Turner v. Commissioner, T.C. Memo. 2011-209 (August 30, 2011)

Family Limited Partnership Assets Included Under § 2036(a)(1) and (a)(2); Payment of Insurance Premium For ILIT Qualifies for Annual Exclusion Even If Crummey Withdrawal Beneficiary Is Not Aware of Indirect Contribution to Trust or Withdrawal Power

September 2011
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Synopsis

The decedent and his wife transferred marketable securities and investment assets to a family limited partnership in return for the 1% general partnership interest and 99% limited partnership interests (owned equally by them). They retained assets, the income from which was sufficient to provide their living expenses. In late 2002 and early 2003, the decedent and his wife made gifts of 43.6% limited partnership interests to family members. The decedent and his wife paid themselves management fees of $2,000 per month although they provided few if any management services. After the gifts of partnership interests were made, no distributions were made to the family members prior to the decedent's death, but various payments were made to the decedent and his wife (although they were treated as repayment of advances made by the decedent and not as distributions). The decedent used partnership funds for personal uses (making gifts, making insurance premium payments, and paying estate planning legal fees).

The court (Judge Marvel) concluded that that one-half of the partnership assets (representing the decedent's one-half of the assets contributed to the partnership) were included in the decedent's estate under § 2036. The bona fide sale exception to § 2036 did not apply. The court rejected the purported nontax reasons urged by the estate: asset consolidation and centralized management, resolving family disputes, and asset protection for one grandchild.

There was an express and implied agreement for retained enjoyment of the transferred assets, triggering inclusion under § 2036(a)(1), even though the decedent and his wife had retained assets outside the partnership that were sufficient to pay their living expenses. Factors pointed out by the court include: (i) the unreasonably high management fee, (ii) the couple transferred most of their assets to the partnership, (iii) disproportionate distributions, (iv) taking distributions "at will," (v) use of partnership assets for personal uses, and (vi) the testamentary nature of the partnership's purpose.

In addition, the court also stated that §2036(a)(2) would apply. The court viewed the decedent as effectively being the sole general partner. (Even if his wife were viewed as a "coequal" general partner, the court said the same result would occur because § 2036(a)(2) applies to powers held "alone or in conjunction with any person.") The court pointed to several powers of the decedent as general partner, without indicating how important each was in its conclusion that §2036(a)(2) applied: (i) the sole and absolute discretion to make distributions of partnership income, (ii) the ability to make distributions in kind, and (iii) the ability to amend the partnership without the consent of limited partners.

The decedent's payment of insurance premiums on policies owned by an irrevocable life insurance trust were indirect gifts that qualified for the annual exclusion because the trust's Crummey withdrawal provision specifically applied to indirect gifts; therefore the gifts were not "adjusted taxable gifts" for purposes of calculating the estate tax. Whether the beneficiaries knew of the indirect gifts or of their withdrawal rights was irrelevant because they had the legal power to withdraw the indirect gift amount.

Basic Facts

1. *Family Background*. (a) Clyde Turner, Sr. (the decedent) had a close relationship with his siblings and owned a lumber company with his brothers. The decedent's son (Clyde Jr.) and his two sons also were involved with that business. (b) Clyde Jr. had a domineering personality and had a poor relationship with his sisters and their husbands. The involvement of Clyde Jr. and his sons in the lumber company caused the sisters to suspect that their parents favored Clyde Jr. (c) One daughter predeceased, leaving two teenage sons. One of them (Rory) abused illegal drugs and was arrested repeatedly.

2. *Assets*. The decedent and his wife owned substantial stock in Regions Bank, which held sentimental value for them. They also owned their home and various investment assets, and also had some real estate investments through two developers.

3. *Life Insurance Trust*. The decedent established an irrevocable life insurance trust. For three years (2000-2003) the decedent paid the life insurance premiums directly, without first contributing the money to the trust to allow the trust to pay the premium. The trust agreement provided that the beneficiaries had "Crummey withdrawal powers" after each "direct or indirect transfer" to the trust.

4. *Management of Assets*. One of Clyde Jr.'s sons, Marc, began helping the decedent with bookkeeping and finances in about 1994. In 2001, the decedent had a meeting with Marc to discuss assets, and Marc testified that his grandparents wanted him to "help them come up with a way to manage their assets, to pool their assets together, to come up with an idea, a vehicle to come forth and be able to take care of business for them."

5. *Meeting to Discuss Family Limited Partnership*. The decedent, his wife, and Marc met with an attorney to discuss the formation of a family limited partnership. The attorney explained in a letter following that meeting that "A key element to a gifting plan is the need of a sound appraisal of the partnership for tax purposes."

6. *Formation of Family Limited Partnership*. The partnership was formed on April 15, 2002.

   General partners: Decedent and his wife each acquired 0.5% GP interests.

   Limited partners: Decedent and his wife each acquired 49.5% LP interests.

7. *Contributions to Family Limited Partnership*. The list of assets to be contributed was not finalized until at least July 2002, and transfers were not completed until at least December 2002. About 60% of the assets contributed to the partnership consisted of Regions Bank stock. The balance consisted of stock and marketable securities. No operating businesses or assets requiring active management were transferred to the partnership.

8. *Retained Assets*. The decedent and his wife retained more than $2 million of assets, generating annual income of at least $90,000, sufficient to pay their living expenses.

9. *Purposes Listed in Partnership Agreement*. The partnership agreement listed three general purposes and nine specific purposes. However, the partnership agreement was based on a standard form used by the attorney, and some of the purposes did not apply (such as consolidating fractional interests in realty when the partnership owned no real property). The court stated as a fact that the decedent's actual purposes for establishing the partnership "were not necessarily reflected in the partnership agreement."

10. *Management Fee*. The partnership agreement provided that the general partner would pay operating expenses personally, and in consideration of that would receive a special allocation of income. Also, the general partner was entitled to "a reasonable management charge." Instead of paying the partnership expenses personally and receiving a special allocation of income, the decedent and his wife paid themselves $2,000 per month as a management fee.

    The partnership paid $500 per month to each of two grandsons (Marc and his brother) for providing "daily management services," but the decedent told the accountant to treat the payments as "gifts of appreciation." Those payments were not deducted by the partnership or treated as taxable income to the grandsons.

