Family Partnerships: Lessons From *Estate of Purdue*

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In this article, the authors analyze *Estate of Purdue* and similar pro-taxpayer family partnership cases since 1978 to learn which factors determine the success of the so-called exception defense to application of the section 2036(a) estate tax inclusion.

I. Introduction

Although *Estate of Purdue*[1] was decided more than seven years ago, it remains the most recent of over a dozen pro-taxpayer decisions since 1978 concerning family-owned entities classified as partnerships for income tax purposes (family partnerships). In *Estate of Purdue*, Tax Court Judge Joseph Robert Goeke held that the value of assets transferred to a family partnership was not includable in the gross estate under section 2036(a) because the transfer satisfied the statutory exception, italicized below. Section 2036(a) provides:

> The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (*except in case of a bona fide sale for an adequate and full consideration in money or money's worth*). [Emphasis added.]

The analysis and ultimate success of the exception defense in *Estate of Purdue* were governed by Goeke's majority opinion in *Estate of Bongard* a decade earlier.[2] There he articulated a method for calculating the additional value that is subject to estate tax when section 2036(a) applies to a transfer to a family partnership. Although that method was later modified in *Estate of Powell*,[3] *Estate of Cahill*,[4] and *Estate of Moore*,[5] the six-factor *Estate of Bongard* balancing test still determines whether the section 2036(a) inclusion and the complexity of the *Estate of Powell* line of cases[6] can

[1] *Estate of Purdue v. Commissioner*, T.C. Memo. 2015-249, in which the petitioners were represented by Montgomery Purdue PLLC members George W. Akers (now retired) and Alan L. Montgomery.

[2] *Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005).

[3] *Estate of Powell v. Commissioner*, 148 T.C. 392 (2017). The majority opinion in *Estate of Powell* modified *Estate of Bongard* by applying section 2036(a)(2) (*see Estate of Strangi v. Commissioner*, T.C. Memo. 2003-145, *aff'd*, 417 F.3d 468 (5th Cir. 2005)) together with section 2043(a) to prevent a double inclusion in the gross estate. *Id.* at 407. For a critique of the *Estate of Powell* court's interpretation of *United States v. Byrum*, 408 U.S. 125 (1972), see Mitchell M. Gans and Jonathan G. Blattmachr, "Family Limited Partnerships and Section 2036: Not Such a Good Fit," 42 *ACTEC J.* 253 (Dec. 2017).

[4] *Estate of Cahill v. Commissioner*, T.C. Memo. 2018-84. *Estate of Cahill* was a non-family partnership case in which the court cited *Estate of Powell* as authority to apply section 2036(a)(2) to the decedent's split-dollar life insurance agreements, which were entered into with an irrevocable trust.

[5] *Estate of Moore v. Commissioner*, T.C. Memo. 2020-40. *See* Elaine H. Gagliardi, "Elaine Gagliardi on the Family Limited Partnership in 2018: *Powell*, *Cahill*, and Income Tax Basis at Death," *Lexis Fed. Tax J.Q.*, ch. 1 (Dec. 2018).

[6] The relatively uncomplicated method for calculating the gross estate inclusion set forth in the *Estate of Bongard* majority opinion (described *infra* note 74) was replaced in *Estate of Moore* by this complex equation: "$V_{included} = C_d + FMV_d - C_t$, where $V_{included}$ = value that must be added to the gross estate; C_d = date-of-death value of the consideration received by the decedent from the transaction that remains in his estate, *see* section 2033; FMV_d = fair market value at date of death of property transferred by the decedent whose value is included in the gross estate under section 2036; and C_t = consideration received by the decedent at the time of the transfer, which has to be subtracted under section 2043(a)." *Estate of Moore*, T.C. Memo. 2020-40, at 62.

be avoided by showing that the family partnership has a "legitimate and significant nontax motive."[7]

As applied in *Estate of Purdue*, the factors for a court to consider in deciding whether a nontax reason existed include:

> (1) the taxpayer's standing on both sides of the transaction; (2) the taxpayer's financial dependence on distributions from the partnership; (3) the taxpayer's commingling of partnership funds with the taxpayer's own; (4) the taxpayer's actual failure to transfer the property to the partnership; (5) discounting the value of the partnership interests relative to the value of the property contributed; and (6) the taxpayer's old age or poor health when the partnership was formed.[8]

Contributing to the success of the exception defense in *Estate of Purdue* were earlier versions of Chart A, "Exception Defense Successes," and Chart B, "Exception Defense Failures," which have been updated and are available online.[9] Those charts, attached to the estate's pretrial memorandum, allowed Goeke to see at a glance how the record would prove that the decedent's family partnership had a legitimate and significant nontax motive.[10] They should be similarly helpful to other tax professionals who advise family partnerships, whether during the formation and administration stages or in defense of a section 2036(a) estate tax return audit.

II. *Estate of Purdue* Facts

The facts are typical of many family partnership cases.[11]

A. The Purdue Generation-Skipping Trusts

In 2000 Barbara Purdue (the decedent) and her husband Robert (Mr. Purdue) implemented their plan to provide for the second and third generations of their family and to fully use their transfer tax exemptions. They intended to eventually transfer all their community property assets to and from a total of 14 irrevocable trusts (the Purdue generation-skipping trusts). The first was the Purdue Family Trust (PFT), which the couple jointly established in 2000.[12] The 13 other trusts were established after their deaths under their wills. After Mr. Purdue's death in 2001, three trusts were funded for the primary benefit of the decedent during her lifetime: a bypass trust; and two qualified terminable interest property trusts described in section 2056(b)(7), one of which was exempt from generation-skipping transfer tax, and the other of which was not. The 10 trusts funded after the decedent's death in 2007 (half of which were GSTT-exempt) were for the primary benefit of the Purdue children and their spouses during their lifetimes. The QTIP trusts and bypass trust were then merged into those 10 trusts. The remainders will eventually pass to the next generation of Purdue descendants (primarily, the decedent's grandchildren), after the deaths of the Purdue children and their spouses.

B. PFLLC

Also in 2000, Mr. Purdue and the decedent transferred some of their jointly owned community property investment assets to the Purdue Family LLC (PFLLC), a Washington

[7] "The desire to consolidate marketable assets and manage them as a family asset for continuing investment purposes is also a genuine nontax motive under section 2036 [citing *Estate of Purdue*]. There, the decedent's children met at least once a year to discuss the family's accounts and assets in great detail." *Moore*, T.C. Memo. 2020-40, at 57.

[8] *Estate of Purdue*, T.C. Memo. 2015-249, at 15-16 (citing *Estate of Bongard*, 124 T.C. at 118-119).

[9] Charts A and B are available to download at https://s3.amazonaws.com/pdfs.taxnotes.com/2023/Montgomery_Tables.pdf.

[10] "And I did like Petitioners' chart which listed all of these family limited partnership cases and all the different factors. It was like a walk down memory lane to look at that chart," Goeke said. Trial transcript at 6, *Estate of Purdue*, T.C. Memo. 2015-249 (Nos. 12994-12 and 29829-12).

[11] For more detailed background facts, summaries, and analyses of *Estate of Purdue*, see Phyllis C. Taite, "*Estate of Purdue*: A Blueprint for FLPing," *Tax Notes*, Feb. 6, 2017, p. 759; Steve R. Akers, "*Estate of Purdue v. Commissioner*, 145 T.C. Memo. 2015-249 (Dec. 28, 2015)," Bessemer Trust (Jan. 8, 2016); and Peter J. Reilly, "Family Partnership Valuation Discounts Approved by Tax Court," *Forbes*, Jan. 2, 2016.

[12] The PFT was a joint and survivor grantor trust for income tax purposes. *See* Alan L. Montgomery and Ryan L. Montgomery, "The Joint and Survivor Grantor Trust and the S Election," *Tax Notes Federal*, Mar. 28, 2022, p. 1815; Montgomery and Montgomery, "Authors' Response to Blattmachr, Boyle, and Zaritsky," *Tax Notes Federal*, May 2, 2022, p. 751; and Montgomery and Montgomery, "Authors Respond to Philip M. Lindquist's 'Two Calculations' Theories," *Tax Notes Federal*, July 25, 2022, p. 738.

member-managed limited liability company, in exchange for 50 percent of the PFLLC interests issued to each of them. The PFLLC voting, decision-making control, profit, loss, and distribution rights were all uniformly allocated in proportion to the PFLLC ownership.

C. Gifts to the PFT

In 2001 Mr. Purdue and the decedent jointly made the first gifts of PFLLC interests to the PFT, which qualified for gift tax annual exclusions[13] because of *Crummey* withdrawal powers[14] held by the Purdue descendants[15] and their spouses.[16] After Mr. Purdue's death later in 2001, the remaining PFLLC interests were divided in a non-pro-rata distribution of the former community property among the decedent, the QTIP trusts, the bypass trust, and the Purdue children individually. In each of the years 2002 through 2007, the decedent continued to make gifts to the PFT of her personally owned PFLLC interests. The total amount of the federal gift tax annual exclusions applicable to those gifts over the seven years preceding the decedent's death, all valued at discounts for her gift tax purposes, was substantial.[17]

D. The Estate Tax Returns

After the decedent's death in 2007, her then-remaining PFLLC interest of approximately 25 percent and the QTIP trusts' PFLLC interests were reported on her state and federal estate tax returns with discounted values.

