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Commentary

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In the current article,[1] Mitchell Gans and Jonathan Blattmachr vigorously argue, as they have before,[2] that under *Byrum*[3] a discretionary power held by a fiduciary of a business entity (e.g., a director, shareholder, partner, etc.) can rarely, if ever, qualify as a "right" under section 2036(a)(2), since the fiduciary obligations of the power holder so restrict the power that it cannot be considered a "legally enforceable 'right'" as that case requires.[4] Accordingly, they assert that the recently decided *Powell*[5] case was wrongly decided since the Tax Court failed to recognize that the discretionary powers of the decedent were not "legally enforceable rights" due to the fiduciary duty she owed her fellow partners.

As I will explain below, I find the authors' thesis is at least questionable and believe it deserves more analysis and study than they give it.

Recall that although the decedent in *Byrum* had no formal right to determine the amount of income payable to the beneficiary of the trust he established, the IRS nevertheless argued that he had de facto control over the income payments through his majority voting power in the shares he had transferred to the trust.[6] Its theory was that his majority voting power enabled the decedent to elect compliant directors whom he could direct to either declare or not declare dividends as he wished and thereby determine who would enjoy the transferred shares and the income therefrom—in other words, he possessed a section 2036(a)(2) right.

The majority in *Byrum* was clearly troubled by the suggestion it should decide a case not on the language in an explicit grant of discre-

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

2 Mitchell M. Gans & Jonathan G. Blattmachr, Strangi*: A Critical Analysis and Planning Suggestions,* 100 Tax Notes 1153 (2002).

3 United States v. Byrum, 408 U.S.125 (1972).

4 Gans & Blattmachr, *supra* note 1, at 260.

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

6 *Byrum*, 408 U.S. at 132.

tion but rather on an analysis of de facto control which would require it to go outside the dispositive document and resolve numerous legal and factual questions—many of which would be far from clear. How, for example, should the court determine whether the number of shares the decedent could vote represented effective control? Does one look solely at the shares that the decedent could vote, or should one also consider any alliances the decedent may have had with other "friendly" shareholders? Do you take into account how widely dispersed the other shares are held, since fewer shares are needed to constitute effective control when the remaining shares are widely dispersed? The majority feared this approach would entail such uncertainty "that it would create a standard . . . so vague and amorphous as to be impossible of ascertainment in many instances."[7] The majority opinion should be read as an attempt to demonstrate the folly of going down the rabbit hole of using de facto control as the basis for finding that a section 2036(a)(2) right exists—*not as an attempt to define the requirements for finding a section 2036(a)(2) right where there is an explicit grant of discretion.*

This raises the question of the role that fiduciary constraints should play in determining the existence of a section 2036(a)(2) right. Clearly, if one is using a de facto control approach, one must consider the constraining effect of fiduciary duty, since such duties actually do curtail the power of the power holder. On the other hand, when there is an explicit grant of discretion in the governing document one could decide whether a section 2036(a)(2) right exists simply on the basis of the language found in the dispositive document without referring to any applicable fiduciary constraint. This latter possibility is left open by the *Byrum* decision, since the Court referred to fiduciary constraints only to demonstrate the impracticality of the de facto approach; it did not discuss the relevance, if any, of fiduciary constraints to cases where the dispositive document explicitly sets forth the scope of the discretion.

Note that fiduciary constraints exist even where there is a seemingly unlimited grant of discretion to a power holder. The current Restatement of Trusts states that no matter how broad the delegation of discretion, the fiduciary is always required "to act, reasonably informed, *with impartiality among the various beneficiaries and interests* . . . ."[8] Unlike a power of appointment, the power may not be "exercised arbitrarily."[9] These are non-waivable fiduciary duties.

In *O'Malley*, the decedent set up a trust which granted the trustees (of which he was one) the power in "in their sole discretion" to either

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7 *Id.* at 137 n.10.

8 RESTATEMENT (THIRD) OF TRUSTS § 50 cmt. b (UNIF. LAW COMM'N 2003) (emphasis added).

9 *Id.* § 50 cmt. a.

"pay trust income to the beneficiary or accumulate the income, in which event it became part of the principal."[10] All the justices in *Byrum* agreed this was a section 2036(a)(2) right but neither the majority nor the minority felt it necessary to consider the trustees' non-waivable fiduciary obligations in making this finding. This suggests either that (I) fiduciary constraints are to be ignored in determining the presence of a section 2036(a)(2) right where the dispositive document spells out the discretion being granted, or more likely (II) that the non-waivable fiduciary duties of a trustee have such a minimal effect on a trustee's power that they can safely be ignored.[11]

This suggests, contrary to the position of the authors, that the fiduciary constraints on a limited or general partner may not preclude a finding of a "right" under section 2036(a)(2). If (I) above is the correct reading of *Byrum*, then the fiduciary constraints imposed on a general or limited partner are simply to be ignored. If the analysis in (II) is correct, then those constraints will preclude the finding of a section 2036(a)(2) right *only* if they restrict the power of a general or a limited partner *more* than the non-waivable fiduciary duties of a trustee restrict the trustee's power. The authors have not made this demonstration in the current article. In an earlier article, the authors argued that the powers of general or limited partner (or a corporate fiduciary) are more restricted than those of a trustee because a limited or general partner (or a corporate fiduciary) must take into account the interests of the business entity.[12] However, this may not be a meaningful distinction where—as in *Powell*—all the interests in the partnership are owned by family members and the entity simply serves as an investment vehicle for the family. The current article would have been strengthened if the authors had discussed this issue and analyzed it in depth.

