

USE OF JUDICIAL DOCTRINES IN RESOLVING TRANSFER TAX CONTROVERSIES

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Abstract: The striking difference in the outcomes in two transfer tax cases involving similar circumstances raises an important question: what role, if any, should judicial doctrines play in resolving transfer tax controversies? This Article traces the development of judicial doctrines in the sphere of income tax controversies and discusses the role these doctrines have played, and should play, in resolving transfer tax controversies. It concludes that judicial doctrines should serve only a limited role in resolving transfer tax controversies, and that this limited role should be taken into account by the Internal Revenue Service when it enforces compliance, by taxpayers when they plan their estates, and by Congress when it crafts transfer tax legislation.

INTRODUCTION

The circumstances surrounding the deaths of Mrs. Murphy and Mrs. Church bear such remarkable similarities that one would assume that their tax plights would share a common destiny. Each was wealthy, each had expert legal counsel, and each died within days of utilizing a similar estate planning technique. This technique—the use of valuation discounts to minimize asset values—was employed to save the estates of both Mrs. Murphy and Mrs. Church several hundred thousand dollars in gift and estate taxes.

Given these similarities, the Internal Revenue Service (“Service”) likely thought that its challenge to the valuation discounts employed by the respective estates would yield the same judicial outcome. Yet, in *Estate of Murphy*, the Tax Court ruled in favor of the Service,¹ while in *Estate of Church*, the U.S. District Court for the Western District of

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¹ 60 T.C.M. (CCH) 645, 664 (1990).

Texas ruled in favor of the taxpayer.² In *Murphy*, the Tax Court used various judicial doctrines to hold that the taxpayer's valuation discounts were not legitimate. In contrast, in *Church*, the federal district court declined to use judicial doctrines and instead upheld the legitimacy of the taxpayer's valuation discounts.

The striking difference in outcomes between the *Murphy* and *Church* decisions raises an important question: what role, if any, should judicial doctrines—i.e., the substance over form doctrine, the business purpose doctrine, and the step transaction doctrine—play in resolving transfer tax controversies? This Article seeks to answer this question. Section I traces the role of judicial doctrines in resolving income tax controversies. Section II discusses the role these doctrines have played in resolving transfer tax controversies. On the basis of this background, Section III turns from the descriptive to the prescriptive. It uses the *Murphy* and *Church* decisions to assess the merits of using judicial doctrines to resolve transfer tax cases. This Article concludes that judicial doctrines should serve only a limited role in resolving transfer tax controversies. This limited role should be taken into account by the Service when it enforces compliance, by taxpayers when they plan their estates, and by Congress when it crafts transfer tax legislation.

I. THE USE OF JUDICIAL DOCTRINES IN RESOLVING INCOME TAX CONTROVERSIES

The use of judicial doctrines to curtail tax avoidance is pervasive in the area of income taxation.³ There are several reasons for this phenomenon: central among them is that courts believe that if the Internal Revenue Code ("Code") were read literally, impermissible tax avoidance would become the norm rather than the exception.⁴ No matter how perceptive the legislature, it cannot anticipate all

² 2000-1 U.S. Tax Cas. (CCH) ¶ 60,369, at 84,781 (W.D. Tex. Jan. 18, 2000).

³ See generally BORIS I. BITTKER & LAWRENCE LOKKEN, 1 FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 4.3.1, at 4-24 (3d. ed. 1999); Alan Gunn, *Tax Avoidance*, 76 MICH. L. REV. 733, 733 (1978); Ralph S. Rice, *Judicial Techniques in Combating Tax Avoidance*, 51 MICH. L. REV. 1021, 1021 (1953); Joshua D. Rosenberg, *Tax Avoidance and Income Measurement*, 87 MICH. L. REV. 365, 385-92 (1988); Harry J. Rudick, *The Problem of Personal Income Tax Avoidance*, 7 LAW & CONTEMP. PROBS. 243, 260-63 (1940).

⁴ See Joseph Isenbergh, *Musings on Form and Substance in Taxation*, 49 U. CHI. L. REV. 859, 880 (1982).

events and circumstances that may unfold,⁵ and, due to linguistic limitations, statutes do not always capture the essence of what is intended.⁶ Judicial doctrines fill the void left either by the legislature or by the words of the Code. Another reason for the popularity of these doctrines is that courts do not want to appear duped by taxpayers; therefore courts use these doctrines to reveal the "true essence" of a transaction.⁷

Despite this popularity, courts do not invoke judicial doctrines on a consistent basis. This is because a certain amount of tax avoidance is permissible—even encouraged—under the Code. Take, for example, the taxation of long-term capital gains. If a capital asset is held for more than one year,⁸ gain upon the sale of the capital asset enjoys preferential tax treatment.⁹ No one would assert that a taxpayer who sells a capital asset after holding title to it for 366 days is engaging in impermissible tax avoidance.

But other kinds of tax avoidance techniques are not sanctioned under the Code. For example, a court may ignore a putative lease agreement if the aggregate lease payments equal the underlying as-

⁵ See Rice, *supra* note 3, at 1022 ("Prescience of statutory draftsmen and members of Congress is limited, and it may not be assumed that Congress could foresee all transactions possible and agree upon a line of demarcation between the taxability of each.").

⁶ See *id.* ("[If we attempted to fashion language in a manner to account for all distinctions, it] would lead to a statute so complex that by comparison the present Code would be rudimentary.").

⁷ See Isenbergh, *supra* note 4, at 882. In *Carriage Square, Inc. v. Commissioner*, one judge observed that:

All the members of the Court recognize that the tax avoidance scheme of [the taxpayer and his accountant] cannot be allowed to stand. It is an obvious attempt, and a somewhat crude attempt, lacking in legitimate business purpose, to spread large anticipated sums of ordinary income among several taxpayer[s]. . . . The only disagreement among the members of the Court is how best to set aside the tax avoidance scheme.

69 T.C. 119, 130-31 (1977) (Goffe, J., concurring). Commenting about a complex transaction that involved the use of an intermediary named "W.R. Deal," the U.S. Court of Appeals for the Fifth Circuit declared that, "The Deal deal was not the real deal. That ends it." *Blueberry Land Co. v. C.I.R.*, 361 F.2d 93, 102 (5th Cir. 1966).

The tax bar may be an indirect contributor to the popularity of these doctrines, in part because it has a financial stake in promoting its ability to navigate skillfully the tax waters left otherwise clouded by judicial doctrines. See Isenbergh, *supra* note 4, at 883. Professors Bittker and Lokken explain that the vagueness of these doctrines serves an important function because "when the meaning of a provision is veiled by fog, taxpayers usually tread more warily than when the landmarks are clearly visible." BITTKER & LOKKEN, *supra* note 3, at 4-26.

⁸ I.R.C. § 1222 (1984).

⁹ I.R.C. § 1(h) (1988).

set's purchase price, the lease is for a tailor-made sprinkler system, and the lease is silent regarding its consequences after its terms have expired.¹⁰ Under these and similar circumstances, courts will rely on the use of judicial doctrines to "call a duck a duck" in order to thwart taxpayers' attempts to impair congressional tax policy,¹¹ contradict the intent of a statute,¹² or jeopardize the federal fisc.¹³

Three separate judicial doctrines form the central structure in the defense against impermissible tax avoidance: (A) the substance over form doctrine, (B) the business purpose doctrine, and (C) the step transaction doctrine. They operate as the courts' fingers to plug holes in the fiscal dike left unintentionally open by the legislature or by the literal words of the Code.

A. *The Substance Over Form Doctrine*

Under the Code, the form a transaction takes often determines its substance and, thus, its tax consequences.¹⁴ For example, suppose the members of a partnership agree to pay a particular partner \$100,000 annually, notwithstanding the partnership's income. The form of this payment dictates that it is a guaranteed payment.¹⁵ As such, the \$100,000 allocation will bear the tax effects associated with being a guaranteed payment rather than a distributive share of the partnership profits, even if the latter classification would prove financially beneficial to the partner receiving the payment.

¹⁰ See *Estate of Starr v. Comm'r*, 274 F.2d 294, 295 (9th Cir. 1959).

¹¹ See, e.g., *Comm'r v. Court Holding*, 324 U.S. 331, 334 (1945) ("To permit the true nature of a transaction to be disguised by mere formalisms, which exist solely to alter tax liabilities, would seriously impair the effective administration of the tax policies of Congress.").

¹² See, e.g., *Gregory v. Helvering*, 293 U.S. 465, 470 (1935) ("The whole undertaking . . . was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else. . . . To hold otherwise would be to exalt artifice above reality and to deprive the statutory provision in question of all serious purpose.").

¹³ See, e.g., *Comm'r v. Phipps*, 336 U.S. 410, 417 (1949) (limiting carryover of deficits in reorganizations was appropriate based on the need to prevent escape of earnings and profits from taxation).

¹⁴ See generally Walter J. Blum, *The Importance of Form in the Taxation of Corporate Transactions*, 54 TAXES 613 (1976); Charles I. Kingson, *The Deep Structure of Taxation: Dividend Distributions*, 85 YALE L.J. 861, 863-66 (1976). Having chosen a particular form, taxpayers are not at liberty "to disavow their prior representations, under such circumstances that would invite similar intentional deceit on the part of other taxpayers seeking to gain a tax benefit." *Cluck v. Comm'r*, 105 T.C. 324, 332 (1995) (citing *Lefever v. Comm'r*, 103 T.C. 525, 544 (1994), *aff'd*, 100 F.3d 778 (10th Cir. 1996)).

¹⁵ I.R.C. § 707(c) (1986).

