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# Time for a New Plan: The LLC Is a Better Option for Estate Planning After *Cannon v. Bertrand*

## I. INTRODUCTION

As the old saying goes, the only two things certain in life are death and taxes. But individuals can never be certain about the tax consequences that accompany death. The desire to reduce tax liability upon death and subsequently increase the value of assets transferred to surviving family members leads many people to actively manage their estates. Active management reduces the uncertainty associated with the taxes levied on a decedent's estate.

There are several useful methods available to reduce estate tax liability, including the family limited partnership. Individuals transfer assets to the family limited partnership in exchange for interest in the partnership.[1] The value, and resulting tax liability, for the partnership interest is generally lower than the aggregate value of the assets valued separately because the IRS permits the application of discounts to business interests to reflect lack of control, illiquidity, and lack of marketability.[2] Maximizing the amount of discounts applied to assets in the estate is a major goal of estate plans.[3] Although death and taxes are certainties, discounts can be used to decrease the tax consequences of death.

The value of these partnership interests is largely dependant on the rights held by the owner under state law.[4] Louisiana partnership law states that a partner ceases to be a member of the partnership at death, and at death, the partner's successors are entitled to the value of his former share.[5] State courts have determined the appropriate method for assigning value to the shares. Prior to the recent Louisiana Supreme Court decision in *Cannon v. Bertrand*,[6] the court determined that fair market value

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1. Russell Standaland, Note, *Valuation Discounts After* Estate of Nowell v. Commissioner*: A Clear Formula for Reducing Estate Taxes*, 30 GOLDEN GATE U. L. REV. 679, 684–85 (2000).
2. LOUIS A. MEZZULLO, BNA TAX & ACCOUNTING CTR., PORTFOLIO 722-3RD: FAMILY LIMITED PARTNERSHIPS AND LIMITED LIABILITY COMPANIES pt. I.C (2011).
3. *Id.*
4. *See* discussion *infra* Part IV.A.
5. LA. CIV. CODE ANN. art. 2823 (2005).
6. 2 So. 3d 393 (La. 2009).

was the proper valuation method.[7] Under this method, family estate plans were still able to utilize the partnership as a means of achieving value-reducing discounts. The *Cannon* court, however, deviated from the manner in which partnerships were valued in prior partnership valuation cases.[8] The type of valuation used by the court in *Cannon* increases the potential judicial award for the interest of a withdrawing partner.[9] This decision is also likely to increase the value of a deceased partner's former interest for estate tax purposes.[10] The potential increase in value of partnership interests makes the family limited partnership a less attractive option for estate planning.[11]

The limited liability company (LLC) is a more effective estate tax planning tool post-*Cannon*.[12] Although the extent to which *Cannon* will affect future partnership valuation is uncertain, the probable result is a higher valuation placed on partnership interests.[13] However, the law on LLC interest valuation after death is different from the law for standard partnerships.[14] This difference makes the *Cannon* decision inapplicable to LLC valuation upon death, meaning Louisiana LLC interests will still be eligible for the valuation discounts that are desirable in estate planning. The uncertainty surrounding partnership valuation post-*Cannon* can be avoided through the use of LLCs in estate planning.

Part I of this Note discusses relevant partnership withdrawal law and the judicially crafted valuation method that existed prior to the *Cannon* decision, as well as relevant estate tax law. Part II presents and analyzes the *Cannon* decision. Part III explains the effects of state law on estate tax and examines the effects of *Cannon* on the valuation of partnership interests for estate tax purposes. Part IV discusses the family limited partnership and presents the limited liability company as a more effective estate planning alternative post-*Cannon*.

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7. Shopf v. Marina Del Ray P'ship, 549 So. 2d 833, 839 (La. 1989).
8. *See* discussion *infra* Part II.B.
9. *See* discussion *infra* Part III.
10. *See* discussion *infra* Part IV.
11. *See* discussion *infra* Part V.A.
12. *See* discussion *infra* Part V.B.
13. *See* discussion *infra* Part III.
14. *See* discussion *infra* Part V.B.

## II. PARTNERSHIP AND ESTATE TAX BACKGROUND

### *A. Partnership Withdrawal Under the Civil Code*

The withdrawal rights of a partner under Louisiana law depend on whether the partnership is constituted for a term.[15] If the partnership is constituted for a term, a partner may withdraw before the expiration of the term only if he has just cause arising out of the failure of another partner to fulfill an obligation.[16] If the partnership is constituted without a term, a partner may withdraw at any time with reasonable notice, as long as the time is not unfavorable to the partnership.[17] The Civil Code articles suggest that withdrawal is generally permitted in a non-term partnership and not permitted in a partnership constituted for a term.[18]

Louisiana Civil Code article 2823 states that a withdrawing partner, or his successors if the partner is deceased, is entitled to an amount equal to the value of the former partner's share at the time membership ceased.[19] The parties can stipulate the value of the former partner's share in the partnership agreement or in a separate agreement.[20] If no agreement on the value of the former partner's share is reached, any party can seek a judicial determination of the value and an order for its payment.[21] Although the Civil Code provides a judicial remedy for a withdrawing partner seeking the value of his share, it does not give guidance as to how this value should be determined.[22]

### *B. Valuation Standard Prior to* Cannon v. Bertrand

The Louisiana Supreme Court first considered the issue of valuing a withdrawing partner's share in a partnership in *Shopf v. Marina Del Ray Partnership*.[23] The case involved a partner who was brought into a partnership as the general manager of a marina

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15. Susan E. Acklin, *Valuation of Closely Held Business Interests: Chapter 14's Special Valuation Rules and Its Effects on Louisiana Partnership and Louisiana Limited Liability Company Law*, 41 LOY. L. REV. 329, 347 (1995).

16. LA. CIV. CODE ANN. art. 2821 (2005).

17. *Id.* art. 2822.

18. GLENN G. MORRIS & WENDELL H. HOLMES, BUSINESS ORGANIZATIONS § 4.07, *in* 7 LOUISIANA CIVIL LAW TREATISE 136 (1999).

19. LA. CIV. CODE ANN. art. 2823.

20. *Id.* cmt. (a).

21. *Id.* art. 2825.

