INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-137148-01/CC:PSI:B04
District Director

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Date of Conference:

LEGEND:

Taxpayer =

Child 1 =

Child 2 =

Company X =

Trust =

P =

State =

ISSUE: For federal gift tax purposes, what is the proper treatment of Taxpayer's transfer of publicly traded municipal bonds to P, a limited partnership?

CONCLUSION: Taxpayer's transfer of municipal bonds to P constituted indirect gifts of the bonds to Child 1 and Child 2. No discount is allowable in determining the fair market value of the transferred bonds for gift tax purposes.

FACTS: On October 31, 1995, Taxpayer and her two children, Child 1 and Child 2, executed a partnership agreement, establishing P, a limited partnership, under State's Revised Uniform Limited Partnership Act. On November 16, 1995, Taxpayer filed the agreement with the Secretary of State of State. P was initially funded with cash and marketable securities as follows:

	Initial Contribution	General Partnership Percentage Interests	Limited Partnership Percentage Interests
Taxpayer		%	%

Child 1		%	%
Child 2		%	%
	$	%	%

Section 6.1 of the P partnership agreement provides that each partner owns that share of the total partnership capital in proportion to his or her partnership interest. Under § 6.4, each partner's capital account shall be adjusted whenever necessary to reflect (1) his or her distributive share of partnership profits, (2) his or her additional contributions to the partnership, (3) distributions made by the partnership to the partner, and any other adjustments required by § 704(b) of the Internal Revenue Code.

Under § 8.2.2 of the P partnership agreement, a limited partner can withdraw from the partnership after giving 60 days notice. A limited partner who files a request is entitled to receive a distribution equal to the "Adjusted Fair Market Value" of the partnership interest to be retired.

Section 13 of the P partnership agreement provides that if a partner wishes to transfer his or her partnership interest, the interest must first be offered for sale at "fair market value" to the other partners. If the other partners do not agree to purchase the interest, then the partner may complete the transfer.

Section 17.1.2 of the P partnership agreement provides that the partnership shall be dissolved whenever the general partner and the limited partners holding a majority of the partnership interests of all limited partners agree in writing that the partnership dissolve. Under § 17.2, upon dissolution, after payment of partnership debts, all remaining assets are to be distributed proportionately among the partners in the ratio of their respective partnership interests.

On July 1, 1996, Taxpayer transferred a % limited partnership interest in P to Child 1 and a % limited partnership interest to Child 2.[1] After the transfers, the partnership interests of Taxpayer, Child 1 and Child 2 were as follows:

	General Partnership Percentage Interests	Limited Partnership Percentage Interests
Taxpayer	%	%
Child 1	%	%
Child 2	%	%
	%	%

On , Taxpayer transferred publicly traded municipal bonds valued at $ to P. On a statement attached to the Form 709 (United States Gift and

[1] Taxpayer timely filed a gift tax return reporting this transfer. The statute of limitations with respect to this return has expired.

(Generation-skipping Transfer) Tax Return filed by Taxpayer for Taxpayer reported that she had gifted the securities to P on , and identified Child 1 and Child 2 as each

having a % limited interest and a % general interest in P. As reported on the statement, the value of the gift was determined as follows:

Value of gifted securities	$
Partnership interests not owned by the Donor	X %
	$
Less: 45% combined discount based on [Company X] report attached hereto	( )
Value of gifts to donees	$

The statement identified Child 1 and Child 2 as the donees. The Company X report referenced on the statement was prepared in 1996 for the purpose of valuing Taxpayer's 1996 gifts of P limited partnership interest to Child 1 and Child 2.

Taxpayer's representative maintains that on the partnership books, the amount of Taxpayer's contribution was initially allocated to Taxpayer's capital account. The amount contributed was then treated as withdrawn from her capital account and one-half of the contribution was then allocated to each of the other partners' capital accounts. Taxpayer has not submitted any partnership books or records.[2] However, on the Schedule K-1 (Form 1065) issued by P to Taxpayer, $ is reflected in Section J (Analysis of Partner's Capital Account) in box (b) as capital contributed during the year, and in box (c) as a withdrawal/distribution during the year. On the Schedule K-1 issued to Child 1 and to Trust[3], % of this amount ($) was reflected in Section J, box (b) as capital contributed during the year.[4]

LAW AND ANALYSIS:

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[2] In conjunction with our consideration of this request for Technical Advice, Taxpayer's representative was asked to provide any partnership books and records. However, no books and records have been produced.