E. The Audit

In the audit of the decedent's federal estate tax return, the IRS alleged that an undivided 50 percent of the alternate-valuation-date value of the underlying PFLLC assets — attributable to her former community property share of those assets — should be subject to estate tax under section 2036(a). That inclusion would be without the benefit of any valuation discounts and despite that she owned only 25 percent of PFLLC at her death.

F. The Notice of Deficiency

The resulting notice of deficiency negated all the estate tax reductions from the valuation discounts taken on the decedent's gift and estate returns attributable to (1) her original 50 percent of the PFLLC assets and (2) the annual-exclusion gifts of PFLLC interests she made to the PFT over the seven years before her death. The alleged combined federal and state[18] estate tax deficiency was $3,681,841[19] — nearly 61 percent more than the tax amount paid with the estate tax returns. The potential maximum of estate taxes, penalties, and interest would have been even larger if the exception defense had not prevented the application of section 2036(a).[20]

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[13]The gifts of PFLLC interests to the PFT qualified for the gift tax annual exclusion because they conferred the right to enjoy the PFLLC income within the meaning of section 2503(b) ("(1) the PFLLC would generate income, (2) some portion of that income would flow steadily to the donees, and (3) that portion of income could be readily ascertained"). *Estate of Purdue*, T.C. Memo. 2015-249, at 26.

[14]*Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968), *aff'g in part and rev'g in part* T.C. Memo. 1966-144.

[15]*See Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991) (withdrawal powers held by contingent beneficiary grandchildren qualified the gifts to an irrevocable trust for gift tax annual exclusions).

[16]*See Estate of Kohlsaat v. Commissioner*, T.C. Memo. 1997-212 (withdrawal powers held by contingent beneficiary descendants-in-law qualified the gifts to an irrevocable trust for gift tax annual exclusions).

[17]In 2007 alone, these gifts of PFLLC interests had a discounted combined value of $300,000 (25 descendants and spouses * the 2007 $12,000 per-donee annual exclusion amount). *See Mikel v. Commissioner*, T.C. Memo. 2015-64 (citing *Crummey*, 397 F.2d 82, the court held that annual exclusion gifts to a family trust with 60 beneficiaries, all of whom were the donor's lineal descendants and their spouses, were present interest gifts because the trust document gave them the unrestricted right — which could not be legally resisted by the trustees — to withdraw an amount equal to the maximum gift tax exclusion).

[18]The 2007 version of the Washington estate tax, with a then-top bracket of 19 percent, generally mirrored the federal estate tax with a then top bracket of 45 percent. After accounting for the federal estate tax deduction for state estate taxes paid, the Purdue estate was subject to a combined 55 percent top Washington and federal estate tax bracket.

[19]The $3,121,959 additional federal estate tax in the notice of deficiency did not account for the corresponding increase to the Washington estate tax or for the increased federal estate tax deduction for that increased state estate tax. The resulting net overall increase to the combined Washington and federal estate tax liability, if the notice of deficiency had been sustained, was $3,681,841.

[20]The notice of deficiency was not based on the more complex deficiency calculation, described *supra* note 6, resulting from the section 2043(a) analysis in *Estate of Powell*, 148 T.C. 392. The concurring judge in that case criticized the majority's method as unnecessary and inappropriate. ("I do not see any 'double inclusion' problem. . . . Neither party in this case advanced any argument based on section 2043(a); indeed, that section is not cited in either party's briefs. . . . The Court's exploration of section 2043(a) seems to me a solution in search of a problem.") *Id.* at 416.

III. The Exception Defense

The exception defense consists of two prongs: the bona fide sale prong and the adequate and full consideration prong,[21] which are interrelated.[22] The defense includes a "proportional to" element,[23] a nontax motive element,[24] and a "recycling of value" element.[25] The last two elements are interdependent in the *Estate of Bongard* balancing test. The more strongly the six balancing test factors[26] weigh in favor of a family partnership, the more likely the deemed existence of a significant and legitimate nontax motive becomes;[27] and if a significant and legitimate nontax motive is deemed to exist, no recycling of value is deemed to occur.[28]

A. The 'Proportional to' Requirement

For the exception defense to succeed, the decedent must receive an interest in the family partnership proportional to the value of the assets contributed. Satisfying this element is relatively straightforward for a family partnership like PFLLC, in which voting, decision-making control, profit, loss, and distribution rights are all uniformly proportionate to ownership.[29] However, this requirement may be more difficult to satisfy when the family partnership agreement includes express capital account maintenance provisions[30] that are not followed,[31] or when the

[21]That is, "(1) whether the transaction qualifies as a bona fide sale and (2) whether the decedent received adequate and full consideration." *Estate of Purdue*, T.C. Memo. 2015-249, at 16 (citing *Estate of Bongard*, 124 T.C. at 119, 122-125).

[22]In the FLP context, "we consider the 'bona fide sale' and 'adequate and full consideration' elements as interrelated criteria." *Id.* (quoting *Estate of Estate of Bigelow v. Commissioner*, 503 F.3d 955, 969 (9th Cir. 2007)).

[23]"The bona fide sale for adequate and full consideration exception is met where the record establishes the existence of a legitimate and significant nontax reason for creating the family limited partnership and the transferors received partnership interests proportional to the value of the property transferred." *Id.* at 15 (citing *Estate of Bongard*, 124 T.C. at 118).

[24]"Whether a transfer is a bona fide sale is a question of motive. . . . We must separate the true nontax reasons for the PFLLC's formation from those that merely clothe transfer tax savings motives." *Id.* at 16-17 (citations omitted).

[25]"A taxpayer's receipt of a partnership interest is not part of a bona fide sale for full and adequate consideration where an intrafamily transaction merely attempts to change the form in which the decedent holds property. . . . We have stated that '[w]ithout any change whatsoever in the underlying pool of assets or prospect for profit, as, for example, where others make contributions of property or services in the interest of true joint ownership or enterprise, there exists nothing but a circuitous "recycling" of value.'" *Id.* at 22 (quoting *Estate of Harper v. Commissioner*, T.C. Memo. 2002-121, at 44-45).

[26]For the list of factors, see the text accompanying *supra* note 8.

[27]When the six *Estate of Bongard* factors weighed strongly in the taxpayer's favor, the mere future possibility of subdividing and developing unimproved real estate, which did not in fact happen during the decedent's lifetime or after her death, was a sufficiently legitimate and significant nontax motive. *See Estate of (Joanne H.) Stone v. Commissioner*, T.C. Memo. 2012-48, at 50 and 55 ("They hoped that the family would one day be able to develop and sell homes near the lake, although there were long-term issues to be worked out," and they "desired that their children, their children's spouses, and their grandchildren work together to develop and sell homes near the lake.").

[28]"With regard to recycling of value, we have stated that when a 'decedent employ[s] his capital to achieve a legitimate nontax purpose, the Court cannot conclude that he merely recycled his shareholdings.'" *Estate of Purdue*, T.C. Memo. 2015-249, at 22 (quoting *Estate of Schutt v. Commissioner*, T.C. Memo. 2005-126, at 63).

[29]"We also believe decedent received interests in the PFLLC proportional to the property she contributed." *Id.* at 20. *See also Kimbell v. United States*, 371 F.3d 256, 267 (5th Cir. 2004) (adopting the Tax Court's characterization of the adequate and full consideration aspect of the requirement as: "(1) whether the interests credited to each of the partners was proportionate to the fair market value of the assets each partner contributed to the partnership, (2) whether the assets contributed by each partner to the partnership were properly credited to the respective capital accounts of the partners, and (3) whether on termination or dissolution of the partnership the partners were entitled to distributions from the partnership in amounts equal to their respective capital accounts").

[30]In *Estate of Beyer v. Commissioner*, T.C. Memo. 2016-183, the agreement required the partner capital accounts to be contemporaneously credited and debited with expressly listed items.

[31]*See id.* at 126 ("The record does not establish that [the FLP] established and maintained respective capital accounts for its partners, let alone that it showed in those accounts the respective interests that those partners received in exchange for any initial and subsequent contribution that any such partner made to the partnership."); and *Estate of Liljestrand v. Commissioner*, T.C. Memo. 2011-259, at 34 (the interests credited to the capital accounts "were not proportionate to the fair market value of the assets each partner contributed to the partnership").

decedent's retained decision-making control is disproportionate to her retained ownership.[32]

B. The Nontax Motive Requirement

For the exception defense to succeed, the family partnership must also have a nontax motive that is legitimate and significant.[33] Although the "legitimate and significant" determination depends in part on how strongly the balancing test factors weigh in favor of the family partnership, the nontax motive itself cannot be theoretical,[34] and sufficient objective evidence[35] of at least one specific nontax motive must be introduced into the record.[36]

General boilerplate provisions in documents[37] and interested witness testimony, without more, might not prove the existence of a non-theoretical nontax motive to the satisfaction of the court.[38] Insufficient credible objective evidence of at least one specific nontax motive caused the exception defense to fail in *Estate of Holliday*[39] and *Estate of Beyer*[40] (neither of which has a column on Chart B because both were decided after *Estate of Purdue* and were not considered by Goeke).

