Case No. 03-10529

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

DAVID A KIMBELL, INDEPENDENT EXECUTOR
UNDER THE WILL OF RUTH A KIMBELL, DECEASED

Plaintiff - Appellant

v.

UNITED STATES OF AMERICA

Defendant - Appellee

ON APPEAL FROM UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF TEXAS

BRIEF FOR AMICUS CURIAE IN SUPPORT OF NEITHER PARTY ON BEHALF OF AMERICAN COLLEGE OF TRUST AND ESTATE COUNSEL

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No. 03-10529

DAVID A KIMBELL, INDEPENDENT EXECUTOR UNDER THE WILL OF RUTH A KIMBELL, DECEASED

Plaintiff - Appellant

v.

UNITED STATES OF AMERICA

Defendant - Appellee

The undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of the case. These representations are made in order that the Judges of this Court may evaluate possible disqualification or recusal.

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REQUEST FOR ORAL ARGUMENT

In light of the importance of the issues, the amicus curiae requests the Court's permission to participate in oral arguments pursuant to Fed. R. App. P. 29(g).

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INTEREST OF THE AMICUS CURIAE

The American College of Trust and Estate Counsel (the "College") is a professional association of lawyers with a current membership of approximately 2,700 from throughout the United States. Members have been elected by their peers on the basis of their professional reputation and their demonstrated exceptional skill and ability in probate, trust, and estate planning law, and on the basis of their substantial contributions to these fields through lecturing, writing, teaching, and bar activities. The College has no "client" in this matter, although many of its members represent clients who may be impacted by the Court's decision, either now or in the future.

Family limited partnerships have been used extensively, not just as estate planning vehicles, but also as relatively flexible investment management vehicles and for many other legitimate purposes. The issues to be decided in this case are central to the predictability and stability of the tax treatment of family limited partnerships. The policies of the College provide for the filing of an amicus curiae brief only sparingly and only where the issues are of special significance. Because of these stringent guidelines, this amicus curiae brief is only the third filed by the College within 10 years, thus reflecting the College's evaluation of the special importance and significance of the issues involved. The College believes that, by

filing this amicus brief pursuant to leave of this Court, it can provide a perspective not available from either the Government or the individual taxpayer.

SUMMARY OF THE ARGUMENT

This amicus brief is being filed by the College to express its extreme concerns about the legal standards relating to Sections 2036(a) and 2038(a)(1) that were used by the District Court in Kimbell v. United States, 244 F. Supp. 2d 700 (N.D. Tex. 2003) ("Kimbell"), or are being proposed in the Government's brief filed with this Court.

The College believes that the determinative issue in regard to whether the decedent retained the "right," alone or in conjunction with one or more other persons, to designate the persons who would possess or enjoy the transferred property within the meaning of Section 2036(a)(2), or retained the "right" to the income within the meaning of Section 2036(a)(1), should be whether there were sufficient constraints, including fiduciary constraints, under applicable state law to prevent any power held by the decedent to control or otherwise participate in partnership or LLC distribution decisions from rising to the level of a "right" within the meaning of the statute. *See* U.S. v. Byrum, 408 U.S. 125 (1972) ("Byrum"). The subjective likelihood of enforcement of those fiduciary duties, as proposed, in effect, by the Government, is not an appropriate standard for determining whether a power is a "right" within the meaning of the statute.

Next, the College believes that the ability of all of the partners and members to dissolve a partnership or LLC should not be a "right," alone or in conjunction with other persons, to designate who would presently "enjoy" the transferred property within the meaning of Section 2036(a)(2) or the power, alone or in conjunction with other persons, to revoke or terminate within the meaning of Section 2038(a)(1). The College concurs with the arguments presented by the decedent's estate in regard to these issues generally and will limit its comments to the meaning of the term "right" under Section 2036(a)(2).

In regard to the applicability of the exception under each of Sections 2036(a) and 2038(a)(1) for a "bona fide sale for an adequate and full consideration in money or money's worth", the College concurs with the principles set forth in this Court's prior analysis in Wheeler v. U.S., 116 F.3d 749 (5th Cir. 1997) ("Wheeler"). The potential applicability of the "bona fide sale for an adequate and full consideration in money or money's worth" exception under Section 2036(a) requires a two-part analysis. First, whether the decedent received "adequate and full consideration in money or money's worth" for her capital contributions to the partnership and LLC should be based on an objective comparison of what the decedent contributed and what she received in the exchange. Such subjective considerations as the decedent's intent are not material to the adequacy of the consideration. Second, in determining whether a sale is "bona fide," the issue

should not be whether the parties negotiated at arm's length but instead should be whether the transferor actually parted with the property supposedly transferred and actually received the full consideration to which he or she was entitled by reason of the sale (that is, whether the transfer or the consideration received was a sham).

