UNC SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 100 | Number 2 Article 7

1-1-2021

# The Happy Families of Tax Law

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Recommended Citation
Carla Spivack, *The Happy Families of Tax Law*, 100 N.C. L. REV. 601 (2022).
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# THE HAPPY FAMILIES OF TAX LAW*

CARLA SPIVACK**

*This Article points to the difference between the treatment of wealthy families and poor families who apply for tax benefits and argues that the same treatment should apply to both. I show that tax breaks for the wealthy and benefits for the poor are both government expenditures that deplete the public fisc; indeed, some have called tax benefits for the rich "hidden" or "submerged" forms of welfare. Yet, as I discuss, the law treats wealthy applicants for tax breaks quite differently from the way it treats poor people applying for similar benefits. The wealthy receive tax breaks based on assumptions about their family dynamics, without any inquiry into the dynamics in a particular family. By contrast, poor people applying for benefits face scrutiny of their intimate lives, relationships, and spaces to establish eligibility. In essence, this Article argues that what's sauce for the goose is sauce for the gander.*

*I advocate for the same treatment of the recipients of government aid at both ends of the spectrum. If the poor must open their family lives to scrutiny as the price for benefits, why shouldn't the rich? I propose that the law employ a presumption that families cooperate in maximizing their wealth and require evidence of disunity to overcome that presumption and prove eligibility for the tax benefit. For the sake of pragmatism, however, I also suggest a safe harbor: a modest statutory discount rate for minority interests with no questions asked. Any applicant seeking a deeper discount would have to show evidence of serious family dysfunction to overcome the presumption.*

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** My profound thanks to many colleagues and friends for their feedback and encouragement: Alice Abreu, Neil H. Buchanan, Bridget J. Crawford, Mirit Eyal Cohen, Paula J. Dalley, Eric T. Laity, Wendy Gerzog, Victoria Haneman, Anthony Infanti, James R. Repetti, and Allison Anna Tait. Special thanks to William P. LaPiana, whose ongoing engagement with me and this project was a constant source of inspiration. And heartfelt thanks to my indomitable Research Assistant Emma Kincaide, J.D., Oklahoma City University School of Law 2021, for outstanding editing, research, and cite checking that truly exceeded all expectations (and all legally sanctioned work hours).

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## INTRODUCTION

Tolstoy said something about happy and unhappy families being different.[1] Tax law does not acknowledge this. Instead, it hands out tax benefits in the form of valuation discounts to wealthy families based on the assumption that these families are all alike.[2] The discounts are based on the assumption that

1. The original quote is: "All happy families are alike; each unhappy family is unhappy in its own way." LEO TOLSTOY, ANNA KARENINA 1 (Richard Pevear & Larissa Volokhonsky trans., 2004) (1878). I cannot in good conscience add to the stack of law review articles and judicial opinions that directly quote this famous adage. *See, e.g.*, Bowen v. Gilliard, 483 U.S. 587, 633 (1987) (Brennan, J., dissenting); Herbert Hovenkamp, *Regulation and the Marginalist Revolution*, 71 FLA. L. REV. 455, 492 (2019); Allison Anna Tait, *Corporate Family Law*, 112 NW. U. L. REV. 1, 2 (2017); Susan R. Schmeiser, *Romancing the Family*, 33 HARV. J.L. & GENDER 327, 336 (2010); William D. Araiza, *The Section 5 Power and the Rational Basis Standard of Equal Protection*, 79 TUL. L. REV. 519, 564 n.187 (2005); Paul Steinberg & Gerald Lescatre, *Beguiling Heresy: Regulating the Franchise Relationship*, 109 PA. ST. L. REV. 105, 187 n.467 (2004). I hope that my allusion takes the trend in new direction.

2. *See infra* Part II. *See generally* Joseph M. Dodge, *Three Whacks at Wealth Transfer Tax Reform: Retained-Interest Transfers, Generation-Skipping Trusts, and FLP Valuation Discounts*, 57 B.C. L. REV. 999, 1022–23 (2016) ("Current law allows a person holding a controlling interest to obtain minority-interest discounts for gift-tax purposes (but not estate-tax purposes) by making separate transfers of minority interests."); John F. Coverdale, *Of Red Bags and Family Limited Partnerships: Reforming the Estate and Gift Tax Valuation Rules To Achieve Horizontal Equity*, 51 U. LOUISVILLE L. REV. 239, 240 (2013) ("Taxpayer B creates an FLP to which she contributes the stock and leaves the interests in the FLP to her children in her will. Her estate will be granted a marketability discount on grounds that an outsider buyer would not pay net asset value for interests in the FLP because the lack of a market for those interests makes them illiquid . . . ."); Ronald H. Jensen, *The Magic of Disappearing Wealth Revisited: Using Family Limited Partnerships To Reduce Estate and Gift Tax*, 1 PITT. TAX REV. 155, 158 (2004) ("F and M transfer their interests in the business to an FLP and each takes back a GP interest representing

all wealthy families are incapable of cooperating to maximize their wealth and that this disunity lowers the value of minority interests in family-owned assets. Tax law assumes this despite the fact that it is clearly in these families' interests to cooperate and maximize wealth—and, if they cannot, to sell the business at its full fair market value. They assume away any possibility that family members will cooperate to maximize the value of their aggregate assets. In short, valuation discounts assume that all wealthy families are alike, and all dysfunctional, and gives them enormous tax breaks based on this assumption without asking for any evidence of actual discord in the individual family at issue. The government also gives tax and other benefits to poor families but makes no such assumptions. Instead, it subjects these families to surveillance of their intimate lives to establish eligibility,[3] and it assumes they will always lie about their family's situation to receive benefits.[4] The wealthy, on the other hand, escape such surveillance, despite also receiving significant benefits that

0.5% of the FLP's equity and LP interests representing 49.5% of its equity [to receive] a combined lack-of-control and lack-of-marketability discount of 30% for the LP interests and a 10% lack-of-marketability discount for the GP interests . . . ."); James R. Repetti, *Democracy, Taxes, and Wealth*, 76 N.Y.U. L. REV. 825, 868 (2001) (noting discounts of partnership interests); William S. Blatt, *Minority Discounts, Fair Market Value, and the Culture of Estate Taxation*, 52 TAX L. REV. 225, 225 (1997) ("In valuing blocks of corporate stock, courts often permit a minority discount—a reduction in value that reflects the difficulty of selling shares lacking corporate control.").

3. *See generally* Jeffrey L. Vagle, *The History, Means, and Effects of Structural Surveillance*, 9 NE. U. L. REV. 103, 133 (2017) (discussing "structural surveillance on poor and minority populations" associated with "broken windows policing"); Michele Estrin Gilman, *The Class Differential in Privacy Law*, 77 BROOK. L. REV. 1389, 1389–90 (2012) ("[The poor] endure a barrage of information-collection practices that are far more invasive and degrading than those experienced by their wealthier neighbors"); Khiara M. Bridges, *Towards a Theory of State Visibility: Race, Poverty, and Equal Protection*, 19 COLUM. J. GENDER & L. 965, 968 (2010) ("[P]oor, pregnant women must submit to a state-erected apparatus that requires them to yield personal and, often, private information about themselves in exchange for a welfare benefit."); JOHN GILLIOM, OVERSEERS OF THE POOR: SURVEILLANCE, RESISTANCE, AND THE LIMITS OF PRIVACY 54 (2001) (discussing the surveillance of the state's welfare recipients and how individuals live in constant fear of having benefits stripped from them because of minor violations).

4. Dorothy E. Roberts, *Digitizing the Carceral State*, 132 HARV. L. REV. 1695, 1698 (2019) (book review) ("[S]tate surveillance concentrates on poor people with an intensity unknown to middle-class and wealthy Americans."); Ronald J. Bacigal, *Some Observations and Proposals on the Nature of the Fourth Amendment*, 46 GEO. WASH. L. REV. 529, 542 nn.94 & 95 (1978) (suggesting that privacy only exists for the wealthy).

can represent as much as 70% of full value[5] and cost taxpayers billions per year in lost taxes.[6] I argue here that what's sauce for the goose is sauce for the gander.[7]

The literature of tax expenditures makes it clear that tax breaks and direct payments are both government benefits that deplete the federal fisc.[8] The difference between welfare benefits for the poor and tax benefits for the rich is mainly that the latter are "hidden" rather than "handed out" directly: tax benefits for the rich exist in the form of tax breaks that allow the wealthy to hold onto money that others must pay.[9] Yet, these benefits for the rich and those for the poor rest on two opposing assumptions about families. Wealthy families claiming valuation discounts are assumed, without investigation into their particular family dynamics, to deserve these benefits.[10] To the contrary, poor families seeking welfare benefits are assumed to be undeserving and

5. Mitchell M. Gans & Jay A. Soled, *Reforming the Gift Tax and Making It Enforceable*, 87 B.U. L. REV. 759, 766 (2007) ("Common combined minority and marketability valuation discounts often range from [fifteen] percent to as high as [seventy] percent."); *see also* Louis A. Mezzullo, *Worksheet 1: Summary of Discounts and Premiums in Selected Cases*, TAX MGMT. PORTFOLIO 831-4TH (2007) (providing summary of the discounts courts have permitted taxpayers).

6. William S. Blatt, *Minority Discounts, Fair Market Value, and the Culture of Estate Taxation*, 52 TAX L. REV. 225, 225–26 (1997) ("[M]inority discounts have cost the Treasury billions in lost taxes.").

7. The original saying, "what's sauce for the goose is sauce for the gander," refers to gender equity—what's good for the wife is good for the husband. *See What's Sauce for the Goose*, FREE DICTIONARY, https://idioms.thefreedictionary.com/What%27s+Sauce+for+the+Goose [https://perma.cc/MH5W-8DEW]. The expression has come to apply to any disparate treatment for similar people or objects: Justice Breyer once noted that "in the law, what is sauce for the goose is normally sauce for the gander." Heffernan v. City of Paterson, 136 S. Ct. 1412, 1418 (2016). Like the Tolstoy quote above, this saying has found its place in many law review articles. *See, e.g.*, Michael L. Hopkins, "*What Is Sauce for the Gander Is Sauce for the Goose:" Enforcing Child Support on Former Same-Sex Partners Who Create a Child Through Artificial Insemination*, 25 ST. LOUIS U. PUB. L. REV. 219, 219 (2006); Howard M. Zaritsky, *Sauce for the Goose? IRS Rejects Discount Based on Aggregating Separate Gifts*, 24 EST. PLAN. 344, 344 (1997); Joseph S. Jackson, *Sauce for the Goose: Some Thoughts on Gay Sex and Equal Protection*, 48 FLA. L. REV. 473, 473 (1996).

8. Wendy A. Bach, *Poor Support/Rich Support: (Re)viewing the American Social Welfare State*, 20 FLA. TAX REV. 495, 498 (2017) ("[Efforts] to redefine the U.S. social welfare state . . . include not only traditional benefit programs (for example, welfare and Social Security) but also a variety of tax benefits that are 'hidden' or 'submerged' forms of 'Welfare for the Wealthy.'"); SUZANNE METTLER, THE SUBMERGED STATE: HOW INVISIBLE GOVERNMENT POLICIES UNDERMINE AMERICAN DEMOCRACY 16–17 (2011); CHRISTOPHER HOWARD, THE HIDDEN WELFARE STATE: TAX EXPENDITURES AND SOCIAL POLICY IN THE UNITED STATES 3 (Ira Katznelson, Martin Shefter & Theda Skocpol eds., 1997) [hereinafter HOWARD, THE HIDDEN WELFARE STATE] (discussing "hidden" tax benefits for the wealthy).

9. *See* CHRISTOPHER G. FARICY, WELFARE FOR THE WEALTHY: PARTIES, SOCIAL SPENDING, AND INEQUALITY IN THE US 5 (2015); METTLER, *supra* note 8, at 16–17; HOWARD, THE HIDDEN WELFARE STATE, *supra* note 8, at 3; *see also* Marjorie E. Kornhauser, *Cognitive Theory and the Delivery of Welfare Benefits*, 40 LOY. U. CHI. L.J. 253, 272 (2009) ("[P]lacing general welfare (child tax credits, home mortgage deductions, and education credits) within the tax system frames them so positively that they all but disappear from consciousness.").

10. *See* discussion *infra* Section III.C.1.

dishonest.[11] While there is no investigation of the family dynamics of wealthy families, poor families are subjected to intimate surveillance of their lives, relationships, and personal space. This surveillance of welfare applicants has drawn considerable—and justified—fire.[12] This Article aims in the opposite direction. I propose that wealthy applicants for tax breaks based on family dynamics should face the same scrutiny that welfare beneficiaries face to determine their eligibility.

Because families are different, both sets of assumptions are true for some families and not for others. Some families cooperate; some do not. Some may misrepresent their circumstances to receive benefits, and some do not. But, today, thanks to an army of family wealth preservation advisors, assumptions of a high-wealth family's lack of cooperation are often wrong. Happy and unhappy families—for valuation purposes at least—are, it turns out, different. And high-wealth families today hire consultants to teach them to be happy—or, at least, to cooperate to maximize growth. Despite the new science of family cooperation for wealth maximization, these families still receive valuation discounts based on the assumption that they are all incapable of working together for aggregate gain.

At the other end of the spectrum, statistics show that only a very small percentage of people applying for government relief actually lie about meeting eligibility requirements.[13] Thus, not only are these two forms of government benefits—tax breaks and welfare (here I will be discussing the Earned Income Tax Credit, or "EITC," and Temporary Assistance to Needy Families, or "TANF")—operated under different standards for these two groups, the standards miss their intended target—people whose family circumstances fail to merit the benefit sought—at both ends.

Many high-wealth families break this uncooperative paradigm. Some simply do not have family structure or dynamics that lead to division. For

11. *See* Peter B. Edelman, *Criminalization of Poverty: Much More to Do*, 69 DUKE L.J. ONLINE 114, 114 (2020) ("Criminalization of poverty, a junior sibling to mass incarceration, is wreaking havoc . . . ."); Sarah Geraghty, *Keynote Remarks: How the Criminalization of Poverty Has Become Normalized in American Culture and Why You Should Care*, 21 MICH. J. RACE & L. 195, 195 (2016) ("[C]riminalization of poverty has become normalized in American culture . . . ."); Kaaryn Gustafson, *Criminal Law: The Criminalization of Poverty*, 99 J. CRIM. L. & CRIMINOLOGY 643, 643 (2009) [hereinafter Gustafson, *The Criminalization of Poverty*] ("This Article maps the criminalization of welfare."). *See generally* KAARYN S. GUSTAFSON, CHEATING WELFARE: PUBLIC ASSISTANCE AND THE CRIMINALIZATION OF POVERTY (2011) [hereinafter GUSTAFSON, CHEATING WELFARE] (providing a detailed and extensive description of how welfare programs are characterized by assumptions of criminality among recipients).

12. *See supra* note 3 and accompanying text.

13. *See* RANDY ALISON AUSSENBERG, ERRORS AND FRAUD IN THE SUPPLEMENTAL NUTRITION ASSISTANCE PROGRAM (SNAP) 11–12 (2018), https://fas.org/sgp/crs/misc/R45147.pdf [https://perma.cc/39GL-LD3D]; *see also* U.S. SENT'G COMM'N, QUICK FACTS GOVERNMENT BENEFITS FRAUD STATISTICS: FISCAL YEAR 2019, at 1 (2020).

example, an only child has no one to feud with, and succession from one generation to the next may well go smoothly. Some just get along better than others. Today, an army of wealth preservation advisors deploys an arsenal of techniques to avoid leaving this to chance.[14] This arsenal includes: family constitutions, laws of governance tailored to each family's wealth preservation needs, articulation of "family values" to guide family decision-making and to resolve disputes, and therapists—from the legion of "family systems" advisors—who specialize in keeping business-owning families harmonious so their wealth can stay in the family.[15] Not all families reap the benefits of this advising, of course. Certainly, the Tax Code's paradigm of the uncooperative family that disadvantages minority shareholders sometimes reflects reality, and shareholder oppression happens. But this has never been true across the board, and is today, I argue here, even less likely. Thus, tax law should distinguish between happy and unhappy families. Not only does this better reflect reality, but it is only fair to require the same showing of eligibility from wealthy families for government benefits as from poor families.

This discrepant scrutiny of the poor has a long history in Anglo-American culture.[16] The Elizabethan Poor Laws created a system of "Overseers of the Poor" to separate the "deserving poor" from those deemed merely lazy.[17]

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14. *See* Allison Anna Tait, *The Law of High-Wealth Exceptionalism*, 71 ALA. L. REV. 981, 994 (2020) [hereinafter Tait, *High-Wealth Exceptionalism*] (discussing the role of wealth preservation advisors in helping families become self-governing entities in autonomous legal worlds). For a classic book within the wealth-preservation genre, see generally JAMES E. HUGHES JR., FAMILY WEALTH—KEEPING IT IN THE FAMILY: HOW FAMILY MEMBERS AND THEIR ADVISERS PRESERVE HUMAN, INTELLECTUAL, AND FINANCIAL ASSETS FOR GENERATIONS (2004).

15. Tait, *High-Wealth Exceptionalism*, *supra* note 14, at 984 n.7; *see also* HUGHES, *supra* note 14, at 4 (summarizing various wealth preservation strategies and instruments); Brian Groom, *The Rise of the Family Business Constitution*, FIN. TIMES (Dec. 13, 2017), https://www.ft.com/content/5d06ec9e-c61b-11e7-b30e-a7c1 c7c13aab [https://perma.cc/5HY5-92GE] (remarking on the usefulness of the family constitution when the family wishes to preserve wealth for multiple generations).

16. *See* Gustafson, *The Criminalization of Poverty*, *supra* note 11, at 658–61; *see also* JILL QUADAGNO, THE COLOR OF WELFARE: HOW RACISM UNDERMINED THE WAR ON POVERTY 15 (1994). *See generally* KENNETH J. NEUBECK & NOEL A. CAZENAVE, WELFARE RACISM: PLAYING THE RACE CARD AGAINST AMERICA'S POOR 35 (2001) (using the term welfare racism to describe "the various forms and manifestations of racism associated with means-tested programs of public assistance for poor families").

17. Joel F. Handler, *The Transformation of Aid to Families with Dependent Children: The Family Support Act in Historical Context*, 16 N.Y.U. REV. L. & SOC. CHANGE 457, 468 (1988); Khiara M. Bridges, *The Deserving Poor, the Undeserving Poor, and Class-Based Affirmative Action*, 66 EMORY L.J. 1049, 1053 (2017) ("[P]rograms that are imagined to benefit the deserving poor enjoy political support, and programs that are imagined to benefit the undeserving poor do not."); Casey Garth Jarvis, *Homelessness: Critical Solutions to a Dire Problem; Escaping Punitive Approaches by Using a Human Rights Foundation in the Construction and Enactment of Comprehensive Legislation*, 35 W. ST. U. L. REV. 407, 414 (2008).

Colonial America employed this same system.[18] In America in the 1800s, the poor labored in poorhouses under the eyes of their "keepers."[19] More benevolently motivated, Henry Mayhew's exhaustive eighteen-volume work, *London Labor and the London Poor*, published between 1850–1862, chronicled in meticulous—and at times tedious—detail every category of working Londoners, transcribing their own words describing their work and lives.[20] Mayhew's work foreshadowed the study of poor people's lives in the twentieth century by sociologists, anthropologists, statisticians, economists, and public health specialists, to name a few, and their scrutiny by courts and welfare agencies. As one website puts it, "the powerful have long agreed: poor and working people must be watched."[21]

By contrast, scrutiny of the lives of the rich is sparse.[22] No government agency scrutinizes their family dynamics, child-rearing practices, household members, substance abuse, or work habits. But, as one author notes, it is important to understand the rich because of their "immense influence" and their growing numbers (an increase of 10% per year).[23] It is also important to focus on the rich because us taxpayers subsidize them with enormous tax breaks based on assumptions about their lives that may often be wrong. I focus here on a particular form of tax subsidy—discount valuations—although my argument has wider application. If the poor must submit to intimate scrutiny to receive benefits, so should the wealthy.

Part I reviews the history of the discount valuation, dispelling any notion that it emerged as a response to the loss of family businesses through estate taxes and a clamor for salvation. Rather, this part will show that the process has been the reverse: the Tax Code provisions dealing with discounts arose as a response to attempts by the wealthy to use the Family Limited Partnership ("FLP") form to reduce taxes on the transfer of their estates. I also survey the criticism these rules have received.

18. *See* WALTER I. TRATTNER, FROM POOR LAW TO WELFARE STATE: A HISTORY OF SOCIAL WELFARE IN AMERICA 18 (6th ed. 1999) (describing Elizabethan Poor Laws and how they applied to the colonies).