22. MORRIS & HOLMES, *supra* note 18, § 4.11, at 157.

23. 549 So. 2d 833 (La. 1989).

that was under development.[24] However, the land for the marina was never developed, and the new partner was soon fired as general manager.[25] Thereafter, the plaintiff withdrew from the partnership and sought to receive the value of his share from the remaining partners because the partnership agreement contained no provision for determining value.[26] However, the majority partner refused to pay anything for the share, even though he had made an offer to purchase the plaintiff's share prior to his firing.[27] The former partner sued to recover the value of his share of the partnership when no agreement was reached.[28]

The court determined in *Shopf* that the proper method for valuing a withdrawing partner's interest was the fair market value approach.[29] The court defined fair market value as "the price that a willing buyer would pay to a willing seller for a certain piece of property in an arm's length transaction, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts."[30] In order to determine fair market value in *Shopf*, the court relied on evidence of the offer by the majority partner to buy the plaintiff's share.[31] This offer was the most significant factor in determining the value of the share because both parties were knowledgeable participants in the transaction.[32] However, the offer did not represent the value that would be paid in an arm's length transaction because of both parties' involvement in the business.[33] The majority owner had a greater interest in the share than a third party because it would increase his percentage of ownership in the partnership. The court took this into account and adjusted the offer to determine fair market value in a true arm's length transaction.[34]

The court further adjusted the majority partner's offer by applying a minority discount because "the plaintiff's share [was] a minority interest in a closely held business."[35] The rationale behind a minority discount is that although a minority interest may be

24. *Id.* at 834–35.
25. *Id.* at 835–36.
26. *Id.* at 836.
27. *Id.* at 835–36.
28. *Id.* at 836.
29. *Id.* at 839.
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.* at 840.
35. *Id.*

uniquely valuable to the owner, it has less value to a third party in an arm's length transaction because of the minority owner's inability to control the distributions and policies of the business.[36] A minority interest is also more difficult to market because the lack of control makes it a less desirable investment, and therefore discounts for lack of marketability are also appropriate.[37] Based on these principles, the court considered the minority status of the share—and its subsequent lack of marketability—in discounting the plaintiff's interest in the partnership to reach fair market value.[38]

*Shopf* established the fair market value approach, which utilizes discounts, as the proper standard to value a minority share in a closely held business in Louisiana.[39] As the controlling case on the issue, lower courts followed the *Shopf* approach prior to the Louisiana Supreme Court decision in *Cannon*.[40] The fair market value standard used in *Shopf* was consistent with the valuation method used for estate tax purposes.[41]

### *C. Estate Tax Provisions*

The estate tax is a federal excise tax imposed on property transferred at death.[42] The tax is calculated based on the value of the gross estate of the decedent, which includes the value of all property held by the decedent on the date of death.[43] The gross estate also includes the value of any *interest* in property held by the decedent at death, such as an interest in a partnership or other closely held business.[44] The value of an item of property includible

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36. *Id.*; *see also infra* notes 56, 59 and accompanying text (further explanation of minority discounts).

37. Thomson v. Thomson, 978 So. 2d 509, 514 (La. Ct. App. 3d 2008).

38. *Shopf*, 549 So. 2d at 840.

39. *Thomson*, 978 So. 2d at 514.

40. *See* Cannon v. Bertrand, 981 So. 2d 169 (La. Ct. App. 3d 2008), *rev'd*, 2 So. 3d 393 (La. 2009); *Thomson*, 978 So. 2d 509.

41. *See* discussion *infra* Part II.C.

42. Treas. Reg. § 20.2031-1 (as amended in 1965); Adams v. United States, 218 F.3d 383, 386 (5th Cir. 2000); Estate of Bright v. United States, 658 F.2d 999, 1001 (Former 5th Cir. 1981); United States v. Land, 303 F.2d 170, 172 (5th Cir. 1962); *see also* 26 U.S.C. § 2001 (2006).

43. 26 U.S.C. § 2031.

44. *Id.* § 2033. A decedent's interest in a partnership falls into this category.

in the gross estate for tax purposes is its fair market value at the time of death.[45]

Estate tax regulations define fair market value as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."[46] This hypothetical transaction is analyzed from the viewpoint of a hypothetical buyer and seller.[47] Under this definition, considerations that depend on the identity of the buyer or seller cannot affect the value of the asset.[48]

The valuation of assets is determined by the interest that passes from the decedent to the successors, as contrasted with the interest held by the decedent prior to death or the interest held by the successor after death.[49] This means that valuation for estate tax purposes reflects any change in the value of the property caused by death.[50] In order to ascertain the value of the transferred property, federal courts must determine the rights afforded the owner of the property under state law.[51] Stated in another manner, "state law . . . determines precisely what property is transferred."[52]

Valuation discounts can reduce the value of assets included in the gross estate, thereby reducing estate tax liability.[53] Discounts for lack of marketability are applied in recognition that closely held business interests have few potential purchasers and, as a result, are difficult to market.[54] The illiquidity of the interest causes a reduction in its value. A separate, but partially overlapping, discount is recognized for minority interests in businesses.[55]

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45. Treas. Reg. § 20.2031-1(b). The executor of the estate can also choose an alternate valuation date under 26 U.S.C. § 2032.

46. Treas. Reg. § 20.2031-1(b).

47. *Id.*; *see also Estate of Bright*, 658 F.2d at 1006; Rev. Rul. 59-60, 1959-1 C.B. 237.

48. Adams v. United States, 218 F.3d 383, 386 (5th Cir. 2000).

49. *Estate of Bright*, 658 F.2d at 1006; United States v. Land, 303 F.2d 170, 172 (5th Cir. 1962).

50. *Land*, 303 F.2d at 172.

51. *Adams*, 218 F.3d at 386; *see also Estate of Bright*, 658 F.2d at 1001; Frazier v. Comm'r, 83 T.C.M. (CCH) 1636 (2002), *rev'd*, 83 F. App'x 164 (9th Cir. 2003); Estate of Chemodurow v. Comm'r, 81 T.C.M. (CCH) 1041 (2001).

52. *Estate of Bright*, 658 F.2d at 1001.

53. *See id.* at 1003.