The College is expressly refraining from taking any position in regard to questions of fact, including any possible implied agreement to retain enjoyment under Section 2036(a)(1), and any application of facts to the appropriate legal standards for the other issues. Therefore, no position is being taken as to which party should prevail.

Despite taking no position on which party should prevail, the College strongly believes that the legal standards used in the Kimbell decision, or proposed by the Government, are in error and should be repudiated for the following reasons:

(1) The use of family limited partnerships and the equivalent in estate planning is widespread, including by College members.

(2) Most estate planning advisers, including College members, and their clients, want to design and use such partnerships within known rules and boundaries, and believed that they had done so until the decisions in Kimbell and Estate of Strangi v. Comm'r, 85 T.C.M. (CCH) 1331 (2003) ("Strangi 2") raised unexpected questions.

(3) Rules and boundaries are by far most useful for that purpose when they are objective and understandable.

(4) While it is understandable that both the Government and taxpayers invoke as many arguments as they reasonably can, including novel legal interpretations, to sustain the positions they hold in litigation, it is extraordinarily disturbing and disruptive when novel legal interpretations are announced by courts, especially in dicta or as extraneous alternative grounds for a decision. Such announcements rarely produce the objective and understandable rules and boundaries that both taxpayers and the Service need.

(5) In particular, the Section 2036(a)(2) analysis proposed by the Government has been widely viewed by estate planners, including College members, as a surprise, extending that statute in a fundamental way far beyond what the language, history, previous judicial construction, and even previous IRS construction of the statute have been commonly understood to require or permit.

(6) Such "new law" is best created by statute (or by regulations pursuant to statutory authority), in a context in which the deliberative process (or the notice and comment process in the case of regulations) presents an opportunity to arrive at the needed objective and understandable

rules and boundaries without the encumbrance of particular, sometimes difficult or extreme, facts.

(7) This is particularly true in a case such as this one where Congress has repeatedly visited, or declined to visit, the very subject matter that is the subject of the dispute. *See* Wheeler, 116 F.3d at 765-66.

(8) Therefore, however this Court rules on the underlying fact-bound merits of the case, it is important that it repudiate the destabilizing subjective standards proposed by the Government for use in determining the existence of "rights" within the meaning of Section 2036(a)(1) and (a)(2) and for applying the "bona fide sale for an adequate and full consideration in money or money's worth" exception of Sections 2036(a) and 2038(a)(1).

ARGUMENT

I. THE DECEDENT'S POWER TO CONTROL OR PARTICIPATE IN THE DISTRIBUTION DECISION-MAKING PROCESS FOR AN ENTITY DOES NOT GENERALLY CONSTITUTE A RETAINED "RIGHT" TO INCOME FROM THE TRANSFERRED PROPERTY WITHIN THE MEANING OF SECTION 2036(a)(1) OR THE "RIGHT," ALONE OR IN CONJUNCTION WITH ONE OR MORE OTHER PERSONS, TO DESIGNATE THE PERSONS WHO WOULD

BENEFIT FROM SUCH INCOME WITHIN THE MEANING OF SECTION 2036(a)(2).

The Government is contending that the power to control or even participate in partnership or LLC distribution decisions was a retained right to the income from the transferred property within the meaning of Section 2036(a)(1) and a retained right, either alone or in conjunction with any person, to designate the persons who would enjoy the property transferred to the family limited partnership or LLC or the income from such property within the meaning of Section 2036(a)(2). (Government Brief ("GB"), at 13, 37-38)

The Government goes so far as to claim that the decedent's power, in conjunction with all of the other partners, to revoke the partnership agreement, in effect, by dissolving the partnership is a right to accelerate "present enjoyment" of partnership assets within the meaning of the Section 2036(a)(2), even though the Supreme Court, in Byrum, 408 U.S., at 149-50, had held that a dissolution right was too speculative and contingent to be regarded as present enjoyment for purposes of Section 2036(a)(1). (GB, at 21-22)

The decedent's estate is arguing that any power the decedent had to participate in any distribution decision was restricted by fiduciary duties imposed by state law and thus was not a "right," as required by Section 2036(a)(1) and (a)(2). The Government is trying to distinguish Byrum factually on the basis of the

presence of an independent corporate trustee and the existence of unrelated minority equity holders and operating businesses in Byrum. (GB, at 24-26) In effect, the Government is trying to apply a likelihood of enforcement standard. Where all equity holders are family members, and where the entity in question is not an operating business, enforcement is purportedly unlikely, and any intrafamily fiduciary duties should be ignored.

The College is extremely concerned that the Government's contention, which was upheld in both Kimbell and Strangi 2, is at odds with the Supreme Court decision in Byrum, with other judicial precedents following Byrum, and with the IRS's own rulings, including at least one published ruling and one General Counsel Memorandum. Since practitioners have reasonably relied upon these judicial precedents and IRS rulings for over 30 years, the estate and investment plans of literally thousands, if not tens of thousands, of taxpayers could be overturned if the Government's contention is sustained on appeal.