19. *See id.* at 57–61 (explaining the conditions of poorhouses); MICHAEL B. KATZ, IN THE SHADOW OF THE POORHOUSE: A SOCIAL HISTORY OF WELFARE IN AMERICA 27–28 (10th ed. 1996) (describing the relationship between poorhouse residents and keepers).

20. HENRY MAYHEW, LONDON LABOUR AND THE LONDON POOR: A CYCLOPAEDIA OF THE CONDITION OF THOSE THAT WILL WORK, THOSE THAT CANNOT WORK, AND THOSE THAT WILL NOT WORK 465–66 (1861). Most lawyers are familiar with at least one of Mayhew's subjects: Jo, the crossing sweeper, in Charles Dickens's *Bleak House*, was typical of the characters Mayhew studied. CHARLES DICKENS, BLEAK HOUSE 160–65 (Oxford Univ. Press 1996) (1853).

21. *The Color of Surveillance: Monitoring of Poor and Working People*, GEO. L. CTR. ON PRIV. & TECH. (Nov. 7, 2020), https://www.law.georgetown.edu/privacy-technology-center/events/color-of-surveillance-2019/ [http://perma.cc/ZR7F-ADUP].

22. JUSTIN FARRELL, BILLIONAIRE WILDERNESS: THE ULTRA-WEALTHY AND THE REMAKING OF THE AMERICAN WEST 19–20 (2020).

23. *Id.* at 18, 33.

Parts II and III turn to the families themselves and the wealth preservation industry that has grown up around them. There, I chronicle the most fractious families in the history of family-owned companies. I do so to show two things. First, family discord that reaches the level of elevating personal enmity over wealth preservation is easy to spot. Second, conflict in families emerges at predictable stress points, and wealth preservation advisors target precisely these points in family life cycles to forestall disunity and conflict. It's impossible to say, of course, whether such advising would have saved Anheuser Busch, Vanderbilt, Seagram's, and the others I discuss from their downfalls. But having learned how, when, and why families splinter, the wealth preservation industry teaches its clients how to navigate past these challenges.

Part IV invokes the tax expenditure literature to show that "tax breaks" such as valuation discounts and welfare for the poor are two forms of government spending. I document the scrutiny and surveillance poor families must accept to receive aid, and I assert that investigating the family dynamics of rich families applying for tax discounts is merely equitable.

Part V offers a solution. First, I discuss the 2016 proposed regulations that the Trump administration disingenuously touted as a step in the right direction. These proposed regulations would have, in essence, applied family attribution rules to certain currently discounted transfers in FLPs. I argue, however, that truly equitable reform would go further, requiring wealthy families to prove their eligibility for discounts. In the spirit of practicality and presidential dealmaking, however, I propose a compromise: a fixed and limited tax break without family investigation. Only families that insisted on deeper discounts than the "no questions asked" discount would need to prove their eligibility.

## I. THE LAW AND LOGIC OF DISCOUNTS

The story of valuation discount is the story of a tug-of-war between the Treasury and the Estate Planning Bar. Estate planners push by devising a new form of asset structure to reduce taxes; the Treasury pulls back by attempting to tax the full value of the estates of the wealthy passing at death; the wealthy and their planners pull back by devising a way to remove value from the estate; the Treasury responds with a new rule pulling the value back in; and the back-and-forth continues.[24]

24. *See* Robert G. Alexander & Dallas E. Klemmer, *Creative Wealth Planning with Grantor Trusts, Family Limited Partnerships, and Family Limited Liability Companies*, 2 EST. PLAN. & CMTY. PROP. L.J. 307, 312–14 (2010) (explaining estate planning issues caused by changes to wealth transfer tax laws); James R. Hines, Jr., *Taxing Inheritance, Taxing Estates*, 63 TAX L. REV. 189, 203 (2009) (describing how the generation-skipping transfer tax was introduced as a reaction to the prevailing estate tax avoidance technique at the time). *See generally* Gans & Soled, *supra* note 5 (describing the historic role of the gift tax, taxpayer strategies to circumvent the gift tax, and recommending reforms).

## A. *How Discounts Work*

Valuation discounts operate to reduce the value of a decedent's estate to reduce the tax levied on that estate, or to reduce the value of a gift to reduce the corresponding gift tax levied. Under the current rules, when a shareholder in an FLP or a trust transfers shares to her children and retains only a minority interest—anything less than 50%—the amount of the estate for tax purposes, under the current rules, is drastically reduced from what would have been its fair market value.[25] In other words, a 40% interest in the business is not valued as 40% of the value of the business; it is valued at significantly less. This is because the law assumes that a minority shareholder in a family business or trust will suffer from her lack of control and will have nowhere to sell her shares should she wish to exit.[26] In shareholder terms, these discounts assume a minority shareholder in a family business will face "shareholder oppression" in the form of "freeze outs" (exclusion from decision making and control) and/or "squeeze outs" (denial of fair share of pay or dividends by majority members)—and that her shares are thus worth less than their fair market value. FLPs can hold either passive assets, such as stock portfolios, or active assets in the form of going businesses. In the former case, a shareholder's minority status might threaten her fair receipt of distributions or exclude her from decisions about management of the trust's assets. In the latter case, minority status might endanger her role in management, her salary as an employee, or her dividends. The law discounts the value of the shares based on the assumption that these scenarios are likely. Thus, the estate of the taxpayer who carves up a business and transfers the shares in minority form pays much less in taxes than it would otherwise.

The plaintiff in the valuation case *Estate of Harrison v. Commissioner*[27] explained the rationale of disappearing value:

> Value does appear and disappear frequently in ordinary transactions. If that is not apparent, only some thought is needed to make it so. Suppose A, B, and C contribute $100 each to form a corporation, each receiving one share. With only one share, none of them alone can force a liquidation so as to get his $100 back. Under the willing buyer-seller test, what is the value of A's share? The value has decreased from the $100 contributed to something much smaller, perhaps $45, that reflects the

25. *See* James R. Hamill & Donald W. Stout, *Valuation Discounts for Intrafamily Transfers*, 59 TAX'N FOR ACCT. 75, 75–76 (1997) (describing how FLPs create valuation discounts); *see also* Martin A. Goldberg & Cynthia M. Kruth, *New Life for Valuation Discounts in Family Entities*, 16 QUINNIPIAC PROB. L.J. 48, 49–52 (2002) (explaining FLP valuation discounts where transferors retain a minority interest and discussing relevant IRS rules and case law).

26. Hamill & Stout, *supra* note 25, at 76–77 (explaining lack-of-control and lack-of-marketability discounts in FLPs).

27. 52 T.C.M. (CCH) 1306 (1987).

> loss of a right to liquidate. Where did the lost $55 go? It did not go to B or C, for each of them has suffered the same $55 loss. Such a loss may continue indefinitely as the corporation does business. We can see that readily by noting that the stocks of hundreds of corporations sell on exchanges at substantially below liquidation values.[28]

In a nutshell, then, a transferor can reduce the value of assets, and thus the taxes computed for them, by the simple expedient of placing them all in an FLP and then distributing minority shares of the partnership to several transferees so that no one recipient has control—or by retaining only a minority interest in her estate at death.[29]

### B. *History: The Tug-of-War Between the IRS and Estate Planners and Their Clients*

Although their partisans like to trot out the struggling farmer who just wants to pass on the family farm to his children,[30] the actual history of

28. S. Stacy Eastland, *Family Limited Partnerships: Transfer Tax* Benefits, PROB. & PROP., July–Aug. 1993, at 59, 60 (exploring a § 2036 case).

29. *See generally, e.g.*, Michael D. Mulligan & Angela F. Braly, *Family Limited Partnerships Can Create Discounts*, 21 EST. PLAN. 195 (1994) (explaining how FLPs can create valuation discounts for lack of marketability and minority interest); Timothy C. Polacek & Richard A. Lehn, *Tax Court Allows Sizable Fractional Interest Discounts*, 133 TR. & ESTS. 29 (1994) (analyzing a case in which a tax court allowed discounts for minority interest and lack of marketability where a taxpayer transferred property interests via a partnership); Louis S. Harrison, *Special Valuation Rules of Chapter 14 and Partnerships Can Save Transfer Taxes*, 11 J. P'SHIP TAX'N 239 (1994) (explaining how partnership can lead to significant estate and gift tax savings); Kathryn G. Henkel & Elizabeth R. Turner, *Family Limited Partnerships Can Play a Major Role in Asset Protection Planning*, 11 J. P'SHIP TAX'N 216 (1994) ("[G]ifts and bequests of partnership interests can be eligible for minority interest and lack of marketability discounts for transfer tax purposes . . . ."); Martin D. Begleiter, *Estate Planning in the Nineties: Friday the Thirteenth Chapter 14: Jason Goes to Washington—Part I*, 81 KY. L.J. 535, 571–72 (1992–1993) (explaining how a minority discount is calculated); Robert B. Coplan & David H. Gerson, *Estate Freeze Transactions Not Covered by Chapter 14*, 23 TAX ADVISER 32, 32–33 (1992) (explaining how partnerships can be used to minimize gift tax value of stocks); S. Stacy Eastland, *Business Valuation Issues, Including Analysis of Selected Parts of IRC Section 2701 and IRC Section 2704*, C743 A.L.I-A.B.A. PLAN. TECHS. FOR LARGE ESTATES 327 (1992) (explaining how partnerships can be set up to reduce the value of, and taxes on, assets); Larry W. Gibbs, *A Family Limited Partnership as the Centerpiece of an Estate Plan*, 131 TR. & ESTS. 45, 47–50 (1992) (describing how FLPs can reduce the fair market value of assets); James R. Hitchner & Kevin J. Rudd, *The Use of Discounts in Estate and Gift Tax Valuations*, 131 TR. & ESTS. 49 (1992) (describing estate and gift tax valuation and available discounts); Rick J. Taylor, *Discount Partnership Arrangements Still Can Be Used To Reduce Transfer Taxes*, 23 TAX ADVISER 382, 383–84 (1992) (explaining how partnerships can be used to reduce the value of senior family members' interests in a family partnership); Richard L. Dees, *The Slaying of Frankenstein's Monster: The Repeal and Replacement of Section 2036(c)*, 69 TAXES 151 (1991) (explaining how valuation and discount rates are calculated).

30. David Cay Johnston, Opinion, *No, the Estate Tax Isn't Destroying Family Farms: The Latest Pitch for an Estate-Tax Repeal Repeats a Long-Discredited Lie*, AL JAZEERA AM. (Mar. 27, 2015, 2:00 AM), http://america.aljazeera.com/opinions/2015/3/the-estate-tax-isnt-destroying-family-farms.html [https://perma.cc/GM73-JGU7].

discounts[31] is far from that of hardworking farm families disinherited by the ravages of the estate tax.

FLPs can serve many nontax purposes in family business planning: they allow pass-though taxation for income[32] and can protect at least some family members from liability.[33] But family wealth planners in the 1970s and 1980s began using FLPs to fractionate interests and argue for valuation discounts based on the limited control and marketability of these noncontrolling interests, and the FLP literature suggests that this is their main purpose today.[34] Courts often went along with these strategies, and, as noted above, an "impressive string of victories by taxpayers in valuation cases . . . led to a predictable increase in interest among taxpayers and their advisors concerning the valuation discounting benefits of family-owned entities in general and FLPs in particular."[35]

The law requires no evidence to support the implicit claim of family disunity underlying discounts, nor does it allow for its rebuttal as a presumption. Not all families cooperate. Siblings bicker, and children resent parental authority. Shareholder oppression is real. But the existing discount regime ignores the possibility that a family might work together, treat shareholders fairly, keep the business in the family and maximize growth—or sell it later for fair market value.[36] In fact, the law ignores the obvious: it is in the family's best interest to cooperate and, if they truly cannot, then it is in their self-interest to sell the business as a whole to maximize the sales price.

Other Tax Code provisions recognize that family members cooperate to manage assets. The family attribution rules of § 318, for example, attribute stock ownership of close family members (spouses, children, and grandchildren) to

31. For a general discussion of valuation discounts in the estate tax context, see generally 15 MERTENS LAW OF FEDERAL INCOME TAXATION § 59:7 (Edward J. Smith ed., 2021); Wendy C. Gerzog, *Actuarial Tables Versus Factually Based Estate Tax Valuation: Ithaca Trust Revisited*, 38 REAL PROP. PROB. & TR. J. 745 (2004); Joshua S. Rubenstein, *Valuation, Taxation & Planning Techniques for Sophisticated Estates: Recent Developments*, *in* VALUATION, TAXATION & PLANNING TECHNIQUES FOR SOPHISTICATED ESTATES 7, 22–27, 32–37 (Practising L. Inst., Tax L. & Est. Plan. Series, Est. Plan. & Admin., Course, Handbook Series No. D-322, 2003).

32. Hamill & Stout, *supra* note 25, at 80–81.

33. *Id.* at 81.

34. Coverdale, *supra* note 2, at 242 n.21 ("The emphasis on tax savings of the many articles touting family limited partnerships also strongly suggests that it is a rare case in which non-tax motives are anywhere near as important as reducing estate and gift taxes." (citing Courtney Lieb, *The IRS Wages War on the Family Limited Partnership: How To Establish a Family Limited Partnership That Will Withstand Attack*, 71 UMKC L. REV. 887, 889–91 (2003); Bradford Updike, *Making Sense of Family Limited Partnership Law After* Strangi *and* Stone*: A Better Approach to Planning and Litigation Through the Bona Fide Transaction Exception*, 50 S.D. L. REV. 1, 1 (2005))).

35. Kenneth P. Brier & Joseph B. Darby, III, *Family Limited Partnerships: Decanting Family Investment Assets into New Bottles*, 49 TAX LAW. 127, 133 (1995).

36. For a discussion of *Kimbell*, see *infra* Section III.C.1.

one another, so that each person's stock is deemed held by the others as well.[37] These attribution rules determine control of a corporation. Family attribution was the IRS's original position regarding minority shares in FLPs. Revenue Ruling 81-253 states that, absent evidence of family discord sufficient to prevent family members from cooperating, interests in entities controlled by a family would be valued as if they were owned by a single individual.[38] This seems to create a rebuttable presumption that families work together to maximize family wealth and that discounts were only merited if the plaintiffs could prove otherwise in a particular case.

This view suffered a major defeat in *Estate of Bright v. United States*[39] and *Propstra v. United States*.[40] In *Bright*, the IRS opposed valuation discounts for shares in a closely held corporation.[41] Professor Russell Stanaland summarized the *Bright* case as follows:

> [A] husband and wife owned fifty-five percent of the stock of an affiliated group of corporations as community property. The wife, who predeceased her husband, had devised her half, 27.5% of the stock, to a trust for the benefit of her children with the husband named as trustee. This devise was subject to a transfer tax.[42]

There were no recent sales of the stock by which to calculate value, however, because the stock was not publicly traded.[43] "[T]he estate used an appraised fair market value and then claimed a fifty percent discount due to lack of liquidity and lack of marketability of the minority interest."[44] The appraiser valued the 27.5% at $4,402,970, which adjusted for inflation would be over $13 million today.[45] The IRS opposed the discount and assessed additional tax and interest, based on the fair market value, of more than $3,000,000 upon the estate.[46]

37. 26 U.S.C. § 318(a)(1)(A).

38. *See* Rev. Rul. 81-253, 1981-2 C.B. 187 ("[T]here is no evidence of the kind of family discord or other factor that would indicate that the family would not act as a unit in controlling the corporation.").

39. 658 F.2d 999 (Former 5th Cir. 1981).

40. 680 F.2d 1248 (9th Cir. 1982).

41. 658 F.2d at 1001.

42. Russell Stanaland, *Valuation Discounts After* Estate of Norwell v. Commissioner*: A Clear Formula for Reducing Estate Taxes*, 30 GOLDEN GATE U. L. REV. 679, 691 (2000).

43. *Bright*, 658 F.2d at 1000. The remaining 45% of the stock was owned by three or four individuals, with one person owning 30%. *Id.*

44. Stanaland, *supra* note 42, at 691 & n.96 ("In this case, an expert witness established the value of the stock. The dissent points out the value of the 27.5% interest was placed at $4,402,970 and a discount of fifty percent was used to reduce this by $2,201,485."); *see also Bright*, 658 F.2d at 1000; *id.* at 1008 n.1 (Rubin, J., dissenting).

45. Ian Webster, *Value of $4,402,970 from 1981 to 2021*, CPI INFLATION CALCULATOR, https://www.officialdata.org/us/inflation/1981?amount=4402970 [https://perma.cc/M9UJ-VN5E].

46. Stanaland, *supra* note 42, at 691; *Bright*, 658 F.2d at 1000.

The estate paid the deficiency and sued for a refund, contesting the IRS's refusal to accept the discount.[47] The estate won at the district court and the IRS appealed.[48] The Fifth Circuit rejected the IRS's arguments that (1) the share of stock was an undivided interest in the community property, and (2) the family attribution rules should apply, giving a family member constructive ownership of stock owned by another family member.[49] This rejection was based both on case law and legislative history.[50] Specifically, it referenced the legislative history of Regulation 20.2031-1(b), which introduces the "willing buyer-willing seller" standard, defining the 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 to sell and both having reasonable knowledge of relevant facts."[51] Using the willing buyer-willing seller standard requires that a minority discount apply, since a hypothetical buyer would likely demand a discount before buying a minority share in a family corporation.

The IRS issued a statement of nonacquiescence to *Bright* in Revenue Ruling 81-253, declining to allow minority discounts with respect to transfers between family members unless it found evidence of family discord or other factors indicating that a family could not act as a unit.[52] Thus began the war between the IRS and the Estate Planning Bar and its clients.

The next attack came in *Propstra*. In *Propstra*, the Ninth Circuit ruled that because Congress had not explicitly required that family attribution rules apply in estate tax situations, the court could not assume that Congress intended for them to be applied.[53] Without specific direction from Congress, the court ruled that it could not require "[e]xecutors . . . to make delicate inquiries into the feelings, attitudes, and anticipated behavior of those holding undivided interests in the property in question."[54]

At this point, the IRS acknowledged defeat and revoked Revenue Ruling 81-253 with Revenue Ruling 93-12, which states that family relationships will not be considered when valuing gifts of stock in closely held corporations.[55] Periodically, there have been legislative proposals to bring family attribution rules back to the FLP: The House Ways and Means Committee Report of the 1987 Omnibus Budget Reconciliation Act recommended family attribution in

47. *Bright*, 658 F.2d at 1000.
48. *Id.*
49. *Id.*
50. *Id.* at 1005 (citing Treas. Reg. § 20.2031-1(b) (1965)).
51. Treas. Reg. § 20.2031-1(b) (1965).
52. *See* Rev. Rul. 81-253, 1981-2 C.B. 187–88.
53. 680 F.2d 1248, 1251 (9th Cir. 1982).
54. *Id.* at 1252.
55. Rev. Rul. 93-12, 1993-1 C.B. 202–03.

the FLP context.[56] The Certain Estate Tax Relief Act of 2009[57] proposed denying minority discounts where the transferee and members of the transferee's family have control of the entity.[58] These efforts have not been successful.

Two notable cases put to rest the idea that valuation discounts were a desperate measure to save family businesses from dismemberment by estate taxes. *Estate of Watts v. Commissioner*[59] involved a family-owned Oregon lumber company, Rosboro Lumber, valued between $28.2 and $42 million.[60] The court noted that:

> The language in [the estate planning] documents indicates . . . [the] partners' intent to continue Rosboro as a going concern. Rosboro had long been a close family partnership and it was quite clear that all the partners and particularly Mr. Cole, the managing partner, intended to keep it that way. Rosboro was not dissolved upon Watts' death, nor was it going to be.[61]

Nonetheless, the court agreed with the estate's proposed 35% lack of marketability discount.[62]

This decision illustrates the peculiar logic of discounts. The estate was devalued by 35% due to the difficulty of selling the overall shares of the family business on the open market, yet the court acknowledged that none of the owners were remotely interested in selling at the time. Indeed, there was testimony that anyone who tried to sell shares would face legal action by the company.[63] Given this family context, the value on the open market seems like an irrelevant standard—or even a perverse one, since it used a standard whose relevance the family implicitly eschewed.[64]

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56. H.R. REP. NO. 100-391, at 1041–44 (1987), *as reprinted in* 1987 U.S.C.C.A.N. 2313-378, 2313-764 to 2313-769; *see* Lee A. Sheppard, *The Need for Family Limited Partnership Legislation*, 2 TAX NOTES 1095, 1099 (1999).