54. Stephen C. Gara & Craig J. Langstraat, *Property Valuation for Transfer Taxes: Art, Science, or Arbitrary Decision?*, 12 AKRON TAX J. 125, 151 (1996); *see also* Estate of Bennett v. Comm'r, 65 T.C.M. (CCH) 1816 (1993).

55. Gara & Langstraat, *supra* note 54, at 153.

Minority discounts make "an allowance for the fact that a minority interest in a closely held corporation or partnership does not possess voting control and is often subject to the controlling ownership interests."[56] The two discounts overlap because lack of marketability is often a characteristic of a minority interest.[57] Although the discounts are frequently applied in tandem, the two discounts are distinct.[58] Minority discounts compensate for a lack of control over the business, whereas discounts for lack of marketability compensate for the market limitations on free exit from the business.[59]

The Louisiana Supreme Court in *Shopf* applied the above discounts to determine the fair market value of a withdrawing partner's interest in a partnership.[60] However, following the *Cannon* decision, it is questionable whether minority discounts and discounts for lack of marketability will be used in Louisiana for valuation of partnership interests.[61]

## III. *CANNON V. BERTRAND*

### A. *The Louisiana Supreme Court Decision*

*Cannon* presents facts similar to those in *Shopf*. The plaintiff in *Cannon* was the holder of a one-third share of a non-term partnership with the two defendants.[62] Similar to *Shopf*, the sole asset of the partnership was a parcel of land in Mississippi used by the three partners for the sale of timber and hunting.[63] After nearly 10 years as a partner, the plaintiff sought to withdraw from the partnership under Louisiana Civil Code article 2822.[64] When the

56. *Id.* at 153.
57. *Id.* at 154.
58. *Id.*
59. *Id.*
60. *See* discussion *supra* Part II.B.
61. *See* discussion *infra* Part III.
62. Cannon v. Bertrand, 2 So. 3d 393, 393–94 (La. 2009). The partnership in *Shopf* was also non-term. Shopf v. Marina Del Ray P'ship, 549 So. 2d 833, 837 (La. 1989).
63. Cannon v. Bertrand, 981 So. 2d 169, 171 (La. Ct. App. 3d 2008), *rev'd*, 2 So. 3d 393 (La. 2009). The only asset of value in *Shopf* was waterfront property. *See supra* notes 24–25 and accompanying text.
64. *Cannon*, 981 So. 2d at 171. Article 2822 states: "If a partnership has been constituted without a term, a partner may withdraw from the partnership without the consent of his partners at any time, provided he gives reasonable

three partners could not reach an agreement on the value of the plaintiff's share, the plaintiff brought suit for judicial determination of value under Louisiana Civil Code article 2825.[65]

The appellate court upheld the trial court's application of a minority discount to the plaintiff's one-third share in the partnership.[66] The *Cannon* court found that *Shopf* gives courts "the flexibility to use, at their discretion, a tool in the form of a minority discount to make a judicial determination of the value of a withdrawing partner's share."[67] The court also noted that the main asset of the partnership was land, similar to *Shopf*.[68] The appellate court upheld the trial court's determination that a minority interest in "land is worth less than a simple mathematical one-third of the total value of that land."[69]

The Louisiana Supreme Court began its analysis by referring to Louisiana Civil Code article 2823, which states that a withdrawing partner is entitled to the value of his share.[70] The main issue in *Cannon*, the court noted, was determining how to calculate the value of a partner's minority interest in a non-term partnership.[71]

The court distinguished *Cannon* from its prior decision in *Shopf* and stated that the discount applied in *Shopf* did not apply to the present case.[72] The determination that *Shopf* was not binding precedent to the *Cannon* case is based primarily on the conclusion that the *Shopf* decision ascertained fair market value of a minority interest by discounting an offer made by the holder of a majority interest.[73] This discount is described in the *Cannon* decision as a "majority discount," which would not apply in *Cannon* because there is no such offer by a majority shareholder.[74] The court found that *Shopf* application of discounts was merely dicta in the present

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notice in good faith at a time that is not unfavorable to the partnership." LA. CIV. CODE ANN. art. 2822 (2005).

65. *Cannon*, 2 So. 3d at 394. Article 2825 states that a withdrawing partner may seek judicial determination of the value of his share if there is no agreement on the amount to be paid under articles 2823 and 2824. LA. CIV. CODE ANN. art. 2825.

66. *Cannon*, 981 So. 2d at 120.

67. *Id.* at 173.

68. *Id.*

69. *Id.*

70. *Cannon*, 2 So. 3d at 394.

71. *Id.*

72. *Id.* at 396.

73. *Id.*

74. *Id.*

case based on its determination that a true minority discount was not applied in the decision.[75] Further, the court determined that *Shopf* did not establish fair market value as the only means of ascertaining the value of a partner's share under Louisiana Civil Code article 2823.[76]

After distinguishing *Shopf*, the court stated that "[m]inority discounts and other discounts, such as for lack of marketability, may have a place in our law; however, such discounts must be used sparingly and only when the facts support their use."[77] The court also noted that the national trend is away from applying such discounts.[78] The facts of *Cannon*, ruled the court, did not warrant the use of a minority discount or one for lack of marketability.[79] A minority discount was not appropriate because of the fact that the remaining two partners had determined that they would purchase the withdrawing partner's share, leading the court to conclude that a minority discount was not appropriate because there is no issue with a third party having a lack of control.[80] A discount for lack of marketability was also inappropriate in *Cannon* because the partner's interest would never be for sale to third parties.[81] Further, the court stated that applying a discount would be tantamount to penalizing the withdrawing partner "for doing something the law allows him to do."[82]

The court recognized several methods of determining the value of a withdrawing partner's share depending on the facts of the case: book value, market value of the underlying assets, fair market value of the partner's share, or other means depending on the circumstances of the case.[83] The court held that "where the remaining partners are to be the buyers of the withdrawing partner's share, market value of the underlying partnership assets is the most equitable manner to value the partnership share."[84] This holding, however, appears to overrule *Shopf*, the prior Supreme Court case dealing with partner withdrawal.

