

ESTATE PLANNING
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PROBLEM SET 10

I. Family Limited Partnerships

Mom forms a family limited partnership (“FLP”). She is convinced that the FLP is an incredible way to save transfer taxes. She is thinking about placing all of her real estate and corporate securities in the FLP. She would own a majority interest in the company serving as the GP of the FLP, and would own most of the limited partner interests in the FLP initially. She would give limited partner interests in the FLP to her family members over time. *Based upon your general knowledge of estate planning, do you have any words of caution? Do not limit yourself to valuation issues. Do not rely on any particular section of the materials. Just think.*

II. Special Valuation Rules in Context of Business Entities

Note: Focus on valuation issues arising under Code section 2701 for Parts A-E, and on those arising under Code sections 2703 and 2704 for Part F. Review these statutory provisions closely.

A

Dad forms a corporation by contributing \$100,000 to its capital. In exchange, Dad receives 5,000 shares of preferred stock and 5,000 shares of common stock. The preferred stock pays 5% **non-cumulative** dividends, has a liquidation preference in the amount of its par value (\$100,000), and carries the right to force the corporation to liquidate. Dad then gives 2,500 shares of common stock to Junior. *What are the gift tax consequences of the transfer?*

B

Same facts as in A, except Dad’s preferred stock pays 5% **cumulative** dividends. *What are the gift tax consequences of the transfer?*

C

Same facts as in B, except that the rate of dividend payment on Dad’s preferred stock is 10%, and the market rate of return on similar investments is the same. *What are the gift tax consequences of the transfer?*

D

Same facts as in B, except that Dad gives Junior 2,500 shares of the preferred stock. *What are the gift tax consequences of the transfer?* If Dad wants to give preferred stock to Junior, would you recommend giving stock with different terms?

E

Same facts as in A, except Dad gives Junior 1,000 shares of preferred stock and 1,000 shares of common stock. *What are the gift tax consequences of the transfer?*

F

Your client, Able Bob Catz, owns a 35% limited partnership interest in the XYZ Limited Partnership. Various family members own a total of 60% of the remaining limited partner interests. Able also owns a 1% general partner interest in the partnership, and an unrelated third party owns a 4% general partner interest. The partners in XYZ Partnership have agreed to offer to sell their interests first to the other partners before they can sell to a third party. The purchase price is determinable under a formula set forth in the partnership agreement. Assume that under state law, a general partner has the power to liquidate a partnership, and that upon the death of Able or a transfer of his general partner interest, his general partner interest will become a limited partner interest. Also assume that the partnership agreement provides that the limited partners shall not have the right to compel a general partner to liquidate the partnership, not even with a unanimous vote of the limited partners. Without such an agreement, state law provides that such a unanimous vote of the limited partners would suffice to dissolve and wind up the partnership. Further, state law provides that a limited partner has the right to withdraw and receive the value of her interest upon notifying a general partner six months in advance, unless the term of the partnership is fixed by the partnership agreement. *Advise Able as to the transfer tax consequences of gifting or retaining his partnership interest. Articulate any questions that you have for him before you can advise him intelligently.*

III. Other Issues in Valuing Family Business Interests

Consider the following examples, and discuss what valuation discounts (if any) are potentially available to your client:

1. Earl owns 1,000 shares of General Motors stock. He wants to give 300 shares of the stock to Bill. What results if the stock is unrestricted as to its resale? What if it is restricted stock under the securities laws? What if this is a bequest, rather than a lifetime gift, and the restrictions lapse upon the death of Earl?
2. Earl owns 80% of the stock of ToyCo, a closely held corporation engaged in the production of mechanical trains and dolls. Earl would like to give 10% of the shares of ToyCo to Bill. ToyCo has assets with an aggregate adjusted basis of \$1 million and a fair

market value of \$5 million.

3. You represent the estate of Earl's father. At his death, he owned 100% of stock in a privately held company holding real property.
4. Earl wants to give \$30,000 to a corporation owned equally by his son, daughter and nephew. He reasons that the gift should be valued at less than \$30,000 because of its being tied up in corporate form. Do you think that the gift would accomplish Earl's purposes? Are the results any better if, instead of these facts, (A) Earl owns the corporation himself, (B) the corporation's assets have been appraised at \$100,000, and (C) Earl gives 10% of the corporate stock to each of his son, daughter, and nephew?