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Tax Court Ruling Benefits Small Business Owners

Owners of closely held businesses, including family owned and other small businesses can now pass assets to heirs with minimal taxation thanks to a recent tax court ruling (*Wandry v. Commissioner*, US Tax Court March 26, 2012).

Under current regulations ownership of the business can be transferred to heirs using yearly and lifetime exemptions (\$5,120,000 in 2012), as well as gifting \$13,000 per year per heir. The catch is that there must be a professional appraisal of the business, but the IRS can contest the appraised value after the gift is given, and if the IRS finds the value is significantly higher there may be tax consequences.

Here's what happened.

In 2001 Albert and Joanne Wandry (the donors), and their children formed Norseman Capital, LLC. In 2004, the Wandrys gifted \$261,000 of business interests to each of their four children. Each of their five grandchildren received \$11,000. The terms specified that the gifts should be equal to the dollar amount of their exemptions, which at the time were \$1 million lifetime and an \$11,000 annual exclusion.

The Wandrys' assignment statement stipulated that an independent appraiser would provide valuation for the company, but that if the IRS challenged the valuation and it was determined to be different in a court of law, then the gifted interests would be adjusted to reflect this. This is known as a defined value clause.

In 2006, the IRS audited the couple's gift tax returns. It appraised the valuation higher than that of the independent appraiser the Wandrys used and said that the gifts now exceeded the exclusion limits. The IRS also argued, among other things, that the defined value clause used in the case was contrary to public policy in part because it discouraged any attempt to collect the tax due.

The tax court disagreed however, and dismissed the argument stating that there was no distinction between a defined value clause in *Wandry* from that where there was a charitable donee. It also stated that the intent was to make gifts that were equal to their exemptions. As such, there was no additional dollar amount per se, and therefore no tax liability.

Wandry was groundbreaking for a couple of reasons. First, in that the defined value clause had hitherto only been used to reallocate fixed dollar amounts of business interests to charities and not the donors and their children and grandchildren; and second in that when the IRS appraises the business value at a higher amount the difference would not be subject to gift tax, provided the *Wandry* formulaic model is used.

The lifetime exemption is scheduled to revert to \$1 million in 2013, so you might want to consider transferring business assets in 2012 while the exemption is still high. Keep in mind however, that while it's likely the *Wandry* case will stand, the IRS has a three month window in which to appeal.

The best strategies for business and personal growth and success are specific to your business and personal situation. Your plan must be tailored to fit your unique circumstances. Contact Lanter, Leonardo & Levy for a no obligation consultation on building and preserving the company and wealth you have worked so hard to achieve.

Call Alex Leonardo or Rick Captain today at 561-998-7770