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75. *Id.*
76. *Id.*
77. *Id.*
78. *Id.*
79. *Id.*
80. *Id.*
81. *Id.*
82. *Id.* at 397.
83. *Id.*
84. *Id.*

*B. Analysis of the* Cannon *Decision*

The Louisiana Supreme Court's decision in *Cannon* relied heavily on distinguishing the facts of *Shopf* in reaching the conclusion that a minority discount should not be applied and that market value of the partnership's underlying assets is the proper method for valuing the interest of a withdrawing partner.[85] However, the relevant facts of the two cases are similar. Therefore, the *Cannon* decision effectively overrules *Shopf*, regardless of the efforts of the court in *Cannon* to distinguish the two cases.

The *Shopf* and *Cannon* cases presented the court with similar facts. Both cases involved a partner holding a minority interest who sought to withdraw from a partnership constituted without a term.[86] Neither partnership agreement contained a clause defining the value of a withdrawing partner's share or providing for a standard of valuation for determining the value of a withdrawing partner's share.[87] In both cases, the withdrawing partner could not reach an agreement with the remaining members of the partnership as to the value of his share and brought suit under Louisiana Civil Code article 2825 seeking judicial determination of the value of the share.[88] There are some differences between the two cases, such as the *Shopf* court's use of an offer by the majority partner to purchase the minority interest.[89] However, the differences are immaterial with respect to their effects on the valuation of the minority partnership interests at issue in each case.

The court in *Cannon* referred to the discount applied in *Shopf* as a "majority discount," referencing the discount applied to the majority partner's offer in order to reach an arm's length transaction price.[90] However, the *Shopf* court considered multiple factors in adjusting the majority partner's offer to find fair market value.[91] "The most significant adjustment," stated the court, "must be made in recognition of the fact that the plaintiff's share is a minority interest in a closely held business."[92] The minority

85. *Id.* at 395–96.

86. *See* LA. CIV. CODE ANN. art. 2822 (2005).

87. *See supra* notes 26, 65 and accompanying text.

88. *See* discussion *supra* Part III.A.

89. *See supra* note 31 and accompanying text. The partnership in *Shopf* was also engaged in a different line of business than the *Cannon* partnership, but this is irrelevant because the business in *Shopf* was not developed, making the land it held its most valuable asset. *See supra* notes 24–25 and accompanying text.

90. *Cannon*, 2 So. 3d at 396.

91. *See supra* notes 35–38 and accompanying text.

92. Shopf v. Marina Del Ray P'ship, 549 So. 2d 833, 840 (La. 1989).

discount recognizes the fact that a minority interest has less value to a third party because of relative illiquidity and lack of marketability.[93]

The "majority discount" referred to in *Cannon* was also considered in the final determination of the value of the minority partner's share in *Shopf*.[94] This discount was necessary in *Shopf* because the court's valuation analysis began with an offer by the majority partner to purchase the minority interest, which the court determined to be a reliable indicator of value under the facts of the case.[95] It was not a misapplication of the minority discount, but rather an entirely different discount. The use of the offer by the majority partner was merely a place to begin the determination of value. The adjustment accounted for the majority partner's increased desire to purchase the minority share compared to an investor in an arm's length transaction who would be less willing to acquire a minority share.[96] Unlike *Shopf*, the *Cannon* court had property appraisals that aided their determination of the value of the withdrawing partner's share.[97] The court in *Cannon* failed to consider that the *Shopf* decision combined multiple discounts, one based on the minority interest and one in recognition of the particular value of the share to a majority partner.[98]

The court in *Cannon* held that minority and other discounts did not apply because fair market value is not the only method for establishing value under Louisiana Civil Code article 2823.[99] However, valuation discounts, a tool used by courts in the determination of the price of an asset in an arm's length transaction,[100] are not applicable when determining the market value of the firm's underlying assets, which the *Cannon* decision held as the proper valuation method in that particular case.[101]

The court pointed out that *Shopf* did not explicitly mandate the use of fair market value as the standard of valuing a partnership interest, and, therefore, the *Cannon* court could use a different method of valuation without explicitly overruling the *Shopf*

93. *Id.*

94. *See supra* notes 73–74 and accompanying text.

95. *Shopf*, 549 So. 2d at 838.

96. *Id.* at 840.

97. Cannon v. Bertrand, 2 So. 3d 393, 394 (La. 2009).

98. *See, e.g.*, Estate of Newhouse v. Comm'r, 94 T.C. 193 (1990) (allowing a minority discount as well as a discount for lack of marketability).

99. *Cannon*, 2 So. 3d 393.

100. *See Shopf*, 549 So. 2d at 840.

101. *Cannon*, 2 So. 3d at 396.

decision.[102] However, the facts of *Cannon* and *Shopf* are similar and typical of partnership withdrawal cases.[103] The attempt in *Cannon* to limit the application of the decision to situations where the remaining partners are the buyers of the withdrawing partner's share has no effect because state partnership law requires the partnership to pay the withdrawing partner the value of his share upon withdrawal.[104] Therefore, although the court notes in *Cannon* that value may be determined as book value, market value of underlying partnership assets, fair market value, or other means, the value of the firm's underlying assets appears to be the method of valuation that will rule in future partner withdrawal cases. As such, the *Shopf* fair market value method, which lower courts followed prior to the *Cannon* decision,[105] is effectively overruled, and "minority and marketability discounting should now be considered the exception, not the rule, in the typical partnership-interest valuation case."[106]

It appears the decision in *Cannon* not to follow the valuation standard used by the *Shopf* court was based primarily on equity. Out of the multiple methods that the court could choose to establish the value of the withdrawing partner's share, the method based on the value of the partnership's underlying assets was the most equitable considering the facts of the case. The withdrawing partner in *Cannon* was essentially a one-third co-owner of a parcel of land.[107] Awarding him less than one-third the value of that land simply because it was held in a partnership would not only be inequitable for the withdrawing partner, but it would give the remaining partners a windfall profit at the withdrawing partner's expense because they would be able to pay much less for the land than it was actually worth.[108] The court itself acknowledged that assigning value based on a percentage of the underlying assets is based in equity when it noted that awarding any less would be punishing the withdrawing partner for doing what the law allows

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102. *Id.*

103. MORRIS & HOLMES, *supra* note 18, § 4.11 (Supp. 2010).

104. *See* LA. CIV. CODE ANN. art. 2824 (2005).

