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Tax Valuation E-Flash

Raymond J. Martin, et al., Plaintiffs v. Martin Bros. Container & Timber Products Corp., et al., Defendants, United States District Court for the Northern District of Ohio, Western Division, Case No. 3:00CV7642

An Ohio district court has ruled that the tax on built-in capital gains in a C corporation should be recorded at its present value, not the full amount of the tax at the valuation date.

This case involved a shareholder dispute in an Ohio "special proceeding" under §1701.85(B) of the Ohio Revised Code. The standard of value in this action was fair market value. There were three business appraisers: one for the plaintiffs, a second for the defendant, a third hired jointly at the suggestion of the court.

The two areas of dispute in the business valuation were the proper level of discounts for lack of control and marketability and the treatment of the tax on built-in gains for a C corporation.

The plaintiff expert concluded the built-in gains tax discount should be the present value of the tax assuming the assets would be sold at the end of 30 years.

The court accepted the 15% discount for lack of control and the 30% for lack of marketability opined by the joint appraiser. The court disagreed with all three appraisers on the built-in gains tax adjustment.

All three appraisers agreed that the fair market value of the corporation was properly calculated by the asset-based approach. The plaintiff expert concluded the built-in gains tax discount should be the present value of the tax assuming the assets would be sold at the end of 30 years. The defendant expert and the joint expert both calculated the built-in gains tax discount assuming the tax would be incurred on the valuation date.

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The court cited *Estate of Pauline Welch v. C.I.R.*, 208 F.3d 213, 2000 WL 263309, **4 (6th Cir. 2000) (*Unpublished Disposition*) and *Eisenberg v. Commissioner*, 155 F.3d 50, 57 (2d Cir.1998) and disagreed with all three appraisers. The court acknowledged that some discount was appropriate, noting that, "...the tax-reduction or avoidance tactics referenced by the plaintiffs' expert (i.e., conversion from a C to an S corporation) are not a realistic means of getting out from underneath, or even significantly reducing, the built-in capital gains tax liability."

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Ultimately, the court determined various future sales dates for the underlying assets, with the last sale being December 31, 2012, and instructed the parties to prepare a revised valuation taking the assumed sales dates into account.