Furthermore, the Government's contention is inconsistent with Chapter 14, which includes express statutory remedies enacted by Congress, when it decided to repeal Section 2036(c), to curb the perceived abuses potentially resulting from the use of family limited partnerships. *See* Wheeler, 116 F.3d at 767.

Byrum and Other Judicial Precedents. In Byrum, the focus was on whether the *de facto* power of a majority shareholder and directors of a closely

held corporation to arrange for dividend payments was "ascertainable and legally enforceable" under state law in light of the fiduciary duties owed by such majority shareholder and directors to the corporation and to the other shareholders. In Byrum, such fiduciary duties were held to effectively constrain the exercise of the *de facto* powers held by the majority shareholder and directors, so such *de facto* powers were not "*rights*" within the meaning of Section 2036(a)(2) (and presumably Section 2036(a)(1)). In contrast, the focus of the Government in this case is on the *likelihood of enforcement*, not "*enforceability*." The Government's proposed standard is therefore materially different from the Supreme Court's standard in Byrum.

In effect, the Government is trying to substitute a subjective facts and circumstances test to determine the likelihood of enforcement, in contrast to the relatively objective bright-line approach favored by the Supreme Court. In Byrum, the Supreme Court expressly rejected a control standard as being "so vague and amorphous as to be impossible of ascertainment in many instances." Byrum, 408 U.S. at 137 n. 10. If the Supreme Court was concerned about the uncertainty resulting from a control standard, with its inherently factual and potentially subjective predicates, what would the Supreme Court's reaction be to a likelihood of enforcement standard, which is clearly factual and highly subjective? If the Supreme Court's goal in Byrum was to establish a relatively objective bright line

test, as opposed to one which was "too variable and imprecise," the likelihood of enforcement standard proposed by the Government would be a radical departure, not only from the general tenor of Byrum but also from the Supreme Court's requirement that a "right," within the meaning of Section 2036(a)(2), must be "ascertainable" as well as "legally enforceable."

The Government is attempting to rationalize its likelihood of enforcement standard on the absence of three facts present in Byrum. In Byrum, but not in Kimbell, there were (1) an independent trustee, (2) unrelated minority equity holders, and (3) operating businesses. The majority opinion in Byrum, however, strongly supports a finding that the cited factors were not determinative but were instead alternative bases or simply additional factual reinforcement of the Supreme Court's Section 2036(a)(2) holding.

The Government has properly conceded that the presence of an independent trustee with sole discretion over trust distributions was an alternative basis for the holding in Byrum that Section 2036(a)(2) was inapplicable. (GB, at 24-25) The real issue, then, is whether Byrum's Section 2036(a)(2) decision was based on the presence of unrelated minority equity holders and operating businesses. The majority in Byrum simply discussed the presence of unrelated minority equity holders and operating businesses as additional factual support buttressing its opinion that there was not a "right" within the meaning of Section 2036(a)(2)

because of the fiduciary constraints on the decedent's exercise of his *de facto* power to control dividends. Supporting this conclusion is the following excerpt, rejecting the Government's contention that the decedent's retention of corporate control (through the retention of the right to vote the shares transferred to the trust) was tantamount to the right to accumulate income in the trust:

> This approach seems to us not only to depart from the specific statutory language,[14] but also to misconceive the realities of corporate life.

Byrum, 408 U.S. at 138-39. Immediately following this excerpt was a discussion of the economic vicissitudes of operating businesses and governance considerations relating to closely held businesses with unrelated minority equity holders. This discussion, while addressed, of course, to the facts of Byrum, was consistently framed in the context of the legal restraints on the exercise of a majority shareholder's and directors' powers by reason of fiduciary duties imposed by state law. Therefore, this discussion is fully consistent with the initial indication in the above excerpt that the Government's control contention "seems . . . to depart from the specific statutory language." Significantly, footnote 14, which appears immediately following the above-cited reference to the departure from the specific statutory language, concludes as follows:

> [T]his case concerns a statute written in terms of the "right" to designate the recipient of income. The use of the term "right" implies that restraints on the exercise of power are to be recognized and that such restraints

> deprive the person exercising the power of a "right" to do so.

The restraints in Byrum are fiduciary duties imposed by state law. In Byrum, the focus was on state law. Although the factual context of this analysis of state law involved operating businesses and unrelated minority shareholders, there is no indication in Byrum that the outcome would have been different if state law had imposed similar fiduciary duties in the context of an investment entity with only related equity holders, which is the case for many, if not most, family limited partnerships.