105. *See* Cannon v. Bertrand, 981 So. 2d 169 (La. Ct. App. 3d 2008), *rev'd*, 2 So. 3d 393 (La. 2009); Thomson v. Thomson, 978 So. 2d 509, 514 (La. Ct. App. 3d 2008).

106. MORRIS & HOLMES, *supra* note 18, § 4.11 (Supp. 2010).

107. *See supra* notes 62–63 and accompanying text.

108. *See Cannon*, 2 So. 3d at 397. If the three men had purchased the property as co-owners, under Louisiana law, any of the three owners could force partition of the property and sell his share for its full value. *See* LA. CIV. CODE ANN. art. 543 (2010).

him to do.[109] Regardless of the reason behind the change in valuation methods, it is clear that *Cannon* is the new authority in Louisiana partnership withdrawal cases. The implications of the decision, however, will likely be seen in areas of law beyond the valuing of withdrawing partner interests, such as in the realm of estate tax.

## IV. IMPLICATIONS OF *CANNON* FOR ESTATE TAX VALUATION OF PARTNERSHIP INTERESTS

The Louisiana Supreme Court in *Cannon* changed the policy regarding the valuation of a minority interest in a partnership.[110] At least in a situation where a minority partner withdraws from a partnership constituted without a term, Louisiana courts will likely assign the minority interest a value equal to the partner's percentage of ownership of the partnership's underlying assets, or a full pro rata share. *Cannon* adds an element of uncertainty to the two certainties that are death and taxes.

### *A. The Effects of State Law on Estate Tax*

In *United States v. Land*, the federal Fifth Circuit analyzed the valuation of a partnership interest subject to a restrictive agreement in order to determine the value of the gross estate.[111] The agreement provided that upon withdrawal of a partner, the remaining partners could purchase the interest with the sales price limited to two-thirds of its value, but at death, the surviving partners became entitled to purchase the interest at its full value.[112] In the event a partner died and the remaining partners did not wish to purchase the decedent's interest, the agreement stated that the partnership would be dissolved and its assets liquidated and distributed according to percentage of ownership.[113] The court noted that the decedent's interest in the partnership before death was irrelevant where death alters value; those provisions of the partnership agreement restricting value had no effect.[114] Although death does not ordinarily alter value, in this case, the partnership agreement provided that the death of a partner would assure that the partner's interest would be purchased at full value or receive

109. *Cannon*, 2 So. 3d at 396–97.
110. *See* discussion *supra* Part III.
111. 303 F.2d 170 (5th Cir. 1962).
112. *Id.* at 171.
113. *Id.*
114. *Id.*

the full value through liquidation.[115] Because the heirs of the deceased partner were guaranteed full pro rata value, the court found that this value controlled for estate tax purposes and applied no discounts.[116]

In *Estate of Bright*, the Fifth Circuit used Texas law to determine the value of property for estate tax purposes.[117] The decedent and her husband owned a 55% block of common stock in a corporation as community property.[118] Upon death, she devised her share of the stock to a trust set up for the benefit of her children with her husband as trustee.[119] The government sought to value the decedent's interest in the corporation as a one-half share of a 55% control block, which would be subject to a control premium.[120] Under Texas law, community property is divided equally upon death with each spouse owning an undivided one-half interest in community property.[121] However, Texas law also provides that the surviving spouse or the estate of the deceased spouse has the right to demand partition of the assets, leaving divided one-half interests held by the surviving spouse and the estate.[122] Based on the right of partition held by the living spouse, the court rejected the government's contention that the proper valuation method would be one-half of the 55% block of stock.[123] The decedent's half of the community shares of stock was valued as distinct property, with a minority discount applied by the court because the ownership interest was less than 50%.[124]

In *Adams v. United States*, the Fifth Circuit examined the estate tax valuation of an assignee interest in a Texas family limited partnership.[125] The decedent held a one-fourth interest in a family partnership with three other siblings, one of whom held sole managerial power.[126] In order to value the interest, the court had to first determine the rights of the holder of the interest under Texas partnership law.[127] The key question was whether the holder of an

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115. *Id.* at 175.
116. *Id.*
117. Estate of Bright v. United States, 658 F.2d 999 (Former 5th Cir. 1981).
118. *Id.* at 1000.
119. *Id.*
120. *Id.* at 1001.
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.* at 1008.
125. 218 F.3d 383 (5th Cir. 2000).
126. *Id.* at 384.
127. *Id.* at 386.

assignee interest in a Texas partnership has the right to force liquidation or to compel the other partners to buy out the interest.[128] The court determined that an interest that included liquidation rights would be entitled to a full pro rata share of the firm's value and that discounts would be inapplicable.[129] However, if the assignee's interest had no accompanying liquidation rights, minority and lack of marketability discounts could be applied to reduce the value of the share and, subsequently, the tax liability associated with it.[130] A hypothetical buyer would know that he could exercise his liquidation rights and trade the interest for cash, thereby making the problems with holding a minority assignee interest in an ongoing partnership immaterial.[131] The court concluded that, although Texas law does not contain a provision for valuing an assignee partnership interest, it explicitly gives partners the right to compel liquidation.[132] Therefore, because assignees were not explicitly granted the same rights as partners with regards to liquidation, the drafters did not likely intend to grant assignees liquidation rights.[133] Because the decedent's interest was an assignee interest with no explicit liquidation rights, the fair market value of the interest could include discounts for the minority status or lack of marketability.[134]

The above decisions evidence the ways in which contract or state law can affect the value of business interests. The terms of the partnership agreement in *Land* dictated the value of the share held in the decedent's estate.[135] *Bright* and *Adams* show how state law determines the value of a business interest.[136] In particular, *Adams* reveals how state laws controlling the liquidation rights of the holder of an interest in a business can affect the value of that interest.[137] Because state law determines the value of assets in the gross estate, a case interpreting and applying state law, such as *Cannon*, directly affects the valuation of assets for estate tax purposes.

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128. *Id.*
129. *Id.* at 387.
130. *Id.*
131. *Id.*
132. *Id.* at 390.
133. *Id.*
134. *Id.* at 391.
135. *See supra* notes 111–16 and accompanying text.
136. *See supra* notes 117–34 and accompanying text.
137. *See supra* notes 125–34 and accompanying text.

