M. Beard Comments For Hearing On Proposed 2704 Regulations

December 1, 2016

I. FAMILY ATTRIBUTION

A. Proposed Regulations Broadly Apply Family Attribution For Transfer Tax Purposes.

The proposed regulations broadly apply family attribution or unity of ownership principles to property valuations for transfer tax purposes. This is in direct conflict with the intent of Congress and judicial precedent. In the absence of explicit directives from Congress, the proposed regulations should not include provisions that apply these principles when computing the value of a transferred interest.[1]

Section 2704(b)(3)(B) provides that the term "applicable restriction" shall not include any restriction imposed, or required to be imposed, by Federal or State law. Section 25.2704-2(b) of the current regulations provides that an applicable restriction is a limitation on the ability to liquidate the entity (in whole or in part) that is more restrictive than the limitations that would apply under the State law generally applicable to the entity in the absence of the restriction. The Tax Court has stated that it views the current regulations as an expansion of the exception contained in section 2704(b)(3)(B).[2]

In sharp contrast, the proposed regulations contain a new and substantially narrowed standard for the exception contained in section 2704(b)(3)(B). Sections 25.2704-2(b)(4)(ii) (with respect to applicable restrictions) and 25.2704-3(b)(5)(iii) (with respect to a new class of restrictions called "disregarded restrictions") of the proposed regulations state that a provision of law that applies only in the absence of a contrary provision in the governing documents or that may be superseded with regard to a particular entity (whether by the partners or otherwise) is not a restriction that is imposed or required to be imposed by federal or state law. Thus, the proposed regulations replace the "no more restrictive" standard in the current regulations with an "applies only in the absence of a contrary provision in the governing documents" standard. This unwarranted revision to the regulations is not the result of a directive from Congress. Section 2704 has not been amended since it was added to the Code in 1990.[3]

Many state statutes governing limited partnerships provide that a partnership may be liquidated on the vote or written consent of all partners.[4] Other state statutes require less than unanimous

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[1] Propstra v. U.S., 680 F.2d 1248 (9th Cir. 1982).
[2] Kerr v. Comm'r, 113 T.C. 449 (1999), *aff'd* 292 F.3d 490 (5th Cir. 2002).
[3] Except for a revision to a section reference in 1996.
[4] *See*, *e.g*., Tex. Bus. Orgs. Code § 11.051(2) (2016) ("Winding up of a domestic entity is required on: *** (2) a voluntary decision to wind up the domestic entity;"); Tex. Bus. Orgs. Code § 11.001(6)(B) (2016) ("'Voluntary decision to wind up' means the determination to wind up a domestic entity made by the domestic entity or the owners, members, or governing authority of the domestic entity in the manner specified by: *** Section 11.058(a)."); Tex. Bus. Orgs. Code § 11.058(a) (2016) ("A voluntary decision to wind up a domestic limited partnership requires the written consent of all partners in the limited partnership unless otherwise provided by the partnership agreement.").

consent.[5] Importantly, many state statutes provide that partners may modify statutory default provisions regarding liquidation by providing otherwise in a partnership agreement.[6] Such statutes are consistent with the uniform partnership acts dating back to 1914.[7] As a result, many state statutes will fall within the description under the proposed regulations as a provision of law that applies only in the absence of a contrary provision in the governing documents or that may be superseded with regard to a particular entity (whether by the partners or otherwise). Thus, the provisions of a partnership agreement restricting liquidation will rarely qualify for the exception under section 2704(b)(3)(B) under the requirements of the proposed regulations.

