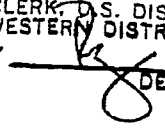


UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS,
SAN ANTONIO DIVISION

FILED

JAN 18 2000

CLERK, U.S. DISTRICT COURT
WESTERN DISTRICT OF TEXAS
BY  DEPUTY CLERK

ELSIE J. CHURCH, DECEASED,
MARSHALL B. MILLER, JR., and
MARY ELSIE NEWTON, Independent
Co-Executors,
Plaintiffs,

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v.

CAUSE NO. SA-97-CA-0774-OG

UNITED STATES OF AMERICA,
Defendant.

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Following trial on the merits and submission of post-trial briefs (docket nos. 60, 63, 64, and 67), and pursuant to the February 17, 1999 agreement of the parties to withdraw this case from the jury and submit it to the Court for decision, the Court enters its findings of fact and conclusions of law. FED. R. CIV. P. 52. To the extent any finding of fact is made in the Conclusions of Law section, or vice versa, the section headings will be disregarded.

Jurisdiction and Venue

1. This court has jurisdiction over this matter pursuant to 28 U.S.C. § 1346(a)(1) because this suit arose under the Internal Revenue laws of the United States for a refund of estate taxes that were allegedly erroneously assessed and collected.
2. Venue for this action properly lies in the Western District of Texas pursuant to 28 U.S.C. § 1391(e).

Findings of Fact

1. Elsie S. Church ("Mrs. Church") died on October 24, 1993, at the age of about 72. (Tr. 166, 223).

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2. Mrs. Church was the mother of plaintiffs Marshall B. Miller, Jr. and Mary Elsie Newton. (Tr. 110).
3. On October 22, 1993, Mrs. Church, Marshall B. Miller, Jr., and Mary Elsie Newton signed an agreement entitled, "Agreement of Stumberg Ranch Partners, Ltd." ("Partnership Agreement"). (Tr. 131, 409, PX 1). The execution of this document resulted in the formation of a Texas limited partnership ("the Partnership"), subject only to substantial compliance with the Texas Revised Limited Partnership Act then in effect, TEX. REV. CIV. STAT. ANN. art. 6132a-1, and the Texas Uniform Partnership Act. TEX. REV. CIV. STAT. ANN. art. 6132b.
4. The purpose of the Partnership was twofold. Most importantly, the partners wished to consolidate their undivided interests in a family ranch known as the W.R. Stumberg Ranch ("the Ranch") to provide for centralized management of their interests and preserve the Ranch as an on-going enterprise for future generations. (Tr. 121-22, 126-27, 141, 148, 225-27). In addition, as she aged, Mrs. Church became concerned about protection of her substantial assets from judgment creditors in the event of a catastrophic tort claim against her. (Tr. 128-29).
5. The Ranch, located in West Texas, consists of approximately 23,000 acres. (Tr. 114). The ranch supports grazing of cattle, sheep, and goats. (Tr. 112, 115-17). Since about 1979, the Ranch has been leased for grazing and hunting. (Tr. 115-17, 126). There is currently an oil and gas lease on the Ranch. (Tr. 121).
6. Mrs. Church was a limited partner in the Partnership. (PX 1). While she had actively managed the Ranch on behalf of all of the owners in years past under an informal