Other form choices do not determine substance. In these cases, courts decide that tax consequences should not stem from form. For example, suppose an attorney drafts a client's will. In lieu of being directly compensated for his services, in the client's will, the attorney drafts a specific, tax-exempt bequest to himself.¹⁶ The form of this bequest, however, belies that its substance is really a deferred payment for services rendered, which is subject to tax.¹⁷ In circumstances such as this, courts have set aside the form of the transaction and have declared that its substance controls.¹⁸

Courts prefer giving greater weight to the substance of a transaction over its form because the latter may be easily manipulated or used in self-serving fashions. This is particularly true in transactions between related or friendly parties. Consider, for example, two 50% shareholders who lend an equal amount of money to their wholly-owned corporation. In return, the corporation issues each shareholder a debt instrument and deducts interest payments as they mature.¹⁹ A court can recharacterize the shareholder loans as capital contributions and the interest payments as nondeductible dividend payments.²⁰ Courts do not think themselves bound by taxpayers' labels that bear little, if any, consequence aside from their beneficial tax effects.

The case that is said to have legitimized the substance over form approach is *Gregory v. Helvering*.²¹ In *Gregory*, the taxpayer held all the shares in one corporation (Company A) that owned several assets, including shares in another corporation (Company B). An opportunity arose to sell the shares in Company B at a large profit. If Company A sold the Company B shares, it would have experienced a large gain, and any distributions made to the taxpayer would have constituted dividends, taxable at ordinary income tax rates. To minimize her taxes, the taxpayer arranged for the transfer of Company B shares to a newly formed corporation (Company C), in which she would

¹⁶ I.R.C. § 102(a) (1986).

¹⁷ I.R.C. § 61 (1984).

¹⁸ See *Wolder v. Comm'r*, 493 F.2d 608, 612 (2d Cir. 1974) (holding bequest made in lieu of compensation taxable to attorney who performed legal services on behalf of the decedent).

¹⁹ I.R.C. § 163 (1994).

²⁰ See, e.g., *Fin Hay Realty Co. v. United States*, 398 F.2d 694, 699 (3d Cir. 1968); *United States v. Snyder Bros.*, 367 F.2d 980, 985 (5th Cir. 1966).

²¹ See 293 U.S. at 470.

hold all the stock.²² Three days later, Company C was liquidated and, under the then-corporate liquidation provisions of the Code, the shares of Company B passed tax-free to the taxpayer. The taxpayer immediately sold the Company B shares, reporting a net capital gain.

The issue before the court was whether the form of the transaction (a tax-free reorganization) or its substance (Company A's sale of Company B's shares followed by a distribution to the taxpayer) should decide the tax effects. The Board of Tax Appeals had ruled in the taxpayer's favor. The essence of its opinion is captured in a single sentence related to the reorganization statute: "A statute so meticulously drafted must be interpreted as a literal expression of the taxing policy and leaves only the small interstices for judicial consideration."²³ Judge Learned Hand, however, writing for the Second Circuit, reversed the Board's decision.²⁴ While acknowledging that taxpayers are at liberty to minimize their taxes,²⁵ he concluded that the taxpayer's reliance upon the reorganization statute was inappropriate. More specifically, he declared that the "reorganization" undertaken by the taxpayer was devoid of substance and intended strictly as a tax minimization device; thus, it could not be "contemplated as a corporate reorganization."²⁶

The United States Supreme Court affirmed Judge Hand's opinion and echoed his sentiments, stating "[t]he whole undertaking, though conducted according to the terms of [the reorganization statute], was in fact an elaborate and devious form of conveyance masquerading as a corporate reorganization, and nothing else."²⁷ Having the endorsement of both Judge Hand and the Supreme Court, the substance over form doctrine has become a hallmark of tax jurisprudence.²⁸ Judges have invoked it in cases involving sale leasebacks, fam-

²² More specifically, the shareholder had Company A contribute its Company B shares to Company C in return for Company C shares. The capital contribution left Company A as the parent of Company C, which owned all of the shares in Company B. Pursuant to the then-corporate reorganization provisions of the Code, Company A then distributed Company C stock to the taxpayer. See Revenue Act of 1924, Pub. L. No. 68-176, § 203(c), 43 Stat. 253, 256 (the predecessor to section 368(a)(1)(D) of the Internal Revenue Code of 1986). The reorganization left Companies A and C wholly owned by the taxpayer.

²³ *Gregory v. Helvering*, 27 B.T.A. 223, 225 (1932).

²⁴ *Gregory v. Helvering*, 69 F.2d 809, 811 (2d Cir. 1934).

²⁵ *Id.* at 810.

²⁶ *Id.* at 811.

²⁷ *Gregory*, 293 U.S. at 470.

²⁸ A judge has referred to this doctrine as "the cornerstone of sound taxation." *Estate of Weinert v. Comm'r*, 294 F.2d 750, 755 (5th Cir. 1961). Not all commentators, however, would agree with that conclusion. See Isenbergh, *supra* note 4, at 864-78; Karen Nelson

ily trusts, interest deductions, and in a myriad of other income tax controversies.²⁹

Over time, two distinct analytical components of the substance over form doctrine have emerged.³⁰ One component relates to fact-finding and the other to statutory construction. Courts use the fact-finding component to analyze whether what the taxpayer purported to do corresponds with what was actually done; for example, whether a bequest is really a bequest or something different.³¹ When this component of the substance over form doctrine applies, the task before the courts is to make adroit fact determinations.³² Courts also use the statutory construction component of the substance over form doctrine to determine the figurative and purposeful, rather than literal, meaning of certain terms of art as they are employed in the Code; for example, the meaning of the phrase "corporate reorganization" in the corporate business context.³³ When this analytical component of the substance over form doctrine applies, the task before the courts is to distill congressional word usage as well as congressional intent.³⁴

B. The Business Purpose Doctrine

Courts require that transactions be driven by business rather than by tax considerations.³⁵ Under the business purpose doctrine, if a

Moore, *The Sham Transaction Doctrine: An Outmoded, and Unnecessary Approach to Combating Tax Avoidance*, 41 FLA. L. REV. 659 (1989). Even Judge Learned Hand lamented that the judicial search for "substance" sometimes becomes an "anodyne for the pains of reasoning." *Comm'r v. Sansome*, 60 F.2d 931, 933 (2d Cir. 1932).

²⁹ For a detailed synopsis of income tax cases involving the substance over form doctrine, see Moore, *supra* note 28, at 683-719.

³⁰ See Isenbergh, *supra* note 4, at 865-66; see also *Kirchman v. Comm'r*, 862 F.2d 1486, 1490 (11th Cir. 1989).

³¹ See, e.g., *Wolder*, 493 F.2d at 611-12.

³² Under circumstances in which this part of the substance over form doctrine applies, courts may assert that the taxpayer engaged in a sham. See *Kirchman*, 862 F.2d at 1492 ("Shams in fact are transactions that never occur. In such shams, taxpayers claim deductions for transactions that have been created on paper but which never took place.").

³³ See, e.g., *Gregory*, 293 U.S. at 470.

³⁴ Under circumstances in which this part of the substance over form doctrine applies, courts often assert that the taxpayer has misread or misunderstood the Code. See *Gregory*, 69 F.2d at 811 ("[T]heir only defect was that they were not what the statute means by a 'reorganization,' because the transactions were not part of the conduct of the business of either or both companies.").

³⁵ See generally Peter L. Faber, *Business Purpose and Section 355*, 43 TAX LAW. 855 (1990); David P. Hariton, *Sorting Out the Tangle of Economic Substance*, 52 TAX LAW. 235 (1999); Robert Thornton Smith, *Business Purpose: The Assault Upon the Citadel*, 53 TAX LAW. 1 (1999). For an historical analysis of the business purpose doctrine, see Boris I. Bittker, *What Is "Business Purpose" in Reorganization?*, 8 N.Y.U. INST. ON FED. TAX'N 134 (1950); Arthur M.

transaction lacks a profit potential aside from its tax effects, courts disallow what the Code otherwise sanctions.³⁶ The theory underlying this doctrine is that Congress extends tax benefits only to those taxpayers who enhance their wealth from sources other than the coffers of the government.³⁷

Application of the business purpose doctrine is common in tax shelter cases.³⁸ Courts adjudicating tax shelter cases often ask "whether the transaction has any practical economic effects other than the creation of tax losses."³⁹ If it does, courts will ordinarily rule in the taxpayer's favor.⁴⁰ Conversely, if a transaction is strictly tax driven, courts will ordinarily rule in the Service's favor.⁴¹ In other words, courts only honor those transactions that are motivated by business considerations. There is, however, no business activity "threshold" that will legitimize a particular transaction; in the eyes of the court, a commercial transaction imbued with even an iota of business purpose usually legitimizes it.

Two factors limit the breadth of the business purpose doctrine. First, there are some transactions that are non-commercial and, thus, do not lend themselves to a business purpose analysis. These transactions include alimony payments, charitable contributions, and medical expenses. Second, there are some transactions where it is clear that Congress does not require taxpayers to be motivated by eco-

Michaelson, "Business Purpose" and Tax-Free Reorganization, 61 YALE L.J. 14 (1952); Harvey M. Spear, "Corporate Business Purpose" in *Reorganization*, 3 TAX L. REV. 225 (1947). For a critical analysis of this doctrine, see Robert S. Summers, *A Critique of the Business-Purpose Doctrine*, 41 OR. L. REV. 38 (1961).

³⁶ See generally Hoffman F. Fuller, *Business Purpose, Sham Transactions and the Relation of Private Law to the Law of Taxation*, 37 TUL. L. REV. 355 (1963); Alvin C. Warren, Jr., *The Requirement of Economic Profit in Tax Motivated Transactions*, 59 TAXES 985 (1981).

³⁷ See *Goldstein v. Comm'r*, 364 F.2d 734, 740 (2d Cir. 1966) ("[Recognition of an arrangement depends upon whether such arrangement can be said] to have purpose, substance or utility apart from [its] anticipated tax consequences.").

³⁸ Recent tax shelter cases where the business purpose doctrine has been used to defeat taxpayers' tax minimization attempts include *Winn Dixie Stores, Inc. v. Commissioner*, 113 T.C. 254, 294 (1999) (denying interest deductions on corporate-owned life insurance); *Compaq Computer Corp. v. Commissioner*, 113 T.C. 214, 215 (1999) (denying the use of foreign tax credits), and *United Parcel Serv. v. Commissioner*, 78 T.C.M. (CCH) 262, 293 (1999) (finding that the sole purpose of corporate restructuring was to avoid tax).

