Gift and Estate Tax Valuation Insights

The Application of a Multi-Level Valuation Discount in the Gift or Estate Valuation of a Tiered Entity—A Review of Relevant Judicial Precedent

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Many high net worth individuals own equity interests in multi-tier entities. These multi-tier entities are created for various asset protection, equity owner protection, family business optimization, and other business purposes. Multi-level valuation discounts are valuation adjustments (e.g., for lack of control and for lack of marketability) that are applied to conclude the value of both entities (e.g., the upper tier entity and the lower tier entity) of the multi-tiered entity. The Internal Revenue Service typically disallows multi-tier valuation discounts that are applied in gift tax or estate tax valuations. This discussion summarizes the judicial factors that the courts have considered in eleven decisions that involve the application of multi-tier valuation discounts.

Introduction

This discussion will focus on the application of multi-level valuation discounts (e.g., a discount for lack of control and a discount for lack of marketability) in the valuation of tiered business entities for gift and estate tax compliance purposes. For purposes of this discussion, tiered business entities are defined as holding companies that own an interest in another company.

The U.S. Tax Court, as well as other federal courts, have opined on the appropriateness of applying multi-level discounts for tiered entities. This discussion presents an overview of 11 judicial decisions that have dealt with the valuation of tiered entities.

In summary, and as will be discussed below, *Astleford*,[1] *Dean*,[2] *Gallun*,[3] *Gow*,[4] *Hjersted*,[5] *Kosman*,[6] *Piper*,[7] and *Whittemore*[8] allowed multi-level valuation discounts. *Martin*[9] largely disallowed multi-level valuation discounts. And, *Janda*[10] and *O'Connell*[11] disallowed multi-level discounts.

At the examination level, the Internal Revenue Service (the "Service") generally challenges as duplicative the application of two layers of valuation discounts for tiered entities. However, the respective taxpayers have been successful in applying multi-level valuation discounts in a majority of the relevant judicial decisions that directly involved tiered entity valuations.

In nine of the eleven tiered entity judicial decisions summarized in this discussion, the court allowed some degree of a multi-level valuation discount. In addition, in a majority of these judicial decisions, even the Service's valuation analyst applied a multi-level valuation discount. In the two decisions that disallowed a multi-level valuation discount (i.e., *Janda* and *O'Connell*), there were unique circumstances that contributed to the court's rejection of a multi-level valuation discount.

The judicial rationales described by the courts in these decisions provide a practical guidance regarding the appropriateness of applying multi-level discounts in the gift or estate tax valuation of a tiered entity.

Judicial Precedent that Allows a Multi-Level Valuation Discount

The *Astleford* Decision

The Facts of the Case

In the *Astleford* decision, the Tax Court opined on the fair market value of a 30 percent limited partnership (LP) interest in the Astleford Family Limited Partnership (AFLP) as of (1) August 1, 1996 and (2) December 1, 1997.

AFLP owned (1) a 50 percent general partnership interest in Pine Bend Development Co. ("Pine Bend"), (2) an ownership interest in an elder-care assisted living facility, and (3) 14 other parcels of real estate.

AFLP was formed by Jane Z. Astleford ("Astleford") on August 1, 1996, as a Minnesota limited partnership. Astleford funded AFLP by transferring to the LP her ownership interest in an elder-care living facility.

On August 1, 1996, Astleford gave each of her three children a 30 percent limited partnership interest in AFLP. Astleford retained a 10 percent general partnership interest in AFLP for herself. On December 1, 1997, Astleford transferred the following assets to AFLP (1) a 50 percent general partnership interest in Pine Bend, and (2) her ownership interest in 14 other real estate properties.

This transfer of assets caused (1) Astleford's ownership interest in AFLP to increase significantly and (2) the ownership interests of her three children in AFLP to decrease significantly. Simultaneously with this asset transfer, Astleford gave additional limited partnership interests in AFLP to her three children. The effect of these additional transfers was to increase their limited partnership ownership interest in AFLP to 30 percent each.

The fair market value of the gifted limited partnership interests was reported on Astleford's 1996 gift tax return at $277,441 and on her 1997 gift tax return at $3,954,506. In its notices of deficiency, the Service determined that the fair market value of the gifted limited partnership interests were $626,898 in 1996 and $10,937,268 in 1997.

At trial, six valuation analysts presented valuation evidence regarding the fair market value of the AFLP limited partnership interests. Four valuation analysts testified for the petitioner, and two valuation analysts testified for the Service.

In the Tax Court published decision, these valuation analysts are simply referred to as the "petitioner's expert" and the "respondent's expert," without further identification. The various valuation analysts relied on the same general method.

First, the valuation analysts all calculated the net asset value of AFLP, based on the fair market value of the assets at the lower tier—that is, (1) the 50 percent general partnership interest in Pine Bend, (2) the ownership interest in the elder-care assisted living facility, and (3) the 14 other parcels of real estate.

Second, the valuation analysts all considered certain valuation discounts at the upper tier. The objective of these discounts was to reflect the fair market value of the limited partnership interests of AFLP.

The values of all of the assets owned by AFLP were stipulated by the disputing parties with the exception of (1) the 50 percent general partnership interest in Pine Bend and (2) the 1,187 acres of Minnesota farmland (the "Rosemount Property").

Valuation Analyst Testimony—Lower Tier Entity

Rosemount Property

The Rosemount property consisted of 1,187 acres of agricultural farmland in Rosemount, Minnesota. This property was significantly larger than the 160 acre average size of a Minnesota farm. The taxpayer valuation analyst valued the Rosemount Property at $3,100 per acre, based on sale transactions involving 18 farm comparable properties.

Due to the large size of the taxpayer property, the valuation analyst calculated the fair market value by:

1. projecting that it would take 4 years to sell the property,
2. projecting that the property would appreciate at a rate of 7 percent each year,
3. reducing the projected cash flow by an estimated sales expense and property tax of 7.25 percent and 0.6 percent, respectively, and
4. applying a discount rate of 25 percent.

The 25 percent discount rate was based on the required rate of return of real estate developers. These procedures indicated a fair market value of $1,817 per acre, implying a 41.4 percent market absorption discount.

The Service valuation analyst valued the Rosemount Property at $3,500 per acre, based on sale transactions involving 125 Minnesota farmland properties. The valuation analyst did not apply a market absorption discount. This was because in 1970, 3,000 acres of land had been sold in a single transaction (in a previous transaction involving the Rosemount Property).

The Service valuation analyst testified that if a market absorption discount was appropriate, the appropriate discount rate to apply in the discounted cash flow analysis used by the taxpayer's valuation analyst would be 9.2 percent. That 9.2 percent discount rate was based on the average rate of return on equity for Minnesota farmers.

Fifty Percent General Partnership Interest in Pine Bend

The taxpayer valuation analyst valued the 50 percent general partnership interest in Pine Bend as an assignee interest. The valuation analyst applied a 5 percent discount because a holder of an assignee interest would have no influence on the partnership management under the Minnesota law.

In addition, the taxpayer valuation analyst applied a 40 percent combined discount for lack of control and discount for lack of marketability. This combined discount was based on price discounts observed in 17 publicly traded real estate limited partnerships (RELPs).

The Service valuation analyst applied no valuation

discount to the 50 percent general partnership interest to reflect an assignee interest. This was because the Service argued that the interest should be treated as a general partnership interest, not an assignee interest.

The Service valuation analyst then rejected a discount for lack of control and for lack of marketability for the 50 percent general partnership interest. The valuation analyst testified that "because the Pine Bend partnership interest was simply an asset of AFLP, discounts he applied at the AFLP level . . . obviated the need to apply an additional and separate discount at the Pine Bend level."

Valuation Analyst Testimony—Upper Tier Entity

The taxpayer valuation analyst then calculated the net asset value of AFLP. The valuation analyst applied a discount for lack of control for the 30 percent limited partnership interest in AFLP of 45 percent and of 40 percent for the August 1, 1996, and December 1, 1997, valuation dates, respectively.

The taxpayer valuation analyst based the discounts on the trading price of units in four comparable RELPs—compared to their underlying net asset values.

The valuation analyst then applied a discount for lack of marketability of 15 percent as of August 1, 1996, and of 22 percent as of December 1, 1997.

The Service valuation analyst discounted the net asset value of AFLP for lack of control by 7.14 percent as of August 1, 1996, and by 8.34 percent as of December 1, 1997. These discounts were based on an analysis of trading prices for 75 real estate investment trusts (REITs). Ownership interests in REITs are fully marketable, but lack ownership control.

Therefore, the Service valuation analyst argued that it is appropriate to "identify and quantify, and then reverse out of the trading prices, any liquidity premiums associated with REIT comparability data, which calculation results in an REIT discount for lack of control that can be applied to the subject property."

Using this procedure, the Service valuation analyst quantified the liquidity premium associated with the REITs. And, the valuation analyst reversed this premium out of the REIT trading price to conclude the discount for lack of control.

The Service valuation analyst then applied a discount for lack of marketability of 21.23 percent as of August 1, 1996, and of 22 percent as of December 1, 1997.

The Tax Court Opinion

The Tax Court determined that the fair market values of the gifted limited partnership interests were $172,525 in 1996 and $2,188,405 in 1997.

Lower Tier—Rosemount Property

The Tax Court agreed with the Service's valuation analyst—that the value of the Rosemount Property before discounts was $3,500 per acre. However, the Tax Court agreed with the taxpayer's valuation analyst that it was not likely that the Rosemount Property could be sold in a year without a price discount.

The Tax Court accepted the discounted cash flow model proposed by the taxpayer's valuation analyst and all of the underlying valuation variables, with the exception of the 25 percent discount rate. The Tax Court applied a discount rate of 10 percent (based on the return on equity of Minnesota farmers). This calculation indicated a value of $2,786.14 per acre, or an implied market absorption discount of 20.4 percent.

Lower Tier—50 Percent General Partnership Interest in Pine Bend

The Tax Court applied no discount at the lower tier to the 50 percent general partnership interest in Pine Bend to reflect the assignee interest. That is, the Tax Court treated the interest as a general partnership interest, not as an assignee interest.

However, the Tax Court applied a combined discount for lack of control and for lack of marketability of 30 percent at the lower tier. This combined discount was based on an analysis of a subset of the RELP data used by the taxpayer's valuation analyst.

The Tax Court stated that, "[w]e note that this Court, as well as respondent, has applied two layers of lack of control and lack of marketability discounts where a taxpayer held a minority interest in an entity that in turn held a minority interest in another entity."

Upper Tier Entity

The Tax Court accepted the general method proposed by the Service valuation analyst to estimate the discount for lack of control. That method was based on REIT data. However, the court concluded that the Service's valuation analyst discount for lack of control was unreasonably low because the calculated liquidity premium was too low.

The Tax Court calculated the liquidity premium based on the difference in average discounts observed in the private placements of registered stock and unregistered stock. Eliminating this liquidity premium of 16.27 percent from the REIT data resulted in a discount for lack of control of 16.17 percent as of August 1, 1996, and of 17.47 percent as of December 1, 1997.

The Tax Court then applied a discount for lack of marketability (1) of 21.23 percent as of August 1, 1996 (based

on the Service's valuation analyst discount), and (2) of 22 percent as of December 1, 1997 (equal to the discount applied by both valuation analysts).

Astleford Summary

The *Astleford* decision is noteworthy because the Tax Court accepted significant valuation discounts at both the upper tier and lower tier. In arriving at its opinion, the Tax Court allowed lower tier discounts as follows:

1. a 20.4 percent market absorption discount on the Rosemount Property
2. a combined discount for lack of control and for lack of marketability of 30 percent for the 50 percent general partnership interest in Pine Bend

At the upper tier entity, for the 30 percent limited partnership interest in AFLP, the Tax Court allowed (1) a discount for lack of control of 16.17 percent and of 17.47 percent and (2) a discount for lack of marketability of 21.23 percent and of 22 percent, as of the two valuation dates.

The Tax Court also provided a rationale for the appropriateness of applying two layers of valuation discounts. The application of two layers of discounts was based on whether the lower tier assets constitute a significant portion of the parent company's assets.

According to the Tax Court decision, "[t]he 50-percent Pine Bend interest constituted less than 16 percent of AFLP's NAV and was only 1 of 15 real estate investments that on Dec. 1, 1997, were held by AFLP, and lack of control and lack of marketability discounts at both the Pine Bend level and the AFLP parent level are appropriate."

The *Dean* Decision

The Facts of the Case

In the *Dean* decision,[13] the Tax Court opined on the fair market value of a 5.5 percent interest in the common stock of Nemours Corporation ("Nemours") as of December 17, 1954.

