Sham Transaction Doctrine

How far will this income tax concept invade the estate and gift tax planning realm?

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Since the 1930s, courts have used what is known as "the sham transaction doctrine" to invalidate deals designed solely to skirt income taxes.[1] Some judges go so far as to treat the doctrine like a chameleon, capable of changing so that they might disallow any tax-motivated transaction that produces a result they deem unjust, or out-of-line with what Congress might want, had it gotten around to legislating on that particular strategy.

The Internal Revenue Service has tried to convince courts to apply the amorphous sham transaction doctrine to estate and gift taxes, but has mostly failed. Still, some judges have been convinced. And it is unclear exactly how far they will take this version of judicial lawmaking into the estate and gift tax area.

Certainly the dissent of Judge Renato Beghe of the U.S. Tax Court in *Strangi*[2] was disturbing. Beghe claimed that the estate planning strategy in question was invalid because a "factual sham analysis can be used in appropriate cases in the transfer tax area." Moreover, he would have applied the step transaction theory to invalidate the family partnership in the case because, he said, under "the end-result test," the "series of formally separate steps are really prearranged parts of a single transaction that are intended from the outset to reach the ultimate result."

Beghe would throw the door wide open. This despite the U.S. Tax Court's warning back in the 1987 *Penrod* case that too liberal a reading of the sham transaction doctrine "promotes uncertainty and therefore impedes effective tax planning."[3] In that case, the court was talking about income tax.

As a general rule, importing the sham transaction doctrine from the income tax to estate and gift tax areas is reasonable.[4] But its application should be greatly limited, considering estate and gift tax statutes are unlike their cousins in the income tax area. Many transfer tax rules rarely make sense other than to let taxpayers reduce their gift and estate taxes.

For example, annual exclusion gifts under section 2503(b) are allowed free of estate and gift tax. A family with five children, all married, and 10 grandchildren, could effectively give away more than $5 million in assets otherwise subject to estate tax,[5] have these assets held in trusts until the grandparents passed away, and essentially turn a testamentary transfer of in excess of $5 million from a transfer subject to estate tax to one free of estate tax.[6]

Less obvious, but equally telling, are the qualified personal residence trust (QPRT) allowances under Internal Revenue Code Section (IRC) 2702, the grantor retained annuity trust (GRAT) allowance under IRC Section 2702, the lifetime use of the unified credit versus testamentary use of the same amount of credit, and the *inter vivos* payment of gift tax versus estate tax.[7] With the blessing of Congress these strategies are, when all is said and done, implemented solely for tax reasons.

> Too liberal a reading of the doctrine "promotes uncertainty and therefore impedes effective tax planning."

The estate planner must be prepared to fight unwarranted incursions of the sham transaction doctrine. So be prepared to recognize its three applications: business purpose, substance over form and step transaction. (See page 12, 14, and 17 for the definitions.)

The estate planning strategies

most at risk for having the IRS assert some version of the doctrine include the sale to a grantor trust in all its iterations, family limited partnerships (and any use of these strategies in conjunction with other strategies, such as grantor trust sales, GRATs, unified credit gifts, or installment notes); and all forms of the *Walton*-GRAT.

IRS Frustrated

The few courts that have used the sham doctrine to invalidate an estate or gift tax transaction have done so by applying the "substance over form" principle, and not on the business purpose or step transaction concepts.[8]

Usually, though, the tax court has flatly rejected the IRS's sham arguments, notably in *Church, Strangi* and *Knight*, all decided in 1999 and 2000.[9]

In *Strangi*, the tax court emphasized: "The partnership, as a legal matter, changed the relationships between decedent and his heirs and decedent and potential and actual creditors. Regardless of subjective intentions, the partnership had sufficient substance to be recognized for tax purposes. Its existence would not be disregarded by potential purchasers of decedent's assets, and we do not disregard it in this case."[10]

Though the court did not believe there was a business purpose behind the partnership and felt that the partnership was done solely, or at least primarily, for tax purposes, it respected the partnership for valuation purposes. Its holding implicitly rejected any "business purpose" requirement for gift and estate tax strategies.[11]

The *Strangi* court also discussed other applications of the sham transaction doctrine—substance over form and step transaction—but was unwilling to use them to invalidate the partnership for estate and gift tax

THE "SUBSTANCE OVER FORM" THEORY

In certain circumstances courts have set aside the form of a transaction, ruling that its substance controls instead. For example, if a taxpayer sets up the structure of a transaction to do one thing but actually takes steps to accomplish another (ignoring the structure that was set up), the court could ignore the form that was set up.