³⁹ *ACM P'ship v. Comm'r*, 157 F.3d 231, 248 (3d Cir. 1998) (quoting *Jacobson v. Comm'r*, 915 F.2d 832, 837 (2d Cir. 1990)).

⁴⁰ See *Frank Lyons Co. v. United States*, 435 U.S. 561, 583-84 (1978) (holding government must honor transactions that are governed by tax-independent considerations that are not shaped entirely by tax-avoidance features); see also Bernard Wolfman, *The Supreme Court in the Lyon's Den: A Failure of Judicial Process*, 66 CORNELL L. REV. 1075 (1981).

⁴¹ See *supra* note 38.

nomic profit. Instead, tax considerations alone may serve as the taxpayers' motivating force. For example, taxpayers may invest in low-income housing projects predicated solely upon the profit opportunity associated with low-income housing credits offered under the Code.⁴²

Just as the substance over form doctrine owes its genesis to *Gregory*, the business purpose doctrine, in large part, does as well. In summarizing the outcome of *Gregory* in another case, Judge Learned Hand stressed the importance of grounding a transaction with a business purpose:

The doctrine of *Gregory v. Helvering* . . . means that in construing words of the tax statute which describe commercial or industrial transactions we are to understand them to refer to transactions entered upon for commercial or industrial purposes and not to include transactions entered upon for no other motive but to escape taxation.⁴³

The Supreme Court's position regarding the importance of business purpose in *Gregory* has been affirmed time after time. Indeed, courts have used *Gregory* in ways likely never anticipated by Judge Hand or the Supreme Court. Consider the case of *Goldstein v. Commissioner*.⁴⁴ The taxpayer in *Goldstein* had the good fortune to win a lottery. To minimize the tax consequences associated with her lottery winnings, the taxpayer borrowed money from four banks at an interest rate of 4%, invested the borrowed funds in United States Treasury notes paying interest of 1.5%, and prepaid several years of interest on the borrowed funds.

This arrangement was designed to help the taxpayer offset the immediate income tax burden stemming from her lottery winnings. The version of the Code effective at that time allowed the taxpayer a deduction for prepaid interest.⁴⁵ The Service nevertheless challenged the allowance of this deduction. Affirming the Tax Court, the Second Circuit upheld the Service's position. Dismissing the literal words of the Code, the Second Circuit declared that a deduction is only "proper if there is some substance to the loan arrangement beyond

⁴² I.R.C. § 42.

⁴³ *Comm'r v. Trans. Trading & Terminal Corp.*, 176 F.2d 570, 572 (2d Cir. 1949).

⁴⁴ See 364 F.2d 734, 734 (2d Cir. 1966).

⁴⁵ I.R.C. § 163(a) (1958).

the taxpayer's desire to secure the deduction."⁴⁶ Courts and commentators have interpreted this declaration to mean that no tax benefits will accrue if a transaction is predicated entirely upon tax avoidance rather than some other purposeful business activity.⁴⁷

C. The Step Transaction Doctrine

Courts are sometimes unwilling to evaluate each part of a transaction in isolation from its related parts. Put differently, circumstances or conditions may exist that warrant viewing all of the steps of a transaction as a whole. Courts commonly refer to this approach to tax analysis as an application of the step transaction doctrine.⁴⁸ Three distinct tests form the foundation of this doctrine:⁴⁹ the binding commitment test, the end result test, and the mutual interdependence test. Courts combine the separate parts of a transaction if (i) the legs of a transaction are linked by a binding commitment,⁵⁰ (ii) each step of the transaction could not stand without the culmination of a particular event,⁵¹ or (iii) each step of a transaction requires the completion of another step until the taxpayer reaches the desired result.⁵²

⁴⁶ *Goldstein*, 364 F.2d at 741; see also *Knetsch v. United States*, 364 U.S. 361, 366 (1960) ("[I]t is patent that there was nothing of substance to be realized by Knetsch from this transaction beyond a tax deduction.").

⁴⁷ See, e.g., *Sheldon v. Comm'r*, 94 T.C. 738, 767 (1990) ("The principle of [*Goldstein*] would not, as petitioners suggest, permit deductions merely because a taxpayer had or experienced some de minimis gain. *Goldstein*, to the contrary, holds that the transactions, in form, were real, but that they lacked substance.").

⁴⁸ A statement delivered by Justice Sutherland in *Minnesota Tea Co. v. Helvering* captures the essence of the step transaction doctrine: "A given result at the end of a straight path is not made a different result because reached by following a devious path." 302 U.S. 609, 613 (1938).

⁴⁹ See *McDonald's Restaurants of Ill., Inc. v. Comm'r*, 688 F.2d 520, 524-25 (7th Cir. 1982).

⁵⁰ See, e.g., *Comm'r v. Gordon*, 391 U.S. 83, 96 (1968) ("[I]f one transaction is to be characterized as a 'first step' there must be a binding commitment to take the later steps."); *Intermountain Lumber Co. v. Comm'r*, 65 T.C. 1025, 1033 (1976) (holding that I.R.C. § 351 did not apply where a taxpayer who otherwise would have been part of the control group had a binding obligation to sell his shares).

⁵¹ See, e.g., *King Enters, Inc. v. United States*, 418 F.2d 511, 516 (Ct. Cl. 1969) ("[P]urportedly separate transactions will be amalgamated into a single transaction when it appears that they were really component parts of a single transaction intended from the outset to be taken for the purpose of reaching the ultimate result.").

⁵² See, e.g., *Redding v. Comm'r*, 630 F.2d 1169, 1177 (7th Cir. 1980) (indicating that the issue is whether "the steps are so interdependent that the legal relations created by one transaction would have been fruitless without a completion of the series.").

Commissioner v. Court Holding Co. provides a useful illustration of when and how the step transaction doctrine applies.⁵³ In *Court Holding Co.*, a corporate taxpayer owned an apartment complex that had appreciated in value.⁵⁴ The sole shareholders of the corporate taxpayer were a married couple. On its behalf, they entered into negotiations with an unrelated third party to sell the apartment complex. These negotiations resulted in an oral sales agreement. To avoid the corporate level tax, however, the shareholders liquidated the corporation and had title to the apartment complex placed in their individual names. The shareholders then sold the apartment complex to the same third party on terms identical to those previously negotiated on behalf of the corporation.⁵⁵

The Service challenged the corporate liquidation, asserting that the corporation, rather than its shareholders, had sold the apartment complex. In analyzing the transaction, the Supreme Court agreed with the Service's position. In a terse opinion, the Court said that:

the transaction must be viewed as a whole, and each step, from the commencement of negotiations to the consummation of the sale, is relevant. A sale by one person cannot be transformed for tax purposes into a sale by another using the latter as a conduit through which to pass title.⁵⁶

The Court chose to ignore the liquidation as an unnecessary step designed to mask the true end sought by the taxpayers—avoidance of the corporate level tax. In the Court's opinion, respecting the legitimacy of the corporate liquidation "would seriously impair the effective administration of the tax policies of Congress."⁵⁷

Just as was the case with the substance over form doctrine and the business purpose doctrine, the step transaction doctrine has become a central feature in income tax adjudication. Its use is particularly pro-

⁵³ See 324 U.S. 331, 331 (1945). The step transaction doctrine has a long and distinguished history that stems back as far as 1932; see also *Warner Co. v. Comm'r*, 26 B.T.A. 1225, 1228 (1932) (holding that a corporate reorganization provision "permits, if it does not require, an examination of the several steps taken which culminated in the taxpayer's acquisition of the [company's] assets."); *Carter Publ'ns, Inc. v. Comm'r*, 28 B.T.A. 160, 164 (1933) ("The whole series of acts, corporate and otherwise, constituted only a single transaction.").

⁵⁴ See 324 U.S. at 332.

⁵⁵ See *id.*

⁵⁶ *Id.* at 334.

⁵⁷ *Id.*

nounced in the corporate income tax area of the law.⁵⁸ Courts skillfully apply this doctrine to see the forest rather than taxpayers' deliberately planted trees that would otherwise camouflage their carefully laid tax avoidance schemes.

II. THE USE OF JUDICIAL DOCTRINES IN RESOLVING TRANSFER TAX CONTROVERSIES

Before examining the role of judicial doctrines in resolving transfer tax controversies,⁵⁹ a few important observations should be made. In analyzing tax avoidance cases, courts commonly relegate the importance of taxpayer motive.⁶⁰ This is because taxpayers' agendas invariably include tax reduction.⁶¹ Making a determination that a taxpayer is motivated to reduce taxes states nothing more than the obvious. A taxpayer's motive, however, to avoid taxes does not go completely unnoticed; when tax avoidance is the taxpayer's overarching objective, courts often reflectively employ judicial doctrines to gauge the legitimacy of a taxpayer's transaction.⁶²

⁵⁸ See Richard D. Hobbet, *The Step Transaction Doctrine and Its Effect on Corporate Transactions*, 19 TUL. TAX INST. 102 (1970); Seymour S. Mintz & William T. Plumb, Jr., *Step Transactions in Corporate Reorganizations*, 12 N.Y.U. INST. ON FED. TAX'N 247 (1954); Note, *Step Transactions*, 24 U. MIAMI L. REV. 60 (1969).

⁵⁹ Transfer tax controversies involve issues of gift, estate, generation-skipping transfer, and valuation issues found respectively under Chapters 11, 12, 13, and 14 of the Code.

⁶⁰ In *Gregory*, Judge Learned Hand issued a statement downplaying the relevance of a taxpayer's motive:

[A] transaction, otherwise within an exception of the tax law, does not lose its immunity, because it is actuated by a desire to avoid, or, if one choose, to evade, taxation. Any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.

