

Tax Committee Meeting Notes 12.07.10
Guest Speaker: IRS official John Darazsdi

House Keeping Tasks:

- No January Meeting
- February Meeting is a review of Heckerling Conference and to set up the next year's agenda

Our Guest Speaker is John Darazsdi, an attorney in the IRS Estate Tax office in Scranton, Pennsylvania. Contact info for John Darazsdi: 570-969-5322, John.Darazsdi@irs.gov

4 Cases of 2010 to Highlight:

1. **Ludwick v. Commissioner**, T.C. Memo 2010-104 (May 10, 2010)
 - a. Undivided interest discount in real estate determined taking into consideration illiquidity and marketability factors in addition to just cost of partition
 - b. **Facts:** Husband and wife each transferred an undivided 50% interest in a Hawaiian vacation home to their separate QPRTs. The issue is how much discount is available for determining the gift tax value of the transfers to the QPRTs. On the gift tax returns, the taxpayers applied a 30% undivided interest discount. The IRS deficiency allowed a discount of only 15% and then later argued for no larger than 11%.
 - c. **Holding:** The Court allowed a 17.2% discount.
 - d. **Significance:** The court hammered both appraisal experts on using what the court felt were improper factors that shouldn't be considered when coming up with the discount value.

2. **Pierre v. Commissioner**, T.C. Memo 2010-106 (May 13, 2010) – "Pierre II"
 - a. Gifts and sales of LLC interests moments apart to same done aggregated for valuation purposes under step transaction doctrine
 - b. **Facts:** Mother created a single-member LLC and transferred \$4.25 million to it. Twelve days later, Mother transferred her entire interest in the LLC to two separate trusts, one for her son and one for her daughter. This process happened in two steps: first she gave a 9.5% interest to each trust then moments later she signed documents to sell a 40.5% interest to each trust for a note to be paid in 10 annual installments. The fact amount of the notes showed that there was a 36.5% discount from lack of control and lack of marketability.
 - c. **Holding:** The Step Transaction Doctrine applied and collapsed the gift and sale, which were made in moments of each other, and thus treated the transfers as an aggregate transfer.
 - d. **Significance:** The Step Transaction Doctrine is a hot topic right now for the IRS

3. **Petter v. Commissioner**, T.C. Memo 2009-280 (Dec. 7, 2009)
 - a. Defined value clause upheld
 - b. **Facts:** Mother wanted to transfer UPS stock to her two children and give some value to charity. Mother transferred the stock to an LLC in three classes of units. Mother was the manager of A units, the Daughter, Donna, was the manager of D units, and the son, Terry, was the manager of the T units. Mother then established Grantor trusts. She made gifts and sales to the grantor trusts so that the gifts reflect about 10% of the trust

assets. These transactions were implemented by formula transferred such that the Charity received some of the assigned units. The Charity had its own legal team and negotiated terms of the agreement. There was a reallocation provision in the documents under which each party agreed to transfer units to the other if a party initially received more units than it was entitled to receive based on values as determined for gift tax purposes. The IRS said the discount applied was too high and that the reallocation provision wouldn't be respected for tax purposes even if the additional units went to charity since charity wouldn't argue for more.

- c. Holding:** Formula allocation provisions are not as contrary to public policy.
 - d. Significance:** Reallocation formula clauses are valid. It was important in this case that the Charity had its own legal counsel and was fighting for as much interest as possible, not just passively taking what they got. It helped that the taxpayer didn't try to get any additional units after the reallocation, showing that there was legitimate charitable intent.
4. **Ringgold Telephone Company v. Commissioner**, T.C. Memo 2010-103 (May 10, 2010)
- a. Facts:** Ringgold, Bell South, Trenton Telephone and Bledsoe Telephone each owned 25% partnership interests in Cellular Radio of Chattanooga (CRC), each subject to a right of first refusal. CRC's primary asset was a limited partnership interest in Chattanooga MSA Limited Partnerships (CHAT). Therefore, Ringgold indirectly owned a non-controlling interest in CHAT. BellSouth directly and indirectly owned a controlling interest in CHAT. When Ringgold was looking to sell its share, BellSouth put in a high bid making it difficult to refuse. Ringgold sold its interest in CRC to BellSouth. The price that Ringgold received for its interest was disputed. Ringgold argued that a controlling interest holder would place a greater value on a minority interest compared to a buyer who lacked control. The IRS argued that since BellSouth already owned a controlling interest in CHAT, it would not have paid a control premium.
 - b. Holding:** BellSouth would not have paid a control premium but it would have paid a premium to discourage bidding by other partners.
 - c. Significance:** The court looked at whether this was an entity that someone wanted to purchase. If so, a right of first refusal clause may increase the value of the interest rather than decrease it.

A packet was handed out by John entitled "IRS Estate & Gift General program and Return Information." A copy of this packet can be found on the Trust and Probate Section's Tax Committee Website OR email Marguerite Weese at MWeese@wilmingtontrust.com