Pierre v. Commissioner, 133 T. C. 24 (2009) (United States Tax Court)

In Pierre v. Commissioner, the U. S. Tax Court ruled that for federal gift tax purposes, transfers of interests in a single-member LLC should be valued as interests in the LLC, not as direct transfers of the LLC's underlying assets. This decision upheld the applicability of valuation discounts, despite the LLC being a disregarded entity for federal tax purposes under the check-the-box regulations. The ruling clarified the interaction between state law property rights and federal tax law, impacting estate planning strategies involving LLCs.

Parties

Suzanne J. Pierre (Petitioner) v. Commissioner of Internal Revenue (Respondent). Pierre was the appellant at the Tax Court level, having filed a petition challenging the Commissioner's determination of gift tax deficiencies.

Facts

In 2000, Suzanne J. Pierre received a $10 million cash gift. Seeking to benefit her son and granddaughter while maintaining family wealth, Pierre established Pierre Family, LLC (Pierre LLC), a single-member limited liability company under New York law. On July 13, 2000, Pierre contributed $4. 25 million in cash and marketable securities to Pierre LLC. On July 24, 2000, she created the Jacques Despretz 2000 Trust and the Kati Despretz 2000 Trust. On September 27, 2000, Pierre transferred her entire interest in Pierre LLC to these trusts in two steps: first, she gifted a 9. 5% interest to each trust, then sold a 40. 5% interest to each trust in exchange for promissory notes. The transfers were valued using discounts for lack of marketability and control, resulting in no gift tax being paid.

Procedural History

The Commissioner of Internal Revenue examined Pierre's gift tax return for 2000 and 2001 and issued notices of deficiency, asserting that Pierre should be treated as transferring the underlying assets of Pierre LLC directly, rather than interests in the LLC. Pierre filed a petition with the United States Tax Court challenging the deficiency notices. The Tax Court heard the case and issued an opinion that focused solely on the legal issue of whether the check-the-box regulations altered the traditional Federal gift tax valuation regime for single-member LLCs.

Issue(s)

Whether, for Federal gift tax valuation purposes, the transfers of interests in a single-member LLC that is treated as a disregarded entity under the check-the-box regulations should be valued as transfers of interests in the LLC or as direct transfers of the underlying assets of the LLC?

Rule(s) of Law

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The Federal gift tax is imposed on the transfer of property by gift under 26 U. S. C. § 2501(a). The amount of the gift is the value of the property at the date of the gift per 26 U. S. C. § 2512(a). The value is determined by the "willing buyer, willing seller" standard, as articulated in 26 C. F. R. § 25. 2512-1, Gift Tax Regs. The check-the-box regulations, found in 26 C. F. R. §§ 301. 7701-1 through 301. 7701-3, Proced. & Admin. Regs. , allow a single-member LLC to be disregarded for federal tax purposes, but their applicability to gift tax valuation is at issue.

Holding

The Tax Court held that for Federal gift tax valuation purposes, the transfers of interests in Pierre LLC should be valued as transfers of interests in the LLC, not as transfers of the underlying assets of the LLC. This holding allowed Pierre to apply valuation discounts for lack of marketability and control, despite Pierre LLC being a disregarded entity under the check-the-box regulations.

Reasoning

The court reasoned that the check-the-box regulations, which govern the classification of entities for federal tax purposes, do not alter the long-standing Federal gift tax valuation regime. The court emphasized that state law determines the property rights transferred, and federal tax law then applies to those rights. New York law recognized Pierre LLC as an entity separate from its member, and Pierre did not have a direct interest in the LLC's underlying assets. Therefore, the court found that the check-the-box regulations, which disregard the LLC for federal tax purposes, do not extend to gift tax valuation. The court also noted that Congress had not acted to eliminate entity-related discounts for LLCs, and thus, the Commissioner could not overrule the traditional valuation regime through regulation. The court rejected the Commissioner's argument that the check-the-box regulations should be interpreted to treat the transfers as direct transfers of the LLC's assets, finding such an interpretation to be "manifestly incompatible" with the Internal Revenue Code and judicial precedent.

Disposition

The Tax Court affirmed the valuation of the transfers as interests in Pierre LLC and rejected the Commissioner's position that the transfers should be treated as direct transfers of the LLC's underlying assets. The court's opinion did not address other issues, such as the application of the step transaction doctrine or the specific valuation discounts, which were to be decided in a separate opinion.

Significance/Impact

This decision is significant for estate planning and gift tax valuation involving single-member LLCs. It clarifies that the check-the-box regulations do not override state law property rights for gift tax purposes, allowing taxpayers to apply valuation

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discounts when transferring interests in a disregarded LLC. The ruling impacts the use of LLCs in estate planning strategies, affirming the ability to use discounts to reduce gift tax liability. The decision has been influential in subsequent cases and planning, reinforcing the interplay between state law and federal tax law in the valuation of transfers. It also highlights the limitations of the Commissioner's regulatory authority in altering established tax regimes without Congressional action.

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