57. H.R. 436, 111th Cong. § 4 (2009).

58. *See* STAFF OF J. COMM. ON TAX'N, 111TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2010 BUDGET PROPOSAL 144 (J. Comm. Print 2009).

59. 51 T.C.M. (CCH) 60 (1985), *aff'd*, 823 F.2d 483 (11th Cir. 1987).

60. *Id.* at 62.

61. *Id.*

62. *Id.* at 63.

63. *Id.*

64. Coverdale, *supra* note 2, at 265 n.161 (citing James Edward Harris, *Valuation of Closely Held Partnerships and Corporations: Recent Developments Concerning Minority Interest and Lack of Marketability Discounts*, 42 ARK. L. REV. 649, 650–54 (1989)). Professor Coverdale notes that Professor Harris argues that "marketability discounts should not apply to controlling interests in privately held companies, or at least that if some marketability discount applies, it cannot be based on the standard restricted stock and IPO studies which focus on minority interests." *Id.* Additionally, Professor Coverdale argues that, while marketability discounts may be appropriate for family businesses, they are not appropriate for

The other important case, *Estate of Harrison*, involved the patriarch of a Texas oil family who had contributed assets worth $59,476,523 to an FLP before his death.[65] Because the assets contributed represented a limited partnership interest, the estate argued that they should be discounted for estate tax purposes, and the court agreed.[66] As in *Watts*, the facts of this case make this standard seem odd. The family's fortune came from oil wells the decedent's father had discovered;[67] the two brothers who inherited the estate were also oil men who ran the business and showed no interest in selling it. Today, the family is still in the Texas oil business, with an estimated fortune in the billions.[68]

### C. *Criticism and Proposed Reform*

Fast forward the discount wars to 2016, when the IRS issued new proposed regulations to § 2704, thirteen years in the drafting, that would have taken a small bite out of minority discounts, as I explain later in Part VI.[69] Shortly thereafter, Donald Trump was elected President of the United States, and the IRS withdrew the proposal.[70] That leaves us where we are today, with a new president who may be more inclined to address inequality with tax reform, although he may also face a resistant Congress.[71] In this context, I revisit the criticism of valuation discounts, offer a new analysis, and propose a new regime.

### D. *Critiques and Proposed Solutions*

Others have expertly and thoroughly covered the history and rationale of valuation discounts,[72] so I only summarize these topics here. Although tax

the investment vehicles that often constitute FLPs because "the last thing [these] owners would consider is selling their interest to an outsider." *Id.* at 266.

65. Estate of Harrison v. Comm'r, 52 T.C.M. (CCH) 1306, 1307 (1987).

66. *Id.* at 1310–11.

67. *See id.* at 1307.

68. Christopher Helman, *America's Oil and Gas Billionaires*, FORBES (Mar. 4, 2013, 12:48 PM), https://www.forbes.com/sites/christopherhelman/2013/03/04/americas-oil-and-gas-billionaires/?sh=feef8247df59 [https://perma.cc/H7GK-3US7].

69. Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest, 81 Fed. Reg. 51,413 (proposed Aug. 4, 2016) (withdrawn Oct. 20, 2017).

70. *See id.*

71. The House of Representatives for the 117th Congress is comprised of 214 Republicans (including one Delegate and the Resident Commissioner of Puerto Rico) and 224 Democrats (including four Delegates). JENNIFER E. MANNING, CONG. RSCH. SERV., R46705, MEMBERSHIP OF THE 117TH CONGRESS: A PROFILE 1 (2021). The Senate for the 117th Congress holds an even closer divide with forty-eight Democratic Senators (with two Independents joining their caucus) and fifty Republican Senators. *Id.* Vice President Kamala Harris, a Democrat, serves as the tie-breaking vote in the case of a Senate split. *Id.*

72. One of the earliest forays into the field is Mary Louise Fellows & William H. Painter, *Valuing Close Corporations for Federal Wealth Transfer Taxes: A Statutory Solution to the Disappearing Wealth Syndrome*, 30 STAN. L. REV. 895 (1978). Professor Brant J. Hellwig noted that Karen C. Burke and Grayson M.P. McCouch's article *Family Limited Partnerships: Discounts, Options, and Disappearing Value*, 6 FLA. TAX REV. 649 (2004) is a more recent example of scholarship concerning valuation discounts.

lawyers, accountants, and estate planning attorneys tout these discounts as an estate planning tool that can significantly reduce the value of a decedent's estate and the value of gifts for tax purposes,[73] they have drawn considerable fire—and, at times, incredulity—from tax scholars.[74] One scholar stated, "[t]he tax avoidance possibilities that derive from the continued availability of discounts for transfers of fractional interests among family members undermine the integrity of the transfer tax system and make a mockery of the principles of tax equity."[75] Professor Joseph Dodge blames discounts for, among other things, "drastic weakening of the wealth transfer taxes—both by legislation and the failure to address loopholes that are exploited by transactions that make little or no sense apart from tax avoidance."[76] Professor Brant Hellwig has called them a "form of self-serv[ing] tax reduction [that] has undermined the integrity of the already politically precarious estate and gift tax regime."[77]

These critics have proposed various solutions. Dodge proposes excluding from the discount regime family-held investment companies, as well as any situation where the discount arises because of marital property rights or gifts.[78] Hellwig proposed revising the definition of "adequate and full consideration in money or money's worth" and that the "bona fide sale" qualifier be defined and employed consistently under both the estate and gift tax provisions.[79] Professor Mitchell Gans has argued that the same family attribution rules in income tax law should also apply to the wealth transfer tax.[80] And twenty-five years ago, Professor James Repetti suggested that a presumption of control should operate

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*See* Brant J. Hellwig, *On Discounted Partnership Interests and Adequate Consideration*, 28 VA. TAX REV. 531, 538 n.14 (2009). Professor Hellwig summarizes that article as "advocating consistent treatment between the tax treatment of partnership formations and assignment of partnership interests, either through the finding of a gift on formation or the disallowance of entity-level discounts upon the transfer of a partnership interest." *Id.*

73. *See, e.g.*, *What Kind of Valuation Discounts Do Irrevocable Trusts Offer?*, EST. & BUS. L. GRP., https://eblawgroup.com/what-kind-of-valuation-discounts-do-irrevocable-trusts-offer/ [https://perma.cc/4TE4-ZLPM]; SHELLEY DRURY, VALUATION DISCOUNTS FOR GIFT AND ESTATE TAX SAVINGS: HOW GETTING VALUATION NOW CAN SAVE YOU LATER, THE DOTY GRP., P.S., https://static1.squarespace.com/static/5bc0c8149b8fe87850886f63/t/5dcc6e8582775766ce79b53b/1573678757827/Valuation+Discounts+-+Gift+and+Estate+Savings [https://perma.cc/WA4P-XMTQ].

74. *See, e.g.*, Stanley D. Neeleman, *Kasner Disregards Sound Tax Policy, Says Professor*, 61 TAX NOTES 867, 867 (1993); *see also* Dodge, *supra* note 2, at 1029–30; Brant J. Hellwig, *On Discounted Partnership Interests and Adequate Consideration*, 28 VA. TAX REV. 531, 533 (2009) [hereinafter Hellwig, *Adequate Consideration*].

75. Neeleman, *supra* note 74, at 867.

76. Dodge, *supra* note 2, at 1000.

77. Hellwig, *Adequate Consideration*, *supra* note 74, at 537.

78. Dodge, *supra* note 2, at 1031–32.

79. Hellwig, *Adequate Consideration*, *supra* note 74, at 617–18.

80. Gans & Soled, *supra* note 5, at 785 ("The first step would be to use a set of attribution rules akin to those in sections 267(b) and 318(a) to determine what the transferor owns, both directly and constructively (i.e., by means of attribution).").

to recapture the value lost under the current rules when a transferor who controls an asset transfers part of the asset as a way of reducing taxes.[81]

These critiques have attacked discounts for many valid reasons: for undermining the integrity of the tax system, shrinking the tax base, contributing to inequality, and straining sheer logic beyond the breaking point. Here, I break new ground by making their unspoken underlying assumptions explicit and by putting those assumptions to the test. Specifically, I address the underlying assumptions about wealthy families and their inability to cooperate to maximize wealth. Not all high-wealth families are dysfunctional. But, as it turns out, it is easy to spot the ones that are.

## II. UNHAPPY FAMILIES AND HOW TO SPOT THEM

Unhappy families are not hard to spot. Conflicts erupt at predictable "hinge moments"[82] in family business life cycles and around certain predictable issues. For example, a troubled succession might lead to a founder losing influence she might have counted on retaining or to a later generation losing interest in the business and bleeding it for cash to the detriment of nonmanaging shareholders.[83] Sibling discord in the second generation might result in a freeze out of a member.[84] At the third generation, the "cousin consortium" conflict might arise between those who work in the business and those who merely want distributions.[85] As the line descends from the founders, generations increasingly risk losing connection with the company's values and vision. These problems can lead to disunity in the family, creating the risk of mistreatment of minority shareholders. In such a situation, a minority shareholder, deprived of fair input and compensation, and unable to sell her shares on the open market, might very well suffer a loss in value of her shares. In this part, I first discuss "hinge moments" that arose in the sagas of several wealthy business families. I then explain three tools that wealth preservation advisors use to prevent these breakdowns at these critical junctures: family governance, family identity creation, and family therapy.

81. *See* James R. Repetti, *Minority Discounts: The Alchemy in Estate and Gift Taxation*, 50 TAX L. REV. 415, 486 (1995).

82. "Hinge moment" is a term Princeton physicist Freeman Dyson used to describe a connection point that ties two distinct periods in time. Doug Sosnik, *America's Hinge Moment*, POLITICO (Mar. 29, 2015), https://www.politico.com/magazine/story/2015/03/2016-predictions-americas-sosnik-clinton-116480/ [https://perma.cc/6TWU-CTG9].

83. *See* Harry Levinson, *Conflicts That Plague Family Businesses*, HARV. BUS. REV. (Mar. 1971), https://hbr.org/1971/03/conflicts-that-plague-family-businesses [https://perma.cc/LY5J-E2WY] (discussing the troubles that beset succeeding generations of family businesses).

84. *See id.*

85. KELIN E. GERSICK, JOHN A. DAVIS, MARION MCCOLLUM HAMPTON & IVAN LANSBERG, GENERATION TO GENERATION: LIFE CYCLES OF THE FAMILY BUSINESS 215–16 (1997).

### A. "*Hinge Moments*"

The most difficult time in a family business is often the time of succession.[86] Psychological studies suggest that founding entrepreneurs have unresolved conflicts with their fathers (these studies focused on men and may be less accurate in the case of female founders).[87] Because of this, these founders tend to resist authority and fear rivalry.[88] These emotional issues, of course, spell trouble for succession planning. While a founder facing succession may consciously want to pass the business on to his heirs, subconsciously, he may fear losing hard-won authority and ceding power to someone else. Such a founder keeps promising to retire but constantly finds excuses not to do so.[89] The heir, meanwhile, feels cheated and victimized. If there is more than one presumptive heir, the founder may play them off against each other, causing further conflict based on rivalry among the children.[90] Another stressful psychological aspect of succession is an Oedipal catch-22, more common in father-son succession cases, in which the son or employee "must imitate the boss to succeed, and . . . must not imitate the boss to succeed."[91] The second generation, the sibling generation, may also be plagued with rivalries among themselves that stems from old grudges and slights. At the next stage, often called the stage of the "cousin consortium," there exists a danger that some family members may lose their connection with the goals and values of the business and treat it as a source of funds.[92] At each generation, there is also the possibility of parent-child conflicts erupting into the business.

In addition to these life cycle "hinge moments," other issues predictably lead to discord in family businesses. A common one is the question of capital allocation: the tension between feeding the profits back into the company so it can grow, on the one hand, and on the other, the desire of family members for dividends to fund their lifestyles.[93] Family members who feel deprived of

86. *See* Levinson, *supra* note 83; Peter S. Davis & Paula D. Harveston, *In the Founder's Shadow: Conflict in the Family Firm*, 12 FAM. BUS. REV. 311, 313 ("[T]he transition between the founder and the next generation of leadership is often seen as the most critical and tumultuous.").

87. Levinson, *supra* note 83. Hugh Hefner's transition of his business to his daughter, Christine, is an example of a successful father-daughter succession. *See* Stephen Rebello, *A Candid Conversation with Christie Hefner, Playboy Enterprise's Former President and CEO*, PLAYBOY (Dec. 12, 2017), https://www.playboy.com/read/playboy-interview-christie-hefner [https://perma.cc/6X5A-N5AP].

88. Levinson, *supra* note 83.

89. *Id.*

90. *See* discussion *infra* Section III.A.3.

91. Jim Grote, *Conflicting Generations: A New Theory of Family Business Rivalry*, 16 FAM. BUS. REV. 113, 119 (2003).

92. *See* GERSICK ET AL., *supra* note 85, at 18–19. For additional discussions of the life cycles of the family business, see generally FRED NEUBAUER & ALDEN G. LANK, THE FAMILY BUSINESS: ITS GOVERNANCE FOR SUSTAINABILITY (1998), and BENJAMIN BENSON, EDWIN T. CREGO & RONALD H. DRUCKER, YOUR FAMILY BUSINESS: A SUCCESS GUIDE FOR GROWTH AND SURVIVAL (1990).

93. Scott E. Friedman, Andrea H. HusVar & Eliza P. Friedman, *Advising Family Businesses in the Twenty-First Century: An Introduction to Stage 4 Planning™ Strategies*, 65 BUFF. L. REV. 425, 455 (2017).

dividends bring lawsuits based on squeeze outs.[94] These family members may truly suffer from minority shareholder status because they lack the votes to change the company's capital-asset allocations and increase their payouts.[95] Majority shareholders can use this squeeze-out tactic to drive out minority shareholders from the business.[96] Regarding conflict, advisors encourage family members to agree on an allocation plan that reflects agreed-upon ways to address capital needs, fund retirements and save taxes.[97]

1. Anheuser Busch: Oedipal Struggles

Cycles of fracture and collapse have appeared dramatically in several prominent high-wealth business families. The Busch family provides an example.[98] Adolphus Busch founded and became president of the Anheuser Busch brewing company in 1880, and upon his death in 1913, the company passed to his son, August A.[99] This generational transition went fairly smoothly, partly because the succession was uncontested,[100] and August A. was able to lead the company through Prohibition by selling "near beer" and beer ingredients.[101]

With the third generation, in a classic father-son succession clash, August Jr. (Adolphus's grandson), or Gussie, quarreled with his father, August A., and his son, August III, over how the business should be run.[102] At one point, Gussie even asked for August III's letter of resignation.[103] Although other top executives managed to smooth things over initially, another family business crisis arose: it became clear that Gussie had no interest in retiring and handing Anheuser Busch on to the next generation.[104] Eventually, August III got rid of his father on terms author William Knoedelseder describes as "brutal," forcing him out, depriving him of any role in running the business, use of company cars, planes, boats or rail cars—even of personal land he had bought.[105] In a rage,

94. *See, e.g.*, Wilkes v. Springside Nursing Home, Inc., 353 N.E.2d 657, 661 (Mass. 1976); Franklin A. Gevurtz, *Squeeze-Outs and Freeze-Outs in Limited Liability Companies*, 73 WASH. U. L.Q. 497, 498–99 (1995).

95. Gevurtz, *supra* note 94, at 498–99.

96. Soren Lindstrom & Lindsey Reighard, *How To Effectively Deal with Minority Shareholders: Some Practice Pointers and Recent Developments*, 36 CORP. COUNS. REV. 187, 194–95 (2017).

97. *See* Friedman et al., *supra* note 93, at 455–56.

98. For the two leading accounts of the Anheuser Busch company, see WILLIAM KNOEDELSEDER, BITTER BREW: THE RISE AND FALL OF ANHEUSER BUSCH AND AMERICA'S KINGS OF BEER (2014), and PETER HERNON & TERRY GANEY, UNDER THE INFLUENCE: THE UNAUTHORIZED STORY OF THE ANHEUSER BUSCH DYNASTY (1991).

99. *See* KNOEDELSEDER, *supra* note 98, at 16, 22, 28.

100. *Id.* at 28. Fortuitously for August, all but one of his brothers had died by this point, and the one remaining son had been born disabled. *Id.*

101. *See id.* at 117; HERNON & GANEY, *supra* note 98, at 133–34.

102. KNOEDELSEDER, *supra* note 98, at 117–19.

103. *See id.* at 118.

104. *Id.* at 119.

105. *Id.* at 137.

Gussie demanded that all family members take sides in the fight.[106] This scenario has the elements of a classic succession fight, a crisis that factionalizes the family. Wealth advisors target succession conflict by encouraging succession planning from an early stage and setting out everyone's expectations for their roles in the business.

As for Anheuser Busch, from the point of Gussie's firing the family descended into intermittent "wealthy family" mayhem. This seems to be a classic case of succeeding generations lacking a sense of the continuity of family values, leaving them only with a sense of entitlement that rules don't apply to them. First, one of Gussie's sons shot and killed a family friend "by accident" at the Busch home (and received probation).[107] Then, a few years later, August IV killed a passenger while driving drunk (and served no time), began doing serious amounts of cocaine, and got into a car chase with police after an evening of drugs and partying (there was a public trial, but he was acquitted).[108] Soon, the company was manifesting similar lawlessness and disregard for family—not to mention legal—values.[109] There was another trial, this time of company executives for mail fraud, tax fraud, and taking kickbacks from clients.[110] The fifth generation heir, August IV, descended into full-time drug use and partying.[111] Finally, August IV appeared at a national distributors meeting in Washington in May of 2008, in Knoedelseder's words, "[in] a deep state of stoned," confusing his words and unable to read the teleprompter.[112] Knoedelseder ascribes August's stress partly to the pressure he felt as heir-presumptive:

> In the Busch family, it seemed as if the firstborn son was offered in sacrifice to the company. The Fourth knew from the age of cognizance that he was expected to become CEO one day. He had no choice in the matter; doing something else with his life was not an option. He also knew he would only become CEO if and when his father judged him worthy. The job was his to lose, every day. The scrutiny was unrelenting, the criticism constant.[113]

August IV had surrounded himself at the company with executives chosen "more for their fealty to him than their knowledge of the business."[114] He

106. *Id.* at 138.
107. *Id.* at 147–49, 153.
108. *Id.* at 196–205, 209–18.
109. *Id.* at 138–40.
110. *Id.* at 239–40.
111. *Id.* at 195–96, 208.
112. *Id.* at 4–5. While the teleprompter said, "[w]hen our forefathers arrived on these shores, one of the first things they did was to erect a beer house," August IV said, "[w]hen our forefathers arrived on these shores with erections." *Id.* at 4.
113. *Id.* at 260.
114. *Id.* at 277.

proceeded to make numerous bad business decisions, including a line of sweet-tasting alcohol in small bottles that looked like nail polish, marketed under the name "Spykes,"[115] and to lead a life of partying and drugs. Eventually, Anheuser Busch sold out to InBev, a major Belgian brewer, a move that, in the words of Fox News, brought "to an end one of the most iconic names in American business."[116] This seems like a classic case of subsequent generations losing touch with the values that inspired the business and kept the family together.

Another famous example of a succession fight broke out within the Dart Drug family when it reached its financial peak—worth $500 million—in 1993.[117] In June of that year, the Wall Street Journal prematurely reported that Robert, the son, was sure to inherit his father's position as head of the company.[118] In a rage, Robert's father immediately fired Robert and sent a fax from his lawyer telling him he was banned from the premises.[119] Robert sued for wrongful termination, a divorce ensued, and the family split into factions which remain estranged today.[120] Such a scenario might justify minority discounts because there was an obvious power struggle going on between father and son, which would have disadvantaged the minority shareholder or anyone in the "wrong" family faction. Again, this is a typical "hinge moment," and exactly the kind of minatory tale wealth advisors share with their clients to urge succession planning.

This trajectory is just what wealth preservation specialists aim to prevent. Successive leaders of the business lose touch with the core values and goals of the company and the family's legacy. In the words of one wealth advisor, "later-generation family members are rarely motivated by the same emotions that fueled the productivity of the originator of the initial family wealth."[121] Unhealthy intergenerational dynamics compound the problem. In a generation where some heirs are wasting company assets and making foolish business decisions, a minority shareholder lacking control to right the company's course and unable to sell on the open market would suffer a loss in value.[122]

115. *Id.* at 306 ("He apparently didn't grasp that the critics weren't so much worried about underage college girls carrying around Spykes in their purses as they were about their twelve- and thirteen-year-old daughters who had nail polish bottles on their makeup tables that looked exactly like Spykes.").

