
THE USE OF DEFINED VALUE AND FORMULA ALLOCATION CLAUSES -- WHERE ARE WE?

Chicago Estate Planning Council

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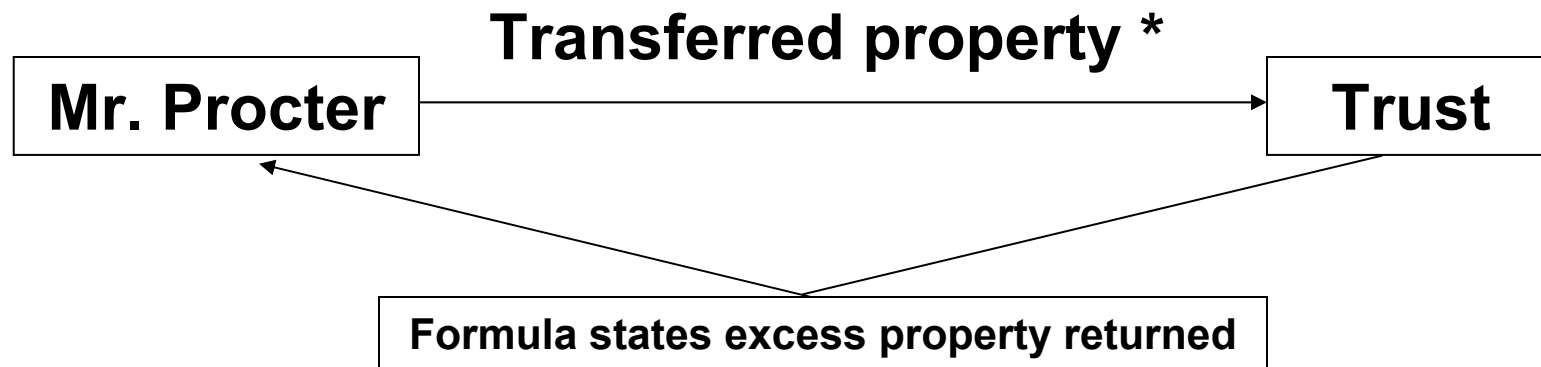
Recent Valuation Decisions

<u>Case</u>	<u>Assets</u>	<u>Court</u>	<u>Discount from NAV/Proportionate Entity Value</u>
<i>Strangi I</i>	securities	Tax	31%
<i>Knight</i>	securities/real estate	Tax	15%
<i>Jones</i>	real estate	Tax	8%; 44%
<i>Dailey</i>	securities	Tax	40%
<i>Adams</i>	securities/real estate/minerals	Fed. Dist.	54%
<i>Church</i>	securities/real estate	Fed. Dist.	63%
<i>McCord</i>	securities/real estate	Tax	32%
<i>Lappo</i>	securities/real estate	Tax	35.4%
<i>Peracchio</i>	securities	Tax	29.5%
<i>Deputy</i>	boat company	Tax	30%
<i>Green</i>	bank stock	Tax	46%
<i>Thompson</i>	publishing company	Tax	40.5%
<i>Kelley</i>	cash	Tax	32%
<i>Temple</i>	marketable securities	Fed. Dist.	21.25%
<i>Temple</i>	ranch	Fed. Dist.	38%
<i>Temple</i>	winery	Fed. Dist.	60%
<i>Astleford</i>	real estate	Tax	30% (GP); 36% (LP)
<i>Holman</i>	Dell stock	Tax	22.5%
<i>Keller</i>	securities	Fed. Dist.	47.5%
<i>Murphy</i>	securities/real estate	Fed. Dist.	41%
<i>Gallagher</i>	publishing company	Tax	47%

Formula Transfers

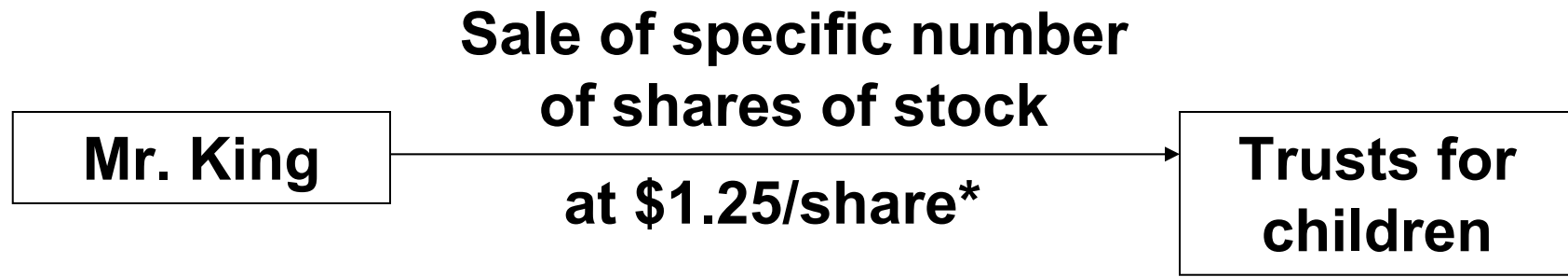
- **Potential Benefit — Allows transferor to define the dollar value of hard-to-value assets passing to taxable transferees**
- **Types of formula clauses:**
 - Defined value clause based on values "as finally determined for estate/gift tax purposes" (*Christiansen/Petter/Wandry*)
 - Defined value clause (*McCord/Hendrix*)
 - Price adjustment clauses (*King*)
 - **Reversion clauses do not work** (*Procter*)