- agreement, she had largely relinquished this role to her two children after her remarriage to William Church in 1984. (Tr. 118, 121, 124-25). The other undivided interest owners in the Drake family had never been active in the management of the Ranch. (Tr 118, 137).
7. Miller and Newton were also limited partners in the Partnership. Stumberg Ranch, L.C. was designated as the general partner, and was to be owned 50-50 by Miller and Newton to reflect their active roles in managing the Ranch. (Tr. 136, PX 1). This corporation, however, had not yet been formed when Marshall Miller signed the Partnership Agreement on its behalf on October 22, 1993. (PX 1 at 17, PX 5, PX 6).
 8. The capital contributions to the Partnership consisted of each limited partner's undivided interest in the Ranch. In addition, Mrs. Church contributed approximately \$1 million in securities inherited from her mother and from her husband Bill Church that were held in street name in an account at Paine Webber. (Tr. 131-32, 139, 192, PX 1 at 2, Ex. A, PX 11). At this time, the limited partners owned 57% of the Ranch while members of the Drake family owned the remaining 43%. Of the 57% interest owned by the Partnership, Mrs. Church owned 62% in her individual capacity, and Miller and Newton each owned 18%. Mrs. Church owned the remaining 2% as a trustee. (Tr. 123, 136, PX 1 at 3). The undisputed market value of the interest in the Ranch contributed by Mrs. Church was \$380,038, while the value of her children's interests was \$232,927. (Tr. 131-32, 154, PX 1, PX 9 at Ex. B).
 9. The Agreement allocated profit or loss from Ranch operations in proportion to the interests contributed by the limited partners. Ninety-nine percent of the taxable income from the securities contributed by Mrs. Church was specially allocated to her after

expenses. (Tr. 133, 136, 187, PX 1 at 2-3). Mrs. Church also received 62% of the income attributable to the operation of the Ranch. (Tr. 136). The result was that the Partnership was a pro rata partnership in the sense that profits, losses, and income were allocated in proportion to each partner's capital contribution, and no partner experienced an economic benefit from the contribution of another.

10. The limited partners conveyed their interest in the Ranch to the Partnership in a Special Warranty Deed signed on October 22, 1993. (PX 4). On the same day, Miller signed an Assignment Separate from Certificate conveying Mrs. Church's securities to the Partnership. (PX 3). He did so under a power of attorney Mrs. Church had given him in July of 1992. (PX 7).
11. Two days after these transactions, on October 24, 1993, Mrs. Church died suddenly and unexpectedly of cardiopulmonary collapse. (PX 8).
12. At the time she died, Mrs. Church had breast cancer. She had first been treated for this condition by Dr. Stephen Cohen in July of 1990. (Tr. 165). Dr. Cohen is an eminently qualified oncologist. (Tr. 163-65). Although the Court finds the cause and timing of Mrs. Church's death is largely irrelevant to this case, the Court accepts as true the testimony of Dr. Cohen that Mrs. Church's death was unexpected and unrelated to her cancer. (Tr. 169-70). After diagnosis and initial treatment, Dr. Cohen initially treated Mrs. Church with chemotherapy that was very debilitating but successful in destroying signs of the disease. (Tr. 165-66). After 1½ years, the cancer recurred and Mrs. Church was again treated with chemotherapy that had to be stopped because of the side effects. (Tr. 166). This course of treatment nevertheless was successful in the sense that Mrs. Church went

into clinical remission for the last six months of her life. (Tr. 171-72).

13. Notwithstanding her cancer, Mrs. Church was living a normal life at the time of her death. She had her own apartment where she lived without assistance, drove a car, visited family and friends, and did not exhibit any signs of a belief that she would die soon. Indeed, she had purchased new clothing shortly before her death, which is not the act of one on her deathbed. (Tr. 146-47, 167, 223-24). I thus accept as true the conclusion of Dr. Cohen that Mrs. Church had no reason to believe that she would soon die. Moreover, there were many available treatments for Mrs. Church's breast cancer that she had not yet undergone because she did not need them. Any estimate of how long she could or would have lived with her cancer would be a guess, with no factual support or probative value. (Tr. 173).
14. While the Partnership was formed on October 22, 1993, the organization of its affairs was not completed prior to Mrs. Church's death. The Certificate of Limited Partnership was not filed in the Office of the Texas Secretary of State until October 26, 1993. (PX 2). This Certificate states it was signed and executed on July 1, 1993 by Marshall B. Miller, Jr. Miller indicated at trial that this was incorrect, and that he probably signed it on October 22 with the other Partnership documents. He attributed this mistake to the fact that the Partnership Agreement, while not signed until October 22, has an effective date of July 1, 1993. Since the date on the Certificate was typed, I find that this was a clerical error that Miller did not notice when he signed the Certificate. Miller made no effort to conceal this mistake, and it is immaterial when the Certificate was signed.
15. The corporate general partner of the Partnership was not actually organized until March