116. *Anheuser-Busch Agrees to InBev Sale*, FOX NEWS, https://www.foxnews.com/story/anheuser-busch-agrees-to-inbev-sale [https://perma.cc/GY9V-4K42] (Jan. 13, 2015).

117. David J. Morrow, *Denouement of a Family Feud?*, N.Y. TIMES (June 20, 1999), https://www.nytimes.com/1999/06/20/business/private-sector-denouement-of-a-family-feud.html [https://perma.cc/FZM2-3MS9 (dark archive)].

118. *Id.*

119. *Id.*

120. *Id.*

121. HUGHES, *supra* note 14, at 8.

122. *See, e.g.*, Donahue v. Rodd Electrotype Co. of New Eng., Inc., 328 N.E.2d 505, 513–14 (Mass. 1975).

2. Vanderbilts and Bronfmans: Losing Connection

There is no shortage of further examples. Arthur T. Vanderbilt's account of his family's saga, titled *Fortune's Children: The Fall of the House of Vanderbilt*, traces the same sad arc.[123] The founder of the family business, Cornelius Vanderbilt, was the world's richest man by 1877; fifty years later, one of his direct descendants died broke, and the family name had disappeared from the Forbes list of the world's richest people.[124] The explanation for the disappearance of the Vanderbilt fortune is simple: the heirs spent it all.[125] Part of the problem, as usual, was succession and loss of connection with family legacy and values. Cornelius had warned about splitting the family fortune, but when his son Billy died in 1885, he left it to both of Billy's sons. This was when the spending began. The third generation's "extensive philanthropy and spending left an estate reportedly worth the amount he had inherited in 1885 when his father died."[126] In April of 2004, "6th generation Vanderbilt Anderson Cooper told Howard Stern's radio show: 'My mom's made clear to me that there's no trust fund.'"[127]

And then there were the Bronfmans, the family that founded Seagram's. Sam Bronfman built the business into the first worldwide wine and spirits company and his son Edgar continued to grow it.[128] Then Edgar's son, Edgar Jr., made numerous ill-advised business decisions, most egregious of which was selling Seagram's stake in DuPont and investing in Universal Studios in a bid to become a media tycoon.[129] In doing so, Edgar Jr. broke with seventy years of family business sense: he chose to rely on valuation systems which were "not only . . . far removed from financial reality but a complete reversal of the financial conservatism that had marked all the family's businesses for seventy years."[130] The family lost most of its fortune when it was forced to sell Seagram's for less than its full value to the French company Vivendi.[131] As the debacle unfolded at the end of 2001, one executive scribbled a note to another: "I've got

123. ARTHUR T. VANDERBILT II, FORTUNE'S CHILDREN: THE FALL OF THE HOUSE OF VANDERBILT 416–17 (1989) ("The Vanderbilt money is certainly bringing no happiness and no greatness to its present claimants . . . .").

124. Natalie Robehmed, *The Vanderbilts: How American Royalty Lost Their Crown Jewels*, FORBES MAG. (Jul. 14, 2014, 10:31 AM), https://www.forbes.com/sites/natalierobehmed/2014/07/14/the-vanderbilts-how-american-royalty-lost-their-crown-jewels/?sh=38e86ed4353b [https://perma.cc/A43M-YZNG (dark archive)].

125. *Id.*

126. *Id.*

127. *Id.*

128. *See* NICHOLAS FAITH, THE BRONFMANS: THE RISE AND FALL OF THE HOUSE OF SEAGRAM 173 (2006).

129. *See id.* at 246–64.

130. *Id.* at 260.

131. *See id.* at 280–98.

the unpleasant feeling of being in a car whose driver is accelerating in the turns and that I'm in the death seat."[132]

3. Mars: Really, Really Bad Parenting

The Mars company was also dysfunctional,[133] although it still managed to remain profitable.[134] Succession was problematic for the chocolate maker from the first father-son transition.[135] Founder Frank Mars made a classic mistake, much warned against in today's wealth preservation literature—he let his son Forrest start at the top instead of making him work his way up and learn the business from the bottom.[136] He nonetheless also behaved in typical father-founder fashion by constantly criticizing Forrest and reminding him that he, Frank, could run the company much better.[137] When, in 1943, Forrest demanded to be made a one-third partner of the business, Frank refused.[138] According to Forrest, he told his father to "stick his business up his ass" and left for Europe to start a company there.[139] Another bump in the road resulted from the blended Mars family: when Frank died, he was married to Ethel, his second wife and Forrest's stepmother, to whom he left half the company.[140] Forrest shared the rest with his half-sister Patty and a company manager who also owned minority shares.[141] Ethel promoted her half-brother to president so he could run the company, and he and Forrest, who felt that the company was rightfully his, did not get along.[142] As a minority shareholder, however, he could neither control the business, nor put his ideas into production, nor persuade his

132. *Id.* at 280.

133. The two principal accounts of the Mars family saga are JOËL GLENN BRENNER, THE EMPERORS OF CHOCOLATE: INSIDE THE SECRET WORLD OF HERSHEY AND MARS (1999), and JAN POTTKER, CRISIS IN CANDYLAND: MELTING THE CHOCOLATE SHELL OF THE MARS FAMILY EMPIRE (1995).

134. But maybe not as profitable as it could be. In 1982, Mars turned down Steven Spielberg's request to feature M&Ms in the blockbuster, ET, leaving Reese's Pieces to fill the spot. Graham Flanagan, *How M&Ms Passed on the Product Placement Opportunity of a Lifetime*, BUS. INSIDER (June 17, 2014, 2:11 PM), https://www.businessinsider.com/mms-product-placement-fails-2014-6 [https://perma.cc/VEB6-8CES]. The movie placement caused a $65 million spike in Reese's Pieces sales. *Id.* Mars also turned down placements on the sitcom *Seinfeld*; the writers instead had Kramer accidentally toss Junior Mints into the body of a patient in surgery. *Id.* Some have speculated that an inability to take risks and move in new directions is a psychological characteristic of the Mars brothers, who still fear making mistakes and angering their father. *See* POTTKER, *supra* note 133, at 81.

135. See BRENNER, *supra* note 133, at 59–60, 173–74, and POTTKER, *supra* note 133, at 35–39, 42–43, for discussion of the troubled transition between Frank Mars and his son, Forrest.

136. *See* POTTKER, *supra* note 133, at 36.

137. *Id.*

138. *Id.* at 36–37.

139. *Id.* at 37.

140. *Id.* at 43. This was understandable: Ethel had been a true partner in the business, selling candy door-to-door and sacrificing considerably to get the company off the ground. *Id.*

141. *See id.* at 54.

142. *See id.* at 55–56.

stepmother and sister to sell him their shares.[143] Eventually, after Ethel died, Forrest was able to gain a majority of shares, but, until then, the company, which was run by factions each loyal to a different owner, did poorly.[144]

Father-son dynamics continued to malfunction in the next generation. Forrest's children—Forrest Jr., John, and Jackie—did not see much of either of their parents while growing up, and, when they began working at the business, their father "treated [them] worse than he treated any other associates, yelling at them, haranguing them[,] and screaming so loudly that he could be heard in the next room."[145] Despite the abuse, Forrest kept promoting them, simultaneously setting them against each other and forcing each one to curry favor with him at the other's expense—a dynamic, according to one author, that "continues to this day."[146]

Many years later, Forrest expressed regret about handing the business to his children, reportedly saying that "[h]e would 'never do it again. Not turn it over to his kids, anyway . . . .'"[147] At the fourth generation, the "cousin consortium" stage, none of the cousins, all of whom grew up wealthy, have been able or willing to return the company to its former status.[148]

As these stories make clear, discord erupts at predictable times and around predictable issues in family businesses: generational succession, sibling control, "cousin consortium," capital allocation, salaries versus dividends. Clearly, Oedipal struggles plagued the Busch and the Mars families, even though there were clear lines of succession. In the case of the Vanderbilts, it was the lack of clear succession and the splitting of the business that led to failure. In each of these situations, it would be easy to see how minority shareholders might suffer harm. But wealth advisors help families prepare for these foreseeable problems and forestall disunity.

## III. FIXING FAMILIES

Invoking Tolstoy again—what is the difference between the happy and unhappy families of tax law? That is, what makes some families cooperate to manage assets and maximize wealth while others find it impossible? One answer is, of course, that some families simply have better dynamics than others. Successful dynastic families have found ways to cooperate for centuries; those that did not, fell apart and went bankrupt, often in three generations.[149] But the

143. *Id.* at 56.
144. *Id.* at 63–64.
145. *Id.* at 69.
146. *Id.* at 81.
147. *Id.* at 239.
148. *Id.* at 239–40.
149. The Stroh family's story is typical, although it might be modified to "shirtsleeves to shirtsleeves in six." Kerry A. Dolan, *How To Blow $9 Billion: The Fallen Stroh Family*, FORBES (July 8,

other answer is that a family with uncooperative dynamics can hire a wealth preservation advisor.[150] These specialists teach business- or trust-owning families to separate the family's emotional life from its financial life and to employ best practices for managing their wealth. This advice seeks to prevent exactly the disunity and lack of cooperation that can cause family members to feel they are being treated unfairly, to suffer from their minority status, and to wish to sell their shares.

Today, a battalion of wealth preservation advisors has reaped the lessons of the past. They provide counseling, strategies, and management techniques to ensure that families get along and keep their wealth and businesses intact. Undergirding this endeavor is what Professor Allison Tait has called "the law of high-wealth exceptionalism," a regime of private government that enables these families to agree on and carry out wealth preservation strategies while keeping everything in the family.[151] Wealth preservation advisors achieve this through various means: governing instruments such as family constitutions and mission statements, asset allocation agreements among family members that prioritize minimizing taxes,[152] and training in conflict avoidance techniques.[153] They also teach family members to sacrifice individual desires for the common (family) good and teach families how to create a culture with its own unique set of values and history that sets it apart from others.[154] These forms of family governance and culture creation nurture family business realities that leave the Tax Code and its assumptions far behind. In fact, one could say that they operate in a parallel universe: the Tax Code displays no inkling of how these families operate and make its provisions irrelevant. Tax law's oblivion to this universe costs the rest of us $18 billion per year.[155]

The goal of the wealth preservation industry is for each family to have a "one-hundred-year financial wealth preservation plan"[156]—that is, one that will keep wealth in the family and growing for at least four generations.[157] Wealth

2014, 8:00 AM), https://www.forbes.com/sites/kerryadolan/2014/07/08/how-the-stroh-family-lost-the-largest-private-beer-fortune-in-the-u-s/?sh=e38b6ac3d13a [https://perma.cc/69Q3-FZYN (dark archive)]. In the 1980s, Forbes estimated the family's worth at $700 million, which by today just by tracking the S&P should have grown to about $9 billion. *See id.* Instead, the Stroh company has ceased to exist as a financial entity and has not paid out its last dividends. *Id.* The decline of the Strohs' beer business was precipitated by bad business decisions, family conflict and a generation who spent millions on luxury items like collections of guns, cameras and guitars—and failed to grow the business. *Id.* There is little left for the current generation, whose members are figuring out how to make their livings. *Id.*

150. *See generally* Tait, *High-Wealth Exceptionalism*, *supra* note 14 (discussing what wealth preservation advisers do and the role they play in preserving family wealth).

151. *See id.* at 983.

152. I refer to these throughout as "wealth preservation documents."

153. *See* Tait, *High-Wealth Exceptionalism*, *supra* note 14, at 987–95.

154. *See id.* at 991–95.

155. *See id.* at 1032 n.300 (describing the decline in U.S. estate-tax receipts).

156. HUGHES, *supra* note 14, at 9.

157. *Id.* at 3–4.

preservation advisors freely admit that this is an ambitious goal: as one has observed, "[t]he phenomenon of the fleeting family fortune is so well-recognized that it inspired a proverb: '[s]hirtsleeves to shirtsleeves in three generations.'"[158] But, when families acquire the tools and techniques to set this "one-hundred-year plan"[159] in motion, they are clearly creating a wealth structure that has no place in the valuation discount scheme. The goal here is the same as that of the Rosboro lumber family: to create a system of wealth management that will not give anyone on the inside a reason to sell. Valuing shares based on the fiction that such a family member might want to sell her shares on the open market is simply that—a fiction. Any hypothetical value on the open market is irrelevant to the value of the share in the hands of the family, where it will stay.

Happy tax families can achieve this—and, increasingly, they use the Tax Code to do so. They keep wealth in the family while avoiding taxes based on fictions about selling the family business and valuing it on the open market. This allows them to grow their wealth at low or nonexistent tax rates. In this part, I first detail the tools and strategies high-wealth advisors use to help families create their one-hundred-year plans: family governance documents and the creation of family identity. Then, I present two examples of families whose wealth management makes a mockery of the discount regime. One is the family in *Kimbell v. United States*.[160] The second family is the Hobby Lobby family of David Green. Both exemplify the self-contained and self-governing world of the family business.[161]

### A. *Family Governance and Boards of Directors*

To shift family dynamics from power to structure, high-wealth advisors deploy governing structures and governing documents to impose rational order on the running of the business. The means are twofold: creating written policies and governance documents that everyone has agreed to; and establishing a board of directors with nonfamily members to help make major decisions and

158. *Id.* at 3.

159. As of this writing, the phrase, "one-hundred-year plan" seems to also reference a variety of op-eds and a book arguing that China is engaged in a hundred-year marathon to overtake the United States as the world's superpower. *See* MICHAEL PILLSBURY, THE HUNDRED-YEAR MARATHON: CHINA'S SECRET STRATEGY TO REPLACE AMERICA AS THE GLOBAL SUPERPOWER 12–14 (2015). The phrase, "five-year plan," famously referred to "a continuing series of Soviet governmental programs designed to achieve usually specified goals in the planned, coordinated, and cumulative development of the Soviet economy and other sectors of Soviet life (as education and science) over a period of five years." *Five Year Plan*, MERRIAM-WEBSTER.COM, https://www.merriam-webster.com/dictionary/five-year%20plan [https://perma.cc/6FUV-JYRP].

160. 371 F.3d 257 (5th Cir. 2004).

161. *See generally* Burwell v. Hobby Lobby Stores, Inc., 573 U.S. 682 (2014) (demonstrating how a national family business gains exceptions to federal insurance laws).

to mitigate—and mediate—family disputes.[162] In fact, most advisors strongly urge family businesses to move to professional management "as soon as possible."[163] Especially in cases of conflict, or "inadequately rationalized territories," one author asserts, "members of the family should move up and out of operations as quickly as possible."[164] Obviously, this would have potentially mitigated considerable trouble in the Anheuser-Busch family and have avoided some of August IV's disastrous business decisions.[165]

Essentially, the wealth industry teaches these families to think of themselves as a collective rather than as a collection of individuals.[166] This collective "family governance begins with the . . . joint decision of two individuals to subordinate their individual freedoms of choice to a system of representative governance in which each has a role."[167] Under this compact, the family members "assert[] their shared values and goals and their willingness to govern themselves according to those values and goals."[168] What one author calls "[t]he Horizontal Social Compact" is key to "[t]he ability of siblings and cousins . . . to work together [which] is critical to long-term wealth preservation."[169] It should be clear that this "social compact" creates a family world far removed from the one the Tax Code envisions when it allows valuation discounts based on minority freeze outs.[170] It creates a system which everyone has agreed to for addressing disagreements and conflicts, so that family members will not be driven to sell their shares in the family business on the regulations' envisioned "open market."[171] This family governance attempts to ensure that differences are resolved within a collaborative framework reflecting values to which all members have agreed to.

This family vision also teaches self-sacrifice for the good of the whole. In *How To Make Your Family Business Last*, Mitzi Perdue, wife of the late Frank Perdue and member of the Henderson family who founded the Hilton hotel chain, advises that members of "high-functioning" (specifically, wealth-preserving and harmonious) families "can't expect always to get their way," and instead must learn to "support the family and at times make sacrifices for the

162. HUGHES, *supra* note 14, at 88.

163. *Id.* at 76.

164. Levinson, *supra* note 83.

165. *See generally* KNOEDELSEDER, *supra* note 98 (describing the successes and failures of the Anheuser-Busch company through the lens of the Busch family dynasty).

166. DANIELA MONTEMERLO & JOHN L. WARD, THE FAMILY CONSTITUTION: AGREEMENTS TO SECURE AND PERPETUATE YOUR FAMILY AND YOUR BUSINESS 4 (2006).

167. HUGHES, *supra* note 14, at 15.

168. *Id.* at 20.

169. *Id.* at 21.

170. *Id.*

171. The rules for valuation discounts refer to the lack of market, since no one would want to buy into the family.

family."[172] She warns members that they do not "get the benefit of [their] family's financial and social benefits without owing a lot in return."[173] Parents must teach their children that the family comes first, and that "losing your family over something like an inheritance issue is probably the worst choice you could possibly make," while also not allowing them to become "addicted to being right."[174] To build a unified family culture, Perdue suggests establishing family traditions. For those families lacking their own indigenous rituals, she helpfully offers a list of suggestions, such as family walks, "holding hands while saying a blessing," "Perseid Shower watching nights," and discussing what happened each day at dinner.[175] Each suggestion is freshly minted and ready to be inserted into a family's culture. It is easy to imagine how such a family culture might have saved the families behind Anheuser Busch, Seagram's and Vanderbilt from imploding as they did.[176] As well as instilling a sense of self-sacrifice for the good of the whole, these instructions serve to create strong family bonds and healthy family dynamics.

Family business advisors also urge their clients to create a family council.[177] Such a council can be an elected or appointed group of family members whose role is to make decisions about the business and educate other family members about it. The council's "fundamental purpose . . . is to provide a forum in which family members can articulate their values, needs and expectations vis-á-vis the company and develop policies that safeguard the long-term interests of the family."[178] Further, the council can help families clarify and confirm in writing "their shared values, vision, and mission, and through that process and those

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172. MITZI PERDUE, HOW TO MAKE YOUR FAMILY BUSINESS LAST: TECHNIQUES, ADVICE, CHECKLISTS, AND RESOURCES FOR KEEPING THE FAMILY BUSINESS IN THE FAMILY 6 (2017).

173. *Id.*

174. *Id.* at 7, 14.

175. *Id.* at 18–19. At times, this book verges on parody, at least to outsiders like this author: Perdue advises making "Married-Ins" feel like part of the family by sending them a "Now-You're-One-Of-Us Welcome Kit" with samples of the products the family makes but helpfully warns readers to keep it appropriate—she recalls a classmate whose family business was sanitary napkins. *Id.* at 40. At another point, she urges family members to ride public transportation to rub elbows with "average people." *Id.* at 35.

176. *See generally Anheuser-Busch Agrees to InBev Sale*, *supra* note 116 (detailing the sale of Anheuser-Busch after the Busch family's failures); Robehmed, *supra* note 124 (discussing the fall of the Vanderbilt family); FAITH, *supra* note 128 (discussing the failures of the Bronfman family behind Seagram's).

177. Ernesto J. Poza, *Rediscovering Just How Much Patient Family Ownership Matters*, FAM. BUS. MAG., Fall 2009, https://www.familybusinessmagazine.com/rediscovering-just-how-much-patient-family-ownership-matters [https://perma.cc/YF62-MPNG]. A substantial amount of literature regarding the family council exists. *See, e.g.*, Julia Suess, *Family Governance—Literature Review and the Development of a Conceptual Model*, 5 J. FAM. BUS. STRATEGY 138, 142–43 (2014); Marta M. Berent-Braun & Lorraine M. Uhlaner, *Family Governance Practices and Teambuilding: Paradox of the Enterprising Family*, 38 SMALL BUS. ECON. 103, 107–08 (2012); CRAIG E. ARONOFF, STEPHEN L. MCCLURE & JOHN L. WARD, FAMILY BUSINESS COMPENSATION 63 (1993).

178. GERSICK ET AL., *supra* note 85, at 237.

guiding principles, reach further agreement on plans and policies that are particularly important to the family."[179]

This council becomes especially critical at keeping families cohesive as subsequent generations take over, that is, in the sibling or cousin stage.[180] In these stages, the family council is critical, according to wealth advisors, in "forging family consensus and counteracting declining family bonds and low identification with the firm, as families grow and spontaneous social contacts among family members decrease, articulating a strategy for family wealth management, including planning, rule setting, and collaborative asset allocation . . . [and] supporting succession planning" by exploring the family's "collective dream of continuity."[181] Of course, not all families so advised do this, but those who do so successfully seem likely to avoid the moral slippage and confusion. The consequences of ignoring this advice are apparent in Gussie Busch's disastrous Spykes campaign, the uncontrolled spending of the Vanderbilts, and Edgar Bronfman's narcissistic business ventures.[182]

A crucial instrument of family governance that tax laws should take note of is the family constitution.[183] While one of the goals of the family constitution-

179. Friedman et al., *supra* note 93, at 442–43.

180. Ivan Lansberg, *The Best Investment the Family Can Make*, FAM. BUS. MAG., Winter 2007, at 1, 1–2.

181. Kelin Gersick & Neus Feliu, *Governing the Family Enterprise: Practices, Performance and Research*, *in* THE SAGE HANDBOOK OF FAMILY BUSINESS 196, 210 (Leif Melin, Mattias Nordqvist & Pramodita Sharma eds., 2014).