In two Tax Court cases decided more than 20 years prior to Kimbell and Strangi 2, the Government litigated the issue of whether Byrum's fiduciary duty limitation applied in an intrafamily setting. In both Estate of Gilman v. Comm'r, 65 T.C. 296 (1975), *aff'd*, 547 F.2d 23 (2nd Cir. 1976), which involved a corporation, and Estate of Cohen v. Comm'r, 79 T.C. 1015 (1982), which involved a Massachusetts business trust, the Government's argument that family members are not likely to enforce fiduciary duties imposed by state law was rejected, and Section 2036(a)(2) was held not to apply by reason of Byrum's fiduciary duty limitation.

The Government's argument that Byrum's fiduciary duty limitation should not apply in an intrafamily setting is nothing more than a reincarnation of the old family attribution notion that was properly repudiated in valuation cases in this

Court (and others) and was ultimately abandoned by the Government. *See* Estate of Bright v. U.S., 658 F.2d 999 (5th Cir. 1981) (*en banc*); Rev. Rul. 93-12, 1993-1 C.B. 202 (1993). The Government's family attribution argument should similarly be rejected in a Section 2036(a)(2) context. Families simply are not inherently the harmonious monoliths portrayed by the Government, and fiduciary duties owed by one family member to another are not illusory, as evidenced by the volumes of fiduciary litigation among family members witnessed by members of the College.

The College believes that the only potential explanation for an unfavorable Section 2036(a)(2) decision in Kimbell, properly using Byrum fiduciary duty limitation standards, would relate to the discretionary standards unique to the limited partnership agreement in question. If, under applicable state law (taking into account the terms of the governing instruments), there were not sufficient fiduciary constraints imposed on the decedent's power to make distribution determinations, Byrum's fiduciary duty limitation would not protect against the applicability of Section 2036(a)(2). Whether there were sufficient fiduciary constraints is a combined question of state law and fact which is unique to this case and thus does not require rewriting the Supreme Court's generally applicable legal standard. Therefore, the College takes no position on this narrower, case-specific issue other than to encourage this Court, if it holds for the Government under Section 2036(a)(2) because of this discretion, to clarify that Byrum's fiduciary duty

limitation is inapplicable not because of the subjective likelihood of enforcement standard proposed by the Government, but instead because of the parties' effective waiver of the fiduciary duties that would have otherwise applied.

IRS Rulings. In Revenue Ruling 81-15, 1981-1 C.B. 457 (1981), the IRS expressly acknowledged that Byrum imposed a fiduciary duty limitation on the applicability of Section 2036(a)(2). The Revenue Ruling then analyzed the extent to which the enactment of Section 2036(b) (which is expressly limited to the retained right to vote shares of stock of a controlled corporation) did and did not reverse the holding in Byrum. To the extent that Section 2036(b) did not apply, especially in the case of a transfer of nonvoting stock or a transfer of a minority block of stock by a majority stockholder, the ruling, relying on explicit legislative history, concluded that "the effect of Byrum . . . is not changed by the enactment of section 2036(b)". This ruling is in stark contrast to the District Court's comment in Kimbell, and the Government's contention on appeal, that Byrum was overruled by Section 2036(b). (GB, at 26)

In Gen. Couns. Mem. 38,984 (May 6, 1983), which in effect was an acquiescence in the Tax Court's decision in Estate of Cohen, 79 T.C. at 1015 (1982), the IRS conceded that Byrum's fiduciary duty limitation applied to a Massachusetts business trust in which the decedent was a trustee and in which only family members were equity holders.

In a series of private letter rulings in the early to mid 1990s (at least some of which expressly involved intrafamily settings), the Service acknowledged that the Byrum fiduciary duty limitation applied to partnerships as well as corporations and Massachusetts business trusts, because the general partner's distribution decisions were subject to fiduciary constraints under state law. *See* Priv. Ltr. Rul. 9026021 (March 26, 1990), Tech. Adv. Mem. 9131006 (April 30, 1991), Priv. Ltr. Rul. 9310039 (December 16, 1992), Priv. Ltr. Rul. 9415007 (January 12, 1994), and Priv. Ltr. Rul. 9546006 (August 14, 1995).

The Government correctly notes that these private letter rulings have no precedential force under Section 6110(k)(3). It then makes a strained attempt to distinguish these rulings factually on the grounds that these rulings involved gifted interests and that the same analysis used in these rulings "might apply" if the decedent in Kimbell had gifted some of her interest, rather than having it pass at death. (GB 26-27) This attempt by the Government to deflect attention from, but not disavow, the IRS's reasoning in these private rulings borders on disingenuousness. The same Section 2036(a)(2) analysis would apply to gifted interests, as the Government would surely argue if its Section 2036(a)(2) analysis were upheld.

