

**T&E Alert March 1, 2012**

Estate of Joanne H. Stone v. Commissioner T.C. Memo. 2012-48 filed February 22, 2012

Mr. and Mrs. Stone owned 740 undeveloped acres of land in a rural Tennessee county where their family had been living for decades. In the early 1990's, one of the sons of the Decedent purchased land near his parents' holding, built a house and obtained approval to dam and develop the resulting lake-front property. After the dam was built, the family recognized that the property of the parents should continue to be controlled by the family, in part because the newly created lake made it difficult to construct sewer lines and litigation could be expected. Also, the family wanted to eventually reap the benefit of selling the property at its highest value. To further the family planning momentum, the Decedent and her spouse created the Stone Family Limited Partnership of Cumberland County ["SFLP."] Their attorney at the time advised that, as the couple wanted to gift real estate interests periodically to family members, a partnership structure would simplify the process by not requiring deeds for each gift; he also indicated that any future land partition effort would be made more difficult by the partnership structure. The partnership agreement placed restrictions on the partners' ability to transfer interests. SFLP was also allowed to buy any partner's interest upon death.

Mr. and Mrs. Stone, as general partners, provided the only management to SFLP, determining what parcels to buy or sell. The limited partners, however, had the right to remove a GP if limited partners owning 67% of the partnership agree. The land transferred to SFLP by the Stones was appraised at \$1.575 million; that appraisal was used as the basis for all subsequent transfers, and no discounts were used to effect the transfers, by the Stones, of LP interests to family members. In 1997, LP interests were gifted to some 21 children, children's spouses and grand children of the couple. After the gift, the 21 recipients held a combined 26.6% limited partnership interest. More gifts were made during the following 3 years and, at the end of 2000, the couple only held a 1% GP interest each, while their descendants and spouses held the remaining 98% balance through LP interests.

The 2000 gifts were for a smaller percentage of the partnership because all other limited interests had already been gifted, and because 2 prior recipients were then involved in divorce proceedings and did not receive any gift. In an effort to keep the development in the family, a deal was reached whereby the divorcing relatives would receive 4 acres of lakefront property in exchange for his/her LP interests.

When the Decedent died, the Service issued a notice of deficiency. At that time, the project had not advanced beyond a large parcel being considered for sub-division into lots. The Service claimed that IRC 2036[a] applied here. IRC 2036 applies if (1) the decedent made an inter vivos transfer of property, (2) the transfer was not a bona fide sale for adequate and full consideration and (3) the decedent retained an interest or right in the property which was not relinquished before death.

As established by Bongard in 2005, the Court looked for a non-tax reason for the creation of the LP. The Court determined that besides gifting, there was another, valid reason to form the LP, namely the creation of a vehicle designed to perpetuate the development of the land by Stone descendants and avoid partition suits. SFLP almost never had cash on hand, and thus had no bank account. Its minimal annual tax liabilities were paid by the Stones. Clearly the Stones never relied on SFLP income because there had been none. Gift transfers were effected by use of a bill of sale form designed for land sales, i.e. partnership formalities were not entirely respected. Accordingly, the Court decided that the funding transfer was a bona fide sale for adequate consideration, and that the other motive precluded application of IRC 2036.

The Court decision can be found at <http://www.ustaxcourt.gov> then click on Opinions Search and insert "Stone" under Case Name Keyword. The decision is the only one published in 2012. The decision is also available at <http://www.NYNJCT-BV.com/StoneEstate.TCM.WPD.pdf>. Please do not hesitate to call or e-mail to discuss this or any other business valuation issue.

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