*B. The Effects of* Cannon *on Partnership Interest Valuation*

It is well settled that estate taxes are levied against the fair market value of the assets held by the estate of the decedent.[138] It is also clear that the fair market value of certain interests depends on the rights afforded the owner of the interest under relevant state law.[139] The rights of a partner under state law determine the value of the partner's interest in the business.

Under Louisiana law, a partner ceases to be a member of a partnership at his death or withdrawal.[140] The former partner, or the successor of a deceased partner, is entitled to an amount equal to the value of the share held by the former partner.[141] Because the Civil Code treats all types of partnership termination the same, the method of valuing a partnership interest held by successors of a decedent will be the same as if it belonged to a withdrawing partner.[142] Prior to *Cannon*, *Shopf* defined the value of a withdrawing partner's interest as fair market value, which made the interest subject to appropriate discounts for minority status or lack of marketability.[143] Viewed from the estate tax hypothetical-buyer standard, a willing buyer of the interest would pay no more than an amount that a Louisiana court would determine as the value of the interest. For estate tax purposes, any discount that a Louisiana court applies to a partnership interest upon withdrawal of the partner, such as a minority or lack of marketability discount, applies in valuation of the interest for estate tax purposes.

The *Cannon* court stated that fair market value was not an equitable valuation method for a withdrawing partner's interest in a partnership, at least under the circumstances of the case.[144] A more appropriate method, held the court, is a percentage of the market value of the underlying partnership assets.[145] Under this approach, a 30% share in a partnership with net assets worth $100,000 would be valued at $30,000, undiscounted. Because *Cannon* presented a factual situation common to most partnership withdrawal cases, the method of valuation applied in the decision

138. *See supra* notes 44–45 and accompanying text.

139. *See* discussion *supra* Part IV.B; *supra* notes 51–52 and accompanying text.

140. LA. CIV. CODE ANN. art. 2818 (2005).

141. *Id.* art. 2823.

142. *See id.*

143. Shopf v. Marina Del Ray P'ship, 529 So. 2d 833, 839 (La. 1989).

144. Cannon v. Bertrand, 2 So. 3d 393, 396 (La. 2009).

145. *Id.* at 397.

will likely control the majority of future partnership withdrawal cases.[146]

If *Cannon* valuation is controlling in cases where a partner withdraws from the partnership, it will also apply in situations where a former partner's interest is valued after his death.[147] A partner's death causes a cessation of his membership in the partnership.[148] The successors of the deceased partner, therefore, are not entitled to the decedent's former interest in the partnership because the interest ceases to exist upon the partner's death. Instead, the successors are entitled to an amount equal to the value of the decedent's interest in the partnership.[149] This amount is equivalent to the amount that the decedent would have been entitled to had he withdrawn from the partnership prior to death.[150] *Cannon* valuation is applicable in valuing a deceased partner's former interest in a partnership, and the successors of the decedent can receive a pro rata share of the partnership's underlying assets.

Because valuation for estate tax purposes is the fair market value of the interest that passes, the value of the interest received by the successors must be ascertained.[151] In Louisiana, where membership in the partnership terminates upon death, the interest that passes is the right to receive an amount equal to the value of the share held by the decedent prior to death.[152] The valuation method applied in *Cannon*, market value of the partnership's underlying assets, determines the value of the transferred interest. Based on this valuation, under the estate tax fair market value standard, a hypothetical buyer could purchase the successors' interest in a family limited partnership and be entitled to receive a pro rata share of the partnership's assets under *Cannon*. The hypothetical buyer would be willing to purchase the successors' rights for an amount equal to the decedent's pro rata share of the firm's underlying assets, with no minority or lack of marketability discounts, making this the controlling value for estate tax purposes.

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146. Cases on the valuation of former partnership interests generally only arise in the same context as *Cannon*: a non-term partnership with no stated value in the partnership agreement. Partners in term partnerships do not enjoy the same withdrawal rights, and Louisiana Civil Code article 2823 does not apply where the partnership agreement dictates value upon withdrawal. If a case arises under one of these scenarios, the applicability of *Cannon* is uncertain.

147. *See supra* notes 138–39 and accompanying text.

148. LA. CIV. CODE ANN. art. 2818 (2005).

149. *Id.* art. 2823.

150. *Id.*

151. *See supra* Part II.C.

152. LA. CIV. CODE ANN. art. 2823.

Although minority and lack of marketability discounts will not likely be applied in partnership withdrawal situations post-*Cannon*, the court did not eliminate all possibilities of their application or the application of other discounts.[153] At least for estate tax consideration, the decedent's interest in a partnership, although theoretically worth its full pro rata share, will likely be subject to some discounting. Under the willing buyer standard, a purchaser of the interest would be entitled to receive the decedent's full share of the partnership's assets. However, the remaining partners are unlikely to agree to pay this value simply upon the demand of the buyer of the share because the partnership would not likely have enough liquid assets on hand to simply pay the value of the former partner's share. In order to cover the share, the partners would either be forced to liquidate partnership assets or incur new liabilities.

The most probable result is that the holder of the former partner's interest in the above situation would sue under Louisiana Civil Code article 2825 to receive the value of the share if the partnership agreement does not provide for a valuation method upon withdrawal. An example of such a situation is the *Cannon* case itself. The three partners in *Cannon* could not reach an agreement on the value of the withdrawing partner's share.[154] Had an agreement been reached that required the partners to pay the withdrawn partner for his share, they would have likely been forced to either sell a portion of the land, the partnership's only asset; take a mortgage on the land; or pay out of their own pockets. With these options, a lawsuit is clearly the most probable result in the case of a withdrawn or deceased partner.

Under the estate tax standard, the hypothetical buyer of the deceased partner's interest would have knowledge of this situation and would be unwilling to pay full value for an amount that he could only receive through a lawsuit. The time delay and expense associated with impending litigation would force a discount on the value of decedent's former partnership interest. In effect, a litigation discount takes the place of the minority and lack of marketability discounts that are no longer applicable. However, this discount is likely to be substantially lower than the discounts applied for lack of marketability and minority status.