Gregory v. Helvering, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935).

⁶¹ There is perhaps no better or more accurate statement on this generalization than that issued by Judge Learned Hand in a dissenting opinion:

Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor; and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.

Comm'r v. Newman, 159 F.2d 848, 850-51 (2d Cir. 1947) (Hand, J., dissenting).

⁶² See, e.g., *Harrison v. Schaffner*, 312 U.S. 579, 582 (1941) (striking down tax savings device because tax avoidance was "obvious purpose and effect" of transaction); *cf. Comm'r v. Webster's Estate*, 131 F.2d 426, 429 (5th Cir. 1942) ("[T]he record clearly shows that several business considerations prompted the selection of the merger as the means by

Consider the relevance of these observations in light of estate planning. As a general proposition, when taxpayers plan their estates, they wish to pass as much wealth as they can at the smallest possible transfer tax cost. Certainly a taxpayer may have other objectives as well, such as ensuring that the assets of his or her estate pass to the children of his or her first marriage, but tax avoidance is often the central reason for incurring the costs associated with estate planning. Given that the very foundation of estate planning often rests upon tax avoidance,⁶³ the role judicial doctrines should play is unclear. On the one hand, courts might commonly use these doctrines as interpretive vehicles to combat tax avoidance; on the other hand, because of the systemic (and accepted?) tax avoidance nature of estate planning, courts might shy away from using judicial doctrines.

These observations suggest that the use of judicial doctrines in resolving transfer tax controversies may have its own set of unique characteristics. The next three subsections of this analysis explore how courts have employed judicial doctrines to combat transfer tax avoidance notwithstanding the fact that their use may be inappropriate.

A. *The Substance Over Form Doctrine*

Form often plays a prominent role in dictating the transfer tax consequences associated with estate planning. The use of irrevocable trusts funded with life insurance illustrates this point. Life insurance owned by a taxpayer at the time of a taxpayer's death is includible in the taxpayer's gross estate.⁶⁴ To avoid this outcome, estate planners usually recommend that the taxpayer establish an irrevocable trust

which to accomplish their intended result. That tax avoidance was one of the considerations is of no importance.”).

Note the overlap between and among these judicial doctrines. Take, for instance, the *Court Holding Co.* decision cited to in the prior section where the shareholders liquidated the corporation immediately prior to the sale of its one asset in order to avoid a corporate level tax. See 324 U.S. 331, 331 (1945). *Court Holding Co.* is cited with regularity in support of not only the step transaction doctrine, for example, *Commissioner v. Clark*, 489 U.S. 726, 738 (1989), but also of the substance over form doctrine, for example, *Kirchman v. Commissioner*, 862 F.2d 1486, 1491 (11th Cir. 1989), and the business purpose doctrine, for example, *Estate of Helliwell v. Commissioner*, 77 T.C. 964, 984 (1981). The overlap among these doctrines is not a mere coincidence; it springs from their common objective to curtail impermissible tax avoidance.

⁶³ See, e.g., *Kincaid v. United States*, 682 F.2d 1220, 1225 (5th Cir. 1982) (“[N]o business [person] would have entered into this transaction, . . . [thus] the moving impulse for the . . . transaction was a desire to pass the family fortune on to others [at minimal transfer tax cost].”) (internal quotations and citation omitted).

⁶⁴ I.R.C. § 2042 (1994).

where the trustee of such trust purchases and holds insurance on the taxpayer's life. By adhering to this strategy, the taxpayer lacks all indicia of policy ownership at death. Policy proceeds, therefore, are not includible in the taxpayer's gross estate,⁶⁵ potentially resulting in significant transfer tax savings.

Estate planners also want to ensure that all trust contributions qualify for the annual gift tax exclusion.⁶⁶ Only a gift of a "present interest" in property—an unrestricted right to the immediate use, possession, or enjoyment of the property gifted—however, qualifies for this exclusion.⁶⁷ A gift of a "future interest" in property—the commencement in use, possession, or enjoyment of the property is limited to some future date or time—does not qualify.⁶⁸ Trusts are generally designed to defer beneficial ownership.⁶⁹ Yet, to capitalize upon the annual gift tax exclusion, estate planners strategically incorporate trust terms that provide trust beneficiaries with limited withdrawal rights (usually for thirty days) thereby transforming otherwise future interest gifts into present interest gifts.⁷⁰

To illustrate, suppose X is married to Y and together they have two adult children, A and B. Suppose further that X wishes to obtain a \$5,000,000 life insurance policy and that the annual premium expenses associated with maintaining this policy are \$50,000. To minimize the size of his gross estate, X establishes an irrevocable trust, naming his wife, Y, as trustee. X then makes a \$50,000 contribution to the trust. The terms of the trust provide Y with the right to withdraw \$10,000 and A and B each with the right to withdraw \$20,000 within thirty days of this trust contribution by X. Assuming no one exercises his or her withdrawal right, Y, in her capacity as trustee, can use the trust contribution to obtain and pay for the life insurance policy on X's life. Each \$50,000 trust contribution qualifies for the gift tax an-

⁶⁵ I.R.C. § 2033 (1994).

⁶⁶ Currently, \$10,000 annually per donee and \$20,000 per donee when spouses agree to split their gifts. I.R.C. § 2503(b)(1).

⁶⁷ Treas. Reg. § 25.2503-3(b). See also *Comm'r v. Disston*, 325 U.S. 442, 446-47 (1945); *Fondren v. Comm'r*, 324 U.S. 18, 24-25 (1945); Rev. Rul. 81-7, 1981-1 C.B. 474.

⁶⁸ Treas. Reg. § 25.2503-3(b). See also *Ryerson v. United States*, 312 U.S. 405, 408 (1941); *United States v. Pelzer*, 312 U.S. 399, 403 (1941).

⁶⁹ See generally 1 AUSTIN W. SCOTT, *THE LAW OF TRUSTS* § 2 (William F. Fratcher ed., 4th ed. 1987 & Supp. 1998).

⁷⁰ For an overview of how these trusts operate and the transfer tax benefits associated with their use, see Marc A. Chorney, *Transfer Tax Issues Raised by Crummey Powers*, 33 REAL PROP. PROB. & TR. J. 755 (1999).

nual exclusion, and the life insurance proceeds on X's life will not be includible in his gross estate.

Courts have consistently upheld the legitimacy of X's arrangement and those of similarly situated taxpayers.⁷¹ This is true even though the substance of these trusts manifests the taxpayers' transfer tax avoidance agenda. More specifically, taxpayers—and their advisors—make no secret that the purpose of these trusts is to avoid all transfer taxes.⁷² No one, for example, expects trust beneficiaries to exercise their withdrawal rights because doing so would thwart the trustee's ability to maintain the insurance policy on the settlor's life by reducing the amount of funds otherwise available to pay the premium. The settlor of the trust may even increase the availability of the annual gift tax exclusion by vesting remote contingent beneficiaries, like grandchildren and great-grandchildren, with rights of withdrawal.⁷³

Courts analyzing these trust arrangements usually ask the following two questions. First, does the taxpayer have any direct indicia of policy ownership? If not, there is no estate tax inclusion of the life insurance proceeds in the taxpayer's gross estate. Second, does the trust beneficiary have a legal demand right? If so, the taxpayer's trust contribution qualifies for the annual gift tax exclusion.⁷⁴ In resolving

⁷¹ See, e.g., *Crummey v. Comm'r*, 397 F.2d 82, 88 (9th Cir. 1968).

⁷² See Bradley E.S. Fogel, *The Emperor Does Not Need Clothes—The Expanding Use of "Naked" Crummey Powers to Obtain Federal Gift Tax Annual Exclusions*, 73 TUL. L. REV. 555, 616 (1998) ("The Service's resolve to continue its efforts to limit Crummey powers is stoked by its opinion that Crummey powers, particularly naked Crummey powers, are essentially shams—an observation shared by numerous commentators."); Benjamin N. Henszey, *Crummey Power Revisited*, 59 TAXES 76, 77 (1981) ("[T]he IRS is aware that the [Crummey] power is a sham in most cases . . ."); Willard H. Pedrick, *Crummey Is Really Crummey!*, 20 ARIZ. ST. L.J. 943, 946 (1988) ("[R]ecently . . . in 1987 the [IRS] recognized that taxpayer's counsel can try to make too much of a good thing out of the Crummey principle."); Christopher Steenson, *A Reluctant Stance by the Internal Revenue Service: The Uncertain Future of the Use of the Section 2503(b) Annual Gift Exclusion Following Crummey and Cristofani*, 38 SANTA CLARA L. REV. 589, 609 (1998) ("[T]he IRS has indicated that it will challenge the use of the Crummey power only when the substance of the transfer clearly indicates that the donor's purpose in making the gift is to obtain the section 2503(b) annual exclusion and not to benefit the recipient.").

⁷³ Under these circumstances, courts have held that the settlor's trust contributions pertaining to these remote beneficiaries still qualify for the gift tax annual exclusion. See *Estate of Cristofani v. Comm'r*, 97 T.C. 74, 84 (1991) ("Although decedent's grandchildren never exercised their respective withdrawal rights, this does not vitiate the fact that they had the legal right to do so."); see also *Estate of Kohlsaat v. Comm'r*, 73 T.C.M. (CCH) 2732, 2733 (1997).