182. *See generally* KNOEDELSEDER, *supra* note 98 (discussing the misadventures of Gussie Busch); Robehmed, *supra* note 124 (discussing the Vanderbilt family); FAITH, *supra* note 128 (discussing Edgar Bronfman's failures).

183. *See* Tait, *High-Wealth Exceptionalism*, *supra* note 14, at 983 n.1, 984 nn.6 & 7, 990 nn.26, 27 & 29 (2020); *see also* CHRISTIAN G. STEWART, HOW TO CRAFT YOUR OWN FAMILY CONSTITUTION: AN OVERVIEW 1 (2013), http://www.familylegacyasia.com/whitepaper_pdf/Overview%20of%20how%20to%20craft%20a%20family%20constitution.pdf [https://perma.cc/Y5TR-RPVF]; HUGHES, *supra* note 14, at 49; Abby Schultz, *Why Asia's Rich Need a Family Constitution*, BARRON'S (Jan. 9, 2015), https://www.barrons.com/articles/why-asias-rich-need-a-family-constitution-1420777286 [https://perma.cc/2LY2-MRSF]; KPMG, CONSTRUCTING A FAMILY CONSTITUTION 1 (2010), https://www.fambiz.com.au/wp-content/uploads/Constructing-a-Family-Constitution-KPMG.pdf [https://perma.cc/EE74-UFM Z]; Karin Prangley & Anne Warren, *We the Family: The Benefits of Creating a Family Constitution*, BROWN BROS. HARRIMAN (Nov. 27, 2017), https://www.bbh.com/us/en/insights/private-banking-insights/we-the-family-the-benefits-of-creating-a-family-constitution.html [https://perma.cc/YTW8-YVAT]; Brad Simmons, *The Six Most Contentious Parts of a Family Constitution*, MUTUAL TR. (2019), https://web.archive.org/web/20190310012214/https:/familyofficeinsiders.mutualtrust.com.au/article/governance/six-common-pressure-points-family-constitution/ [https//perma.cc/3935-RXXV]; Varsha, *Note on Family Constitution*, LAWYERSCLUBINDIA (July 5, 2017), https://www.lawyersclubindia.com/articles/Note-on-Family-Constitution-8279.asp [https://perma.cc/RZ66-Q9KC]; Brian Groom, *The Rise of the Family Business Constitution*, FIN. TIMES (Dec. 13, 2017), https://www.ft.com/content/5d06ec9e-c61b-11e7-b30e-a7c1c7c13aab [https://perma.cc/MX4D-Dk3D] (noting the usefulness of family constitutions where a family's goal is to manage and control wealth over multiple generations). For large and multigenerational families, consultants recommend a family constitution of up to seventy pages. Rocio Arteaga & Susana Menéndez-Requejo, *Family Constitution and Business Performance: Moderating Factors*, 30 FAM. BUS. REV. 320, 325 (2017). These

making process is to foster a cohesive family culture, "the uniqueness of their tribe, and . . . their special place in it,"[184] the truth is that these families have much more in common than not. A reading of sample family constitutions makes clear that their point is to preserve family wealth from "creditor claims, family feuds, reckless investments"—and taxes.[185] To keep wealth—and business—in the family, the constitution often sets out rules for the employment of family members in the business, remuneration, and dividends for family members.[186] Reading seemingly any family constitution will make a few things clear: the family business is not for sale, and its rules and procedures have been carefully designed to ensure that the business is managed to meet the needs and wishes of individual family members in a way that makes everyone happy to stay in and makes "lack of control" a nonissue.

The family constitution's goal is to "keep family ownership united and to forge a broad and strong owning family's commitment to the future of the family business."[187] While not legally binding, these constitutions are intended to be "morally enforceable" and a "meaningful piece of a family's culture."[188] A family business that has taken the time to establish and ratify a constitution is not one in which shareholders will want to sell their shares.

Another governing instrument is the family mission statement.[189] This is an expression of the "purpose, vision, values, and goals" of the family.[190] The "family mission statement is the starting point for organizing the family to preserve its wealth."[191] This statement of shared values will become critical when the family faces conflict and difficult decisions because it will give the family a way to resolve them based on their agreed-upon values.[192] One wealth preservation advisor admits that crystalizing a family's unique value system in this way can be challenging because it serves to emphasize the particular family's "uniqueness."[193] He ruefully concedes the difficulty in getting a family to recognize its "uniqueness" since "Americans still maintain the cultural myth of

consultants also allot six to eight months to draft a constitution, so family members can come to an agreement on matters of family wealth and governance—which takes time. *Id.*

184. HUGHES, *supra* note 14, at 51.

185. Tait, *High-Wealth Exceptionalism*, *supra* note 14, at 984–85 (citing Varsha, *supra* note 183).

186. Simmons, *supra* note 183, at 163.

187. MONTEMERLO & WARD, *supra* note 166, at 1.

188. Friedman et al., *supra* note 93, at 458 (citation omitted).

189. HUGHES, *supra* note 14, at 43. The literature on the family mission statement is also vast. *See* Friedman et al., *supra* note 93, at 449 n.63 (citing an example of a mission statement from a family-owned business).

190. HUGHES, *supra* note 14, at 43.

191. *Id.*

192. *Id.*

193. *Id.* at 44. If business mission statements are anything to go by, these families are not unique at all.

common membership in the middle class."[194] Regretfully, however, Americans must learn that "[w]ealth automatically sets a family apart" and articulates its own "uniqueness."[195] The mission statement sets out a family's history, its chosen governance structure, and each person's role in family governance.[196] A family may also articulate its specialness through family rituals, storytelling, and the practice of writing family history.[197]

Because conflict over business control is one of the main causes of business disintegration, family governance structures are specifically designed to avoid it. There are even detailed instructions for communicating at family meetings. One advisor urges to "[n]ever start a sentence with the word '[b]ut'" because this word signals to the other speaker that "you didn't listen affirmatively to what was said."[198]

### B. *Fixing Unhappy Family Dynamics*

Governing instruments and professional management are one side of the family-harmony coin, but internal family dynamics also require attention, even when they are insulated, to some extent, from the business. Family constitutions are only part—if a very important part—of managing conflict in family businesses.[199] Even if a wealthy family does not take the time to draw up a constitution, it must learn to deal with family conflict and prevent it from destroying the business.

An important insight of wealth preservation is that it is a "question of human behavior" and "a dynamic process of group activity, or governance."[200] To "preserve its wealth, a family must form a social compact among its members reflecting its shared values, and each successive generation must reaffirm and readopt that social contract."[201] To achieve this, a family must form a system of representative governance, whose mission is "the enhancement of the pursuit of happiness of each individual member."[202]

This training seeks to impart a critical lesson—decisions about family wealth and business management need to be insulated away from family conflict. As one family business advisor puts it: "Successful business families manage to balance the needs of [family] interest groups and to keep the domains

194. *Id.*
195. *Id.*
196. *Id.* at 45–46.
197. Tait, *High-Wealth Exceptionalism*, *supra* note 14, at 992.
198. HUGHES, *supra* note 14, at 46.
199. *See, e.g.*, PERDUE, *supra* note 172, at 67; KENT RHODES & DAVID LANSKY, MANAGING CONFLICT IN THE FAMILY BUSINESS: UNDERSTANDING CHALLENGES AT THE INTERSECTION OF FAMILY AND BUSINESS 68 (2013).
200. HUGHES, *supra* note 14, at 14.
201. *Id.* at 19.
202. *Id.* at 4.

[of family and business] separate through clear boundaries."[203] They achieve this by operating their businesses "according to best business practices, while minimizing the influence of potentially competing family interests," and "act[ing] as responsible shareholders and stakeholders in the best interest of the enterprise."[204] As they pass the company to later generations, literature reminds the founders to "articulate[] a vision and mission" which codifies the members' commitment to "avoid the 'ruler' mentality of one family member dominating those processes," and to "operate as a team, as opposed to being led by one family member dominating those processes."[205]

As an example of systematic conflict avoidance, advisors urge families to separate the issues of compensation for working *in* the business and the rewards of ownership distributed *from* the business.[206] They warn that paying all family employees the same amount, regardless of qualifications, often "feeds rivalry and jealousy in the next generation."[207] To avoid this,

> [c]ompensation for family members must be realistic. Those working in the business should neither be overly compensated nor paid minimum wage (unless that is appropriate to the job) . . . . The compensation should be appropriate for the job being done; if it is too low, the family member may be drawn elsewhere, but if [it] is too high, they will be trapped, and may experience a disincentive to truly being productive.[208]

Most importantly, family issues must be separated from issues of pay. "Above all, compensation should not be tied to need."[209] If a family member is in need of other funds, the family should have capital allocation plans set in place to address such eventualities.[210]

Employing family members presents another problem the family must account for with rules and procedures. According to one consultant, "[e]ffective policies generally include minimum educational and experience requirements, a clear application process, advancement criteria, and a disciplinary and termination process."[211] This consultant goes on to advise families to make clear "that they will not artificially create jobs" for otherwise unqualified or unneeded family members, and that they require "some employment experience outside the family business" before being hired.[212] Thus, when family members have

203. RHODES & LANSKY, *supra* note 199, at 16.

204. *Id.* at 16–17.

205. *Id.* at 81–82.

206. *Id.* at 23 (emphasis in original).

207. *Id.* at 24.

208. Friedman et al., *supra* note 93, at 455 n.71 (quoting EDWARD F. KOREN, NON-TAX CONSIDERATIONS IN FAMILY BUSINESS SUCCESSION PLANNING 46 (2011)).

209. *Id.*

210. *Id.* at 455–56.

211. *Id.* at 457 n.77.

212. *Id.*

satisfied the hiring requirements, then these members should fill positions necessary to the business, and their pay should reflect the established compensation plan.[213] If shareholder-oppression cases are anything to go by, claims of unfair compensation practices in family businesses are a major cause of conflict in family businesses.[214] As a result, wealth advisors try to prevent these claims with early planning for family members' roles in the business.

To help succession go smoothly—or happen in the first place—all family business advisors insist on succession planning. Without such planning, "family businesses can be put at great risk because of survivors competing to fill the resulting vacuum in leadership without sufficient support and/or capable successors."[215] These strategies of planning and articulating shared family values and vision works to prevent fracture.[216] A quantitative study of 100 next-generation family firm leaders and 350 family and nonfamily leaders and employees found a positive correlation between the development of a shared vision and effective next-generation leaders, which, in turn, increased the "multigenerational survival rate" of family-owned businesses.[217] All the troubled families in the previous section began to fracture around succession. By insisting on planning for this difficult transition, wealth advisors work to forestall the psychological and emotional turmoil that can lead to infighting. This kind of planning might have saved the Dart Drug company.

Advisors urge family members to have outside interests "from which they can derive gratification equal to what they can obtain in the company."[218] Preventing family members from deriving all their emotional satisfaction from the business can play a substantial role in keeping the business running smoothly and prevents against poor decision-making. If this sounds like therapeutic advice, it is. One suggestion is that family members should talk about their conflicts and anger toward each other "in the presence of a neutral third person[,] [s]ometimes [with] professional help."[219]

213. *Id.*

214. *See generally, e.g.*, ARONOFF ET AL., *supra* note 177 (discussing the matter of compensation in the family business).

215. Friedman et al., *supra* note 93, at 452.

216. *See id.* at 449 n.61 ("For example, results from a quantitative study of 100 next-generation family firm leaders and 350 family and non-family leaders and employees found a positive correlation between the development of a shared vision and effective next-generation leaders, which, in turn, increased the 'multigenerational survival rate' of family owned businesses.").

217. Stephen P. Miller, *Next-Generation Leadership Development in Family Businesses: The Critical Roles of Shared Vision and Family Climate*, FRONTIERS PSYCH., Dec. 2014, at 1, 10; *see also* UNC Kenan-Flagler Business School, *The Importance of Shared Vision in a Family Business*, YOUTUBE (Sept. 10, 2015), https://youtu.be/ienfwTuKSv0 [https://perma.cc/E5V4-GHAM].

218. Levinson, *supra* note 83.

219. *Id.*

These documents, governing bodies, and family rituals "serve as a compass to guide behavior"[220] in the interests of family wealth and business preservation. They foster a "positive family climate" as much as a successful business one.[221] In doing so, they paint a picture of a world in which valuation discounts have no place. When families set in place dynamics that will prevent the disadvantaging of minority shareholders, they will likely avoid the exact scenarios that the tax rules envision: freeze outs, squeeze outs, shareholders wishing to get rid of their shares, and more. In fact, the whole purpose of these wealth preservation regimes and all their apparatus is to keep the family and its wealth separate, functioning smoothly as a harmonious whole. They spell out in detail "basic expectations about employment and compensation systems, stock ownership, and dividend policies, and marriage and divorce."[222] Families with significant wealth as well as a business spell out investment policies and "responsible stewardship of the wealth for future generations."[223] Attorney James E. Hughes Jr. describes an example of this stewardship as:

> [T]he allocation to each family member on the family balance sheet (whether the member is an individual or a trust, a pooled vehicle, or a philanthropy) of that portion of the family's financial assets most likely to assist the long-term growth of those financial assets while minimizing U.S., estate, gift, or generation-skipping transfer taxation.[224]

For example, this system would allocate to "the oldest family member . . . the investments offering the lowest growth, and the youngest family member buys the investments offering the highest growth."[225] This way, "the family [will be] delighted because Grandmother's estate didn't grow even though the family balance sheet" did[226]—perhaps they can celebrate while watching a Perseid shower. When everyone in the family agrees to participate in the investor allocation process because it is good for the family as a whole: it turns the family into a vast, well-oiled, tax-avoidance machine.

Hughes offers advice specific to trust management in the family. The strategy of family unity also smooths out trustee-beneficiary relationships in the context of the family trust—another vehicle to which the discount valuation rules apply. According to Hughes, the goal of the trust is that "the relationship between the beneficiary and the trustee be so smooth that each sees himself as an equal member of a team working for a common goal of long-term family

220. Friedman et al., *supra* note 93, at 444.

221. *Id.* at 449 (citation omitted).

222. James John Jurinski & Gary A. Zwick, *How To Prevent and Solve Operating Problems in the Family Business*, 47 PRAC. LAW. 37, 43 (2001).

223. *Id.* at 38.

224. HUGHES, *supra* note 14, at 64.

225. *Id.* at 65.

226. *Id.* at 66.

wealth preservation."[227] The beneficiary's role is to become educated about the role of the trustee and to meet with the trustee regularly to discuss long-term personal goals and how the trust can contribute to them. The trustee's role is to be a mentor, balance the needs of all the beneficiaries, and help the family members achieve their goals.[228] This joint governance of the trust should create a "positive experience for both parties" in which the "likelihood of ever facing a turndown [of a request for funds] is very small."[229] Such a regime of trust management makes it unlikely that a beneficiary will feel cheated out of her fair share of distributions.

A good example of how a trust for such a family might look is the Kaestner Family Trust, at issue in *North Carolina Department of Revenue v. Kaestner*.[230] This trust instrument allowed the trustee, while making distribution decisions, to "consider only the interests of the person or persons for whom it is deemed advisable to use income or principal and not the interests of any other person who at any time may be or become interested in any trust hereunder."[231] In other words, the trust allows the trustee to distribute all of the assets to one beneficiary without taking into account the needs or future needs of any others.[232] This language seems designed to grant the trustee maximum discretion in making distribution decisions, but it is hard to believe that the settlor would have had it drafted this way if he had really thought the trustee would have depleted the trust for one child and left nothing for the others (there were three beneficiaries in the first generation). It seems more likely that the family and the trustee had an understanding about how the children would receive the distributions and could be relied upon not to quarrel with each other or the trustee.

A related approach to conflicts in the family business is "paradox management," a term coined by the authors of the book *Family Business as Paradox*.[233] These authors urge their readers (and clients—they all offer consulting services to family business owners) to see conflicts in their businesses as paradoxes requiring management.[234] These "paradoxes" are more challenging than "solvable problems" and require a special technique: recognizing that both

227. *Id.* at 111.

228. *Id.* at 111–23.

229. *Id.* at 112, 119.

230. 139 S. Ct. 2213 (2019).

231. Joseph Lee Rice III, Family 1992 Trust, art. 1.4(b) (Dec. 30, 1992) (unpublished trust) (on file with author).

232. This absolves the trustee of liability for any breach of the duty of impartiality among beneficiaries.

233. *See* AMY SCHUMAN, STACY STUTZ & JOHN L. WARD, FAMILY BUSINESS AS PARADOX 100 (2010).

234. *Id.* at 11–12.

sides have validity, learning to live with ambiguity, and creatively getting past the paradox.[235]

The paradox authors identify the same stress points in the family business that other consultants do. At the founder stage, the tension is between the founder's urgent wish to act and move forward and the need for planning, research, and stewardship.[236] Conflicts at the sibling stage revolve around leadership and decision-making, while at the stage of the "cousin consortium," the challenges emerge from conflicting views of and roles in the business. For example, cousins may exhibit tensions over salaries and dividend payouts.[237] Like most other family business consultants, the paradox authors recommend expressly stated company polices about employment and shareholder issues, as well as a family mission statement and constitution, to help avoid and solve these conflicts. These vehicles, they suggest, allow families to "dig deeper" into these conflicts "in search of the underlying paradox" and then address the paradox with these "strong governance vehicles."[238]

This procedure works because it returns the family back to the basic rules and values they originally agreed upon and resolves the paradox based on those rules and values. For example, a conflict in the second and third generations is typically between employment and compensation, those who manage and those who only receive dividends, and those who do not play an active management role.[239] Under the surface of these conflicts, the paradoxes the authors identify concern whether to implement strict rules and requirements for entry into the business or an open-door policy for family members. This boils down to the paradox of exclusion versus inclusion and resolving it requires understanding both sides and acknowledging that they both have validity. Once discussion—perhaps mediated by a consultant—has occurred, the family's "strong governance vehicles" can be referred to, or created, to address issues in a way that all the family members can agree on. For example, in most family businesses, members all agree that a primary goal of the business is its continuity and preservation of the business for future generations. The governing instruments remind them of this main value. In doing so, these value statements allow for resolution of the conflict.

These wealth preservation strategies achieve outcomes similar to those of family therapy. Specifically, they operate much like family-systems therapy, a form of practice most famously developed by psychiatrist Murray Bowen.[240] The practice is defined as a school of therapy which helps family members to

235. *See id.* at 12.
236. *See id.* at 60.
237. *See id.* at 66–71.
238. *Id.* at 90.
239. *See id.* at 80–85.
240. *See* MURRAY BOWEN, FAMILY THERAPY IN CLINICAL PRACTICE, at xvii (1993).

achieve a healthy psychological balance between their emotional involvement with their families and their own individuality.[241] Family-systems theory sees families as unified emotional units which Bowen calls the "undifferentiated family ego mass."[242] While emotional fusion is present in most families, it is most intense in the least mature families and only disappears when "family members have attained complete emotional maturity."[243] The goal of this type of family therapy is for one member to "differentiate a self from the amorphous we-ness" of the family ego mass.[244] When one person achieves this differentiation, she is able to control her responses to family emotional triggers, and she moves toward achieving maturity and selfhood.[245] In other words, the balance of the "togetherness-individuality forces in a family [must] exactly balance each other out."[246] Conversely, a "lack of differentiation among the individuals in [a family] leads to a social crisis."[247] This is what leads to trouble in families and in family businesses.

The role of the therapist is to help ease tensions in the family by allowing each member to achieve differentiation within the family and to identify patterns that make the family dysfunctional. Family business consultants simply apply these insights to the family business. The therapist achieves this by "remain[ing] free of the emotional field between [family members] while actively relating to each."[248] A member who has achieved this differentiation can avoid responding irrationally to emotional triggers from other members and instead respond to dilemmas logically. In the family-business context, this means making decisions based on best business practices rather than emotional entanglement with family members.

Manuals of wealth preservation advise discovering and breaking family patterns of dysfunction to achieve family stability through individual and group adhesion.[249] Translated into the language of family-business counseling, family-systems therapy seeks to "identify family patterns that impair operations or impede business progress."[250] They create a space free from what Bowen calls

241. *See id.* at 294–95.