Nemours was a personal holding company. Its principal asset was 33,300 common shares (or 4.24 percent of the outstanding shares) of Delaware Realty and Investment Company ("Delaware Realty"), a closely held company. In addition, Nemours conducted farming on 14,000 acres of land in Alabama and Delaware.

The principal asset of Delaware Realty consisted of stock in other corporations. Delaware Realty owned:

1. noncontrolling ownership interests in the stock of publicly traded companies (including shares of E.I. DuPont de Nemours & Company ("DuPont") and Hercules Powder Company) and
2. a noncontrolling ownership interest in the common stock of Christiana Securities Company ("Christiana"), a publicly traded holding company.

The principal assets of Christiana were noncontrolling ownership interests in the stock of publicly traded companies.

As of December 17, 1954, Christiana owned 12,199,200 common shares of DuPont, 170,000 common shares of General Motors Corporation, 7,210 shares of Wilmington Trust Company, and 7,460 shares of The News-Journal Company. As of December 17, 1954, the mean of the bid and asked prices of the Christiana common shares was $10,850 per share.

The net asset value of Christiana, based on the prices of the stock of the four publicly traded companies owned by Christiana was $13,661 per share. Accordingly, the Christiana common stock traded at a 20.58 percent discount to its underlying net asset value.

For calendar 1954, Nemours reported revenue of $1,110,937 and a net profit of $721,913. As of December 17, 1954, Nemours reported a total asset book value of $2,448,816, and a shareholders equity book value of $1,576,680. Delaware Realty reported total income in calendar 1954 of $27,345,012. A majority of that income related to dividends received from its ownership interests in common stocks.

The net asset values of each company, without any valuation discounts, were as follows: Christiana—$13,661 per share, Delaware realty—$957.95 per share, and Nemours—$924.57 per share.

On December 17, 1954, Paulina DuPont Dean and J. Simpson Dean each gifted 2,000 shares of Nemours common stock (or 5.5 percent of the outstanding shares) to separate trusts for the benefit of their children. The fair market value of the gifted shares was reported on the gift tax return at $425 per share.

In the notices of deficiency, the Service determined that the fair market value of the stock was $884.17 per share.

Four valuation analysts presented evidence regarding the fair market value of the common stock of Nemours at the trial. The taxpayer presented three valuation analysts, and the Service presented one valuation analyst. All of the valuation analysts relied on the same general methodology.

First, the valuation analysts calculated the net asset value of Nemours. This net asset value was based on the fair market value of the assets at the lower tier—the noncontrolling ownership interests in Delaware Realty and

Christiana.

Second, the valuation analysts applied certain discounts at the upper tier in order to reflect the fair market value of the noncontrolling ownership interest in the Nemours common stock.

Valuation Analyst Testimony—Lower Tier Entity

Delaware Realty Net Asset Value

The net asset value of Delaware Realty was $957.95 per share. This amount was calculated as (1) the value of its ownership interest in Christiana, based on its publicly traded price, plus (2) the market value of its shares in DuPont and Hercules Powder Company, based on the publicly traded stock prices.

Two of the taxpayer valuation analysts based their computation of the Delaware Realty net asset value on an assumed liquidation of the underlying assets. These valuation analysts deducted discounts for blockage and for capital gains taxes. These adjustments resulted in a net asset value for Delaware realty ranging between $644.63 per share and $649 per share.

The third taxpayer valuation analyst determined a net asset value for Delaware Realty of $948 per share based on:

1. the net asset value of Christiana—excluding its ownership in the stock of Wilmington Trust Co. and The News Journal Co.—discounted by 21 percent, plus
2. the market value of its shares in DuPont and Hercules Powder Company.

The Service valuation analyst determined a net asset value for Delaware Realty of $957.95 per share. This amount was based on (1) the market value of the Christiana common stock plus (2) the market value of the DuPont and Hercules Powder Company common stock.

Fair Market Value of 33,000 Delaware Realty Shares

The taxpayer analyst who determined a net asset value of $948 per share applied a 25 percent discount in arriving at the fair market value of the 33,000 shares of Delaware Realty held by Nemours of $711 per share.

The Tax Court opinion did not present the rationale for (1) the selected lower tier discount of 25 percent or (2) the concluded discounts applied by the two other taxpayer valuation analysts.

The Service valuation analyst accepted the net asset value of Delaware Realty of $957.95 per share as the fair market value of the 33,000 shares owned by Nemours. The Service valuation analyst did not apply any valuation discount at the lower tier.

Valuation Analyst Testimony—Upper Tier Entity

The rationale for the upper tier valuation discounts selected by the valuation analysts was not provided in the Tax Court opinion. However, all of the analysts applied a discount at the upper tier when calculating the fair market value of the gifted Nemours common shares.

The two taxpayer valuation analysts, who had applied blockage and capital gains tax discounts at the lower tier, applied a 20 percent discount to the net asset value of Nemours. This calculation indicated the fair market value of the gifted 5.5 percent interest in the Nemours common stock. This calculation resulted in a fair market value of the gifted shares ranging from $508.89 per share to $512.11 per share.

The third taxpayer valuation analyst applied a 33 1/3 percent discount to the net asset value of Nemours. This calculation resulted in a fair market value of the gifted shares of $610.27 per share.

The Service valuation analyst discounted the net asset value of Nemours by 25 percent. This calculation resulted in a fair market value of the gifted shares of $693.42 per share.

The Tax Court Opinion

The Tax Court concluded that the fair market value of the gifted stock was $640 per share.

Lower Tier—Delaware Realty Net Asset Value

The Tax Court concluded the net asset value per share of the Delaware realty common stock was $957.95 per share. This conclusion was based on the market values of the shares owned in Christiana, DuPont, and Hercules Powder Company.

The Tax Court rejected the liquidation analysis proposed by two of the taxpayer valuation analysts stating that "it is considered unrealistic to assume a liquidation by the sale of the assets."

Lower Tier—Fair Market Value of 33,000 Delaware Realty Shares

The Tax Court concluded the fair market value of the 33,000 Delaware Realty shares owned by Nemours was $823.84 per share. This conclusion was calculated as the net asset value of $957.95, discounted by 14 percent.

The Tax Court did not agree with any of the taxpayer analysts regarding the appropriate discount to apply to the Delaware Realty shares owned by Nemours. The Tax Court stated, "While we do not agree with any of petitioners' witnesses as to the percentage or amount by which the net asset value or net worth of Delaware should be reduced, we are convinced that it should be reduced."

Upper Tier—Fair Market Value of Gifted Nemours Shares

Based on the concluded fair market value of the 33,000 Delaware Realty shares owned by Nemours of $823.84 per share, the net asset value of Nemours was $801.09 per share. The Tax Court applied a discount of 20 percent to result in a value of $640 per share for the Nemours gifted shares.

In arriving at its conclusion, the Tax Court considered:

> . . . the fact that the number of shares which were the subject of the gift constitute less than one-ninth of the outstanding shares of Nemours; the possible difficulties and discounts involved in any sale in quantity of the stocks or assets herein involved; the fact that Nemours is thrice removed from the actual source of its earnings; the substantial nature of the companies which provide the actual earnings for this multiplicity of holding companies; [and] the desirability to petitioners of keeping ownership of Nemours stock within the family of petitioners. . . .

Dean Summary

In the *Dean* decision, the Tax Court accepted discounts at both the lower tier and the upper tier. In arriving at its opinion, the Tax Court allowed a valuation discount of 14 percent at the lower tier and 20 percent at the upper tier.

The Tax Court stated it was convinced that a valuation discount should be applied at the lower tier, rejecting the Service valuation analyst testimony that no lower tier discount was appropriate.

In addition, regarding the valuation discount at the upper tier, the Tax Court stated, "we are convinced that the net asset value or net worth of Nemours must be discounted to arrive at the fair market value of the shares."

The *Gallun* Decision

The Facts of the Case

In the *Gallun* decision,[14] the Tax Court opined on the fair market value of a noncontrolling ownership interest in the common stock of A.F. Gallun & Sons Corporation ("Gallun") as of September 29, 1969. Gallun operated as a closely held leather tanning company in Milwaukee, Wisconsin. In addition, Gallun also owned a significant portfolio of publicly traded stocks and bonds.

As of September 30, 1969, Gallun reported a total asset book value of $9,474,485 and a shareholders' equity book value of $7,071,843. For the year ended September 30, 1969, the company reported net income of $861,264 on sales of $9,705,117. In addition, the company paid dividends of $361,606 in fiscal 1969.

The Gallun tannery operation was one of only a few remaining in the United States in 1969. The domestic tannery industry had declined primarily due to (1) increased foreign competition and (2) the increased cost of animal hides. As a result, the recent historical financial performance of the tannery operation was mediocre. And, finding a buyer for the operating portion of the Gallun business would likely be difficult.

The bulk of the company's value was in its investment portfolio. The market value of the investment portfolio totaled $18,087,263, while the concluded value of the tannery operation was $900,000. The Gallun investment portfolio included two blocks of publicly traded stock that were significant in size relative to the total outstanding shares and trading volume.

On September 26, 1969, Edwin A Gallun—the largest company shareholder, with a 28.7 percent ownership interest—gifted 400 shares of common stock of Gallun (approximately 2.5 percent of the outstanding shares) to family members.

The fair market value of the gifted shares was reported on the gift tax return at $6,229,685, or $396.24 per share. In the notices of deficiency, the Service determined that the fair market value of the stock was $10,398,059, or $661.37 per share.

Three valuation analysts presented evidence regarding the fair market value of the common stock of Gallun at the trial, two for the taxpayer and one for the Service. All of the valuation analysts relied on the same general method.

First, the valuation analysts calculated the net asset value of Gallun, based on the fair market value of the assets at the lower tier—that is, the tannery operation and the investment portfolio.

Second, the valuation analysts applied certain discounts at the upper tier in order to reflect the fair market value of the ownership interests in the common stock of Gallun on a nonmarketable, noncontrolling ownership interest basis.

Valuation Analyst Testimony—Lower Tier Entity

Tannery Operation

The tannery operation was valued by the taxpayer two valuation analysts using the asset-based valuation approach at $2,708,900 and $1,470,636. One would expect the Service's valuation analyst to conclude a value for the tannery operation that would be higher than the taxpayer valuation analyst.

However, the Service valuation analyst valued the tannery operation at only $415,000. This value was based on a comparison of the tannery operation to a publicly traded

company with leather operations.

Investment Assets

In valuing the net asset value of the company investment assets, the taxpayer two analysts calculated the market value of the stocks and bonds at $18,087,263. This amount was based on the market prices of these publicly traded securities as of September 29, 1969. Next, both analysts discounted the investment portfolio value to account for the built-in capital gains tax payable on the liquidation of the investment portfolio.

The taxpayer first valuation analyst applied a built-in gains tax discount of 33 percent. The taxpayer second valuation analyst applied a discount of 31 percent.

The Service valuation analyst did not deduct a discount for built-in capital gains tax. Instead, he noted that two of the blocks of stock owned by Gallun were relatively large in size compared to the number of outstanding shares and the historical trading volume. Therefore, the Service valuation analyst (1) applied a blockage discount to the market value of those securities and (2) subtracted the estimated expense of underwriting a registered secondary public offering.

This procedure resulted in a net asset value of the investment portfolio of $16,204,439. Therefore, the combined discount at the lower tier applied by the Service valuation analyst was 10.4 percent.

Valuation Analyst Testimony—Upper Tier Entity

The taxpayer first valuation analyst used three valuation methods to arrive at the fair market value of the noncontrolling ownership interest in Gallun. First, he applied a discount of 35 percent to the net asset value of Gallun to reflect the lack of control of a noncontrolling shareholder over operations. Second, he capitalized the 5-year average earnings of Gallun at a rate of seven times. Third, he capitalized the historical dividends paid by Gallun at a 9 percent dividend capitalization rate. Then, he averaged the indicated values from each method to arrive at a fair market value for the gifted shares of $6,229,685, or $396.24 per share.

The taxpayer second valuation analyst (1) discounted the net asset value of the investment portfolio by 24 percent, based on a comparison of the company's investments to those of a closed-end investment company, and (2) discounted the net asset value of the company by 50 percent to reflect a combined discount for lack of control and for lack of marketability.

The Service valuation analyst discounted the net asset value of the company by 20 percent at the upper tier to reflect lack of control and lack of marketability. The Service valuation analyst concluded that no additional discount was necessary. This was because the stock of eight publicly traded closed-end investment companies was not selling at a price discount from net asset value at the time of the gift. This procedure resulted in a fair market value of the gifted shares of $10,398,059, or $661.37 per share.

The Tax Court Opinion

The Tax Court concluded the fair market value of the gifted stock was $8,175,440, or $520 per share. To arrive at a value for the ownership interest in Gallun, the Tax Court (1) valued the operating portion of the business (the leather tanning company) and (2) added the net asset value of the company's investment assets.