Accordingly, the proposed regulations will have the effect of broadly extending family attribution or unity of ownership principles to valuation for transfer tax purposes via section 2704(b)(1). This was not the result intended by Congress. Legislative history for section 2704 recognizes that courts have refused to consider familial relationships among co-owners in valuing property, and states that Chapter 14 was not intended to affect discounts available under then present law.[8] Further, the language of section 2704(b)(3)(B) refers to "any restriction

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[5] *See*, *e.g*., Delaware Revised Uniform Limited Partnership Act § 17-801(2) (2016) ("A limited partnership is dissolved and its affairs shall be wound up upon the first to occur of the following *** (2) Unless otherwise provided in a partnership agreement, upon the affirmative vote or written consent of (i) all general partners and (ii) limited partners who own more than two-thirds of the then-current percentage or other interest in the profits of the limited partnership owned by all the limited partners.").

[6] *See*, *e.g*., Tex. Bus. Orgs. Code § 11.058(a) (2016) ("A voluntary decision to wind up a domestic limited partnership requires the written consent of all partners in the limited partnership *unless otherwise provided by the partnership agreement*.") (Emphasis added); *see also*, *e.g*., Delaware Revised Uniform Limited Partnership Act § 17-801(2) (2016) ("A limited partnership is dissolved and its affairs shall be wound up upon the first to occur of the following *** (2) *Unless otherwise provided in a partnership agreement*, ***.") (Emphasis added).

[7] Uniform Limited Partnership Act (2001) § 801(2) ("[A] limited partnership is dissolved, and its activities must be wound up, only upon the occurrence of any of the following: *** (2) the consent of all general partners and of limited partners owning a majority of the rights to receive distributions as limited partners at the time the consent is to be effective;"); Uniform Limited Partnership Act (2001) § 110(a) ("Except as otherwise provided in subsection (b), the partnership agreement governs relations among the partners and between the partners and the partnership. To the extent the partnership agreement does not otherwise provide, this [Act] governs relations among the partners and between the partners and the partnership."); Uniform Partnership Act (1997) § 801(2)(ii) ("A partnership is dissolved, and its business must be wound up, only upon the occurrence of any of the following events: *** (2) in a partnership for a definite term or particular undertaking: *** (ii) the express will of all of the partners to wind up the partnership business;"); Uniform Partnership Act (1997) § 103(a) ("Except as otherwise provided in subsection (b), relations among the partners and between the partners and the partnership are governed by the partnership agreement. To the extent the partnership agreement does not otherwise provide, this [Act] governs relations among the partners and between the partners and the partnership."); Uniform Limited Partnership Act (1976) with 1985 Amendments § 801(3) ("A limited partnership is dissolved and its affairs shall be wound up upon the first to occur of the following: *** (3) written consent of all partners;"); Uniform Partnership Act (1914) § 31(1)(c) ("Dissolution is caused: (1) Without violation of the agreement between the partners, *** (c) By the express will of all the partners who have not assigned their interests or suffered them to be charged for their separate debts, either before or after the termination of any specified term or particular undertaking.").

[8] 136 Cong. Rec. 15679, 15681 (October 18, 1990) ("The value of property transferred by gift or includable in the decedent's gross estate generally is its fair market value at the time of the gift or death. Fair market value is the price at which the property would change hands between a willing buy and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts (Treas. Reg. sec. 20.2031-1(b)). This standard looks to the value of the property to a hypothetical seller and buyer, not the actual parties to the transfer. Accordingly, courts generally have refused to consider familial relationships among co-owners in valuing property. For example, courts allow corporate stock to be discounted to reflect minority ownership even when related persons together own most or all of the underlying stock. *** The bill does not affect minority discounts or other discounts available under present law."); H. Conf. Rept. 101-964, at 1137 (1990), 1991-2 C.B. 560, 606

imposed, or required to be imposed," by Federal or State law. The addition of the phrase "or required to be imposed" shows that Congress intended the exception to apply with respect to both default and mandatory statutory provisions.