242. *Id.* at 107.

243. *Id.*

244. *Id.* at 180 (internal quotation marks omitted).

245. *See id.* at 217.

246. *Id.* at 277.

247. RENE GIRARD, RESURRECTION FROM THE UNDERGROUND: FEODOR DOSTOEVSKY 49–51 (1997).

248. BOWEN, *supra* note 240, at 251 (emphasis omitted).

249. Playing the role of therapist in this context might not be as dangerous as it sounds. Bowen calls family group therapy "one of the easiest methods for the inexperienced therapist" requiring only that she be able to "relat[e] to multiple people in a group without taking sides and without becoming too entangled in the family emotional system." *Id.* at 295.

250. Steven H. Hobbs & Fay Wilson Hobbs, *Family Businesses and the Business of Families: A Consideration of the Role of the Lawyer*, 4 TEX. WESLEYAN L. REV. 153, 167–68 (1998). For a discussion

the family's "enmeshment"—its members' emotional entanglement with one another that causes them to react irrationally to stimuli from other members.

Translated into business therapy: families can manage conflict by setting boundaries between personal and professional interactions.[251] For example, one such manual describes successful business families as ones which "operate their businesses according to best business practices, while minimizing the influence of potentially competing family interests."[252] These authors present a checklist for family business owners to assess their conflict management skills.[253] It asks, among other things, "[h]ave I made time to check out my own interpretation of information or events with other family members?"[254] "How might I develop a more open-minded approach . . . to other family members' interpretation of . . . events?"[255] "Can I separate my feelings from what the other person may have intended?"[256] "Which of my own buttons is being pushed right now?"[257] "Is my reaction in proportion to the conflict?"[258]

It is not hard to imagine how these governance and therapy strategies could have aided the families discussed in the previous part. The Anheuser-Busch family offers a good example. As the beer company passed down the generations, there were clearly a number of psychological problems that emerged: dangerously destructive father-son dynamics, enormous psychological pressure on successor-sons, and a succession fight that led to self- and business-destructive behavior.[259] It is impossible to know, but one can imagine how a wealth preservation advisor, employed early on, could have put in place vision and mission statements and succession planning that might have allowed the family to orient themselves around the future of the company rather than their own personal tensions. And a board of professional directors would have made a huge difference in running the company. All of these tools would perhaps have prevented some of the worst decisions, such as the Spykes marketing disaster, and the sale to InBev might never have become a necessity. Similar problems appear in the Dart Drug family feud. Wealth preservation advisors

of the literature of systems applied to business, see generally *id.* at 154 n.9 (citing DAVID BORK, FAMILY BUSINESS, RISKY BUSINESS: HOW TO MAKE IT WORK (1986); W. GIBB DYER, JR., CULTURAL CHANGE IN FAMILY FIRMS: ANTICIPATING AND MANAGING BUSINESS AND FAMILY TRANSITIONS (1986); and JOHN L. WARD, KEEPING THE FAMILY BUSINESS HEALTHY: HOW TO PLAN FOR CONTINUING GROWTH, PROFITABILITY, AND FAMILY LEADERSHIP (1987)).

251. Samantha K. Ammons, *Work-Family Boundary Strategies: Stability and Alignment Between Preferred and Enacted Boundaries*, 82 J. VOCATIONAL BEHAV. 49, 50 (2013).

252. RHODES & LANSKY, *supra* note 199, at 16.

253. *Id.* at 57–58.

254. *Id.* at 57.

255. *Id.* at 58.

256. *Id.*

257. *Id.*

258. *Id.*

259. *See* KNOEDELSEDER, *supra* note 98, at 100–10.

are adept at forestalling these toxic father-son dynamics and might have been able to prevent the balkanization of this family as well.

Similarly, hindsight raises the question of what wealth preservation advising could have done for the Bronfman family of Seagram's. The third-generation son, Edgar, Jr., seems to have lost all connection to the vision and mission of the business, leading to his fatal decision to invest in media. Better planning might have enabled him to try his luck in the movie business without bankrupting his family's company.

The Mars family also made classic mistakes that these advisors warn against. For example, Forrest installed his sons at the top of the company rather than making them work their way up and learn the business. This more gradual absorption into the company might well have eased some of the succession-related tensions that plagued it. It might also have released the sons from their anxiety about risk and allowed them to make better decisions when Steven Spielberg and Jerry Seinfeld came calling.

Of course, there is no way of knowing the extent to which competent wealth preservation advising would have helped the above families. The overall lesson here is simply that, even in the most dysfunctional families, there are predictable moments of breakage and sources of tension. And the wealth advising industry has found ways to address them to keep families cooperating and maximizing growth.

### C. *Happy Families: Kimbell and Green*

While it is impossible to know anything for sure about the family dynamics or internal governance of most families,[260] sometimes enough information emerges to allow for speculation. This section describes two families for which such information is available. The first, the Texas oil family of Ruth Kimbell, fought the IRS over valuation discounts for interests transferred to a partnership a few years before Ruth's death. The Fifth Circuit case, *Kimbell v. United States*, demonstrated how the Kimbell family's collective management of family assets prevented future internal conflict. The second is the family of David Green, founder of Hobby Lobby. Though the Green family has not faced the IRS in court over a valuations issue,[261] it seems to be an example the kind of family-run, active business that exhibits the cooperation and unity that I have argued belies their justification.

260. *See generally* Tait, *High-Wealth Exceptionalism*, *supra* note 14, at 1012–17 ("[A] problem stemming from the financial exceptionalism of high-wealth families is the resultant financial privacy and opacity.").

261. It did, however, lose a battle with the IRS about a charitable deduction made to its trust. Green v. United States, 880 F.3d 519, 533 (10th Cir. 2018).

### 1. *Kimbell v. United States*

Ruth A. Kimbell, the matriarch of a large Texas oil company, died in 1998.[262] In the years before her death, she transferred much of her estate to three entities. First, she created a revocable living trust. Then, a few years later, her son and his wife created an LLC to which the trust contributed $20,000 for a 50% interest.[263] Later that year, the trust and the LLC formed a partnership under Texas law, to which the trust contributed about $2.5 million in cash and oil-related assets for a 99% limited partner interest.[264] At this point, it should be clear where this is headed: this transfer gave Ruth 99.5% ownership of the partnership as a limited partner.[265] The LLC was the general partner, with authority to manage the assets and make distributions.[266]

Ruth's estate filed its tax return in December 1998.[267] The assets of the partnership were worth $2.4 million, but the estate claimed a 49% discount in Ruth's interests in the LLC and the partnership for lack of control and marketability.[268] The estate actually claimed the discount under § 2036, a different section of the Tax Code from the one I focus on here.[269] But § 2036 arrives at the same discounts using the same logic. The only difference under § 2036 is that the test for allowing the discounts asks whether there was a "bona fide" business reason for establishing the partnership under which the discounts are claimed.[270] The *Kimbell* court, in finding that "business reasons" justified the formation of the partnership, again ignored obvious family reality.[271]

The IRS disagreed with the discounts claimed and increased the tax based on its belief that the assets transferred to the LLC and the partnership were includible in Ruth's gross estate.[272] The estate paid the deficiency and filed for a refund; the district court ruled for the IRS.[273] The estate appealed to the Fifth Circuit.[274]

On appeal, the government argued that partnerships merited different treatment for estate-tax purposes than from arm's length transactions because they are often "a vehicle for changing the form in which the decedent held his property—a mere 'recycling of value' . . . only a paper transaction without

262. Kimbell v. United States, 371 F.3d 257, 259 (5th Cir. 2004).
263. *Id.*
264. *Id.*
265. *Id.*
266. *Id.* at 260.
267. *Id.*
268. *Id.* at 259.
269. I.R.C. § 2036 is the subject of a forthcoming second article on this topic by this author.
270. *Kimbell*, 371 F.3d at 261.
271. *Id.* at 269.
272. *Id.* at 260.
273. *Id.*
274. *Id.*

substance."[275] The court agreed that transactions like this one among family members were "subject to heightened scrutiny"[276] but vacated the lower court's grant of summary judgment for the government and remanded for a finding of whether the "objective facts" indicated that the transfers at issue were a "bona fide sale" under § 2036(a)(2).[277] The court helpfully set out "objective facts"[278] it deemed indicative of a bona fide sale: Ruth retained "sufficient assets outside the [p]artnership for her own support and there was no commingling of [p]artnership and her personal assets"; "[p]artnership formalities were satisfied and the assets contributed to the [p]artnership were actually assigned to the [p]artnership"; "[t]he assets contributed to the [p]artnership included working interests in oil and gas properties which do require active management"; and the estate "advanced several credible and unchallenged non-tax business reasons for the formation of the [p]artnership that could not be accomplished via Mrs. Kimbell's [t]rust" alone.[279]

In reality, however, these "objective facts" fail to support the conclusion that there was a bona fide sale.[280] The court found Ruth's retained interest of $450,000 in assets "sufficient . . . for her own support."[281] But even a few years of long-term care for the eighty-nine-year-old Ruth would have used up this amount. And of course, since "[t]he assets were formally assigned to the [p]artnership,"[282] the Kimbells could afford competent tax advice. The failure to segregate assets is a well-known pitfall in FLP planning. It may be that the assets assigned to the partnership required "active management," but there was no evidence that their management differed under the LLC from what it had been before.[283]

The irony, however, is that the reasons offered for forming the partnership clearly indicated that there was no basis for valuation discounts. For example, one reason was that Mrs. Kimbell "wanted the oil and gas operations to continue beyond her lifetime and . . . felt that by putting the assets in a limited partnership, [the family] could keep the pool of capital together in one entity

275. *Id.* at 264–65.

276. *Id.* at 269. *But see* Kevin A. Lucid, *It's a Tax Thing: The Misnamed "Heightened Scrutiny" Standard for Evaluating Family Limited Partnerships*, 26 QUINNIPIAC PROB. L.J. 403, 429 (2013) (demonstrating that the "heightened scrutiny" analysis that courts apply to FLP transfers is not as demanding as the "heightened scrutiny" analysis that is applied in the Equal Protection Clause context).

277. *Kimbell*, 371 F.3d at 267.

278. *Id.* at 260.

279. *Id.* at 267.

280. *Id.*

281. *Id.*

282. *Id.* at 269.

283. *See* Wendy Gerzog, *Valuation Discounting Techniques: Terms Gone Awry*, 61 TAX L. 775, 797 (2008) (critiquing the court's analysis in *Kimbell* because "decedent was 96 years old, the assets transferred to her FLP were mainly liquid ones, and management remained essentially the same").

that would be enhanced over time rather than subdivided by distributions to subsequent generations," and to "keep the asset[s] in an entity that would preserve the property as separate property of her descendants."[284] During the divorce of one of Mrs. Kimbell's grandsons, the family was confronted with that issue.[285] To manage these issues, "[t]he partnership agreement provided that all disputes be resolved through mediation or arbitration to avoid interfamily litigation if disputes should arise."[286]

In short, the goals of the partnership were to

> increase Family wealth; establish a method by which annual gifts can be made without fractionalizing Family Assets; continue the ownership and collective operation of Family Assets and restrict the right of non-Family members to acquire interests in Family Assets; provide protection to Family Assets from claims of future creditors against Family members . . . promote the Family's knowledge of and communication about Family Assets; provide resolution of any disputes which may arise among the Family in order to preserve Family harmony and avoid the expense and problems of litigation; and consolidate fractional interests in Family Assets.[287]

In furtherance of these goals, the family had arranged its assets carefully to avoid the very detriment which was the basis for its discounts. The phrase from the partnership agreement itself, "collective operation of family assets" shows that Ruth's partnership interest was "limited" in name only. The family's goal was to manage its assets collectively to maximize their value.

Moreover, marketability discounts made no sense here because the partnership agreement was designed to inhibit marketability. It created an entity that was meant to be kept in the family, in one piece, to pass down as a whole to future generations. Nor was lack of control—the other basis for discounting—an issue: Ruth and her son, David, were cotrustees of the trust that funded the partnership.[288] The family's wealth preservation strategy worked: the family business's initial public offering on February 3, 2017, brought in $90 million.[289] At the time of the case, it was worth slightly over $2.6 million.[290]

The *Kimbell* court's analysis is just one example of the kind of disembodied analysis courts tend to apply to these transfers. By "disembodied," I mean

284. *Kimbell*, 371 F.3d at 268.

285. *Id.*

286. *Id.*

287. *Id.* at 260.

288. *Id.* at 259.

289. *Kimbell Royalty Partners Opens IPO*, HARTENERGY NEWS (Feb. 3, 2017), https://www.hartenergy.com/news/kimbell-royalty-partners-opens-ipo-112487 [https://perma.cc/EM8U-JM2K].

290. *Kimbell*, 371 F.3d at 259. At least by this author's calculation based on facts in the opinion.

analysis that is disconnected from the actual relationships of the families involved and what their acts of asset allocation meant within those relationships. Rather than attend to substance, courts hover at the level of pure form, ignoring the obvious reality below. That reality consisted of a succession that was from a mother to an only child—a son—a relationship that usually escapes the tensions of father-son transitions. Additionally, the lack of siblings, and a Texas oil family with a tradition of keeping land and wealth in the family, also indicated that the Kimbell family was a "happy" one. Though we do not know whether this family had a constitution or any other governing instruments, the partnership agreement itself served as a clear statement of the family's mission: collective management of family assets and the prevention of internecine conflict.

2. The Hobby Lobby Family

As was the case with the Kimbells, the Hobby Lobby family offers an example of a happy family of tax law.[291] Again, we do not know whether the family has a family constitution or mission statement, but we do know that its business has a mission statement and a vision statement. Its mission statement is "offering our customers exceptional selection and value. Serving our employees and their families by establishing a work environment and company policies that build character, strengthen individuals, and nurture families."[292] And, though the company has not yet published its complete vision statement, it states that its vision is "to influence and market creative arts while incorporating Christian values."[293] As with the Kimbell's partnership agreement, this mission statement and the partial vision statement tell a great deal about how the family will run the company in the future. Rather than being subject to disagreement and conflict, business decisions will be channeled through the mission statement's "exceptional selection and value" and "nurturing families" requirements rather than the number of shares a member owns. Green wrote a book about the company and his philosophy of business and life behind it.[294] As for selling, Green states:

> Another thing I don't have to mess with is dealing with stockholders and all the federal and state paperwork of being a public company. We're still family-owned, which keeps life a whole lot simpler. When my wife and

291. Brian Solomon, *Meet David Green: Hobby Lobby's Biblical Billionaire*, FORBES (Sept. 8, 2012, 7:51 AM), http://www.forbes.com/sites/briansolomon/2012/09/18/david-green-the-biblical-billionaire-backing-the-evangelical-movement/?sh=264dce335807 [https://perma.cc/NH5R-A7UJ (dark archive)].

292. *Our Story*, HOBBY LOBBY, https://www.hobbylobby.com/about-us/our-story [https://perma.cc/6PQF-75SB].

293. *Hobby Lobby Mission and Vision Statements Analysis*, HOBBY LOBBY, https://mission-statement.com/hobby-lobby/ [https://perma.cc/8M38-C26Q].

294. *Id.*

> kids and I decide to make a business move, we don't have to ask Wall Street about it.[295]

While the book is blatantly self-serving and irritatingly cloying, it indirectly reveals the workings of a family business which functions as a self-contained and harmonious unit. The book makes it clear that Hobby Lobby runs so smoothly as a family-held company that both family and business are run according to the same sets of religious values. Green references their "corporate commitment to follow biblical principles in everything we do," and emphasizes that "[w]e on the executive team at Hobby Lobby are of one mind on this."[296] The company employs a "full-time chaplain to meet employees' needs."[297] Its Christian values shape its business policy as well. Green decided to "go[] against the tide of American retail" by closing the stores at 8:00 p.m. and on Sundays, despite taking a financial hit for doing so.[298] He did so to help fulfill the business' mission statement goal of "nurturing families."

Green has also successfully integrated family members into the business. He insists that he has welcomed them into the company but only as "careful stewards of this third generation and not to let our successes warp their view of the hard work that life requires."[299] Indeed, the Green's estate planning reflects this concern: he told *Forbes Magazine* in 2017 how worried he was when wealth "advisors . . . told him to set up his business affairs in a way which would cause Hobby Lobby to be passed on to multiple generations of his descendants."[300] His worry: "What will this money do to them? How can he be assured that future generations will not turn away from the original mission and culture of the company and become a hundred 'hooks' into the company, taking from it rather than giving to it?"[301] According to the *Forbes* article, Green and his wife resolved the issue by asking their children to put their 15% shares of the company into a trust that was devoted to ensuring "that Hobby Lobby remains true to the mission and values on which it was founded—in perpetuity."[302] This

295. DAVID GREEN WITH DEAN MERRILL, MORE THAN A HOBBY: HOW A $600 STARTUP BECAME AMERICA'S HOME AND CRAFT SUPERSTORE 11 (2005).

296. *Id.* at 122–23.

297. Julie McGowan, *Exec Recounts Hobby Lobby's Ministry*, BAPTIST PRESS (Dec. 29, 2008), https://www.baptistpress.com/resource-library/news/exec-recounts-hobby-lobbys-ministry/ [https://perma.cc/9SNN-X4JN].

298. GREEN WITH MERRILL, *supra* note 295, at 132–37. Green asserts that the stores at the time were making $100 million per year on Sundays. *Id.* at 133.

299. *Id.* at 195.

300. Jerry Bowyer, *Restoring Trust Through Trusts: Hobby Lobby CEO Is a Steward, Not an Owner*, FORBES (May 1, 2017, 11:08 AM), https://www.forbes.com/sites/jerrybowyer/2017/05/01/restoring-trust-through-trusts-hobby-lobby-ceo-is-a-steward-not-an-owner/?sh=715f7bed3632 [https://perma.cc/4L33-R5QL (dark archive)].

301. *Id.*

302. *Id.* This trust recently lost a battle with the IRS over a charitable tax deduction for property it contained. *Id.*

strategy, accompanied by the transmission of family culture, will likely forestall the "cousin consortium" problems that plagued—and ultimately destroyed—families like the Vanderbilts and the Strohs.

So far, we have seen that many government benefits accrue to happy high-wealth families whose members cooperate to maximize their wealth. Because the Tax Code assumes, without investigation, that these families do not cooperate, they are able to save millions of dollars. The next part turns to the other end of the wealth spectrum—where poor families also receive government benefits. But, here, the law makes no assumptions about eligibility. Rather, the law subjects these families to ruthless surveillance.

## IV. TAX BREAKS, WELFARE, AND SURVEILLANCE OF THE POOR

As I have tried to make clear, the assumption of lack of family cooperation underlying valuation discounts is often inappropriate in the culture of the happy (or at least cooperative) tax families I have described, and I advocate for fact-finding in cases where wealthy families decline to opt for the statutory safe harbor I have proposed. Some will argue that it is too burdensome on the courts and too intrusive into intimate family matters.[303] They will cite the ideology of the protected private sphere, removed from state interference and intrusion.[304] In short, like the *Propstra* court, they will shudder at the prospect of inquiry into the "delicate feelings, attitudes, and anticipated behavior of those holding undivided interests in the property in question."[305]

These objections are misplaced. First, government agencies are well-experienced in investigating family dynamics when other public benefits are at stake, and, second, by the same token, such intrusions into family life are not unusual in the context of government benefits aimed at the poor. As the literature of tax expenditures makes clear, the distinction between tax breaks for the wealthy and direct relief payments to the poor is a false one. Both are "tax

303. Propstra v. United States, 680 F.2d 1248, 1252 (9th Cir. 1982) ("Without an explicit directive from Congress we cannot require executors to make such inquiries.").

304. *See* Khiara M. Bridges, *Privacy Rights and Public Families*, 34 HARV. J.L. & GENDER 113, 135–36 nn.76 & 77 (2011) [hereinafter Bridges, *Privacy Rights*]. The cases that comprise this tradition of judicial recognition of the domestic private sphere are iconic. *See, e.g.*, Griswold v. Connecticut, 381 U.S. 479, 485 (1965) (calling the right of privacy within marriage "a right of privacy older than the Bill of Rights—older than our political parties, older than our school system"); Prince v. Massachusetts, 321 U.S. 158, 166 (1944) (demarcating "the private realm of family life which the state cannot enter"); Pierce v. Soc'y of Sisters, 268 U.S. 510, 535–36 (1925) (striking down legislation that undermined "the liberty of parents and guardians to direct the upbringing and education of children under their control"); Meyer v. Nebraska, 262 U.S. 390, 399 (1923) (defining "liberty" under the Fourteenth Amendment to include to the right to "marry, establish a home and bring up children").

