Graegin loans in FLP audits, but John has used them successfully in a number of cases.

[Some attorneys suggest that the preferred approach is to have other family members or family entities purchase some of the decedent's partnership interest to generate cash flow to the estate for paying post-death expenses. The partnership assets would not be utilized at all under that scenario.]

4. Actual Operation of Partnership Critical in Reviewing Nontax Reasons. Despite the fact that the nontax reasons for creating the partnership was described in a letter written more than a year after the partnerships were created, the court focused primarily on the fact that the actual operation of the partnerships was not consistent with the purported nontax reasons.

5. Partnership Interests Transferred More Than Three Years Before Decedent's Death. If an individual relinquishes within three years of death an interest or power that would cause estate inclusion under the "string" statutes, the assets are still included in the gross estate under §2035. Conversely, if an interest or power that causes estate inclusion under the string statutes is relinquished more than three years before death, §2035 does not apply. It is understandable that if a decedent retains control over partnership assets that causes estate inclusion under §2036(a)(2) or 2038, the three-year rule should not come into play, because the decedent still actually has that degree of control at his or her death. However, it would seem that the answer would be different if §2036(a)(1) is being considered, because it depends on retained enjoyment of assets, and under state law a partner is not entitled to assets attributable to partnership interests that the decedent does not own. In fact, distributions of partnership assets that cannot be attributed to the decedent's interest in the partnership would be theft or an illegal diversion of property from the rightful owners. Nevertheless, a troublesome number of courts have now concluded that a decedent retained personal enjoyment of all partnership assets, even those attributable to interests that were transferred more than three years prior to the decedent's death. The court's analysis of this issue in Jorgensen is dictum; nevertheless, the court makes clear that it would have found that the decedent retained enjoyment of all partnership assets attributable to her original contributions, even though there were apparently never any distributions for the decedent's benefit in excess of her pro rata value of the partnership assets.

   Other examples where the decedent was found to have retained personal enjoyment of the FLP assets even after limited partnership interests had been given away were the Estate of Korby and Estate of Rosen cases, Even though the gifts in the Korby cases may have been made more than three years before death, that apparently was irrelevant because the court found the existence of an implied agreement to retain enjoyment of all of the income of the partnership even after the limited partnership interests had been given away. 471 F.3d 848 (8th Cir. 2006). Similarly, the Rosen case held that all partnership assets were included even though the decedent had given away substantial partnership interests more than three years before her death. She was the only partner to receive cash flow from the partnership, and the court concluded very simply that §2035 was not relevant because "Decedent continued to possess and enjoy the transferred assts up until her death." T.C. Memo. 2006-115. See also Estate of Bigelow (all FLP assets included under

§2036 even though decedent made gifts of over 50% of the limited partnership interests by the time of his death).

The obvious planning implication is that following gifts of partnership interests, only proportionate distributions should be made, and nothing should be done to create any implication that the decedent will receive any distributions of partnership assets attributable to previously transferred partnership interests. Furthermore, in light of the inherent §2036(a)(1) uncertainty that can arise by mere implied agreement based on the court's interpretation of the facts, planners may want to consider advising clients who have successfully transferred substantial interests in an FLP to terminate the FLP to remove any possible taint of retained enjoyment of partnership assets that are attributable to transferred partnership interests. If the court would find the existence of a retained enjoyment in all partnership assets, the client would have to live three years after the partnership termination to avoid §2035, but at least the three period could begin running to close the books on the possible application of §2036 to the prior successful transfers. (Of course, the termination of the partnership would be inconsistent with the nontax purposes of the partnership; a reasonable reply would seem to be that the family hates giving up the nontax benefits of the FLP, but it is forced to do so because of the possible tax disadvantages of continuing the FLP.)

6. Practical Planning Pointers From Jorgensen.

a. Documentation of Nontax Purposes. Correspondence or advice given contemporaneously with the creation of the partnership should refer to the nontax reasons for the partnership. Saving estate taxes should not be the overriding primary purpose for creating the partnership in order to avoid §2036. In Jorgensen, tax savings (and facilitating gift-giving to save taxes) were apparently the only reasons discussed when the partnerships were created. Under the statutory language of §2036, having nontax reasons should be unimportant if the decedent does not retain interests or powers that would trigger §2036(a)(1) or (2). However, so far, every court that has concluded that there were no legitimate nontax reasons has also managed to find some interest or power that would trigger §2036(a)(1)(or (a)(2).