[3] A Schedule K-1 was issued to Trust, a family trust of which Child 2 is a co-trustee, as a % limited partner. The facts as submitted do not indicate the terms of Trust or at what point Trust acquired this interest.

[4] The figures for Taxpayer's capital contribution ($) and the amounts allocated to the capital accounts of Child 1 and Trust do not exactly coincide with the amount listed on the Form 709 as the pre-discounted value of the gift ($). Further, it appears that the entire amount transferred by Taxpayer was allocated to the capital accounts of Child 1 and Trust rather than 97.02%, as indicated on the Form 709.

Section 2501 imposes a tax for each calendar year on the transfer of property by gift during the calendar year by any individual. Section 2511 provides that the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(a) provides that if a gift is made in property, the value in the property at the date of the gift is the amount of the gift. Section 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property transferred exceeds the value of the consideration received is deemed to be a gift, and is included in computing the amount of gifts made during the calendar year.

Section 25.2511-1(a) of the Gift Tax Regulations provides that the gift tax applies to a transfer by way of gift whether direct or indirect and whether the property is real or personal, tangible or intangible. Section 25.2511-1(c)(1) provides that the gift tax also applies to gifts indirectly made. Thus, any transaction in which an interest in property is gratuitously passed or conferred on another, regardless of the means or device employed constitutes a gift subject to gift tax.

Section 25.2511-1(h)(1) provides an example of an indirect gift, as follows:

> A transfer of property by B to a corporation generally represents gifts by B to the other individual shareholders of the corporation to the extent of their proportionate interests in the corporation.

Section 25.2511-2(a) provides that the gift tax is not imposed on the receipt of property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee from the transfer. Rather, the gift tax is a primary and personal liability of the donor, is an excise upon the donor's act of transfer, and "is measured by the value of the property passing from the donor...."

The regulations promulgated under § 2512 provide rules for determining the value of property transferred for gift tax purposes. Under § 25.2512-1, the value of property, for gift tax purposes, is the price at which such property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts. Section 25.2512-2(b)(1) provides that, in general, if there is a market for stocks or bonds, on a stock exchange, in an over-the counter market or otherwise, the mean between the highest and lowest quoted selling prices on the date of the gift is the fair market value per share or bond.

The indirect gift analysis illustrated in § 25.2511-1(h)(1) has been applied repeatedly by the courts. For example, most recently, in Shepherd v. Commissioner, 115 T.C. 376 (2000), appeal docketed, No. 01-12250 (11^{th} Cir. April 23, 2001), a donor transferred land and bank stock to a general partnership in which the donor held a 50% partnership interest and the donor's two sons each held a 25% partnership interest. The transfers were allocated to each partner's capital account in proportion to their respective partnership interests. The court rejected petitioner's argument that the transfers, to the extent inuring to the benefit of the sons, should be characterized for gift tax purposes as enhancements of the then sons' existing partnership interests, and valued accordingly. Rather, the court reasoned the gift tax is imposed on the value of the property passing from the donor, and not on the value received by the donee, citing Robinette v. Helvering, 318 U.S. 184, 186, (1943). Under the facts presented, the property that the donor possessed and transferred was his interest in the land and stock. Therefore, in accordance with § 25.2511-1(h)(1), the transfer to the partnership represented indirect gifts to each of the donor's sons of undivided 25% interests in the land and bank stock.

