INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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CASE MIS No.: TAM-104462-03/CC:PSI:B4

MAY 06, 2003

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Years Involved:

Date of Conference:

LEGEND:

Taxpayer =
Date 1 =
Date 2 =
Date 3 =
Year 1 =
Partnership =

Trust =

a =
b =
c =
d =
e =

ISSUE:

Is paragraph B of the Assignment of Limited Partnership Interest in Partnership, that transfers a fractional interest in Partnership having a certain fair market value, effective for gift tax purposes under section 2511 of the Internal Revenue Code?

CONCLUSION:

Paragraph B is not effective for gift tax purposes.

FACTS:

On Date 1, Taxpayer and his spouse formed Partnership. Section 2.6 of the Partnership Agreement provides that Taxpayer has a c% general interest and a d% limited interest in Partnership. On Date 2 in Year 1, Taxpayer executed an Assignment which reads:

> Assignor [Taxpayer] desires to transfer as a gift to Assignee [Trust] that fraction of Assignor's Limited Partnership Interest in Partnership which has a fair market value on the date hereof of $a.

Pursuant to this assignment, Trust received an e% interest in Partnership from Taxpayer. On Date 3, Taxpayer filed a Form 709 (United States Gift (& Generation-Skipping Transfer) Tax Return) for Year 1. On the return, Taxpayer reported the value of gift, the e% interest, to equal $b, an amount equal to $5,000 less than $a.

LAW AND ANALYSIS:

Section 2511 provides that the gift tax applies 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 25.2511-1(g) of the Gift Tax Regulations provides that donative intent on the part of the transferor is not an essential element in the application of the gift tax to the transfer. The application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor.

Section 2512 provides that, if the gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift. 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 exceeded the value of the consideration shall be deemed a gift.

In Commissioner v. Procter, 142 F.2d 824 (4th Cir. 1944), the donor transferred to two trusts benefitting his children the remainder interests in certain trusts created by his grandfather. The donor's trust indenture contained the following provision:

> The settlor is advised by counsel and satisfied that the present transfer is not subject to Federal gift tax. However, in the event it should be determined by final judgment or order of a competent federal court of last resort that any part of the transfer in trust hereunder is subject to gift tax, it is agreed by all the parties hereto that in that event the excess property hereby transferred which is decreed by such court to be subject to gift tax, shall automatically be deemed not to be included in the conveyance in trust hereunder and shall remain the sole property of [the settlor] free from the trust hereby created.

The Fourth Circuit Court of Appeals concluded that the provision was a condition subsequent and void because contrary to public policy. The court of appeals explained that the condition was contrary to public policy because: (i) it has a tendency to discourage the collection of the tax by the public officials charged with its collection, since the only effect of an attempt to enforce the tax would be to defeat the gift, (ii) the effect of the condition would be to obstruct the administration of justice by requiring the courts to pass upon a moot case. If the condition were valid and the gift was subject to tax, the only effect of the holding would be to defeat the gift so that it would not be subject to tax, and (iii) the condition is to the effect that the final judgment of a court is to be held for naught. Commissioner v. Procter, 142 F.2d at 827.

The Tax Court reached a similar conclusion in Ward v. Commissioner, 87 T.C. 78 (1986). In that case, a husband and wife transferred 85 shares of stock in a closely held corporation to each of their three sons. The donors and donees executed a gift adjustment agreement providing that if it should be finally determined for federal gift tax purposes that the fair market value of each share of stock transferred exceeded or was less than $2,000, an adjustment will be made in the number of shares constituting each gift so that each donor will give to each donee the maximum number of shares, the total value of which will be $50,000 from each donor to each donee and a total of $150,000 from each donor to each donee. The court concluded that the gift adjustment clause was void as contrary to public policy. See also, Estate of McClendon v. Commissioner, TCM 1993-459.

The Service reached a similar conclusion in Rev. Rul. 86-41, 1986-1 C.B. 300. In that ruling, A transferred an interest in a tract of income-producing real property to B.

Under the deed, B received a one-half undivided interest in the property. In Situation 1, the deed provided that, if for federal gift tax purposes, the Service determined the that value of the one-half interest was more than $10,000, then B's interest would be reduced so that its value equaled $10,000. Under local law, the adjustment clause operated as a condition subsequent. Thus, if the Service determined the gift was more than $10,000, the adjustment clause would effectively reconvey to A a fractional share of the property sufficient to reduce the value of B's interest to $10,000 as of the date of the gift.. The revenue ruling concludes that the adjustment clause will be disregarded for federal tax purposes and, consequently, the value of the gift will be determined without regard to the adjustment clause.

In this case, Paragraph B is similar to the clauses in Ward and Rev. Rul. 86-41. In the instant case, Taxpayer transferred an e% interest in Partnership to Trust pursuant to the assignment. However, if the Service determines that the value of the e% interest is greater than $a, and Paragraph B is given effect, then pursuant to Paragraph B, the percentage interest in Partnership that exceeds the value of $a, would be retransferred to Taxpayer. Such a clause is void as contrary to public policy.

Taxpayer argues that Paragraph B is distinguishable from the clauses in Proctor because Paragraph B is purportedly a "definitional clause," not a "formula clause." A different label does not nullify the effect Paragraph B would have on the gift. The Taxpayer argues that "the donor gets nothing "back" as he never intended to transfer any interest beyond that having a value of $a." However, pursuant to the assignment, Trust received an e% interest in Partnership from Taxpayer. If Paragraph B is given effect and the value of the e% interest, as finally determined by the Service, is greater than $a, a certain percentage of the Partnership interest held by Trust would be retransferred to Taxpayer. This is the type of clause that the courts in Proctor and Ward conclude are void as contrary to public policy. Accordingly, in conclusion, Paragraph B is void as contrary to public policy and the Service will make adjustments to the gift tax on the Year 1 return to reflect the value of the e% interest, as finally determined by the Service.

CAVEAT:

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