IV. The Balancing Test

Although the six factors of the *Estate of Bongard* balancing test must collectively weigh in favor of the family partnership for the nontax motive to be sufficiently legitimate and significant to avoid section 2036(a), some of them carry more weight than others.

[32] *Estate of Powell*, 148 T.C. at 407, held that the "proportional to" inquiry extends to both the bona fide sale and adequate and full consideration prongs ("The proportion of the partnership's assets contributed . . . by a decedent-transferor . . . is more germane to the nontax bonafides of the transaction than to the adequacy of . . . consideration for the transferred assets."). Thus, the contrived divestment of decision-making control that, for no nontax reason, is disproportionate to the decedent's retained ownership might counterproductively risk failing both prongs. The exception defense failed in *Estate of Strangi*, 417 F.3d at 472 (the decedent, a 99 percent limited partner, "had no formal control") and *Estate of Holliday v. Commissioner*, T.C. Memo. 2016-51, at 4 (the divestment of her interest in the general partner OVL Capital by the 89.9 percent limited partner decedent "created the appearance that [she] had no control").

[33] *See Estate of Powell*, 148 T.C. at 408 ("In *Estate of Bigelow*, . . . the Ninth Circuit warned that an estate cannot qualify for the exception merely by establishing the proportionality of an exchange (that is, that each partner received an interest in the partnership proportionate to the value of the assets that partner contributed). 'To avoid the reach of section 2036(a),' the Court cautioned, 'the Estate must also show the "genuine" pooling of assets' and 'a potential [for] intangibles stemming from pooling for joint enterprise.'").

[34] "The objective evidence must indicate that the nontax reason was a significant factor that motivated the partnership's creation. . . . A significant purpose must be an actual motivation, not a theoretical justification." *Purdue*, T.C. Memo. 2015-249, at 15 (citing *Bongard*, 124 T.C. at 118).

[35] A nontax motive may be objectively proven from the family partnership activities, both before and after the decedent's death. *See Estate of Mirowski v. Commissioner*, T.C. Memo. 2008-74, at 39 ("At all relevant times, including after Ms. Mirowski's death, MFV has been a valid functioning investment operation.").

[36] Management of assets of special family significance (or "legacy assets," as defined in *Estate of Murphy v. United States*, 104 AFTR 2d 2009-7703 (W.D. Ark. 2009)) is the most common of many diverse nontax motives held to be legitimate and significant (shown in bold on Chart A rows 6, 17, 18, 19, 21, 25, 27, 28, 29, 32, and 35 through 39. PFLLC's interest in the Hocking Building and low-basis telecommunications stocks derived from Mr. Purdue's investment in Tele-Vue Systems Inc., the pioneering cable television company eventually bought by CBS, were both legacy assets.

[37] Extensive boilerplate provisions did not avoid failure of the exception defense in *Beyer*. *See Beyer*, T.C. Memo. 2016-183, at 117 n.36 ("Section 1.03 of EGBLP's agreement also contains a list of 28 so-called boilerplate purposes to be accomplished by forming EGBLP. Although that list contains 28 purposes, none of Mr. Beyer's desires is explicitly set forth in the list.").

[38] *See Estate of Erickson v. Commissioner*, T.C. Memo. 2007-107, at 15 ("We are not compelled to believe evidence that seems improbable or to accept as true uncorroborated, although uncontradicted, evidence by interested witnesses.").

[39] In *Estate of Holliday*, T.C. Memo. 2016-51, the exception defense failed despite the positive balancing test factors weighing in favor of the family partnership, as described in Example 4 (*infra* note 74). The three alleged nontax motives (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 heirs) were held to be theoretical because they were not proven by credible objective evidence. *Id.* at 12-17.

[40] *Estate of Beyer*, T.C. Memo. 2016-183. Although the "proportional to" requirement also was not satisfied (*see supra* note 31), the primary cause for failure of the exception defense was insufficient proof of the three alleged nontax motives: "On the record before us, we find that decedent's estate did not introduce credible evidence" of (1) his desire to keep certain stock in a block and maintain his investment portfolio intact; (2) his desire to transition his nephew/executor into managing his assets; and (3) his desire to ensure continuity of management of his assets. *Id.* at 121-124.

A. Low-Value Factors

For example, the exception defense may still succeed despite these negative factors:

- the decedent was advised of or took advantage of valuation discounts on gift and estate tax returns;[41]
- the terms of the family partnership were not negotiated;[42]
- the other family partnership owners were not represented by independent advisers or attorneys;[43]
- the family partnership lacked a business purpose;[44]
- the family partnership owned only a single asset;[45]
- the family partnership assets remained unchanged after the transfer;[46]
- the family partnership assets were not actively managed;[47]
- the family partnership assets were predominantly or exclusively marketable securities;[48]

[41] *See Kimbell*, 371 F.3d at 263 ("A taxpayer's testamentary or tax saving motive for a transfer alone does not trigger section 2036(a) recapture if objective facts demonstrate that the transfer was made for a full and adequate consideration."). The exception defense succeeded in *Estate of Purdue* despite the tax savings motive for PFLLC. *See Estate of Purdue*, T.C. Memo. 2015-249, at 19 ("Decedent discounted the value of the partnership interest relative to the value of property contributed, and this factor weighs against the estate.").

[42] *See Kimbell*, 371 F.3d at 264 ("The absence of negotiations between family members over price or terms is not a compelling factor in the determination as to whether a sale is bona fide, particularly when the exchange value is set by objective factors" (citing *Wheeler v. United States*, 116 F.3d 749 (5th Cir. 1997))). The exception defense succeeded in *Estate of Purdue* despite the absence of negotiations. *See Estate of Purdue*, T.C. Memo. 2015-249, at 19-20 ("There were no negotiations over the terms of the PFLLC operating agreement between the parents and the Purdue children.").

[43] In *Estate of Miller v. Commissioner*, T.C. Memo. 2009-119, for the earlier of two transfers to which section 2036(a) did not apply, only the decedent's lawyer provided legal advice about the FLP, and the exception defense succeeded. Although one of the Purdue children was a licensed lawyer who advised the other siblings about the PFLLC, the IRS argued that "the Purdue children did not retain an independent adviser or attorney to represent them in the formation of the PFLLC." *Estate of Purdue*, T.C. Memo. 2015-249, at 20, and the exception defense succeeded.

[44] Judge David Laro's concurring opinion in *Estate of Bongard* would require a "business purpose" for the exception defense to succeed, but Goeke's majority opinion requires only a "legitimate and significant nontax reason." *See Estate of Mirowski*, T.C. Memo. 2008-74, at 55 ("Moreover, we reject the suggestion in respondent's contention . . . that the activities of MFV had to rise to the level of a 'business' under the Federal income tax laws in order for the exception under section 2036(a) . . . to apply."); and *Estate of Bigelow*, 503 F.3d at 969 ("The crux of the bona fide transfer inquiry is whether the taxpayer can demonstrate that the transfer had 'legitimate and significant nontax reasons'" (citing *Estate of Bongard*).).

[45] The failure of the exception defense for one transfer in *Estate of Bongard*, 124 T.C. at 97, might suggest that the defense is less likely to succeed when the family partnership owns only a single asset (the non-income-producing and nonvoting minority interest in WCB Holdings LLC in that case). Arguably, a true pooling of assets might imply multiple assets. *See also Estate of Bigelow*, 503 F.3d at 972 ("The Padaro Lane property was Spindrift's sole asset, required no active management, and was the partnership's only business."). However, in *Estate of (Joanne H.) Stone*, T.C. Memo. 2012-48, the family partnership owned only a single non-income-producing asset (unimproved and unsubdivided lakefront property), but the exception defense succeeded.

[46] In *Estate of (Joanne H.) Stone*, T.C. Memo. 2012-48, the unimproved and unsubdivided lakefront property was unchanged before and after its transfer to the family partnership ("SFLP has yet to develop or otherwise improve the woodland parcels"). *Id.* at 9. It therefore was arguably "recycled" as defined in *Estate of Harper*, T.C. Memo. 2002-121. The exception defense still succeeded ("when a decedent employ[s] his capital to achieve a legitimate nontax purpose, the Court cannot conclude that he merely recycled his shareholdings" (internal quotations and citation omitted)).

[47] The unimproved and unsubdivided lakefront property in *Estate of (Joanne H.) Stone* was not actively managed, but the exception defense succeeded. *See Estate of Stone*, T.C. Memo. 2012-48, at 9 ("Decedent and Mr. Stone made no particular use of the woodland parcels held by SFLP other than to fish and visit Steve Stone. Each of the limited partners had the same access to the land as decedent and Mr. Stone.").

[48] The transfers to the family partnerships were predominantly or exclusively of marketable securities, but the exception defenses succeeded, in *Estate of Schutt*, T.C. Memo. 2005-126 ($29 million and $13.5 million); *Estate of Mirowski*, T.C. Memo. 2008-74 ($60.5 million); *Estate of Miller*, T.C. Memo. 2009-119 ($2.8 million for the earlier of the two transfers to which section 2036(a) did not apply); *Keller v. United States*, 697 F.3d 238, 240 (5th Cir. 2012), *aff'g* 104 AFTR 2d 2009-6015 (S.D. Tex. 2009) ($250 million); and *Estate of Purdue*, T.C. Memo. 2015-249 ($22 million).