Procter v. Comm'r (4th Cir. 1944)



- * Clause provided that any "excess property hereby transferred which is decreed by such court to be subject to gift tax, shall automatically be deemed not to be included in the conveyance. . . ."

King v. U.S. (10th Cir. 1976)



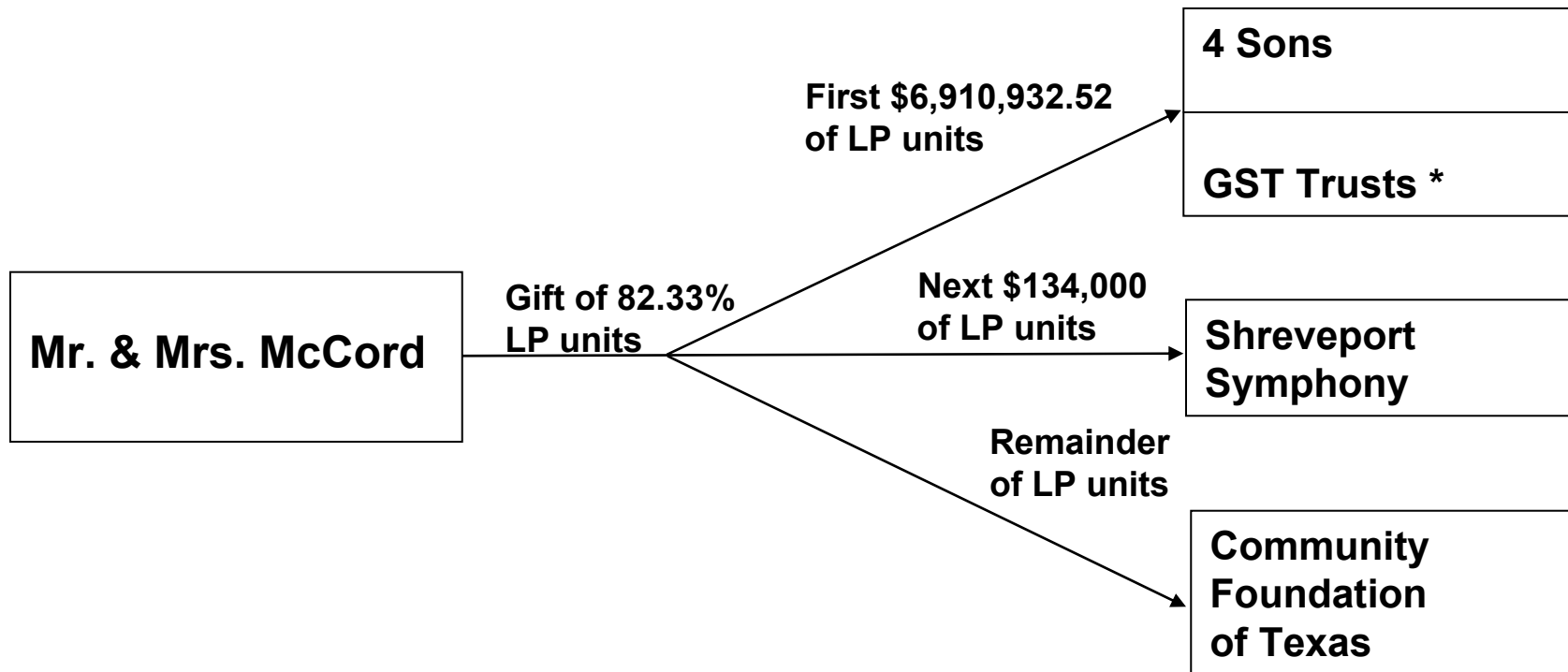
- * Formula stated that "if the fair market value . . . as of the date of . . . [the agreement] is ever determined by the Internal Revenue Service to be greater than the fair market value determined in the . . . manner described above, the purchase price shall be adjusted to the fair market value determined by the Internal Revenue Service."

