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IRS Wins Family Limited Partnership Case

More taxpayers have turned to family limited partnerships (FLPs) as a vehicle to transfer assets to the next generation while retaining significant control of the assets during their lifetimes. A recent decision by the Tax Court, however, indicates the IRS may have a stronger argument against these arrangements in some cases, thereby eliminating some of their advantages.

FLPs in General

To take advantage of an FLP, a taxpayer typically transfers his or her assets to it and is named general partner. The taxpayer's children or other family members are granted limited partnership interests — as such, they share in profits but have no control of the management of the FLP's assets. The FLP generally provides savings in income, estate and gift taxes.

The IRS Court Victory

In *Strangi v. IRS*, TC Memo 2003-145 (May 20, 2003), the issue was whether Internal Revenue Code (IRC) Section 2036 applied, so that the assets a decedent had transferred to an FLP should be included in the gross value of his estate.

The FLP had been established two months before his death, with a transfer of almost \$10 million in cash and securities. Strangi received a 99% limited partnership interest and purchased a 1% general partnership interest through a corporation owned by him and his children. The IRS argued that Strangi retained a life estate in the assets he transferred, making the transfer a taxable gift under IRC 2036.

The Tax Court ruled that Section 2036 did apply, essentially because the FLP wasn't actually independent of the taxpayer — it seemed more like an estate plan than an investment. In particular, the court noted that the decedent retained an unfettered right to distribute income to himself; the transfers included 98% of his wealth, including his home, where he continued to reside; the FLP made numerous payments for his personal and the estate's expenses; and his relationship to the assets failed to change despite their transfer.

The Implications

Experts say Strangi could have some implications for the proper use of FLPs in the future. The court's decision may embolden the IRS to apply its arguments to more cases, making it more important than ever to take the correct steps in creating and maintaining an FLP.



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