- the family partnership was the source of the cash used to pay estate taxes;[49]
- the nontax motive was never actually pursued or accomplished;[50]
- the family partnership documents and planning were contemporaneous or integrated with testamentary documents and planning;[51] or
- the decedent had health issues[52] or died shortly after the transfer of assets to the family partnership.[53]

Although these negative factors are appropriately emphasized in the Chart B cases (exception defense failures), they generally have less balancing test weight than some other factors. Each factor described above is less likely to determine the result of the exception defense[54] than each of the high-value factors described next.

B. High-Value Factors

The factors primarily responsible for exception defense outcomes concern the existence (or conversely, the absence or opposite) of retained income interests or retained control interests that disproportionately or preferentially benefit the decedent.[55] These factors are derived from language in section 2036(a) stating that the value of the transfer is included in the gross estate if the decedent retained "(1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom."[56]

The following are examples of high-value factors involving retained income interests:

- holding back insufficient assets outside the family partnership necessary for the decedent's support, resulting in an implied disproportionate retention by the decedent of the economic benefits of the family partnership assets;[57]

[49] *See Estate of Mirowski*, T.C. Memo. 2008-74, at 42 ("estate tax of $14,119,863.13, which decedent's estate paid . . . with funds that MFV distributed to it"); *Estate of Black v. Commissioner*, 133 T.C. 340 (2009) ("Mrs. B's estate lacked sufficient liquid assets to discharge its tax and other liabilities."); and *Estate of Purdue*, T.C. Memo. 2015-249, at 261 ("The $5,040,090 of combined PFLLC dividend shares of the estate and the QTIP Trust was insufficient to pay their estate tax liabilities."), in which the exception defenses succeeded.

[50] In *Estate of (Joanne H.) Stone*, T.C. Memo. 2012-48, the nontax purpose (a desire for family members to someday subdivide and sell the unimproved lakefront property) was never pursued or accomplished before or after the decedent's death, but the exception defense succeeded.

[51] "Although this transfer to the PFLLC was also made with testamentary purposes in mind, we have previously noted that '[l]egitimate nontax purposes are often inextricably interwoven with testamentary objectives.'" *Estate of Purdue*, T.C. Memo. 2015-249, at 19 (citing *Estate of Bongard*), and the exception defense succeeded.

[52] *See Estate of Harrison v. Commissioner*, T.C. Memo. 1987-8 (the decedent's health was declining); and *Estate of Schutt*, T.C. Memo. 2005-126 ("Decedent's health history during the period included coronary artery disease, congestive heart failure, hyperlipidemia, hypertension, renal insufficiency, and gout."), in which both exception defenses succeeded.

[53] In *Estate of Mirowski*, T.C. Memo. 2008-74, the decedent unexpectedly died only six days after transferring the assets to the family partnership; and in *Kimbell*, 371 F.3d at 251, the 96-year-old decedent died two months after her transfer to the family partnership, but the exception defenses still succeeded.

[54] The descriptions after the case citations at the bottom of Chart A show that the character of the family partnership assets (independent of their "legacy" or "actively managed" status) is not a significant factor in the exception defense success decisions. Five of the Chart A family partnerships (those described in columns 6, 7, 9, and 10, and PFLLC) held mostly or all marketable securities; three (those described in columns 1, 2, and 12) held mostly or all real estate; and six (those described in columns 3, 4, 5, 8, 11, and 13) held a mixture of mostly other assets.

[55] Half of the six *Estate of Bongard* balancing test factors are high-value factors: "(2) the taxpayer's financial dependence on distributions from the partnership," "(3) the taxpayer's commingling of partnership funds with the taxpayer's own," and "(4) the taxpayer's actual failure to transfer the property to the partnership." *Estate of Bongard*, 124 T.C. at 118-119.

[56] *See* reg. section 20.2036-1(c)(1)(i) ("An interest or right is treated as having been retained or reserved if at the time of the transfer there was an understanding, express or implied, that the interest or right would later be conferred."); *Estate of Reichardt v. Commissioner*, 114 T.C. 144, 151 (2000) (the express or implied understanding principle applies even if the retained right is not legally enforceable); and *Estate of Erickson*, T.C. Memo. 2007-107, at 20 ("Some factors we have previously considered important . . . include . . . a history of disproportionate distributions . . . [and] when the individual conveys nearly all of his or her assets.").

[57] The exception defense failed in *Estate of Strangi*, 417 F.3d at 472 (the FLP received 98 percent of the decedent's assets, valued at $9,932,967); *Estate of Hurford v. Commissioner*, T.C. Memo. 2008-278 ("She needed that money because she had transferred nearly everything she owned into the FLPs"); *Korby v. Commissioner*, 471 F.3d 848, 853 (8th Cir. 2006) (less than $10,000 in assets was retained outside the FLP); *Estate of Turner v. Commissioner* (*Estate of Thompson*), 382 F.3d 367, 374 (3d Cir. 2004) ("decedent did not retain sufficient assets to support himself for the remainder of his life"); and *Bigelow*, 503 F.3d at 970 (the decedent was "impoverished" by the transfer to the partnership, leaving her "unable to meet her financial obligations").

- the decedent receiving disproportionately beneficial family partnership cash distributions;[58]
- the decedent taking preferential unsecured loans from the family partnership not evidenced by promissory notes;[59]
- the decedent failing to make sufficient payments to the family partnership on preferential unsecured loans;[60]
- payment of the decedent's personal expenses directly from the family partnership account;[61] and
- the decedent continuing to live in a residence until death without paying rent.[62]

The following are examples of high-value factors involving retained control interests:

- the disproportionately beneficial right to amend the family partnership agreement[63] or to make distributions from the family partnership;[64]
- the failure to transfer the assets to the family partnership, leaving those purported family partnership assets under the control of the decedent;[65]
- the exercise of direct control over the family partnership account;[66] and
- commingling of the family partnership funds with personal funds, leaving the family partnership assets under the control of the decedent.[67]

V. Charts A and B

Charts A (exception defense successes) and B (exception defense failures) compare the PFLLC positive and negative factors with those of the family partnerships in the reported cases. That comparison provided the big-picture perspective necessary for the Purdue estate to make the otherwise difficult decision to decline a settlement offer from the IRS and proceed with the Tax Court trial.

As defined above, the positive high-value factors are listed on Chart A only (the italicized rows), the negative high-value factors are listed on Chart B only (also italicized rows),[68] and seven of the more common negative low-value factors (the shaded rows) are listed on both charts.[69]

[58] The exception defense also failed in *Estate of Rosen v. Commissioner*, T.C. Memo. 2006-115, at 143 (the 35 percent owner received 100 percent of the FLP distributions); *Korby*, 471 F.3d at 850 (the 2 percent FLP owner received $120,795 of $155,357, or 77.75 percent of the total FLP cash distributions); *Estate of Liljestrand*, T.C. Memo. 2011-259 ("the partnership made disproportionate distributions to the trust and directly paid a number of Dr. Liljestrand's personal expenses"); and *Estate of Turner v. Commissioner*, T.C. Memo. 2011-209 (decedent took disproportionately large distributions from Turner & Co. "at will").

[59] *See Estate of Bigelow*, 503 F.3d at 960 ("These transfers, which are characterized by the Estate as 'loans,' were interest free and unaccompanied by a promissory note.").

[60] The exception defense failed in *Estate of Rosen*, T.C. Memo. 2006-115 ("During her life, decedent never repaid any of the principal or interest reflected in note 1 or note 2.").

[61] The exception defense failed in *Estate of Bigelow*, 503 F.3d at 959 ("Despite decedent's personal obligation to make the $2,000 monthly payment on the Great Western loan, the partnership made each payment in her stead."); and in *Estate of Reichardt*, 114 T.C. at 150 ("These were the amounts of decedent's personal expenses that the partnership paid in those years.").

[62] The exception defense failed in *Estate of Strangi*, 417 F.3d at 473 ("Although the accrued rent was recorded in SFLP's books, it was not actually paid until January 1997, more than two years after Strangi's death."); and in *Estate of Reichardt*, 114 T.C. at 149 (the decedent "paid no rent to the trust or the partnership to use that residence").

[63] The exception defense failed in *Estate of Turner*, T.C. Memo. 2011-209 ("the right, as general partner, to amend the partnership agreement at any time without the consent of the limited partners").

[64] The exception defense failed in *Estate of Rector v. Commissioner*, T.C. Memo. 2007-367 ("As the direct general partner of RLP, decedent was given the right by the RLP partnership agreement to cause a distribution of RLP's net cashflow to RLP's partners. . . . Decedent held both a majority interest in RLP and the powers incident to serving as RLP's general partner"); and *Estate of Strangi*, T.C. Memo. 2003-145, in which the decedent, acting through his attorney-in-fact son-in-law, had the unfettered right to distribute income to himself ("Decedent's attorney in fact thereby stood in a position to make distribution decisions.").

[65] The exception defense failed in *Estate of Turner*, T.C. Memo. 2011-209, at 241 ("Delays in transferring assets to Turner & Co. cannot be blamed on Clyde Sr.'s and Jewell's poor recordkeeping.").