Of the three major sham transaction theories in use in the income tax area, "substance over form" can have the least feel of judicial lawmaking. Used correctly, the court is merely applying legislative intent when examining what the taxpayer has actually done. If what the taxpayer has done (the substance of her actions) is consistent with the documentation (the form), then the court can uphold the transaction. If not, the court can ignore the form concluding, in essence, that the statutory standards have not been met.

Unfortunately, judges often apply the "substance over form" theory incorrectly. They focus not on the "substance" of what was done, but rather on "why" it was done. In those cases, like *ACM*,[1] an income tax case, the test looks like a "tax savings smell test." The strategy employed by the taxpayer is too successful; the intent to avoid taxes, too bold. The court is offended and invalidates the transaction, claiming "substance over form."

The purpose of the "substance over form" theory is to recharacterize a transaction in accordance with its true nature. For example, in *Rogers*,[2] a Kansas City Royals partial owner needed cash. The only other owner lent the team money to make the loan. The note was secured by the debtor's partial interest in the team. Six months later, the team accepted the debtor's interest in the team in lieu of foreclosure on the note. The "lender" claimed a bad debt deduction (under Internal Revenue Code Section 166), but the court denied the deduction, finding the transaction was a redemption, not a loan. Upon signing the note, the debtor actually gave up ownership rights he had held, including the right to vote his shares, participate in team management, receive distributions, and exercise an option he held as an owner. He also gave up his right to attend home games as an owner. All parties treated the debtor as if he had sold his interest at the time of the note transaction.

Applying "substance over form" to estate and gift taxes has given birth to the reciprocal trust doctrine. That doctrine can apply when two grantors create nearly identical trusts at about the same time and there is a crossing of the beneficial interests or powers. In all cases though, explicitly or implicitly, the "plan" of the taxpayers was a quid pro quo, essentially for consideration, that does not match up with the form, which are gratuitous transfers.[3]

But courts should not extend the doctrine in the estate and gift tax area to one in which substantial estate tax savings, standing alone, invokes the doctrine. If the form and substance are in synchronization, courts should rule in favor of the taxpayer, and write opinions that draw Congress's attention to strategies they feel are abusive or in need of legislative restraint. The Internal Revenue Service's urging of a wholesale import of the liberal reach of the substance over form doctrine as applied in the income tax area, into the estate and gift tax area, can create confusion and increased litigation in an area that should be well settled.

—Louis S. Harrison and Robert S. Held

Endnotes

1. *ACM Partnership v. Commissioner*, 157 F.3d 231 (3rd Circuit 1998), cert. denied, 526 U.S. 1017 (1999).
2. *Rogers v. United States,* 281 F.3d 1108 (10th Cir. 2002)
3. *Sather v. Commissioner*, 251 F.3d 1168 (8th Cir. 2001); *U.S. v. Grace's Estate*, 395 U.S. 316 (1969); *Lehman v. Commissioner*, 109 F.2d 99 (1940); *In re: Perry's Estate*, 162 A. 146 (1932) (citing In re: *Hall's Estate*, 94 N.J.Eq. 398 (1923)

purposes. Its most interesting dicta involved treating the economic substance theory as a subset of the substance over form argument (versus the same as business purpose). The court did make noise that it would be willing to apply a substance analysis to partnerships in the future.

Where's the Beef?