11. *Gifts of Limited Partnership Interests*. The decedent and his wife made gifts of limited partnership interests on December 31, 2002 and January 1, 2003. The gifts were reported on a gift tax return

filed in October, 2004. (This estate tax case makes no mention of the fact that the 2002 gifts were reported late.) The reported values of the limited partnership interests were based on an appraisal. Partnership interests were given to Clyde, Jr. and the decedent's two surviving daughters and to the two children of his predeceased daughter. (The gifts for Rory were made to a trust for his benefit.) After the gifts were completed in January, 2003, the decedent and his wife still owned collectively 1.0% general partnership interests and 55.6% limited partnership interests. Immediately before the first gifts were made in 2002, the two daughters demanded an amendment to the partnership agreement (so that Clyde Jr.'s sons would not become the successor general partners of the partnership following the deaths of the decedent and his wife.)

12. *Partnership Operations*. Few changes were made in the investment assets other than "a handful of asset purchases and sales." None of the Regions Bank stock was sold. The partnership paid legal fees, some of which represented estate planning for the decedent. The partnership purchased two separate real estate investments, using the same developers that the decedent had previously used in acquiring real estate investments. At one point, the decedent paid the outstanding acquisition indebtedness on the first property that was acquired ($171,543), and subsequent payments from the partnership to the decedent and his wife were treated as repayments of that advance. (The advance was not reflected as a loan on the partnership's general ledger until over a year after the advance was made.) When the second real estate investment was acquired, the partnership was unable to obtain a loan by the date of the closing, and the Decedent personally paid for the investment, and was repaid the following day after the partnership received a loan to finance the purchase.

13. *Partnership Payments to Decedent and His Wife*. The Partnership made $41,500 of payments in 2002 and $86,815 of payments ($46,170 of which was for estimated federal and state taxes) in 2003 to the decedent and his wife, not counting the reimbursement of his payment for the second real estate investment. No distributions were made to the other limited partners in 2002 or 2003. The partnership's 2003 income tax return did not report any distributions to the general or limited partners, but took the position that the payments in 2003 (other than the monthly management fee) reduced the balance of the loan from the decedent's payment of the acquisition indebtedness on the first property. In 2004, the partnership made a variety of distributions to the partners, but disproportionately large distributions were made to the decedent (or his estate) and his wife.

14. *Decedent's Death and Estate Tax Audit*. The decedent became seriously ill in October 2003 and died February 4, 2004. The estate reported the decedent's general and limited partnership interests at $30,744 and $1,578,240, respectively, on the estate tax return. The IRS asserted that one-half of the net asset value of the partnership was includable in the decedent's gross estate under §§ 2035 (the gifts were made within three years of death), 2036, and 2038. The stipulated net asset value of the partnership was $9,580,520. Because all of the partnership interests given by the decedent were brought back into his gross estate, the total "adjusted taxable gifts" were reduced by the amount of those gifts for purposes of calculating the estate tax. The IRS also asserted that premiums paid on the life insurance policies did not qualify for the gift tax annual exclusion and should be treated as adjusted taxable gifts for purposes of the estate tax calculation.

Holdings

1. *Partnership Assets Included in Estate Without Discount*. One-half of the partnership assets (attributable to the decedent's one-half interest) were included in the decedent's gross estate under § 2036. (Because § 2036 applied, the court did not address §§2035 or 2038.)

> "In summary, we conclude that Clyde Sr. made an inter vivos transfer of property to Turner & Co., the transfer was not a bona fide sale for adequate and full consideration because it was not motivated by legitimate and significant nontax purpose, and Clyde Sr. retained by both express and implied agreement the right to possess and enjoy the transferred property, as well as the right to designate which person or persons would enjoy the transferred property."

2. *Payment of Life Insurance Premium Directly By Decedent Qualified for Annual Exclusion and Are Not "Adjusted Taxable Gifts" for Purposes of the Estate Tax Calculation.*

> "The terms of Clyde Sr.'s Trust gave each of the beneficiaries the absolute right and power to demand withdrawals from the trust after each direct or indirect transfer to the trust. The fact that Clyde Sr. did not transfer money directly to Clyde Sr.'s Trust is therefore irrelevant. Likewise, the fact that some or even all of the beneficiaries may not have known they had the right to demand withdrawals from the trust does not affect their legal right to do so… We therefore conclude that the premium payments Clyde Sr. made as indirect gifts to Clyde Sr.'s Trust in 2000-2003 were gifts of present interests and are subject to the annual exclusion."

Analysis

1. *Burden of Proof Not Addressed*. The court did not decide whether the burden of proof was shifted to the IRS under §7491(a), because its conclusion is based on a preponderance of the evidence. (The IRS argued that the estate did not comply with the IRS's reasonable request for information during informal discovery, which necessitated the use of formal discovery procedures.)

2. *General Statement of Purpose and Requirements of § 2036 (a).*

> "The purpose of section 2036 (a) is to include in a decedent's gross estate the values of the inter vivos transfers that were "essentially testamentary" in nature.… The Supreme Court has defined as "essentially testamentary" those "transfers which leave the transferor a significant interest in or control over the property transferred during his lifetime."

Section 2036(a) applies if three conditions are satisfied: (1) the decedent made an inter vivos transfer of property; (2) the transfer was not a bona fide sale for adequate and full consideration; and (3) the decedent retained an interest or right described in § 2036(a)(1) or (2) or § 2036(b) that he did not relinquish before his death.

3. *Contributions of Assets to Partnership Satisfied Transfer Requirement.* The contribution of assets to the partnership in return for the decedent's general and limited partnership interests satisfy the transfer requirement.

4. *Transfers to Partnership Did Not Satisfy Bona Fide Sale for Adequate and Full Consideration Exception.* The bona fide sale for full consideration exception has two requirements: (1) a bona fide sale, and (2) adequate and full consideration. The IRS stipulated that the partnership interests received by the decedent and his wife were proportionate to the fair market values of assets contributed and were properly credited to capital accounts. The court concluded that satisfied the full and adequate consideration requirement (the second requirement listed above). The issue is whether the first "bona fide sale" leg is satisfied.

   a. *General Requirement.* The court stated that a bona fide sale means an arm's length transaction. Footnote 20 clarifies that is not limited to transactions between unrelated parties, but transactions between related parties are subject to a higher level of scrutiny.

In the context of a family limited partnership, this requires the existence of a legitimate and significant nontax reason for creation of the family limited partnership. "The objective evidence must establish that the nontax reason was a significant factor that motivated the partnership's creation." Whether the transfer was bona fide is a "question of motive."

b. *Nontax Reasons Urged by Estate*. The court did not merely rely upon the purposes listed in the partnership agreement because they were taken from a form agreement and do not necessarily reflect the actual reasons. "In any event, we do not simply rely on a list of reasons."