The Tax Court valued the tannery operation at $900,000. This value was based on an average of the two lowest values for the tannery business presented by the three valuation analysts.

In arriving at the opinion of the net asset value of the company's investment assets, the Tax Court disallowed a discount for the built-in capital gains tax. This was because "the record does not establish that the management of the portfolio had any immediate plans to liquidate the investment portfolio. Furthermore, it is possible that the management at some time in the future may dispose of certain or all of the investment assets without incurring a capital gains tax."

The Tax Court accepted the method applied by the Service's analyst at the lower tier. This resulted in a discount of 10.4 percent at the lower tier to reflect blockage and the estimated expenses of underwriting a registered secondary public offering associated with the two large blocks of stock owned by Gallun. And, the Tax Court applied a discount of 55 percent at the upper tier to reflect a combined discount for lack of control and for lack of marketability.

Gallun Summary

In the *Gallun* decision, the Tax Court accepted valuation discounts at both the lower tier and upper tier. In arriving at its opinion, the Tax Court allowed a discount of 10.4 percent at the lower tier and of 55 percent at the upper tier.

The magnitude of the valuation discount at the upper tier (i.e., 55 percent) was affected by (1) the declining state of the tannery industry and (2) the fact that "it would be difficult to find an investor willing to invest in such an operation."

According to the Tax Court, "This factor was an additional consideration in convincing us that a substantial discount of the underlying net asset value was necessary." Even the Service valuation analyst in the *Gallun* matter concluded that it was appropriate to apply valuation discounts at both the lower tier and the upper tier.

The *Gow* Decision

The Facts of the Case

In the *Gow* decision,[15] the Tax Court opined on the

fair market value of 800 shares of the common stock of Williamsburg Vacations, Inc. (WVI) as of February 16, 1989, and 400 shares of the WVI common stock on February 15, 1990.

WVI was a 1/3 partner in a joint venture known as Powhatan Associates ("Powhatan"). Powhatan operated a time-share resort project.

Powhatan was formed on November 19, 1986. WVI contributed certain development assets (including the Powhatan Plantation time-share project and land) in exchange for a 1/3 joint venture ownership interest. The other two members of the joint venture were Offsite International and Bush Construction Co. Each of these members owned a 1/3 interest.

The joint venture agreement contained restrictions on the transferability or sale of the ownership interests. These restrictions included (1) the requirement to obtain prior written consent of all joint venture owners prior to completion of a transfer and (2) a right of first refusal of the nontransferring joint venture owners.

The Powhatan Plantation time-share project included (1) a manor house built in 1735 and (2) 20 surrounding acres of gardens, pools, athletic facilities, meeting rooms, and restaurants. An additional 236 acres included time-share condominiums and townhouses, land, and woods.

As of February 1989, a total of 106 residential units had been sold at Powhatan, and sales increased to 140 units in 1990. A purchase of a time-share unit at Powhatan entitled the owner to an undivided interest in a time-share estate located at Powhatan Plantation.

On February 16, 1988, the WVI board of directors approved a stock bonus plan for Dr. Kay F. Gow, the president and chairman of the board of directors of WVI. In accordance with the stock bonus plan, WVI issued 800 shares of WVI common stock to Dr. Gow on February 16, 1989. In addition, WVI issued an additional 400 shares of common stock to Dr. Gow on February 15, 1990.

Robert T. Gow and Dr. Kay F. Gow reported the value of the WVI common stock awarded to Dr. Gow as $40,000 as of February 16, 1989, and $20,000 as of February 15, 1990, on their 1989 and 1990 income tax returns. In the notice of deficiency, the Service determined the fair market value of the WVI common stock was $1,600,000 on February 16, 1989, and $800,000 on February 15, 1990.

After the notice of deficiency was issued, the Service valuation analysts valued the WVI common stock awarded to Dr. Gow at $2,142,313 as of February 16, 1989, and at $597,353 as of February 15, 1990.

Three valuation analysts presented evidence regarding the fair market value of the common stock of WVI at the trial, one analyst for the taxpayer and two analysts for the Service. All of the valuation analysts relied on the same general method.

First, the valuation analysts calculated the net asset value of WVI, based on the fair market value of the asset at the lower tier—the 1/3 ownership interest in Powhatan.

Second, the valuation analysts applied discounts for lack of control and lack of marketability at the upper tier to reflect the fair market value of the ownership interest in the common stock of WVI on a nonmarketable, noncontrolling ownership interest basis.

Valuation Analyst Testimony—Lower Tier Entity

The taxpayer valuation analyst used the discounted cash flow method to estimate the value of Powhatan as of February 16, 1989, and February 15, 1990.

First, the valuation analyst developed income statement projections for Powhatan by (1) projecting the number of time-share intervals sold and (2) estimating the sales price for the intervals.

Second, the valuation analyst (1) subtracted the costs of sales for the intervals, (2) added nonoperating income, and (3) subtracted nonoperating expenses and income taxes.

Third, the valuation analyst (1) converted the projected net income for Powhatan to net cash flow and (2) applied a discount rate of 32 percent based on a build-up model.

Based on this analysis, the taxpayer valuation analyst concluded that the value of 100 percent of Powhatan was $11.7 million as of February 16, 1989, and $14 million as of February 15, 1990. Since WVI owned a 1/3 interest in Powhatan, the analyst then applied a discount for lack of control and for lack of marketability.

Based on ownership control premium studies, the valuation analyst concluded a discount for lack of control of 15 percent for both valuation dates.

The valuation analyst then applied a discount for lack of marketability of 30 percent for both valuation dates. The discount for lack of marketability was based on "the lack of 'special purchasers' in the time-share industry, the restrictive nature of the buy-sell provision in the joint-venture agreement, the overall restrictions placed on transferability of the joint venture's interest, and the size and composition of each partner's one-third interest."

After applying the discount for lack of control and for lack of marketability, the WVI 1/3 interest in Powhatan was $2,321,690 as of February 16, 1989, and $2,770,320 as of February 15, 1990.

The Service's two valuation witnesses were both Internal Revenue Service employees. One witness was a real estate appraiser, who valued the Powhatan inventory of time-share intervals and yet-to-be-developed land. The other witness was a business valuation analyst, who relied on the real estate appraiser's conclusions to value the WVI ownership interest in Powhatan.

The Service real estate appraiser valued the Powhatan

inventory of time-share intervals and yet-to-be-developed land based on the discounted cash flow method.

First, this method was based on (1) the projected number of time-share sales and (2) the average projected sales price.

Second, the Service real estate appraiser arrived at projected net income by deducting operating expenses, including: sales/marketing, cost of construction, development fees, and reserves.

Third, applying a discount rate of 25 percent based on a build-up model resulted in a fair market value of the Powhatan inventory of time-share intervals and yet-to-be-developed land at $28,732,000 as of February 16, 1989, and $28,402,000 as of February 15, 1990.

The Service business valuation analyst then calculated the net asset value of Powhatan by (1) incorporating the fair market values of the inventory and the land on the Powhatan balance sheet, (2) adding other assets, and (3) subtracting liabilities.

Based on these calculations, the value of 100 percent of the equity of Powhatan was $32,866,718 as of February 16, 1989, and $35,001,760 as of February 15, 1990.

The Service business valuation analyst then considered a discount for lack of control and for lack of marketability associated with the WVI 1/3 ownership interest in Powhatan. She concluded (1) a discount for lack of control of 5 percent and (2) a discount for lack of marketability of 10 percent (revised from 0 percent).

The Service business valuation analyst based the discount for lack of control of 5 percent on the fact that "the history of the joint venture displays a careful attention to conservative development . . . there is no reason that these practices should change if another entity stepped into the shoes of WVI as administrator of the project."

The Service's business valuation analyst based the discount for lack of marketability of 10 percent on the fact that "the chief asset of Powhatan Associates is the inventory and land to be developed for time shares, and ample allowance for lack of marketability was taken into account for that asset, both in the projections of income and in the application of a relatively large discount rate. There is judicial precedent for this judgment not to duplicate discounts already taken."

After applying the discount for lack of control and for lack of marketability, the Service valuation analysts opined that the WVI 1/3 interest in Powhatan was $9,367,015 as of February 16, 1989, and $9,975,502 as of February 15, 1990.

Valuation Analyst Testimony—Upper Tier Entity

The taxpayer valuation analyst calculated the net asset value of WVI by (1) adding the book value of other assets owned by the company to the concluded value for the WVI 1/3 ownership interest in Powhatan, and (2) subtracting the WVI liabilities.

Next, the taxpayer valuation analyst applied a 15 percent "contingency discount" that reduced the adjusted net asset value of WVI to $2,829,401 as of February 16, 1989, and $3,434,805 as of February 15, 1990.

The taxpayer valuation analyst then applied a discount for lack of control and for lack of marketability to arrive at a value for the stock issued to Dr. Gow.

As of February 16, 1989, the valuation analyst applied a 20 percent discount for lack of control and a 30 percent discount for lack of marketability, resulting in a fair market value for the shares in WVI of $685,000 (or $856.25 per share).

As of February 15, 1990, the valuation analyst applied a 30 percent discount for lack of control and a 30 percent discount for lack of marketability, resulting in a fair market value for the shares in WVI of $299,000 (or $747.50 per share).

Some of the factors considered by the taxpayer valuation analyst in determining the size of the discount for lack of control included:

1. the size of the blocks of stock granted as noncontrolling interests,
2. the lack of swing vote characteristics,
3. a lack of "special purchasers" in the marketplace,
4. the company's reluctance to issue dividends in the past,
5. the transferability restrictions on the stock, and
6. the lack of recent sales in WVI stock.

To estimate the appropriate discount for lack of marketability, the valuation analyst reviewed several empirical studies and considered factors such as (1) the lack of an organized market for the WVI stock, (2) the lack of sales of similar companies, (3) the low degree of probability regarding the sale of Powhatan, and (4) the probability that a dispute would arise among the joint venturers regarding the Powhatan operations.

The Service's two valuation analysts calculated the net asset value of WVI in the same manner as the taxpayer valuation analyst. To arrive at the value for the noncontrolling interest in the common stock of WVI granted to Dr. Gow, the Service valuation analyst applied (1) a 20 percent discount for lack of control and a 10 percent discount for lack of marketability as of February 16, 1989, and (2) a 50 percent discount for lack of control and a 10 percent discount for lack of marketability as of February 15, 1990.

Applying these valuation discounts resulted in a fair market value for the shares in WVI granted to Dr. Gow

of $2,142,313 (or $2,678 per share) as of February 16, 1989, and $596,353 (or $1,493 per share) as of February 15, 1990. The Service's valuation analyst did not rely on empirical studies to estimate the appropriate discount for lack of control and for lack of marketability.

The Tax Court Opinion

Lower Tier Entity

The Tax Court agreed with the Service valuation analysts that the value of 100 percent of the equity of Powhatan was $32,866,718 as of February 16, 1989, and $35,001,760 as of February 15, 1990.

However, the Tax Court agreed with the taxpayer valuation analyst regarding the appropriate level of discounts at the lower tier—15 percent for lack of control and 30 percent for lack of marketability at both valuation dates.

The Tax Court noted that the discounted cash flow model applied by the taxpayer valuation analyst contained fatal errors, including (1) an understatement of projected income and (2) a discount rate (32 percent) that was too high relative to the risks of the projected income.

The Tax Court, however, found the reasoning applied by the taxpayer valuation analyst to be more compelling than the reasoning of the Service valuation analyst regarding the appropriate discounts.

The Tax Court stated in particular that the taxpayer valuation analyst "used empirical studies and factors . . . that we believe appropriate in formulating his opinion as to the discount amounts, whereas respondent's experts did not."

Upper Tier Entity

The Tax Court accepted the taxpayer valuation analyst conclusion regarding the appropriate level of discounts to apply at the upper tier:

1. a 20 percent discount for lack of control and a 30 percent discount for lack of marketability as of February 16, 1989, and
2. a 30 percent discount for lack of control and a 30 percent discount for lack of marketability as of February 15, 1990.

The Tax Court noted that the taxpayer valuation analyst conclusions regarding discounts:

> . . . were consistent and uniform. In contrast, we are not persuaded by respondent's experts' reasoning in determining the quantum of the discounts. The quantum of the discount for lack of control ranged from a low of 5 percent at the joint venture level to a high of 50 percent at the WVI level. Moreover, we are mindful that initially respondent's experts believed a discount for lack of marketability was not appropriate at the joint venture level, but eventually changed their minds and applied a 10-percent discount.