Inexplicably, the Government does not cite Revenue Ruling 81-15, even though that published ruling remains outstanding and even though the IRS is

obligated to respect its published rulings. *See* Rauenhorst v. Comm'r, 119 T.C. 157 (2002); McLendon v. Comm'r, 135 F.3d 1017 (5th Cir. 1998). Also not cited was Gen. Couns. Mem. 38,984 (May 6, 1983), even though a General Counsel Memorandum may be entitled to more deference than private letter rulings. *See* Morganbesser v. U.S., 984 F.2d 560 (2nd Cir. 1993).

Rauenhorst and McLendon represent not only controlling precedent but also sound policy. Taxpayers should be able to rely upon published IRS rulings, as this Court held in McLendon.

Legislative History. Congress has considered family limited partnerships and other estate planning techniques on several occasions since the Byrum decision was rendered in 1972. Although a taxpayer's ability to retain voting rights in a 20% or more family controlled entity has been limited by the adoption of Section 2036(b), the Byrum fiduciary duty exception to Section 2036(a)(2) otherwise remains intact from a legislative perspective.

When Congress enacted Chapter 14 in 1990, it specifically adopted an approach of treating the gift as complete at the time of the transfer or relinquishment of voting or liquidation rights. Generally, gift or other transfer tax consequences were to be determined at that time through use of special valuation rules designed to take into account the likelihood that related parties would not exercise rights in an arm's length manner. In taking this approach and by

simultaneously repealing Section 2036(c) retroactively to its enactment in 1987, Congress consciously decided to abandon the inherently testamentary approach briefly adopted when Code Section 2036(c) was passed. *See Present Law and Proposals Relating to Federal Transfer Tax Consequences of Estate Freezes, Before the Senate Joint Comm. on Taxation*, 101st Cong. 27-28 (1990) (prepared by the Staff of the Joint Committee on Taxation). *See also* Informal Senate Report on S. 3209, 136 Cong. Rec. 515,680 (daily ed. Oct. 18, 1990) (statement of various committees to the Budget Committee).

In enacting Chapter 14, Congress specifically considered voting rights. Nonlapsing rights with respect to proportional interests, such as those in Kimbell, were expressly excepted from the new special valuation rules. *See* I.R.C. §§ 2701(a)(2)(C), 2704(a). Even under the testamentary approach of repealed Section 2036(c), inclusion in the gross estate was not required if the transferred and retained interests had the same interests, or if the only difference between the two interests related to voting or managerial powers. *See* Notice 89-99, 1989-2 C.B. 422, 428 (1989). *See also Present Law and Proposals Relating to Federal Transfer Tax Consequences of Estate Freezes*, *Before the Senate Joint Comm. on Taxation*, 101st Cong. at 21.

It is impossible to reconcile the Government's Section 2036(a)(2) position with this legislative history. Needless to say, Congress has been aware of Byrum,

and it has the power to reverse Byrum's fiduciary duty limitation, but it has chosen not to do so in the more than 30 years during which that decision has been outstanding. As the Supreme Court noted in Byrum, courts should be loath to depart from long-standing principles on which taxpayers have relied when the departure could have far-reaching consequences:

> When a principle of taxation requires re-examination, Congress is better equipped than a court to define precisely the type of conduct which results in tax consequences. When courts readily undertake such tasks, taxpayers may not rely with assurance on what appear to be established rules lest they be subsequently overturned.

Byrum, 408 U.S. at 135.

II. SUBJECTIVE STANDARDS BASED ON INTENT AND ARM'S LENGTH NEGOTIATIONS ARE INCONSISTENT WITH THE OBJECTIVE STANDARDS ENACTED BY CONGRESS AND PROPERLY APPLIED BY THIS COURT PREVIOUSLY IN CONSTRUING THE BONA FIDE SALE FOR AN ADEQUATE AND FULL CONSIDERATION EXCEPTION UNDER SECTION 2036(a).

Section 2036(a) expressly excepts from inclusion under that provision a transfer which is "a bona fide sale for an adequate and full consideration in money or money's worth." Two requirements must be met before this exception would apply. First, the sale must be for "adequate and full consideration in money or money's worth." Second, the sale must be "bona fide." The College believes that

the standards proposed by the Government for use in analyzing each of these two requirements are at odds with this Court's prior decision, Wheeler, 116 F.3d at 749. The College further believes that this Court's approach carries out the objective of the exception in question by properly focusing on what the decedent really gave up and really received in the exchange.