Nontax reasons urged by the estate were:

> "(1) To consolidate their assets for management purposes and allow someone other than themselves or their children to maintain and manage the family's assets for future growth pursuant to more active and formal investment management strategy; (2) to facilitate resolution of family disputes through equal sharing of information; and (3) to protect the family assets and [the decedent's wife] from Rory and protect Rory from himself."

(1) *Asset Consolidation and Centralized Management Pursuant to a Formal Strategy*. In rejecting asset consolidation and centralized management as a significant nontax purpose, the court pointed to the following facts: (i) the assets consisted primarily of marketable securities "that did not change in a meaningful way"; (ii) the assets were passive investments rather than assets requiring active management or special protections, such as a large block of voting stock in a closely held corporation (*Black v. Commissioner*), patent royalties and related investments (*Mirowski v. Commissioner*), a closely held business (*Stone v. Commissioner*), working oil and gas interests (*Kimbell v. United States*), or perpetuation of decedent's buy-and-hold investment philosophy for particular investments (*Schutt v. Commissioner*). [Observation: The court cited the *Schutt* buy-and-hold investment philosophy purpose as an example of a "special protection" situation that can represent a legitimate and significant nontax reason, but did not attempt to distinguish the fact that the decedent wanted to retain the Regions Bank stock and would not allow sales of that stock by the partnership. A possible distinction is that the partnership agreement did not reflect that purpose and did not purport to restrict sales of that stock or in any manner reflect an intent that the stock continued to be held following the deaths of decedent and his wife.]

The estate argued that the decedent contributed passive assets so that their grandsons could start an active and profitable real estate development business within the partnership. The court responded that the two real estate deals were of the same kind and with the same individuals as the decedent's real estate activity before the formation of the partnership. The decedent merely "channeled" real estate opportunities to the partnership.

The estate argued that the partnership afforded more efficient management. The court responded that Marc already has significant responsibilities with respect to his grandparents' finances before the partnership was formed. Any genuine concern regarding the scattered state of investments or lack of a formal investment strategy "could have been readily addressed without transferring the assets to a family limited partnership."

(2) *Resolution of Family Discord*. The court distinguished *Stone v. Commissioner* that had relied upon resolving family disputes as a nontax reason for creating a partnership. In that case, there was (i) bitter litigation among the family members (ii) involving a family business (iii) that required active management. In Stone the partnership identified children who would manage particular assets at various times. None of those conditions applied to the decedent's situation. The discord among the siblings arose not because of money issues but because of the sisters resentment of Clyde Jr, and the partnership did not resolve that discord.

(3) *Protection From and For Grandson*. There is no evidence that the decedent's wife wanted to be protected from requests for money from her grandson. In any event, the partnership did not protect the decedent's wife from Rory because she retained more than $2 million outside the partnership and still had access to money to give to Rory.

The partnership was not needed to protect Rory from himself, because he had no assets to protect before the gifts of limited partnership interests. Furthermore, his trust adequately protected any assets that the decedent wished to transfer to Rory, either during lifetime or at death.

c. Factors Indicating Transfers Were Not Bona Fide Sales.

(i) *"Stood on Both Sides" of Transaction*. The decedent stood on both sides of the transaction without any meaningful bargaining or negotiation. [Observation: It is surprising to see this oft-repeated justification in this case because the decedent's daughters did indeed demand changes to the partnership agreement before they became partners. However, that did not happen at the time of the original contributions to the partnership.]

(ii) *Commingling of Personal and Partnership Funds*. The decedent commingled personal and partnership funds when he used partnership funds to make gifts to his grandsons (in light of management assistance that they provided to the partnership), to pay life insurance premiums on policies that were not owned by the partnership, and to pay estate planning legal fees.

(iii) *Not Complete Transfers for Eight Months*. The decedent did not complete the transfer of assets to the partnership for at least eight months after the partnership's formation.

5. Retained Possession of Enjoyment Under § 2036(a)(1).

a. *General Requirements and Factors Under § 2036(a)(1).* Section 2036(a)(1) applies "if there is an express or implied agreement at the time of the transfer that the transferor will retain the present economic benefits of the property, even if the agreement is not legally enforceable." The court listed several general factors suggesting inclusion under § 2036(a)(1):

> "a transfer of most of the decedent's assets, continued use of transferred property, commingling of personal and partnership assets, disproportionate distributions to the transferor, use of entity funds for personal expenses, and testamentary characteristics of the arrangement."

The taxpayer bears the burden of proving that an implied agreement did not exist. The court pointed to various factors suggesting that there was an express or implied agreement of retained enjoyment.

b. *Factors In This Case Suggesting Express and Implied Agreement of Retained Enjoyment.*

(i) *High Management Fee*. The partnership agreement expressly provides that the general partner is entitled to a "reasonable" management fee. The decedent and his wife received a management fee of $2000 per month, although they apparently performed few if any management services. [Observation: Even if the management fee in absolute terms seems low, there must be some actual justification for the fee.]

(ii) *Right to Amend*. The impression that the partnership resembled an investment account from which withdrawals could be made at will is reinforced by a provision in the partnership agreement that gave the decedent the right to amend the agreement without consent of the limited partners.

(iii) *Transferred Most of Assets to Partnership*. The decedent transferred most of his assets to the partnership. [Observation: Interestingly, this is one case in which the decedent retained substantial assets outside the partnership, the income from which was sufficient to provide for living expenses. That is generally a *strong factor* suggesting that there was no implied agreement that there would be access to partnership assets to provide necessary living expenses.] The court viewed that generally strong factor of retaining assets for living expenses as being overridden by the payment of the management fee for few or no services, the disproportionate distributions to the decedent and his wife, taking distributions "at will," the use of partnership funds to pay personal expenses (even though they were treated as distributions to the decedent), and the decedent's personal payment of partnership debts and expenses without contemporaneous documentation (even though later accounted for and repaid).

(iv) *Purpose Was Primarily Testamentary*. The court viewed as "most important" that the purpose of the partnership was primarily testamentary. The decedent's initial conversations about the partnership were premised on he and his wife "not getting any younger" and wanting "to discuss estate planning." The stated goals were testamentary ("providing for [the decedent's wife] after his death, providing income for future generations, and protecting his children and grandchildren from predators").