The authors point out that applying section 2036(a)(2) to limited partnerships "is like trying to put a square peg into a round whole."[13] One issue that arises is how to prevent an improper double inclusion of assets when the decedent formed a limited partnership and section 2036(a)(2) applies.

Suppose a decedent forms a limited partnership by contributing property worth $1,000,000 to the partnership in exchange for a partnership interest. Suppose further that the value of the partnership interest

[10] United States v. O'Malley, 383 U.S. 627, 629 (1966).

[11] The District Court in *O'Malley* held that the non-waivable fiduciary duties did not "so circumscribe the trustee's powers" so as to exclude the trust from the predecessor of section 2036. O'Malley v. United States, 220 F. Supp. 30, 33-34 (N.D. Ill. 1963). The estate did not contest this holding on appeal.

[12] Gans & Blattmachr, *supra* note 2, at 1156.

[13] Gans & Blattmachr, *supra* note 1, at 270-71.

is properly discounted by 30% (because of lack of marketability, etc.) so that it is worth only $700,000 and finally suppose that section 2036(a)(2) applies. If there is no adjustment, $1,700,000 will be included in the decedent's gross estate (assuming no change in the value of the assets): $1,000,000 by reason of section 2036(a)(2) *plus* $700,000, the value of the partnership interest held at death.

Once again I differ with the authors. I believe the statute *mandates* the use of section 2043 to solve the double inclusion problem while the authors prefer the solution proposed by the minority in *Powell*.

I submit that use of section 2043 is mandatory—not optional—in the above case since the decedent failed to receive "adequate and full consideration" upon the formation of the partnership: the decedent received a partnership interest worth only $700,000 while the value of the assets transferred was $1,000,000.

Moreover, section 2043 works well if the value of the assets remains unchanged. In the above case, (A) *$300,000* would be included under section 2043, that is: $1,000,000, the value of transferred assets, *minus* $700,000, the value of the partnership interest received *and* (B) *$700,000*, the value of the partnership interest at death, resulting in a total inclusion of $1,000,000—the correct result.[14]

However, section 2043 does not work well if the value of the transferred assets changes between the date of transfer and the date of death. This is because the *date-of-death value* of the transferred property will be included under section 2036(a)(2), while the offset is limited to the *date-of-transfer value* of the consideration received. Thus, the net amount included will be excessive if the transferred assets appreciate and insufficient if the assets depreciate.[15]

However, this problem is not unique to partnerships. It occurs whenever any property is included in the decedent's estate under sections 2035 through 2038 and where the decedent received inadequate consideration. This result has been questioned but the courts have felt powerless to rectify it given the express language of section 2043.[16] I see no justification for according special treatment to limited partnership situations in preference to the other cases where property is included in a decedent's estate under sections 2035 through 2038 but inadequate consideration was received.

The authors prefer the solution proposed by the concurring opinion in *Powell*.[17] Under this approach, the date-of-death value of the trans-

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14 *See id.* at 274.

15 *Id.* at 274-75.

16 *See, e.g.,* STANLEY S. SURREY ET AL., FEDERAL WEALTH TRANSFER TAXATION: CASES AND MATERIALS 387-88 § B (Successor ed. 1987).

17 Gans & Blattmachr, *supra* note 1, at 275.

ferred property would be included under section 2036(a)(2) while decedent's partnership interest would simply be ignored as it had "no distinct value because it was an alter ego for the . . . cash and securities" the decedent transferred.[18] However, I reject this approach. The allowance of a discount proves the partnership interest is not simply the alter ego of the transferred property; they are separate property interests having differing values. The minority approach advocated by the authors simply solves a problem by wishing away the "inconvenient fact" that the decedent owns a partnership interest at his death which must be included in the decedent's estate under section 2033.

The authors conclude with some timely and sage planning suggestions in light of *Powell*. Thus, any person having a discretionary power over the transferred property, for example, the general partner of a limited partnership to which the decedent has transferred property, should not hold a power-of-attorney from the decedent, since otherwise a court following *Powell* might attribute those powers to the decedent.[19] I commend their advice to anyone practicing in this area.

As my comments above show, I sometimes differ from the authors in their analyses, but this should not detract from the fact that they have produced an article that is carefully reasoned, thought provoking, clearly written and stimulating. It deserves close and careful study.

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[18] Estate of Powell v. Comm'r, 148 T.C. No. 18, 2017 WL 2211398, at *15 (T.C. May 18, 2017) (Lauber J., concurring).

[19] Gans & Blattmachr, *supra* note 1, at 275-76.