In contrast, the Government's focus on the decedent's testamentary intent substitutes a highly subjective standard destined to eviscerate the exception in most intrafamily settings, without regard to what the decedent in fact gave up and received and thus without proper regard to the statutory language and history of the exception. The Government attempts to turn the clock back more than a quarter of a century in defiance of Congress's unmistakable repudiation of such subjective, intent-based approaches to estate taxation. An early predecessor of Section 2036 purported to apply to a decedent's transfers "in contemplation of or intended to take effect in possession or enjoyment at or after his death." Revenue Act of 1916, ch. 463, § 202(b), 39 Stat. 756, 777-78 (1916). In Burnet v. Northern Trust Co., 283 U.S. 782 (1931) (per curiam), following May v. Heiner, 281 U.S. 238 (1930), the Supreme Court held that this subjective language was not sufficient to subject a transfer with a reserved life estate to estate tax. Burnet, 283 U.S. at 783. The very next day, Congress responded with a joint resolution, H.R.J. Res. 131, 72nd Cong. (1931), adding essentially the same objective standards now found in Section

2036(a)(1) and (2). The "in contemplation of. . .death" provision was retained as an alternative subjective basis for inclusion and, after numerous revisions, appeared as Section 2035 of the 1954 Code. In 1976, Congress amended Section 2035 to eliminate the in contemplation of death concept. *See* Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1848 (1976). This change made the donor's intent immaterial, as previously recognized by this Court in Wheeler, 116 F.3d at 765-66, and left only the objective and understandable standards in Sections 2035 and 2036 that are so important to members of the College.

Adequate and Full Consideration. What constitutes "adequate and full consideration" has been the subject of extensive analysis in this Court's prior decision, Wheeler, 116 F.3d at 749. That case involved the sale of a remainder interest for the actuarial value of that interest determined in accordance with gift tax regulations. This Court concluded that the consideration paid was "adequate and full" and that the sale was "bona fide." In support of its finding that the consideration was "adequate and full," the Court reasoned as follows:

> (1) The meaning of "adequate and full consideration in money or money's worth" for estate tax purposes under Section 2036(a) should be the same as the meaning of that term for gift tax purposes under Section 2512(b), for the estate and gift tax provisions are *in pari materia* and should be construed together. Id., at 761.

(2) The purpose for excepting a transfer for adequate and full consideration is the absence of any net depletion of the gross estate for ultimate estate tax purposes. For the sale to accomplish an "equilibrium" for estate tax purposes, then, the property received must be commensurate in amount monetarily with the property transferred. Id., at 759-60.

In contrast to the approach taken by this Court in Wheeler, the Government is disregarding what the decedent received personally in exchange for her contribution to the partnership and LLC general partner and is focusing instead on what other partners or members may have contributed. If the other equity holders did not contribute an undefined sufficient amount, either in property or services, there would be a mere "'recycling' of value not rising to the level of a payment of consideration." (GB, at 36-37) *See* Estate of Harper v. Comm'r, 83 T.C.M. (CCH) 1641 (2002), Estate of Thompson v. Comm'r, 84 T.C.M. (CCH) 374 (2002), Kimbell, 244 F. Supp. 2d at 708, and Strangi 2, 85 T.C.M. (CCH) at 1331.

The "recycling of value" standard proposed by the Government to test whether there was "adequate and full consideration" is nothing more than a backdoor attempt to apply a business purpose test, even though such a test was expressly rejected in Estate of Strangi v. Comm'r, 115 T.C. 478 (2000) ("Strangi 1"), *aff'd sub nom*, Gulig v. Comm'r, 293 F.3d 279 (5th Cir. 2002) ("Gulig"), when the Tax Court and this Court rejected the economic substance test based on income

tax standards that had been proposed by the Government. In questioning whether there was a true joint enterprise resulting from a meaningful contribution of assets or provision of services by persons other than the decedent, the Government is simply questioning whether there was a business purpose, as opposed to a testamentary or estate planning purpose, for the entity and decedent's contribution to it. (GB at 15, 33, 35-37)

Whether there is a business purpose is inherently a subjective inquiry devoid of any objective consideration of whether the equity interests received bear a sufficient monetary relationship to the assets contributed to the respective entities to be regarded as "adequate and full consideration in money or money's worth." In Wheeler, this Court expressly rejected a subjective testamentary intent standard for determining the adequacy of consideration and instead held that an analysis based on objective criteria (as opposed to the relationship of the transferee to the decedent or other indications of testamentary intent) is required:

> [T]he present transfer tax scheme eschews subjective determinations in favor of the objective requirements set forth in the statutes. Therefore, section 2036(a) permits the *conclusion* that a split-interest transfer was testamentary when, and if, the objective requirement that the transfer be for an adequate and full consideration is not met. Section 2036(a) does not, however, permit a perceived testamentary intent, *ipse dixit*, to determine what amount constitutes an adequate and full consideration. Unless and until the Congress declares that intrafamily transfers are to be treated differently, . . . we must rely on the objective criteria in the statute and

> Treasury Regulations to determine whether a sale comes within the ambit of the exception to section 2036(a). The identity of the transferee or the perceived testamentary intent of the transferor, provided all amounts transferred are identical, cannot result in transfer tax liability in one case and a tax free transfer in another.

Wheeler, 116 F.3d at 766.

