

Estate of Holliday: **'FLPing' the Script**

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In this article, Taite examines *Estate of Holliday*, in which the Tax Court held that the full value of property transferred to a family limited partnership was properly includable in the decedent's estate because the decedent had a retained right in the property and no significant nontax reasons for making the transfer.

*Estate of Holliday*¹ involved property transferred to a limited partnership, Oak Capital Partners LP. Sarah D. Holliday (decedent) was previously married to Joseph Holliday (Joseph), and they had accumulated substantial assets. At Joseph's death, his will directed that his assets be placed in three trusts for the benefit of decedent. When decedent moved into a nursing home, her son used a power of attorney to manage her property.

The certificate for Oak Capital was executed on November 30, 2006. Stated purposes for creating Oak Capital were to provide "a means for members of the Holliday family to acquire interests in the Partnership business and property, and to ensure that the Partnership's business and property is continued by and closely-held by members of the Holliday family."

On the same day, decedent executed the articles of organization of a limited liability company, OVL Capital Management LLC (OVL Capital), and OVL Capital's operating agreement.² The primary purpose for creating OVL Capital was to make it the general partner for Oak Capital. Oak Capital was funded with marketable securities from decedent's

account, and a portion of that contribution was made on behalf of OVL Capital. After the transfer, the gross value of Oak Capital's assets was approximately \$5.9 million.

In consideration for her transfer to Oak Capital, decedent received a 99.9 percent interest in Oak Capital, and OVL Capital received a 0.1 percent interest as a general partner. Later, on December 6, 2006, decedent assigned her interest in OVL Capital to Joseph and H. Douglas Holliday (H. Douglas) in exchange for \$2,959.84 from each. The aggregate price paid by Joseph and H. Douglas equaled the gross value of 0.1 percent of Oak Capital's assets on December 6, 2006, without a discount or other adjustment. Joseph and H. Douglas's purchase of decedent's interest in OVL Capital created the appearance that decedent had no control over the assets she transferred to Oak Capital.

After decedent transferred her interest in OVL Capital to Joseph and H. Douglas, she gave 10 percent of her limited partnership interest in Oak Capital to the 2006 Holliday Irrevocable Trust.³ After the transfer, decedent held an 89.9 percent limited partnership interest in Oak Capital. The partnership made one \$35,000 pro rata distribution to its partners.

Decedent died on January 7, 2009. The fair market value of her assets was \$4,064,759, and the estate reported a value of \$2,428,200, based on a 40 percent discounted value for the family limited partnership. The IRS issued a notice of deficiency for \$785,019 in estate taxes.

Under section 2036, the value of a gross estate includes property transferred by a decedent, in trust or otherwise, for which decedent has retained a right to possession or income unless the retained right was released or relinquished before death. An interest or right will be treated as a retained right if, at the time of the transfer, there was an understanding, express or implied, that decedent would have access to the property.⁴

In this case, the IRS argued that based on an implied agreement, decedent retained possession of the property transferred to Oak Capital and that she

¹*Estate of Holliday v. Commissioner*, T.C. Memo. 2016-51.

²Following OVL Capital's formation, decedent was the sole member.

³Decedent executed the 2006 Holliday Irrevocable Trust on November 30, 2006 — the same day that OVL Capital and Oak Capital were formed.

⁴Reg. section 20.2036-1(c)(1)(i).

retained the right to receive the income from it until her death. Section 5 of the limited partnership agreement provided, in relevant part, that cash distributions would be made to the partners “to the extent that the General Partner determines that the Partnership has sufficient funds in excess of its current operating needs.”

The burden is on the decedent’s estate to disprove the existence of any adverse implied agreement or understanding, and that burden is particularly onerous when intrafamily arrangements are involved.⁵ While the estate denied the existence of an agreement, based on the broad powers of the limited partnership agreement and her son’s testimony, the IRS argued that there was an implied agreement that decedent could access the assets if she wanted. The court agreed.

An exception to section 2036 is a transfer based on a bona fide sale for adequate consideration in money or money’s worth.⁶ In the case of an FLP, the estate must also show a legitimate and significant nontax reason for creating the FLP.⁷

The estate argued the following significant nontax reasons for the creation of Oak Capital: to protect the assets from “trial attorney extortion”; to protect the assets from the “undue influence of caregivers”; and to preserve the assets for the benefit of the decedent’s heirs. The IRS argued that the facts surrounding the creation of Oak Capital indicate that there were no significant nontax reasons for its creation and that the transfer was not an arm’s-length transaction.

The IRS contended that the claims of attorney extortion and risk of undue influence were invalid because decedent lived in a nursing home and had never been sued, and there was no evidence of undue influence by a caregiver. With the assistance of her adult children in managing her financial affairs, litigation risk was minimal.

Further, the IRS demonstrated that the decedent stood on both sides of the transaction. Decedent made the only capital contribution to Oak Capital and held, directly or indirectly, 100 percent of the partnership immediately after formation. There were no meaningful negotiations in the formation of the partnership, Oak Capital did not maintain

books, Oak Capital did not operate as a business, and no payments were ever made to OVL Capital.

Based on the facts and circumstances, the court found that decedent did not have a legitimate nontax reason for forming Oak Capital and that there was not a bona fide sale for adequate consideration in money or money’s worth. Because the court held that the decedent’s gross estate included the assets in Oak Capital, the property did not qualify for a discount attributable to the FLP.

Analysis and Conclusion

The IRS has been consistent in its war against entities created to avoid tax obligations. Within a few months of each other, the Tax Court decided two similar cases with opposite results. In *Estate of Purdue*,⁸ the court found that section 2036 did not apply to contributions made to the LLC in question. It found that there were nontax reasons for creating the LLC because the LLC followed its operating agreement.

In *Holliday*, the testimony of decedent’s son made it clear that decedent faced no risk of the assets being unavailable to her. Whether she needed the assets was not relevant; the question was whether she could have accessed the property if she had wanted. Thus, the retained right was not hard to find.

The asserted nontax reasons were equally damaging to the estate. The sham transaction was obvious in the lack of care the parties took in managing the FLP. Basic formalities such as maintaining books, keeping minutes of meetings, making required distributions, and making compensation payments to the general partner were not followed as required by the operating agreement.

Finally, if the transfer had been made for adequate and full consideration in money or money’s worth, section 2036 would not have been applicable. There were no real changes to decedent’s financial status before and after the transactions. That is tantamount to inviting the IRS to challenge the transactions.

While there is no guarantee that the IRS will respect any closely held business’s purpose, it is imperative for clients to respect the operating agreements and treat the transfers as real businesses. The more it looks and operates like a legitimate business, the better the chance that the transaction will be respected. ■

⁵*Estate of Maxwell v. Commissioner*, 3 F.3d 591 (2d Cir. 1993).

⁶Section 2036.

⁷*Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005).

⁸*Estate of Purdue v. Commissioner*, T.C. Memo. 2015-249.