# INSIGHTS & STRATEGIES

FINANCIAL AND ESTATE PLANNING

***Insights & Strategies*** is a monthly newsletter designed to keep you up-to-date on the most recent developments in the areas of financial and estate planning. Written by accomplished estate planning attorneys, this important newsletter provides details on the latest federal estate tax cases and rulings. Additional commentary is included focusing on relevant planning ***strategies*** and related ***insights*** that add value by applying the tax information to practical situations.

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POST-MORTEM PLANNING

**Application of Equitable Recoupment When FLP Assets Included in Decedent's Estate: Taxpayer Victory**

In a recent case, the Tax Court included in decedent's gross estate all of her assets (marketable securities) transferred to two family limited partnerships (FLPs) as transfers with a retained life estate under Code Sec. 2036(a). The inclusion resulted in a substantial increase in the estate tax. The estate wanted to offset the increased estate tax by the excess capital gains taxes paid by the FLP partners for the year 2003 since the refund claims for that year were barred by the statute of limitations. (This article discusses the equitable recoupment claim. The next article discusses the Sec. 2036(a) issues.) *Estate of Erma V. Jorgensen*, T.C. Memo. 2009-66.

*Carryover Basis*

In the *Jorgensen* case, after decedent's death, securities were sold by the FLPs at substantial gains. The gains were passed through to children and grandchildren as partners of the FLPs and reported by them on their individual income tax returns for the years 2003 through 2006.

The gains on the sold securities were based on decedent's cost basis carried over to the FLPs at the time of the transfers. There was no step-up in basis since the securities were not included in decedent's estate; only the FLP interests were included. Therefore, the children and grandchildren overpaid their capital gains taxes once the court held that the securities were included in decedent's estate at their higher date of death values rather than the discounted values of the FLP interests.

*Protective Refund Claims*

The children and grandchildren filed protective refund claims for the years 2003 through 2006. For 2003, the IRS denied the refund claims since the statute of limitations had expired. The issue which the Tax Court had to decide was whether the doctrine of equitable recoupment applied so that decedent's estate could offset the additional capital gains tax paid by the children and grandchildren for 2003 against the increased estate tax.

**Planning Strategy**

If the FLPs had not been used the securities would have received a step-up in basis to their date of death fair market values. Since decedent transferred her assets to FLPs, her estate included her discounted interests in the FLPs rather than the FLP assets. In the event of FLP asset sales, FLP partners will want to file protective claims for refund with respect to their individual income tax returns since the estate return audit might result in a basis increase that would reduce the capital gain. This was the situation in the *Jorgensen* case, except for the fact that in *Jorgensen* the protective refund claim for 2003 was not timely filed.




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