of 1994. (PX 5, 6). The Paine Webber account in the name of Elsie Church was not changed to a Partnership account until the same month. To the limited extent that a determination of relevance involves findings of fact, common experience tells us that it is not unusual that all of the paperwork associated with the formation of a business entity was not completed in a single day, or in the short interval of two days between execution of the Partnership Agreement and Mrs. Church's death. Indeed, the failure to complete the paperwork on Friday, October 22, 1993 lends credence to the testimony that the state of Mrs. Church's health and her possible death were not motivating factors in the decision to form the Partnership. After Mrs. Church's death, it was obviously immaterial whether paperwork was completed in a day or a month. The legal consequences, if any, arising from the failure to complete the paperwork prior to death were fixed.

16. I find that the primary purpose of the partners in forming the Partnership was a desire to preserve the family ranching enterprise for themselves and their descendants. Both Miller and Newton testified to, and I accept as true, their feelings that their and their mother's association with a working ranch was an important and beneficial influence on their otherwise urban lives that would also benefit their descendants. Bringing organization to the Ranch would remove it from the control of one or more fractional, undivided-interest owners who could use the property at will, interfere with operations, and ultimately force a partition or sale of the Ranch. (Tr. 120-122, 126-27, 141-45, 148, 225-27).
17. The evidence of this motivation is concrete and persuasive. In the first instance, Mrs. Church and her children had already experienced the consequences of undivided ownership in a real-estate-based business enterprise. Prior to formation of the Partnership,

Mrs. Church's nephew, Rod Drake, had exercised his rights as an undivided owner by moving onto the Ranch, interfering with operations, threatening legal action, and almost driving off the grazing lessee who was the major source of the Ranch's income. (Tr. 122). Mrs. Church, her two children, and their cousin had to solve this threat by borrowing money to purchase the nephew's interest. (Tr. 122, 225). Moreover, they knew this nephew would likely inherit additional interest in the Ranch through his father and would likely have to be bought out again. (Tr. 123). This in fact occurred after formation of the Partnership. The securities contributed to the Partnership by Mrs. Church provided the \$200,000 in capital necessary for this second buy-out that increased the Partnership's interest in the Ranch from 57% to its present 75%. It also was, and is, the intention of the Partnership to purchase the outstanding 25% undivided interest of Whit Drake when, and if, the Partnership has accumulated sufficient capital to do so. (Tr. 144-45).

18. The Partnership was also formed with an eye towards the possibility of actively engaging in raising cattle. The Ranch was in the midst of a prolonged and continuing drought. The grazing lease expired in 1994, and there was a question whether it would be renewed. The Partnership was prepared, if necessary, to replace this lost income through active operations. (Tr. 184-85). Working capital over and above income from the Ranch would have been necessary to engage in this activity.
19. The Government contends that while the formation of the Partnership took the form of a bona fide business transaction, the transaction had no substance and was entered into for no purpose other than to reduce the taxation of Mrs. Church's estate. I do not find this to be the case. The character of the interests owning a majority of the Ranch changed

dramatically as a result of the Partnership. Prior to its formation, Plaintiffs and their descendants would have owned undivided interests in the Ranch, with each interest carrying the right to use and enjoy the property, or force a partition or possible sale. The Partnership eliminated these individual rights and placed ownership of a majority of the Ranch in a Partnership that was not controlled by any single person.