The court did not find as credible testimony that tax savings were not discussed at an estate planning meeting. The lack of credibility of that testimony "infected" the court's view of other testimony about the decedent's purposes for creating the partnership:

> "… that lack of credibility infects all of the testimony petitioner offered about what Clyde Sr. allegedly said or intended about the purpose of the family limited partnership."

The court looked to a particular sentence written by the attorney as an indication that tax savings was an essential element of the planning: "A key element to a gifting plan is the need of a sound appraisal of the partnership for tax purposes." Perhaps the court's negative attitude toward the creation of the family limited

partnership, and its view of the partnership as primarily a testamentary planning tool is best summarized by the following sentence:

> "And indeed such appraisal was the key to Clyde Sr.'s estate plan: both the gift tax and estate tax returns used substantial discounts despite the fact that the partnership assets at each relevant date consisted of, inter alia, cash, cash equivalents, and marketable securities. In summary, we conclude that the formation of Turner & Co. had testamentary characteristics and Clyde Sr. did not curtail his enjoyment of the transferred assets after formation of the partnership."

6. *Retained Powers Causing Inclusion Under § 2036(a)(2).* The court concluded that the decedent retained the right to designate which person or persons would enjoy the transferred property, which would cause estate inclusion under § 2036(a)(2). After acknowledging that a transferor's retention of the right to manage transferred assets does not necessarily require inclusion under § 2036(a)(2), the court then listed several reasons for its conclusion that § 2036(a)(2) applied in this case. (i) The decedent effectively was the sole general partner. (In footnote 28, the court acknowledged that the decedent's wife was an equal co-general partner, but the court concluded that even if it were to treat her as a "coequal" general partner, it would reach the same conclusion because § 2036(a)(2) applies if the power is held "alone or in conjunction with any person." (ii) The partnership agreement gave the decedent as general partner "broad authority not only to manage partnership property, but also to amend the partnership agreement at any time without the consent of the limited partners." (iii) As general partner, the decedent "had the sole and absolute discretion to make pro rata distributions of partnership income (in addition to distributions to pay Federal and State tax liabilities) and to make distributions in kind." (iv) Even after the gifts of limited partnership interests, the decedent and his wife held more than 50% of the limited partnership interests and could make any decision requiring a majority vote of the limited partners. [Observation: Interestingly, the court did not include in its list of reasons the fact that the partnership gave the general partner the right to terminate and dissolve the FLP without a vote of the limited partners.]

7. *Indirect Gifts to Trust Qualified for Annual Exclusion and Those Gifts Are Not In Gross Estate.* The court's opinion is very confusing in its discussion of whether making life insurance premium payments resulted in gifts that "are included in his gross estate" (the court's statement of the issue in the opening paragraph of the case), that are includable in the decedent's "taxable estate," or that are included "for purposes of calculating [the decedent's] adjusted taxable gifts." Apparently, the issue is whether the payments resulted in taxable gifts that would be treated as "adjusted taxable gifts" for purposes of the estate tax calculation under § 2001(b).

   For three years (2000-2003) the decedent paid the life insurance premiums on policies owned by an irrevocable life insurance trust directly, without first contributing the money to the trust to allow the trust to pay the premium. The trust agreement provided that after each "direct or indirect transfer" to the trust, the beneficiaries had the absolute right to demand withdrawals from the trust. Because of the statement in the trust agreement that the "Crummey withdrawal right" applied to "indirect transfers" to the trust, the court concluded that the fact that the decedent did not transfer money directly to the trust is irrelevant.

   The court held that notice of the withdrawal powers by the beneficiaries as to each indirect transfer was not important. Citing *Crummey v. Commissioner* and *Cristofani v. Commissioner*, the court concluded that "the fact that some or even all of the beneficiaries may not have known

that they had the right to demand withdrawals from the trust does not affect their legal right to do so."

The IRS argued that even if the withdrawal powers applied to the gifts, the gifts of partnership interests in 2002 and 2003 used up the decedent's annual exclusions, so the life insurance payments could not be covered by the gift tax annual exclusions. [Observation: That argument is quite confusing particularly as to 2002, because the partnership interest gifts were made on December 31, 2002, and any life insurance premium payments presumably occurred before December 31, 2002.] The court responded that because the partnership assets were included in the decedent's gross estate under § 2036, gifts of partnership interests "must be disregarded for purposes of calculating [the decedent's] adjusted taxable gifts" (apparently in light of the last phrase of § 2001(b), "other than gifts which are includible in the gross estate of the decedent"). In the court's view (to my knowledge, a case of first impression), disregarding gifts under § 2001(b) that are brought back into the decedent's gross estate means disregarding any use of annual exclusions by those gifts, so that other gifts could be covered by annual exclusions that would otherwise constitute adjusted taxable gifts. [Observation: The wording of § 2001(b) certainly does not make clear that including as adjusted taxable gifts only taxable gifts after 1976 that are not otherwise included in the gross estate means that any use of annual exclusions by gifts that are included in the gross estate can be shifted to other taxable gifts to reduce the amount that must be included as adjusted taxable gifts in the estate tax calculation.]

Planning Implications

1. *Bona Fide Sale Exception Is Critical.* This continues the unanimous result in the FLP/§2036 cases — if the bona fide sale exception does not apply, the court finds that there is sufficient retained interest or control to cause § 2036 to apply.

2. *What Situations Can Satisfy the Bona Fide Sale Exception? Turner* reiterates the standard for the bona fide sale exception to § 2036 for FLPs that was announced in *Bongard v. Commissioner* — there must be a legitimate and significant nontax reasons for the partnership. The *Turner* case cites five FLP cases that have recognized situations involving asset consolidation and centralized management that satisfy the bona fide sale exception to § 2036. These situations include:

   - Large block of voting stock in closely held corporation, *Black v. Commissioner*
   - Joint management and keeping a single pool of assets for investment opportunities, patent royalties and related investments, *Mirowski v. Commissioner*
   - Closely held business; resolution of family litigation regarding active management of closely held business, *Stone v. Commissioner*
   - Maintaining a single pool of investment assets, providing for management succession, and providing active management of oil and gas working interests, *Kimbell v. United States*
   - Perpetuating buy-and-hold investment philosophy for du Pont stock, *Schutt v. Commissioner*.