Other courts have reached similar conclusions. Stinson Estate v. U.S., 214 F.3d 846 (7th Cir. 2000) (decedent's cancellation of indebtedness owed to decedent by a closely held corporation owned by decedent's five children and two grandchildren constituted a gift of cash to the seven shareholder-children and grandchildren of the corporation); Kincaid v. United States, 683 F.2d 1220 (5th Cir. 1982) (transfer of ranch to a closely held corporation represented a gift of 33% of the value of the ranch to each of the shareholders to the extent of their interests in the corporation); Heringer v. Commissioner, 235 F.2d 149 (9th Cir. 1956) (transfer of farm land to a family corporation of which the donors were 40% owners were gifts to the other shareholders in the amount of 60% of the fair market value of the land); Georgia Ketteman Trust v. Commissioner, 86 T.C. 91 (1986) (transfer of property to closely held corporation in exchange for a note of lesser value was gift to the other shareholders to the extent of their interests in the corporation); Estate of Bosca v. Commissioner, T.C. Memo. 1998-251 (father's transfer to a family corporation of voting common stock in exchange for nonvoting common stock was a gift to each of his two shareholder-sons of 25% of the difference between the value of the stock transferred and the value of the stock received); Rev. Rul. 71-443, 1971-2 C.B. 338 (allowing a gift tax marital deduction for a portion of the property transferred to a corporation in which donor's spouse owned 46% of the stock). See also Estate of Hitchon v. Commissioner, 45 T.C. 96 (1965) (parent's transfer of stock to a family corporation was a gift by parent of a 25% interest to each of his three shareholder-sons for purposes of determining the sons' basis in the stock under § 1015).

In the case at hand, Taxpayer transferred the bonds to the P partnership, and the entire amount of the contribution was allocated to the capital accounts of Child 1 and Child 2. The assets possessed and transferred by Taxpayer were the municipal bonds. Under §25.2511-1(h)(1), Shepherd, and the decisions cited above, Taxpayer's transfer is properly characterized as an indirect gift of the municipal bonds to Child 1 and Child 2.

The result would be the same even if Taxpayer's contribution were initially allocated to Taxpayer's capital account, and then reallocated to the capital accounts of the other partners. It is well established that where the steps of a donative transaction have no independent significance, the courts will collapse the individual steps in determining the substance of the transaction. Heyen v. United States, 945 F.2d 359, 363 (10th Cir.1991) (characterizing a transfer to third party who then retransferred to son as a transfer to son); Griffin v. United States, 42 F. Supp.2d 700 (W.D. Tex. 1998) (holding that a transfer to spouse who subsequently retransferred the property to a child was in substance a transfer to child by the original transferor); Estate of Bies v. Commissioner, T.C. Memo. 2000-338 (holding that a mother's transfers to daughters-in-law who immediately retransferred property to sons were indirect gifts to the sons); Estate of Cidulka v. Commissioner, T.C. Memo. 1996-149 (finding that a transfer to daughter-in-law who retransferred to son was in substance a transfer to son by the original transferor). In this case, the transitory allocation to Taxpayer's capital account, if such allocation even occurred at all, was merely a step in an integrated transaction intended to pass Taxpayer's contribution to Child 1 and Child 2. Taxpayer's capital account acted as a conduit for the transfer. Accordingly, the transaction is properly treated as an immediate allocation to the capital accounts of Child 1 and Child 2. This treatment is consistent with the substance of the transaction.

Taxpayer argues that in Shepherd, the court characterized the donor's transfers as indirect gifts to each of the other partners of undivided 25% interests in the land and bank stock, and allowed a 15% discount in valuing these interests. Taxpayer concludes, therefore, that even assuming the transfers in this case are properly characterized as gifts of municipal bonds to Child 1 and Child 2, at least a 15% discount should be allowed in valuing the transferred municipal bonds.

However, the bank stock at issue in Shepherd was closely held stock. It is well established that in valuing minority interests in closely held stock, valuation discounts may be appropriate in certain circumstances to reflect the fact that the shares may not be readily marketable and that the hypothetical willing purchaser would not be able to control the entity. See Rev. Rul 59-60, 1959-1 C.B. 237. Similarly, the court in Shepherd allowed a discount in valuing the fractional interest in the land to reflect lack of control, possible disagreement among the owners, and potential partition costs (considered a "fairly minor factor"). Shepherd v. Commissioner, 115 T.C. at 401-402. However, the municipal bonds at issue in this case are readily marketable publicly traded securities that could be easily divided among the donees. Based on the facts presented, the bonds should be valued in accordance with §25.2512-2(b)(1) and no discount is allowable in valuing the interest in these bonds. See Stinson Estate, supra (decedent's cancellation of indebtedness constituted a gift of cash to the other shareholders and therefore under § 25.2511-2(a) of the Gift Tax Regulations the value of the property passing from the donor is the value of the gift without reduction for minority and marketability discounts).

CAVEAT:

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(k)(3) provides that it may not be used or cited as precedent.