20. I find as a matter of fact that the Partnership had bona fide business purposes and was not a sham as that term is used in estate taxation.
21. I also find that the Partnership was not formed solely to reduce estate taxes.
22. Mrs. Church intended to, and did, convey her interest in the securities held by Paine Webber on October 22, 1993. This intent to relinquish her interest is explicitly expressed in the Partnership Agreement she signed on that date
23. There is no ambiguity in the Partnership Agreement with respect to the power to amend it, and no claim of ambiguity has been brought to the attention of the Court. Even if such a claim had been made, no extrinsic evidence was offered to explain any claimed ambiguity.
24. Mrs. Church did not have the unilateral right to alter, amend, revoke, or terminate the Partnership Agreement. Section 29 of the Partnership Agreement provides that it may be amended "only upon the written agreement of the Partners then entitled to eighty percent (80%) or more of the Partnership interests in profits from operations." The reference to "profits from operations" can logically refer only to Ranch operations, and therefore Mrs. Church was entitled to only 62% of those profits. Nor could Mrs. Church dissolve the Partnership through the use of her amendment power, even if she could cast more than

80% of the vote to do so. As Texas partnership law provides, no act in contravention of the agreement (such as dissolution) may be done without the consent of all the partners. TEX. REV. CIV. STAT. ANN. art. 6132b § 18(h). Such a unilateral act would also contravene sections 15(a) and 22 of the Partnership Agreement.

25. There was no expressed or implied agreement between the partners in the Partnership that Mrs. Church could continue to use, possess, or enjoy partnership property, or retain the right to income from Partnership property, within the meaning of I.R.C. § 2036.
26. To the extent that the safe harbor exceptions to application of I.R.C. § 2703 involve issues of fact, I find that the Partnership was a bona fide business arrangement, and not a device to transfer property to members of Mrs. Church's family for less than full and adequate consideration in money or money's worth. I also accept as true the uncontradicted testimony of Charles Hornberger that the terms and restrictions in the Partnership Agreement were comparable to similar arrangements entered into by persons in arms-length transactions. With respect to the issue of consideration, I reject the Government's contention that the difference in value between the Partnership interest Mrs. Church received on formation and the value of the assignee interest transferred upon her death is the appropriate measure of the consideration she received for her contribution of assets to the Partnership. These are two different interests that are not comparable. My finding that she received full and adequate consideration is premised upon the fact that whatever the value of her Partnership interest on the date of formation, it was directly proportionate to the contributions and Partnership interests of the other partners to a Partnership that had a bona fide business purpose.

27. The fair market value of the assets contributed by Mrs. Church to the Partnership, as of the date of her death or the alternate valuation date of April 24, 1994, was \$1,467,748 (Tr. 410). Of this figure, the value of the Ranch accounted for \$380,038, and the value of the cash and securities contributed by Mrs. Church was \$1,087,710.
28. The fair market value of Mrs. Church's limited partnership interest in the Partnership, as of the date of her death or the alternate valuation date of April 24, 1994, was \$617,591. (PX 13 at i). While this is precisely the estimate of Plaintiffs' valuation expert, Mr. Bruce Johnson, and presumably could have been challenged given that the valuation of such interests are ultimately a matter of opinion, the Government chose not to present any valuation evidence of its own. Since the Court must find facts based on the record before it, it accepts Mr. Johnson's uncontradicted estimate.
29. On July 25, 1994, the Estate of Elsie Church timely filed a Form 706, United States Estate Tax Return. (Tr. 410).
30. On February 16, 1996, the Internal Revenue Service served a Notice of Deficiency proposing to assess against the estate a deficiency of \$212,503 plus interest. (Tr. 410).
31. After adjustments, the estate made full payment of the deficiency on April 8, 1996 in the amount of \$230,100, representing the principal sum of \$197,221 and statutory interest of \$32,879. (Tr. 410).
32. On October 9, 1996, Plaintiffs filed a claim for refund that the IRS denied. (Tr. 411).
33. On March 3, 1997, the IRS refunded \$14,631.65 to the estate. This refund was attributable to additional deductible attorney's fees of \$43,769 and appraisal fees of \$5,594 incurred in connection with this matter and necessary in the administration of the

estate. (Tr. 411).