Gow Summary

In the *Gow* decision, the Tax Court accepted valuation discounts at both the lower tier and upper tier. The amount of the discounts accepted by the Tax Court at both the lower tier and the upper tier were substantial:

1. lower tier—15 percent for lack of control and 30 percent for lack of marketability
2. upper tier—a 20 percent discount for lack of control and a 30 percent discount for lack of marketability at the first valuation date and a 30 percent discount for lack of control and a 30 percent discount for lack of marketability at the second valuation date

In addition, even the Service's valuation analysts in the *Gow* matter concluded that it was appropriate to apply discounts for both lack of control and lack of marketability at both the lower tier and the upper tier.

The *Hjersted* Decision

The Facts of the Case

In the *Hjersted* decision,[16] a probate proceeding, the Kansas Supreme Court opined on whether discounts were precluded in the valuation of a 96 percent limited partnership interest in Hjersted Family Limited Partnership (HFLP) for purposes of determining a surviving spouse's elective share, as of March 1, 2000.

In this decision, Maryam Hjersted ("Maryam"), a widow, and her stepson, Lawrence Hjersted ("Lawrence"), were at odds regarding the value of Maryam's elective share of the estate of her deceased husband, Norman B. Hjersted ("Norman").

HFLP was formed on February 20, 1997, by Norman and Lawrence. As of the partnership formation date, the ownership in HFLP was as follows:

1. 2 percent general partnership interest—Norman
2. 1 percent general partnership interest—Lawrence
3. 96 percent limited partnership interest—Norman
4. 1 percent limited partnership interest—Lawrence

The only asset of HFLP was all of the outstanding com-

mon stock (500 shares) of Midland Resources, Inc. (MRI). MRI was a closely held company that manufactured chemicals used in the treatment of water and wastewater.

On March 1, 2000, Norman entered into a gift/sale transaction with Lawrence regarding his 96 percent HFLP limited partnership interest. In this transaction, Norman gifted $675,000 worth of the 96 percent limited partnership interest to Lawrence, and the balance was sold at a price to be determined by an appraisal.

In May 2000, the valuation analyst for Norman and Lawrence ("Lawrence's analyst") used the following method to estimate the fair market value of the 96 percent limited partnership interest in HFLP.

First, the analyst calculated the net asset value of HFLP. This estimate was based on the fair market value of the primary asset at the lower tier—the controlling ownership interest in MRI.

Second, the analyst applied discounts at the upper tier to reflect the fair market value of the 96 percent limited partnership interest in HFLP.

On April 28, 2001, Norman died. And, in August 2001, Maryam filed a petition for elective share of surviving spouse. The District Court then admitted Norman's will into probate and appointed Lawrence as the estate's executor.

Maryam did not agree with Lawrence's proposed calculation of her unsatisfied elective share. And, a trial took place on June 16-19, 2003.

During the trial, Lawrence's analyst provided testimony regarding the fair market value of the 96 percent limited partnership interest in HFLP, and the valuation analyst retained by Maryam ("Maryam's analyst") testified regarding the fair market value of the 500 common shares of MRI, both as of March 1, 2000.

Valuation Analyst Testimony—Lower Tier Entity

Lawrence's analyst valued the 500 shares of MRI common stock at $2.25 million. This value included a discount for lack of marketability of 20 percent for the controlling ownership interest.

Maryam's analyst determined that the fair market value of the 500 MRI common shares was $2.66 million, which included a discount for lack of marketability of 10 percent.

Valuation Analyst Testimony—Upper Tier Entity

To value the 96 percent limited partnership interest in HFLP, Lawrence's analyst:

1. calculated the net asset value of HFLP based on the fair market value of the MRI common stock ($2.25 million),
2. multiplied the net asset value by the 96 percent ownership interest, and
3. applied a discount for lack of control of 10 percent and a discount for lack of marketability of 25 percent.

This analysis resulted in a fair market value of $1,458,000.

Maryam's analyst was not asked to value the 96 percent limited partnership interest in HFLP. Based on his calculation of the fair market value of the MRI common shares of $2.66 million, multiplied by 96 percent, the implied value of the 96 percent interest in MRI common stock was $2,553,600.

The District Court Opinion

The District Court found that Maryam's analyst report was "better supported (in particular with regard to use of more recent data concerning the increase in pretax income in early 2000, the on sight investigation, and the inherent bias to minimize value by [Lawrence's analyst] in performing the task hired for)."

And, the District Court found that the value of the 500 common shares of MRI was $2.66 million.

In addition, since Maryam did not consent to the transfer from Norman to Lawrence, the District Court declined to analyze the upper tier discounts. And, the District Court concluded that the undiscounted value of the 96 percent limited partnership interest should be included in the augmented estate.

Both parties filed notices of appeal on several grounds.

The Court of Appeals Opinion

The Court of Appeals held that although the District Court "erred in focusing on Maryam's lack of consent in determining whether discounts purportedly inherent in limited partnership interests should be applied in the valuation process . . . it further held that on the question of the value of this interest, the District Court's adoption of [Maryam's analyst] evaluation of the MRI stock at $2.66 million was supported by substantial competent evidence."

In addition, the Court of Appeals rejected the upper tier discount. This was because the valuation discounts were "unnecessary under these circumstances."

One of the reasons cited by the Court of Appeals for disallowing upper tier discounts was based on its conclusion regarding the "artificiality or illusory nature of the partnership entity" as the Court of Appeals highlighted "a lack of filing of state or federal partnership tax returns."

The Court of Appeals concluded that "[a]t some time before his death, Norman apparently visited his attorneys and expressed a desire to disinherit his wife."

Another reason presented by the Court of Appeals for rejecting upper tier discounts was "its belief that discounting individual share holdings injects into the appraisal process speculation on the various factors which may dictate

the marketability of such holdings."

Both parties again appealed on several grounds.

The Kansas Supreme Court Opinion

The Kansas Supreme Court ruled that "partnership interests in [HFLP] were never unified, and thus, in valuing the assets of the partnership for purposes of determining spousal elective share, control and marketability discounts were not precluded."

In addition, the "spousal elective share statute did not preclude use of discounts for lack of control and marketability in valuing assets for purposes of determining surviving spouse's elective share."

The case was then remanded to the District Court, with the requirement that the court address the validity of the upper tier discounts. The Kansas Supreme Court stated that, should the District Court on remand determine that Norman's transfer to Lawrence was based on legitimate estate and business planning and not simply a desire to disinherit Maryam, "discounts for lack of control and lack of marketability can appropriately be applied. . . ."

Hjersted Summary

In the *Hjersted* decision, the Kansas Supreme Court concluded that applying discounts at both the lower tier and the upper tier was appropriate in valuing the 96 percent limited partnership interest in HFLP. That conclusion assumed that the Norman transfers were based on his estate planning and objective to pass the family business to Lawrence—and not simply on an intention to disinherit his wife.

The *Kosman* Decision

The Facts of the Case

In the *Kosman* decision,[17] the Tax Court opined on the fair market value of a noncontrolling ownership interest in the voting and nonvoting common stock of Kosman, Inc. (KI) as of September 30, 1986, and March 31, 1987.

KI was a holding company that owned:

1. 12,834 common shares (or 32.085 percent) of Scottsbluff National Corp. (SNC), which owned 100 percent of Scottsbluff National Bank, and
2. 2,000 common shares (or 10.0 percent) of Western National Bank (WNB).

Scottsbluff National Bank was the seventh largest bank in Nebraska. WNB was a smaller bank in Nebraska.

In October 1986, the SNC board of directors approved a plan to acquire WNB. In this transaction, WNB shareholders received 1 share of SNC stock for every 3.3 shares of WNB stock.

As of December 1986, SNB reported total asset book value of $208.9 million and a shareholders' equity book value of $15.1 million. As of December 1986, Western National Bank reported a total asset book value of $28.1 million and a shareholders' equity book value of $2.3 million. In addition, during the early and mid-1980s, WNB had significant problems with nonperforming loans.

On September 30, 1985, Jane O. Kosman gifted 1,926 shares of voting common stock and 2,340 shares of nonvoting common stock of KI to her three children. On March 31, 1987, she gifted an additional 348 shares of voting common stock to one of her daughters.

During this time period, the KI capital structure consisted of 5,000 total outstanding voting common shares, 5,000 nonvoting common shares, and 12,000 shares of nonvoting preferred stock. Therefore, the gifted interests were noncontrolling ownership interests in the voting and nonvoting common stock.

The fair market value of the KI shares was reported on the gift tax returns at $125.63 per share as of September 30, 1986, and $153.62 per share on March 31, 1987.

In an amended answer, the Service stated that the fair market value of the voting and nonvoting KI common stock on September 30, 1986 and March 31, 1987, was $294 per share for voting shares and $282 per share for nonvoting shares.

Both the taxpayer and the Service presented a valuation report regarding the fair market value of the KI common stock at the trial. The Service's valuation report was co-authored by three valuation analysts. Each valuation analyst report relied on the same general method.

First, the valuation analysts calculated the net asset value of KI. This was based on the fair market value of the primary assets at the lower tier—the noncontrolling ownership interests in SNC and WNB.

Second, the valuation analysts applied discounts at the upper tier to reflect the fair market value of the noncontrolling voting and nonvoting ownership interests in the KI common stock.

Valuation Analyst Testimony—Lower Tier Entity

Value of the SNC Stock

The taxpayer valuation analyst compared SNC to Nebraska's nine other largest banks. He noted that First Commerce Bankshares, Inc. ("First Commerce") was the most comparable to SNC, based on its operations. First Commerce traded at 57.7 percent of book value on September 30, 1986, and March 31, 1987.

Since SNC was in better financial condition than First Commerce, the valuation analyst concluded that SNC would trade at a small premium, or 60 percent of book value.

Accordingly, the taxpayer valuation analyst concluded

a fair market value of $218.96 per share for the SNC stock owned by KI as of September 30, 1986, and $233.09 per share as of March 31, 1987.

The Service valuation analysts relied on the income approach (based on the SNC projected earnings over a 5-year period) and the market approach (based on the prices of stock in comparable publicly traded banks).

In addition, the Service valuation analysts also considered data from several stock purchases SNC made from directors and employees of SNC before 1986. These purchases were made at prices that ranged between 90 to 115 percent of book value.

Based on the income and market approach and on the prior transactions, the Service valuation analysts concluded that a 100 percent interest in SNC was worth $19 million. Applying a 15 percent discount for lack of control and a 10 percent discount for lack of marketability resulted in a value for the KI 32.085 percent ownership interest in SNC stock of $363.38 per share, or 86 percent of book value, on both September 30, 1986, and March 31, 1987.

Value of the WNB Stock

The taxpayer valuation analyst used (1) the market approach to value the KI ownership in WNB as of September 30, 1987, and (2) the implied transaction price based on the merger of WNB and SNC to value WNB as of March 31, 1987. For the market approach, the taxpayer valuation analyst found that Lincoln Bank South, trading at 61.2 percent of book value, was comparable to WNB.

However, due to the WNB high percentage of nonperforming loans, the taxpayer's analyst discounted the Lincoln Bank South multiple. Discounting the pricing multiple to 40 percent of book value resulted in a value based on the market approach of $46 per share as of September 30, 1987.

As of March 31, 1987, the taxpayer valuation analyst relied on the implied price of WNB stock based on the March 4, 1987, merger between SNC and WNB. In this transaction, WNB shareholders received 1 share of SNC stock for every 3.3 shares of WNB stock.

Based on the taxpayer valuation analyst concluded value of SNC of $233.09 per share as of March 31, 1987, the implied WNB value was $70.63 per share.

Accordingly, the taxpayer valuation analyst concluded that the value of the KI 2,000 shares in WNB was $92,000 as of September 30, 1986, and $141,260 as of March 31, 1987.

The Service valuation analysts relied on (1) two income approach methods (i.e., a discounted cash flow method and a direct capitalization of earnings method) and (2) one market approach method (based on the price of stock in comparable publicly traded banks). Based on the income and market approach, the Service valuation analysts concluded that 100 percent of the WNB equity was worth $2.25 million.

Applying a 20 percent discount for lack of control and a 15 percent discount for lack of marketability resulted in a value for the KI 2,000 shares of WNB of $153,000 as of both September 30, 1986, and March 31, 1987.

Valuation Analyst Testimony—Upper Tier Entity

The taxpayer valuation analyst calculated the adjusted net asset value of KI by (1) substituting the fair market value of the noncontrolling interests in the SNC and WNB common stock for the book value, and (2) subtracting the liabilities. The taxpayer's analyst then applied:

1. a discount for lack of control of 10 percent,
2. a discount for lack of marketability of 25 percent, and
3. a discount for lack of voting power of 10 percent.

The discount for lack of marketability was based on restricted stock transaction data presented in the SEC Institutional Investor Study.[18] The taxpayer valuation analyst did not explain the rationale for selecting a discount for lack of voting power of 10 percent.