⁷⁴ Jeffrey G. Sherman, *Tis a Gift to be Simple: The Need for a New Definition of "Future Interest" for Gift Tax Purposes*, 55 U. CIN. L. REV. 585, 655-56 (1987) ("[A]lthough the IRS is

these questions, courts do not consider the likelihood that X and X's family members can and are apt to collude. This potential for conspiracy casts harsh shadows on indicia of control issues and the bona fide nature of the beneficiaries' withdrawal rights. Nevertheless, the courts focus on the form of these insurance trust arrangements rather than on their substance. With respect to resolving transfer tax controversies, insurance trusts are just one illustration of the important role that form plays. The field of estate planning is replete with other examples.⁷⁵

In general, courts rarely challenge taxpayers' transfer tax minimization strategies by invoking the substance over form doctrine. The courts' reluctance stems from the nature of the substance over form doctrine and that of estate planning. Recall that the substance over form doctrine has two distinct analytical components: one that courts use to make fact determinations and the other for statutory construction. Insofar as the statutory construction component of the substance over form doctrine is concerned, consider how the business and investment worlds commonly imbue words with special meanings that transform them into terms of art. These terms of art—such as the meaning of the term “corporate reorganization” in *Gregory*—often result in courts having to engage in statutory construction exercises that necessitate judicial doctrine use.

justified in its opposition to *Crummey* . . . there is no logical basis, . . . as the IRS has finally, albeit reluctantly, conceded.”).

⁷⁵ Consider that taxpayers may establish so-called Section 2503(c) trusts for the benefit of minor children. As a condition for trust contributions qualifying for the annual exclusion, the assets of the trust must vest with the child by age twenty-one. Estate planners often incorporate this vesting schedule, but add that if the minor does not exercise his or her withdrawal right at age twenty-one, the trust assets will remain in further trust until a later time, say age thirty-five. When taxpayers establish these trusts, they often do so with the full expectation that they do not intend their children—the beneficiaries of the trust—to exercise their withdrawal rights. Now, even the Service recognizes the legitimacy of these arrangements. See Rev. Rul. 74-43, 1974-1 C.B. 285.

Likewise, if a partnership is validly formed under state law it is respected as having a bona fide existence although the partners themselves ignore the entity's existence. For example, in *Knight v. Commissioner*, taxpayers validly formed a limited partnership under Texas law. The partnership did not keep any records, prepared no annual reports, had no employees, and never conducted any business. Nonetheless, the partnership was respected as being legitimate for gift tax valuation purposes. See 115 T.C. 506 (2000). *Accord* *Strangi v. Comm'r*, 115 T.C. 478 (2000) (holding that where partnership validly formed under state law for the sole purpose of minimizing the taxpayer's estate tax—indeed, partnership assets were used to meet the taxpayer's personal expenses—“[r]egardless of subjective intentions, the partnership had sufficient substance to be recognized for tax purposes [because] its existence would not be disregarded by potential purchasers of decedent's assets”).

In contrast, an analysis of transfer tax issues generally requires fewer statutory construction exercises. Put differently, words and phrases in the sphere of estate planning such as "indicia of ownership" and "present interest gift" are more apt to be used in a literal rather than in a figurative fashion. Thus, courts have little need to apply the part of the substance over form doctrine that attempts to discern figurative meanings.⁷⁶

But courts have not abandoned the factual determination component of the substance over form doctrine that essentially declares that a taxpayer cannot call a duck a swan.⁷⁷ *Heyen v. United States* illustrates this point in the estate planning context.⁷⁸ In *Heyen*, a taxpayer transferred blocks of stock, each individually valued by her to be less than \$10,000 (the maximum annual gift tax exclusion) to twenty-nine beneficiaries. Twenty-seven of the twenty-nine beneficiaries immediately signed the stock certificates in blank so that the stock could be reissued to the taxpayer's family. The form of these gifts would have qualified them for the annual gift tax exclusion. The Tenth Circuit, however, ignored the form of the taxpayer's gifts, ruling instead that the substance of this transaction was that the taxpayer had really made stock gifts to her family members, not to the twenty-nine shills.⁷⁹ Many other courts have followed the *Heyen* example to expose supposed swans to be ducks.⁸⁰

⁷⁶ See *Estate of Frank v. Comm'r*, 69 T.C.M. (CCH) 2255, 2259 (1995) ("As a general rule, we will respect the form of a transaction. We will not apply substance over form unless the circumstances so warrant.").

⁷⁷ See, e.g., *Estate of Starr v. Comm'r*, 274 F.2d 294, 295 (9th Cir. 1959); *Lee v. United States*, 86-1 U.S. Tax Cas. (CCH) ¶ 13,649 (W.D. Ky. 1985) (holding substance determines the character of transactions for purposes of section 2036, regardless of the form).

⁷⁸ See 945 F.2d 359, 361 (10th Cir. 1991).

⁷⁹ See *id.* at 364-65.

⁸⁰ See, e.g., *Estate of Maxwell v. Comm'r*, 3 F.3d 591, 591 (2d Cir. 1993) (finding mother's transfer of personal residence to son a transfer of a retained life estate, not a bona fide sale for full and adequate consideration); *Schultz v. United States*, 493 F.2d 1225, 1225 (4th Cir. 1974) (disallowing use of annual exclusion when two brothers made reciprocal gifts to each of their respective three children); *Bies v. Comm'r*, 80 T.C.M. (CCH) 628 (2000) (holding annual transfers of stock from closely held corporation to daughters-in-law and granddaughter-in-law actually were indirect transfers to sons made to obtain additional annual gift tax exclusions); *Sather v. Comm'r*, 78 T.C.M. (CCH) 456 (1999) (applying reciprocal trust doctrine to limit number of present interest annual exclusion gifts where gifts made by aunt and uncle to niece and nephew predicated upon similar gifts made by other aunt and uncle to niece and nephew); *Griffin v. United States*, 42 F. Supp. 2d 700, 701-02, 707 (D. Tex. 1998) (holding no minority or marketability discount applied to the value of shares where taxpayer gave 45% interest in wholly-owned company to wife who, in turn, gave shares to trust because taxpayer's wife was used as mere intermediary to command lower stock valuations); *Estate of Cidulka v. Comm'r*, 71 T.C.M.

The substance over form doctrine thus plays a limited role in transfer tax adjudication. Courts do not use it as a device of statutory construction, but rather only invoke its use when taxpayers' estate planning endeavors are not factually anchored to reality.

B. *The Business Purpose Doctrine*

Given the theoretical underpinnings of the business purpose doctrine, where the legitimacy of transactions is governed by whether they have an underlying business purpose,⁸¹ one might think that this doctrine would play little or no role in resolving transfer tax controversies. This is because, aside from transfer tax minimization, estate planning usually involves the transfer of wealth from one taxpayer to another taxpayer; there is nothing in these transfers that is inherently commercial or economic in nature.

The worlds of business and estate planning, however, are not mutually exclusive. There are taxpayers, for example, who hold interests in business enterprises. Interests held in these business enterprises sometimes constitute something more than mere passive investments; they represent a taxpayer's lifetime of work and achievement. When taxpayers attempt to transfer this form of wealth, they often have another agenda item in mind, namely business continuity. These taxpayers, therefore, take steps—job training or the implementation of a buy-sell agreement—to help ensure the orderly and smooth transition of the business enterprise in question from one generation to the next. For these taxpayers, there is a translucent overlap between estate planning and business planning.

The Service ordinarily recognizes and respects this overlap. Indeed, the Service has issued a myriad of administrative rulings that allow taxpayers to arrange their estate planning affairs in a manner that fosters business continuity.⁸² These rulings even go a step further:

(CCH) 2555 (1996) (treating gifts of ten shares to each of controlling shareholder's son, daughter-in-law, and their two children, coupled with a redemption for less than adequate consideration of the controlling shareholder's remaining stock, in substance as gift of the entire controlling interest to the son).

⁸¹ See *supra* notes 35–47 and accompanying text.

⁸² See, e.g., Rev. Rul. 69–608, 1969–2 C.B. 42 (discussing circumstances where a corporation's redemption of its own shares will not constitute a constructive dividend to the other shareholders); Rev. Rul. 69–74, 1969–1 C.B. 43 (setting forth the principles to be applied in determining the tax consequences of the transfer of appreciated property for a private annuity contract in an intra-family exchange); Rev. Rul. 65–289, 1965–2 C.B. 86 (holding corporation's own installment promissory note to be property for purposes of receiving preferential redemption treatment under I.R.C. § 303).

for valuation purposes, they permit interests in business enterprises to reflect, when appropriate, minority and marketability discounts.⁸³ The rationale underlying a minority interest discount rests upon a number of factors, including: a minority interest holder's inability to realize his or her pro rata share of the entity's net assets through liquidation, a lack of control over corporate policy, and the payment of dividends, etc.⁸⁴ The rationale underlying a lack of marketability discount rests upon the principle that a downward price adjustment should be made because the business interests are not actively traded or otherwise readily marketable.⁸⁵

The Service does not sanction all forms of business succession planning, however. On several occasions, for example, the Service has attacked the validity of valuation discounts when a terminally ill taxpayer gives away business interests.⁸⁶ On several other occasions, the Service has questioned the legitimacy of arrangements where a taxpayer establishes a non-operational business enterprise, like a limited partnership, makes contributions to it of stock or other passive investments, and then transfers interests in these enterprises at steeply discounted values.⁸⁷ From the Service's perspective, these transfers and arrangements have nothing to do with business continuity and represent mere transfer tax minimization devices.

Despite the Service's misgivings regarding the validity of these transfers, its attacks on them have thus far met with only marginal

⁸³ See, e.g., Rev. Rul. 93-12, 1993-1 C.B. 202. (stating that in determining the value of gift of minority block of stock in closely-held corporation, block should be valued for gift tax purposes without regard to family relationship of donee to other shareholders); see also Priv. Ltr. Rul. 94-49-001 (Mar. 11, 1994) (stating that in transfer by gift of 100% of stock to eleven children in equal shares; each of the eleven gifts entitled to minority discount); Priv. Ltr. Rul. 94-32-001 (Mar. 28, 1994) (stating that decedent's 48.59% interest bequeathed to son entitled to minority discount even though son owned the remaining 51.41% interest in company).

⁸⁴ See, e.g., *Harwood v. Comm'r*, 82 T.C. 239, 267-68 (1984), *aff'd*, 786 F.2d 1174 (9th Cir. 1986) (unpublished table decision); *Estate of Andrews v. Comm'r*, 79 T.C. 938, 957 (1982); *Estate of Zaiger v. Comm'r*, 64 T.C. 927, 945-46 (1975).

