Estate of Wayne C. Bongard, Deceased, James A. Bernards, Personal Representative, Petitioner v. Commissioner of Internal Revenue, Respondent, 124 T. C. 95 (2005)

The U. S. Tax Court's ruling in Estate of Bongard clarified the application of Sections 2035 and 2036 to family limited partnerships, distinguishing between bona fide sales and testamentary transfers. Decedent's transfer of Empak stock to WCB Holdings was upheld as a bona fide sale, motivated by positioning the company for a corporate liquidity event. However, his transfer to the Bongard Family Limited Partnership (BFLP) failed to meet this exception due to lack of significant non-tax motives, resulting in the inclusion of certain assets in his estate. This decision underscores the importance of demonstrating legitimate business purposes in estate planning to avoid estate tax inclusion.

Parties

The Petitioner was the Estate of Wayne C. Bongard, with James A. Bernards serving as the Personal Representative. The Respondent was the Commissioner of Internal Revenue.

Facts

In 1980, Wayne C. Bongard (Decedent) incorporated Empak, Inc. In 1986, he established the Wayne C. Bongard Irrevocable Stock Accumulation Trust (ISA Trust), transferring 15% of Empak's stock into it. By the mid-1990s, to position Empak for a corporate liquidity event, Decedent and ISA Trust transferred their Empak stock to WCB Holdings, LLC (WCB Holdings), receiving membership units in return. Subsequently, Decedent transferred his WCB Holdings Class B units to the Bongard Family Limited Partnership (BFLP) in exchange for a 99% limited partnership interest. In 1997, Decedent gifted a 7. 72% interest in BFLP to his wife, Cynthia Bongard. Decedent died unexpectedly in 1998, and his estate was challenged on the tax treatment of these transfers by the IRS.

Procedural History

The IRS issued a notice of deficiency on February 4, 2003, to Decedent's estate, asserting that the Empak shares transferred to WCB Holdings should be included in Decedent's gross estate under Sections 2035(a) and 2036(a) and (b). The estate filed a timely petition with the U. S. Tax Court, contesting the IRS's determination. The case was reviewed by the Tax Court, where the estate argued that both transfers to WCB Holdings and BFLP constituted bona fide sales for adequate and full consideration. The Tax Court, applying a de novo standard of review, heard the case and issued its opinion on March 15, 2005.

Issue(s)

Whether Decedent's transfer of Empak stock to WCB Holdings and his subsequent transfer of WCB Holdings Class B units to BFLP constituted bona fide sales for adequate and full consideration under Section 2036(a)?

Whether Decedent retained an interest in the transferred property under Sections 2036(a) and 2035(a) that would necessitate the inclusion of the transferred assets in his gross estate?

Rule(s) of Law

Section 2036(a) of the Internal Revenue Code includes in a decedent's gross estate the value of any property transferred if the transferor retains certain rights or interests in the property, unless the transfer was a bona fide sale for adequate and full consideration in money or money's worth. Section 2035(a) includes in the gross estate property transferred within three years of death if such property would have been included under Section 2036 had the transferor retained it until death.

Holding

The Tax Court held that Decedent's transfer of Empak stock to WCB Holdings satisfied the bona fide sale exception of Section 2036(a) due to a legitimate and significant non-tax business purpose of positioning Empak for a corporate liquidity event. However, the transfer of WCB Holdings Class B units to BFLP did not satisfy the bona fide sale exception, as it lacked a significant non-tax motive. The court further found that an implied agreement existed allowing Decedent to retain enjoyment of the property held by BFLP, necessitating the inclusion of the WCB Holdings Class B units in Decedent's gross estate under Section 2036(a)(1). Consequently, the 7. 72% BFLP interest gifted to Cynthia Bongard within three years of Decedent's death was also included in the estate under Section 2035(a).

Reasoning

The court applied a two-pronged test for the bona fide sale exception in the context of family limited partnerships: (1) the existence of a legitimate and significant non-tax reason for the transfer, and (2) the transferor receiving partnership interests proportionate to the value of the property transferred. For the transfer to WCB Holdings, the court found that positioning Empak for a corporate liquidity event was a legitimate business purpose, satisfying the first prong. The second prong was met as Decedent received WCB Holdings membership units proportionate to his contribution of Empak stock.

Conversely, the transfer to BFLP failed the first prong as no significant non-tax reason was evident; the court found it primarily motivated by tax benefits. The court also identified an implied agreement allowing Decedent to retain enjoyment of the property transferred to BFLP, based on his ability to influence the redemption of Empak stock and WCB Holdings units, which could affect BFLP's liquidity. This retention of enjoyment triggered the application of Section 2036(a)(1).

Disposition

The court’s decision partially overruled the Commissioner’s notice of deficiency, excluding the value of Empak stock transferred to WCB Holdings from Decedent’s gross estate but including the value of WCB Holdings Class B units transferred to BFLP and the portion gifted to Cynthia Bongard.

Significance/Impact

The Estate of Bongard decision clarified the criteria for the bona fide sale exception under Section 2036(a) in the context of family limited partnerships. It emphasized the necessity of demonstrating legitimate and significant non-tax business purposes for such transfers to avoid estate tax inclusion. This ruling has had a significant impact on estate planning strategies involving family limited partnerships, influencing subsequent judicial interpretations and prompting practitioners to carefully document non-tax motives for entity formations and transfers.

