DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224
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OFFICE OF CHIEF COUNSEL CC:DOM:FS:P&SI

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR ASSISTANT REGIONAL COUNSEL (TAX LITIGATION)

FROM: ASSISTANT CHIEF COUNSEL (FIELD SERVICE)
CC:DOM:FS

SUBJECT:

This Field Service Advice responds to your memorandum dated . Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:

Donor =
Partnership =

$a =
$b =

date x =
date y =

ISSUE:

Whether the provisions of the partnership agreement preventing liquidation constitute an applicable restriction within the meaning of section 2704(b).

CONCLUSION:

The provisions of the partnership agreement preventing liquidation constitute an applicable restriction within the meaning of section 2704(b) which may be disregarded in valuing the transferred partnership interests to the extent that such provisions are more restrictive than the limitations that would apply under state law generally applicable to partnerships in the absence of such provisions.

FACTS:

On date x Donor and his spouse formed a limited partnership. Donor transferred $a in cash and publicly traded securities in exchange for an approximate 1 percent interest general partnership interest and a 98.9 percent limited partnership interest. Donor's spouse transferred $b in exchange for a .08 percent general partnership interest.

The partnership agreement provides that Partnership will continue for 50 years or until the general partner and the holders of more than 50 percent of the limited partnership interests agree to terminate the partnership. No partner may withdraw or reduce his capital contribution until termination. The agreement may be amended only with the consent of the general partner and the holders of more than 50 percent of the limited partnership interests.

On Date y Donor gave his limited partnership interest in four equal shares to his three children and a trust for his grandchildren. In valuing the transfers for gift tax purposes, Donor reduced the net asset value of the interests by 45 percent to reflect the minority status and lack of marketability of the interests despite the fact that the underlying assets of the partnership consisted of readily marketable assets.

LAW AND ANALYSIS

I.R.C. section 2501(a)(1) imposes a tax on the transfer of property by gift. Section 2511(a) provides that the tax shall apply whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Section 2512(a) provides that the value of the transferred property at the date of the gift shall be considered the amount of the gift.

Section 2704(b)(1) of the Code provides, in part, that in the case of a transfer of an interest in a partnership to a member of the transferor's family, if the transferor and members of the transferor's family hold, immediately before the transfer, control of the entity, then any "applicable restriction" shall be disregarded in determining the value of the transferred interest.

Section 2704(b)(2) of the Code provides in part that the term "applicable restriction" means any restriction: (A) which effectively limits the ability of the partnership to liquidate, and (B) with respect to which the transferor or any member of the transferor's family, either alone or collectively, has the right after such transfer to remove, in whole or in part, the restriction.

The legislative history of section 2704(b) provides, in part, as follows.

> Under the conference agreement, any restriction that effectively limits the ability of a corporation or partnership to liquidate is ignored in valuing a transfer among family members if (1) the transferor and family members control the corporation or partnership, and (2) the restriction either lapses after the transfer or can be removed by the transferor or members of his family, either alone or collectively.
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> Example 8.--Mother and Son are partners in a two-person partnership. The partnership agreement provides that the partnership cannot be terminated. Mother dies and leaves her partnership interest to Daughter. As the sole partners, Daughter and Son acting together could remove the restriction on partnership termination. Under the conference agreement, the value of Mother's partnership interest in her estate is determined without regard to the restriction. Such value would be adjusted to reflect any appropriate fragmentation discount.
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> This rule does not apply to a commercially reasonable restriction which arises as part of a financing with an unrelated party or a restriction required under State or Federal law. The provision also grants to the Treasury Secretary regulatory authority to disregard other restrictions which reduce the value of the transferred interest for transfer tax purposes but which do not ultimately reduce the value of the interest to the transferee.

H. R. Conf. Rep. No. 101-964, 101st Cong., 2nd Sess. 1138 (October 27, 1990).

Treas. Reg. section 25.2704-2(b) provides, in part, 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 state law generally applicable to the entity in the absence of the restriction. A restriction is an applicable restriction only to the extent that the transferor (or the transferor's estate) and any members of the transferor's family can revoke the restriction immediately after the transfer.

Treas. Reg. section 25.2704-2(c) provides, in part, that if an applicable restriction is disregarded, the transferred interest is valued as if the restriction does not exist and as if the rights of the transferor are determined under state law that would apply but for the restrictions.

Treas. Reg. section 25.2704-3 provides that section 25.2704-2 applies to transfers occurring after January 28, 1992, of property subject to applicable restrictions created after October 8, 1990.

The Missouri Uniform Limited Partnership Law, Mo. Ann. Stat. § 359.341 (West 1994), as in effect on the dates of formation and gift:

> Sec. 359.341 A limited partner may withdraw from a limited partnership at the time or on the happening of events specified in writing in the partnership agreement. If the agreement does not specify in writing the time or the events upon the happening of which a limited partner may withdraw or a definite time for the dissolution and winding up of the limited partnership, <u>a limited partner may withdraw upon not less than six months prior written notice</u> to each general partner at his address on the books of the limited partnership.
>
> Sec. 359.351 Except as otherwise provided in sections 359.321 to 359.391, upon withdrawal <u>any withdrawing partner is entitled to receive</u> any distribution he is entitled to receive under the partnership agreement and, if not otherwise provided in the agreement, he is entitled to receive, <u>within a reasonable time after withdrawal, the fair value of his interest</u> in the limited partnership as of the date of withdrawal based upon his right to share in distributions from the partnership. [Emphasis added.]

As noted above, under the Partnership agreement, the Partnership will terminate in 50 years. Dissolution prior to the termination date or amendment of the agreement requires the consent of the general partner and the holders of more than 50 percent of the limited partnership interests. Under applicable state law, however, in the absence of the restrictions in the partnership agreement, a transferee could have liquidated the subject interests in six months notice and received the fair value of the interests. The provisions of the Partnership agreement are more restrictive than state law, and thus constitute an applicable restriction within the meaning of section 2704(b)(2)(A). See Treas. Reg. section 25.2704-2(d), Example 5, illustrating that a restriction on a right to put preferred stock to the corporation is a limitation on the ability to liquidate the entity (in whole or in part) and is disregarded in valuing the preferred stock for transfer tax purposes. Finally, the requirements of section 2704(b)(2)(B) of the Code are satisfied. That is, the restriction could be removed after the transfer by Donor and members of his family.

Accordingly, the provisions of the partnership agreement preventing liquidation constitute an applicable restriction within the meaning of section 2704(b) which may be disregarded in valuing the transferred partnership interests to the extent that such provisions are more restrictive than the limitations that would apply under state law generally applicable to partnerships in the absence of such provisions.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

[redacted]

[redacted]

By: ______________________________

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