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Estate of Etta Weinberg v. Commissioner T.C. Memo 2000-51

At the time of her death on December 15, 1992, Decedent held a general power of appointment over a marital deduction trust that owned a 25.235% limited partnership interest. The estate argued for a \$971,839 value calculated by weighing the income approach 75% and the asset approach 25%. For the asset approach, the estate used a 51% minority discount. No separate minority discount was required for the income approach since the cash flow stream being capitalized was a minority cash flow. The taxpayer expert used an 11% capitalization rate and subtracted a 35% marketability discount.

The IRS expert determined a fair market value of \$1,770,103, using only the income approach, applying a 9.70% capitalization rate. Unlike the taxpayer expert who capitalized average cash flow, the IRS used the most recent year's cash flow, which was higher than the average. The IRS expert used a 15% marketability discount based on the Quantitative Marketability Discount Model (QMDM). The Tax Court dismissed the QMDM approach noting that small changes in the assumptions produce substantially different results and the "assumptions are not based on hard data and a range of data may be reasonable."

The Tax Court did its own calculation using the taxpayer's cash flow, the IRS' capitalization rate, the weighting of the income and asset approaches used by the taxpayer, and a 20% marketability discount, arriving at a final value of \$1,309,650.

Decedent, Etta Weinberg, passed away holding a general power of appointment over a marital deduction trust that owned a minority limited partnership interest. The limited partnership owned an 11-story apartment unit with an agreed upon value of \$10,050,000, plus other assets of some \$840,000. There was a \$448,544 mortgage remain-

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ing on the property at the date of death and there were additional liabilities of approximately \$109,000. Decedent's son was the sole general partner, with a 1% interest. He was also a limited partner.

Taxpayer Expert

The taxpayer expert valued the limited partnership using both the income and asset approaches. The basis of much of this expert's valuation was data from Partnership Profiles. Using this data, he found only one comparable partnership with an 11% dividend yield and a 51% discount from underlying net asset value. [Editor's note - The reported discount for a similar partnership would be much less today than it was in 1992.]

Cash flow to partners had varied, averaging \$683,333 for the most recent three-year period, and this average was the benefit stream used by the taxpayer expert. This expert applied a 35% marketability discount, relying in particular on the SEC restricted stock study that showed a 30% average discount. There were two reasons the expert applied the extra 5% to the average: (1) there was no pros-

The IRS expert applied only the income approach, arguing that net asset value was irrelevant because a hypothetical buyer could not control the sale of the underlying property or liquidation of the partnership.

pect of this partnership having a public market and (2) the perpetual restrictions on the sale of this interest were more restrictive than the one to three year restrictions for the interests in the study.

IRS Expert

The IRS expert applied only the income approach, arguing that net asset value was irrelevant because a hypothetical buyer could not control the sale of the underlying property or liquidation of the partnership. For his capitalization rate, the expert also relied on data from Partnership Profiles, but he believed there were 16 comparable partnerships. These partnerships had an average yield of

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10.45%, but this average needed adjustment to take into account the different characteristics of the subject partnership. He added .5% for lack of diversification, deducted 1% because the general partner was also a limited

To determine the marketability discount, he used the Quantitative Marketability Discount Model (QMDM).

partner (thus, tending to assure cash distributions), and subtracted .25% because the comparable partnerships might include distressed sales. This analysis resulted in a capitalization rate of 9.7%. He used the \$800,000 cash distribution in 1992 as the benefit stream to capitalize.

To determine the marketability discount, he used the Quantitative Marketability Discount Model (QMDM). In order to use this model, the expert had to make assumptions about the expected distribution rate, the growth rate in the underlying asset value, the required holding period return, and the assumed holding period. After making the required assumptions, the expert determined a marketability discount of 15%.

Tax Court Analysis

Judge Whalen first calculated the implied minority discount. Since both experts had started with a minority income stream, this discount was implicit in the capitalized income value. Based on a comparison of the net asset value to the fair market value before the marketability adjustments determined by each expert, Judge Whalen determined a 42.7% minority discount had been taken by the taxpayer and 20.1% by the IRS. The Judge then calculated that the total discounts taken were 62.7% by the taxpayer and 32.1% by the IRS.

The Judge agreed with the taxpayer that both the income and asset approaches should be used and in the same 75% - 25% ratio used by the taxpayer. The Judge also agreed that the three-year average distribution should be used rather than the higher 1992 amount, believing that this better reflected the cash distributions an investor could reasonably anticipate. The Judge preferred the IRS

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expert's use of the 16 comparables compared to the single comparable used by the taxpayer expert. Based on these 16 comparables, there was an implicit minority discount to net asset value of 53.4%.

The Court disagreed with the use of the QMDM analysis because "slight variations in the assumptions used in the model produce dramatic differences in the results." The Court's analysis showed how changes in the QMDM assumptions would double the marketability discount calculated by the model and concluded, "Because the assumptions are not based on hard data and a range of data may be reasonable, we did not find the QMDM helpful in this case." The taxpayer expert's marketability discount was likewise rejected because the expert did not take into account certain characteristics of the subject limited partnership: (1) consistent dividends, (2) the nature of the underlying assets, and (3) the low degree of financial leverage. The Judge determined a 20% marketability discount was appropriate. The original case contains a worksheet showing how Judge Whalen arrived at the final \$1,309,650.64 value, an effective 50% discount to underlying net asset value.

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

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