The IRS's greatest victory with the sham doctrine came in the substance-over-form application some 13 years ago in *Estate of Murphy vs. Commissioner*.[12]

In *Murphy*, matriarch Elizabeth Murphy transferred a .88-percent interest in a corporation to each of her two children 18 days before her death. Prior to the transfer, Murphy controlled a 51.41-percent block of voting stock in the corporation. By virtue of the transfer, she reduced her ownership to 49.65 percent. On the gift tax return Murphy took the position that the transfers constituted minority interests and therefore a minority discount was appropriate in valuing the shares. For estate tax valuation purposes, Murphy's estate sought to obtain a minority discount for her 49.65-percent interest in the corporation's voting stock held at her death.[13]

The court refused to allow a minority discount on either the gift or estate tax issues. It reasoned that the transfer of 1.76 percent of the stock, the purpose of which was to relinquish control, "lacked substance and economic effect." Accordingly, it disregarded "the plan to appear to relinquish control for transfer tax purposes, and treat[ed] the gift and transfer as part of one plan transferring control over to decedent's children."[14]

Undertaking an estate and gift tax strategy solely for tax purposes is permissible,[15] and the *Murphy* court could not invalidate the transaction merely because of its offensiveness. So it resorted to the sham transaction doctrine's "substance over form" reasoning, and said: "We believe that all concerned intended nothing of substance to change between the time of transfer and the time of her death, and that nothing of substance did change. Although Mrs. Murphy did in fact transfer stock 18 days before death, the substance of what she did was to retain control" [emphasis added].

It is permissible to undertake an estate and gift tax strategy solely for tax purposes.

The court skirted the family attribution argument [see *Bright's Estate vs. U. S*, 658 F.2d 999 (5th Cir. 1981)] and focused on Murphy's retained control, even though it was posited in the attribution sense. Control, the court said, "was kept in and exercised continuously by the Murphy family, including decedent, followed by her children...The rationale for allowing a minority discount does not apply because decedent and her children continuously exercised control powers. …other than the power to liquidate or sell assets, decedent, and her children thereafter, enjoyed the powers of control."[16]

Murphy shows how strictly the tax court might apply the substance over form theory to invalidate transactions that it finds offensive. The actions that are taken after an estate tax strategy such as in Murphy is set up must comply with what could have happened in a real business setting. For example, there would have been evidence of a real shift in control if—after the transfer of the Murphy shares—the controlling block immediately called a meeting

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to elect new directors, or had the then-current directors determined to replace mother Murphy as the controlling director. This move, assuming it was permissible under state law and the company's by-laws, would have substantially impaired the "substance" prong of the court's argument. We believe that were the case reviewed today and that single action taken, the tax court would approve the transaction and minority discounts.[17]

Beware, though, of a version of the substance over form theory that is now in vogue at the IRS: the reciprocal trust doctrine.

Contrary to general perception, this concept's genesis is not the 1969 Supreme Court opinion in *U.S. vs. Grace's Estate*,[18] but rather *Lehman vs. Commissioner.*[19]

In *Lehman*, the court frequently discussed the "substance" of what

THE "BUSINESS PURPOSE" THEORY

The business purpose theory—in its broadest read, and as applied by many cases in the income tax area—postulates that transactions must be driven by business rather than tax motivations, or the courts will deny the tax benefits sought. If, for example, a transaction lacks a profit potential (aside from its tax effects), courts may disallow what the Internal Revenue Code would otherwise permit. Typically, in the income tax area, judges examine the subjective intent of the taxpayer in entering into the transaction.

Interestingly, the seminal case in this area, *Gregory vs. Helvering*[1] (decided by the U.S. Supreme Court in 1935), concerned a statute that arguably did require a business purpose. In *Gregory*, the taxpayer owned a corporation, "United," which in turn owned another corporation, "Monitor." Mrs. Gregory, in an attempt to avoid a taxable event, had United transfer the Monitor shares to a new corporation that she'd just formed, then liquidated the new corporation and transferred the Monitor stock to herself, and asserted she had not recognized any taxable gain on the distribution of Monitor stock. Her transaction satisfied each element of the Revenue Act of 1928, because her actions constituted a transfer of assets between corporations under common control. But the Supreme Court considered "whether what was done, apart from the tax motive, was the thing which the statute intended." The court concluded that the taxpayer's actions were not "pursuant to a plan of reorganization" as the statute required, because business purpose was, according to the court, an explicit prerequisite of the statute.