[66] The exception defense failed in *Estate of Hurford*, T.C. Memo. 2008-278 (the decedent continued to control the FLP's accounts: "She impermissibly took distributions for her living expenses directly from the FLP accounts.").

[67] The exception defense failed in *Estate of Liljestrand*, T.C. Memo. 2011-259 ("PLP failed to open and maintain a separate bank account for the first 2 years of its existence. During this period all of PLP's banking was conducted through the trust's bank account, resulting in an unavoidable commingling of partnership and personal funds.").

[68] The Chart A positive "retained income/control" high-value factors are listed in italicized rows 2, 3, 4, and 5, and the Chart B negative "retained income/control" high-value factors are listed in italicized rows 6, 9, 12, 14 (the parenthetical only), 15, 20, 21, 23, 24, 27, 28, 32, 34, and 40.

[69] The seven most common negative low-value factors that were not fatal to the exception defense are listed at Chart A's shaded rows 8, 10, 11, 13, 24, 26, and 40. They are also listed at Chart B's shaded rows 2, 3, 7, 8, 13, 14 (excepting the parenthetical), and 17.

Every successful family partnership, including PFLLC, shared all the positive high-value factors listed in the top five rows of Chart A.[70] Even though all those Chart A family partnerships also shared one to five of the more common negative low-value factors listed in the top 17 rows of Chart B, their exception defenses were successful.

Although many of the Chart B negative low-value factors overlap onto Chart A, none of its high-value factors do. This demonstrates that the high-value factors are primarily responsible for the exception defense outcomes in this predictable way:

1. if the "proportional to" requirement is satisfied and there is an objectively provable nontax motive; and
2. all the positive high-value factors weigh in favor of the family partnership; then
3. its negative low-value factors will not prevent the nontax motive from being legitimate and significant.

The following examples of this pattern are based on four post-*Bongard* Tax Court decisions:

Example 1. Condition 1 is met, and:

- discounts are taken on gift or estate tax returns (a negative low-value factor);
- the decedent is in ill health at the time of the transfer (a negative low-value factor);
- the assets are passively managed marketable securities and bonds (a negative low-value factor);
- the family partnership is the source of funds to pay estate taxes (a negative low-value factor);
- the assets are actually transferred without delay, and no commingling occurs (a positive high-value factor);
- insufficient assets are retained for lifetime needs (a negative high-value factor);
- personal gifts to family members are made from the family partnership account (a negative high-value factor);
- during her lifetime, the 35 percent owner-decedent disproportionately receives 100 percent of the family partnership cash distributions and preferential unsecured loans for which no required payments are timely made (a negative high-value factor); and
- no disproportionately beneficial decision-making control is retained (a positive high-value factor).

The exception defense fails in Example 1 because the three negative high-value factors and four negative low-value factors outweigh the two positive high-value factors.[71]

Example 2. Condition 1 is met, and:

- no discounts are taken on gift or estate tax returns (a positive low-value factor);
- the decedent is in good health and lives for eight years after the transfer (a positive low-value factor);
- the family partnership is not the source of funds to pay estate taxes (a positive low-value factor);
- there is only a single, non-actively managed asset (a negative low-value factor);
- the asset is actually transferred without delay, and no commingling occurs (a positive high-value factor);
- sufficient assets are retained for lifetime needs (a positive high-value factor);
- during the decedent's lifetime, no disproportionately beneficial distributions or preferential loans are made (a positive high-value factor); and
- no disproportionately beneficial decision-making control is retained (a positive high-value factor).

The exception defense succeeds in Example 2 because the four positive high-value factors and three positive low-value factors outweigh the one negative low-value factor.[72]

Example 3. Condition 1 is met, and:

- discounts are taken on gift or estate tax returns (a negative low-value factor);
- the decedent is in good health and lives for seven years after the transfer (a positive low-value factor);

[70] As indicated by no contrary finding of fact in the decisions.

[71] Example 1 is *Estate of Rosen*, T.C. Memo. 2006-115 (Chart B, column 12).

[72] Example 2 is *Estate of (Joanne H.) Stone*, T.C. Memo. 2012-48 (Chart A, column 12).

- the assets are predominantly actively managed marketable securities (a positive low-value factor);
- the assets are actually transferred without delay, and no commingling occurs (a positive high-value factor);
- sufficient assets are retained for lifetime needs (a positive high-value factor);
- during the decedent's lifetime, no disproportionately beneficial distributions or preferential unsecured loans are made, while the loans that are made are evidenced by interest-bearing and secured promissory notes and are timely repaid, and no personal expenses are paid directly from the family partnership account (a positive high-value factor); and
- no disproportionately beneficial decision-making control is retained (a positive high-value factor).

The exception defense succeeds in Example 3 because the four positive high-value factors and two positive low-value factors outweigh the one negative low-value factor.[73]

Example 4. Condition 1 above is *not* met, because there is a lack of credible objective proof of a non-theoretical nontax motive, and:

- discounts are taken on gift or estate tax returns (a negative low-value factor);
- the assets are passively managed marketable securities and cash (a negative low-value factor);
- there is no meaningful negotiation or bargaining (a negative low-value factor);
- the decedent is in good health and lives for three years after the transfer (a positive low-value factor);
- the family partnership is not the source of funds to pay estate taxes (a positive low-value factor);
- the assets are actually transferred without delay, and no commingling occurs (a positive high-value factor);
- sufficient assets are retained for lifetime needs (a positive high-value factor);
- during the decedent's lifetime, there are no disproportionately beneficial distributions or preferential unsecured loans (a positive high-value factor); and
- no disproportionately beneficial decision-making control is retained (a positive high-value factor).

Even though the four positive high-value factors and two positive low-value factors may outweigh the three negative low-value factors, the exception defense fails in Example 4 because of the lack of the required non-theoretical nontax motive.[74]

The "bad facts" of examples 1 and 4 are typical of exception defense cases that fail.[75] More notably, the negative low-value factors in examples 2 and 3 do not prevent the exception defense from succeeding, because the positive high-value factors receive greater weight in the balancing test.

VI. The *Estate of Purdue* Decision

The early versions of Chart A and Chart B were easy-to-view scorecards whose far-right columns showed that PFLLC's 32 possible positive factors (including all the positive high-value factors) strongly outweighed its two possible negative low-value factors. The charts were a convincing and convenient summary of

[73]Example 3 is *Estate of Purdue*, T.C. Memo. 2015-249 (Chart A, far right column).

[74]Example 4 is *Estate of Holliday*, T.C. Memo. 2016-51, in which the 100 percent gross estate inclusion result conforms to the *Estate of Bongard* calculation result, but without specifically applying it. Since there were no findings of fact of any impliedly retained income or control interests that disproportionately or preferentially benefited the decedent (the antithesis of *Estate of Rosen*, T.C. Memo. 2006-115, in which section 2035(a) was inapplicable), the section 2036(a) inclusion would be limited to the 89.9 percent limited partnership interest owned at death that produced the expressly proportionate retained income. *Estate of Bongard*, 124 T.C. at 117; and reg. section 20.2036-1(c)(1)(i). The *Estate of Bongard* calculation would then include the other interests that the decedent transferred within three years of death under section 2035(a). *Estate of Bongard*, 124 T.C. at 130-131.

[75]"Not surprisingly both cases, *Estate of Powell* and *Estate of Cahill*, rest on facts that some would characterize as egregious." Gagliardi, *supra* note 5, at 1.

why the exception defense should succeed in *Estate of Purdue*.[76] They also served as checklists for organizing the documents introduced into the record to satisfy the Tax Court that section 2036(a) did not apply to the decedent's transfer to PFLLC.

A. Positive Factors Far Outweighed Negatives

The Tax Court's findings of fact regarding PFLLC incorporate about 24 of the 32 possible Chart A positive factors (including all the positive high-value factors), against which Goeke expressly weighed only one of the two possible negative low-value factors (the tax savings motive).[77]

B. Legitimate and Significant Nontax Motives

The estate argued that there were seven nontax motives for the decedent's transfer of assets to PFLLC.[78] The court merged them into its finding that the required legitimate and significant nontax motive existed.[79]

1. Relieving the parents' burdens.

The transfer relieved the decedent and Mr. Purdue[80] of the burdens of managing the family investments.[81]

2. Consolidating investments.

The transfer allowed multiple investment accounts to be consolidated into a single successor account controlled by one financial adviser and governed by a new and different investment strategy and asset allocation.[82]

3. Investment management education.

Another nontax motive was to educate the Purdue children to jointly manage a family investment company.[83]

4. Avoiding repetitive successive transfers of the underlying PFLLC assets.

Although simple gift giving alone is not an acceptable nontax motive,[84] avoiding repetitive, successive separate transfers of the underlying

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[76] At trial in *Estate of Purdue*, Goeke emphasized that litigants may rely on the factors in Chart A and Chart B to anticipate how the Tax Court will rule in family partnership exception defense cases: "The Government has a major risk on the question of whether the LLC will be respected just based upon the jurisprudence and based upon the facts. . . . I think the jurisprudence about these LLCs is pretty mature at this point. . . . There [are] many potential factors . . . that have been respected relative to LLCs. . . . Those cases are pretty clear. And I don't think there's much argument left in my court about the standard." Trial transcript, *supra* note 10, at 129. Despite the high probability that the PFLLC exception defense would succeed, the government persisted with its contrary position, which precluded settlement of the case.