The proposed regulations also ignore long established case law.[9] Beginning at least as early as 1940, the case law reflects that family attribution should not apply to combine a person's ownership interest with that of related parties for valuation purposes.[10]

B. Revise Proposed Regulations To Give Effect To Section 2704(b)(3)(B).

In light of the foregoing, we respectfully suggest that Treasury revise sections 25.2704-2(b)(4)(ii) and 25.2704-3(b)(5)(iii) of the proposed regulations to provide clarity on the issues it raised in the preamble, but (1) without narrowing the exception under section 2704(b)(3)(B) to the extent it is meaningless and has rare or no effect, and (2) without causing family attribution or unity of ownership principles to broadly apply for transfer tax purposes in the absence of an explicit directive from Congress. This can be accomplished by retaining the "no more restrictive standard" set forth in section 25.2704-2(b) of the current regulations.

("These rules are intended to prevent results similar to that of Estate of Harrison v. Commissioner, 52 T.C.M. (CCH) 1306 (1987). These rules do not affect minority discounts or other discounts available under present law. The conferees intend that no inference be drawn regarding the transfer tax effect of restrictions and lapsing rights under present law.").

[9] Minahan v. Comm'r, 88 T.C. 492 (1987) ("In so holding, we emphasize that we find [the Service]'s position unreasonable only because, by espousing a family attribution approach, he seeks to repudiate a well-established line of cases of long and reputable ancestry, going back as far as 1940.").

[10] Bright v. U.S., 658 F.2d 999 (5th Cir. 1981) ("First, we reject any family attribution to the estate's stock because established case law requires this result. *** Beginning at least as early as 1940, the Tax Court has uniformly valued a decedent's stock for estate tax purposes as a minority interest when the decedent himself owned less than 50%, and despite the fact that control of the corporation was within the decedent's family. *** Our research has uncovered no cases, and the government has cited none, which have attributed family owned stock to the estate's stock in determining the value thereof for estate tax purposes. *** We conclude that the case law reflects long established precedent that family attribution should not apply to lump a decedent's stock with that of related parties for estate tax valuation purposes."); Propstra v. U.S., 680 F.2d 1248 (9th Cir. 1982) ("[W]e are unwilling to impute to Congress an intent to have 'unity of ownership' principles apply to property valuations for estate tax purposes. *** In comparison, Congress has made explicit its desire to have unity of ownership or family attribution principles apply in other areas of the federal tax law. See, e.g., I.R.C. §§ 267, 318, and 544. In the absence of similarly explicit directives in the estate tax area, we shall not apply these principles when computing the value of assets in the decedent's estate."); Andrews v. Comm'r, 79 T.C. 938 (1982) ("The leading case dealing with this question is [*Bright*], in which the court recognized that a minority interest in a corporation should not be seen as having any control value, even though the family unit had control of the corporation. *** We see no reason to depart from such established precedent but follow the Fifth Circuit's well-reasoned and thoroughly researched opinion."); Rev. Rul. 93-12, 1993-1 C.B. 202; Mellinger v. Comm'r, 112 T.C. 26 (1999) ("Historically, undivided fractional interests in property included in an estate have been valued at a discount to reflect lack of marketability and minority interest holdings. Respondent, however, has long opposed such discounts and has argued for unity of ownership principles in estate tax cases. Specifically, respondent has argued that a decedent's fractional interest in property should be aggregated with fractional interests owned by family members in the same property for purposes of valuing the property in the estate. Respondent's basis for this position was that such undivided fractional interests should be valued by taking into consideration family cooperation and the likelihood that fractional interests will be sold together rather than separately. *** Ultimately, respondent reviewed this position and conceded that, for estate tax purposes, respondent would follow [*Bright*] and [*Propstra*] where family attribution had been rejected.")(citations omitted); Kerr v. Comm'r, 113 T.C. 449 (1999), *aff'd* 292 F.3d 490 (5th Cir. 2002).

Alternatively, we respectfully request that Treasury add additional examples to the proposed regulations that illustrate how the exception under section 2704(b)(3)(B) will have effect under the new standard contained in sections 25.2704-2(b)(4)(ii) and 25.2704-3(b)(5)(iii) of the proposed regulations.