



WHEN RESULTS COUNT

ESTATE AND GIFT E-FLASH

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Estate of Richard R. Simplot v. Commissioner 112 T.C. No. 13

The decedent died owning 18 of the 76,445 outstanding Class A voting shares of J.R. Simplot Co. and 3,942,048 of the 141,288,584 outstanding Class B non-voting shares. All of the remaining Class A and Class B shares were owned by the decedent's three siblings.

The petitioner had asserted the fair market value per share of both the voting and non-voting shares was the same at \$2,964.10. The argument was that since the decedent's interest was not controlling, there should be a no or a negligible premium for voting. Also the voting shares had a 360 day transferability restriction versus unrestricted transferability for the non-voting shares.

The respondent argued for a voting privilege premium for the Class A shares because of the disparate ratio between the number of shares of voting stock outstanding and the number of shares of non-voting stock outstanding. Further, the respondent argued that the premium should be expressed as a percent of the entire equity value of the company.

The Tax Court agreed that the voting shares should have a 3% premium, calculated as 3% of the fair market value of the entire equity of the company. The Tax Court applied a 35% marketability discount to the Class A shares and 40% to the Class B shares. These marketability discounts were allowed despite the fact that both before and after the valuation date, several of J.R. Simplot Co's competitors had inquired into whether the company or parts of the company might be available for acquisition.

The final Tax Court value was \$215,539.01 per share for the Class A voting shares and \$3,417.05 for the Class B non-voting shares.

This case underscores the importance of a thorough analysis and understanding of complex capital structures. Also of note is that the built-in gains tax on the appreciation of the Micron stock owned by J.R. Simplot Co. was treated as a dollar for dollar reduction in fair market value with-

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out question, despite a lack of plans to liquidate this investment.

The first expert for the petitioner calculated the fair market value using both the comparable public companies and discounted cash flow methods. Since the company owned a sizable holding in Micron Technology, this stock was added back separately as a non-operating asset. This expert subtracted selling costs, 5% for blockage, and a 6% minority discount in arriving at the Micron fair market value. In addition, the expert reduced the value of the Micron stock for 100% of the tax on the difference between the value of the stock and the underlying tax basis.

This expert averaged the results obtained from the two valuation methods and arrived at a value of \$4,560.18 per share for the Simplot stock. He applied a 35% marketability discount, resulting in a final fair market value for all shares of \$2,964.10 per share.

The petitioner's second expert was engaged solely to render an opinion on the value of the voting rights on the Class A shares. His opinion was that a buyer would not pay a significant premium for the Class A shares.

The IRS's first expert determined that the voting shares had a fair market value of \$616,116.36 per share, and the non-voting shares had a value of \$3,522.79 per share. He, like the petitioner's expert, calculated the fair market value using both the discounted cash flow and comparable public companies methods. In calculating the amount to be included for the value of the Micron stock owned by the company, this expert assumed that any blockage discount would be offset by a premium on the sale of the stock. He did, however, subtract a 3.825% discount for underwriting costs plus the entire built-in gains tax on the appreciation of the Micron stock above its tax basis.

The most striking difference between this expert and the petitioner's expert was in the premium applied for the voting rights on the Class A stock. This expert found "relevant empirical evidence" that premiums range from 8.58% to 23.9% of equity value. He ultimately settled on a 10% premium applied to the entire equity of the company, less the \$110,000,000 value of the Micron stock. Since he

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determined a \$720,000,000 equity value exclusive of Micron, he calculated a \$72,000,000 or \$942,000 per share voting stock premium. He then applied a 35% marketability discount to the voting stock and 40% to the non-voting stock.

The second IRS expert was instructed to take the equity value calculated by the first IRS expert and simply determine the value of the voting rights. He opined that 6% to 7% of equity would be fair as a premium, but the amount could be as little as 3%. He further suggested a 15% minority discount and a 35% to 40% discount on the voting stock and a 35% marketability discount on the non-voting stock.

In the Tax Court's analysis, Judge Jacobs said, "Petitioner's experts used a simple, traditional methodology to value an unusual corporate capital structure, which resulted in little or no premium for voting rights. On the other hand, respondent's experts used a valuation methodology which, given the Simplot family's philosophy, appears to accord the class A stock an extraordinarily high premium for its voting privileges."

The Judge applied a 3% voting stock premium saying, "We wish to stress at the outset that we are not valuing the premium for CONTROLLING voting power, but rather the premium for voting rights. The premium for controlling voting power would be substantially greater than the premium we determine for voting rights."

The Tax Court determined the value of the Class A voting shares to be \$3,879,702.19 or \$215,539.01 per share, including a 35% discount for lack of marketability. The class B non-voting shares were valued at \$13,470,190.88 or \$3,417.05 per share with a 40% discount for lack of marketability.

[*Click Here for a Complete Copy of the Case*](#)

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