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In their new article, *Family Limited Partnerships and Section 2036: Not Such a Good Fit*, Jonathan Blattmachr and Mitchell Gans address the resurrection of a troubling argument aimed at family partnerships. For years, the IRS has argued that family partnerships it views as abusive are subject to challenge under Section 2036. In the recent *Powell*[1] case, the IRS convinced the Tax Court, in a reviewed opinion, to take up favorable dicta from *Strangi*[2] and sanction its expanded use of this tool by invalidating a family partnership under Section 2036(a)(2). The overarching theme of the article – that Section 2036 was never designed to address family partnerships – is evident from the title and the authors provide thorough and persuasive arguments as to why many believe the positions embraced by the IRS and Tax Court in *Strangi* and *Powell* are misguided. The article also offers important planning tips for practitioners — flawed though the *Powell* decision may be, the Tax Court's view of these issues must be taken into account in the planning process.

The rationale advanced by the *Powell* majority is difficult to reconcile with prior law, and Blattmachr and Gans offer little deference in their critique. The relative weakness of the first half of the court's analysis may be due to the fact that Mrs. Powell's estate chose to concede to the IRS's aggressive arguments under Section 2036: first, that the mere right of a limited partner to vote with respect to liquidation is a retained string under Section 2036(a)(2); and second, that the bona fide sale exception to Section 2036 was inapplicable. The balance of its analysis, which attempts to shoehorn failed family partnerships into Section 2043, was raised *sua sponte* and not briefed by either party. In both aspects, the *Powell* court was without the benefit of the vigorous development of

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[1] Estate of Powell v. Comm'r, 148 T.C. No. 18, 2017 WL 2211398 (T.C. May 18, 2017).

[2] Estate of Strangi v. Comm'r, T.C. Memo. 2003-145, 85 T.C.M. (CCH) 1331 (2003), *aff'd on other grounds*, 417 F.3d 468 (5th Cir. 2005).

legal and factual argument that is meant to be the bulwark of our adversarial system.

Although the Tax Court's desire to produce an equitable result by addressing a fact pattern that gestured strongly toward transfer tax manipulation is understandable, we believe the analysis advanced is ultimately incorrect and unworkable. Blattmachr and Gans neatly summarize the near-universal consensus among commentators that *Powell*'s bad facts made bad law, asserting that the Tax Court's shortcoming is "the analytical methodology on which [the decision] is based, not the outcome."[3] In other words, it is clear on the facts that Mrs. Powell's estate deserved to lose, but the reasons advanced by the Tax Court have the potential to create undeserved and inequitable losses in future cases.

Section 2036 and the Illusory Fiduciary

Blattmachr and Gans rightly note that Section 2036 was not drafted or designed for application to family partnerships. In particular, their analysis of the Supreme Court's holding on Section 2036(a)(2) in *Byrum*[4] stands in stark contrast to that of the *Powell* court. Blattmachr and Gans offer an analysis that is straightforward, rational and easily applied to family partnerships, including the partnership at issue in *Powell*. The *Powell* court, by contrast, struggles desperately to free itself from the rule established in *Byrum*, a concerning choice in an area of law that sees little oversight from the nation's highest court.

At the heart of this divergence is *Byrum*'s conclusion that, to prompt estate inclusion under Section 2036(a)(2), a decedent must retain a "legally enforceable right" to affect the beneficial enjoyment of transferred property.[5] If fiduciary duties restrain the exercise of a power, *Byrum* reasons that the holder of the power is deprived of the right to exercise it as he or she sees fit and, thus, the power is outside of Section 2036(a)(2). Applied to family partnerships, it should be clear that the mere existence of a voting right, if restricted by fiduciary duties, should not result in estate inclusion under ordinary circumstances.

The *Powell* court attempts to break free of this rule – one our constitutional system tells us should bind lower courts – by simply disregarding the existence of fiduciary duties altogether. It does so on two alternate grounds: first, that "intra-family fiduciary duties" are "illusory" and may be ignored; and second, that because Mrs. Powell's son

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[3] Mitchell M. Gans & Jonathan G. Blattmachr, *Family Limited Partnerships and Section 2036: Not Such a Good Fit*, 42 ACTEC L.J. 253, 269 (2017).

[4] United States v. Byrum, 408 U.S. 125 (1972).

[5] *Id.* at 136-37.

was both the general partner of the family partnership and her attorney-in-fact, any relevant fiduciary duty was owed almost entirely to Mrs. Powell and may likewise be ignored.

Blattmachr and Gans provide a thorough review of the authority undermining these points, but could perhaps do more to emphasize the fundamental shortcoming of the Tax Court's rationale. There is no body of federal law governing the fiduciary relationships at issue in *Powell* – those owed by trustees to beneficiaries, those owed among partners in a partnership, and those owed by agents to principals. Rather, such duties are creatures of state law and their existence and character under state law not only should be respected by federal courts, but is critical to the administration of federal tax law. The *Powell* decision does not cite any state law to support its two theories to disregard fiduciary duties, and we have not found a single state case invalidating intra-family fiduciary duties as "illusory." Indeed, Delaware courts (the jurisdiction of the Powell's family partnership) have repeatedly held that fiduciary duties are enforceable as between majority and minority owners of an entity, and make no distinction based on family ownership.[6]

Unless the *Powell* court undertook an analysis of state law not cited in its opinion, the fiduciary duties owed by the trustee, general partner and attorney-in-fact in *Powell* should be within the scope of *Byrum* and thus should not result in estate inclusion under Section 2036(a)(2). As in *Strangi*, the Tax Court's attempt to create a new federal law of fiduciary duties was an unforced error that was unnecessary to reach its desired result. The *Powell* court would have been better off relying on its core holding – the transfer of Mrs. Powell's partnership interest under a power of attorney was ineffective under state law, and the value of the interest was thus subject to estate tax under Section 2038(a).