As with much urban folklore, the holding in *Gregory* regarding business purpose has over the years been transmogrified so that some courts see it as a stand-alone *a priori* requirement of the Internal Revenue Code. The U.S. Tax Court's 1999 holding in *UPS,*[2] is representative of this judicial extrapolation. In it Judge Robert P. Ruwe said, "While a taxpayer may structure a transaction to minimize tax liability, that transaction must have economic substance if it is to be respected for tax purposes…The inquiry into whether transactions have sufficient substance to be respected for tax purposes turns on both the objective economic substance and the subjective business motivation behind them…In making our determination as to whether a transaction has substance, we will first look to whether the taxpayer had a business purpose for engaging in the transaction other than tax avoidance…The determination of whether the taxpayer had a legitimate business purpose in entering into the transaction involves a subjective analysis of the taxpayer's intent."

Recent income tax shelter cases provide additional examples of this extension of the business purpose theory. Only when the transaction has a practical economic effect other than the creation of tax losses, are courts likely to rule in the taxpayer's favor. Transactions that are strictly tax-driven are generally invalidated. As judge Emmett R. Cox of the Court of Appeals for the 11th Circuit explained in *UPS*: "A 'business purpose' does not mean a reason for a transaction that is free of tax considerations. Rather, a transaction has a 'business purpose'…as long as it figures in a *bona fide*, profit-seeking business [quoting *ACM*]. This concept of 'business purpose' is a necessary corollary to the venerable axiom that tax-planning is permissible. [quoting *Gregory*]"

We believe this is going too far. As in *Gregory,* "business purpose" should be required directly or indirectly by statute. Absent such a mandate, the courts are legislating a new requirement. Applied to the estate and gift tax area, this could be catastrophic. In many estate-planning initiatives the only reason for the transaction is to reduce or eliminate exposure to estate and gift taxes. *—Louis S. Harrison and Robert S. Held*

Endnotes
1. *Gregory vs. Helvering*, 293 U.S. 465 (1935).
2. *United Parcel Service vs. Commissioner*, 78 T.C.M 262 (1999) Rev'd 254 F.3d 1014 (11th Cir. 2001)

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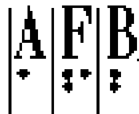

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transpired when two parties created multiple trusts, and found that, though the form indicated these trusts were gratuitously created, the substance indicated that they were created as part of a bargained for consideration. *Grace* loosens the standard of review by imposing an "interrelated" requirement in lieu of bargained for consideration,[20] but clearly the concept of interrelationship means the parties have engaged in a plan to enter into the trusts, and that the trusts are not actually gratuitous creatures as the form would suggest. Applying the substance-over-form theory, once the substance of what transpired does not match up with the form in a reciprocal trust context, the court can recharacterize the transaction for tax purposes along the lines it wants.

Avoiding Problems

It is therefore essential to focus on the parties' actions, before and after an aggressive strategy is structured. And *Reichardt*[21] can serve as a road map for what not to do in aggressive estate tax planning.

In *Reichardt*, the taxpayer transferred all of his property to a partnership. After the transfer of the limited partnership interests to the children, the taxpayer ignored the partnership requirements, and continued to control the partnership assets as if he owned them individually. The taxpayer, for instance, transferred partnership funds directly into his personal checking account. Because the taxpayer's relationship with his assets did not change following his conveyance to the partnership, the court was able to look through the transaction, and ignore the form(alities) imposed by the partnership on the assets. Although the court did not cite "substance over form," as the IRS had abandoned this argument at trial,[22] this is in essence exactly what it did.[23]

An oft-cited 1991 estate and gift tax sham case, *Heyen*,[24] is another substance over form application. In *Heyen*, annual exclusion gifts were made to donees (the "intermediaries"), who immediately signed blank stock certificates so that stock could be reissued to the original donors' descendants. The U.S. Court of Appeals for the 10th Circuit ignored those transfers to the intermediaries.

The form of the transaction, an annual exclusion gift to intermediaries, did not match the substance of what had occurred: an immediate transfer by the intermediaries to the donor's descendants without any real right to retain the stock. Interestingly, two of the intermediaries retained the stock interest, however the transfer agent transferred their shares on the transfer agent's records. This reflected, contrary to the taxpayer's argument, that there was no substantive acknowledgement, most notably by the transfer agent, that the intermediaries would be given real control.