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153. Cannon v. Bertrand, 2 So. 3d 393, 396 (La. 2009). By refusing to strike the use of discounts entirely, the court leaves the door open for the potential application of discounts if a situation warrants their use. It is uncertain whether *Cannon* or discounts will apply to inter vivos transfers of partnership interests.

154. *See supra* note 65 and accompanying text.

The *Cannon* decision will increase the value of partnership interests held by deceased partners for estate tax purposes in many circumstances. The method of valuation applied in *Cannon* makes those interests more valuable to their owner and therefore more valuable for estate tax purposes because the discounts applied for minority status and lack of marketability will no longer be applicable. Even after applying a discount due to the likelihood of future litigation, Louisiana partnership interests will likely be more valuable for estate tax purposes post-*Cannon*.

## V. PRACTICAL ESTATE PLANNING AFTER THE *CANNON* DECISION

The change in valuation of partnership interests following *Cannon* is likely to have an effect on the use of family limited partnerships for estate planning purposes. Although the extent to which *Cannon* will affect estate tax valuation is unknown, the likely result is that the *Cannon* decision has at least some negative impact on the use of limited partnerships for estate planning. The limited liability company is a better alternative to the family limited partnership because it avoids the negative implications of the *Cannon* decision on estate tax valuation.

### *A. The Effect of* Cannon *on the Use of Family Limited Partnerships for Estate Planning*

Family limited partnerships are widely used to hold family assets for estate planning purposes.[155] These partnerships allow for the reduction of estate tax liability through the use of valuation discounts, such as minority and lack of marketability discounts.[156] These valuation discounts are not only useful for decreasing the value of assets for estate tax purposes, they also allow for increased inter vivos transfers under the annual gift tax exclusion.[157] The family limited partnership is also attractive for estate tax planning because it allows the parents to retain control of

155. Rebecca B. Hawblitzel, Note, *A Change in Planning:* Estate of Strangi v. Commissioner*'s Effect on the Use of Family Limited Partnerships in Estate Planning*, 57 ARK. L. REV. 595, 602 (2004).

156. Standaland, *supra* note 1, at 685–86.

157. *See* MEZZULLO, *supra* note 2, pt. I.C. A 15% interest in a business valued at $100,000 could potentially be transferred because discounts for minority status and lack of marketability may reduce the value of the interest to an amount less than the $10,000 maximum annual gift tax exclusion.

the partnership through ownership of the general partnership interests.[158]

In a typical family limited partnership, parent members contribute assets in exchange for general and limited partnership interests.[159] Parent members then generally make annual gifts of limited partnership interests to their children with a value that falls under the amount excludable from the gift tax.[160] These transfers are subject to valuation discounts, giving transferors the ability to transfer interests in the partnership with a higher pro rata value than fair market value.[161] If a partnership's net asset value is $150,000, a transferor could potentially transfer 10% of the ownership interests because discounting would allow the value for gift tax purposes to be reduced to an amount that falls under the annual $13,000 exclusion amount.[162] These inter vivos transfers of partnership interests reduce the value of the parent members' estate for taxation purposes.

However, *Cannon* makes the use of a family limited partnership a less attractive option for estate tax planning because the ownership interest retained by the parent will likely not be discounted.[163] Any remaining interest that has not been transferred from the estate of the decedent would be the equivalent of the interest held by the plaintiff in *Cannon*, which is the right to receive the value of the former partner's share under Louisiana Civil Code article 2823.[164] Based on *Cannon*, the holders of the limited partnership interest would be entitled to receive a pro rata share of the underlying assets of the firm.[165] The classification of the interests held by the decedent as either general or limited partnership interests would be irrelevant because a limited partner is entitled to the same value upon withdrawal or death as a general partner.[166]

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158. Standaland, *supra* note 1, at 684–85.

159. *Id.*

160. MEZZULLO, *supra* note 2. Gifts of up to $13,000 (as adjusted for inflation) are excluded from the total amount of gifts made during the calendar year. *See* 26 U.S.C. § 2503(b) (2006). Spouses can combine gift exclusions, doubling the excluded amount. *See id.* § 2513.

161. MEZZULLO, *supra* note 2.

162. 26 U.S.C. § 2503(b).

163. *See* discussion *supra* Part III.A.

164. *See* discussion *supra* Part III.A.

165. Louisiana Civil Code article 2818 does not distinguish between a withdrawing and a deceased partner. *See* discussion *supra* Part III.A.

166. *See* LA. CIV. CODE ANN. art. 2836 (2005).

The change in the method of valuing partnership interests under the *Cannon* decision will lead to increased values for partnership interests formerly held by withdrawn or deceased partners. Although the extent to which the *Cannon* decision will apply is uncertain, the possibility of higher values placed on former partnership interests for estate tax purposes makes the family limited partnership a less attractive option for estate planning.

### *B. The Use of Limited Liability Companies for Estate Planning*

The effects of *Cannon* on the taxation of partnership interests make the limited liability company a more attractive option for estate planning. The default rules under Louisiana LLC law create the opportunity for estate planners to utilize discounts to reduce the value of transferred assets in the estate.[167] Through the use of an LLC, the effects of *Cannon* on partnership valuation can be avoided for estate tax purposes.

A basic family LLC under Louisiana law would be an LLC constituted for a term with a parent or parents as the sole members.[168] As the sole members, the parents would be equal managers of the LLC and possess financial rights in the company.[169] Alternatively, the articles of organization can designate one person as the manager of the LLC, leaving remaining members with limited voting rights.[170] The members could subsequently utilize the annual gift exclusion by transferring interests in the LLC to their children or other family members. The transferred interests would likely be subject to valuation discounts, such as discounts for lack of control and marketability, allowing the transferor to transfer more property from the estate under the annual gift exclusion.[171]

The parent members of the LLC can transfer either full membership interests or assignee interests.[172] A holder of an assignee interest has no managerial rights in the company and is

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167. SUSAN KALINKA, LIMITED LIABILITY COMPANIES AND PARTNERSHIPS: A GUIDE TO BUSINESS AND TAX PLANNING § 3.27, *in* 9 LOUISIANA CIVIL LAW TREATISE 378 (3d ed. 2001).