After *Procter* -- Formulas Sanctioned by the Treasury

- Formula marital deduction clauses
- Formula GST transfers
- Split interest charitable trusts
- Formula transfers to a GRAT

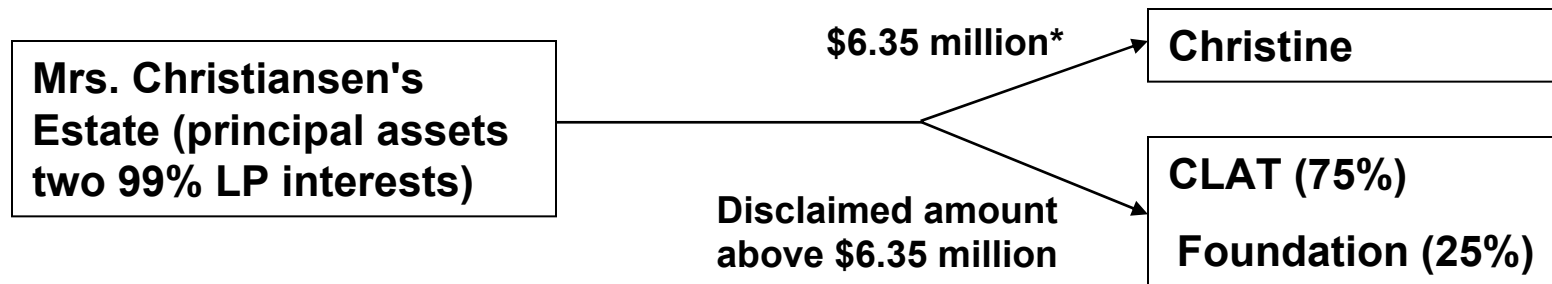
Formalistic adjustment would be made **only** if the value of the transferred property is determined to be different than originally reported value.

McCord v. Comm'r (5th Cir. 2006)



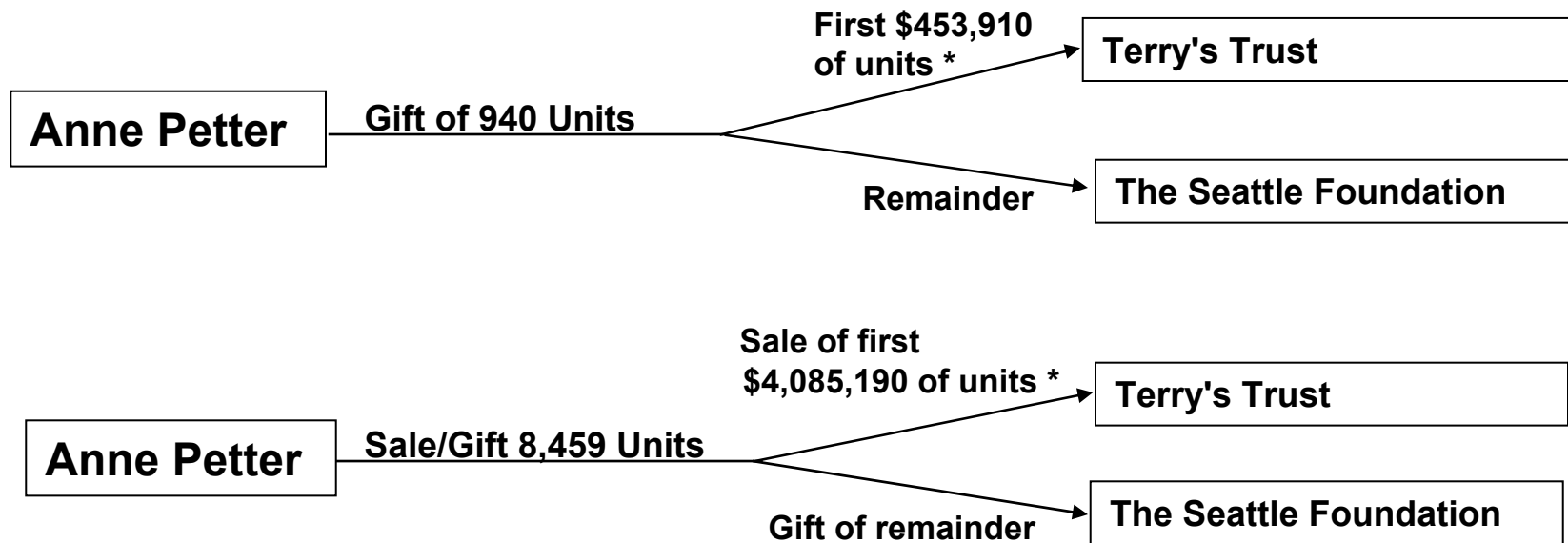
- Formula not based on values as finally determined
- Sons, GST Trusts and Charities reached agreement post-transfer on number of units each received (Confirmation Agreement)
- * Remaining GST exemption

