Estate of Nancy H. Powell, Deceased, Jeffrey J. Powell, Executor v. Commissioner of Internal Revenue, 148 T. C. No. 18 (2017)

The U. S. Tax Court ruled that the value of assets transferred to a family limited partnership (FLP) must be included in the decedent's estate under Sections 2036(a)(2) and 2043(a) of the Internal Revenue Code, but only to the extent they exceeded the value of the partnership interest received. The decision clarifies the application of estate tax rules to FLPs, emphasizing that retained control over the partnership's dissolution can trigger estate tax inclusion, while also limiting the extent of inclusion to prevent double taxation.

Parties

The petitioner was the Estate of Nancy H. Powell, represented by Jeffrey J. Powell as executor. The respondent was the Commissioner of Internal Revenue. The case was heard in the United States Tax Court.

Facts

On August 8, 2008, Jeffrey Powell, acting under a power of attorney on behalf of his mother Nancy H. Powell, transferred cash and securities valued at $10,000,752 from her revocable trust to NHP Enterprises LP (NHP), a limited partnership, in exchange for a 99% limited partner interest. NHP's partnership agreement allowed for its dissolution with the consent of all partners. On the same day, Jeffrey Powell transferred Nancy Powell's 99% interest in NHP to a charitable lead annuity trust (CLAT), which was to provide an annuity to the Nancy H. Powell Foundation for the remainder of her life, with the remaining assets to be divided between her two sons upon her death. Nancy Powell died on August 15, 2008, one week after the transfer.

Procedural History

The Commissioner of Internal Revenue issued notices of deficiency for a $5,870,226 estate tax deficiency and a $2,961,366 gift tax deficiency. The estate moved for summary judgment on both deficiencies, while the Commissioner moved for partial summary judgment on the estate tax deficiency. The Tax Court granted the Commissioner's motion regarding the estate tax deficiency but denied the estate's motion for summary judgment on that issue. The estate's motion for summary judgment on the gift tax deficiency was granted.

Issue(s)

Whether the transfer of cash and securities to NHP was subject to a retained right to designate the persons who shall possess or enjoy the property or the income therefrom under Section 2036(a)(2)?
Whether the value of the assets transferred to NHP should be included in the decedent's gross estate under Section 2036(a)(2) as limited by Section 2043(a)?
Whether the transfer of the decedent's 99% limited partner interest in NHP to the

CLAT was valid under California law, and if not, whether it should be included in her gross estate under Sections 2033 or 2038(a)?

Rule(s) of Law

Section 2036(a)(2) of the Internal Revenue Code includes in the gross estate the value of transferred property if the decedent retained the right to designate the persons who shall possess or enjoy the property or the income from it.
Section 2043(a) limits the amount includible in the gross estate under Section 2036(a)(2) to the excess of the fair market value of the transferred property at the time of death over the value of the consideration received by the decedent.
Section 2033 includes in the gross estate the value of all property to the extent of the decedent's interest at the time of death.
Section 2038(a) includes in the gross estate the value of property transferred if the enjoyment thereof was subject at the date of death to any change through the exercise of a power to alter, amend, revoke, or terminate.

Holding

The Tax Court held that the transfer of cash and securities to NHP was subject to a retained right under Section 2036(a)(2) due to the decedent's ability to dissolve the partnership with her sons' consent. However, the value includible in the decedent's gross estate under Section 2036(a)(2), as limited by Section 2043(a), was only the excess of the fair market value of the transferred assets at the time of her death over the value of the 99% limited partner interest received. The court also held that the transfer of the decedent's 99% interest in NHP to the CLAT was either void or revocable under California law because Jeffrey Powell did not have the authority to make gifts in excess of the annual federal gift tax exclusion, and thus, the value of the 99% interest was includible in the gross estate under either Section 2033 or Section 2038(a).

Reasoning

The court reasoned that the decedent's ability to dissolve NHP with the consent of her sons constituted a retained right under Section 2036(a)(2) to designate the beneficiaries of the transferred assets. This right was likened to the situation in *Estate of Strangi v. Commissioner*, where a similar right to dissolve a family limited partnership was held to trigger Section 2036(a)(2). The court also considered the decedent's indirect control over partnership distributions through her son, who was both the general partner and her attorney-in-fact, but deemed any fiduciary duties limiting this control as "illusory. "
The application of Section 2043(a) was necessary to prevent double taxation of the same economic interest. The court interpreted Section 2043(a) to limit the inclusion under Section 2036(a)(2) to the amount by which the transfer depleted the decedent's estate, i. e. , the value of the transferred assets minus the value of the partnership interest received.

The court found that the transfer of the decedent’s NHP interest to the CLAT exceeded the authority granted to Jeffrey Powell under the power of attorney, which only authorized gifts within the annual federal gift tax exclusion. Therefore, under California law, the transfer was either void or revocable, resulting in the inclusion of the value of the 99% interest in the gross estate under either Section 2033 or Section 2038(a).

The court rejected the estate’s arguments that the general authority to convey property included the power to make gifts, citing California case law and statute that require an express grant of authority to make gifts. The court also dismissed the estate’s reliance on the power of attorney’s ratification provision, as it could not be read to authorize acts beyond the granted authority.

The concurring opinion agreed with the result but disagreed with the majority’s reliance on Section 2043(a), arguing that Section 2036(a)(2) should be read to include the full value of the transferred assets without the need for Section 2043(a) to prevent double inclusion.

Disposition

The court granted the Commissioner’s motion for partial summary judgment on the estate tax deficiency and denied the estate’s motion for summary judgment on that issue. The estate’s motion for summary judgment on the gift tax deficiency was granted.

Significance/Impact

This decision clarifies the application of Sections 2036(a)(2) and 2043(a) to family limited partnerships, emphasizing that retained control over dissolution can trigger estate tax inclusion, but the inclusion is limited to prevent double taxation. The case also reinforces the principle that an attorney-in-fact’s authority to make gifts must be expressly granted under California law. The decision may impact estate planning involving FLPs, as it highlights the importance of structuring partnerships to avoid triggering Section 2036(a)(2) and ensuring that powers of attorney clearly delineate the authority to make gifts.