At its core, *Heyen* is another case where the substance of what happened reflected a direct transfer from the donor to the donors' children with no rights being vested in the intermediaries. The question in *Heyen*, not discussed in the literature, is what would have been required in substance to have this transaction respected for tax purposes. Our answer:

- Transfer stock to the intermediary donees, registered as such by the transfer agent with the transactions fully completed;
- Have the intermediaries take all of the formal steps (not just endorsement of a stock certificate) to transfer the shares to the descendants of the original donor;
- Make sure there is no actual or implied obligation by the intermediary donees to transfer the

THE "STEP TRANSACTION" THEORY

Courts sometimes will view all the steps of a transaction as a whole. If a taxpayer takes step A, then B, then C, leading eventually to result D, and if the step transaction doctrine is deemed to apply, the court recharacterizes the taxpayers' actions as going from step A directly to result D. There are three different tests that have been applied to determine if intermediate steps of a transaction should be ignored. Although courts often discuss these tests as alternatives in evaluating whether a step transaction is to be found, often a court will focus on just one of these tests to make a determination.

The "binding commitment" test collapses the steps if, as the Supreme Court has explained, "at the time the first step is entered into, there was a binding commitment to undertake the later step."[1]

A more liberal standard, the "interdependence test," asks whether the steps are so interdependent that , as a federal appeals court put it, "the legal relations created by one transaction would have been fruitless without a completion of the series."[2] The interdependence test focuses upon each step in a series of events, and asks whether those steps have independent significance.

The most liberal standard is the "end-result" test. This test ignores intermediate steps if it appears that a series of formally separate steps are really prearranged parts of a single transaction intended from the outset to reach the ultimate result.[3] Subjective intent is relevant, because it allows the court to determine whether the taxpayer directed a series of transactions for an intended purpose.

Application of the step transaction doctrine to complicated and substantial income tax cases has produced uneven results. It is difficult to tell when and how the courts will apply a specific prong or alternative of the step transaction test.

We suggest going back to the origins of the step transaction doctrine. This theory is simply an outgrowth of 'substance over form,' in which congressional intent is observed by interpreting a statute consistent with the actions of the parties. From a legislative intent perspective, the "binding commitment" test is the truest—and should be the sole—test of the step transaction doctrine in the income tax area. Under this test, a court must make an objective determination as to whether the taxpayer is bound by an obligation to undertake subsequent steps of a transaction. Other factors, such as subjective intent, are not considered.

The step-transaction doctrine has been effectively used in the area of tax-free reorganizations but should probably never be applied in the transfer tax area. The three prongs, binding commitment, interdependence and end result, have little application to estate-planning transactions, although some of the tax court judges would like to apply them. If these applications were imported into the estate and gift tax area, in theory, seemingly innocuous planning strategies such as the formation of a partnership and subsequent transfer of limited partnership interests (at a discount) to children may well become more difficult. The Internal Revenue Service could simply collapse the steps, under this doctrine, and argue that the underlying assets of the partnership should be valued rather than the non-controlling limited partnership interests themselves.

—Louis S. Harrison and Robert S. Held

Endnotes

1. *Commissioner vs. Gordon*, 391 U.S. 83, 96 (1968)
2. *Redding vs. Commissioner*, 630 F. 2d 1169, 1177 (7th Cir. 1980)
3. *King Enterprises vs. U.S.*, 418 F. 2d 511, 516 (Ct. Cl. 1969)

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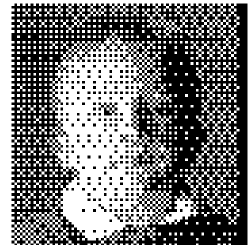

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stock by gift to the original donor's descendants.

Apply Step Transaction?

Courts could invoke the "end result" prong of the step transaction doctrine in virtually every estate and gift tax planning case. This is because a taxpayer almost always has as a final objective to transfer wealth to the next generation with the least transfer tax cost. Thus, although difficult to imagine in the transfer tax area, a court could look at the end result and, notwithstanding that the intermediate steps otherwise complied with the technical requirements, deny the independent significance of an intermediate step.