The Service valuation analysts also calculated the adjusted net asset value of KI by:

1. substituting the fair market value of the noncontrolling interests in the SNC and WNB common stock for the book value and
2. subtracting the liabilities.

The Service valuation analysts then applied (1) a discount for lack of control of 10 percent, (2) a discount for lack of marketability of 10 percent, and (3) a discount for lack of voting power of 4 percent.

The Service valuation analysts based the 10 percent discount for lack of marketability on restricted stock transaction data that indicated discounts for lack of marketability for companies with similar earnings as KI ranged from 10 to 20 percent. These analysts applied a 10 percent discount, or at the low end of the range. This was because they had already applied a discount for lack of marketability to the SNC stock at the lower tier.

The Service valuation analysts 4 percent discount for lack of voting power was based on data presented in a study published in the *Journal of Financial Economics*.[19]

The Tax Court Opinion

The Tax Court concluded that the fair market value of the KI common stock (1) as of September 30, 1986, was $164.85 per share for the voting stock, and $156.06 for the

nonvoting stock and (2) as of March 31, 1987, was $185.58 per share for the voting stock, and $175.69 for the nonvoting stock.

This judicial conclusion was based on (1) the fair market value of the KI 12,834 shares of Scottsbluff National Corp. stock of $3,278,009 on September 30, 1986, and $3,530,454 on March 31, 1987, and (2) the fair market value of the KI 2,000 shares of Western National Bank stock of $120,000 on September 30, 1986, and $144,000 on March 31, 1987.

Lower Tier—Value of the SNC Stock

The Tax Court concluded a fair market value for the KI ownership interest in SNC of $3,278,009 on September 30, 1986, and $3,530,454 on March 30, 1987. This value was based on applying a pricing multiple of 70 percent to the SNC book value, a figure between the 86 percent used by the Service valuation analysts and the 60 percent used by the taxpayer valuation analyst.

The Tax Court concluded that a pricing multiple of 60 percent of book value as applied by the taxpayer's analyst was too low considering the SNC better financial condition. In addition, the Tax Court rejected data based on prior transactions. This was because "the shareholders received higher prices for their shares because of their association with the corporation."

Lower Tier—Value of the WNB Stock

The Tax Court concluded a fair market value for the KI ownership interest in WNB of $120,000 on September 30, 1986, and $144,000 on March 30, 1987. For the September 30, 1986, valuation date, the Tax Court found some fault with the analysis prepared by both the taxpayer valuation analyst and the Service valuation analyst. Therefore, the Tax Court concluded a value near the midpoint. For the March 30, 1987, valuation date, the Tax Court reduced the Service valuation analysts' concluded value for 100 percent of WNB slightly, and then applied the same discounts for lack of control and lack of marketability as applied by the Service valuation analysts (i.e., 20 percent discount for lack of control and a 15 percent discount for lack of marketability).

Upper Tier Entity

The Tax Court allowed the following discounts at the upper tier:

1. a 10 percent discount for lack of control (equal to the discount for lack of control applied by both the taxpayer valuation analyst and the Service valuation analysts)
2. a 15 percent discount for lack of marketability
3. a 4 percent discount for lack of voting power

Kosman Summary

In the *Kosman* decision, the Tax Court accepted discounts at both the lower tier and the upper tier. In the valuation of the ownership interest in SNC at the lower tier, the Service's analysts applied a 15 percent discount for lack of control and a 10 percent discount for lack of marketability.

Although the Tax Court did not comment on the discounts taken at the lower tier by the Service valuation analysts, the Tax Court concluded value of the interest in SNC at the lower tier was lower than the value concluded by the Service valuation analysts.

In addition, the Tax Court accepted discounts of 20 percent for lack of control and 15 percent for lack of marketability at the lower tier regarding the value of WNB. The Tax Court also accepted discounts of 10 percent for lack of control, 15 percent for lack of marketability, and 4 percent for lack of voting power at the upper tier.

In addition, even the Service valuation analysts in the *Kosman* matter concluded that it was appropriate to apply discounts for both lack of control and lack of marketability at both the lower tier and the upper tier.

The *Piper* Decision

The Facts of the Case

In the *Piper* decision,[20] the Tax Court opined on the fair market value of:

1. a noncontrolling ownership interest in the common stock of Piper Investment Co., Inc. ("Piper Investment") and
2. a noncontrolling ownership interest in the common stock of Castanea Realty Co., Inc. ("Castanea"), both as of January 8, 1969.

Piper Investment and Castanea were holding companies. These companies owned nonregistered shares of Piper Aircraft Corp. (PAC), real estate, and cash. Piper Investment owned 37,500 shares of PAC, and Castanea owned 67,500 shares of PAC. PAC was a manufacturer of light aircraft. Its common stock was listed on the New York Stock Exchange (NYSE).

As of January 1969, Piper Investment reported a total asset book value of $2,270,003. The majority of the Piper Investment assets on a book value basis were the investment in PAC common shares and real estate.

As of January 1969, Castanea reported a total asset book value of $2,762,043. The majority of the Castanea assets on a book value basis were the investment in PAC common shares and real estate.

The 105,000 total common shares of PAC owned by Piper Investment and Castanea had not been registered with the Securities and Exchange Commission. And, these shares represented 6.4 percent of the total outstanding common stock of PAC.

On January 8, 1969, the average price of the PAC common stock was $53 per share. The average weekly trading volume of PAC shares on the NYSE in the three months prior to January 8, 1969, was 9,500 shares.

William T. Piper Sr. made gifts of all the outstanding shares of Piper Investment and Castanea (1) to his son and (2) to 11 individual trusts for the benefit of his grandchildren on January 8, 1969. The fair market value of the Piper Investment shares was reported on the gift tax return at $76.68 per share. And, the fair market value of the Castanea shares was reported at $158.59 per share.

In its notice of deficiency, the Service determined that:

1. the fair market value of the Piper Investment shares was $101.89 per share and
2. the fair market value of the Castanea shares was $226.15 per share.

Three valuation analysts presented evidence regarding the fair market value of the common stock of Piper Investment and Castanea at the trial, one analyst for the taxpayer and two analysts for the Service. Each valuation analyst relied on the same general method.

First, the valuation analysts calculated the net asset value of Piper Investment and Castanea, based on the fair market value of the primary asset at the lower tier—the noncontrolling ownership interest in PAC.

Second, the valuation analysts applied a discount at the upper tier to reflect the fair market value of the noncontrolling ownership interests in the common stock of Piper Investment and Castanea.

Valuation Analyst Testimony—Lower Tier Entity

At trial, the valuation analysts agreed to the fair market value of all of the assets of Piper Investment and Castanea, except for the value of the ownership interest in PAC.

The taxpayer valuation analyst applied a combined discount to the PAC shares of 37.5 percent to reflect the following:

1. the stock was not registered, and the stock could only be sold through a private placement at a substantial price discount from the market price
2. blockage issues
3. exposure to capital gains tax

As of January 8, 1969, the market price of the PAC common stock was $53 per share. Applying a valuation discount of 37.5 percent to the market price of $53 per share resulted in a fair market value of the PAC common stock owned by Piper Investment and Castanea of $33.125 per share.

The Service valuation analysts concluded the position that the stock could have been registered, and that the price discount from the market price should not be greater than the costs involved in (1) registering the PAC stock and (2) selling the registered stock on the NYSE.

The Service valuation analysts testified that the costs of registration and distribution (including the risk of price change during the registration period) of the PAC common stock would be 12 percent of its market value.

The Service valuation analysts concluded that no further discounts for blockage or exposure to capital gains tax were appropriate.

Applying a discount of 12 percent to the January 8, 1969, PAC common price of $53 per share, results in a fair market value of the PAC common stock owned by Piper Investment and Castanea of $46.64 per share.

Valuation Analyst Testimony—Upper Tier Entity

The taxpayer valuation analyst calculated the adjusted net asset value of Piper Investment and Castanea by:

1. substituting the fair market value of the noncontrolling ownership interest in the PAC common stock of $33.125 per share for the book value,
2. adding the value of the other assets owned by Piper Investment and Castanea, and
3. subtracting the liabilities.

The taxpayer valuation analyst then applied

1. a portfolio discount of 17 percent to reflect the fact that Piper Investment and Castanea had portfolios that were not diversified and
2. a discount for lack of marketability of 43.8 percent based on an analysis of restricted stock transaction data presented in the SEC Institutional Investor Study.[21]

The taxpayer valuation analyst did not simply rely on the average discount based on the SEC Institutional Investor study. Rather, he noted that a higher discount than the average was appropriate. This conclusion was based on an analysis of the earnings and other attributes of Piper Investment and Castanea compared with data for companies in the study.

The Service valuation analysts calculated the adjusted net asset value of Piper Investment and of Castanea by:

1. substituting the fair market value of the noncontrolling ownership interest in the PAC common stock of $46.64 per share for the book value,
2. adding the value of the other assets owned by Piper Investment and Castanea, and
3. subtracting the liabilities.

The Service first valuation analyst then applied:

1. a portfolio discount of 7.7 percent to reflect the fact that Piper Investment and Castanea had portfolios that were not diversified and
2. a discount for lack of marketability.

The portfolio discount of 7.7 percent was based on the average discount from net asset value of 14 nondiversified investment companies. The discount for lack of marketability was based on the estimated costs of a secondary public offering.[22]

The Service second valuation analyst then applied:

1. a portfolio discount of 17 percent to reflect the fact that Piper Investment and Castanea had portfolios that were not diversified and
2. a discount for lack of marketability of 24.0 percent.

The portfolio discount of 17 percent was based on an analysis of discounts from net asset value of 24 publicly traded closed-end investment companies. Since Piper Investment and Castanea had relatively unattractive portfolios due to the lack of diversification, the Service second valuation analyst applied a discount at the high end of the range based on the closed-end fund data.

The discount for lack of marketability of 24 percent applied by the Service second valuation analyst was based on the average discount from restricted stock transactions as presented in the SEC Institutional Investor Study.

The Tax Court Opinion

The Tax Court concluded the fair market value of the Piper Investment common stock was $85.55 per share, and the fair market value of the Castanea common stock was $176.80 per share. These judicial conclusions were based on the fair market value of the PAC common stock owned by Piper Investment and Castanea of $46.64 per share.

Lower Tier Entity

In arriving at its opinion, the Tax Court accepted the value for the PAC common stock of $46.64 per share at the lower tier as determined by the Service valuation analysts. These values were based on the discount of 12 percent to reflect the costs of registering and selling the PAC common stock.

The Tax Court rejected the discount for built-in capital gains applied by the taxpayer valuation analyst. This conclusion was because there was "no evidence that a liquidation of the investment companies was planned or that it could not be accomplished without incurring a capital gains tax at the corporate level."

Upper Tier Entity

The Tax Court allowed the following valuation discounts at the upper tier:

1. a 17 percent portfolio discount due to the undiversified nature of the assets owned by Piper Investment and Castanea and
2. a 35 percent discount for lack of marketability.

The Tax Court was critical of the method used by the Service first valuation analyst to select the portfolio discount—simply using the average discount from net asset value of 14 nondiversified investment companies. This is because the portfolios of Piper Investment and Castanea were less attractive than the average nondiversified investment company.

In determining the discount for lack of marketability, the Tax Court also favored the analysis of the underlying data of the restricted stock studies as performed by the taxpayer valuation analyst instead of the conclusion of the Service valuation analyst—that is, of simply relying on the average discount from the restricted stock transactions.

Piper Summary

In the *Piper* decision, the Tax Court accepted discounts at both the lower tier and the upper tier. The Tax Court accepted a discount of 12 percent at the lower tier, and discounts at the upper tier as follows:

1. a 17 percent portfolio discount and
2. a 35 percent discount for lack of marketability.

In addition, even the Service valuation analysts concluded that it was appropriate to apply discounts at both the lower tier and the upper tier.

Piper is also noteworthy because, in considering the appropriate discounts, the Tax Court rejected testimony regarding discounts based simply on the average discount from studies such as restricted stock studies.

And, the Tax Court favored testimony regarding valua-

tion discounts based on (1) an analysis of the underlying data in the studies and (2) a comparison to the characteristics of the subject company.

The *Whittemore* Decision

The Facts of the Case

In the *Whittemore* decision,[23] the U.S. District Court opined on the fair market value of 200 common shares (or 24.4 percent of the total outstanding common shares) of J.H. Whittemore Company ("Whittemore"), a holding company, as of December 29, 1947.

Whittemore owned 18,366 common shares (a noncontrolling ownership interest) in the common stock of Peter Paul, Inc. ("Peter Paul"). The Peter Paul common stock was traded over-the-counter.

