Estate of Albert Strangi, Deceased, Rosalie Gulig, Independent Executrix v. Commissioner of Internal Revenue, 115 T. C. 478 (2000)

A family limited partnership is recognized for estate tax purposes if it has sufficient economic substance, despite lacking a valid business purpose.

Summary

Albert Strangi transferred assets to a family limited partnership (SFLP) two months before his death, receiving a 99% limited partnership interest. The IRS argued that SFLP should be disregarded for estate tax purposes due to lack of business purpose and economic substance. The Tax Court recognized the partnership for tax purposes due to its validity under state law and the economic substance it possessed, despite finding no valid business purpose. The court applied valuation discounts to Strangi's interest, rejecting a gift tax argument on the transfer to the partnership. This case highlights the importance of economic substance over business purpose in determining the validity of family limited partnerships for estate tax purposes.

Facts

Albert Strangi, a multimillionaire, formed the Strangi Family Limited Partnership (SFLP) in 1994, two months before his death. He transferred assets valued at $9,876,929, including cash, securities, real estate, insurance policies, and partnership interests, to SFLP in exchange for a 99% limited partnership interest. Stranco, Inc. , a corporate general partner owned by Strangi and his children, managed SFLP. After Strangi's death, SFLP made substantial distributions to his estate and children, indicating continued control over the assets.

Procedural History

The IRS determined a deficiency in Strangi's estate tax, arguing that SFLP should be disregarded due to lack of business purpose and economic substance. The estate contested this, and the case proceeded to the U. S. Tax Court. The Tax Court recognized SFLP for tax purposes but applied valuation discounts to Strangi's interest, leading to a decision on the estate's value.

Issue(s)

1. Whether the Strangi Family Limited Partnership (SFLP) should be disregarded for Federal estate tax purposes due to lack of business purpose and economic substance?
2. Whether the SFLP agreement constitutes a restriction on the sale or use of property that should be disregarded under section 2703(a)(2)?
3. Whether the transfer of assets to SFLP constituted a taxable gift?
4. If SFLP is not disregarded, what is the fair market value of Strangi's interest in SFLP at the date of death?

Holding

1. No, because SFLP, although lacking a valid business purpose, had sufficient economic substance to be recognized for tax purposes.
2. No, because section 2703(a)(2) does not apply to the partnership agreement, as the property included in the estate is the partnership interest, not the underlying assets.
3. No, because the transfer did not constitute a taxable gift, as Strangi's beneficial interest in the partnership exceeded 99%, and contributions were reflected in his capital account.
4. The fair market value of Strangi's interest in SFLP at the date of death, after applying valuation discounts, was determined to be $6,560,730.

Court's Reasoning

The court applied the economic substance doctrine, finding that SFLP had sufficient economic substance to be recognized for tax purposes despite lacking a valid business purpose. The court noted that SFLP was validly formed under state law, and its existence would not be disregarded by potential purchasers. The court rejected the IRS's argument that the partnership lacked economic substance due to its tax-avoidance purpose, as the assets were managed and distributed post-formation. The court also rejected the application of section 2703(a)(2), stating that the property to be valued was Strangi's partnership interest, not the underlying assets. The court found no taxable gift at the inception of SFLP, as Strangi's beneficial interest exceeded 99%, and the transfer was reflected in his capital account. The valuation of Strangi's interest was determined using the net asset value approach, applying discounts for lack of marketability and minority interest.

Practical Implications

This decision emphasizes that family limited partnerships may be recognized for estate tax purposes even if they lack a valid business purpose, as long as they have economic substance. Practitioners should focus on ensuring that such partnerships have a genuine economic impact, as the court will look beyond stated business purposes. The ruling also clarifies that section 2703(a)(2) does not apply to disregard the partnership agreement when valuing partnership interests for estate tax purposes. This case may encourage taxpayers to use family limited partnerships for estate planning, as long as they can demonstrate economic substance. Subsequent cases have referenced this decision when evaluating the validity of family limited partnerships for tax purposes.

