

**RECENT SETTLEMENTS ON FAMILY LIMITED PARTNERSHIPS
AND OTHER INVESTMENT ENTITIES:
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INTRODUCTION

Family limited partnerships (FLPs) have become a popular medium for estate planning.

As with any closely held, private security, the Internal Revenue Service (IRS) requires the taxpayer to set forth the basis for the fair market value of any interests transferred and therefore potentially taxable for gift, estate, or generation-skipping tax purposes.

The IRS has expressed its skepticism of FLPs as nothing more than a “wrapper” for family assets. Thus, discounts for the relative lack of control and marketability of fractional limited partnership interests are often rejected by the IRS.

VALUATION ISSUES IN FLP CASES

The chief challenges seen for valuations of FLP interests transferred relate to the adequacy of the valuation report.

The appraiser may have to provide a supplement to the original valuation report in order to satisfy the new “adequate disclosure” rules under the proposed regulations arising from recent changes in the tax law in 1997–98.

For transfers after July 22, 1998, the burden of proof will shift to the IRS on factual issues such as valuation. This only occurs if the taxpayer first introduces credible evidence regarding the disputed factual issue.

AREAS OF IRS SENSITIVITY

- FLPs formed shortly before the death of a terminally ill senior generation member.
- FLPs formed where a senior generation partner is incompetent and a power of attorney is used to form the entity.
- FLPs that consist completely of cash and marketable securities.

Statements from IRS officials indicate that they clearly feel that the IRS has inadequate resources to fight every suspicious FLP transfer.

More recently the IRS appears to be willing to settle cases at combined discounts that approach 25 to 30 percent, providing that the facts and circumstances of the specific case are not abusive (see areas of sensitivity noted above).

FLP SETTLEMENT DATA

The following data was compiled by Curtis Kimball and members of Willamette from our own case files and from materials presented by others. Sources for more of this data are set forth in an appendix at the end of this outline.

Settlement data is interesting because it shows what the IRS and taxpayers have agreed to as fair market value in cases that are similar in nature to FLP valuation engagements in which one may be currently involved. Absent a comprehensive list of private transactions in non–publicly registered limited partnerships, these data may be helpful in providing the appraiser with some insight into the issues that create conflicts between the IRS and taxpayers. These cases, however, should not be treated as something akin to guideline transactions, but rather should be viewed in the same manner as court case decisions. Please remember that these settlements do not represent arm’s-length transactions. In fact, given the prospect of further litigation if a settlement is not reached, settlements are anything but arm’s-length!

1. SETTLEMENT

By: Willamette Management Associates

Date: 1993

Type: Estate, plus six prior gifts (1987–92)

Interest: FLP

State law: Georgia

Assets: Real estate and a closely-held business conducted on the real estate (bed and breakfast)

Other factors: The real estate was environmentally sensitive

Discount settlement: -75%

2. SETTLEMENT

By: Willamette Management Associates

Date: 1997

Type: Gift (1995)

Interest: FLP

State law: Alabama

Assets: Real estate (60%), municipal bonds, and a closely held business (real estate management company)

Other factors: Gift made under a power of attorney; IRS hired outside appraiser after this case was docketed for Tax Court

Discount settlement: -35.6%

3. SETTLEMENT

By: Willamette Management Associates
Date: 1996
Type: Gift (1995)
Interest: FLP
State law: Arizona
Assets: Real estate—shopping center interests
Other factors: Significant leverage
Discount settlement: -55%

4. SETTLEMENT

By: Attorney
Date: 1997
Type: Gift (1992)
Interest: FLP
State law: Nevada
Assets: Predominantly real estate (no debt) and some publicly traded securities
Other factors: 83-year-old donor
Discount settlement: -30%

5. SETTLEMENT

By: Attorney
Date: 1997
Type: Estate and gifts (1986–91)
Interest: General partnership (preferred interest)
State law: California
Assets: Real estate, promissory note, vehicles, and equipment
Other factors: Real estate management activities
Discount settlement: -35%

6. SETTLEMENT

By: Attorney
Date: 1998
Type: Gift
Interest: FLP
State law: Washington
Assets: Publicly traded stock
Other factors: Other problems with prior family gifts made attorney willing to settle quickly
Discount settlement: -35%

7. SETTLEMENT

By: Attorney
Date: 1997
Type: Gift
Interest: FLP
State law: Delaware
Assets: Publicly traded stock
Other factors: Client instructed attorney to avoid Tax Court at all costs
Discount settlement: -25%

8. SETTLEMENT

By: Attorney

Date: 1997

Type: Estate (1994)

Interest: FLP

State law: Texas

Assets: Publicly traded stocks and municipal bonds (93%) and real estate and oil and gas (7%)

Other factors: Settlement after taxpayer's attorney filed motion for partial summary judgment

Discount settlement: -56%

9. SETTLEMENT

By: Attorney

Date: 1997

Type: Estate (1993)