Even if the objective standard required by Wheeler is used, however, a question remains as to whether the *discounted* value of the equity interests received by the decedent in exchange for her capital contributions in Kimbell represents "adequate and full consideration in money or money's worth."

The answer to this question turns upon this Court's resolution of possible tension between the two "adequate and full consideration" standards set forth in Wheeler, (1) the *in pari materia* principle and (2) the equilibrium test.

On the one hand, the gift and estate tax definitions of "adequate and full consideration" should be read *in pari materia* and should be accorded the same meaning. Id., at 761. In Kimbell, the Government is not contending that a gift occurred upon formation of the partnership. (GB, at 34) In not raising a gift on formation argument, the Government is tacitly acknowledging that this argument has been rejected by all courts which have considered it, including this Court, where the decedent's capital account and interest in profits and losses were proportionate to the value of his or her capital contribution. *See* Strangi 1, 115 T.C. at 490, and Gulig, 293 F.3d at 282. Under Wheeler's *in pari materia* standard,

then, the existence of "adequate and full consideration in money or money's worth" for gift tax purposes should mean that there was also "adequate and full consideration in money or money's worth" for purposes of Section 2036(a).

On the other hand, the equilibrium standard, which is also set forth in Wheeler, seems to focus on whether there has been a depletion of the gross estate for estate tax purposes. The allowable discounts for the equity interests received in exchange for the capital contributions would have the effect of reducing the decedent's estate for estate tax purposes, at least for the foreseeable future.

In a recent Tax Court decision, Estate of Stone v. Comm'r, 86 T.C.M. (CCH) 551 (2003), the tension between these conflicting standards was expressly considered, and the receipt of partnership interests with discounted values was nonetheless held to represent "adequate and full consideration in money or money's worth" for both gift and estate tax purposes where the partnership interests received were proportionate in all material economic respects to the decedent's capital contributions. As the Tax Court noted, a contrary holding would almost universally negate the availability of the "bona fide sale for an adequate and full consideration in money or money's worth" exception whenever property is transferred to an entity as a capital contribution, apparently irrespective of whether the transferor is a family member, and such a construction would be inconsistent with Congress's intent. Id., at 581.

If the discounted value of the equity interest received for the capital contribution were held not to represent "adequate and full consideration," and if, as a result, Section 2036(a)(1) or (a)(2) were held to apply to the transfer, appreciation between the date of initial contribution to the partnership and the date of death could effectively result in double inclusion in the gross estate. The value of the partnership interest owned by the decedent at death would be includible in the decedent's gross estate under Section 2033. If a proportionate part of the underlying net asset value of the partnership attributable to the same interest is also includible in the decedent's gross estate under Section 2036(a), there would be double inclusion attributable to the same interest. This double inclusion would be offset to some degree by a reduction in the amount includible under Section 2036(a) by the value of the partnership interest received at the time of the initial contribution to the partnership. *See* I.R.C. § 2043. The problem is that there would be double inclusion based on floating values (until the date of death) with only a single offset fixed at the time of the initial capital contribution. If the value of the underlying partnership assets, and thus the retained partnership interest, appreciates materially between the date of the capital contribution and the date of death, the decedent's estate could be taxed on a materially larger amount than would have been includible in his or her gross estate in the absence of any transfer.

Since even the discredited Section 2036(c) was not that onerous, but instead generally permitted a full offset for the value of the interest includible under Section 2033, it is especially difficult to believe that Congress intended such double inclusion attributable to the same partnership interest in the absence of an express statutory provision. Even the Government acknowledges that the "bona fide sale for adequate and full consideration in money or money's worth" exception was enacted to prevent double counting. (GB, at 31) Although post-contribution appreciation and thus double inclusion was apparently not a material problem in Kimbell, it could be a major problem for many family limited partnerships.

In summary, the College concurs with Wheeler that an objective standard focusing on what the decedent received in exchange for the transfer is appropriate to determine whether a decedent has received "adequate and full consideration in money or money's worth." Such subjective criteria as testamentary intent or absence of a primary business purpose should not be relevant. The College also concurs that "adequate and full consideration in money or money's worth" should be accorded the same meaning for gift and estate tax purposes and that, as the Tax Court determined in Estate of Stone, 86 T.C.M. (CCH) 551, receipt by a transferor of equity interests in an entity which are proportionate in all material economic respects to the transferor's capital contributions should be considered "adequate

and full consideration in money or money's worth," notwithstanding any discounts properly allowable with respect to such equity interests for transfer tax purposes.

Bona Fide Sale. For the Section 2036(a) exception to apply, in addition to "adequate and full consideration" there must also be a "bona fide sale."

According to the District Court in Kimbell, a "bona fide sale" connotes an "arm's-length transaction," which by definition requires that the parties not be related. *See* Kimbell, 244 F. Supp. 2d at 704. In Strangi 2 and apparently in Kimbell, the respective trial courts focused on whether there were meaningful negotiations among the prospective equity holders. *See* Strangi 2, 85 T.C.M. (CCH) at 1331, 1343, and Kimbell, 244 F. Supp. 2d at 704.

