# Taxpayer Wins Court Approval of Defined Value Gift Clause

By James F. McDonough, Jr. on May 4th, 2012

Perhaps no recent taxpayer victory is more important to estate and gift tax planning than the case of Wandry v. Commissioner, T.C. Memo 2012-88. The Court in *Wandry* held that a taxpayer may use a defined value gift clause ("DVGC") to make a gift expressed in terms of a dollar figure rather than as a specified number of units of property (e.g., $10,000 of XYZ stock). A DVGC protects a taxpayer against an increase in estate or gift tax as the result of a tax audit.

The government has litigated successfully against DVGC's since 1944; see for example, Commissioner v. Procter, 142 F.2d 824 (4th Cir. 1944). The clause in *Procter* provided that any part of the transfer that because subject to gift tax because of IRS revaluation should be returned to the donor and should not be deemed to be part of the gift. The Court held that taking back property (a "condition subsequent") to avoid taxation violated public policy.

Although, *Wandry* is the fifth taxpayer victory in the DVGC area, it is the first case where the excess gift did not pass to a charity. Three of the taxpayer victories were won in Courts of Appeal in the Fifth, Eighth and Ninth Circuits. These taxpayers avoided the *Procter* rule by having the increase in value, resulting from an audit adjustment, pass to a charity and qualify for a charitable deduction rather than go back to the donor.

In *Wandry*, the *parents transferred property to a limited liability company (LLC) and caused the LLC to be appraised. Then, the parents assigned a sufficient number of LLC units (percentage interests) so the fair market value of the units equaled the dollar amount of the gift next to the child's name. The parents filed gift tax returns using units rather than dollar values. The court held for the taxpayers stating that the gift was of the stated dollar amount rather than percentages (units) of the LLC.*

There are different types of DVGC's, such as formula transfer clause and formula allocation clause, each replete with nuances. Although use of DVGC's is beneficial, it raises a number of other issues that and require careful planning. One such issue is the income tax consequences of an audit that changes the number of units of property transferred.

*Wandry* offers a type of insurance against revaluation upon audit, especially in the context of family limited partnerships and should prove useful to taxpayers.