305. *Propstra*, 680 F.2d at 1252.

expenditures"—that is, income the government has chosen to forego in the interest, theoretically at least, of some policy goal.[306]

The Budget Act formally defines tax expenditures as: "Revenue losses attributable to provisions of Federal income tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."[307] In other words, if a tax code applies a certain tax rate to a certain income level and then reduces that tax by giving "credits" for, say, childcare, the amount lost to the government is a "tax expenditure."[308]

Stanley Surrey, a former Assistant Secretary of the U.S. Treasury, coined the term "tax expenditure" in a 1967 speech.[309] Surrey "compile[d] a list of preferences and concessions in the income tax that were similar to expenditure programs."[310] In addition to improving the budget process, he also wished to highlight subsidies in the Tax Code in the interest of creating support for tax reform.[311] In 1968, the U.S. Department of the Treasury issued the first tax expenditure budget report, a practice that continues today.[312]

Prior to 2003, the estate and gift tax report contained a list of tax expenditures.[313] Economists Rosanne Altschuler and Robert Dietz note that "[o]ne of the reasons given for the [2003] elimination of the tax expenditure estimates under the estate and gift tax may be viewed as being political"—the

306. *See* Rosanne Altshuler & Robert Dietz, *Reconsidering Tax Expenditure Estimation*, 64 NAT'L TAX J. 459, 460 (2011).

307. *Id.* at 459 (observing that "for many in the tax policy community, the term suggests tax breaks for limited constituencies that result in a narrow tax base and higher marginal tax rates" or simply, "tax expenditures are tax loopholes that need to be closed"); *see also* Congressional Budget and Impoundment Control Act of 1974, Pub. L. No. 93-344, § 3(3), 88 Stat. 297, 299 (codified at 2 U.S.C. § 622); STAFF OF J. COMM. ON TAX'N, 113TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2014-2018, at 2 (J. Comm. Print 2014).

308. This definition, of course, is the subject of contention. Despite widespread acceptance and employment of the concept of tax expenditures through federal law and by organizations like the Congressional Budget Office, the Joint Committee on Taxation, and the Tax Policy Center, significant questions about what tax provisions should be included remain. These questions generally involve what to define as the "normal tax system" and what constitutes a "departure." Nevertheless, there is general agreement that "there are numerous provisions in the tax code that represent disguised spending under any reasonable definition and would not be part of any broadly based, normative tax system." ERIC J. TODER, BENJAMIN H. HARRIS & KATHERINE LIM, URB.-BROOKINGS TAX POL'Y CTR., DISTRIBUTIONAL EFFECTS OF TAX EXPENDITURES 3 (2009), http://www.taxpolicycenter.org/sites/default/files/alfresco/publication-pdfs/411922-Distributional-Effects-of-Tax-Expenditures.PDF [https://perma.cc/N6J6-Z5YU]. This Article relies on analysis from the Congressional Budget Office, the Tax Policy Center, and the Joint Committee on Taxation for discussion of what constitutes a tax expenditure, the value of particular tax expenditures, and the distributional impact of those provisions.

309. Stanley S. Surrey, Assistant Sec'y, U.S. Treasury Dep't, Address Before the Money Marketers: The U.S. Income Tax System—The Need for a Full Accounting (Nov. 15, 1967).

310. Altshuler & Dietz, *supra* note 306, at 460.

311. *Id.*

312. *Id.*

313. *Id.* at 460 n.1.

fact that the tax had been repealed under the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGGTRA"), although EGGTRA was set to expire at end of 2010.[314] Valuation discounts, however, belong on the list of tax expenditures because they deviate from valuation norms based on a legal fiction—the loss of value.

As noted above, the main difference between welfare benefits for the poor and tax benefits for the rich is that the latter are "hidden" tax breaks rather than "handed out" directly.[315] Some have called them "Welfare for the Wealthy."[316] As Professor Marjorie Kornhauser notes, "Americans generally define welfare narrowly to mean helping the poor. . . . They tend not to call government spending 'welfare' when it benefits middle and upper-income individuals or corporations."[317] An oft-cited example is the different perceptions of housing assistance for the poor and subsidies for middle class home ownership.[318] The lion's share of tax benefits, however, goes to the middle and upper class. A 2006 study sponsored by the Pew Charitable Foundation found that: "approximately seventy-two percent of federal spending to further economic mobility . . . [benefited] middle- and higher-income individuals through such items as housing support, in comparison to twenty-eight percent to lower- and moderate-income individuals."[319] Much of that consisted of tax expenditures, like those available through valuation discounts.[320] Tax expenditures like these are the hidden or submerged forms of welfare for the wealthy.[321]

314. *Id.*; *see also* OFF. OF TAX ANALYSIS, U.S. DEP'T OF TREASURY, TAX EXPENDITURES UNDER THE ESTATE TAX 2 (2016), https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/Tax-Expenditures-Estate-Tax.pdf [https://perma.cc/G66S-YE7X] ("[T]he first estate tax expenditure budget was published in the annual Budget for Fiscal Year 1994, alongside those of the individual and corporate income taxes. The Budget continued to publish tax expenditures for the estate tax for nine years. But for the Fiscal Year 2003 Budget, the estate tax expenditure section was dropped, a change attributed at the time to a lack of agreement on an appropriate baseline to define estate tax expenditures. Estate tax expenditures have remained out of the Budget since then.").

315. HOWARD, THE HIDDEN WELFARE STATE, *supra* note 8, at 3; *see* METTLER, *supra* note 8, at 16–17; Kornhauser, *supra* note 9, at 272 ("[P]lacing general welfare (child tax credits, home mortgage deductions, and education credits) within the tax system frames them so positively that they all but disappear from consciousness."). *See generally* FARICY, *supra* note 9 (examining the relationship between political party power, social spending, and benefits to socioeconomic groups).

316. FARICY, *supra* note 9, at 11.

317. Kornhauser, *supra* note 9, at 261.

318. *Id.* at 261–62.

319. Kornhauser, *supra* note 9, at 262 & n.24.

320. *Id.* at 262 n.25. Professor Kornhauser noted that journalist David Cay Johnston "argu[ed] that the rich have 'captured' the government, so much so that the subsidy often outweighs the economic benefits it produces." *Id.*; *see also* DAVID CAY JOHNSTON, FREE LUNCH: HOW THE WEALTHIEST AMERICANS ENRICH THEMSELVES AT GOVERNMENT EXPENSE (AND STICK YOU WITH THE BILL) 7–8, 23 (2007) (asserting the subsidy outweighs the potential economic benefits because the rich have "captured" the government).

321. *See* HOWARD, THE HIDDEN WELFARE STATE, *supra* note 8, at 3; METTLER, *supra* note 8, at 16–17; FARICY, *supra* note 9, at 25.

These hidden forms of welfare are costly. In 2013, the ten largest tax expenditures totaled over $900 billion or 5.6% of GDP. Of this amount, "more than half of the combined benefits . . . accrue to households with income in the highest income quintile . . . with 17[%] going to households in the top 1[%] of the population."[322] This does not include the benefits attributable to minority discounts.[323] But discounts are one of the many forms of this "hidden welfare."[324]

Families benefiting from such a large percentage of government aid based on assumptions about their intimate lives should be subject to the same inspection and surveillance applied to those receiving a much smaller fraction. However, as Professor Wendy Bach notes, "as one moves from benefits for the poor to benefits for the rich, one can trace a linear progression from highly invasive and punitive administrative systems to systems that function as near entitlements."[325]

The difference between the lack of scrutiny of wealthy families and the invasive surveillance of poor families receiving analogous benefits is particularly striking in the case of the Earned Income Tax Credit ("EITC"). Credited with lifting more families out of poverty than any other antipoverty measure,[326] the EITC allows a credit against taxes owed and a tax refund of up to $6,000.[327] Filers must meet several requirements, including paid employment and the care

322. CONG. BUDGET OFF., THE DISTRIBUTION OF MAJOR TAX EXPENDITURES IN THE INDIVIDUAL INCOME TAX SYSTEM 3 (2013), https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/reports/taxexpendituresone-column.pdf [https://perma.cc/XM45-WJU4].

323. *See supra* notes 5–6 and accompanying text.

324. Kornhauser, *supra* note 9, at 261 ("Americans generally define welfare narrowly to mean helping the poor, what this Article labels 'poor' welfare. They tend not to call government spending 'welfare' when it benefits middle and upper-income individuals or corporations."). The following is only a sample of the vast literature on tax expenditures. *See, e.g.*, David M. Schizer, *Limiting Tax Expenditures*, 68 TAX L. REV. 275, 275 (2015) ("The federal government devotes over a trillion dollars each year to tax provisions that pursue 'nontax' goals, such as the deduction for mortgage interest and the exclusion for employer-provided health insurance."); Jason S. Oh, *The Social Cost of Tax Expenditure Reform*, 66 TAX L. REV. 63, 65 (2012) (explaining the social cost of business tax expenditures); CHRISTOPHER HOWARD, THE WELFARE STATE NOBODY KNOWS: DEBUNKING MYTHS ABOUT U.S. SOCIAL POLICY 122–23 (2007) (providing a classic discussion of tax expenditures). In 2019, tax expenditures reduced the amount of income tax the federal government collected by $1.3 trillion and cut payroll taxes and other sources of tax revenue by $140 billion. *Policy Basics: Federal Tax Expenditures*, CTR. ON BUDGET & POL'Y PRIORITIES (Dec. 8, 2020), https://www.cbpp.org/research/federal-tax/federal-tax-expenditures [https://perma.cc/442B-S3BK].

325. Bach, *supra* note 8, at 498.

326. *See* STEVE HOLT, THE BROOKINGS INST., THE EARNED INCOME TAX CREDIT AT AGE 30: WHAT WE KNOW 13 (2006), https://www.brookings.edu/wp-content/uploads/2016/06/20060209_Holt.pdf [https://perma.cc/CQ4W-PYWW].

327. *Key Elements of the U.S. Tax System*, TAX POL'Y CTR. (May 2021), https://www.taxpolicycenter.org/briefing-book/what-earned-income-tax-credit [https://perma.cc/HXY6-r9w7].

and custody of dependent children.[328] Although this is a tax break like those available under § 2704, the IRS treats EITC filers as presumptive tax cheats from the outset.[329]

First, the IRS requires some EITC filers to be precertified by producing additional documentation that they are eligible to file for the EITC.[330] Second, Congress and the General Accounting Office study "error rates" of EITC filings to a degree unmatched by the study of any other classification of returns.[331] Third, as Professor Dorothy Brown has noted, "EITC taxpayers are audited more than any other taxpayer group."[332] Indeed, about half of all individual income tax examinations are EITC returns.[333] On the other hand, only about 5% of the tax gap—the difference between what the government actually collects and what it would have collected with full compliance—is attributable to EITC errors.[334] Over half results from underreporting of self-employment and business income.[335] Further, there is no evidence that EITC filers commit fraud more than other filers.[336]

This targeting is expensive. Brown calculates that "Congress has made direct appropriations of over $1 billion since 1998 on EITC compliance initiatives."[337] No comparable number is available for the compliance initiatives for any other group of taxpayers, leading her to observe that "[i]f we wanted to find out how much, if anything, the IRS spends on denying unlawful tax

328. *Who Qualifies for the Earned Income Tax Credit (EITC)*, IRS (Sept. 13, 2021), https://www.irs.gov/credits-deductions/individuals/earned-income-tax-credit/who-qualifies-for-the-earned-income-tax-credit-eitc [https://perma.cc/4EBB-HJZV].

329. *See* Dorothy A. Brown, *Race and Class Matters in Tax Policy*, 107 COLUM. L. REV. 790, 791–93 (2007) (noting that "[l]ow-income taxpayers are under attack" due to the "political rhetoric surrounding the low-income tax credit"); *see also* Gustafson, *The Criminalization of Poverty*, *supra* note 11, at 647 ("[M]any of the policies written into the federal and state welfare reform laws assumed a latent criminality among the poor.").

330. *See* Lawrence Zelenak, *Tax or Welfare? The Administration of the Earned Income Tax Credit*, 52 UCLA L. REV. 1867, 1870 (2005); I.R.S. Announcement 2003-40, 2003-1 C.B. 1132.

331. *See* Brown, *supra* note 329, at 800 ("EITC taxpayers have been targeted because they are viewed as being the equivalent of welfare recipients. That perception in turn leads to a higher level of scrutiny than that faced by any other taxpayer group.").

332. *Id.* at 801.

333. *Id.* at 808; *see also* W. Edward Afield, *Social Justice and the Low-Income Taxpayer*, 64 VILL. L. REV. 347, 353 (2019) ("[T]he EITC is subject to a high audit rate, even in a climate of low overall governmental tax enforcement.").

334. Stephen D. Holt, *Keeping It in Context: Earned Income Tax Credit Compliance and Treatment of the Working Poor*, 6 CONN. PUB. INT. L.J. 183, 188 (2007).

335. *Id.*

336. NAT'L TAXPAYER ADVOC., 2 ANNUAL REPORT TO CONGRESS: CRIMINAL INVESTIGATION REFUND FREEZE STUDY 13–14 (2005), https://www.irs.gov/pub/tas/section_4.pdf [https://perma.cc/F234-Y56P] (analyzing Taxpayer Advocate Service cases involving refund freezes); *see also* Holt, *supra* note 334, at 200–01 (listing reasons other than intentional misrepresentation for EITC noncompliance, such as: the complexity of the rules, brokered noncompliance, and "Refund Anticipation Loans" to buy big-ticket items such as cars).

337. *See* Brown, *supra* note 329, at 806.

shelters to high income taxpayers, we can't because those data are not separately stated."[338]

Brown ascribes the different treatment of families receiving EITC credits to "the political rhetoric surrounding" the EITC.[339] This rhetoric has framed the EITC as a form of welfare, signaling government handouts to people too lazy to work, although it clearly requires "earned income" for eligibility. In doing so, Brown argues that politicians have made it "racially and politically charged."[340] While whites receive welfare, it is not called welfare.

Courts and administrative agencies also routinely examine intimate details of family life to establish poor people's "eligibility" (some might say worthiness) to receive welfare and other public benefits.[341] Courts adjudicating alimony disputes between former spouses routinely inquire as to who is sleeping with whom.[342] In this context, it is clear that such inquiries are nothing new for the court system. They have simply been inequitably practiced. As one scholar puts it: the poor "endure a barrage of information collection practices that are far more invasive and degrading than those experienced by their wealthier neighbors."[343] Moreover, "[t]he law reinforces this class differential in privacy."[344] I might add that the discrepancies I describe in tax law specifically do the same. They do so by forcing the poor to pay for benefits with invasions of intimate life while handing the wealthy much greater benefits and allowing them to escape similar scrutiny under cover of assumptions about their families. The assumptions about poor families that animate welfare are quite different: they are "the criminality of the poor . . . [and] the logics of crime control now reign supreme over efforts to reduce poverty or to ameliorate its effects."[345]

To illustrate the type of family scrutiny the poor face in applying for benefits, take the case of Rocio Sanchez, who "applied for welfare benefits and food stamps at a San Diego County welfare office to support her infant daughter" after separating from her husband.[346] The following facts are taken from the complaint Ms. Sanchez filed as part of a class action asserting the

338. *Id.*

339. *Id.* at 792–93.

340. *Id.* at 794.

341. GUSTAFSON, CHEATING WELFARE, *supra* note 11, at 23.

342. CARLA SPIVACK, THE SMART WOMAN'S GUIDE TO PROPERTY LAW: PROTECT YOUR ASSETS WHEN YOU LIVE WITH SOMEONE, MARRY, DIVORCE, AND MORE 40–51 (2020) (detailing judicial investigation into intimate details of ex-spouses' personal lives).

343. Gilman, *supra* note 3, at 1389–90.

344. *Id.* at 1390.

345. GUSTAFSON, CHEATING WELFARE, *supra* note 11, at 1.

346. Gilman, *supra* note 3, at 1390. Gilman recounts the events of Rocio Sanchez in *The Class Differential in Privacy Law*. *Id.* A comprehensive account of the facts are also available in the complaint filed in *Sanchez v. County of San Diego*. First Amended Complaint for Declaratory & Injunctive Relief at 4–11, Sanchez v. Cnty. of San Diego, No. 00-CV-1467-JM(JFS) (S.D. Cal. Sept. 12, 2000).

unconstitutionality of the intrusion, as described by Michele Estrin Gilman in *The Class Differential in Privacy Law*:

> One month [after she filed for benefits], an investigator from the Public Assistance Fraud Division of the San Diego District Attorney's Office made an unannounced visit to [Sanchez's] home pursuant to a county policy called Project 100%, which required home visits of all welfare applicants who were *not* suspected of fraud or ineligibility. The investigator asked Ms. Sanchez a series of questions about her husband and his whereabouts, [including] when she had last talked with or seen him, and the reasons for their separation. [The investigator] then searched the home, including her bedroom closet, and left to question her neighbors.
>
> Ms. Sanchez encountered the investigator a few days later when he arrived at her former residence searching for her husband. She was there alone, cleaning the residence so that she could recover the rental security deposit. In her presence, the investigator proceeded to search the bathroom cabinets, the bedroom, and the dresser drawers—all of which were empty. Again, he questioned Ms. Sanchez about her husband, including asking why she was still speaking to her sister-in-law if she was in fact separated. He demanded that she pull out papers from her husband's trash can that might lend clues to his location, remarking that it was "funny" that she had never filed a domestic violence complaint.[347]

Ms. Sanchez filed a complaint as a member of a class challenging the constitutionality of this invasion of privacy.[348] The Ninth Circuit ultimately "upheld the home visits against a Fourth Amendment challenge, reasoning that 'a person's relationship with the state can reduce that person's expectation of privacy, even within the sanctity of the home.'"[349] Seven judges dissented from the denial of an en banc rehearing, calling the case "nothing less than an attack on the poor."[350] Gilman chronicles that the dissenters noted that

> most government benefits do not flow to the poor, "yet this is the group we require to sacrifice their dignity and their right to privacy." By contrast, "[t]he government does not search through the closets and medicine cabinets of farmers receiving subsidies. They do not dig

347. *Id.* at 1390; *see also* First Amended Complaint for Declaratory & Injunctive Relief, *supra* note 346, at 4–6.

348. Sanchez v. Cnty. of San Diego, 464 F.3d 916, 918 (9th Cir. 2006). Unfortunately, Ms. Sanchez's case is not unusual. *See, e.g.*, Smith v. Bd. of Supervisors, 128 Cal. Rptr. 2d 700, 713 (Ct. App. 2002) (dismissing a writ of mandamus challenging the searches because the home visits did not contradict the purpose of the state welfare statute since the purpose of the searches was to determine eligibility).

349. Gilman, *supra* note 3, at 1391 (quoting *Sanchez*, 464 F.3d at 927).

350. *Id.* (quoting *Sanchez*, 483 F.3d at 969 (Pregerson, J., dissenting from the denial of rehearing en banc)).

through the laundry baskets and garbage pails of real estate developers or radio broadcasters." As the dissenters concluded, "This situation is shameful."[351]

Justice Douglas noted in his dissent from *Wyman v. James*,[352] in which the Supreme Court upheld the constitutionality of home visits by welfare workers, "[n]o such sums are spent policing the government subsidies granted to farmers, airlines, steamship companies, and junk mail dealers, to name but a few."[353]

These invasions of poor people's privacy are widespread. Single mothers seeking public assistance face drug tests, DNA testing of children, fingerprinting and "intrusive questions about their child rearing and intimate relationships."[354] Women seeking subsidized prenatal care often face interviews by "a battery of professionals—including nurses, health educators, financial officers, HIV counselors, and social workers."[355] These interviews include questions about the mother's relationship with the father, the father's job, financial support for the child, whether the child was wanted or planned, and whether the mother has parenting skills or needs someone to teach her those skills.[356] It is worth noting that digital technology has enabled even more invasive family surveillance of those receiving benefits. Many states now distribute funds electronically, allowing for monitoring of who buys what when.[357]

I draw an even tighter nexus here than the Ninth Circuit dissent did in *Sanchez*. I compare the invasion of family privacy based on presumptions of deceit—how else to explain the rummaging through garbage cans for evidence of the husband's presence—with the blanket presumption of the deserving family in Chapter 14 of the Tax Code. Both of these presumptions authorize the conferral of benefits, yet they are diametrically opposed as applied to the two groups.

In rejecting Sanchez's challenge to the home search, the Ninth Circuit relied on the 1971 case of *Wyman v. James*, in which the Court answered the question of whether the state could condition the receipt of public benefits on

351. *Id.* (footnotes omitted) (quoting *Sanchez*, 483 F.3d at 969 (9th Cir. 2007) (Pregerson, J., dissenting from the denial of rehearing en banc)).

