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In *Turner*, the Tax Court determined that section 2036 applied to the decedent's transfers of assets to his family limited partnership but that the insurance premiums he paid indirectly to his insurance trust qualified for the annual exclusion.

In *Turner*,[1] the Tax Court addressed two issues. The primary question was whether the value of the underlying assets in the decedent's family limited partnership was included in his estate under section 2035, 2036, or 2038. The secondary issue was whether the decedent made additional taxable gifts or whether his insurance payments qualified for annual exclusions under *Crummey*.[2] The estate lost on the FLP question but won on the *Crummey* issue.

Clyde Turner Sr. died on February 4, 2004, and was survived by his widow, Jewell, and three of their four children: Clyde Jr., Betty, and Janna.[3] A third daughter, Joyce, died in 1993. One of Joyce's sons, Rory, had been arrested multiple times for illegal drug offences; however, Rory had a close relationship with his grandmother, Jewell.[4]

The decedent and Jewell held more than 170,000 shares of Regions Bank stock, and because of a family relationship with the bank, they sold few of its shares.[5] Although the decedent at times traded other stock holdings, he had no special investment strategy.[6] The decedent established an irrevocable trust to hold life insurance policies for the benefit of 12 beneficiaries: his then-living children and grandchildren. The trust itself did not pay the insurance premiums; rather, the decedent paid the premiums with checks from his joint checking account with Jewell.[7] According to the trust agreement, each beneficiary had the right to withdraw the lesser of $10,000 (or $20,000, if married) minus any amounts earlier transferred during the year, or the amount of the transfer divided by the number of beneficiaries. The beneficiary was required to give notice of his desire to exercise his withdrawal right within 30 days of the decedent's direct or indirect transfer to the trust. The court found no evidence that any anyone requested a withdrawal before the decedent's death.[8]

Marc, Clyde Jr.'s son, had assisted his grandparents in their financial affairs and with their bookkeeping. They called Marc to discuss pooling their assets to manage them. Marc and his brother, Travis, contacted an attorney at a law firm their grandparents had previously used, and the attorney contacted the decedent and Jewell about establishing an FLP and contributing assets to that entity. At that time, the decedent was in his early 80s, and Jewell in her late 70s, and both were healthy.[9]

Approximately two years before his death, the decedent and Jewell formed their FLP, with each of them owning a 0.5 percent general partnership interest and a 49.5 percent limited partnership interest. There was no objective evidence of any partnership meetings before the decedent's death, although there were two meetings afterward, once in 2004 and once in 2005, to discuss the FLP's "past performance and investment plans" as well as the decedent's estate and his will.[10]

In 2002 the decedent and Jewell each contributed half of the total $8,667,342 FLP contributions, consisting of liquid assets (cash, certificates of deposit (CDs), marketable securities, bonds, and annuities). They received proportionate FLP interests in exchange for their contributions, and the assets were

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[1]*Estate of Turner v. Commissioner*, T.C. Memo. 2011-209, *Doc 2011-18498*, *2011 TNT 169-7*.
[2]*Crummey v. Commissioner*, 397 F.2d 82 (9th Cir. 1968).
[3]*Turner*, T.C. Memo. 2011-209, at 2.
[4]*Id.* at 4.
[5]*Id.*
[6]*Id.* at 5.
[7]*Id.* at 5-6.
[8]*Id.* at 6-7.
[9]*Id.* at 7-8.
[10]*Id.* at 8-9.

retitled in the FLP's name.[11] The couple also retained more than $2 million in assets that produced sufficient income to pay their living expenses.[12]

The stated general purposes of the FLP were: ''(1) To make a profit, (2) to increase the family's wealth, and (3) to provide a means whereby family members can become more knowledgeable about the management and preservation of the family's assets.''[13] The FLP agreement also stated nine specific purposes for formation; however, the list was based on the law firm's standard form. ''Consequently, some of the purposes listed in the partnership agreement did not apply to the Turner family, and Clyde Sr. and Jewell's actual purposes for establishing Turner and Co. were not necessarily reflected in the partnership agreement,'' the court said.[14]

The partnership agreement provided that the general partner ''shall be the sole manager of the Partnership and have sole authority in the conduct and management of the business of the Partnership.''[15] According to the agreement, the general partner would keep the books and records, and distribute reports to the limited partners. The general partner would pay all the partnership's operating costs and for that, he would receive ''a special allocation of income in an amount to be determined in good faith by the general partner'' as well as a reasonable management fee.[16] Despite that provision, the decedent and Jewell opted to receive a $2,000-per-month management fee that the FLP treated as a nondeductible distribution instead of a deductible expense.[17]