Interest: FLP

State law: Texas

Assets: Publicly traded stocks (39%), real estate (13%), cash (12%), municipal bonds (10%), other assets including mineral interests

Other factors: Settlement after taxpayer's attorney filed motion for partial summary judgment

Discount settlement: -55%

10. SETTLEMENT

By: Attorney

Date: 1998

Type: Gift (1992)

Interest: FLP

State law: California

Assets: Real estate (unimproved)

Other factors: Small size of FLP and gift made it uneconomic to litigate

Discount settlement: -15%

11. SETTLEMENT

By: Attorney

Date: 1998

Type: Gift (1992)

Interest: FLP

State law: California

Assets: Real estate (improved)

Other factors: None

Discount settlement: -33.33%

12. SETTLEMENT

By: Attorney

Date: 1998

Type: Gift (1993)

Interest: FLP

State law: California

Assets: Real estate

Other factors: None

Discount settlement: -40%

13. SETTLEMENT

By: Willamette Management Associates

Date: 1997

Type: Gift (1995)

Interest: FLP

State law: Georgia

Assets: Cash (to be invested in venture capital interests over a multi-year period)

Other factors: none

Discount settlement: -42%

14. SETTLEMENT

By: Attorney

Date: 1998

Type: Gift (1993)

Interest: FLP

State law: Texas

Assets: Cash (67%) and marketable securities (33%)

Other factors: No appraisal report filed initially, per decision of clients' CPA

Discount settlement: -15%

15. SETTLEMENT

By: Attorney

Date: 1998

Type: Gift (1992)

Interest: FLP

State law: Texas

Assets: Real estate

Other factors: None

Discount settlement: -40%

16. SETTLEMENT

By: Attorney

Date: 1998

Type: Gift (1992)

Interest: FLP

State law: Maryland

Assets: Real estate

Other factors: Senior generation donor died within two months after gift (no prior history of health problems)

Discount settlement: -41%

17. SETTLEMENT

By: Willamette Management Associates

Date: 1997

Type: Estate (1995)

Interest: S corporation stock (control block)

State law: Georgia

Assets: Publicly traded common stock (97%), real estate (3%)

Other factors: S election made just prior to date of death; substantial built-in gains on stock

Discount settlement: -30%

18. SETTLEMENT

By: Willamette Management Associates and Management Planning, Inc.

Date: 1998

Type: Gift (1994)

Interest: S corporation stock (minority)

State law: Pennsylvania

Assets: Municipal bonds (80%), publicly traded stocks (15%), real estate (5%)

Other factors: Review by IRS National Office

Discount settlement: -43%

19. SETTLEMENT

By: Attorney

Date: 1999

Type: Estate (1993)

Interest: General partnership

State law: Florida

Assets: Real estate (timberland)

Other factors: A 2032A special use valuation deduction was also allowed

Discount settlement: -30%

20. SETTLEMENT

By: Attorney

Date: 1999

Type: Estate (1994)

Interest: General partnership

State law: Oregon

Assets: Real estate (unimproved), cash, equipment

Other factors: Fractional interest in the real estate; partnership alleged to have dissolved upon death of partner; IRS faced trial date without having retained an expert witness on valuation

Discount settlement: -35%

21. SETTLEMENT

By: Houlihan Valuation Advisors

Date: 1999

Type: Gift (1995)

Interest: Limited partnership

State law: Rocky Mountain state

Assets: Municipal bonds, Real estate (ranch land)

Other factors: Municipal bonds represented most of the assets; an additional of the discount was allowed to account for call and bidding inconsistencies which made the value of the bonds less certain

Discount settlement: -36%

22. SETTLEMENT

By: Willamette Management Associates

Date: 2000

Type: Gift (1996)

Interest: Limited partnership

State law: North Carolina

Assets: One block of publicly traded stock (not large enough to require a blockage discount)

Other factors: Transferor was in a coma

Discount settlement: -33%

23. SETTLEMENT

By: Willamette Management Associates

Date: 2000

Type: Gift (1996)

Interest: Limited Partnership

State Law: North Carolina

Assets: One block of publicly traded stock (50%), undeveloped real estate (20%), money market and bond funds (30%)

Other Factors: donor terminally ill at transfer date, died just over one year later

Discount settlement: -35%

24. SETTLEMENT

By: Appraiser

Date: December 1995

Type: Gift (1998))

Interest: Limited Partnership

State Law: Texas

Assets: Municipal bonds and bond funds (85%), common stock, and undeveloped real estate

Other Factors: No independent appraisal made of the gift until it was audited; attorney "estimated" a discount for the original filing

Discount settlement: -39%

25. SETTLEMENT

By: Attorney

Date: December 1997

Type: Estate (2000)

Interest: Limited Partnership

State Law: South Carolina

Assets: Publicly traded stock and money market funds

Other Factors: Death occurred within one year of formation and transfer, but there was no evidence of illness at the time of formation and transfer

Discount settlement: -23%

26. SETTLEMENT

By: Attorney

Date: October 1995

Type: Estate (2000)