Furthermore, as discussed in Item 4 above of these "Observations," the court will scrutinize whether the partnership is actually operated in a way that implements those nontax reasons.

b. Avoid Non Pro Rata Distributions for Paying Personal Expenses. The court concluded that that an implied agreement of retained enjoyment existed in large part because of the actual non pro rata payments from the partnerships for the decedent's personal uses. If possible, avoid making any distributions to avoid assisting the government in making an implied agreement of retained enjoyment argument. At the least, only make pro rata distributions, and make the distribution decisions based on factors relating to the partnership assets and not based on the personal needs of the partners.

c. Keeping Sufficient Assets to Pay Living Expenses Is Not a Safe Harbor Around §2036(a)(1). Do not assume that §2036(a)(1) can be ignored just because the client retains sufficient assets to pay his or her normal living expenses.

d. Control of Partnership Checkbook. It looked extremely suspicious in Jorgensen that the decedent retained the enjoyment of partnership assets when she could (*and did*) write checks on the partnership account even though she was not a general partner.

e. Involve Others in Negotiations. In light of the court's emphasis on the importance of arm's length transactions (more than any other court so far), planners may want to place more emphasis on having meaningful negotiations when partnerships are created. Consider having some third party partners at the outset who can enter into negotiations. If there are not other family members as partners from the outset, include family members who may receive interests in the future (by gift, sale, investment in the partnership, or bequest) in the negotiations. The parent may wish to pay for an attorney to represent the other partners to facilitate actual bargaining and negotiation. It would seem to be particularly helpful if meaningful revisions were made to the partnership structure or partnership investments in light of the negotiations.

f. Investment Changes. The court, in its final statement of what particularly troubled the court, pointed to the lack of negotiations and the fact that the partnership consisted of a "largely untraded portfolio of marketable securities." After the creation of the partnership, it is helpful if there are changes in the investment mix. If possible, the partnership might even considering purchasing assets other than marketable securities with a portion of its assets.

g. Satisfying Qualified Purchaser and Accredited Investor Rules. A very real concern of many wealthy families is that the parents have sufficient wealth to qualify as "qualified purchasers" (which generally requires that individuals have $5 million of net "investments" — not including the home or assets that are not held for investment) and "accredited investors" and are able to invest in unregistered securities, but their children may not. Pooling of assets in this situation, to allow the flexibility of future investments in such opportunities if they arise, is an important nontax reason for pooling investments in a partnership. That reason apparently did not exist in the Jorgensen situation, but if it applies in another family situation, highlight that nontax reason. (Consistent with the prior statements, it would be helpful if that reason gets implemented under the actual operation of the partnership if the opportunity arises for the partnership to invest in such an investment requiring qualified purchasers or accredited investors.)

h. Investment by Fiduciary of Revocable Trust. The court pointed out that investment in an FLP by a revocable trust for the decedent, where she had the right to access trust assets at any time, was one indication of an implied agreement that the partnership assets could be used for the decedent's benefit. This factor was more sensitive under the Jorgensen facts where the co-trustees of the revocable trust were also the general partners of the FLP.

i. Insulate Spendthrift From Distribution Decisions. If part of the reason for creating an FLP is because of creditor concerns for a particular partner who is a spendthrift, do not name that person as a general partner with authority over distributions.

k. File Protective Claims for Refund If Gain Recognized Attributable to Hard-To-Value Assets in an Estate. The Jorgensen family could have avoided having to make the equitable recoupment argument (which it may have been fortunate to win) if it had just filed a timely protective claim for refund with respect to income taxes paid with respect to the sale of partnership assets. Whenever taxable gain is recognized from the sale of assets that might possibly be subject to scrutiny (either inclusion or valuation) in an estate tax audit, the persons who pay the income tax should file a protective claim for refund in case the estate tax audit results in an increased value, which would therefore result in an increased basis. (For a partnership, this issue should only arise for a sale of partnership assets if the partnership has a §754 election in effect at the death of the relevant partner, which would then result in an increase of the "inside basis" of the partnership in the partnership assets.)