⁸⁵ See, e.g., *Mandelbaum v. Comm'r*, 69 T.C.M. (CCH) 2852 (1995), *aff'd*, 91 F.3d 124 (3d Cir. 1996) (unpublished table decision); *Estate of Ford v. Comm'r*, 66 T.C.M. (CCH) 1507 (1993), *aff'd*, 53 F.3d 924 (8th Cir. 1995).

⁸⁶ See, e.g., Tech. Adv. Memo. 97-19-006 (Jan. 14, 1997) (denying valuation discounts for stock transferred on behalf of taxpayer taken off life-support system two days prior to death); Tech. Adv. Memo. 95-04-004 (Oct. 20, 1994) (denying valuation discounts for stock transferred nineteen days before death by taxpayer suffering from terminal cancer).

⁸⁷ See, e.g., Field Serv. Adv. 19995-0014 (ignoring for transfer tax purposes partnership funded only with marketable securities insofar as the partners did not truly intend to carry on a business and share in any profits).

success. Courts do not apply the business purpose doctrine in the traditional fashion to inquire into the taxpayers' profit-making objectives. Instead, when it comes to business succession planning, they deem the business purpose test met as long as one of the taxpayer's objectives is business continuity.

To illustrate, consider the situation in which a taxpayer forms a limited partnership with her daughter. The taxpayer contributes \$990,000 of marketable securities in return for a 98% limited partnership interest and a 1% general partnership interest and her daughter contributes \$10,000 cash in return for a 1% limited partnership interest. The partnership conducts no business other than to manage its investment portfolio. Periodically, the taxpayer gives limited partnership interests to her daughter, and, for gift tax valuation purposes, discounts the value of the gifted limited partnership interests by 30% to reflect their minority stake in the partnership and their lack of marketability.

In reviewing fact patterns similar to the one posited in this example, the Service has concluded that the absence of a business purpose indicates that these arrangements are designed solely as a device to command lower gift and estate tax valuations for the taxpayer's marketable securities.⁸⁸ Courts, however, have systematically rejected the Service's opposition to these kind of arrangements, declaring that even proper investment portfolio management and its orderly transfer to the next generation constitutes a sufficient business purpose to legitimize these arrangements.⁸⁹

In the end, application of the business purpose doctrine in its traditional fashion in the estate planning context makes little sense.

⁸⁸ See *id.*

⁸⁹ See, e.g., *Estate of Church v. Comm'r*, 2001-1 U.S. Tax Cas. (CCH) ¶ 60,369 (W.D. Tex. 2000); *Estate of Harper v. Comm'r*, 79 T.C.M. (CCH) 2232 (2000) (recognizing valuation discounts associated with a limited partnership arrangement funded with marketable securities).

The dissent in *Knight v. Commissioner* succinctly summed up the court's overall approach:

Generally the economic substance doctrine, with its emphasis on business purpose, is not a good fit in a tax regime dealing with typically donative transfers. Business purpose will often times be suspect in these transactions because estate planning usually focuses on tax minimization and involves the transfer of assets to family members. If taxpayers, however, are willing to burden their property with binding legal restrictions that, in fact, reduce the value of such property, we cannot disregard such restrictions. To do so would be to disregard economic reality.

115 T.C. 506, 511 (2000) (Foley, J., dissenting).

This is because profit making is not the force that drives taxpayers to plan their estates. Instead, for owners and prospective owners of business enterprises, business continuity is the Holy Grail of estate planning. Courts recognize this fact and legitimize transfers on this basis.

C. *The Step Transaction Doctrine*

Virtually every estate plan shares a similar objective, namely the orderly distribution of wealth to a taxpayer's intended beneficiaries. Given this objective, there is a possibility that under the so-called end result test of the step transaction doctrine—where steps of a transfer can be collapsed into one when the taxpayer has a final objective in mind—courts could ignore some steps of a carefully conceived estate plan.⁹⁰ But this rarely happens. No court, for example, has disallowed the estate tax marital deduction for an otherwise qualifying marital trust simply because all trust assets ultimately pass to the taxpayer's children. Courts generally recognize the independence of each element of an estate plan.

On a few occasions, however, courts have applied the end result test in the estate-planning context. In *Driver v. United States*, for example, a taxpayer owned all the shares of a telephone company.⁹¹ As part of her estate plan, the taxpayer gave a 42% interest in the company on December 31, 1968, and gave another 42% interest in the company to the same beneficiaries on January 2, 1969. On her gift tax return, the taxpayer reflected steep minority and marketability discounts in the value of the gifted shares. On audit, the Service challenged the legitimacy of these discounts because control of the company was transferred in two steps, only three days apart.⁹²

In analyzing the value of the shares, the U.S. District Court for the Western District of Wisconsin applied the end result test of the step transaction doctrine. The court found that between the two transfer dates, the taxpayer "transferred a majority interest and control to her nephew and members of his family."⁹³ The court concluded, therefore, that it was "unreal to be talking about the Decem-

⁹⁰ See *Redding v. Comm'r*, 630 F.2d 1169, 1177 (7th Cir. 1980); see also *Strangi*, 115 T.C. at 482 ("Thus, under the end-result test, the formally separate steps of the transaction . . . that were employed to achieve Mr. Strangi's testamentary objectives should be collapsed and viewed as a single integrated transaction: the transfer at Mr. Strangi's death of the underlying assets.").

⁹¹ See 76-2 U.S. Tax Cas. (CCH) ¶ 13,155, at 85,695 (W.D. Wis. 1976).

⁹² See *id.*

⁹³ *Id.*

ber 31, 1968 transaction as the transfer of a minority interest.⁹⁴ On the basis of this conclusion, the court viewed the two gifts as one and held that the valuation discounts were not appropriate. In resolving transfer tax controversies, other courts have followed *Driver*.⁹⁵ But the paucity of decisions following this model indicates that courts recognize the danger of a "willy-nilly" use of this doctrine. Left unchecked, the Service could be vested with the power to defeat many estate plans.

III. ANALYSIS OF USING JUDICIAL DOCTRINES IN RESOLVING TRANSFER TAX CONTROVERSIES

A survey of judicial doctrine use reveals that judicial doctrines are not commonly used in resolving transfer tax controversies. Indeed, only the fact-finding component of the substance over form doctrine seems to have earned judicial acceptance.⁹⁶ Use of the statutory construction component of the substance over form doctrine and other judicial doctrines have been subject to harsh criticisms from commentators⁹⁷ and often summarily dismissed by the courts.⁹⁸ An analysis of the *Murphy* and *Church* cases helps confirm why either an over or under utilization of judicial doctrines may prove problematic.⁹⁹

A. The *Murphy* Decision

Mrs. Murphy had married into wealth. As evidenced by the facts of this case (albeit, simplified for purposes of this analysis), she wanted to retain control of her wealth, at least as near to her death as possible. Her husband had owned and operated the Evening Telegram Company, a business that his father had started almost a century earlier. Upon Mr. Murphy's demise and in the family tradition, Mrs. Murphy continued to operate the business as company president.

⁹⁴ *Id.* at 85,699.

⁹⁵ See, e.g., *Blanchard v. United States*, 291 F. Supp. 348, 348-50 (S.D. Iowa 1968) (holding valuation discounts inappropriate when taxpayers made gifts to children and three weeks later gifted property was sold); *Estate of McMullen v. Comm'r*, 56 T.C.M. (CCH) 507 (1988) (denying minority discount for taxpayer's beneficial trust interest in real estate where governing trust document required that real estate be sold as a single parcel).

⁹⁶ See *supra* note 80 and accompanying text.

⁹⁷ See, e.g., Jerry A. Kasner, *IRS Argues Substance Over Form in Gift and Estate Tax Cases*, 76 TAX NOTES 247 (1997).

⁹⁸ See, e.g., *Estate of Monroe v. Comm'r*, 124 F.3d 699, 714 (5th Cir. 1997).

⁹⁹ Compare *Estate of Murphy*, 60 T.C.M. (CCH) 645 (1990), with *Comm'r v. Estate of Church*, 2000-1 U.S. Tax Cas. (CCH) ¶ 60,369 (W.D. Tex. Jan. 18, 2000).

During her tenure as company president, Mrs. Murphy began to groom her two children to assume company control. She made no secret that she wanted control and ownership of the company to remain in the Murphy name.¹⁰⁰

To help her realize her goal, Mrs. Murphy periodically sought professional advice. For example, soon after her husband's death, Mrs. Murphy's tax advisor and certified public accountant recommended that she decrease her company ownership from 65% to about 51%. Mrs. Murphy followed this advice and made gifts of company stock in trust for the benefit of her two children and retained a 51.41% interest in the company. Over the next several years, Mrs. Murphy's advisor repeatedly implored her to reduce her company ownership to under 50%. By relinquishing her control position, thereby becoming a minority shareholder, Mrs. Murphy could significantly reduce the value of company stock included in her gross estate. Preliminary computations indicated that multi-million dollar transfer tax savings could be achieved. Still, Mrs. Murphy was reluctant to heed this advice.¹⁰¹

But after being diagnosed with lung cancer and suffering from obstructive pulmonary disease, Mrs. Murphy knew that death was imminent. She therefore took the necessary steps to transfer company ownership to her children. After serving as company president for close to a decade, she named her son in her place and, in addition, named her daughter as company vice-president. Also, Mrs. Murphy finally followed the advice of her advisor and transferred a 0.88% interest in the company to her son and another 0.88% interest in the company to her daughter, thereby reducing her ownership in the company below 50% to 49.65%.¹⁰²

Eighteen days later, Mrs. Murphy died. On her gift tax return, the executors of Mrs. Murphy's estate discounted the value of the company stock to reflect the fact that the gifted stock represented a minority interest in the company. Likewise, the same approach was taken on Mrs. Murphy's estate tax return. Her executors discounted the value of Mrs. Murphy's stock to reflect that it, too, represented a minority interest in the company (49.65%).¹⁰³

The Service challenged the validity of these valuation discounts, claiming that Mrs. Murphy's gifts of company stock days before her

¹⁰⁰ See *Murphy*, 60 T.C.M. (CCH) at 647.