Christiansen v. Comm'r (Tax Court 2008) (8th Cir. 2009)



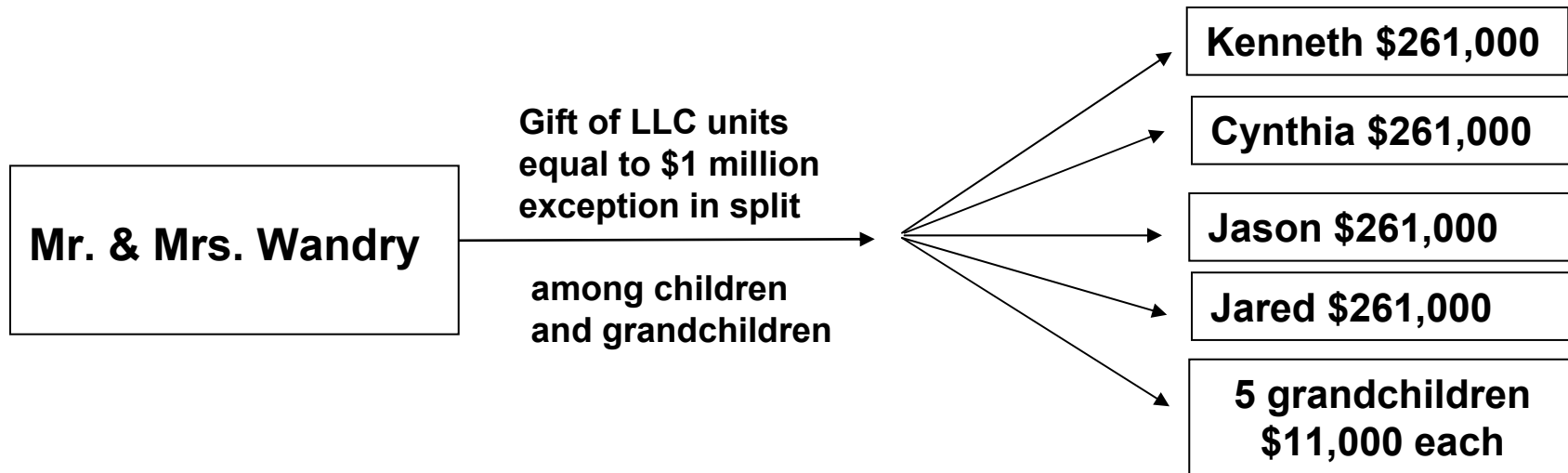
* Based on values as finally determined for federal estate tax purposes.

Petter v. Comm'r (Tax Court 2009) (9th Cir. 2011)



* Based on value of units as finally determined for federal gift tax purposes.

Wandry v. Comm'r (Tax Court 2012) (IRS Non-acq.)



- * Formula stated "Although the number of Units gifted is fixed on the date of the gift, that number is based on the fair market value of the gifted Units, which cannot be known on the date of the gift but must be determined after such date based on all relevant information as of that date. Furthermore, the value determined is subject to challenge by the Internal Revenue Service ("IRS"). I intend to have a good-faith determination of such value made by an independent third-party professional experienced in such matters and appropriately qualified to make such a determination. Nevertheless, if after the number of gifted Units is determined based on such valuation, the IRS challenges such valuation and a final determination of a different value is made by the IRS or a court of law, the number of gifted Units shall be adjusted accordingly so that the value of the number of Units gifted to each person equals the amount set forth above, in the same manner as a federal estate tax formula marital deduction amount would be adjusted for a valuation redetermination by the IRS and/or a court of law."

Potential Donees of the "Excess Amount" Under Formula Clause

- 1) Public Charity/Donor Advised Fund
 - Independent fiduciary obligation
 - Subject to private inurement and excess benefit rules
 - *McCord, Hendrix, Petter*
- 2) Private Foundation
 - Self-dealing, excess business holdings and other rules make it difficult
- 3) Lifetime QTIP
- 4) GRAT
 - IRS has argued this is a reversionary interest similar to *Procter*
- 5) None? — *Wandry*
- 6) Consideration Adjustment? — *King*

Gift Tax Reporting

1) Starts the statute of limitations

- Need to file to obtain "as finally determined value"

2) Report consistent with formula

- Avoid *Knight v. Comm'r* problem
- Reflect formula in gift tax return schedule
- Units initially allocated based on formula and appraisal
- Attach formula transfer documents and appraisal

Income Tax Issues

- 1) If charity receives interest, value deductible
 - Consider protective claim in event value going to charity increases to obtain additional charitable deduction

- 2) If units may be reallocated based on "values as finally determined," consider protective claim to reallocate income/deduction items in event of change in value
 - Not necessary with *McCord* type transaction because units allocated remain unaffected -- not based on "values as finally determined"



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