It is instructive to look at the majority opinion in the pivotal family partnership case of *Kerr vs. Commissioner*.[25] There, a family limited partnership was established followed closely by the gifting of discounted partnership interests to a GRAT. The valuation of the gift to the GRAT was, unsurprisingly, reduced by discounting. *Kerr* was certainly a case in which the "end result" prong of the step transaction could have been applied to collapse the three steps into one: Step A was the formation of partnership, step B was the transfer of assets to partnership, and step C was the transfer of limited partnership interests to a GRAT. The intent of the taxpayers clearly was to use the partnership discount to reduce the value of the GRAT transfer. Therefore, using the "end result" test, the IRS could collapse all steps into step C, the transfer to the GRAT, and ignore the partnership steps.

Interestingly, the tax court did not comment on ignoring the partnership formalities using the step transaction doctrine. Perhaps the court was demonstrating benevolent ignorance. Or maybe it was, very reasonably, sidestepping an aggressive interpretation of the step transaction theory that could invalidate many estate and gift tax strategies.

Yet the extension of the step transaction is the exact approach proposed by Beghe in *Strangi*. He claimed that "the facts of this case invite us to use the end-result version of the step-transaction doctrine to treat the underlying partnership assets – the property originally held by decedent – as the property to be valued for estate tax purposes."[26]

U. S. Tax Court Judge Carolyn M. Parr agreed with Beghe. Thankfully, the other judges on

the tax court did not.

Go to Congress

The Service has sought to import traditional income tax equitable arguments, under the sham transaction heading, into the estate tax area. This move is legislatively justified only if done conservatively, using a narrow reading of "substance over form" to review aggressive estate tax strategies and make sure the parties' actions match the form of their transactions. But if done liberally, for example by using of the "end result" test of the step transaction doctrine or the "business purpose," the result would be unfair, illogical and unsupported by congressional intent. Treasury should lobby Congress for changes to rules it deems unfair, rather than ask judges to create laws it thinks would be more just. ◆