¹⁰¹ See *id.* at 647-48.

¹⁰² See *id.* at 648.

¹⁰³ See *id.* at 650-51.

death constituted a mere device to circumvent her transfer tax obligations. In response, the executors of the taxpayer's estate contended that the shares Mrs. Murphy gifted and those included in her gross estate constituted, in each case, a minority interest and should be valued accordingly. In a decision marked by a cautious yet unyielding tone, the Tax Court held in favor of the Service. Recognizing that it was voyaging into largely uncharted waters, the Tax Court resorted to the use of all three judicial doctrines—the substance over form doctrine, the business purpose doctrine, and the step transaction doctrine—to help anchor its position.¹⁰⁴

Insofar as the substance over form doctrine was concerned, the court pointed out that minority interest discounts are appropriate only where a taxpayer relinquishes control.¹⁰⁵ In terms of corporate governance, rights associated with control include (among others) the privilege of electing board members, deciding compensation, and handling general corporate policy concerns.¹⁰⁶ As a practical matter, the court asserted, Mrs. Murphy remained in control before and after the gifts were made. In fact, until her death Mrs. Murphy remained at the company's helm as chairman of the board. The court therefore concluded that "all concerned intended nothing of substance to change between the time of transfer and the time of [Mrs. Murphy's] death, and that nothing of substance did change."¹⁰⁷

Citing to *Gregory* and *Knetsch*, the court also made implicit reference to the business purpose doctrine.¹⁰⁸ In repeated passages throughout the decision, the court declared that the *sole* objective in giving the company shares was to avoid federal transfer taxes.¹⁰⁹ There is no hint in the court's factual determinations that Mrs. Murphy made these gifts as a means to augment her income or to ensure business continuity. Finally, the court determined Mrs. Murphy's pur-

¹⁰⁴ See *id.* at 656–66.

¹⁰⁵ See *Murphy*, 60 T.C.M. (CCH) at 658.

¹⁰⁶ *Id.* at 658–59.

¹⁰⁷ *Id.* at 659.

¹⁰⁸ See *supra* notes 12 and 46 and accompanying text.

¹⁰⁹ See *Murphy*, 60 T.C.M. (CCH) at 645 ("Transfer of the gift fragments did not appreciably affect the decedent's beneficial interest except to avoid Federal transfer taxes on the control premium."); *id.* at 648 ("The only purpose for the two gifts of 100 shares each was the anticipated tax benefit."); *id.* at 651 ("Decedent's fragmentation of her control block by gift of two .88 percent blocks to her children 18 days before her death did not substantially affect her beneficial interest in the corporation. The only intended effect was to obtain a minority discount for the control block."); *id.* at 658 ("A minority discount should not be applied if the explicit purpose and effect of fragmenting the control block of stock was solely to reduce Federal tax.").

poseful fragmentation of company control in two steps really constituted a single testamentary transfer. Mrs. Murphy's gifts were categorized as a mere ploy to reduce transfer tax valuations while maintaining the company stock in the Murphy family name. Put differently, "the transfer of control to decedent's children in two steps in substance [was] one transaction."¹¹⁰ Having drawn this conclusion, the court coalesced Mrs. Murphy's gifts and her bequest into one transfer for purposes of valuing the company stock and thereby negated the application of any minority discount.

B. *The Church Decision*

Like Mrs. Murphy, Mrs. Church, a widow, had property that she wanted to leave to her two children. She was suffering from terminal breast cancer and she, too, did not want to let fate take its course. On October 22, 1993, Mrs. Church formed a limited partnership with her children. A corporation was to serve as the general partner of the limited partnership and Mrs. Church and her two children were to serve as its limited partners. That same day, Mrs. Church made (or attempted to make) contributions to the limited partnership of a \$380,038 ranch and \$1,087,710 of marketable securities she owned. Two days after the purported establishment of the limited partnership, however, Mrs. Church died suddenly as a result of cardiopulmonary collapse.¹¹¹

On her estate tax return, her executors set forth the value of her limited partnership interest to be \$617,591, or less than one-half of the value of the property Mrs. Church contributed to the limited partnership. The estate justified the size of this steep discount based on the facts that Mrs. Church's limited partnership interest did not give her a voice in partnership governance matters and her limited partnership interest was not marketable.¹¹²

Positing that the limited partnership was a sham, the Service claimed that the entire fair market value of all the assets Mrs. Murphy contributed—or attempted to contribute—to the limited partnership should be included in her gross estate. The Service cited several facts to support its position: (1) the corporate general partner of the lim-

¹¹⁰ *Id.* at 662. The court further elaborated that "[t]he explicit plan was to transfer .88 percent of the stock to each of the children to make it appear that control had temporarily disappeared. This had no intended effect or purpose other than the anticipated tax savings." *Id.* at 663.

¹¹¹ See *Church*, 2000-1 U.S. Tax Cas. (CCH) at 84,781.

¹¹² See *id.* at 84,779-80.

ited partnership was formed several months after Mrs. Church's death, (2) the establishment of the partnership coincided with a point in time when Mrs. Church's cancer, although apparently in clinical remission, had reoccurred and, due to undisclosed medical side effects, she could not be treated with chemotherapy, (3) close to 70% of the underlying partnership property was comprised of passive assets in the form of marketable securities rather than business property, (4) the account holding the marketable securities was not changed into the name of the limited partnership until several months until after Mrs. Church's death, and (5) the certificate of limited partnership denoted that it was executed on July 1, 1993—months before it admittedly had been executed.¹¹³

These facts could have provided fertile grounds for the use of judicial doctrines. Like *Heyen*, the court could have found, in substance, that the limited partnership was in an embryonic stage and not yet worthy of recognition or that Mrs. Church had not effectuated her intended partnership contributions prior to her death.¹¹⁴ Alternatively, like *Murphy*, the court could have found that the establishment of the limited partnership served no legitimate business purpose because the issue of business continuity was never truly at stake.¹¹⁵ Finally, like *Driver*, the court could have found that the establishment of the limited partnership was a temporary stepping-stone to transfer wealth to Mrs. Church's children.¹¹⁶ Despite having these facts at its disposal, the U.S. District Court for the Western District of Texas declined the Service's implicit invitation to use judicial doctrines to defeat the taxpayer's tax minimization strategy and held in favor of the taxpayer.

The court either dismissed as irrelevant or, instead, ruled in the taxpayer's favor with respect to virtually every fact the Service had cited. More specifically, the court made the following factual determinations: (1) under Texas law, the establishment of a limited partnership may precede the establishment of its corporate general partner, (2) based upon the testimony of Mrs. Church's physician, the cause of Mrs. Church's death was "largely unrelated" to her cancer, (3) the limited partnership could use the marketable securities as a source of working capital, (4) Mrs. Church had relinquished ownership over the securities even though they remained in her personal

¹¹³ See *id.* at 84,780-82.

¹¹⁴ Cf. 945 F.2d at 361.

¹¹⁵ Cf. 60 T.C.M. (CCH) at 645.

¹¹⁶ Cf. 76-2 U.S. Tax Cas. (CCH) ¶ 13,155, at 85,699 (W.D. Wis. 1976).

account, and finally, (5) the incorrect date on the limited partnership certificate was attributed to a clerical error. Drawing upon these factual determinations, the court held that Mrs. Church, along with her children, had formed a legitimate limited partnership for legitimate business reasons.¹¹⁷ The strength of these factual determinations slammed the door on the use of judicial doctrines proffered by the Service.

C. *Analysis of the Church and Murphy Decisions*

The similarities in the situations confronting the Murphy and Church families are remarkable. For both Mrs. Murphy and Mrs. Church, Death and the Taxman were each on the doorstep impatiently waiting side-by-side. Each family knew that while Death's entry was inevitable, the Taxman's was not—at least, if proper steps were taken. In what were likely last minute desperate acts, both families attempted to capitalize on valuation discounts to minimize their respective tax burdens. In Mrs. Murphy's case, the strategy failed; in Mrs. Church's case, the strategy prevailed. There is no easy way to reconcile the difference in outcomes. One might presume that one court was right and the other wrong. Further analysis reveals, however, that both courts were wrong.

There is a sense that justice was done in the *Murphy* decision because the taxpayer was not able to defeat her transfer tax burden in such a seemingly transparent manner. But upon closer examination, it becomes clear that this sense of satisfaction is misplaced. The Code and the regulations support the taxpayer's use of valuation discounts.¹¹⁸ Thus, judicial doctrines were the only weapon available to the Service to defeat Mrs. Murphy's transfer tax minimization strategy.

As discussed in Section II, the use of judicial doctrines in the context of transfer tax controversies has unique characteristics. More specifically, only the fact-finding component of the substance over

¹¹⁷ See *Church*, 2000-1 U.S. Tax Cas. (CCH) at 84,781.

¹¹⁸ I.R.C. §§ 2031(a), 2512(a); Treas. Reg. § 25.2512-1. In analyzing the validity of these discounts in the context of intra-family transfers, courts respect taxpayers' use of valuation discounts and have repeatedly rejected the Service's quest to use family attribution rules in making valuation determinations. See *Citizens Bank & Trust Co. v. Comm'r*, 839 F.2d 1249 (7th Cir. 1988); *Propstra v. United States*, 680 F.2d 1248 (9th Cir. 1982); *Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981); *Estate of Andrews v. Comm'r*, 79 T.C. 938 (1982); *Estate of Lee v. Comm'r*, 69 T.C. 860 (1978). In 1993, the Service finally conceded that family attribution is not an appropriate rationale for denying a minority discount. See Rev. Rul. 93-12, 1993-1 C.B.

form doctrine has earned legitimacy. In the *Murphy* case, Mrs. Murphy did give a 0.88% interest in the company to each of her two children and, upon her death, she held a 49.65% minority interest in the company. As a practical matter, once these gifts were made, Mrs. Murphy could no longer unilaterally make corporate decisions without the approval of at least one other shareholder who held a 0.35% or greater stake in the company. This state of affairs admittedly lasted only a very short period of time, but the fact that it existed at all indicates that Mrs. Murphy had forever changed her position in the company.¹¹⁹ In the final analysis, it appears that the Tax Court was too overzealous in its use of judicial doctrines.