   There have been a variety of other situations that courts have found to constitute a legitimate and significant nontax reason:

   - Preserve family ranching enterprise, consolidate undivided ranch interests, *Church v. United States*
   - Placing ownership of closely held company in a single entity for purposes of shopping the company by a single seller rather than by multiple trusts, *Bongard v. Commissioner*
   - Continue investment philosophy and special stock charting methodology, *Miller v. Commissioner*

- Protect family assets from depletion in divorces, *Keller v. United States*
- Centralized management and prevent dissipation of family "legacy assets," *Murphy v. Commissioner*
- Asset protection and management of timberland following gifts of undivided interests, *Shurtz v. Commissioner*

3. *Bad Factors in Turner For Bona Fide Sale Exception*. The *Turner* court recognized various factors that the court viewed as problematic in finding significant nontax reasons for a partnership, particularly where the primary nontax reason is to provide for asset consolidation or centralized management.

   - Merely holding an untraded portfolio of marketable securities ("portfolio of marketable securities did not change in a meaningful way")
   - No assets requiring active management
   - No assets requiring "special protection" such as a "swing vote" bloc of stock or assets.
   - "No unique or distinct investment philosophy" that the decedent hoped to perpetuate
   - Subsequent investment activity or purchases merely reflect decedent's activities before creation of the partnership. (The real estate purchases were merely real estate opportunities that "came Clyde Sr.'s way" and that he "channeled" through the FLP.
   - Same management continues, despite claims of increased management efficiencies. (Marc assisted grandparents with finances before the partnership's creation and could have continued to do so without the partnership.)
   - Existence of trusts that can provide spendthrift protection for spendthrift beneficiaries, such that the partnership adds no meaningful additional asset protection.
   - No meaningful bargaining or negotiation with anticipated partners at the time the partnership is originally formed.
   - Commingling of personal and partnership funds; using partnership assets for personal uses of the decedent (such as for making gifts, paying life insurance premiums [on policies not owned by the partnership]), and paying legal fees for the decedent's estate planning.
   - Not completing transfers to the partnership soon after the partnership is created.

4. *Factors Indicating Retained Enjoyment Triggering § 2036(a)(1)*. In *Turner*, the court specifically observed that the testamentary purposes of the partnership were "most important" in finding that there was retained enjoyment under § 2036(a)(1). Partnerships that are structured as part of an overall estate planning process will typically fall in that category. Indeed one of the reasons given by the court was that the decedent wanted to discuss estate planning in the meeting in which the FLP was discussed. Of course, that alone is not enough--§ 2036 requires "transfers which leave the transferor a significant interest in or control over the property transferred during his lifetime." *United States v. Estate of Grace*, 395 U.S. 316, 320 (1969) (interpreting predecessor statute to § 2036).

   Factors mentioned by the court as reflecting an express or implied agreement of retained enjoyment include:

   - Decedent receiving an excessive management fee where apparently no management services were actually provided.
   - Operation resembles an investment account from which withdrawals may be made at will; reinforced by partnership agreement provision that gave decedent and his wife as general partner the right to amend the agreement without consent of the limited partners.

- Transferring most the decedent's assets to the partnership. The court did some "fine dancing" around the facts to justify this as a reason suggesting an implied agreement of retained enjoyment, because the decedent in fact kept enough assets out of the partnership to provide his living expenses. Therefore, there was no apparent indication that the decedent would have to take withdrawals for living expenses.
- Taking distributions from the partnership "at will."
- Disproportionate distributions (indeed *NO* distributions were made to any other partners in 2003 while $86,815 of payments were being made for the decedent and his wife, including the monthly management fees and $46,170 for estimated income taxes).
- Using partnership assets to pay for personal uses of the decedent (such as for making gifts, paying life insurance premiums [on policies not owned by the partnership]), and paying legal fees for the decedent's estate planning.
- The decedent's personally paying debts or buying assets for the partnership, and failing to contemporaneously document those transactions as advances to the partnership.

The question is sometimes raised as to whether making distributions for paying income taxes attributable to the partnership income triggers § 2036(a)(1). While the disproportionate distributions to the decedent included largely an amount to pay federal and state income taxes, the court did not specifically suggest that making pro rata distributions to all partners to pay their income taxes attributable to partnership income would trigger § 2036(a)(1).

5. *Application of § 2036(a)(2) — Prior Discussion of § 2036(a)(2) in Strangi*. The *Turner* court goes further than any case since *Strangi* to apply § 2036(a)(2) in addition to § 2036(a)(1). (As in *Strangi*, the § 2036(a)(2) discussion may technically be dictum in that the court had already decided that the assets would be included in the gross estate under § 2036(a)(1).)

In *Strangi v. Commissioner,* the court held that § 2036(a)(1) applied and also held that § 2036(a)(2) applied to transfers to the corporation that was the general partner and to the partnership. T.C. Memo 2003-145. (This is the Tax Court opinion on remand from the Fifth Circuit, directing it to consider the §2036 issue, and is sometimes referred to as *Strangi 3*.) Judge Cohen's discussion of § 2036(a)(2) is the most expansive application of that section in any estate tax case *ever*, and drew considerable criticism from tax planners and academics. The Fifth Circuit's affirmance of *Strangi 3* did not address § 2036(a)(2). (Because §2036(a)(1) applied, the court did not reach the alternative § 2036(a)(2) issue.)

a. *Statutory Provision*. Section 2036(a)(2) provides that if the decedent has made a transfer of property (other than a bona fide sale for adequate and full consideration), the property is included in the decedent's gross estate if "the decedent, either alone, or in conjunction with others, controlled the power to designate the persons who would enjoy the property."

b. *Factors Causing § 2036(a)(2) Inclusion in Strangi*. Judge Cohen analyzed in detail the facts of *Strangi* compared to the *Byrum* case.

(1) *Background Facts*. Ninety eight percent of the decedent's wealth (about $10 million) was contributed to a partnership having a corporation as the 1% general partner and decedent as 99% limited partner. The corporation was owned 47% by the decedent, 52% by family members, and 1% by a charity (which the court ignored as de minimis).

(2) *Problematic Retained Powers*. Judge Cohen concluded that the decedent retained legally enforceable rights to designate who shall enjoy property and income from

the partnership and corporation. Judge Cohen emphasized that it is immaterial whether the documents and relationships create rights exercisable by decedent alone or in conjunction with other corporate shareholders and the corporation's president.

Partnership income — the agreement gave the general partner "sole discretion to determine distributions."