352. 400 U.S. 309 (1971).

353. Gilman, *supra* note 3, at 1413; *see also id.* at 1413 n.171.

354. Bridges, *Privacy Rights*, *supra* note 304, at 114–16 (discussing Medicaid); *see* Kaaryn Gustafson, *Degradation Ceremonies and the Criminalization of Low-Income Women*, U.C. IRVINE L. REV. 297, 312–21 (2013); Gilman, *supra* note 3, at 1397–400 (discussing welfare).

355. Bridges, *Privacy Rights*, *supra* note 304, at 114.

356. *Id.* at 115–16.

357. Mary Madden, Michele Gilman, Karen Levy & Alice Marwick, *Privacy, Poverty, and Big Data: A Matrix of Vulnerabilities for Poor Americans*, 95 WASH. U. L. REV. 53, 123 (2017) ("[T]he digital world will replicate, if not reinforce, both covert and overt patterns of surveillance [of the poor].").

regular home visits by caseworkers.[358] The Court began its analysis with an acknowledgment that "over the years, the Court consistently has been most protective of the privacy of the dwelling,"[359] but it went on to state that this "quite proper and protective attitude" was irrelevant to the case at hand because home visits fell outside of Fourth Amendment protections.[360] There were two reasons for this: first, these visits, according to the Court, were rehabilitative in nature, rather than investigative, and second, the visits were consensual.[361]

These rationales drew fire from a range of sources.[362] My purpose is not to itemize them here. I focus rather on another rationale the Court offered: that the state's interest in the fiscal integrity of the public assistance program justified the searches.[363] Because "tax funds provided from federal as well as from state sources" supported the relief at issue, the Court found a "paramount interest and concern in seeing and assuring that the intended and proper objects of that tax-produced assistance are the ones who benefit from the aid it dispenses" because the public rightly "expects to know how [its] charitable funds are utilized and put to work."[364]

As Professor Jordan Budd has argued, *Wyman*'s reach has stretched further and further in the decades since the decision.[365] As Budd shows, investigatory intrusion into the private spaces of aid recipients is now the norm in many jurisdictions, conducted not by the at least putatively rehabilitative caseworkers in *Wyman*, but by "law-enforcement officers whose sole purpose is to search the home for evidence of ineligibility or fraud."[366] In San Diego County, for example, as Budd points out, "Project 100%"—the subject of the Sanchez class action—aims to ensure that every aid applicant submit to a "highly invasive"

358. Wyman v. James, 400 U.S. 309, 309 (1971).

359. *Id.* at 316.

360. *Id.* at 317.

361. *Id.* at 317–18.

362. *See* Robert A. Burt, *Forcing Protection on Children and Their Parents: The Impact of* Wyman v. James, 69 MICH. L. REV. 1259, 1302–03 (1971); Harry Kalven, Jr., *Forward: Even When a Nation Is at War*, 85 HARV. L. REV. 258, 259–62 (1971); *see also* Ginny Kim, *Unconstitutional Conditions: Is the Fourth Amendment for Sale in Public Housing?*, 33 AM. CRIM. L. REV. 165, 180–84 (1995).

363. *Wyman*, 400 U.S. at 318–19.

364. *Id.* at 319; Jordan C. Budd, *A Fourth Amendment for the Poor Alone: Subconstitutional Status and the Myth of the Inviolate Home*, 85 IND. L.J. 355, 370 (2010) (analyzing the Court's holding in *Wyman*).

365. Budd, *supra* note 364, at 375.

366. *Id.* at 380; *see also* Sanchez v. Cnty. of San Diego, 464 F.3d 916, 918–19 (9th Cir. 2006) (describing San Diego County's program); *id.* at 934–36 (Fisher, J., dissenting); S.L. v. Whitburn, 67 F.3d 1299, 1301–03 (7th Cir. 1995) (describing Milwaukee County's program); *see also* Bach, *supra* note 8, at 539 ("Not only have welfare agencies adopted the mechanisms and modalities of the criminal justice system in the policing of the application and retention of welfare benefits, but they are part and parcel of a system of intersecting regulatory systems that expose women and children to the risk of ever-increasing punishment in the child welfare and criminal law systems."); GUSTAFSON, CHEATING WELFARE, *supra* note 11, at 1 ("Welfare rules assume the criminality of the poor . . . [and] the logics of crime control now reign supreme over efforts to reduce poverty or to ameliorate its effects.").

home search by law enforcement officials.[367] Applicants must show officials "bank statements, pay stubs, tax returns, benefit check stubs, and other documents . . . [N]othing is 'off-limits.'"[368] Also, "[i]nvestigators may search any space within the home that they deem relevant to verification,"[369] and if the applicant refuses inspection of any portion of the home then it will result in denied benefits.[370] Investigators can request "to look at the contents of bedrooms, closets, kitchens, bathrooms, medicine cabinets and drawers in search of evidence of ineligibility or fraud."[371] Looking primarily for traces of a male presence, officials "count toothbrushes, look for men's bath products, examine the contents of laundry baskets, open refrigerators, and explore the contents of trash cans and dresser drawers."[372] Budd points to other programs similar to Project 100% in other jurisdictions around the country,[373] noting that courts have consistently found these searches constitutional under the "special needs" exception to the Fourth Amendment's protections.[374] One court concluded that "home visits at issue are reasonable intrusions upon an applicant's privacy" because the state has an interest in those who benefit from the tax-produced assistance.[375]

Rather than argue with the logic of this line of cases, I propose to apply their logic more broadly. If a "relationship with the state" and the receipt of benefits from the public fisc require, as the *Wyman* Court stated, a citizen to relinquish his expectation of privacy so the state may establish the truth of his intimate relationships, then this principle should apply to everyone who receives benefits at taxpayer's expense. It should be obvious that this includes the wealthy who receive tax breaks in the form of valuation discounts based an implied assertion about family relationships.

While all tax breaks are a form of government benefit, discounts are especially egregious. The main difference is that there is much more money at stake. One commentator notes that "[e]very citizen is in a 'relationship' with

367. Budd, *supra* note 364, at 382.

368. Plaintiffs-Appellants' Opening Brief at 22–23, *Sanchez*, 464 F.3d 916 (No. 04-55122), 2004 WL 1949000, at *22–23; Budd, *supra* note 364, at 382 n.228 (citing Plaintiffs-Appellants' Opening Brief, *supra*, at 22–23).

369. Budd, *supra* note 364, at 382; *see also id.* at 382 n.229 (quoting Sanchez v. Cnty. of San Diego, No. 00-CV-1467-JM(JFS), 2003 WL 25655642, at *8 n.8 (S.D. Cal. Mar. 10, 2003) ("[N]o specific protocol limits where the investigator may look . . . .")).

370. *Id.* at 382; *see also* Plaintiffs-Appellants' Opening Brief, *supra* note 368, at 27 n.20 ("[E]ligibility technicians deny applications if the Fraud Investigator reports that an applicant refused to answer questions, or refused full entry to her residence.").

371. Budd, *supra* note 364, at 382 (citing *Sanchez*, 464 F.3d at 936 (Fisher, J., dissenting)).

372. *Id.* at 382.

373. *Id.* at 383–85.

374. *Id.* at 395–404.

375. S.L. v. Whitburn, 67 F.3d 1299, 1310 (7th Cir. 1995); *see also* Budd, *supra* note 364, at 402–03 ("[W]elfare applicants necessarily must have a diminished privacy expectation in view of the benefits they seek to obtain.").

the government, and fraud abounds in all governmental programs. What will distinguish this case from the case in which investigators want to rummage through drawers in citizens' homes to 'prevent' tax fraud?"[376] The discrepant treatment of welfare applicants and discount recipient suggests that the answer is the cost of the home in which the drawers are located.

## V. SOLUTIONS

Section 2704, and the whole Chapter 14 of which it is a part, was drafted to allow for the reality of intrafamily transactions, specifically, to prevent outcomes like the one in the 1987 case of *Estate of Harrison*.[377] In *Harrison*, six months before the decedent died, his sons transferred his assets to a partnership in exchange for 1% general partnership interest and a 77.8% limited partnership interest.[378] The sons each also received a general partnership interest.[379] The general partnership interests included the right to force the liquidation of the partnership, while the limited partnership interest did not.[380] This right was obviously valuable because it allowed the holder to turn his interest into cash at any time.[381] The right of the general partnership holder to force liquidation lapsed at that holder's death.[382]

The dispute in the case was about the general partnership interest that the decedent held.[383] Because the valuable liquidation right had lapsed at death, the estate argued that the value of the interest was significantly lower than it had been before his death.[384] The IRS urged the court to overlook the technicalities of the partnership agreement in favor of the reality that the decedent's interest passed to his sons, who were general partners themselves and could exercise the same liquidation right that had lapsed with decedent's death.[385] But the court was counterfactual[386] instead:

376. *See* Budd, *supra* note 364, at 403 & n.401 (citing Recent Case, *Constitutional Law — Fourth Amendment — Ninth Circuit Upholds Conditioning Receipt of Welfare Benefits on Consent to Suspicionless Home Visits. —* Sanchez v. County of San Diego*, 464 F.3d 916 (9th Cir. 2006).*, 120 HARV. L. REV. 1996 (2007)).

377. 52 T.C.M. (CCH) 1306 (1987).

378. *Id.* at 1307.

379. *Id.*

380. *Id.*

381. *Id.*

382. *Id.*

383. *Id.*

384. *Id.*

385. *Id.*

386. "Counterfactual thinking" refers to the human tendency to create possible alternatives to real life events that have already occurred and that are contrary to what actually happened. *See generally* Neal J. Roese, *Counterfactual Thinking*, 121 PSYCH. BULL. 133 (1997) (discussing how counterfactual thinking relies on mental depictions of alternatives to past events).

> To find the fair market value of a property interest at the decedent's death we put ourselves in the position of a potential purchaser of the interest at that time. Such a person would not be influenced in his calculation by past risks that had failed to materialize or by restrictions that had ended. Death tolls the bell for risks, contingencies, or restrictions which exist only during the life of the decedent. A potential buyer focuses on the value the property has in the present or will have in the future. He attributes full value to any right that vests or matures at death, and he reduces his valuation to account for any risk or deprivation that death brings into effect . . . .[387]

The problem with this thinking, of course, is that there was no "potential purchaser" in the sense the court intended. There were only the sons, who inherited the limited shares, making them immediately subject to their rights as general partners to liquidation. Sections of Chapter 14 tried to address this type of intrafamily transfer by treating liquidation (and other rights) that lapsed upon a transferor's death as gifts or as part of the decedent's gross estate if "the individual holding such right immediately before the lapse and members of such individual's family hold, both before and after the lapse, control of the entity."[388] Section 2704 also provides that restrictions on liquidation will be disregarded—that is, not allowed to deflate value for tax purposes—if "the transferor and members of the transferor's family hold, immediately before the transfer, control of the entity."[389] Restrictions covered by the statute exclude "any restriction imposed, or required to be imposed, by any Federal or State law."[390]

By 2016, however, the IRS had concluded that, over the years, various changes in state laws and other subsequent developments had "rendered [§ 2704] substantially ineffective in implementing the purpose and intent of the statute."[391] First, courts had ruled that under the current regulations, § 2704(b) applied only to restrictions on the ability to liquidate an entire entity, and not to restrictions on the ability to liquidate the transferred interest in that entity.[392] Second, many states helpfully passed more restrictive partnership laws, thus allowing most restrictions in partnership agreements to fall under the exclusion for any "restriction imposed, or required to be imposed, by any Federal or State

387. *Est. of Harrison*, 52 T.C.M. at 1308.

388. 26 U.S.C. § 2704(a)(1)(B).

389. *Id.* § 2704(b)(1)(B).

390. *Id.* § 2704(3)(B).

391. Estate, Gift, and Generation-Skipping Transfer Taxes; Restriction on Liquidation of an Interest, 81 Fed. Reg. 51,413 (proposed Aug. 4, 2016) (withdrawn on Oct. 20, 2017).

392. Kerr v. Comm'r, 113 T.C. 449, 473 (1999), *aff'd*, 292 F.3d 490 (5th Cir. 2002).

law."[393] Finally, people avoided the application of the section by transferring interests to assignees or nonfamily members.[394]

The IRS drafted the 2016 proposed regulations to address these attempts to chip away at the effectiveness of the statute. The proposed regulations clarify that they apply to restrictions on the liquidation of transferred parts of the entity, not just the entity as a whole.[395] The IRS removed the loophole for restrictions imposed by state law and limited the ability of an assignee or a nonfamily member to cause the entity to escape the family control definition.[396] In essence, the proposed regulations reimpose family attribution rules to covered entities, acknowledge that families work together to manage assets, and recognize that the lapse of a liquidation right means something different when the interest passes to a family member than when it passes to a stranger.

Predictably, these regulations elicited much wailing and gnashing of teeth from tax lawyers, CPAs, estate planners, financial advisors, and family business owners[397] Much of this took place at the hearings on the proposed regulations, held on December 1, 2016, where family businesspeople gloomily predicted that the imposition of the family attribution rules would force their heirs to sell these "legacy businesses" or ranch lands to pay the taxes.[398] The Treasury withdrew the proposal in early days of the Trump administration.[399]

This withdrawal was unfortunate. The proposed regulations would have eliminated a large tax expenditure that is based on a legal fiction. As one of its few supporters at the hearing pointed out, the change would affect only a very small percentage of estates, even at the 2016 estate tax exemption rates of $5.45 million, or $10.9 million for married couples.[400] The exemption rate now is over $15 million, and, whatever happens to it under future administrations, it is unlikely to return to anything below the 2016 level.

393. *Id.* at 462.

394. *Id.* at 468.

395. *See* § 2704.

396. *See id.*

397. *See, e.g.*, Kevin Robertson, *Proposed Regulations Under IRC Section 2704 Seek To Eliminate Discounts on Transfers of Family Business Interests*, BAKER HOSTETLER: WEALTH DIR. BLOG (Sept. 23, 2016), https://www.wealthdirector.com/2016/09/proposed-regulations-under-irc-section-2704-seek-to-eliminate-discounts-on-transfers-of-family-business-interests/ [https://perma.cc/D299-S57F].

398. *Public Hearing on Proposed Regulations: Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest Before the IRS* (2016) (statement of Clarene Law), https://www.nmmlaw.com/pdf/IRS%20Public%20Hearing%20on%20Proposed%20Regulations.pdf [https://perma.cc/4E9R-VUQL].

399. STEVEN T. MNUCHIN, SECOND REPORT TO THE PRESIDENT ON IDENTIFYING AND REDUCING TAX REGULATORY BURDENS 2–3 (2017), https://www.treasury.gov/press-center/press-releases/Documents/2018-03004_Tax_EO_report.pdf [https://perma.cc/B3W7-6HJP].

400. *Public Hearing on Proposed Regulations: Estate, Gift, and Generation-Skipping Transfer Taxes; Restrictions on Liquidation of an Interest Before the IRS* (2016) (statement of Dawn Jinsky), https://www.nmmlaw.com/pdf/IRS%20Public%20Hearing%20on%20Proposed%20Regulations.pdf [https://perma.cc/4E9R-VUQL].

These proposals take a promising step, but the abuse of valuation discounts requires more broad-based reform. We need to acknowledge that family fact-finding is as appropriate at one end of the wealth spectrum as it is at the other. A family seeking government benefits in the form of reduced taxes through drastic discounts in the valuation of family-held assets should reasonably expect to support its claim with evidence of the family's discord and inability to cooperate in managing assets. Evidence of family cooperation, in the form of the use of wealth preservation strategies or something else, would support the presumption of family unity. Evidence of family disunity could rebut the presumption. If the case histories recounted here are anything to go by, family antagonism is not hard to spot.

The regime I propose does not create perverse incentives, as some might argue. A family can accrue much more wealth by cooperating in maximizing assets than it can by intentionally ignoring best practices to gain tax discounts. Under the current rules, the incentive is to do both. Since the discounts are automatic, the family can cooperate to maximize asset growth while avoiding taxes at the same time with a legal fiction of lost value. Faced with a real choice, no family would choose to destroy a dollar's worth of value for forty cents worth of tax savings.

As a matter of political and administrative practicality, I propose that the new rules should include a safe harbor. Minority shares in passive assets in an FLP will automatically receive a 10% discount; those in an active business will receive a 15% discount. This difference reflects the different nature of the two kinds of assets, and the greater number of avenues for freezing or squeezing a shareholder out in a going concern. A family seeking a deeper discount would need to show clear and convincing evidence that a minority shareholder would suffer harm at the hands of a controlling shareholder

This regime would, I suggest, create powerful incentives, because there are positive effects on both sides. While the 10–15% discount is lower than the average one granted by courts, the safe harbor aspect would make it a tempting alternative to litigation. In the case of the FLP holding passive assets, a family that chose to argue for a higher percentage would be forced, in the case of the FLP holding passive assets, to admit to a breach of its duty toward the beneficiaries of those assets. A family running an FLP business would, likewise, have to acknowledge internal strife and the likelihood that some family members were likely to be squeezed out. Neither of these are an appealing litigation strategy. Such risks would likely only be worthwhile in extreme cases.

Safe harbors appear regularly in the Tax Code.[401] They exist to "protect[] taxpayers from the vast unknown of facts and circumstances tests."[402] The usually function in the following way:

> [A] safe harbor accompanies such a facts and circumstances test. If a taxpayer satisfies the safe harbor's clearly defined criteria, the taxpayer will receive specific, generally favorable, tax treatment and need not evaluate how he or she would fare under the facts and circumstances test. If a taxpayer operates outside the boundaries of a safe harbor, he or she will not automatically forfeit the tax treatment accorded to taxpayers falling within the safe harbor. Rather, an underlying standard will determine the tax consequences imposed upon taxpayers who function beyond the limits of a safe harbor, and, under this standard, some taxpayers will receive the same treatment provided to taxpayers within the safe harbor while some will not.[403]

The standard that lies outside the safe harbor is that valuation discounts will only be granted if there is clear and convincing evidence of family strife or mismanagement of assets to a degree that threatens the fair treatment of minority shareholders. If a filer declines the safe harbor, what kinds of evidence would constitute a clear and convincing threat to a minority shareholder's security and fair treatment?

To summarize: the existing regime fails to value accurately transferred shares in family businesses for a variety of reasons. The 2016 proposed regulations tried to address some of those failings, but in addition to being withdrawn, they ignored the fundamentally flawed premise of the discount regime—that high-wealth families are all unhappy (and all unhappy in the same way). My proposal would require proof that a family truly was dysfunctional in a way that disadvantaged minority shareholders. For political palatability and efficiency, I offer a safe harbor where families can take a proffered discount without submitting to fact-finding. This solution injects a dose of reality into the discount regime and brings it into line with the treatment of people receiving benefits on the other side of town.

401. Emily Cauble, *Safe Harbors in Tax Law*, 47 CONN. L. REV. 1385, 1385 (2015) (observing that "[s]afe harbors pervade tax law"). For safe harbor provisions in other tax code areas, see *Tax Court Approves Reverse Like-Kind Exchange Outside of Safe Harbor*, 44 REAL EST. TAX'N 13, 13 (2016); *IRS Provides Optional Safe Harbor Method for Claiming Home-Office Deduction*, 118 J. TAX'N 59, 59 (2013); *Safe and Not-So-Safe Harbors*, 36 J. CORP. TAX'N 29, 29 (2009) (discussing safe harbors in corporate tax law); C*hoosing Interest Rates for Family Transactions To Avoid a Gift as well as Imputed Income*, 83 J. TAX'N 155, 155 (1995); *The Impact on Partners of Allocations That Have Substantial Economic Effect*, 4 J. P'SHIP TAX'N 112, 112 (1987).

402. Cauble, *supra* note 401, at 1391.

403. *Id.* at 1391–92.

## CONCLUSION

This Article is based on the premise that welfare benefits for the poor are analogous to tax breaks for the wealthy. Both cost taxpayers money: welfare benefits are a direct cost, while tax benefits cost taxpayers in unpaid taxes that they must subsidize. Given this analogy, it is unfair to subject one group of recipients to surveillance while letting the other group benefit from assumptions about their families—especially when those assumptions are questionable at best.

My proposal both levels the field and prevents the group that has escaped scrutiny from continuing to receive unmerited benefits. Invasion of poor people's privacy is too deeply entrenched in our law and political culture to change, but we can at least treat everyone who receives benefits the same way. Doing so, moreover, is not just fair, it can bring millions back into the public fisc for the national benefit.