



How to Untangle the Tangle

How to Handle Gifting of Partnership Interests with Multiple Assets to Minimize Appraisal Costs

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Summary: One of the key detriments to gifting Limited Partnership interests is the expensive appraisal costs and the chance of making a mistake which will trigger an even more expensive IRS audit. A Limited Partnership sometimes contains stocks, bonds and other securities, limited liabilities company holdings, real estate, real estate directly and sometimes even more complicated Limited Partnerships owning Limited Liability Companies which own Limited Liability Companies! In these situations we have a cost of the appraisal of the properties and then an appraisal for the amount of discounts. Both of these appraisals are subject to IRS attack after we make the tax free gifts. This Preventative Law Study will simplify the process and minimize the IRS exposures.

Limited Partnerships usually contain a mixture of properties -- stocks, bonds, other securities, real estate, limited liabilities owning real estate, and Promissory Notes.

Even if we hire the best appraisers to appraise each of these items and to appraise the amount of discount, we are subject to expensive attacks from the government after gifting and then expensive litigation where our client's appraiser challenges the appraisals of the government. In martial arts tactics, the samurai which makes the first strike is at a disadvantage and is likely to lose. Therefore, analogously, it will be better for a client to stimulate the IRS to go through the expensive appraisal cost first. In order to put our clients in this advantageous position, we are recommending these tactics for appraising Limited Partnership interest in making gifts.

1. No Operating Business As Assets in the Partnership. Operating businesses, whether they are Limited Liability Companies or corporations, should not be placed in a Limited Partnership. The first reason is that if more than 20% of the corporation is owned by the Limited Partnership it creates anti-byrum problems. Even if the Limited Partnership shares are gifted, the value of the corporate ownership in the limited liability company is brought back into the Estate for taxation. Another reason for not having businesses owned by limited liabilities companies, you are faced with an appraisal of the business and an appraiser to determine the discount in addition to the appraisal for the Limited Partnership and an appraisal for the discount of the Limited Partnership. We are also subject to fluctuations in the value of the business which have a greater valuation – benefactor – than other more solid, passive assets.

2. Keep Stocks of Corporations Which Are Not Qualified On One Of The Stock Markets Where Valuations May Be Easily Ascertained – Out of the Limited

Partnership. When you have unlisted stocks, you have a problem of getting an appraisal – requiring you to appraise the entire entity in order to determine your percentage share values – very expensive.

3. **No S-Corporation Stock.** Of course you can not put S-Corporation stock in a Limited Partnership. If you do, it will disqualify the corporation for S-Corporation purposes.

4. **Appraising Listed Stocks, Bonds and Securities.** This is a slam-dunk. You may contact a brokerage firm and get a letter certifying the values and then take a standard 35% discount on the total valuation of all the securities.

5. **Real Estate and Limited Liability Companies Owning Real Estate.** The cost of real estate is so expensive that I recommend you file the gifts based on a standard real estate valuation using the estate's full cash values as determined by the estate's real estate assessors. This is a solid governmental number that the IRS cannot attack as fraudulent. If we use this for one taxing purpose we should be able to use it for the other taxing purpose. When we own a percentage interest in real estate we take a percentage of the full cash value as determined by the assessor. Having done this we waive the expense of a formal appraisal. We waive taking discounts. By initially waiving the discounts and initially waiving the formal appraisals, we trade that disadvantage for the advantage of using a solid governmental number for the value determination.

I want us to take the position, initially, with the IRS that if the valuation is good enough for one taxing purpose as determined objectively by the State it should be usable for federal taxing purposes. A taxpayer should not be put into a position where they must pay for expensive appraisals in order to prepare their tax returns – and appraisals which we all know are subject to prejudicial fluctuation one way or another.

6. **Promissory Notes and Debts Receivable.** Instead of paying for an expensive appraisal, I suggest we use the balance due on the notes as the value of the notes unless we have evidence that the notes are uncollectible in which case we would have the lawyer or the accountant write a letter substantiating the uncollectibility and take that out of the valuation calculation entirely.

7. **Simplified Gift Tax Return.** Therefore, on a gift tax return, we have evidence of the listed stock value from the date of gift as documented with a letter from the responsible stock brokerage firm or investment bank. We can take a solid 35% discount on this because we can take a solid number on the Promissory Notes and debts. We have a statement from the CPA as to the amount owed and when this is a solid number we can take a 35% discount on the notes or debts receivable. Next, with the real estate, we take the assessor's full cash value, determine the percentage of ownership in the real estate, disregard whether it is in a limited liability company or not and send copies of the tax returns that reflect the full cash value along with the tax return. Next, in order to substantiate the 35% discount on the securities and the debts receivable, we attach two or three tax cases in point where 35% was acceptable as a Limited Partnership discount. In the gift tax return we provide a footnote indicating that since it is arguable that the full cash value is not realistic because of the sometimes inefficiency of the assessor's office, we have not taken a 35% discount in order to be as fair as possible

on the valuation. This statement is a challenge to the government who “looks at the whole cart” and see if they think that if they hire an expensive appraisal it will be subject to a discount whether that is going to be more fair than what the taxpayer has proposed. It puts the IRS agent who makes the decision in a position where they could be criticized by their superiors for exercising bad judgment for ordering an appraisal at good cost to the government only to find there was very little increase in the valuation.

8. The Samurai Counter-Attack. When the IRS agent makes the mistake of the Samurai to make the first attack, the taxpayer is in a position to have the benefit of free appraisals and a chance to see what the position of the IRS is. The taxpayer is and then in a position to counter-attack with a 40% or 45% discount overall which the taxpayer waived in favor of simplicity and accuracy. The last times we had formal Limited Partnership appraisals we arrived at a 45% discount and therefore the IRS is in jeopardy if they do not like the numbers given to them. They could lose even more when we seek the full discount rather than a very conservative discount going into the gifting process.

When we implement the guidelines of this memorandum we will be able to very quickly and inexpensively document gifting Limited Partnership interest with a low probability of a later attack. If they have not attacked within three years, the IRS waives their opportunity to challenge.

9. Gifting of the Business Interests. Business interests are gifted, we will restructure the businesses with voting and non-voting or management and non-management shares and gift percentages with a very high discount. Here we want to have a very highly qualified appraiser but all they will have to appraise is one entity rather than the multiple assets we find in a Limited Partnership.

10. General Advice. There is always general advice as to the amount of gifts. Never knowing the manipulation that Congress may do with the gift and the estate tax laws, my recommendation is always to give as much as you can, as fast as you can, as early as you can of non-voting, non-control assets so that whatever the Government does it will not hurt the family that is gifting – they will have maximized their odds of favorable tax reductions and avoidance.

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