Partnership property — decedent can act together with the other shareholders to dissolve the partnership. (Under the partnership agreement, the partnership is dissolved by unanimous vote of limited partners and general partner. Under the corporation's bylaws, all of the corporation's shareholders must consent to dissolution of the partnership. Thus, decedent could act in his capacity as a limited partner and shareholder with the other owners to dissolve the partnership.) Corporation property and income (of the corporate general partner) — decedent "held the right, in conjunction with one or more other Stranco directors, to declare dividends."

"Banding together" is sufficient. Taxpayers argued that if the mere fact that a decedent "could band together with all of the other shareholders of a corporation" is sufficient to cause inclusion under § 2036(a)(2), the Supreme Court could not have reached its decision in *Byrum*. The court responded with an analysis of the additional constraints in *Byrum* that were not present in *Strangi*.

(3) *Comparison to Byrum*. Judge Cohen pointed to additional constraints upon rights to designate in *Byrum* that are not present in this case. Commentators, however, suggest that the key rule from *Byrum* is the announcement of a bright-line test turning on whether the grantor's retained powers were legally enforceable. "The [Supreme] Court's ensuing discussion of the variety of constraints that typically narrow the scope of a majority shareholder's ability to control the flow of dividends was an explication of the rationale for its bright-line test, not a listing of elements that must be present in every case if the section is to be rendered inoperative." Gans & Blattmachr, *Strangi: A Critical Analysis and Planning Suggestions*, 100 Tax Notes 1153, at 1157 (Sept. 1, 2003).

Independent Trustee. In *Byrum*, the decedent retained the right to vote stock, which could be used to elect directors, who decided what distributions would be made from the corporation. However, the stock was given to a trust with an independent trustee who had the sole authority to pay or withhold income. Under the *Strangi* facts, distribution decisions were made by the corporation.

Economic and Business Realities. The flow of funds in *Byrum* was dependent on economic and business realities of small operating enterprises that impact the earnings and dividends. "These complexities do not apply to [the partnership or corporation], which held only monetary or investment assets."

Fiduciary Duties. Judge Cohen distinguished fiduciary duties in *Byrum* because there were unrelated minority shareholders who could enforce these duties by suit. "Intrafamily fiduciary duties within an investment vehicle simply are not equivalent in nature to the obligations created by the *United States v. Byrum*, *supra*, scenario."

c. *"In Conjunction With" Broad Application.*

(1) *Judge Cohen's Analysis and Broad Potential Effects*. The court, to a larger extent than any previous § 2036(a)(2) case, interpreted the "in conjunction with" language in the statute and regulations very broadly. The court's analysis, when pushed to its extreme, would mean that any family entity could be ignored under § 2036(a)(2) because the decedent — regardless how small of an interest that the decedent held — would hold the power, "in conjunction with others" to vote its interest as a member of the entity (i) to affect indirectly when income distributions would be made, and (ii) to liquidate the entity and distribute its assets. An extension of this analysis could ultimately lead to negating any fractionalization discounts where family members hold the other interests in an asset. (For example, the taxpayer could act "in conjunction with" other family owners to sell the asset, thus avoiding or minimizing any minority or marketability discounts. This basically yields the result — under § 2036 rather than under a valuation approach — that the Treasury Department has pushed in several different legislative sessions, but that has, so far, been rejected by Congress.) It seems very doubtful that courts will extend the application of § 2036 in this manner to negate fractionalization discounts.

(2) *Prior Cases Have Limited Broad Application of "In Conjunction With" Provision*. Section 2036(a)(2) was enacted with almost identical "in conjunction with" language as § 2038. Several § 2038 cases have limited the application of this provision in determining whether a decedent held a joint power to terminate a trust. For example, a power conferred by state law to revoke or terminate a trust with the consent of all beneficiaries is not taxable. *Helvering v. Helmholz*, 296 U.S. 93 (1935), *aff'g* 75 F.2d 245 (D.C. Cir. 1934) (reasoning that this power exists under state law in almost all situations, and to hold otherwise would cause all trusts to be taxable). (This exception seems analogous to the power under state law of all partners to agree to amend the partnership agreement or to cause the liquidation of the partnership.) Another example is *Tully Estate v. Commissioner*, 528 F.2d 1401 (Ct. Cl. 1976). In *Tully*, decedent was a 50% shareholder. The corporation and decedent entered into a contract to pay a death benefit to the decedent's widow. Even though the beneficiary designation was irrevocable, the IRS argued that it could be amended for several reasons, including that the decedent and the other 50% shareholder could cause the corporation to agree with the decedent to change the beneficiary. The court's analysis is analogous to the broad extension of § 2036(a)(2) to FLPs:

> "In light of the numerous cases where employee death benefit plans similar to the instant plan were held not includable in the employee's gross estate, we find that Congress did not intend the 'in conjunction' language of section 2038(a)(1) to extend to the mere possibility of bilateral contract modification. Therefore, merely because Tully might have changed the benefit plan 'in conjunction' with T & D and DiNapoli, the death benefits are not forced into Tully's gross estate." 528 F.2d at 1404-05.

The Supreme Court in *Byrum* implicitly rejected this broad construction of the "in conjunction with" phrase in §§ 2036(a)(2) and 2038. The IRS argued that the power to vote the stock in a way that could cause liquidation of the company caused § 2036(a)(2) to apply. The Supreme Court observed that even if the decedent had conveyed a majority interest in the corporation to the trust, the right

to cause a liquidation through voting the transferred stock would have been too speculative and contingent for § 2036(a)(2) to apply. Thus, even though the decedent could participate in the process of getting cash to the trust, this participation was not treated as a right to effect distributions "in conjunction with" others.

6. *Application of § 2036(a)(2) in Turner*. The *Turner* court acknowledged that a transferor's retention of the right to manage transferred assets does not necessarily require inclusion under § 2036(a)(2), citing *Byrum* and *Schutt v. Commissioner*. However, the court gives no further analysis whatsoever of limits imposed by *Byrum*, in particular.

   One of the reasons given by the court for applying § 2036(a)(2) was that the decedent effectively was the sole general partner. (In footnote 28, the court acknowledged that the decedent's wife was an equal co-general partner, but the court concluded that even if it were to treat her as a "coequal" general partner, it would reach the same conclusion because § 2036 (a)(2) applies if the power is held "alone or in conjunction with any person.") This again raises the specter of applying the "in conjunction with" language broadly that was addressed in *Strangi* (and criticized roundly by commentators after the *Strangi* opinion was issued).