[77] "The estate concedes that decedent was advised of the transfer tax savings. Therefore, decedent discounted the value of the partnership interest relative to the value of property contributed, and this factor weighs against the estate." *Estate of Purdue*, T.C. Memo. 2015-249, at 19. The second possible negative factor (that PFLLC was the source of the cash used to pay estate taxes) did not weigh against the estate because it had $3,228,125 of assets outside PFLLC that could have been liquidated or leveraged to pay its $2,928,861 share of the estate taxes (the larger $3,345,126 balance of the estate taxes was the QTIP trusts' share). *Id.* at 13. *C.f. Estate of Mirowski*, T.C. Memo. 2008-74 ("At no time before Ms. Mirowski's death did the members of MFV have any express or unwritten agreement or understanding to distribute assets of MFV in order to pay that gift tax liability.").

[78] *See Estate of Purdue*, T.C. Memo. 2015-249, at 17.

[79] "We find that decedent's desire to have the marketable securities and the Hocking Building interest held and managed as a family asset constituted a legitimate nontax motive for her transfer of property to the PFLLC." *Id.* at 19.

[80] "Mr. Purdue's memory problems were evident to the Purdue children at the time assets were contributed to the PFLLC. He was later diagnosed with Alzheimer's disease." *Id.* at 10. "Decedent was a homemaker, and her participation in the control and management of the PFLLC assets was limited." *Id.* at 3.

[81] *See also Estate of (Eugene E.) Stone v. Commissioner*, T.C. Memo. 2003-309, at 106 n.74 (the decedent and his wife "no longer were interested or actively involved in managing those assets and wanted their children to become actively involved."); *Estate of Michelson v. Commissioner*, T.C. Memo. 1978-371 (after a heart attack, the decedent devoted less time to his business operations, and his son assumed greater management responsibility); *Murphy*, 104 AFTR 2d 2009-7703 (the decedent "removed himself more and more from the management of the family's assets," and the children began to take over the day-to-day management.); and *Estate of Kelly*, T.C. Memo. 2012-73 (the decedent had little or no business and investment experience, and her children helped her manage the family business formerly run by her deceased husband) in which the exception defense all succeeded.

[82] "Thereafter, all the assets formerly held by the parents individually in the five accounts at three different management firms were consolidated into PFLLC accounts with the Rainier Group subject to an overall, well-coordinated professional investment strategy applied to all of the investments as a whole." *Estate of Purdue*, T.C. Memo. 2015-249, at 12. The exception defense similarly succeeded in *Estate of Mirowski*, T.C. Memo. 2008-74 ("Ms. Mirowski began to realize that her investment portfolio could perform better if she were to diversify that portfolio and consolidate her investments at one investment firm.").

[83] "Since 2001 the Purdue children have held annual meetings . . . [and] . . . discussed the Purdue family's accounts and assets, ratified prior PFLLC distributions, approved annual cash distributions, heard presentations from the Rainier Group investment manager, and received estate tax planning updates and advice from Mr. Montgomery." *Estate of Purdue*, T.C. Memo. 2015-249, at 8. *See also Estate of Mirowski*, T.C. Memo. 2008-74 (the daughters held meetings with Goldman Sachs representatives several times a year to review asset allocation and the performance of the family partnership's account; and *Murphy*, 104 AFTR 2d 2009-7703 ("The partners have met from six to eight times a year to discuss partnership business.").

[84] *Estate of (Joanne H.) Stone*, T.C. Memo. 2012-48 ("We agree with respondent that gift giving alone is not an acceptable nontax motive.").

PFLLC assets to and from the 14 Purdue generation-skipping trusts[85] through simple assignments of PFLLC percentage interests was a nontax motive.[86]

5. Common ownership of assets.

Another nontax motive was to provide for the common ownership of assets for efficient joint management and to meet minimum investment requirements.[87]

6. Dispute resolution and voting; transfer restrictions.

Providing for dispute resolution, transfer restriction rules, and manager voting rules in the PFLLC agreement and the governing documents of the Purdue generation-skipping trusts, to facilitate PFLLC decisions and resolve disagreements, was a PFLLC nontax motive.[88]

7. Giving the children a minimum annual cash flow.

A final nontax motive was to substitute the annual PFLLC cash distributions for the annual cash gifts formerly made directly by the decedent and Mr. Purdue individually to their children. This would ensure the children would continue to receive a minimum annual cash flow.[89]

VII. Lessons From *Estate of Purdue*

A. Concentrate on the Top Positive Factors

If all the positive factors at the top of Chart A apply, the benefits of a diligently administered family partnership can generally be obtained with minimal risk of violating section 2036(a).[90] Consistently favorable exception defense outcomes result if the decedent (1) receives an interest in the family partnership proportionate to the value of the assets contributed (Chart A, row 1);[91] (2) does not expressly or impliedly retain a disproportionately beneficial or preferential income or control interest (Chart A, rows 2 through 5);[92] and, most importantly, (3) has at least one objectively provable nontax motive for the family partnership (Chart A, rows 6 and following).[93]

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[85]The legacy asset Hocking Building real estate interest required only the single initial deed to PFLLC ("The parents also had an undivided one-sixth interest in a commercial building in Honolulu, Hawaii (Hocking Building). . . . In November 2000 the parents funded the PFLLC by contributing . . . the Hocking Building valued at approximately $900,000."). *Estate of Purdue*, T.C. Memo. 2015-249, at 4.

[86]This common nontax purpose for a family partnership, which is integral to intergenerational estate planning, was acknowledged in *Kimbell*, 371 F.3d at 269 (reversing summary judgment in favor of the government on the application of section 2036(a), noting "the partnership would also avoid costs of recording transfers of oil and gas properties as the property was passed from generation to generation"). *See also Keller*, 104 AFTR 2d 2009-6015 at 6022 ("The primary purpose of these partnerships was to consolidate and protect family assets for management purposes and to make it easier for these assets to pass from generation to generation.").

[87]"After the formation of the PFLLC, the Purdue children made the PFLLC investment decisions jointly." *Estate of Purdue*, T.C. Memo. 2015-249, at 18. The exception defense similarly succeeded in *Estate of Mirowski*, T.C. Memo. 2008-74, at 50 n.44 ("ensuring joint management of the family's assets by her daughters and eventually her grandchildren"), and at 50-51 ("maintenance of the bulk of the family's assets in a single pool of assets in order to allow for investment opportunities that would not be available if Ms. Mirowski were to make a separate gift of a portion of her assets to each of her daughters or to each of her daughters' trusts").

[88]"Beverly Purdue created the deadlock by not voting for the recommended option, making the loan necessary." *Estate of Purdue*, T.C. Memo. 2015-249, at 28-29.

[89]"Before 2000 Mr. Purdue and decedent generally made annual cash gifts of $40,000 to each of the Purdue children and made annual cash gifts in other amounts to the Purdue grandchildren. . . . From 2001 to 2007 the Purdue children received, in approximately equal shares, cash distributions totaling $1,997,304 in their capacities as PFT beneficiaries. Of the $1,997,304 of PFT cash distributions, $51,920 was net rent paid to the PFT for its 50 percent interest in the Purdue residence and $1,945,384 was its share of net cash loans and dividends from the PFLLC." *Estate of Purdue*, T.C. Memo. 2015-249, at 8-9. The exception defense similarly succeeded in *Estate of Mirowski*, T.C. Memo. 2008-74 ("providing for each of her daughters and eventually each of her grandchildren").

[90]Some of the low-value factors in Chart A and Chart B are PFLLC-specific. There may be other low-value factors described in the decisions that are more relevant to other family partnerships.

[91]*See* Chart A, row 1; and *Estate of Purdue*, T.C. Memo. 2015-249, at 20 ("We also believe decedent received interests in the PFLLC proportional to the property she contributed.").

[92]*See Estate of Purdue*, T.C. Memo. 2015-249, at 5 ("Decedent retained the right to income and distributions from the property she transferred to the PFLLC in proportion to her PFLLC ownership percentage."); and the Chart A positive high-value factors listed at italicized rows 2, 3, 4, and 5.

[93]Non-theoretical nontax motives are described at Chart A bolded rows 6, 17, 18, 19, 21, 25, 27, 28, 29, 32, and 35 through 39.

B. Maintain a Good Written Record

A well-developed written record is essential to proving that the "proportional to" requirement and the non-theoretical nontax motive requirement are satisfied,[94] and that there are enough positive balancing test factors for the exception defense to succeed.[95] The written evidence in *Estate of Purdue* included:

- correspondence and emails between the Purdue family members and their legal and investment advisers;
- customized non-boilerplate provisions in governing instruments;
- written investment plans;
- minutes of annual PFLLC meetings in which nontax motives were discussed;
- written PFLLC resolutions showing that all PFLLC decisions were made by the Purdue children rather than their parents;
- written PFLLC resolutions declaring PFLLC cash dividends and formally authorizing loans to PFLLC members on a nonpreferential basis;
- the contemporaneous execution of interest-bearing and adequately secured promissory notes evidencing the loans to the PFLLC members;
- financial account statements proving that PFLLC all-cash distributions were made in proportion to the PFLLC ownership and that interest and principal of the promissory notes were timely paid; and
- other documents showing that entity formalities were consistently respected, which helped prove that the decedent impliedly retained no disproportionately beneficial or preferential income interest or control interest.

