TAX COURT CASE UPDATE

Citation:

Joanne M. Wandry, et al. v. Commissioner, T.C. Memo 2012-88, March 26, 2012.

Overview:

The issues for decision in this case were as follows:

(1) Whether the petitioners transferred gifts of a specified dollar value of membership units or fixed percentage interests in Norseman Capital, LLC, a Colorado limited liability company, to their children and grandchildren in 2004, and

(2) Whether the petitioners' transfer documents were void for Federal tax purposes as against public policy.

The Facts:

Albert and Joanne Wandry formed the Wandry Family Limited Partnership ("Wandry FLP") in 1998, funding it with cash and marketable securities. Based on consultation with an attorney/CPA, Mr. and Mrs. Wandry began gifting limited partnership interests. Rather than giving a specific number of units which would not be known until after the gift was made and a valuation performed, the attorney advised them to give gifts of a specific dollar amount. He also advised that the gifts be given on December 31 and January 1 of a given year so that an interim closing of the books of Wandry FLP was not necessary.

In April 2001, Mr. and Mrs. Wandry and their children started a family business and formed Norseman Capital, LLC ("Norseman"), a Colorado limited liability company. By 2002, all of Wandry FLP's assets had been transferred to Norseman. Under advice of counsel, the petitioners began a gift giving program, giving gifts of a specific dollar amount rather than a specific number of units.

On January 1, 2004, the Wandrys each executed various assignment documents giving gifts of specific dollar amounts to their four children and five grandchildren. The total amount of the gifts was $1,099,000 each. The assignment documents included the following:

> Although the number of units gifted is fixed on the date of the gift that number is based on the fair market value of the gifts Units, which cannot be known on the date of the gift but must be determined after such date based on all relevant information as of that date.

In addition, the documents included a provision that if the IRS challenged the taxpayer's valuation, "the number of gifted Units shall be adjusted accordingly so that the value of the number of Units gifted to each person equals the amount set forth above."

A valuation of Norseman was performed and a 1 percent interest was valued at $109,000. All capital accounts were adjusted based on the dollar amounts of the gifts and gift tax returns were

prepared. The petitioners' CPA included a schedule that included the dollar amount per gift, as well as the percentage interest of each gift based on the valuation of the 1 percent interest.

On audit, the IRS ignored the dollar amounts of the gifts and assessed additional tax based on a 1 percent interest being valued at approximately $150,000 per 1 percent interest. The petitioners and the IRS stipulated to a value of approximately $132,000 per 1 percent interest.

Discussion:

The IRS argued that the Wandrys were liable for gift tax because they transferred completed gifts of fixed percentage interests to the donees and the gifts exceeded their Federal tax exclusions. To support this, the IRS made the following arguments:

> (1) the gift descriptions, as part of the gift tax returns, are admissions that petitioners transferred fixed Norseman percentage interests to the donees; (2) Norseman's capital accounts control the nature of the gifts, and Norseman's capital accounts were adjusted to reflect the gift descriptions; and (3) the gift documents themselves transferred fixed Norseman percentage interests to the donees. Respondent further argues that the adjustment clause does not save petitioners from the tax imposed by section 2501 because it creates a condition subsequent to completed gifts and is void for Federal tax purposes as contrary to public policy.

In response, the taxpayers argued that they transferred percentage interests to the donees equal to the dollar amounts included in the transfer documents. They also argued that the IRS's public policy concerns did not apply to the adjustment clause of the documents.

The Court did a thorough analysis of how the gifts were defined to determine if the IRS prevailed on any of its arguments. With respect to the nature of the gifts, The Court ruled that the taxpayer's consistent intent and actions prove that dollar amounts of gifts were intended.

Judge Haines then analyzed how Norseman adjusted its capital accounts to reflect the gifts. To make this argument, the IRS relied on a case that The Court did not find persuasive. In addition, Judge Haines did not find the IRS's presentation of facts to be persuasive and ruled, "Therefore, respondent's argument fails in both law and fact."

The final argument challenged the Wandrys' attempt to use a formula to transfer assets with uncertain value at the time of the transfer. The IRS relied on *Commissioner v. Proctor* to make its case, however after a lengthy analysis, The Court ruled that the taxpayers' formula clauses were valid, and that the public policy concerns of the IRS were without merit.

Conclusion:

"The Court, in reaching its holdings, has considered all arguments made, and to the extent not mentioned, concludes that that are moot, irrelevant, or without merit."

Following on the heels of a number of cases decided over the past few years, The Court seems to approve the use of defined value clauses in estate planning.