TAX COURT CASE UPDATE

Citation:

Estate of Lois L. Lockett et al. v. Commissioner, T.C. Memo 2012-123, April 25, 2012.

Overview:

The Tax Court has found that a family limited partnership terminated under state law when one partner, an individual, became the entity's sole owner. As a result, the individual owned 100 percent of the former entity's assets at her death and they were taxable in her estate at full fair market value. The Court also determined that some transfers from the entity to the decedent's children were loans and others were gifts.

The Facts:

This case involved the Estate of Lois L. Lockett who died on October 14, 2004. Her husband predeceased her and his will established a trust for her benefit (Trust A.) As part of her estate planning, in 2000, Mrs. Lockett participated in the creation of Mariposa Monarch, LLP, an Arizona limited liability limited partnership (Mariposa). A formal agreement for Mariposa was not signed, however, until 2002. The agreement named Mrs. Lockett's sons, Joseph and Robert, as general partners, and Mrs. Lockett, Joseph, Robert, and Trust A as limited partners. Soon after the agreement was signed, Mrs. Lockett and Trust A began funding the partnership. In May 2003, Trust A was terminated and Mrs. Lockett became the owner of Trust A's limited partnership interest in Mariposa.

In 2002, Mariposa made transfers to Joseph and Robert. In 2004, additional transfers were made to them and a transfer was made to a grandchild of Mrs. Lockett. On the date of Mrs. Lockett's death, Mariposa held assets worth over $1 million. On its Form 706, the estate reported Mrs. Lockett as the 100 percent owner of Mariposa at her death. The estate valued Mrs. Lockett's 100 percent ownership interest in Mariposa at $667,000. The estate applied control and marketability discounts in determining the value of Mrs. Lockett's 100 percent ownership interest in Mariposa.

Subsequently, the IRS issued two deficiency notices, taking inconsistent positions with respect to the transfers. One asserted that the transfers were gifts, while the other said they were loans and the receivables for them were assets of the estate.

Discussion:

The Tax Court observed that the parties were in agreement that Mariposa transferred $335,000, $135,000, and $5,000 to Joseph, Robert, and Meredith (the granddaughter), respectively. The only dispute was whether the transfers at issue were loans or gifts. The estate contended that the transfers were in form and substance loans. The IRS countered that while they were in form loans, in substance, they were gifts. The Tax Court found as follows:

- A $315,000 transfer to Joseph was a loan

- A $20,000 transfer was a gift.
- A $135,000 transfer to Robert was a loan.
- A $5,000 transfer to Meredith was a gift.

The IRS argued that Mariposa was not a valid partnership under state (Arizona) law because only Mrs. Lockett contributed assets to the partnership, and thus there was no association of two or more persons. It further argued that Mariposa was not a valid partnership under Arizona law because it did not operate a business for profit. The estate argued that a valid partnership was formed under Arizona law because the partnership was formed with two limited partners, Mrs. Lockett and Trust A, and two general partners, Robert and Joseph. The estate further argued that Mariposa operated a business for profit. The Tax Court found as follows:

- Mariposa operated a business for profit.
- Robert and Joseph at no time held interests in Mariposa.
- Trust A contributed assets to Mariposa and was a limited partner.
- There was an association of two persons to carry on as co-owners a business for profit in 2002–Trust A and Mrs. Lockett.
- Trust A was terminated effective December 31, 2002. As a result, Mrs. Lockett became the owner of Trust A's limited partnership interest in Mariposa. Since Trust A was the only other partner in Mariposa, upon termination of Trust A, Mrs. Lockett became the sole partner in Mariposa.
- Arizona law provides that a partnership is dissolved and its business wound up upon the occurrence of an event agreed to in the partnership agreement resulting in the winding up of the partnership business. The Mariposa agreement provided Mariposa would be dissolved upon the acquisition by a partner of all the interests of the other partners. Therefore, Mrs. Lockett's acquisition of Trust A's limited partnership interest caused the dissolution of Mariposa under Arizona law.

Conclusion:

Mrs. Lockett held a legal and beneficial interest in all of the assets of Mariposa on the date of her death. As a result, the Tax Court held that 100 percent of the fair market value of those assets on had to be included in her gross estate.