   The court mentioned three powers that the general partner had, without giving any weight to how important each was in triggering § 2036(a)(2). Those powers were:

   - The sole and absolute discretion to make pro rata distributions of partnership income (in addition to distributions to pay Federal and State tax liabilities);
   - To make distributions in kind; and
   - To amend the partnership agreement at any time without the consent of the limited partners. (Even if the consent of limited partners had been required to amend the agreement, the court observed that the decedent and his wife retained more than 50% of the limited partnership interests and could make any decision requiring a majority vote of limited partners.)

   Perhaps the court was focusing on the general partner's unilateral power to amend the partnership agreement, which is not a typical provision in family limited partnership agreements. If that is the case, the court conclusion will not have broad application to family limited partnership planning. However, the detailed discussion of § 2036(a)(2) eight years after *Strangi 3* points out that § 2036(a)(2) cannot be ignored in structuring FLPs.

7. *Observations Regarding Byrum and Importance of Fiduciary Duties*. *Byrum* was decided against the backdrop of numerous cases that had established that § 2036(a)(2) would not apply if the decedent had the discretion to make distributions that were limited by an ascertainable standard. The IRS issued Rev. Rul. 73-143, 1973-1 C.B. 407 soon after *Byrum* was decided. That Revenue Ruling explicitly agreed to an ascertainable standard exception to § 2038 where the decedent could make distributions for the support and education of the beneficiary, even though only family members are beneficiaries. Further, the fact that other partners were family members should not diminish the importance of the fiduciary duties.

   > "…a fiduciary duty is no less constraining simply because it is owed to a family member…Most critical, the Service appears to have endorsed this reading of *Byrum* in a published ruling as well. In Rev. Rul. 81-15, invoking *Byrum's* fiduciary-duty analysis, the Service concluded that § 2036(a)(2) did not apply in the case of corporate stock where the decedent had retained voting rights even though the only shareholders were apparently the decedent and a family trust created by the decedent." Gans & Blattmachr, *Strangi: A Critical Analysis and Planning Suggestions*, 100 Tax Notes 1153, at 1159 (Sept. 1, 2003).

The Tax Court has previously rejected arguments by the IRS that the presence of unrelated minority shareholders lent substance to the decedent's fiduciary duty that was critical to the outcome of the *Byrum* case. *Estate of Gilman v. Commissioner*, 65 T.C. 296 (1975), *aff'd per cur*., 547 F.2d 32 (2nd Cir. 1976)(no estate inclusion; decedent was co-trustee with power to vote stock; there was active conduct of a business and 40% of voting shares of corporation were held by sisters and there was family disharmony); *Estate of Cohen*, 79 T.C. 1015 (1982)(§ 2036(a)(2) did not apply to decedent as co-trustee of Massachusetts real estate trust; because courts hold business trustees to a "fair standard of conduct," and the decedent and his sons [as co-trustees] did not have the power to withhold dividends arbitrarily).

Holding that fiduciary duties provide a limit on the right to designate who enjoys or possesses transferred property only if there are unrelated persons who can enforce those duties is inconsistent with many cases that have held that very broad administrative powers retained by a donor as trustee do not invoke § 2036, primarily because of the restriction imposed by the fiduciary duties that were legally enforceable. Those cases involve trust transactions that do not involve any unrelated parties. *E.g. Old Colony Trust Co. v. U.S.*, 423 F.2d 601, 603 (1st Cir. 1970)(broad trustee administrative powers that could "very substantially shift the economic benefits of the trust" did not invoke § 2036(a)(2) because such powers were exercisable by the donor-trustee in the best interests of the trust and beneficiaries, and were subject to court review).

Judge Cohen's narrow interpretation of the *Byrum* case in *Strangi* is far more restrictive than the IRS's published position on *Byrum* in Rev. Rul. 81-15, 1981-1 C.B. 457. This Revenue Ruling revoked Rev. Rul. 67-54, which had held that transferring nonvoting stock, while retaining voting stock, would result in the transferred nonvoting stock being included in the estate under § 2036(a)(2). The prior Rev. Rul. was revoked in light of the *Byrum* case. The following is the complete discussion in Rev. Rul. 81-15 of the IRS's interpretation of the *Byrum* case:

> "In *United States v. Byrum*, the Supreme Court addressed the issue of includibility of transferred stock where the decedent had transferred the stock in trust, retaining the right to vote the transferred shares, the right to veto the sale or acquisition of trust property and the right to replace the trustee.
>
> The court concluded that because of the fiduciary constraints imposed on corporate directors and controlling shareholders, the decedent 'did not have an unconstrained *de facto* power to regulate the flow of dividends, much less the right to designate who was to enjoy the income.' See *Byrum, supra* at 143.
>
> Thus, *Byrum* overruled the proposition on which Rev. Rul. 67-54 was based; that is, that a decedent's retention of voting control of a corporation, coupled with restrictions on the disposition of the stock, is equivalent to the right to designate the person who shall enjoy the income."
>
> This statement was included in the Supreme Court's majority decision despite the Supreme Court's acknowledgement in footnote 25 that its conclusion was not based just on the premise that "the general fiduciary obligations of a director are sufficient to eliminate the power to designate with the meaning of § 2036(a)(2)."

This Revenue Ruling has not been modified or withdrawn. Therefore, the most recent official guidance as to the interpretation of the *Byrum* case is "that *because of the fiduciary constraints imposed on corporate directors and controlling shareholders*, the decedent did not have an unconstrained de facto power to regulate the flow of dividends, much less the right to designate

who was to enjoy the income." (emphasis added). Furthermore, under CC-2003-014, Chief Counsel attorneys cannot argue contrary to "final guidance," which includes Revenue Rulings.

8. *Section 2036(a)(2) Arguments Being Made in Litigation by IRS.* The IRS's brief in Black v. Commissioner made the argument suggested by Judge Cohen in the lower court *Strangi* opinion that the decedent's power, "in conjunction with others" triggered §2036(a)(2). In *Black*, the decedent was the 1% general partner and his son was a 0.5% general partner. The decedent held 77% of the limited partner interests at his death. The brief argued that the FLP could be dissolved and liquidated on the approval of all partners, and the decedent, "in conjunction" with the other partners could have amended the partnership agreement or simply dissolved the partnership and accelerated the enjoyment of the partnership's assets. Furthermore, the decedent, acting alone as the holder of a majority of limited partnership interests, retained the right to approve transactions not in the ordinary course of business.