By the same token, the district court in *Church* was incorrect in its reluctance to use judicial doctrines. The facts of the *Church* case illustrate that Death greeted the taxpayer too quickly. Mrs. Church had no time to put all her affairs in proper order and, for that matter, participate in the limited partnership arrangement. The establishment of the limited partnership was really a work in progress; it had not yet resulted in a vital, functioning entity. More specifically, at the moment of Mrs. Church's death, the limited partnership had no general partner to operate it or any working capital at its disposal; it was more a concept than a reality.

Although the business purpose and the step transaction doctrines play marginal roles in resolving transfer tax controversies, the *Church* court still could have resorted to the fact-finding component of the substance over form doctrine to deny the taxpayer any valuation discount.¹²⁰ The limited partnership was an inchoate estate planning de-

¹¹⁹ Even if the business purpose doctrine were relevant, Mrs. Murphy's objective in making her stock gifts was no different than that of most other closely-held business owners who want their children to continue to operate the family business. The Tax Court, however, emphasized that Mrs. Murphy made gifts for reasons related to transfer tax minimization. See *supra* note 109 and accompanying text. And the sky is blue: many taxpayers make gifts for the identical reason (for example, a \$10,000 cash gift to capitalize on the annual gift tax exclusion) and no court attacks the validity of these transfers. The fact Mrs. Murphy had also made the gift to ensure business continuity should have insulated the legitimacy of her gifts from a business purpose doctrine challenge.

In its analysis, the Tax Court also made dubious reliance on the step transaction doctrine. See *supra* note 110 and accompanying text. Thus far, this doctrine has played only a marginal role in resolving transfer tax controversies and for good reason. The estate planning process usually involves several steps. Taken at face value, liberal use of the step transaction doctrine could have a Draconian chilling effect in area of estate planning. See discussion *supra* Part II.C.

¹²⁰ The court possibly could have relied upon I.R.C. § 2036(a) to cause Mrs. Church's purported capital contributions to the limited partnership to be included in her gross estate. This section of the Code provides that if a taxpayer retains a direct or indirect in-

vice that precedent indicates would have served her purposes well had Mrs. Church survived.¹²¹ Mrs. Church's untimely death, however, should have negated its legitimacy. Instead, poof! Two days after signing her name to a piece of paper that had no legal effect over her assets, several hundred thousand dollars of asset value were said to have disappeared.¹²² Given the strong piscatorial odor of the court's factual determinations, something seems amiss in the court's reasoning and the conclusions the court reaches from these facts.

CONCLUSION

Had the courts in *Murphy* and *Church* properly surveyed the use of judicial doctrines in transfer tax controversies, perhaps each would have reached a different conclusion. This survey would have revealed that, given the general tax avoidance nature of estate planning, the use of judicial doctrines plays a limited, albeit sometimes vital, role in transfer tax controversies. Only the substance over form doctrine has relevance; its application, however, is limited to its analytical component that probes what the taxpayer did and not the analytical component that is used as a tool of statutory construction.

Taxpayers, the Service, the courts and Congress have lessons to learn from this analysis and the outcomes reached in the *Murphy* and *Church* decisions. In planning their estates, taxpayers are at liberty to capitalize upon and exploit the literal language of the Code. This can be done without fear that the words utilized constitute special terms of art. When it comes to making present interest gifts that qualify for the annual exclusion, for example, a transfer passes muster if the beneficiary has an immediate and direct right to gifted property.¹²³ But if a taxpayer instead orchestrates the passage of wealth to A, using B as a mere conduit, a court will view the transaction skeptically. It will

terest in property until death, the value of such property is included in the taxpayer's gross estate. See *Estate of Reichardt v. Comm'r*, 114 T.C. 144, 155 (2000) (finding that because of an implied agreement that the taxpayer could continue to use assets she had contributed to the limited partnership as her own, such assets were held includible in her gross estate); *Estate of Schauerhauser v. Comm'r*, 73 T.C.M. (CCH) 2855 (1997).

¹²¹ See *supra* notes 83–84 and accompanying text.

¹²² For an excellent exposition of this disappearing wealth phenomenon, see James Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX LAW REV. 415 (1995). For two recent expositions of how Congress should remedy valuation issues that beset the transfer tax system, see Laura E. Cunningham, *Remember the Alamo: The IRS Needs Ammunition in Its Fight Against the FLP*, 86 TAX NOTES 1461 (2000), and Leo L. Schmolka, *FLPs and GRATs: What to Do?*, 86 TAX NOTES 1473 (2000).

¹²³ See *supra* notes 67–68 and accompanying text.

pierce the taxpayer's machinations and analyze the facts of the transaction as they truly exist.¹²⁴

During the audit process, the Service should rely upon judicial doctrines with great circumspection. Only when taxpayers are less than forthright regarding the nature of their actions should the Service's challenges predicated upon judicial doctrines meet with success. Otherwise, the Service's reliance on these doctrines will be counterproductive, belying a weakness in its position.

In analyzing transfer tax controversies, courts should follow the model of its predecessors. More specifically, courts historically have been reluctant to rely upon judicial doctrines to attack taxpayers' estate plans.¹²⁵ This is because the underpinnings of these doctrines—save the component of the substance over form doctrine that makes factual determinations—hold little relevance for resolving transfer tax controversies.

Finally, there is a message in this analysis for Congress. Taxpayers will continue to aggressively employ transfer tax minimization techniques, particularly because the chilling effects of judicial doctrines are virtually nonexistent in the estate planning arena.¹²⁶ This means that Congress must be vigilant in drafting transfer tax statutes.¹²⁷

¹²⁴ See, e.g., *Heyen*, 945 F.2d at 363.

¹²⁵ See *supra* notes 111–121 and accompanying text.

¹²⁶ The popularity of tax avoidance in the area of estate planning cannot be understated. For a classic article that surveys these techniques, see George Cooper, *A Voluntary Tax? New Perspectives on Sophisticated Estate Tax Avoidance*, 77 COLUM. L. REV. 161 (1977).

¹²⁷ The use of judicial doctrines often acts as a bellwether for legislative action. Recall, for example, how *Gregory* required that a legitimate corporate reorganization have an underlying business purpose. See *supra* note 43 and accompanying text. This amorphous "business purpose" standard was thus made part of the common law of the then reorganization provisions. See generally Bittker, *supra* note 35; Michaelson, *supra* note 35. But Congress generally recognizes that amorphous common-law standards are not good standards for tax practice; therefore, after the *Gregory* decision was rendered, Congress incorporated a more specific business purpose test into the Code. I.R.C. § 355(a)(1)(B). See Treas. Reg. § 1.355-2(b) ("A corporate business purpose is a real and substantial non-Federal tax purpose, germane to the business . . ."); Herbert N. Beller, *Business Purpose Under Section 355: What Works and What Doesn't*, 58 TAX NOTES 1109 (1993); Mark J. Silverman et al., *What is a Business Purpose Under the Section 355 Regs.?*, 71 J. TAX'N 4 (1989).

The *Gregory* decision is not alone in this respect. There are many other cases where the use of judicial doctrines served as a catalyst to propel Congress into action. For example, in *Helvering v. Clifford*, 309 U.S. 331, 336 (1940), the Supreme Court held that, under certain circumstances, the Service could ignore the separate existence of a trust. After *Clifford* was rendered, to reduce the tax uncertainties associated with trust formation, Congress was subsequently obliged to introduce the so-called grantor trust rules under Subchapter J of the Code. See generally Sherwin Kamin et al., *The Internal Revenue Code of 1954: Trusts, Estates, and Beneficiaries*, 68 HARV. L. REV. 1237, 1259–64 (1954).

When a transfer tax minimization technique that is ostensibly sanctioned under the Code arises, Congress cannot afford to wait for the courts to stymie its use. Instead, Congress must swiftly respond with specific legislation to eliminate the technique in question. Failure to close these loopholes will serve as an open invitation to taxpayers to siphon transfer tax dollars from the federal coffer.¹²⁸

In the end, most courts—the gatekeepers of judicial doctrines—understand that judicial doctrines will never be a substitute for well-crafted legislation. Nowhere is this aphorism truer than with respect to transfer taxes. But the use of judicial doctrines in the context of resolving transfer tax controversies cannot be entirely discarded. As is evident from the *Murphy* and *Church* decisions, courts must understand the role these doctrines play in the transfer tax setting, lest they risk rendering other miscarriages of justice.

¹²⁸ For example, to minimize their transfer taxes, taxpayers used to recapitalize their corporations with common and preferred stock. They would then gift the common stock at a greatly reduced value and retain the preferred stock. By participating in this exercise, taxpayers would “freeze” the value of the preferred stock in their estates and potentially save significant transfer taxes. Courts upheld the validity of these arrangements and the discounts associated with the transfer of common stock. See *Estate of Anderson v. Comm’r*, 56 T.C.M. (CCH) 553 (1988); *Estate of Gilman v. Comm’r*, 65 T.C. 296 (1975). In reaction to this ploy and to reduce the hemorrhage of federal transfer tax dollars then being lost, Congress first enacted I.R.C. § 2036(c) to combat the perceived abuses of these estate freeze recapitalizations used by taxpayers in circumventing their transfer tax obligations. Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10402(a), 101 Stat. 1330-431 (repealed 1990). Because I.R.C. § 2036(c) proved to be too complicated and ineffectual, it was repealed and supplanted by Chapter 14 of the Code. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11602(a), 104 Stat. 1388, 1388-491.