Also, the agreement provided that the partnership's net cash flow be distributed to each partner, limited and general, relative to each one's income tax liability resulting from the FLP's income, and that any excess income be distributed ''at such times and in such amounts as determined by the General Partner in its sole and absolute discretion.''[18] The general partner controlled in-kind distributions and was entitled to dissolve the FLP after selling its assets.[19] Likewise, the agreement provided that the general partner could amend the agreement ''at any time without the consent or approval of the limited partners.''[20]

An amendment to the partnership agreement provided that on the later of the decedent's or Jewell's death, their three children would become the FLP's general partners. Those three general partners, together with Trey (Joyce's son and Rory's brother) and the Habersham Bank, which was the trustee of Rory's trust,[21] could require that the FLP undergo a tax-free reorganization to create five separate partnerships, which would receive a pro rata share of liquid and illiquid assets after the latter were sold.[22]

The general partners signed a management fee agreement with their grandsons, Marc and Travis, to pay them a monthly fee of $500 for their daily management services as defined by the general partner.[23] The FLP paid them each $2,500 in 2002, $5,500 in 2003, and $7,000 in 2004. In 2003 and 2004 the decedent classified those payments as gifts. The partnership neither took deductions for those payments nor issued any tax forms indicating that those amounts were taxable income, and neither Marc nor Travis included them in their 2002-2004 federal income tax returns.[24] The FLP investment accounts showed either no change in investments or a few purchases and sales of stocks, notes, and money market funds. Because the decedent had a sentimental attachment to Regions Bank stock, he refused to sell any of those shares. The FLP also participated in a few real estate purchases and sales.[25]

The FLP paid legal fees, some of which related to estate planning for the decedent and Jewell. The decedent paid an FLP bank debt from his personal checking account. More than a year later, the accountant entered that transaction as a partnership debt to the decedent.[26] In 2002 the FLP paid the decedent $41,500 but made no payments to Jewell or to any limited partner. However, the FLP's tax return indicated distributions of $235 to each general partner and distributions to the decedent and Jewell as limited partners, respectively, of $23,277 and $23,276, presumably including the $5,000 fee paid to Marc and Travis.[27] In 2003 the FLP distributed a total of $86,815 to the decedent and Jewell,

[11] *Id.* at 9-10.
[12] *Id.* at 11.
[13] *Id.*
[14] *Id.* at 12.
[15] *Id.* at 13.
[16] *Id.*
[17] *Id.* at n.11.
[18] *Id.* at 14.
[19] *Id.*
[20] *Id.* at 15.

[21] Because of Rory's drug and legal problems, a trust had been created for him. *Id.* at 17.
[22] *Id.* at 18-19.
[23] *Id.* at 15-16.
[24] *Id.* at 16.
[25] *Id.* at 19-21.
[26] *Id.* at 21-22.
[27] *Id.* at 24. The court assumed that it included $5,500 paid to Marc and Travis, but the 2002 payments were $2,500 paid to each of them, which were treated as distributions to the decedent and Jewell although the court stated that the numbers were wrong because there was no explanation for a $23 discrepancy. *Id.* at 24, n.16.

$46,170 of which was paid to the decedent to cover his estimated federal and state income taxes associated with FLP income to them, and $13,645 was to pay premiums on the insurance policy on the decedent's life, which benefited the decedent's children and grandchildren.[28] In 2004 the FLP made payments of $5,312, $911, and $12,267 to cover Rory's, Janna's, and Betty's tax liabilities. The FLP also paid $58,000 to Jewell to purchase an automobile.[29]

On December 31, 2002, and on January 1, 2003, the decedent and Jewell made gifts of partnership interests, respectively valued at $1,652,315 and $474,315, to their three living children and to their deceased daughter's children.[30] On October 13, 2004, after the decedent's death, the executor of his estate filed gift tax returns for those gifts.[31]

The Tax Court first addressed the section 2036 issue.[32] It said that the purpose of that statute was to include the date of death value of *inter vivos* transfers that were intrinsically testamentary, in that the transferor retained a significant interest in or control over the transferred property.[33] The court held that the decedent made an *inter vivos* transfer when he transferred his assets to his FLP in exchange for general and limited partnership interests.[34]