On December 29, 1947, Harris Whittemore Jr., the sole shareholder of Whittemore, made a gift of 200 shares of Whittemore common stock to each of his three sons.

The gift was made by the transfer of 600 shares under an irrevocable deed of trust to two co-trustees. One of the co-trustees was a donee-beneficiary of 200 shares for the equal benefit of the three sons severally.

Harris Whittemore Jr. valued the 200 shares of Whittemore common stock in his original gift-tax returns at $1,000 per share. The Service valued the stock at $3,228 per share.

As of December 29, 1947, the bid and asked prices for Peter Paul common stock was $44-45 per share and $46-46½ per share, respectively. For the first six months of 1948, the daily average trading volume for the Peter Paul common stock was 273 shares. No single transaction during this period involved over 1,000 shares.

Eight valuation analysts presented evidence regarding the fair market value of the common stock of Whittemore at the trial, five valuation analysts for the taxpayer and three valuation analysts for the Service. All of the valuation analysts relied on the same general method.

First, the valuation analysts calculated the net asset value of Whittemore, based on the fair market value of the asset at the lower tier—the noncontrolling ownership in the common stock of Peter Paul.

Second, the valuation analysts considered discounts at the upper tier to reflect the fair market value of the ownership interest in the common stock of Whittemore on a nonmarketable, noncontrolling basis.

Valuation Analyst Testimony—Lower Tier Entity

The value of all of the assets of Whittemore except the 18,366 common shares of Peter Paul was stipulated at $1,825,032.27.

The taxpayer valuation analysts valued the Peter Paul shares by applying blockage discounts ranging between 22.9 percent and 47.1 percent to the Peter Paul common stock price on December 29, 1947. This calculation indicated values for the Peter Paul shares ranging between $24 per share and $35 per share for the five taxpayer valuation analysts.

The Service valuation analysts also valued the Peter Paul shares by applying blockage discounts. However, the discounts applied by the Service valuation analysts were significantly less, ranging between 7.4 percent and 11.8 percent.

Applying these discounts indicated values for the Peter Paul shares ranging between $40 per share and $41.8 per share for the three Service valuation analysts

Valuation Analyst Testimony—Upper Tier Entity

At the upper tier, the taxpayer valuation analysts concluded that, since 200 shares were gifted to each of three sons, it was appropriate to value the 200 shares as noncontrolling ownership interests. This was because these shares represented 24.4 percent of the total outstanding shares.

However, the Service valuation analysts concluded that it was appropriate to value all 600 gifted shares as one block. The 600 shares represented 73.2 percent of the outstanding Whittemore shares, large enough to carry some ownership control—but less than the 75 percent required in Connecticut to dissolve the corporation.

At trial, three of the taxpayer valuation analysts provided testimony regarding both the fair market value of 600 shares and 200 shares of Whittemore. Three of the Service valuation analysts provided testimony regarding the fair market value of 600 shares, and only one Service analyst provided testimony regarding the fair market value of 200 shares.

Two of the taxpayer valuation analysts did not provide testimony regarding the value of the shares in Whittemore. These valuation analysts only provided testimony regarding the value of the Peter Paul shares.

The first taxpayer valuation analyst concluded that the fair market value of 600 shares of Whittemore was equal to $1,500 per share, or a 50 percent discount from his assumed net asset value of $3,000 per share. This conclusion was primarily based on considerations such as (1) powers of control and (2) the liquidity of the investment. The taxpayer valuation analyst then concluded that an appropriate discount from net asset value for 200 shares would be 60 percent, based "solely on his judgment as to the comparative desirability of the two investments."

The second taxpayer valuation analyst concluded a fair market value of $1,150 per share for the 600 shares, due to the fact that the block was large enough to carry control—but less than the 75 percent required to have the ability to force liquidation. He also opined that a 200 share block would not have a value greater than $850 per share.

The third taxpayer valuation analyst analyzed a group of closed-end investment trusts which sold at discounts from net asset value ranging from 15 percent to 52 percent, with an average of 28 percent. He then increased this discount (1) to 48 percent for the 600 shares in Whittemore and (2) to 66 percent for the 200 shares in Whittemore.

These increases were based on the relative underperformance of the Whittemore asset portfolio relative to the closed-end investment trusts.

The first Service valuation analyst testified that the value of the 600 shares in Whittemore was $2,900 per share (an 8 percent discount from net asset value), and the value of 200 shares was $2,000 per share (a 36 percent discount).

The second and third Service valuation analysts testified that the 600 shares would trade at an approximate 10 percent discount from net asset value. These valuation analysts did not provide testimony regarding the value of the 200 shares.

The Tax Court Opinion

Lower Tier Entity

The Tax Court agreed with one of the Service valuation analysts regarding the appropriate blockage discount. This agreement was because he "appears to be the most thoroughly qualified."

The Tax Court found that the fair market value of the Peter Paul shares owned by Whittemore was $40 per share, reflecting a blockage discount of approximately 11.8 percent.

Upper Tier Entity

Based on this value for the Peter Paul stock, the Tax Court concluded a net asset value for Whittemore of $3,118 per share.

The Tax Court then concluded that it was appropriate to value the 200 shares of Whittemore, not the 600 shares. This was because 200 shares were gifted to each son.

The Tax Court applied a combined discount for lack of control and for lack of marketability of 66.1 percent. This discount was based on an average of the discounts applied by the three taxpayer valuation analysts. This calculation concluded a value of $1,057 per share for the 200 gifted shares.

Whittemore Summary

The *Whittemore* decision is noteworthy because:

1. the Tax Court accepted discounts at both the upper and the lower tier,
2. the amount of the combined discounts accepted by the Tax Court at both the lower tier and the upper tier was substantial (lower tier—11.8 percent for blockage; upper tier—66.1 percent for lack of control and lack of marketability), and
3. even the Service valuation analysts concluded that it was appropriate to apply discounts at both the upper tier and the lower tier.

Judicial Precedent that Largely Disallow Multi-Level Valuation Discounts

The *Martin* Decision

The Facts of the Case

In the *Martin* decision,[24] the Tax Court opined on the fair market value of the voting and nonvoting common stock of Arbor, Inc. ("Arbor"). Arbor was classified as a personal holding company for federal income tax purposes. Arbor owned (1) 4,000 acres of timberland and (2) noncontrolling interests in seven closely held corporations.

The Arbor investment interests in the seven closely held corporations comprised approximately 75 percent of the Arbor total assets.

The seven closely held corporations included: Martin Home Centers, Inc. ("Martin Home"), Roy O. Martin Lumber Co., Inc. ("Martin Timber"), Verneco, Inc. ("Verneco"), Martin Development Co., Inc. ("Martin Development"), Martin Park, Inc. ("Martin Park"), and Teche Acres, Inc. ("Teche").

The seven corporations were successor family-owned corporations to the original Roy O. Martin Lumber Co., founded in 1923.

Martin Home was the parent of six corporations that operated 12 lumber centers in Louisiana, Arkansas, and Texas. In addition, the company owned 745,535 shares of Louisiana Pacific Corporation common stock.

The net asset value of Martin Home, before valuation discounts, was $22,773,228 as of July 31, 1980.

Martin Lumber owned 158,000 acres and leased 40,000 acres of Louisiana timberlands. In addition, Martin Lumber operated a tie and creosote plant and received royalty income from oil and gas lease royalty payments. The company also owned 424,584 shares of Martin Home common stock.

The net asset value of Martin Lumber, before valuation discounts, was $133,093,725 as of July 31, 1980.

Martin Timber owned 60,000 acres of timberland and operated a sawmill. The company also owned 24,000 shares of Martin Home common stock.

The net asset value of Martin Timber, before valuation discounts, was $54,305,567 as of July 31, 1980.

Exhibit 1
Taxpayer Gifts of Shares in Arbor

Gift Donor	Date of the Gift	Shares of Voting Preferred Stock	Shares of Nonvoting Common Stock	Shares of Voting Common Stock
Roy O. Martin Jr.	1/25/78	None	3,510	1,710
Roy O. Martin Jr.	1/31/79	None	3,510	1,710
Roy O. Martin Jr.	7/05/79	470	None	None
Roy O. Martin Jr.	8/13/79	10,500	1,000	10,000
Roy O. Martin Jr.	4/25/80	None	2,457	570
Barbara Martin	4/25/80	None	2,457	570
Roy O. Martin Jr.	7/31/80	500	592.5	509
Barbara Martin	7/31/80	500	592.5	509

Verneco owned 7,000 acres of timberland, 11,215 shares of Martin Home common stock, 1,339 shares of Martin Lumber preferred stock, and 1,800 shares of Martin Lumber voting common stock.

The net asset value of Verneco, before valuation discounts, was $6,335,833 as of July 31, 1980.

Martin Development owned 23,000 acres of timberland. In addition, the company constructed and sold homes in Louisiana. The company also owned 12,000 shares of Martin Home common stock.

The net asset value of Martin Development, before valuation discounts, was $19,838,881 as of July 31, 1980.

Martin Park was a land development company in Louisiana. The equity book value of Martin Park was $556,884 as of July 31, 1980.

Teche was a land development company in Louisiana. The equity book value of Teche was $598,801 as of July 31, 1980.

Roy O. Martin Jr. and Barbara M. Martin made gifts of shares in Arbor as indicated in Exhibit 1.

In addition, the taxpayers reported the values of the gifted stock as indicated on Exhibit 2.

Exhibit 2
Taxpayer Reported Per Share Values of Arbor Stock

Date of the Gift	Nonvoting Common	Voting Common	Preferred Stock
1/25/78	$8.67	$10.70	—
1/31/79	8.66	10.85	—
7/05/79	—	—	$12.84
8/13/79	8.66	10.85	12.84
4/25/80	8.55	10.70	—
7/31/80	8.55	10.70	12.84

In notices of deficiency, the Service determined the fair market value of the Arbor stock as indicated in Exhibit 3.

Exhibit 3
Service Per Share Values of Arbor Stock

Period Ended	Nonvoting Common	Voting Common	Preferred Stock
December 31, 1979	$34.50	$36.50	$36.50
September 30, 1979	37.50	39.50	39.50
June 30, 1989	40.00	42.00	42.00
September 30, 1980	40.00	42.00	42.00

Three valuation analysts presented evidence regarding the fair market value of the common stock of Arbor at the trial, two valuation analysts for the taxpayer and one valuation analyst for the Service. Each valuation analyst relied on the same general method.

First, the valuation analysts calculated the net asset value of Arbor, based on the fair market value of the primary assets at the lower tier—the noncontrolling ownership interests in the stock in seven closely held corporations and the 4,000 acres of timberland.

Second, the valuation analysts considered the application of certain discounts at the upper tier to reflect the fair market value of the noncontrolling ownership interest in the common stock of Arbor.

Valuation Analyst Testimony—Lower Tier Entity

The litigant parties agreed that (1) the fair market value of the Arbor preferred stock was $5 per share and (2) the fair market value of the 4,000 acres of timberland owned by Arbor was $3,275,056. The only issue for decision at trial was the fair market value of the gifted noncontrolling ownership interests in the Arbor voting common stock and nonvoting common stock.

First Taxpayer Valuation Analyst

The first taxpayer valuation analyst determined that all of the seven companies were operating companies with the exception of Martin Park and Teche. For the operating companies, he applied two valuation methods:

1. He capitalized the 5-year weighted average earnings by a price/earnings multiple of 5.
2. He determined the net asset value of each company, after deducting:
   a. the built-in capital gains tax liability of 28 percent and
   b. a discount of 33 1/3 percent from the value of the Louisiana Pacific stock (because it was restricted stock).

For Martin Home, after weighting the indicated values from the two methods equally, the taxpayer valuation analyst then applied a combined discount of 50 percent to reflect the lack of control and the lack of marketability of the shares.

For Martin Lumber, Martin Timber, Verneco, and Martin Development, the valuation analyst applied the same valuation methods as he applied to value Martin Home. However, due to the operating nature of the companies, the valuation analyst weighted the asset value by 25 percent and the value based on capitalizing earnings by 75 percent.

The taxpayer valuation analyst then applied a combined discount of 50 percent to reflect lack of control and lack of marketability.

For Teche and Martin Park, since the primary asset of the companies was land, the valuation analyst then applied a combined discount of 50 percent to reflect lack of control and lack of marketability.

Second Taxpayer Valuation Analyst

The second taxpayer valuation analyst taxpayer simply discounted the net asset value of each of the seven corporations by 75 percent to reflect the illiquidity of the shares.

The Service Valuation Analyst

The Service valuation analyst agreed with the first taxpayer analyst that (1) Martin Home should be valued as an operating company and (2) Martin Park and Teche should be valued as holding companies.