168. *See* LA. REV. STAT. ANN. § 12:1325 (2010). By constituting the LLC for a term, the ability of the members to withdraw is restricted, limiting the value of the interests held by the members. *See infra* note 181 and accompanying text.

169. *See* LA. REV. STAT. ANN. § 12:1301 (Supp. 2011).

170. *Id.* § 1312 (2010). *See generally* KALINKA, *supra* note 167, § 1.38, at 101.

171. *See* KALINKA, *supra* note 167, § 3.27, at 381.

172. *See id.* § 3.31, at 409.

entitled only to the financial rights of a member.[173] Assignee interests are worth less than membership interests under the estate tax willing buyer standard because a buyer would pay less for an interest with no control over the business.[174] However, the transferred interest may still be included in the estate of the transferor under Internal Revenue Code section 2036(a) because the transferor would retain the right to designate the persons who receive income from the LLC.[175] This can be avoided if the members consent to admission of the assignee as a member, giving the transferee managerial rights in the LLC.[176] The transferor with a managing interest could still retain actual control over the distribution policy of the company as long as any transfers of interest in the LLC are nonmanaging interests.[177] The transferred interest would still be subject to valuation discounts because of the prohibition against the transferring of managerial rights in the LLC without unanimous consent of the members under the default LLC rules.[178]

The true advantage that an LLC has over a partnership for estate tax planning purposes after *Cannon* is the valuation of the interest in the estate of a deceased member. The difference between partnership and LLC law is important to note here. LLC law, unlike partnership law, treats withdrawal and death differently.[179] Under Louisiana LLC law, the death of an individual member causes his membership to cease, and the member's executor is treated as an assignee of the member's former interest in the company.[180] An assignee does not have the right to withdraw from the LLC and receive a payment for his interest because this is a right reserved for members.[181] Partnership law, on the other

173. LA. REV. STAT. ANN. § 12:1330 (2010).

174. *See* KALINKA, *supra* note 167, § 3.31, at 409.

175. 26 U.S.C. § 2036(a) (2006).

176. *See* KALINKA, *supra* note 167, § 3.31, at 409.

177. *Id.*

178. LA. REV. STAT. ANN. § 12:1330; *see* KALINKA, *supra* note 167, § 1.38, at 101.

179. *Compare* LA. REV. STAT. ANN. § 12:1325(C) (a withdrawing member is entitled to the fair market value of his interest), *and id.* § 1333 (a member's membership ceases at death and his legal representative is treated as an assignee of his interest), *with* LA. CIV. CODE ANN. art. 2823 (2005) (a withdrawing partner, or his successors if he is deceased, is entitled to the value of his former share).

180. LA. REV. STAT. ANN. § 12:1333.

181. *See id.* § 1330 (an assignee has no rights as a member until he is admitted as a member); *see also id.* § 1325(C) (stating that a member in a partnership may withdraw).

hand, entitles the successors of a deceased partner to the same value as a withdrawing partner.[182] Even if the operating agreement allowed an assignee of an LLC interest to withdraw, unlike the Louisiana Civil Code article that says a withdrawing partner is entitled to the *value* of his share, LLC law provides that a withdrawing member is entitled to the *fair market value* of the interest.[183] The *Cannon* decision is unlikely to have an effect on LLC interest valuation.

The default LLC laws provide that a holder of an assigned interest, which would be held by the legal representative of a deceased member, cannot become a member of the LLC without the unanimous written consent of all members.[184] A discount for lack of control could be applied to the assignee interest.[185] Further, the assignee interest may not enjoy liquidation rights, even if the company were not constituted for a term, because only members hold liquidation rights.[186] The lack of liquidation rights associated with the interest would make the interest less attractive to a hypothetical buyer, further reducing its value for estate tax purposes. There may also be no market for such an interest, meaning a discount for a lack of marketability may also be available in valuing the interest for estate tax purposes.[187] The availability of multiple discounts in the valuation of the interest of a deceased member of a limited liability company makes the LLC a better option than a family limited partnership for estate tax purposes because such discounts may no longer be available in valuing the interests of a former partner after *Cannon.*

## VI. CONCLUSION

Following *Cannon*, Louisiana courts will likely no longer apply valuation discounts in valuing partnership interests held by withdrawing partners.[188] The effects of *Cannon* are also likely to carry over into the valuation of an interest formerly held by a deceased partner.[189] Without the availability of discounts for

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182. LA. CIV. CODE ANN. art. 2823. The *Cannon* decision determined this value as the value of the underlying business assets. *See supra* note 84 and accompanying text.

183. LA. REV. STAT. ANN. § 12:1325(C).

184. *Id.* § 1332(A)(1).

185. *See generally* KALINKA, *supra* note 167, § 3.27, at 381.

186. LA. REV. STAT. ANN. § 12:1330; *id.* § 1325.

187. KALINKA, *supra* note 167, § 3.27, at 381.

188. *See* discussion *supra* Part III.B.

189. *See* discussion *supra* Part III.B.

minority interests, lack of marketability, and others, the interests of former partners upon death will be more valuable for estate tax purposes.[190] The increased value of a deceased partner's interests will increase the estate tax burden on the decedent's estate.[191] Due to the likelihood of higher estate taxes levied on partnership interests post-*Cannon*, the family limited partnership is a less attractive option for managing family assets in an estate tax plan.[192] A more effective option is the limited liability company.[193] Louisiana default rules regarding the transfer of an interest in a limited liability company allow opportunities for discounting that the *Cannon* decision effectively eliminates for family limited partnerships.[194] Estate planners should consider using limited liability companies in creating estate plans in lieu of the family limited partnership. Further, family limited partnerships currently in use as a part of an estate plan should be converted to limited liability companies to make the most effective utilization of valuation discounts. With death and taxes being the only things certain in life, the use of a limited liability company instead of a family limited partnership for estate planning will alleviate the uncertainty that surrounds the taxes that accompany death.

*Jonathan J. Rose*[*]

190. *See* discussion *supra* Part V.
191. *See* discussion *supra* Part V.
192. *See* discussion *supra* Part V.A.
193. *See* discussion *supra* Part V.B.
194. *See* discussion *supra* Part V.B.

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