Moreover, the court held that the transfer did not fall within the bona fide sale exception, which, under the *Bongard*[35] test requires that there was a "legitimate and significant nontax reason for creation of the family limited partnership and the transferors received partnership interests proportionate to the value of the property transferred."[36] Whether there was a bona fide sale focuses on the taxpayer's motive. The reasons enumerated in the partnership agreement reflected those in the attorney's form agreement and did not necessarily constitute the decedent's and Jewell's intentions or goals. The estate argued that at a minimum, the couple wanted to "consolidate their assets for management purposes, to facilitate resolution of family disputes through equal sharing of information," and to provide protection to and from Rory, but the court found that the record did not support that those reasons constituted "a legitimate and significant reason" motivating the FLP formation.[37]

The court held that the creation of the FLP merely involved changing the form of asset management. First, the assets in the FLP did not necessitate "active management or special protection."[38] The couple owned passive, marketable investments, and they did not have "a coherent investment plan."[39] The estate contended that the decedent and Jewell had contributed liquid assets to the FLP to start up a real estate business, a new investment strategy. The court, however, found that the FLP's sporadic and minor real estate activity was similar to the decedent's pre-FLP real estate investment activities.[40] Also, there was no significant change in the decedent's investment portfolio. The estate's argument that opening and closing CDs represents active investing was unpersuasive because CDs are cash equivalents. Likewise, there was no real change in investment management, because Marc performed virtually identical management functions for the decedent before the FLP's creation.[41] The FLP did not "meaningfully consolidate [decedent's] and Jewell's assets or implement an active and formal investment strategy."[42]

The court found no credible evidence that the FLP was created to resolve family disputes.[43] Their family issues were not matters of financial disagreements, but rested on personality conflicts between Clyde Jr. and his sisters and their spouses. The court considered this purported FLP rationale to be "an after-the-fact, hypothetical justification" for the FLP's formation.[44] Similarly, the court was not persuaded that asset protection to and from Rory was a significant nontax motive for FLP creation. Jewell's gifts to him were purely voluntary, and she neither wanted nor required protection from him. Also, the decedent and Jewell retained $2 million in assets, and there was no evidence that those funds were in any danger from Rory.[45] Finally, Rory had no assets of his own to protect.[46]

The court further underscored the ways in which the decedent's transfers were not bona fide sales: The decedent stood on all sides of the transaction at FLP formation; he commingled his personal assets

[28]*Id.* at 25-26.
[29]*Id.* at 27.
[30]*Id.* at 17.
[31]*Id.* at 18.
[32]The taxpayer had argued that section 7491(a) shifted the burden of proof to the government, but the court explained that its decision was not based on burden of proof but on the preponderance of the evidence. *Id.* at 30.
[33]*Id.* at 31-32.
[34]*Id.* at 32.
[35]*Estate of Bongard v. Commissioner*, 124 T.C. 95 (2005), *Doc 2005-5359*, *2005 TNT 50-11*.
[36]*Turner*, T.C. Memo. 2011-209, at 33.
[37]*Id.* at 34-35.
[38]*Id.* at 36.
[39]*Id.* at 38-39.
[40]*Id.* at 39.
[41]*Id.* at 40-41.
[42]*Id.* at 41-42.
[43]*Id.* at 42.
[44]*Id.* at 43.
[45]*Id.* at 44.
[46]*Id.* at 45.

with FLP funds (for example, gifts to his grandchildren, life insurance premium payments, estate planning legal fee payments); and there was an eight-month delay in transferring assets to the partnership.[47] Therefore, although the parties stipulated that the decedent and Jewell received proportionate partnership interests in exchange for their asset transfers, the court held that the bona fide sales exception of section 2036 did not apply.[48]

The court enumerated factors showing that the decedent retained an interest in the FLP assets, which required including the transferred assets in his gross estate under section 2036(a)(1): ''a transfer of most of the decedent's assets, continued use of the transferred property, commingling of personal and partnership assets, disproportionate distributions to the transferor, use of entity funds for personal expenses, and the testamentary characteristics of the arrangement.''[49] The decedent and/or Jewell received $2,000 as a fixed management fee without regard to their duties and without evidence that they performed any management duties for the FLP.[50] Also, the decedent's use of FLP funds for his gift giving, his payment of his own life insurance policy premiums and his personal attorney fees, his personal payment of an FLP debt, his personal purchase of property for the FLP, and his receipt of disproportionate FLP distributions all indicated a retained interest in the partnership assets.[51] The court stressed the testamentary character of the decedent's FLP creation in the context of his contacting and meeting with the attorneys to do his estate planning.[52] ''We are particularly struck by the implausibility of petitioner's assertion that tax savings from the family limited partnership were never discussed during a meeting focusing in part on estate planning. We do not find testimony to that effect to be credible, and that lack of credibility infects all of the testimony petitioner offered'' about the decedent's intended purposes of FLP formation, the court wrote.[53]