However, the Service valuation analyst valued Martin Lumber, Martin Timber, Verneco, and Martin Development as holding companies.

For Martin Home, the Service valuation analyst capitalized operating profit by 13 percent and added the value of the Louisiana Pacific shares, based on the quoted market price with no restricted stock discount. Next, the Service valuation analyst applied a discount for lack of control of 35 percent and an additional discount for lack of marketability ranging between 21 percent and 35 percent for each of the gift dates.

For Martin Lumber, Martin Timber, Verneco, and Martin Development, the Service valuation analyst applied a 35 percent discount to the net asset values to reflect Arbor's minority ownership interest in each company. The valuation analyst then applied an additional 35 percent discount to reflect the lack of marketability of the shares.

For Martin Park and Teche, the Service valuation analyst relied on the net asset value of the companies. The valuation analyst then applied a 70 percent discount (based on a 35 percent discount to reflect lack of control and 35 percent to reflect lack of marketability of the Arbor ownership interests in the companies).

Valuation Analyst Testimony—Upper Tier Entity

First Taxpayer Valuation Analyst

The first taxpayer valuation analyst valued the Arbor shares by applying two valuation methods: (1) he capitalized 5-year weighted average earnings by a price/earnings multiple of 5, and (2) he determined the net asset value of Arbor by:

1. adjusting the book value of the Arbor ownership interest in the seven corporations to fair market value,
2. deducting the built-in capital gains tax liability of 28 percent, and
3. further reducing the net asset value by the $12.84 per share redemption price of the Arbor preferred stock.

The taxpayer valuation analyst then applied a 1/3 weight to the capitalization of earnings value and 2/3 weight to the adjusted net asset value. Next, he applied a 50 percent combined discount to reflect lack of control and lack of marketability of the Arbor shares.

This calculation resulted in the concluded values for the gifted Arbor shares indicated in Exhibit 4.

Exhibit 4
Taxpayer Valuation Analyst
Fair Market Value of Arbor Stock

Date of the Gift	Voting Common	Nonvoting Common
1/25/78	$3.68	$3.68
8/13/79	$4.27	$4.27
4/25/80	$5.02	$5.02
7/31/80	$5.02	$5.02

Second Taxpayer Valuation Analyst

The second taxpayer valuation analyst determined the net asset value of Arbor by: (1) adjusting the book value of the Arbor ownership interest in the seven corporations to fair market value and (2) deducting the $5 per share stipulated value of the preferred stock.

Next, the second taxpayer valuation analyst applied a 20 percent discount to reflect the lack of control of the Arbor shares. The valuation analyst concluded that the value of the gifted Arbor shares would not exceed $19.17 per share.

The Service Valuation Analyst

The Service valuation analyst determined the net asset value of Arbor by:

1. adjusting the book value of the Arbor ownership interest in the seven corporations to fair market value and
2. deducting the value of the preferred stock.

The Service valuation analyst did not apply any upper-tier discounts "because it was his opinion that any reduction in value of the Arbor shares due to minority interests or lack of marketability had already been recognized and accounted for through the 70 percent discounts used at the underlying corporation level."

This calculation resulted in the concluded values for the gifted Arbor shares indicated in Exhibit 5.

Exhibit 5
Service Valuation Analyst
Fair Market Value of Arbor Stock

Date of the Gift	Voting Common	Nonvoting Common
1/25/78	$45.13	$45.13
1/31/79	45.79	45.79
7/05/79	46.56	46.56
8/13/79	46.74	46.74
4/25/80	48.70	48.70
7/31/80	49.25	49.25

The Tax Court Opinion

The Tax Court concluded the fair market values for the gifted Arbor shares as indicated in Exhibit 6.

Exhibit 6
The Tax Court Decision
Fair Market Value of Arbor Stock

Date of the Gift	Voting Common	Nonvoting Common
1/25/78	$25.25	$25.25
1/31/79	$25.65	$25.65
7/05/79	$25.60	$25.60
8/13/79	$25.75	$25.75
4/25/80	$26.00	$26.00
7/31/80	$26.35	$26.35

Lower Tier Entity

In arriving at its opinion, the Tax Court generally accepted the Service's method to value Martin Home. The Tax Court capitalized the company's operating profit (1) by 13 percent and then (2) added the market value of the Louisiana Pacific stock based on its trading price, to result in the nondiscounted equity value.

For Martin Lumber, Martin Timber, Verneco, and Martin Development, the Tax Court largely accepted the first taxpayers analyst's method. The Tax Court capitalized the weighted average earnings by a multiple of 5, calculated the net asset value of the company, and then weighted the earnings value by 1/3 and the asset value by 2/3 to result in the nondiscounted equity value.

For Teche and Martin Park, the Tax Court relied on the book value for the nondiscounted equity value.

In arriving at its opinion regarding the discounted values of the seven corporations, the Tax Court rejected the first taxpayer valuation analyst application of a 28 percent discount to reflect the built-in capital gains tax liability stating that "petitioners presented no evidence which would suggest that liquidation of the assets . . . was imminent, planned, or even likely at any time in the near future."

In addition, the Tax Court accepted the Service valuation analysts 70 percent discount to reflect lack of control and lack of marketability.

Upper Tier Entity

The Tax Court also rejected the application of upper tier discounts of 50 percent by the first taxpayer valuation analyst. The Tax Court decision stated that "upon careful examination of the minority interests in Arbor transferred by petitioners, we conclude that the second stage 50 percent discounts are mostly duplicative of the 50 percent discounts applied at the level of the underlying corporations and, therefore, they unreasonably reduce the value of the Arbor shares."

However, the Tax Court applied a 5 percent upper tier discount to reflect the:

> . . . transferred indirect minority interest in Arbor's timberland, the value of which comprises less than one-quarter of Arbor's total assets. Any transferred interest in Arbor's timberland obviously could not have been addressed at the level of the underlying corporations inasmuch as it is held by Arbor, not the corporations. By applying discounts only at the level of the underlying corporations, respondent ignores the fact that the interest in Arbor's stock transferred by petitioners affords no control over the management or liquidation of Arbor's timberland. Thus, we agree with petitioners, at least with respect to the interest transferred in arbor's timberland, that a small second-stage discount is appropriate, albeit a much smaller one than advocated by petitioners.

Martin Summary

In the *Martin* decision, the Tax Court largely rejected the notion of multi-level discounts for an entity in which the discounted assets at the lower tier represent a material percentage of the total upper tier assets.

The Tax Court largely rejected the upper tier valuation discount. This judicial position was because "Arbor's investment interests in the seven underlying corporations, which represent minority interest in each of the corporations, comprise approximately 75 percent of Arbor's total assets."

However, the Tax Court did accept a significant discount at the lower tier (i.e., 70 percent for lack of control and for lack of marketability relating to the noncontrolling ownership interests in the seven family corporations, as testified to by the Service's valuation analyst).

And, the Tax Court also accepted a small upper tier discount (i.e., 5 percent for lack of control relating to the Arbor timberlands).

Judicial Precedent That Disallow Multi-Level Valuation Discounts

The *Janda* Decision

The Facts of the Case

In the *Janda* decision,[25] the Tax Court opined on the fair market value of a noncontrolling interest in the common stock of St. Edward Management Co. ("St. Edward") as of November 1992.

St. Edward was a holding company that owned 94.6 percent of the outstanding common stock of the Bank of St. Edward (the "Bank"). The Bank operated in a small rural community in Nebraska.

As of December 31, 1992, St. Edward reported a total asset book value of $23,953,000 and a shareholders' equity book value of $4,517,000.

In November 1992, Donald Janda and Dorothy Janda each made gifts of 6,850 shares of common stock of St. Edward to each of their four children. Prior to the gifts, Mr. and Mrs. Janda were the largest shareholders in St. Edward. And, each spouse owned 23.74 percent of the outstanding common shares. Each gift represented 5.27 percent of the total outstanding common shares of St. Edwards.

After the gifts, the four children were the largest shareholders in St. Edward, with individual ownership interests of 23.67 percent.

The fair market value of the gifted shares was reported on the gift tax return at $145,357, or $21.22 per share. In the notices of deficiency, the Service determined that the fair market value of the stock was $218,680, or $31.92 per share.

Two valuation analysts presented evidence regarding the fair market value of the common stock of St. Edward at the trial, one valuation analyst for the taxpayer and one valuation analyst for the Service. Each valuation analyst relied on the same general method.

First, the valuation analysts calculated the net asset value of St. Edward, based on the fair market value of the primary asset at the lower tier—the 94.6 percent ownership interest in the Bank.

Second, the valuation analysts applied certain discounts at the upper tier to reflect the fair market value of the ownership interest in the common stock of St. Edward on a nonmarketable, noncontrolling basis.

Valuation Analyst Testimony—Lower Tier Entity

The 94.6 percent ownership interest in the Bank was valued by the taxpayer's analyst using the prices paid in sales of closely held banks in Nebraska.

Based on the pricing multiples paid in these transactions, the taxpayer valuation analyst estimated the fair market value of 100 percent of the Bank at $6,708,900. Multiplying this value by 94.6 percent resulted in the concluded fair market value of $6,346,619 for St. Edward's ownership interest in the Bank.

The Service valuation analyst accepted the conclusion of the taxpayer valuation analyst regarding the fair market value of St. Edward's ownership interest in the Bank.

Valuation Analyst Testimony—Upper Tier Entity

The taxpayer valuation analyst then calculated the adjusted net asset value of St. Edwards by:

1. substituting the fair market value of the 94.6 percent interest in the Bank for the book value,
2. adding the value of the other assets owned by St. Edward, and
3. subtracting the liabilities.

This calculation resulted in an adjusted net asset value for St. Edward of $6,679,224. The taxpayer valuation analyst then applied a 10 percent discount for lack of control and a 65.77 percent discount for lack of marketability. The 65.77 percent discount for lack of marketability was based on the application of the Quantitative Marketability Discount Model (QMDM).

The Service valuation analyst agreed with the adjusted net asset value of St. Edwards of $6,679,244 concluded by the taxpayer's analyst. In addition, the Service valuation analyst agreed with the 10 percent discount for lack of control applied by the taxpayer analyst.

However, the Service valuation analyst applied a 20 percent discount for lack of marketability. This discount was based on general data from:

1. restricted stock studies,
2. initial public offering studies, and
3. prior Tax Court decisions.

In addition, the Service valuation analyst stated than an ownership interest in St. Edwards would be highly marketable because the Bank had strong profitability.

The Tax Court Opinion

The Tax Court concluded the fair market value of each block of gifted stock was $211,186, or $30.83 per share.

Lower Tier Entity

In arriving at its opinion, no valuation discount was applied at the lower tier for the 94.6 percent ownership interest in the closely held Bank.

Upper Tier Entity

The Tax Court allowed a combined discount for lack of control and for lack of marketability of 40 percent at the upper tier.

The Tax Court rejected the QMDM analysis proffered by the taxpayer's valuation analyst, stating that "[w]e have grave doubts about the reliability of the QMDM model to produce reasonable discounts, given the generated discounted of over 65 percent."

In addition, the Tax Court also rejected the testimony provided by the Service's analyst regarding the discount for lack of marketability. This judicial position was because the Service's analyst "looked at only generalized studies which did not differentiate marketability discounts for particular industries" and relied on previous Tax Court opinions "that describe different factual scenarios from the instant cases."

Janda Summary

In the *Janda* decision, although no discount was applied by the Tax Court at the lower tier for the St. Edward 94.6 percent ownership interest in the Bank, neither the taxpayer valuation analyst nor the Service valuation analyst testified that a discount was appropriate at the lower tier.

Both valuation analysts valued the 94.6 percent ownership interest by multiplying 94.6 percent by the fair market value of 100 percent of the common stock of the Bank.

Therefore, valuation discounts were only applied at the upper tier and not the lower tier. And, no evidence was presented at trial regarding discounts at the lower tier. Therefore, this issue was not considered by the Tax Court.

The *O'Connell* Decision

The Facts of the Case

In the *O'Connell* decision,[26] the Tax Court opined on the fair market value of a 95.3 percent interest in the common stock of Capri, Inc. ("Capri") as of April 8, 1973.

Capri was a holding company that owned various pieces of real estate, a portfolio of securities, several nonoperating subsidiaries, and a 74.31 percent interest in Glacier General Assurance Company ("Glacier"). Glacier was a multiple line fire and casualty insurance company.

As of April 1973, Capri reported a total asset book value of $7,878,803. The majority of the Capri assets on a book value basis were cash and marketable securities.

As of December 31, 1972, Glacier reported a total asset book value of $25,582,000 and capital and unassigned surplus of $3,869,000. In calendar 1972, Glacier reported premiums written of $21,710,000 and net income of $1,512,000. Premiums written had increased considerably over the five-year period ending 1972, from $239,000 in 1968. In addition, Glacier had consistently been profitable over the ten years prior to the valuation date.