34. This lawsuit was filed on June 26, 1997. (Tr. 411).
35. Since March 3, 1997, Plaintiffs have actually and necessarily incurred the sum of \$101,442.71 in additional attorney's fees and expenses in seeking a refund through this suit. I find that these attorney's fees and expenses were necessary in the administration of the estate because they were actually incurred in the collection of assets within the meaning of Treas. Reg. 20.2053-3. This sum is accordingly an additional deduction from the federal estate tax heretofore paid.
36. Plaintiffs are entitled to a refund based on the proper valuation of Mrs. Church's Partnership in the amount of \$617,591. In accordance with the parties' stipulation, the Government shall calculate the refund and submit its calculation to Plaintiffs for approval within thirty (30) days of this decision. Any dispute thereafter as to the amount of the refund shall be submitted to the Court, which shall include the dollar amount of the refund in its final judgment.

Conclusions of Law

1. For the reasons stated in its order on the Government's motion in limine (docket no. 44), the Court concludes that the formation of Stumberg Ranch Partners, Ltd. was in substantial compliance in good faith with the Texas Revised Limited Partnership Act, and TEX. REV. CIV. STAT. ANN. art. 6132a-1, and the Texas Uniform Partnership Act. TEX. REV. CIV. STAT. ANN. art. 6132b.
2. Accordingly, the Partnership was a valid Texas limited partnership as of October 22, 1993, and Mrs. Church's limited partnership interest must be taxed as such under I.R.C.

§§ 2033 and 7701(a)(2).

3. The Government contends that prior to her death, Mrs. Church did not effectively convey to the partnership legal title to the securities in her Paine Webber account. Based on the undisputed facts, the Court concludes this contention is without merit. Mrs Church did not hold legal title to these securities; hers was an equitable beneficial interest and legal title was held by Paine Webber. It would make no difference even if this were not the case because neither Texas law nor the federal law of estate taxation concern themselves with legal title in determining ownership of partnership property. Under well-established principles of Texas law, ownership of property intended to be a partnership property is not determined by legal title, but rather by the intention of the parties. Logan v. Logan, 156 S.W.2d 507, 512 (Tex. 1941); Foust v. Old Am. County Mut. Fire Ins. Co., 977 S.W.2d 783, 786 (Tex App.-- Fort Worth 1998, no writ). Mrs. Church's intention to relinquish her beneficial interest in the securities held by Paine Webber was clearly expressed by her executions of the Partnership Agreement in which these securities are specifically described. This intention governs without regard to legal title to the securities and the securities were the property and assets of the Partnership.
4. If Mrs. Church effectively conveyed the securities in her Paine Webber account to the Partnership, as the Court has concluded, the Government next contends that there was a taxable gift on formation of the Partnership. The taxable value of this gift is represented to be the difference between the \$1,467,748 in assets contributed by Mrs. Church to the Partnership, and what the Government claims was the value of the Partnership interest she received in return. This latter sum is the \$617,591 estimated market value of Mrs.

Church's interest in the Partnership at death.

5. Initially, the Government's contention confuses the market value of the assignee interest passing at death with the value of the Partnership interest Mrs. Church received in return for her contribution. The two interests are not comparable. More importantly, the Government ignores the fact that this was a pro rata partnership that did not confer a financial benefit on, or increase the wealth of, any partner. Implicit in the Government's argument is the notion that since the value of Mrs. Church's Partnership interest was less than the assets she contributed, someone must have received a gratuitous transfer of the difference. This was not the case, and never could be in the formation of a business entity in which each investor's interest is proportional to the capital contributed.
6. A gift can be made in many guises, and it is the intention of I.R.C. § 2501, et. seq. to tax them whatever their form. Nevertheless, a taxable gift must involve a gratuitous transfer, which by definition requires a donee. Dickman v. Commissioner, 465 U. S. 330, 334, 104 S.Ct. 1086 (1984). There was none in this case. Kincaid v. United States, 682 F.2d 1220 (5th Cir. 1982) and the other cases cited by the Government reinforce this point rather than contradict it. Each involved an attempt to donatively pass property to others through the formation of business entities in which the donor did not receive an interest proportionate to his or her capital contribution.
7. I.R.C. §§ 2036 and 2038 likewise require a "transfer" as a predicate to their application. Shafer v. Commissioner, 749 F.2d 1216, 1221 (6th Cir. 1984); Estate of Harrison v Commissioner, 52 T.C.M. (CCH) 1306, 1309 (1987). Since the gift and estate taxes are considered *in pari materia*, Wheeler v United States, 116 F.3d 749, 761 (5th Cir. 1997),