The court held that section 2036(a)(2) also applied. The decedent was a general partner and could amend the partnership return at any time without the limited partners' consent. Even after his family gifts of FLP interests, the decedent and Jewell owned more than 50 percent of the FLP interests; they therefore also controlled all partnership decisions requiring a majority of limited partners' consent.[54]

On whether there were additional taxable gifts because the decedent and Jewell claimed annual exclusions for indirect amounts transferred to the insurance trust that contained *Crummey* demand rights, the court held for the estate. According to *Cristofani*,[55] which cited *Crummey*, ''The test is not whether the beneficiary was likely to receive the present enjoyment of the property, but whether he or she had the legal right to demand it.''[56] The court said that in *Crummey* the taxpayers' trust agreement provided that following a direct or indirect transfer of property to the trust, each beneficiary had a right to demand cash from the trust and that if a beneficiary was a minor, a guardian could make that demand on the minor's behalf. It was immaterial that any minor beneficiary would actually make that demand, and the Ninth Circuit in *Crummey* acknowledged that some beneficiaries likely did not even know that they had that demand right. Yet, the court allowed annual exclusions for those gifts.[57]

In *Turner*, the decedent made gifts to his children and grandchildren in trust when he paid the insurance premiums. However, the government maintained that the beneficiaries' withdrawal rights were illusory because the decedent made direct payments of the insurance premiums and because the beneficiaries never received notice of the transfers, which in turn deprived them of their opportunity to make a demand. The court held that the fact that the decedent did not transfer money directly to the trust or that the beneficiaries may not have known about their withdrawal rights was irrelevant.

Likewise, the court found in favor of the taxpayers regarding the government's alternative argument that the transfers of limited partnership interests in 2002 and 2003 already exhausted some of the beneficiaries' annual exclusion. The court said that since the date of death value of the assets the decedent transferred to the FLP was included in the decedent's estate, his gifts of partnership interests reported on his estate tax return must be disregarded in computing his adjusted taxable gifts.[58]

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[47] *Id.* at 45-46.
[48] *Id.* at 46-47.
[49] *Id.* at 47-48.
[50] *Id.* at 48. Further, the decedent could amend the partnership agreement at any time without the consent of the limited partners.
[51] *Id.* at 49-50.
[52] *Id.* at 50.
[53] *Id.* at 50-51.
[54] *Id.* at 52.
[55] *Estate of Cristofani v. Commissioner*, 97 T.C. 74 (1991).
[56] *Turner*, citing *Cristofani*, T.C. Memo. 2011-209, at 53.
[57] *Id.* at 55-56.
[58] *Id.* at 56-58.

Analysis and Conclusion

The court's discussion of, and holding on, the application of section 2036 to the decedent's transfers of assets to his FLP and his retained interests and powers is very clear and thorough. On the second issue of *Crummey* and the annual exclusion, the court seemed to expand prior case law on the annual exclusion. First, the court effectively held that there was no need for the beneficiaries to receive *Crummey* letters, but, more significantly, the court included indirect gifts to a trust as also qualifying for the annual exclusion under *Crummey.* Citing *Crummey* and *Cristofani*, the court held: ''Likewise, the fact that some or even all of the beneficiaries may not have known they had the right to demand withdrawals from the trust does not affect their legal right to do so.''[59]

On one hand, eliminating the need for *Crummey* letters might give practitioners a sigh of relief. Explaining the need for the letters and, at the same time, the reasons the beneficiaries should not exercise their demand rights, must confirm clients' beliefs that all lawyers are crazy. On the other hand, there's a further illogic in extending *Crummey* to indirect gifts because those gifts are not actual transfers of any funds into the trust, so that makes the exercise of *any* demand rights created by and existing in the trust a virtual impossibility. Both *Crummey* and *Cristofani* involved actual, direct transfers to a trust; there at least was a fund from which the beneficiaries could demand withdrawals.

[59]*Turner*, T.C. Memo. 2011-209, at 57.