During 1972, Glacier management began negotiations for an underwritten public offering of its securities. However, by April 2, 1973, the underwriter notified Glacier that it would not be willing to proceed with the offering.

In the draft registration statement, the underwriter noted that on April 24, 1973, an offering of $15 to $16 per share would not be feasible. This conclusion was reached

despite the fact that previously discussed prices ranged from $20 to $26 per share. The underwriter reached this conclusion primarily because of deteriorating stock market conditions in early 1973.

J.E. O'Connell died on October 8, 1972. The decedent's estate owned 34,423.5 common shares of Capri, or 95.3 percent of the outstanding common shares. The executor of the decedent's estate elected to use the alternate valuation date of April 8, 1973.

The fair market value of the Capri shares was reported on the estate tax return at $4,733,575, or $137.51 per share. In the notices of deficiency, the Service determined that the fair market value of the stock was $10,912,937, or $317.02 revised to $316.50 per share.

Three valuation analysts presented evidence regarding the fair market value of the common stock of Capri at the trial, two valuation analysts for the estate and one valuation analyst for the Service. Each valuation analyst relied on the same general method.

First, the valuation analysts calculated the net asset value of Capri, based on the fair market value of the primary asset at the lower tier—the 74.31 percent ownership interest in Glacier.

Second, the valuation analysts considered the application of certain discounts at the upper tier to reflect the fair market value of the 95.3 percent ownership interest in the Capri common stock.

Valuation Analyst Testimony—Lower Tier Entity

At trial, the valuation analysts agreed to the fair market value of all of the Capri assets, except for the value of the ownership interest in Glacier.

The Capri 74.31 percent ownership interest in Glacier was valued by the first estate valuation analyst based on mutual fund and insurance investment company comparables. Based on these data, the valuation analyst determined the value of the Glacier common stock to be $2.13 per share.

The second estate valuation analyst supported the estate's first valuation analyst concluded per share value for Glacier.

The Service valuation analyst determined the value of the Glacier common stock at $3.09 per share. This conclusion was based on applying the net book value multiple based on the market prices of comparable public companies.

The Service valuation analyst then applied a 20 percent discount for lack of marketability for the Glacier common stock. The analyst based this percentage on adjustments made by the Montana Insurance Examination to the Glacier earnings in 1972 in conjunction with the proposed public stock offering.

These adjustments resulted in a 40 percent reduction from data presented in the public offering registration statement. Also, the Service valuation analyst opined that since the Glacier public offering did not materialize, the shares were negatively affected by lack of marketability.

Valuation Analyst Testimony—Upper Tier Entity

The first estate valuation analyst then calculated the adjusted net asset value of Capri by:

1. substituting the fair market value of the 74.31 percent interest in Glacier for the book value of the 74.31 percent interest,
2. adding the value of the other assets owned by Capri, and
3. subtracting the liabilities.

The first estate valuation analyst then applied a 50 percent discount to the concluded net asset value, resulting in a value for the Capri common stock of $138.37 per share. This valuation discount was based on an analysis of data from:

1. insurance holding companies, which sold at discounts from liquidation value of up to 50 percent, and
2. closed-end mutual funds, which sold at discounts from net asset value of up to 58.8 percent.

The second estate valuation analyst calculated the adjusted net asset value of Capri in the same manner applied by the first estate valuation analyst. Based on this calculation, the valuation analyst concluded the underlying net asset value of 100 percent of Capri of $9,949,035. Next, the valuation analyst made a series of adjustments.

First, the valuation analyst calculated the publicly traded equivalent value of the Capri shares by analyzing the prices that comparable publicly traded closed-end investment companies sold at as a percentage of underlying net asset value (58 percent of net asset value). Based on this analysis, he multiplied the 100 percent equity value of Capri by 58 percent.

Second, since the closed-end investment companies were publicly traded, the valuation analyst applied a discount for lack of marketability of 35 percent.

Third, since the estate's ownership interest is a controlling interest, the valuation analyst applied a control premium of 12 percent, to result in the fair market value of 100 percent of Capri common stock of $4,056,489.

Fourth, the valuation analyst multiplied the estate's ownership interest of 95.74 percent to result in the fair market value of $3,883,587, or $112.82 per share.

At trial, the Glacier president testified that the method employed by the second estate valuation analyst was a standard business formula for the insurance industry.

The Service valuation analyst calculated the adjusted net asset value of Capri by:

1. substituting the fair market value of the 74.31 percent interest in Glacier for the book value,
2. adding the value of the other assets owned by Capri, and
3. subtracting the liabilities.

Next, the Service valuation analyst divided the concluded net asset value of Capri by the outstanding common shares to result in a per share value of $3.16 for Capri.

The Service valuation analyst concluded that it was inappropriate to apply a discount for lack of marketability for the estate's ownership interest in Capri, since "the company was a wealthy family holding company" and the largest portion of the assets owned by Capri (excluding its investment in Glacier) was cash and marketable securities.

The Tax Court Opinion

The Tax Court concluded the fair market value of the Capri common stock was $10,318,444, or $299.75 per share. This judicial conclusion was based on the fair market value for the Glacier common stock owned by Capri of $2.73 per share.

Lower Tier Entity

In arriving at its opinion, the Tax Court accepted the pre-discount value for Glacier as determined by the Service valuation analyst.

Next, the Tax Court applied a discount for lack of marketability of 30 percent to the indicated value of Glacier, greater than the 20 percent discount applied by the Service valuation analyst. This discount was based on the failure of Glacier's public offering shortly before the valuation date.

Upper Tier

The Tax Court did not allow a valuation discount at the upper tier. This was because the Tax Court was "unconvinced that the approach utilized by [the estate's experts] in the appraisal of Capri made sufficient allowances for the decedent's controlling interest."

The Tax Court stated that the method used by the estate valuation analysts to calculate the appropriate valuation discount at the upper tier:

> . . . might be applicable for minority stock interests . . . but here we are valuing a 95 percent majority interest where recognition of the asset value is critical to any purchaser who, having effectively acquired the company, has an obvious interest in the net worth that is beyond the interest in the security.

In addition, in rejecting a discount at the upper tier entity, the Tax Court said:

> Glacier General is Capri's principal operating subsidiary. Since we have already provided for a discount with regard to Glacier General's closely-held stock, the result of an additional discount for the aggregate assets of Capri, which are primarily investment holdings not subject to discount, would in effect only increase the discount previously designated to Glacier General. Assuming no other reason to discount the stock, we reject such an inflated reduction.

The Tax Court opinion was affirmed on this point by the Ninth Circuit Court.

O'Connell Summary

In the *O'Connell* decision, the Tax Court rejected the application of multi-level discounts for an entity in which the discounted assets at the lower tier represent a material percentage of the total upper tier assets.

The Tax Court applied a discount for lack of marketability of 30 percent at the lower tier. But, the Tax Court did not allow an upper tier valuation discount.

However, in rejecting the upper tier valuation discount, the Tax Court decision indicated that although no discount was allowed at the upper tier for the estate's ownership interest in Capri, the application of a discount at the upper tier "might be applicable for minority stock interests . . . but here we are valuing a 95 percent interest. . . ."

Summary and Conclusion

The Service generally challenges the application of multi-level valuation discounts as duplicative. However, a majority of the judicial decisions summarized above (nine of the eleven total cases) concluded that it was appropriate to apply some level of valuation discounts at both the lower tier and the upper tier.

The *Astleford*, *Dean*, *Gallun*, *Gow*, *Hjersted*, *Kosman*, *Martin*, *Piper*, and *Whittemore* decisions allowed some level of multi-level valuation discounts.

In a majority of these judicial decisions, even the Service valuation analyst applied some level of multi-level valuation discounts.

The *Martin* decision largely disallowed multi-level discounts by stating that the taxpayer valuation analyst "second stage 50-percent discounts are mostly duplicative of the 50-percent discounts applied at the level of the underlying corporations."

However, in that decision, the Tax Court did accept both a combined discount for lack of control and for lack of marketability of 70 percent at the lower tier and a 5 percent discount at the upper tier.

Only two of the eleven decisions, *Janda* and *O'Connell*, disallowed multi-level valuation discounts. However, in both decisions, there were unique aspects that contributed to the rejection of multi-level valuation discounts.

In the *Janda* decision, although no discount was applied by the Tax Court at the lower tier for the 94.6 percent ownership interest in the closely held company, neither the taxpayer valuation analyst nor the Service valuation analyst testified that a discount was appropriate at the lower tier.

It is noteworthy that, in *Hjersted*, expert testimony regarding the application of a discount for lack of liquidity for a controlling ownership interest in a closely held company at the lower tier was accepted by the court.

In the *O'Connell* decision, the Tax Court rejected multi-level valuation discounts for an entity in which the discounted assets at the lower tier represented a material percentage of the upper tier total assets. However, in that case, the Tax Court also noted that an upper tier discount "might be applicable for minority stock interests . . . but here we are valuing a 95 percent interest. . . ."

These judicial decisions also provide insight into factors to be considered regarding the appropriateness and magnitude of applying multi-level valuation discounts for tiered entities. *Martin*, *O'Connell*, and *Astleford* concluded that an important factor to consider when applying discounts at the upper tier is the composition of the assets of the upper tier company.

The *Martin* and *O'Connell* decisions concluded that multi-level valuation discounts for tiered entities are largely inappropriate when the lower tier interest constitutes a significant percentage of the upper tier company assets.

The *Astleford* decision concluded multi-level valuation discounts for tiered entities are appropriate when the lower tier interest constitutes a relatively small percent of the upper tier company assets.

Notes:

1. *Estate of Astleford v. Commissioner*, T.C. Memo 2008-128.
2. *Estate of Dean v. Commissioner*, T.C. Memo 1960-54.
3. *Estate of Gallun v. Commissioner*, T.C. Memo 1974-284.
4. *Estate of Gow v. Commissioner*, T.C. Memo 2000-93, *aff'd* 19 Fed.Appx. 90 (4th Cir. 2001).
5. *Estate of Hjersted*, 175 P.3d 810 (Kan. 2008).
6. *Estate of Kosman v. Commissioner*, T.C. Memo 1996-112.
7. *Piper v. Commissioner*, 72 T.C. 1062 (1979).
8. *Whittemore v. Fitzpatrick*, 127 F.Supp. 710 (D. Conn. 1954).
9. *Estate of Martin v. Commissioner*, T.C. Memo 1985-424.
10. *Estate of Janda v. Commissioner*, T.C. Memo 2001-24.
11. *Estate of O'Connell v. Commissioner*, T.C. Memo 1978-191, *aff'd* on this point, *rev'd* on other issues 640 F.2d 249 (9th Cir. 1981).
12. *Estate of Astleford v. Commissioner*, T.C. Memo 2008-128.
13. *Estate of Dean v. Commissioner*, T.C. Memo 1960-54.
14. *Estate of Gallun v. Commissioner*, T.C. Memo 1974-284.
15. *Estate of Gow v. Commissioner*, T.C. Memo 2000-93, *aff'd* 19 Fed.Appx. 90 (4th Cir. 2001).
16. *Estate of Hjersted*, 175 P3d 810 (Kan. 2008).
17. *Estate of Kosman v. Commissioner*, T.C. Memo 1996-112.
18. "Discounts Involved in Purchases of Common Stock," in U.S. 92nd Congress, 1st Session, House, *Institutional Investor Study Report of the Securities and Exchange Commission*, (Washington: Government Printing Office, March 10, 1971, 5:2444-2456, Document No. 92-64, Part 5).
19. "The Market Value of Control in Publicly Traded Corporations," *Journal of Financial Economics*, April 1983.
20. *Piper v. Commissioner*, 72 T.C. 1062 (1979).
21. "Discounts Involved in Purchases of Common Stock," in U.S. 92nd Congress, 1st Session, House, *Institutional Investor Study Report of the Securities and Exchange Commission*.
22. The discount for lack of marketability applied by the Service's first valuation analyst was not noted in the Tax Court proceedings. It was simply noted that this valuation analyst position regarding the discount was rejected since there was no support in the record for the premise that a public distribution of the Piper Investment and Castanea common stock would be an efficient method of selling the stock.
23. *Whittemore v. Fitzpatrick*, 127 F.Supp. 710 (D. Conn. 1954).
24. *Estate of Martin v. Commissioner*, T.C. Memo 1985-424.
25. *Estate of Janda v. Commissioner*, T.C. Memo 2001-24.
26. *Estate of O'Connell v. Commissioner*, T.C. Memo 1978-191, *aff'd* on this point, *rev'd* on other issues 640 F.2d 249 (9th Cir. 1981).

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