Kerr v. Commissioner, 113 T. C. 449 (1999)

Restrictions on partnership liquidation in partnership agreements are not applicable for valuation purposes if they are no more restrictive than those under state law.

Summary

In Kerr v. Commissioner, the petitioners created family limited partnerships and transferred interests to grantor retained annuity trusts (GRATs) and their children. The IRS argued that the partnership agreements' restrictions on liquidation should be disregarded under IRC section 2704(b), which could increase the taxable value of the transferred interests. The Tax Court held that the interests transferred to the GRATs were limited partnership interests, not assignee interests. However, it granted summary judgment to the petitioners on the section 2704(b) issue, ruling that the partnership agreements' liquidation restrictions were not more restrictive than those under Texas law and thus not applicable restrictions for valuation purposes.

Facts

Baine P. Kerr and Mildred C. Kerr formed the Kerr Family Limited Partnership (KFLP) and Kerr Interests Limited Partnership (KILP) under Texas law. They transferred life insurance policies and other assets to these partnerships. The Kerrs then transferred limited partnership interests to their GRATs and their children. The partnership agreements stipulated that the partnerships would dissolve and liquidate on December 31, 2043, or by agreement of all partners. The IRS issued notices of deficiency, arguing that the liquidation restrictions in the partnership agreements should be disregarded under section 2704(b), thereby increasing the taxable value of the transferred interests.

Procedural History

The Kerrs filed a joint petition for redetermination with the Tax Court, challenging the IRS's determinations. They moved for partial summary judgment, arguing that the transferred interests were assignee interests and that section 2704(b) did not apply. After conceding that the interests transferred to their children were limited partnership interests, the Kerrs maintained that all interests should be valued as assignee interests. The court granted the Kerrs' motion for leave to amend their petition to raise the assignee issue and subsequently held hearings and received testimony on the matter.

Issue(s)

1. Whether the interests transferred to the GRATs were limited partnership interests or assignee interests.
2. Whether the partnership agreements' restrictions on liquidation constituted applicable restrictions under section 2704(b).

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Holding

1. No, because the Kerrs, in substance and form, transferred limited partnership interests to the GRATs.
2. No, because the partnership agreements' restrictions on liquidation were not more restrictive than those under Texas law, and thus not applicable restrictions under section 2704(b).

Court's Reasoning

The court applied the substance over form doctrine, finding that the Kerrs transferred limited partnership interests to the GRATs despite the absence of formal consents from their children. The court noted the similarity in rights between limited partners and assignees under the partnership agreements and the tax motivation behind structuring the transfers as assignee interests. Regarding the section 2704(b) issue, the court compared the partnership agreements' liquidation provisions with Texas law, concluding that the agreements' restrictions were no more restrictive than those under state law. Therefore, the restrictions did not constitute applicable restrictions under section 2704(b). The court rejected the IRS's argument that a different Texas statute on partner withdrawal should be considered, as it did not pertain to partnership liquidation.

Practical Implications

This decision clarifies that partnership agreements' restrictions on liquidation will not be disregarded under section 2704(b) if they are no more restrictive than those under state law. Practitioners should carefully compare partnership agreement provisions with applicable state law when structuring transfers of partnership interests. The case also reinforces the substance over form doctrine's application in determining the nature of transferred interests. Subsequent cases, such as Estate of Strangi v. Commissioner, have distinguished Kerr, applying section 2704(b) when partnership agreements' restrictions were more restrictive than state law.

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