

# TRANSFER TAX AUDIT AND LITIGATION ISSUES

## 2021 STANLEY M. JOHANSON ESTATE PLANNING WORKSHOP

UT LAW CLE

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## Stages of the Dispute

- **Prepare for audit at the planning stage**
- **Potential IRS challenges**
  - Valuation
  - Formula transfers
  - Section 2036
  - Installment sales to intentionally defective grantor trusts
  - GRATs
  - S corporation valuation
  - Ahmanson Foundation/Warne
  - Split dollar life insurance
  - Penalties

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## Prepare for Audit

- **Anticipate your potential audience at the planning stage**
- **IRS issues broad requests**
  - "All documents relating to the creation of the entity from any attorney, accountant or firm involved in recommending the creation of the entity."
- **Understand and preserve all privileges**
  - Attorney-client privilege
  - Work product immunity
  - Tax practitioner's privilege
- **Your files could be subpoenaed — including emails**
- **You might have to testify about reasons for creating entity**
- **Help your client — best evidence of non-tax reasons comes from contemporaneous correspondence (see *Stone, Schutt*)**
- **Okay to discuss tax attributes, but talk about non-tax attributes and reasons too (see *Stone, Schutt, Mirowski*)**

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## Relevant Valuation Decisions

Case	Assets	Court	Discount from NAV/ Proportionate Entity Value
<i>Strangi I</i> (2000)	securities	Tax	31%
<i>Knight</i> (2000)	securities/real estate	Tax	15%
<i>Jones</i> (2001)	real estate	Tax	8%; 44%
<i>Dailey</i> (2001)	securities	Tax	40%
<i>Adams</i> (2001)	securities/real estate/minerals	Fed. Dist.	54%
<i>Church</i> (2002)	securities/real estate	Fed. Dist.	63%
<i>McCord</i> (2003)	securities/real estate	Tax	32%
<i>Lappo</i> (2003)	securities/real estate	Tax	35.4%
<i>Peracchio</i> (2003)	securities	Tax	29.5%
<i>Deputy</i> (2003)	boat company	Tax	30%
<i>Green</i> (2003)	bank stock	Tax	46%
<i>Thompson</i> (2004)	publishing company	Tax	40.5%
<i>Kelley</i> (2005)	cash	Tax	32%
<i>Temple</i> (2006)	marketable securities	Fed. Dist.	21.25%
<i>Temple</i> (2006)	ranch	Fed. Dist.	38%
<i>Temple</i> (2006)	winery	Fed. Dist.	60%
<i>Astleford</i> (2008)	real estate	Tax	30% (GP); 36% (LP)
<i>Holman</i> (2008)	Dell stock	Tax	22.5%
<i>Keller</i> (2009)	securities	Fed. Dist.	47.5%
<i>Murphy</i> (2009)	securities/real estate	Fed. Dist.	41%
<i>Gallagher</i> (2011)	publishing company	Tax	47%
<i>Koons</i> (2013)	cash	Tax	7.5%
<i>Richmond</i> (2014)	marketable securities	Tax	46.5% (37% LOC/LOM & 15% BIG)
<i>Giustina</i> (2016)	timber company	Tax	25% LOM
<i>Streightoff</i> (2018)	marketable securities	Tax	18% LOM
<i>Grieve</i> (2020)	marketable securities	Tax	35% (98.8% non-vot. LLC int.)
<i>Nelson</i> (2020)	equipment co.	Tax	40.5% (stock); 31.6% (LP)

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## Formula Transfers

- **Potential Benefit — Allows transferor to define the dollar value of hard-to-value assets passing to taxable transferees**
- **Types of formula clauses:**
  - Defined value clause based on values "as finally determined for estate/gift tax purposes" (*Christiansen, Petter, Wandry*)
  - Defined value clause (*McCord, Hendrix*)
  - Price adjustment clauses (*King*)
  - Reversion clauses don't work (*Procter*)

## Formula Language – It Matters!

- **Wandry** – "I hereby transfer to \_\_\_\_ that number of shares of ABC Company with a fair market value as finally determined for federal gift tax purposes equal to \$[X]."
- **Petter** – "I hereby transfer X shares of XYZ Company to [taxable transferee] and [charity/QTIP/GRAT] to be allocated between the transferees as follows: (1) that number of shares with a fair market value as finally determined for federal gift tax purposes equal to \$[X] to [taxable transferee]; and (2) the remainder of the shares to [charity/QTIP/GRAT]"
- **King** – "I hereby sell X shares of XYZ Company in exchange for a promissory note with a principal amount of \$[X] (which the parties believe to be equal to the fair market value of the shares). The term of the promissory note shall be [add note terms/interest]. If the fair market value of the shares as finally determined for federal gift tax purposes is greater or less than \$[X], the principal amount of the note shall be adjusted to the finally determined value effective as of the date of the transfer. The parties intend for the sale to be at fair market value and that no gift result from the sale."

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