Interest: Limited Partnership

State Law: South Carolina

Assets: Publicly traded stocks (50%) and undeveloped real estate (50%)

Other Factors: Decedent was terminally ill at formation and died within 10 months

Discount settlement: -37.5%

27. SETTLEMENT

By: Attorney

Date: 1997

Type: Estate (1999)

Interest: Limited Partnership

State Law: California

Assets: Apartment buildings

Other Factors: None

Discount settlement: -39%

28. SETTLEMENT

By: Willamette Management Associates

Date: September 1995

Type: Gift (2000)

Interest: Limited Partnership

State Law: Georgia

Assets: Mutual funds of publicly traded stocks (86%) and undeveloped real estate (14%)

Other factors: No independent appraisal made of the gift until it was audited, at which time Willamette was retained; attorney "estimated" a discount for the original filing

Discount settlement: -40%

29. SETTLEMENT

By: Appraiser

Date: 1995

Type: Gift (settlement date: 2000)

Interest: Limited Partnership

State Law: Tennessee

Assets: The LP held a minority interest in a privately-held company's common stock.

Other Factors: It was important to the taxpayer to preserve the value of the privately-held company's stock and negotiate valuation issues only at the LP level. Taxpayer and IRS agreed to accept the valuation of the privately-held stock as submitted and reflect any adjustments in the finally-negotiated LP discount.

Discount settlement: -36%

30. SETTLEMENT

By: Willamette Management Associates

Date: January 2000

Type: Estate (settlement date: 2001)

Interest: Limited Liability Limited Partnership

State Law: Georgia

Assets: A diversified portfolio of publicly-traded common stock (63%) and fixed income securities (24%) managed by an independent professional management firm, plus some private placements, money market and stock mutual funds.

Other Factors: This represented the husband's remaining 37% LP interest in his estate.

Discount settlement: -38.4%

31. SETTLEMENT

By: Willamette Management Associates

Date: September 2000

Type: Estate (settlement date: 2001)

Interest: Limited Liability Limited Partnership

State Law: Georgia

Assets: A diversified portfolio of publicly-traded common stock (63%) and fixed income securities (24%) managed by an independent professional management firm, plus some private placements, money market and stock mutual funds.

Other Factors: This represented the wife's remaining 35% LP interest in her estate.

Discount settlement: -40.2%

32. SETTLEMENT

By: Willamette Management Associates

Date: 1995

Type: Estate (settlement date: 2001)

Interest: Limited Partnership

State Law: New York

Assets: Common stock (90%) and residential and undeveloped real estate (10%).

Other Factors: 99 percent LP interest of elderly owner (87 years old) who died shortly after formation. Original appraisal done by taxpayer's CPA (a 2 page report) deemed to be not credible. Post-date of death actions by heirs did not respect partnership structure. These factors, plus the small size of this partnership (less than \$2 million) made executor unwilling to litigate.

Discount settlement: No discount (0%)

33. SETTLEMENT

By: CPA

Date: 1998

Type: Gift (settlement date: 2001)

Interest: Limited Partnership

State Law: Maine

Assets: Commercial real estate rental property (100%).

Other Factors: Property had a mortgage of about 50% of appraised value.

Discount settlement: 32.5%

34. SETTLEMENT

By: CPA

Date: 1998

Type: Gift (settlement date: 2001)

Interest: Limited Partnership

State Law: Maine

Assets: Commercial real estate rental property (100%).

Other Factors: Property had a mortgage of about 60% of appraised value.

Discount settlement: 32.5%

35. SETTLEMENT

By: Appraiser

Date: 1998

Type: Gift (settlement date: 2002)

Interest: Limited Liability Company

State Law: Oregon

Assets: Publicly traded stocks and bonds (100%).

Other Factors: Small annual gift.

Discount settlement: 39.6%

36. SETTLEMENT

By: Attorney

Date: 1998

Type: Estate (settlement date: 2001)

Interest: Limited Partnership

State Law: Florida

Assets: Publicly traded stocks and bonds (100%).

Other Factors: Donor, although apparently healthy, died within six months after formation.

Discount settlement: 37%

37. SETTLEMENT

By: Willamette Management Associates

Date: 2002

Type: Gift (1996)

Interest: Limited Partnership

State Law: California

Assets: Majority stock interest in a large private business (98%), private real estate limited partnerships (2%).

Other Factors: Taxpayers originally relied on a restrictive agreement requiring a formula price for transfers at book value, and did not get an independent appraisal until the case was headed to Tax Court. Settlement negotiations completed just prior to trial date.

Discount settlement: 47%

LIMITED PARTNERSHIP/LLC SETTLEMENT DATA

If you wish to participate in broadening this database of FLP settlement discounts, please send me your experiences with settlements by clicking on the link and sending in the form. Please include as much key information as possible. I will try to keep this database current as additional information is received from ASA members and other practitioners, and post the data periodically on our Web site.

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