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Family Limited Partnerships Under Renewed Attack By IRS

Clients Need Advice On Discounts, Appraisals

By Reni Gertner

The IRS plans to offer lower discount rates for family limited partnerships, according to an internal e-mail sent to all IRS estate and gift tax appellate officers, sources tell Lawyers Weekly USA.

The message was sent by IRS National Appeals Family Limited Partnership Coordinator Mary Lou Edelstein, according to Clearwater, Fla., attorney Alan Gassman, who attended a panel discussion in late October where Edelstein and others discussed changes the IRS is making with respect to how it will handle FLPs.

Gassman said that the panel discussion revealed that the IRS intends to:

- reduce FLP discounts on appeal from 35 percent to between 25 and 30 percent for basic FLPs;
- evaluate appraisals for accuracy, the appropriate use of comparable market data and qualified appraisers;
- stratify valuation discounts by class of asset, which means appeals officers will apply weighted average discounts based on whether assets are marketable securities or real estate; and
- select nearly all FLP cases for audits.

Boca Raton, Fla., estate planner Donald Tescher, who sat on the panel, said that Edelstein explained that the discount guidelines would apply to "plain vanilla partnerships" where there were "no red flags" about when they were formed and no personal assets in the partnership.

Advising Clients Carefully

Some experts said that the IRS' plans send a message to estate planners that they must advise their clients carefully about what discounts they should – and shouldn't – expect.

Gassman said the IRS "is ratcheting down on discounts. The impact in the field is that we will approach discounts with more caution. We will have to tell clients they should expect to accept a lower percentage discount."

Dallas estate-planning attorney Steve Akers, who didn't attend the panel discussion, said he interprets the message the same way.

"The primary implication is that this is an attempt by the IRS to persuade practitioners not to take significant discounts," Akers said.

However, Dallas estate planner Norm Lofgren said that the IRS position on discounts might not be as bad for taxpayers as it seems. He recalled that in spring 2001, Edelstein spoke at another panel where she stated that the guideline for discounts would be 25 percent.

"Her statements now appear intended to try to spook … the … audience," said Lofgren.

"A 25-30 percent discount is good news anyway you slice it."

Attorneys speculate that the strict tone of the IRS's position is a reaction to recent favorable U.S. Tax Court decisions – especially a recent case in which the court held that the value of FLP assets was includible in the decedent's gross estate because he retained the beneficial enjoyment of the partnership income. (*Strangi v. Commissioner*, T.C. Memo. 2003-145 (2003); see "FLP Assets Included In Tax Estate," Lawyers Weekly USA, June 9, 2003. Search words for LWUSA Archives: Wright and Strangi.)

Lofgren represents the taxpayer in the *Strangi* case, which he will soon be appealing.

Although the panel didn't explicitly reference the opinion, Akers said that many planners "think that because of the IRS' success in … estate tax cases [including *Strangi*], they are getting more aggressive toward limited partnership interests."

The IRS refused Lawyers Weekly USA's requests for comment on the internal e-mail, and refused to provide a copy of the message.

Lofgren complained that by using an internal e-mail in lieu of promulgating regulations, the IRS is "putting FLPs on double-secret probation."

Better Appraisals

In addition to advising clients about possibly lower discounts on FLPs, lawyers must make certain they provide the IRS with strong appraisals of their clients' partnership interests.

Steve Leimberg, an estate and financial planning expert in Bryn Mawr, Pa., said practitioners will be forced "to get more solid and more realistic appraisals." Leimberg reported the panel discussion in his Internet-based Estate Planning Newsletter.

How solid an appraisal is depends on the quality of the data used for the valuation analysis.

Tescher said that the IRS is "getting tired of seeing canned appraisals. They are looking for more qualitative information, data more current to the date of death or the date of gift, and for data that is truly as comparable as it can be to what they are valuing."

Timothy Bronza, a CPA and appraiser who sat on the panel with Edelstein, agreed.

"The data used for an appraisal must be contemporaneous to the date of valuation," said Bronza, president of Business Valuation Analysts, LLC. "It makes sense to get relevant market data that corresponds to what is held by the partnership. The courts and the IRS want relevant and sufficient capital market evidence to support valuation conclusions."

According to Bronza, "closed-end funds" – for which the market price is less than the net asset value – are frequently used to support a minority interest discount for a partnership that contains marketable securities.

For any real estate component of an FLP, data on the value of publicly held real estate limited partnerships (RELPs) is commonly used to quantify discounts, Bronza said.

From the panel discussion, it seems clear that the IRS will be checking on who performed an appraisal as well.

"It suggests the use of qualified … accredited, court-tested, full-time appraisers," said Leimberg. "Too many appraisers do this part time. They are CPAs, not full-time appraisers."

However, Gassman said that trying to use an expert appraiser when a client wants his CPA to do the appraisal puts the attorney in a difficult quandary.

"What am I supposed to do, rock the boat with the CPA?" Gassman asked. "What kind of position does that put me in?"

In addition, some appraisers might charge twice as much as a CPA to do an appraisal, he noted.

Find Out More

The IRS e-mail was sent to appeals officers on Oct. 19. The panel discussion was part of a Florida bar CLE seminar entitled: Family Limited Partnerships – Transfer Tax Planning During Good, Bad, Ugly and Uncertain Times, which took place on Oct. 24.

For more information about the panel discussion, go to http://www.floridataxlawyers.org and click on CLE, or contact Donna Byrd at dbyrd@flabar.org or (850) 561-5630. LWUSA

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