PFLLC generally made cash distributions or loans to its members only once annually, rather than more frequently or randomly. That made it easy to prove with relatively few documents that the decedent's cash distributions were always proportionate to her PFLLC ownership and that she did not control the timing or the amounts of those distributions or loans.

C. Rethink the Attorney-Client Privilege

An experienced tax litigator should be retained at the start of a family partnership tax return audit to provide advice about whether or not to assert the attorney-client privilege. Asserting the privilege solely to withhold evidence of a gift or estate tax savings motive may be counterproductive, since unavoidably self-serving (and thus perhaps not as credible) oral witness testimony downplaying the tax savings motive might be interpreted as lack of candor.[96] For that reason, the Purdue estate voluntarily produced all the documents demonstrating both the nontax and tax savings motives. A tax savings motive may already be independently established by the discounting of the family partnership interests on gift or estate tax returns. It is a negative low-value factor common to most of the Chart A family partnerships whose exception defenses still succeeded, and it is unlikely to be the most important reason for exception defense failure.[97]

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[94] An insufficient written record risks exception defense failure. *See Estate of Michelson*, T.C. Memo. 1978-371 ("Our consideration of this case has been hampered by a poor record in which much of the evidence was loosely presented and in which many potentially relevant details are tantalizingly missing."); and *Estate of Holliday*, T.C. Memo. 2016-51 ("Despite the purported nontax reasons for Oak Capital's formation, *on the record before the Court*, the estate has failed to show that there were significant legitimate reasons.") (emphasis added).

[95] A contemporaneous written record containing credible objective proof that specific nontax motives were considered or implemented, and that the other activities of the family partnership both before and after the death of the decedent satisfy its requirements, is essential to the success of the exception defense. *See supra* notes 35, 50, and the text accompanying note 8. *See also* James I. Dougherty and Kenneth A. Pun, "Best Practices Related to IRC Section 2036, Annual Exclusion Transfers and Graegin Loans," WealthManagement.com (Jan. 7, 2016); and Pun, Margaret St. John, and N. Todd Angkatavanich, "FLP Transfer Runs Afoul of IRC Section 2036(a)," WealthManagement.com (Mar. 22, 2016).

[96] "While we acknowledge much of the daughters' testimony was uncontradicted, we find their testimony, particularly regarding the rationale for the Partnership . . . to be self-serving and, more importantly, not credible." *Estate of Erickson*, T.C. Memo. 2007-107.

[97] "As Mr. Sweeney and Mr. Dinneen acknowledged at trial, both had a background in tax and so would naturally have taken tax and valuation matters into account in any recommendations they made for decedent." *Estate of Schutt*, T.C. Memo. 2005-126.

VIII. Conclusion

Charts A and B show that courts apply the balancing test in a principled and intelligible fashion,[98] and that the factors shown on those charts can be used to reliably quantify the probability of exception defense success or failure. They demonstrate the general premise about predicting exception defense outcomes stated earlier in this article: If (1) the "proportional to" requirement is satisfied and there is an objectively provable nontax motive; and (2) all the positive high-value factors weigh in favor of the family partnership; then (3) its negative low-value factors will not prevent the nontax motive from being legitimate and significant. ■

[98] "The important doctrine of stare decisis [is] the means by which we ensure that the law will not merely change erratically, but will develop in a principled and intelligible fashion. . . . Stare decisis is the preferred course because it promotes the evenhanded, predictable, and consistent development of legal principals, fosters reliance on judicial decisions, and contributes to the actual and perceived integrity of the judicial process." *Johnson v. Commissioner*, 117 T.C. 204, 214 (2001).

Chart A (Exception Defense Successes)

Regular typeface rows = positive low-value factors from exception defense successes compared with PFLLC

Shaded rows = negative low-value factors that did not prevent exception defense success

Italicized rows = positive high-value factors

Bolded rows = the "proportional to" and nontax motive requirements

#		1978 1 Mich	1987 2 Harr	2003 3 Kimb	2003 4 E. Stone	2005 5 Bong	2005 6 Schu	2008 7 Miro	2009 8 Murp	2009 9 Mill	2009 10 Kell	2009 11 Blac	2012 12 J.H. Stone	2012 13 Kelly	Total + & - Factors	PFLLC + & - Factors
1	**Partnership interest received was proportional to the value of the assets contributed**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**13**	**X**
2	*Partnership distributions during life did not disproportionately favor decedent*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*13*	*X*
3	*No express disproportionately beneficial right to amend agreement or make partnership distributions*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*13*	*X*
4	*Sufficient assets retained (decedent was not dependent on the partnership assets)*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*13*	*X*
5	*Assets actually transferred/personal assets not commingled with the partnership assets*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*X*	*13*	*X*
6	**Nontax motive: management of a legacy asset, or a working interest leased to/involving third parties**	**X**	**X**			**X**	**X**	**X**	**X**			**X**	**X**	**X**	**9**	**X**
7	Transfer to the partnership was many months or years before death	X	X			X	X		X	X		X	X	X	9	X
8	Negative: tax motive — gift/estate tax discounts (decedent was advised of tax advantages)			X	X	X	X	X	X	X	X	X			9	X
9	Not in failing health at time of transfer to the partnership (transfer not in contemplation of death)	X			X	X			X	X		X	X		7	X
10	Negative: partnership assets were lent or distributed to estate for estate taxes, expenses				X			X	X	X	X	X			6	X
11	Negative: health was failing at time of transfer, or decedent had terminal illness	X	X				X	X			X			X	6	
12	The nontax motive was actually fulfilled (not theoretical)				X		X	X		X		X		X	6	X
13	Negative: either a deathbed transfer or a relatively short time between the transfer and death		X	X	X			X			X				5	
14	Multiple managers/decision-makers, requiring voting rules, dispute resolution rules				X			X	X		X		X		5	X
15	Children participated in planning for the partnership or had independent legal advice/divergent interests				X			X	X			X	X		5	X
16	Active management of partnership assets was required or occurred				X			X	X	X				X	5	X
17	**Nontax motive: facilitating passing family assets to future generations**							**X**	**X**		**X**		**X**		**4**	**X**
18	**Nontax motive: protecting against interfamily litigation/partition actions**			**X**	**X**								**X**	**X**	**4**	**X**
19	**Nontax motive: relieving business-/investment-experienced spouse of management burdens**	**X**			**X**				**X**	**X**					**4**	**X**
20	Partnership asset management was extensive and time consuming				X			X		X					3	X
21	**Nontax motive: protected against actual divorce of descendant (not theoretical)**								**X**		**X**	**X**			**3**	**X**
22	Post-death loans for estate taxes were evidenced by interest-bearing notes								X		X	X			3	X
23	Post-death loans for estate taxes were secured by the partnership interests								X		X	X			3	X
24	Negative: transfer delayed for substantial time after partnership formation (but was eventually made)							X		X	X				3	
25	**Nontax motive: planning for management of partnership assets by children**				**X**			**X**					**X**		**3**	**X**
26	Negative: manager of the partnership assets was the same before and after, or same brokers before and after		X	X									X		3	
27	**Nontax motive: furthering family investment goals, pooling of interests, joint management**							**X**					**X**	**X**	**3**	**X**
28	**Nontax motive: providing for management succession**			**X**									**X**	**X**	**3**	**X**
29	**Nontax motive: consolidating and protecting non-legacy/"working" assets**							**X**			**X**				**2**	**X**
30	Securities actively traded after the transfer to the partnership							X		X					2	X
31	Partnership managers acquired new or special skills through training, education, and research							X		X					2	X
32	**Nontax motive: avoiding redundant transfers of real estate between generations**			**X**									**X**		**2**	**X**
33	Regular partnership meetings occurred; written minutes kept							X						X	2	X
34	Estate considered non-partnership sources or loans to pay estate taxes											X			1	X
35	**Nontax motive: making gifts of partnership interests to provide cash flow to descendants**								**X**						**1**	**X**
36	**Nontax motive: qualifying for investments not otherwise available to partners separately**							**X**							**1**	**X**
37	**Nontax motive: ensuring that decedent's assets are invested "in a manner desired and trusted"**									**X**					**1**	**X**
38	**Nontax motive: transfer was "advantageous to and in best interests of decedent"**		**X**												**1**	**X**
39	**Nontax motive: facilitating a corporate liquidity event**					**X**									**1**	
40	Negative: nothing changed in how assets managed, or in dedecent's relationship to them, before and after transfer												X		1	
	Total Positive Factors	**9**	**8**	**8**	**14**	**9**	**8**	**19**	**17**	**14**	**11**	**14**	**16**	**13**		**32**
	Total Negative Factors	**1**	**3**	**3**	**3**	**1**	**2**	**5**	**2**	**3**	**5**	**2**	**2**	**1**		**2**