the term “transfer” must be given the same meaning in construing sections 2036 and 2038 as it is in the taxation of gifts. Having previously concluded that there was no gratuitous donative transfer in the formation of Stumberg Ranch Partners, Ltd. in connection with the Government’s contention of a gift on formation, I likewise conclude that sections 2036 and 2038 do not apply to the transaction in issue. Estate of Harrison v. Commissioner, 52 T.C.M. (CCH) 1306, 1309 (1987); Estate of Michelson v. Commissioner, 37 T.C.M. (CCH) 1534, 1538 (1978).

8. The Government makes two contentions with respect to the application of I.R.C. § 2703 to this case. It first suggests that the term “property” refers to the assets Mrs. Church contributed to the Partnership prior to death, rather than her Partnership interest. There is no statutory basis for this contention. Mrs. Church did not own the assets she contributed to the Partnership on the date of her death; she owned a Partnership interest. The estate tax is imposed on that which a decedent transfers at death without regard to the nature of the property interest before or after death. I.R.C. § 2033; Estate of Bright v. United States, 658 F.2d 999, 1001 (5th Cir. 1981) (en banc). I.R.C. § 2033 provides that the gross estate shall include any partnership interest owned by a decedent as defined by I.R.C. § 7701 (a)(2). Lusthaus v Commissioner, 327 U.S. 293, 66 S.Ct. 539 (1946); Estate of Winkler v. Commissioner, 73 T.C.M. (CCH) 1657 (1997). I.R.C. § 2703 does not define the term “property” in any matter inconsistent with these provisions, or indeed at all, and cannot have a meaning attributed to it without Congressional authorization that would make it unique in the estate tax provisions of the Code.
9. The Government alternatively contends that if I.R.C. § 2703 does require taxation of Mrs.

Church's Partnership interest, it may nonetheless disregard the term restriction, and restrictions on sale in the Partnership Agreement that serve to reduce its market value. No case supports the Government's position, and nothing in the legislative history, or the regulations adopted by the IRS itself, convince this Court to read into Section 2703 something that is not there. By its very nature, a partnership is voluntary association of those who wish to engage in business together, and upon whom the law imposes fiduciary duties. Term restrictions, or those on the sale or assignment of a partnership interest that preclude partnership status for a buyer, are part and parcel of the property interest created by state law. These are not the agreements or restrictions Congress intended to reach in passing I.R.C. § 2703. Reviewing the legislative history, and construing I.R.C. § 2703 with its companion statute, I.R.C. § 2704, it is clear that the former was intended to deal with below-market buy-sell agreements and options that artificially depress the fair market value of property subject to tax, and are not inherent components of the property interest itself.

10. The Court concludes that Plaintiffs have carried their burden of proof and are entitled to the refund prayed for in the amount set out in the findings of fact.
11. Interest on the Court's judgment shall run in accordance with the provisions of 28 U.S.C. § 2411.

SIGNED and ENTERED this 18th day of June, 2000.

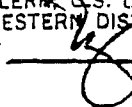


ORLANDO L. GARCIA
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
SAN ANTONIO DIVISION

FILED

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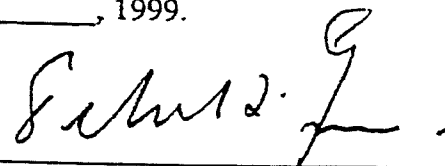
Civil Action No. SA-97-CA-774-OG

ORDER

The Court has considered Plaintiffs' motion to order deduction of attorney's fees under I.R.C. § 2053(a), and finds that it should be granted. Accordingly, Plaintiffs are entitled to an additional deduction from the value of the gross estate for administration expenses in the amount of \$101,442.71. This ruling will be incorporated in the Court's final judgment.

It is so ORDERED.

SIGNED this 14 day of January, 1999.



ORLANDO GARCIA
UNITED STATES DISTRICT JUDGE