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Estate of Alice Friedlander Kaufman v. Commissioner  
T.C. Memo. 1999-119, April 6, 1999

*This case deals with a 19.86% common stock ownership in a closely held, primarily family-owned corporation. Judge Laro determined that the estate relied too heavily on two sales of stock two months after the date of death to determine the fair market value of the decedent's shares. These sales were not sufficiently negotiated, were not arms' length, and the 4.67% and 3.25% blocks sold were too small to be comparable to the 19.86% owned by the decedent. Judge Laro recognized the IRS financial analyst as an expert, but expressed concern as to his potential bias as a full-time IRS employee. Judge Laro criticized a number of items in the petitioners' expert report, including determination of the discounts for lack of control and marketability. Judge Laro also commented that the record fell short of the Court's standards and he was left to decide the case against the party who had the burden of proof, in this case, the petitioner.*

Seminole Manufacturing Co is a family-owned corporation, and the decedent's estate includes 46,020 shares (19.86%) of Seminole's class A stock and is the largest block of stock owned by one person. The estate reported on its Federal estate tax return that the fair market value of these shares was \$29.77 each at the April 14, 1994, alternative valuation date for the October 14, 1993, date of death. The IRS determined that the fair market value of the estate's stock was \$70.79 per share, but made concessions via brief to arrive at \$56.50 per share.

In 1993, Merrill Lynch was engaged to appraise the value of a minority interest in Seminole so that one of the shareholders could offer to buy the shares of those shareholders who were not interested in the company. Merrill Lynch prepared a report dated and delivered it on July 5, 1994, valuing minority shares at \$29.77 each as of December 8,

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1993. Merrill Lynch assumed, among other things, that Seminole had 16 shareholders and that the per-share value of each shareholder's shares was the same.

The petitioners argued that the sales by two minority shareholders establish the per share value. The petitioner asserted that these sales were the most accurate measure of value because both sellers were knowledgeable persons who were under no compulsion to sell.

Judge Laro disagreed with the petitioners that either sale was indicative of the value of the estate's stock. He noted that estate's holdings were the largest single ownership of Seminole stock by one person, and the isolated 3.25% and 4.67% interest sales were not sufficiently similar to the estate's much larger interest to make their sale price representative of the value of the estate's stock. There was also substantial disagreement whether these sales were made by a person who was reasonably informed on the date of sale as to the relevant facts surrounding the value of the underlying property. The two sellers signed affidavits that they reviewed the Merrill Lynch report before selling their stock. Judge Laro found these assertions "incredible" since Merrill Lynch had not yet finished its report as of the sales dates of these two blocks. These affidavits also contradicted the sellers' court testimony.

Each party called an expert to testify as to the fair market value of the decedent's stock. The petitioner's expert analyzed the fair market value of the estate's stock as of April 14, 1994, concluding that the estate's stock interest was a minority, noncontrolling interest that had a fair market value on that date of \$30.85 per share. He reached his conclusion after analyzing two of the three relevant valuation approaches; namely, the market and the income approaches. He did not analyze the asset approach.

Respondent called a financial analyst employed by the Internal Revenue Service. Judge Laro recognized this person as an expert on business valuation, but expressed concern that he might be biased because he was a full-time employee of the Commissioner. The IRS expert's initial report ascertained the value of Seminole stock as of December 8, 1993, the date for which the Merrill Lynch re-

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port had set forth a value. Judge Laro did not admit this report into evidence, holding that it was irrelevant because the December 8, 1993, valuation date was too far removed from the applicable April 14, 1994, alternate valuation date.

Judge Laro was unpersuaded by the petitioner's expert's report, criticizing the reliance on "the unverified representations of Seminole's management..." Judge Laro was also critical that the expert relied on faulty assumptions to arrive at his value, neglected to analyze key indicia of value (including Seminole's certificate of incorporation and bylaws), and assumed erroneously that the two small stock sales were at arm's length when he took the sales price into account to reach his conclusion of value.

The Court went into a more detailed analysis of problems with the petitioner's expert's report.

First, the expert provided an inadequate analysis of like public corporations engaged in the same or a similar line of business. Judge Laro did not find enough information on these corporations to decide whether they were sufficiently similar to Seminole, to permit a proper valuation analysis. The expert was also criticized for not explaining (e.g. through the use of SIC codes) how he concluded that the industry of his similar corporations was the same as Seminole's industry.

Second, the expert did not analyze all three valuation methods. While he recognized all three methods and the fact that all three methods enter into a determination of fair market value, he failed to ascertain a value under the net asset method. Valuation experts must thoroughly analyze all applicable methods of valuation, and they may not simply assert without sufficient explanation that they have concluded that a particular method is irrelevant.

Third, the expert assumed that the per-share value of the estate's shares equaled the per-share value of all other shares. Under his analysis, shares of stock have one of two values; controlling or noncontrolling, or as Judge Laro put it "pigeonholed into one of two values". Judge Laro

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looked to distribution and voting rights and concluded different blocks of stock can have different per share values, even if both are noncontrolling blocks.

Fourth, every shareholder who was outside the extended family was a Seminole employee (or spouse), whose shares had to be redeemed when the shareholder retired. Judge Laro concluded that it was not unreasonable to conclude that a hypothetical buyer of the estate's shares would contemplate that a member of the family, or Seminole itself, would pay a greater price for those shares as long as they were owned by a nonfamily member who was not an employee. Judge Laro further concluded that introducing an outside shareholder could result in a minority shareholder lawsuit and thus the family had incentive to purchase the shares and the shares did not lack marketability.

In concluding, Judge Laro said, "...we are unpersuaded by [the taxpayer's expert's] opinion and reject it. Having done so, we would typically proceed to value the estate's shares on the basis of the record at hand. In the typical case, we find much information and data on the subject corporation, as well as financial studies and data which allow us to compute value and marketability discounts using the Mandelbaum and other factors mentioned above. The instant case, however, is atypical. Petitioners, in short, ask us to close our eyes to the inadequate record and adopt without adequate verification [the taxpayer's expert's] conclusion and the managerial representations upon which he relied. We decline to do so ... Where, as is the case here, the record falls short of the standard which we require, we are left to decide the case against the party who has the burden of proof. Because petitioners bear the burden here, we sustain respondent's determination, as modified by concessions in brief. We hold that the fair market value of the estate's stock was \$56.50 per share on the applicable valuation date."

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

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