	Exception Defense Success Cases	Character of Assets
1	*Estate of Michelson v. Commissioner,* T.C. Memo. 1978-371	Real estate
2	*Estate of Harrison v. Commissioner*, T.C. Memo. 1987-8	Real estate
3	*Kimbell v. United States*, 371 F.3d 257 (5th Cir. 2004)	Other
4	*Estate of (Eugene) Stone v. Commissioner*, T.C. Memo. 2003-309	Other
5	*Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005) (as to the first transfer)	Other
6	*Estate of Schutt v. Commissioner*, T.C. Memo. 2005-126	Marketable securities
7	*Estate of Mirowski v. Commissioner*, T.C. Memo. 2008-74	Marketable securities
8	*Estate of Murphy v. United States*, 104 AFTR 2d 2009-7703 (W.D. Ark. 2009)	Other
9	*Estate of Miller v. Commissioner*, T.C. Memo. 2009-119 (as to the first transfer)	Marketable securities
10	*Keller v. United States*, 104 AFTR 2d 2009-6015 (S.D. Tex 2009), *aff'd*, 697 F.3d 238 (5th Cir. 2012)	Marketable securities
11	*Estate of Black v. Commissioner*, 133 T.C. 340 (2009)	Other
12	*Estate of (Joanne H.) Stone v. Commissioner*, T.C. Memo. 2012-48	Real estate
13	*Estate of Kelly v. Commissioner*, T.C. Memo. 2012-73	Other

Chart B (Exception Defense Failures)

Regular typeface rows = negative low-value factors from exception defense cases compared with PFLLC

Shaded rows = negative low-value factors that did not prevent Chart A exception defense success

Italicized rows = negative high-value factors

Bolded rows = the "proportional to" requirement

		1997	2000	2002	2007	2008	2004	2004	2004	2005	2005	2006	2006	2006	2007	2007	2007	2009	2009	2009	2011	2011	Total	PFLLC
		1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**11**	**12**	**13**	**14**	**15**	**16**	**17**	**18**	**19**	**20**	**21**	**Negative**	**Negative**
#	**Description**	Scha	Reic	Harp	Gore	Hurf	Abra	Hill	Thom	Bong	Stra	Disb	Rose	Korb	Eric	Bige	Rect	Jorg	Mill	Malk	Turn	Lilj	**Factors**	**Factors**
1	No substantial joint enterprise before and after death of decedent		X	X	X	X		X	X	X	X	X	X		X	X	X		X	X	X	X	17	
2	Health was failing at time of transfer, or decedent had terminal illness	X	X	X	X	X	X	X			X	X	X	X	X	X	X		X	X	X		17	
3	A tax savings motive: gift/estate tax discounts (decedent was advised of tax advantages)					X	X		X	X	X	X	X	X	X	X	X	X		X	X	X	15	X
4	No new business/investment plan or strategy was implemented	X	X	X		X		X	X	X	X	X	X		X		X			X	X	X	15	
5	"Mere recycling of value/asset container," passive, untraded marketable securities portfolio			X	X	X		X	X	X	X	X	X		X		X	X		X	X		14	
6	*Decedent was impoverished by transfer, remained dependent on partnership assets*		*X*			*X*	*X*	*X*	*X*		*X*		*X*	*X*	*X*	*X*	*X*		*X*	*X*		*X*	*14*	
7	Nothing changed in how assets managed, or dedecent's relationship to them, before and after	X	X		X	X		X	X	X	X	X	X		X					X	X	X	14	
8	Manager of the partnership assets was the same before and after/same brokers before and after	X	X		X	X		X	X	X	X		X		X					X	X	X	13	
9	*Disproportionate distributions favoring decedent during life; or estate after death*	*X*		*X*		*X*		*X*	*X*				*X*	*X*		*X*	*X*		*X*	*X*	*X*	*X*	*13*	
10	Multiple parties not involved in partnership formation, decedent on both sides, no arm's-length bargain			X	X			X	X	X	X		X	X	X			X		X	X	X	13	
11	Partnership formalities disregarded/no change to books and records/inadequate documentation for loans	X			X	X		X					X		X	X	X	X		X	X	X	12	
12	*Personal funds commingled with partnership funds*	*X*	*X*	*X*	*X*	*X*		*X*				*X*						*X*			*X*	*X*	*10*	
13	Partnership assets were loaned or distributed to estate for estate taxes, expenses			X		X		X	X				X		X		X	X	X			X	10	X
14	Transfer delayed for substantial time after partnership formation *(or never made)*			X	X	X		X							X		X		X		X	X	9	
15	*Decedent's personal expenses and bills paid directly from the partnership account*		*X*		*X*	*X*										*X*	*X*	*X*		*X*	*X*	*X*	*9*	
16	Post mortem/after-the-fact accounting adjustments made to correct failure of formalities		X	X	X			X			X		X					X				X	8	
17	Transfer to the partnership was a deathbed transfer (death occurred very shortly after transfer)	X			X	X		X			X				X				X	X			8	
18	No independent legal advice for other partners/members					X				X					X		X	X	X	X		X	8	
19	No regular partner/member meetings					X		X					X				X	X		X		X	7	
20	*Decedent/attorney-in-fact is sole general partner/manager or otherwise controlled the partnership*		*X*						*X*	*X*			*X*		*X*		*X*				*X*		*7*	
21	*Express retention of a disproportionate or preferential income right*						*X*		*X*			*X*								*X*	*X*	*X*	*6*	
22	**Initial partnership interest received not proportional to contribution**					**X**		**X**				**X**						**X**				**X**	**5**	
23	*Decedent made personal gifts to family members directly from partnership account*								*X*				*X*					*X*			*X*	*X*	*5*	
24	*Decedent or attorney-in-fact personally controlled the partnership checking account*	*X*	*X*			*X*							*X*					*X*					*5*	
25	No written minutes of partner meetings							X					X					X				X	4	
26	Inconsistent positions taken on estate tax return and income tax returns							X						X								X	3	
27	*Decedent lived rent-free, or enjoyed a bargain rent, in partnership-owned residence*		*X*								*X*	*X*											*3*	
28	*Decedent took loans from partnership not evidenced by notes*															*X*		*X*					*2*	
29	Partnership asset management was not extensive or time consuming									X						X							2	
30	Protection from claims/litigation was purely theoretical									X						X							2	
31	Partnership provided no management advantages versus a durable power of attorney/revocable trust												X					X					2	
32	*Partnership loans were made preferentially to decedent*												*X*			*X*							*2*	
33	No team of partnership managers (only one manager vote needed)									X												X	2	
34	*Decedent had unilateral right to amend the partnership agreement*																				*X*		*1*	
35	Transfer did not include "a regularly conducted real estate activity that required active management"																				X		1	
36	No series of multiple partnership gifts made to lower generations, which might be a valid nontax purpose									X													1	
37	**Contributions not properly credited to capital accounts**																					**X**	**1**	
38	Ignored own appraisers' values in valuing the partnership interests																					X	1	
39	Joint enterprise ended at death (limited partnership divided into separate partnerships)																				X		1	
40	*Loans to decedent from the partnership were never repaid during life*												*X*										*1*	
	Total Negative Factors	**9**	**12**	**10**	**12**	**19**	**4**	**19**	**13**	**13**	**12**	**10**	**21**	**6**	**15**	**11**	**14**	**16**	**8**	**16**	**19**	**24**		**2**

Exception Defense Failure Cases 1 - 11

1 *Estate of Schauerhamer v. Commissioner*, T.C. Memo. 1997-242

2 *Estate of Reichardt v. Commissioner*, 114 T.C. 144 (2000)

3 *Estate of Harper v. Commissioner*, T.C. Memo. 2002-121

4 *Estate of Gore v. Commissioner*, T.C. Memo. 2007-169

5 *Estate of Hurford v. Commissioner*, T.C. Memo. 2008-278

6 *Estate of Abraham v. Commissioner*, T.C. Memo. 2004-39

7 *Estate of Hillgren v. Commissioner*, T.C. Memo. 2004-46

8 *Turner v. Commissioner* (*Estate of Thompson*), 382 F.3d 367 (3d Cir.2004)

9 *Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005) (as to the second transfer)

10 *Estate of Strangi v. Commissioner*, 417 F.3d 468 (5th Cir. 2005)

11 *Estate of Disbrow v. Commissioner*, T.C. Memo. 2006-34

Exception Defense Failure Cases 12 - 21

12 *Estate of Rosen v. Commissioner*, T.C. Memo. 2006-115

13 *Korby v. Commissioner* (*Estate of Korby*), 471 F.3d 848 (8th Cir. 2006)

14 *Estate of Erickson v. Commissioner*, T.C. Memo. 2007-107

15 *Estate of Bigelow v. Commissioner*, 503 F.3d 955 (9th Cir. 2007)

16 *Estate of Rector v. Commissioner*, T.C. Memo. 2007-367

17 *Estate of Jorgensen v. Commissioner*, T.C. Memo. 2009-66

18 *Estate of Miller v. Commissioner*, T.C. Memo. 2009-119 (as to the second transfer)

19 *Estate of Malkin v. Commissioner*, T.C. Memo. 2009-212

20 *Estate of Turner v. Commissioner*, T.C. Memo. 2011-209

21 *Estate of Liljestrand v. Commissioner*, T.C. Memo. 2011-259

Not shown above: *Estate of Holliday v. Commissioner*, T.C. Memo. 2016-51; and *Estate of Beyer v. Commissioner*, T.C. Memo. 2016-183. Both were decided after *Estate of Purdue* and were not considered by Judge Joseph Robert Goeke.