Overall, this arm's length transaction standard applied by the District Court in Kimbell and by the Tax Court in Strangi 2 is at odds with the following standards set forth by this Court in Wheeler to analyze whether a sale is "bona fide":

> (1) In a case where "adequate and full consideration in money or money's worth" has been determined to exist, the only grounds for contesting whether a sale is "bona fide" are (1) whether the transferor actually parted with the property supposedly transferred and (2) whether the transferor actually received the full consideration to which he or she was entitled by reason of the sale. Wheeler, 116 F.3d at 764. In other words,

was either the transfer or the consideration received a "sham"? Id., at 766 n. 20.

(2) The absence of negotiations is not compelling. Id., at 769.

(3) The fact that the parties to the sale are family members should make no difference:

> The term 'bona fide' preceding 'sale' in section 2036 is not, as the government seems to suggest, an additional wicket reserved exclusively for intrafamily transfers that otherwise meet the Treasury Regulations' valuation criteria. The government implicitly asserts that the term 'bona fide' in section 2036(a) permits the IRS to declare that the same remainder interest, sold for precisely the same (actuarial) amount but to different purchasers, would constitute adequate and full consideration for a third party but not for a family member. This construction asks too much of these two small words. In addition to arguing that 'adequate and full consideration' means different things for gift tax purposes than it does for estate tax purposes, the government would also have us give 'bona fide' not only a different construction depending on whether we are applying the gift or estate tax statue, but also different meanings depending upon the identity of the purchaser in a section 2036(a) transaction. We do not believe that Congress intended, nor do we believe the language of the statute supports, such a construction.

Id., at 764.

(4) Similarly, any consideration of the testamentary intent of the transferor should not be material. Id., at 765-66 n. 20. Supporting this Court's conclusion is substantial legislative history, including Congress's

adoption in 1931 of the predecessor to Section 2036(a) as an objective alternative to the old "contemplation of or intended to take effect. . . at. . .death" concept, the repudiation in 1976 of a "contemplation of death" concept in Section 2035, the retroactive repeal in 1990 of Section 2036(c) (which, in Section 2036(c)(2), had abrogated the "bona fide sale" exception for an intrafamily transfer), and the specific but comparatively narrow limits on intrafamily transfers in Chapter 14 which Congress added in 1990 to replace Section 2036(c):

> [T]here are overwhelming indications that the estate freeze provisions adopted by Congress in 1990 [Chapter 14] were designed to address the perceived shortcomings of section 2036(a).

Id., at 767.

The "sham transfer" or "sham consideration" standard applied in Wheeler to determine whether a transfer for "adequate and full consideration in money or money's worth" constitutes a "bona fide sale" still leaves room for a sham transfer or sham consideration determination in regard to clearly abusive situations in which a family limited partnership is disregarded by the parties, and especially by the decedent, after the formation of the entity. Disregard of the entity after its formation, such as the decedent's rent free use of tangible property transferred to the entity, deposit in the decedent's personal account of monies properly belonging

to the entity, use of entity funds to pay the decedent's personal expenses, and disproportionate distributions to the various equity holders, could properly be regarded as evidence of a possible sham transfer or sham consideration. If the instances of such post-formation disregard of the entity are recurring or blatant, such evidence may be sufficient to establish that the sale was not "bona fide" on grounds that the transfer or the equity interest received was a sham. The College's primary concern in regard to the formulation and application of an appropriate sham transfer or sham consideration standard is that isolated, inadvertent operational peccadilloes not be blown out of proportion by adoption of a zero tolerance standard for the inevitable administrative errors occurring from time to time with respect to almost any entity.

The College expressly refrains from attempting to evaluate the Kimbell facts in the context of the Wheeler sham transfer or sham consideration standard, for the College does not believe that its proper role is to try to influence essentially factual determinations so long as the legal standards announced and applied are not unexpectedly broad, needlessly ad hoc, or mischievously subjective.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that (a) two paper copies and (b) one computer readable 3-1/2 inch diskette copy in portable document file (PDF) format, prepared and labeled in accordance with 5th Cir. R. 31.1, of the foregoing Brief for Amicus Curiae in Support of Neither Party on Behalf of American College of Trust and Estate Counsel, has been sent via Federal Express on this ____ day of January, 2004 to:

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CERTIFICATE OF COMPLIANCE

Pursuant to 5th Cir. R. 32.2 and 32.3, the undersigned certifies this brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7).

1. EXCLUSIVE OF THE EXEMPTED PORTIONS IN 5th Cir. R. 32.2, THE BRIEF CONTAINS:

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2. THE BRIEF HAS BEEN PREPARED:

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Dated: January ____, 2004