Endnotes

1. *See Joseph Cohen*, T.C.M. (P-H) 43,372 (1943), 1943 WL 9207 (applying substance over form to invalidate a taxpayer's attempt to split income among family members citing *Chisholm vs. Commissioner,* 79 F.2d 14 (1935)).
2. *Estate of Strangi vs. Commissioner,* 115 TC No. 35 (2000) affirmed in part, reversed in part 293 F.3d 279 (5th Cir. 2002) rehearing and rehearing en banc denied 2002 WL 31017825 (5th Cir. 2002)
3. *Penrod vs. Commissioner,* 88 T.C. No. 79 (1987). The Penrod court provides an interesting discussion of the reach of the step transaction doctrine. The court refused to say whether the absence of a "binding commitment" was enough to defeat a step transaction claim, but in any event determined that the more liberal end result test would not even be satisfied under the facts of that case. One view is that the court impliedly preferred a narrower read and application of this doctrine.
4. In *Murphy v Commissioner, T.C. Memo.* No. 1990-472, the Court, citing *Gregory vs. Helvering*, 293 U.S. 465 (1935) and *Knetsch vs. United States*, 364 U.S. 361 (1960), determined to extend the substance over form doctrine to the estate and gift tax area.
5. 20 donees times $22,000 per donee (with gift splitting under section 2513) provides $440,000 per year transfer-tax free. In twelve years, ignoring increase in asset values, $5,280,000 could be removed from the donor's estate.
6. *Crummey vs. Commissioner,* 397 F.2d 82 (9th Cir. 1968) held that a demand power created a present interest in an irrevocable trust. Furthermore, the IRS has approved of the use of Crummey powers within irrevocable life insurance trusts. And even remote contingent beneficiaries are permissible. *Cristofani vs. Commissioner*, 97 TC No. 5 (1991). The Service has acquiesced: Action on Decision CC-1996-010, July 15, 1996. The Crummey power is clearly a step transaction using the "end result" test, but not a step transaction using the "binding commitment" test. See text infra.
7. The QPRT statutes allow taxpayers to transfer a personal residence at a fraction of its value. GRATs under section 2702 allow the taxpayer to give away substantial increase in asset values free of gift tax. Payment of gift tax, which is tax exclusive, versus estate tax, which is tax inclusive, can result in a gift transfer that has a marginal tax rate, in effect, lower than the estate tax rate of the same amount. Lifetime use of the unified credit (versus testamentary use) transfers appreciation (post lifetime transfers) free of gift and estate tax.
8. See *Kerr vs. Comm'r,* 113 T.C. No. 30 (1999) aff'd 292 F.3d 490 (2002), for a discussion of the narrow application of the substance over form doctrine in the estate and gift tax area where the court held limited partnership interests rather than assignee interests were assigned. See also Grace's Estate, infra at fn. 20. But cf. Driver vs. United States, 1976 WL 1188 (W.D. Wis. 1976), (step transaction wrongly applied to nullify gift and estate tax discounts).
9. Strangi, fn. 2 supra; *Estate of Church v Commissioner,* 2000 WL 206374 (W.D. Tex); and Knight at fn. 14. See the following substantive sham Technical Advice Memos: 9723009, 9736004, 9725002 and 9730004.
10. Strangi, fn. 2.
11. See also *Knight vs. Commissioner*, 115 T.C. No. 36 (2000).
12. See fn. 4
13. The court upheld a 15% discount for lack of marketability and an additional 5% discount for lack of authority to liquidate the corporation.
14. Id.
15. *Gregory v Helvering,* 293 U.S. 465 (1935)
16. Murphy at fn. 5.
17. An argument can be made that even without the formal change of control within 18 days of death, the substance of the transaction was still compatible enough with its form that the tax code could have allowed minority discounts for both the small lifetime gift and the non-controlling testamentary interest. The case does point out that overly cautious matching of the substance with the form, even if that matching is contrived, can be of great help in aggressive gift and estate tax strategies. For example, in the family partnership deathbed TAMs, the IRS goes to great length to conclude that the purposes stated for the formation of the partnership are often fabricated and fictitious. As a result, a practitioner may be lulled into thinking that putting forth non-tax reasons is window dressing. However had these same TAMs gone before the Tax Court, the enumeration of non-tax reasons for the establishment of the partnership are evidence of the "substance" of the transaction, and would certainly be of help to defend against a substance over form argument.
18. *United States vs. Grace's Estate,* 395 U.S. 316 (1969).
19. 109 f.2d 99 (1940).
20. But the Court's opinion is strained on this point, to say the least. See, e.g, fn. 10 in the opinion in which it implies that there is a consideration requirement, just one that is too hard for the Court to define. See also *Sather vs. Comm'r*, 251 F3d 1161 (8th Cir. 2001) for a further discussion of the "interrelated" concept as it results to a plan entered into by the parties.
21. *Reichardt vs. Commissioner,* 114 T.C. No. 9 (2000)
22. See *Reichard* at fn. 1 of Judge John O. Colvin's opinion.
23. By ignoring the partnership, the court was able to hold that section 2036 caused full inclusion in the taxpayer's estate for federal estate tax purposes. To arrive at that statutory conclusion, the court by implication had to apply the substance over form doctrine, thereby looking past the "form" of the transaction. See also *Estate of Schauerhamer v Commissioner, T.C. Memo.* 1997-242 in which the court indicated that "where a decedent's relationship to transferred assets remains the same after as it was before the transfer, section 2036(a)(1) requires that the value of the assets be included in the decedent's gross estate."
24. *Heyen vs. United States,* 945 F.2d 359 (10th Cir. 1991)
25. *Kerr vs. Commissioner,* 113 T.C. No. 30 (1999) Aff'd 292 F.3d 490 (5th Cir. 2002)
26. *Strangi*, supra at fn. 2. Judge Beghe advises that he is not using the step transaction to conclude anything about the fair market value of the transferred limited partnership interests. Instead, he says, the step transaction doctrine identifies the property subject to tax. Accordingly, by treating the formation of the partnership, its corporate general partner and the transfer of the limited partnership interest to the children as one transaction solely to achieve a discount, Judge Beghe would then ignore all of the steps and include all the partnership assets in the decedent's estate. The reliance seems to be, primarily, on *Penrod vs. Commissioner*. See fn .3, supra. However, in *Penrod*, the Tax Court found that an exchange of stock did qualify as a reorganization and prevented the Service from immediately taxing the gain.