



Estate of Strangi vs. Commissioner, Tax Court: Tax Transfer Valuations - What Counts?

Has the IRS succeeded in negating some attractive estate-planning tax breaks afforded family limited partnerships? The latest ruling — Strangi II — has caused great debate.

When Albert Strangi's attorney, son-in-law Mike Gulig, created a family limited partnership (FLP) on Albert's behalf in 1994, the goal almost certainly was to take advantage of the generous tax breaks afforded FLPs. Albert had been diagnosed with cancer, and it was of interest to his family to reduce the value of his estate.

Gulig transferred 99 percent of Strangi's assets — a total of \$9.8 million in cash and marketable securities, including his principal residence — into the FLP. In return, Albert received a 99 percent limited partnership interest. One percent of the FLP was given to a newly formed family corporation, in which Albert owned 46 percent of the stock and his family owned 53 percent.

When Albert died only months after the FLP was formed, his partnership claimed a discount of 33 percent off the full value of the assets in the FLP, citing lack of marketability and minority interest discounts — common in the valuation of FLPs. The value of the property held by the FLP when Albert died was \$11.1 million, but the stated value of his interest in the FLP and the associated corporation was just over 67 percent of that.

IRS Disallows Claim

Not so fast, said the IRS. The IRS rejected the estate's discount claims and asserted that the full value of the

assets, rather than the 67 percent value, would be subject to estate taxes. The reasons? Basically, the IRS said the FLP was a gift, not created for a business purpose, and was not run according to the respective interests of all interest holders. The IRS determined that the FLP simply “recycled” Albert’s assets back to him and, therefore, those assets should be included in the valuation of his estate.

Strangi 1: IRS 0

In 2000, in the case now known as “Strangi I,” the Tax Court rejected the IRS’s claims. Among other rulings, the court held that the FLP was not a gift. The court also rejected the IRS’s Section 2036(a) claim regarding Albert’s continued control over the assets because, the court claimed, the IRS hadn’t raised the issue in a timely manner. On appeal, the Fifth Circuit upheld most of the Tax Court rulings, but reversed and remanded the ruling on the timeliness of the IRS’s Section 2036(a) “arm’s-length” claim.

Strangi II: IRS Prevails

In a second ruling in 2003, known as “Strangi II,” the Tax Court ruled that the full value of the FLP assets should indeed be included in Albert’s estate because he retained the “beneficial enjoyment” of the partnership under Section 2036(a)(1). In fact, the court found that Albert had virtually unrestricted access to the FLP assets through his attorney/son-in-law, and the partnership paid nearly all of Albert’s expenses, from his healthcare bills to his funeral costs.

The court was also sensitive to the issue of Albert’s residence being part of the FLP, although he continued to occupy it and never paid the accrued rent. The fact that the FLP treated these expenses as an “advance” and made corresponding distributions to the family corporation was negated by Albert’s access to the assets in the FLP. The court stated that creation of the FLP did nothing to change Albert’s relationship to his assets — that the use of the assets in the FLP was dictated by his personal circumstances, not by the business direction of the FLP. Therefore, the court said, the value of his estate should include the assets of the FLP as well.

What Does It Mean?

For years, the IRS has tried to find ways to negate the attractive estate-planning tax breaks afforded family limited partnerships and force individuals to “play or pay”: Either play by the IRS’s “arm’s-length” rules and be cognizant of the fiduciary duties, rights and responsibilities of all interest holders, or pay the taxes due on the full value of the estate.

Strangi II is a monumental decision relative to a CPA’s transfer-tax valuation analysis, and has created a lot of debate in the offices of FLP attorneys and valuers nationwide. It underscores the importance of considering FLP business operational requirements and FLP value relative to the transferor of the assets. Moreover, the IRS’s ruling in Strangi II emphasizes the necessity of involving an independent business valuator early on when considering these issues.

If you’re interested in discussing the Strangi case and its potential impact on your situation, call our office. And stay tuned — the Strangi family may be considering an appeal.