**Title:** IRS Wins Case Due To "Bad Facts"

**Subtitle:** &nbsp;Estate of Liljestrand T.C. Memo 2011-259&nbsp;(November 14, 2011): IRS wins case where “bad facts” all but guaranteed a taxpayer defeat.

**Meta Description:** IRS Wins Case entitled " Estate of Liljestrand T.C. Memo 2011-259" because of the presentation of bad facts reported on the taxpayers end.

**Date:** 10-2-2011

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The taxpayer failed to properly implement the basic steps that would support the validity of the partnership. Taxpayer’s revocable living trust owned sizable investments in commercial real estate. A limited partnership was formed with the taxpayer taking back preferred (Class A) and  non-preferred (Class B) interests. Taxpayer formed the entity in April, yet did not open bank accounts until August, 1999. Notwithstanding gifts were made in 1997 and 1998. The taxpayer obtained an appraisal; however, the net equity of the taxpayer’s contribution of real estate subject to mortgage debt did not match the value of the interests reported as gifts. The taxpayer assigned its own values to the Classes A and B, then sought to rely upon the appraisal at trial.

It is imperative that a taxpayer respect the business form he or she has chosen. In the instant matter, the taxpayer (and his son) ran the business exactly as they had before the limited partnership was formed. If the form were respected, the general partner should exert some authority to manage the affairs of the limited partnership cognizant of fiduciary duties owed to all partners. The failure to establish the bank account resulted in the co-mingling of personal and business funds in the same account. Suppose the taxpayer were faced with a judgment or tax lien. A creditor would be better able to set aside the transfer and collect upon the judgment because of the failure to respect form.

The IRS travels the shortest road to victory when taxpayers co-mingle funds, whether in income tax or estate tax cases. Another factor contributing to the taxpayer loss was the substantial disproportionate distributions to taxpayer, ignoring the calculated preferred return on Class A units.  Taxpayer used the limited partnership funds to make gifts to grandchildren and pay personal expenses.  The limited partnerships failed to maintain capital accounts, which are an elementary feature of any tax partnership.

There must be a business purposes supporting the formation of the entity. Defeating the estate tax should not be the stated purpose. A taxpayer and his advisors would do well to read Turner, Bongard, Harper, Harrison, and  Stone. In Lifjestrand, there was the potential argument that, upon the taxpayer’s death, the other limited partners, taxpayer’s other three children, would sue for partition under state law. The argument was not well developed or thought out and was refuted by the government. Cleary, a careful analysis of state law should be made if this is to be the reason for forming the entity.

The successful partnership cases have had proportionate or pro rata contributions by all partners. Here there were no contributions by the other limited partners. Thus, any suggestion that the partners were diversifying individual risk by pooling capital and spreading risk across more assets or broader classes of assets falls apart.

The business reasons for forming the entity should be tailored to the family’s circumstances. It does no good to mention professional or centralized management if there is no discernable difference if operating procedures before formation and after are the same. If you are seeking to create a new generation of managers, they had better participate in a meaningful way.

The taxpayer must not have an express or implied understanding that the taxpayer is to enjoy the property or have a right to income that would negate the transfer. Treas. Reg. § 20.2036 -1(a). Stated simply, the taxpayer must understand that he or she does not own the property in the same way as before. Here, the taxpayer transferred most of his assets (99%)  and had to rely on the disproportionate distributions to maintain his life style. In Mirowski, the taxpayer retained $7.5 million is securities, an amount sufficient to support her lifestyle based upon the income from the portfolio and analysis of cash-flow needs.

Delays in funding the partnership create problems. Aside from indicating  a lack of respect on the part of the taxpayer for the form of the transaction, appraisals that become stale, raise valuation issues on audit that must be refuted.

I always ask the taxpayer-client the following question:  Name the owner of the property transferred? The answer tells me if the client has been listening.

**Raw Content:** <!-- wp:heading -->
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<h3><strong>What lessons can we learn from this case?</strong></h3>
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