A Problematic Lacuna

While the Section 2036 issue has generated discussion and debate amongst practitioners, it was actually not the issue that led to the Tax Court's divided opinion – instead, it was a disagreement over the applicability of Section 2043. To summarize, Section 2036 is an anti-abuse provision and not intended to be punitive. When applied to partnerships, however, Section 2036 could potentially result in double taxation by taxing the value of the partnership interest (under Section 2033) and the value of the underlying assets (under Section 2036). This issue was easily addressed in earlier cases involving family partnerships by includ-

6 *See, e.g.*, Weinstein Enters. v. Orloff, 980 A.2d 499 (Del. 2005) (noting that fiduciary duties are no less salient when owed to minority owners and "do not run directly" to majority owners). *See also*, Gilbert v. El Paso Co., 490 A.2d 1050 (Del. Ch. 1984) (noting that controlling ownership can give rise to concomitant fiduciary status).

ing the date of death value of the underlying assets and simply disregarding the partnership interest, the value of which is derived from those very same assets.

However, the *Powell* majority raised the question of what authority prevented double taxation, stating that it had gone "unarticulated" and that the case "provide[d] us the opportunity to fill that lacuna and explain why a double inclusion in a decedent's estate is not only illogical, it is not allowed."[7] The position set forth by the majority was that double inclusion was avoided by including in the gross estate (1) the value of the partnership interest, and (2) the value of the underlying assets *less* the consideration received in return for the assets at the time of contribution (*i.e.* the partnership interest) under Section 2043.

This gratuitous pronouncement was wrong on two fundamental levels: first, the Tax Court addressed this issue in previous cases, including *Strangi*, which the *Powell* decision so heavily relied on in its Section 2036 analysis; and second, *Powell* did not provide an opportunity to address the issue. The word "opportunity" refers to a situation where circumstances allow for a desired outcome. In *Powell*, neither the IRS nor the taxpayer raised this issue, meaning it was not properly briefed or argued. As such, the circumstances necessary for a meaningful discussion and decision on the issue were not present. Because there was no argument on the issue, any discussion by the court is mere dicta. This sentiment was well articulated in the *Powell* concurrence.

Blattmachr and Gans also address this issue by presenting it as another example of how applying Section 2036 to partnerships is like putting a square peg into a round hole. Their explanation of the majority's position and how it is problematic in practice is clearly demonstrated through the use of examples. From the examples, readers will be able to see for themselves the similarity of the majority's Section 2036 and 2043 analyses — correct results reached for the wrong reasons which, if applied in other cases, could produce incorrect results. Ultimately, Blattmachr and Gans conclude that the opinion of the concurrence, under which the value of the partnership interest is disregarded and the underlying assets are included under Section 2036, is likely the preferable approach as it would consistently achieve the objective of preventing abusive transfers without punitive double taxation.

Although we agree with Blattmachr and Gans that the majority's opinion is unworkable from a policy perspective, we also contend that its approach is simply incorrect. The technical underpinnings of the *Powell* majority's Section 2043 position deserve as much (if not more)

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[7] Estate of Powell v. Comm'r, 148 T.C. No. 18, 2017 WL 2211398, at *9 (T.C. May 18, 2017).

scrutiny than the Section 2036 issue. In our previous review of the *Powell* decision, we set forth our arguments as to why the majority's opinion is incorrect.[8] The majority's analytical approach is not based on policy preferences, but is instead predicated on the inaccurate assumption that no approach based in the Code and case law had been previously articulated. In reviewing the *Powell* decision, we believe it is necessary to grapple with the majority's assertion that its new position was needed and/or correct.

Lessons for Practitioners

As noted above, in their article, Blattmachr and Gans offer real world insight for practitioners working with family partnerships in the post-*Powell* world. We agree with Blattmachr and Gans that the *Powell* decision is fundamentally flawed on many levels, and that a different result might have come about had Mrs. Powell's estate fully briefed and argued the legal points advanced by the IRS and endorsed by the Tax Court. However, practitioners should not take this criticism as gospel and simply ignore the Tax Court's stated position.

Blattmachr and Gans offer practical advice that can be used by practitioners to "neutralize" the arguments raised in *Powell* in the estate planning phase. The Tax Court's willingness in *Powell* to invoke Section 2036(a)(2) where a decedent owns only a limited partnership interest should counsel practitioners to carefully restrict the rights granted to senior generation family members in new family partnerships and to perhaps revisit and pursue decontrolling techniques for existing family partnerships.

As important as these points are in crafting wealth transfer structures, we also believe *Powell* offers an important lesson for estate administration. *Powell* is a case in point of why an estate should not simply concede potential arguments against estate tax inclusion.[9] When defending against Section 2036 attacks by the IRS, practitioners should be prepared to contest the inapplicability of the provision, even if it is an alternate argument to the estate's primary argument.

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[8] *See* N. Todd Angkatavanich, James I. Dougherty & Eric Fischer, *Stranger than* Strangi *and Partially Fiction*, 156 Tr. & Est. 9 (Sept. 2017).

[9] Stephanie Loomis-Price, *Family Limited Partnerships—Update,* Presentation to the ABA Sec. of Tax'n and Sec. of Real Prop. (2017).