> "Each of these rights conferred by the BILP agreement constitutes the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the transferred assets or the income therefrom during the decedent's lifetime for purposes of §2036(a)(2). . . And none of these rights were circumscribed by any meaningful fiduciary duty [citing a provision in the agreement that the managing partner will be indemnified for all claims except those based on gross negligence, fraud, deceit or wrongful taking]… Stated another way, on these facts, the existence of limited fiduciary duties is not a meaningful constraint on the powers conferred under the BILP agreement."

9. *IRS Likely To Increase § 2036(a)(2) Attacks in Light of Turner.* As a practical matter, the IRS has not seemed to be pressing hard on §2036(a)(2) claims. For example, in *Mirowski* the IRS did not even argue that the decedent's serving as the sole manager of the LLC by itself triggered §2036(a)(2). However, the IRS does sometimes still make the §2036(a)(2) argument in addition to other arguments under §2036(a)(1), as evidenced by the IRS's § 2036(a)(2) arguments in *Black* and *Turner*, and the IRS will likely raise the issue more frequently following its § 2036(a)(2) victory in *Turner*.

10. *Section 2036(a)(2) — Summary of Structuring Implications*. Should a senior family member serve as the general partner of the partnership? Not many cases have addressed §2036(a)(2) — *Kimbell* (which concluded that § 2036(a)(2) did not apply), *Strangi 3*, and now *Turner*. Conservative planners prefer that the decedent own none of the general partner interest, and that the decedent gets rid of the general partner interest more than three years before death. (However, even that structure would not be immune from attack, under the reasoning of *Strangi 3*, if the partnership can be liquidated with the consent of all partners; the decedent could then act "in conjunction with" other owners to liquidate the entity at any time and regain possession of his proportionate part of the assets in the entity.) But many senior family members are not willing to contribute assets to an FLP unless they have some say in the management. How should the FLP agreement be planned to avoid §2036(a)(2)?

    a. *Emphasize State Law Constraints.* John Porter has suggested that under *Estate of Cohen*, 79 T.C. 1015 (1982), if there are reasonable constraints on the exercise of discretion that can be enforced in a state law proceeding — so that the general partner can't act "willy nilly," § 2036(a)(2) should not apply.

    b. *Explicit Fiduciary Duty; No Distributions in "Sole and Absolute Discretion" of General Partner; No Exculpation.* If senior family members serve as the general partner (or are owners of the entity that serves as general partner), impose an explicit fiduciary duty on the general partner and do not allow distributions in the "sole and absolute discretion" of

the general partner, and include other more-than-de minimis partners to whom the fiduciary duty is owed. Also, do not include exculpatory language that would exculpate the general partner as to distribution decisions. (However, in *Kimbell*, there was exculpatory language and the taxpayer still won the §2036(a)(2) issue.)

c. *Concentrate Voting Decisions Regarding Distributions and Liquidation.* If the decedent has an interest in the general partner, consider concentrating all voting decisions on distributions and liquidations in a small ownership interest and having that interest owned by someone other than the decedent.

d. *All Limited Partnership Interests Owned by Trusts*. The decedent apparently could serve as general partner if all of the limited partnership interests are owned by trusts with an independent trustee or with the decedent as trustee as long as there are ascertainable standards on distributions.

e. *Trust as General Partner; Removal Power Over Trustee.* For clients that wish to plan as conservatively as possible regarding the §2036(a)(2) issue, some planners prefer using an irrevocable trust as the general partner, and if the client wishes to have some degree of input, the client could keep a trustee removal power that complies with Revenue Ruling 95-58.

11. *"Scorecard" of §2036 FLP Cases (11-20, With 2 on Both Sides)*. Of the various FLP/LLC cases that the IRS has chosen to litigate, eleven have held that at least most of the transfers to an FLP qualified for the bona fide sale exception — *Church* (preserve family ranching enterprise, consolidate undivided ranch interests); Stone (partnerships to settle family hostilities); *Kimbell* ("substantial business and other nontax reasons" including maintaining a single pool of investment assets, providing for management succession, and providing active management of oil and gas working interests); *Bongard* (placing ownership of closely held company in a single entity for purposes of shopping the company by a single seller rather than by multiple trusts); *Schutt* (maintaining buy and hold investment philosophy for family du Pont stock); *Mirowski* (joint management and keeping a single pool of assets for investment opportunities); *Miller* (continue investment philosophy and special stock charting methodology); *Keller* (protect family assets from depletion in divorces); *Murphy* (centralized management and prevent dissipation of family "legacy assets"), *Black* (maintaining buy and hold investment philosophy for closely held stock), and *Shurtz* (asset protection and management of timberland following gifts of undivided interests). In every FLP case resulting in taxpayer successes against a §2036 attack the court relied on the bona fide sale exception to §2036.

Interestingly, four of those eleven cases have been decided by (or authored by) two Tax Court judges. Judge Goeke decided the *Miller* case and authored the Tax Court's opinion in *Bongard*. Judge Chiechi decided both *Stone* and *Mirowsk*i. (Judge Wherry decided *Schutt*, Judge Halpern decided *Black*, Judge Jacobs decided *Shurtz*, and *Church* and *Kimbell* were federal district court opinions ultimately resolved by the 5th Circuit. *Keller* and *Murphy* are federal district court cases.)

Including the partial inclusion of FLP assets in *Miller* and *Bongard*, 20 cases have applied §2036 to FLP or LLC situations: *Schauerhamer, Reichardt, Harper, Thompson, Strangi, Abraham, Hillgren, Bongard* (as to an LLC but not as to a separate FLP), *Bigelow, Edna Korby, Austin Korby, Rosen, Erickson, Gore, Rector, Hurford, Jorgensen, Miller* (as to transfers made 13 days before death but not as to prior transfers), *Malkin*, and *Turner*. In addition, the district court applied §2036 in Kimbell, but the 5th Circuit reversed.

12. *Crummey Trust Drafting Implications*. The court's reasoned that indirect gifts to the irrevocable life insurance trust, by the decedent's payment of premium payments, were subject to the Crummey withdrawal power because the trust agreement explicitly stated that the withdrawal power applies to both direct and indirect gifts to the trust. Drafting the trust agreement in that manner may have "saved the day" for the annual exclusion qualification for those indirect gifts.

    The court reasoned that the annual exclusion applied whether or not the beneficiaries were aware of the indirect gifts or their withdrawal powers. Cautious planners will not rely upon such a favorable ruling, and will continue to give notice to beneficiaries of each specific gift to the trust and of their withdrawal rights.