

Corporate Offices

California (Los Angeles)

James S. Rigby ABV, ASA
213.362.9991

Erich Z. Sylvester JD., ASA
213.362.9991

Florida (Tampa)

Michael J. Mard ABV, ASA
813.985.2232

Steven Hyden ASA
813.985.2232

Regional Offices

California (Oakland)

John J. Mayerhofer FACHE
510.531.2943

California (Silicon Valley)

Robert T. Lanz
408.777.2914

Illinois (Chicago)

Michael J. Mattson
773.769.3045

Iowa (Des Moines)

Terry J. Allen ABV, ASA
515.953.4498

Massachusetts (Boston)

Stephen J. Bravo ABV, AM
508.872.4002

Missouri (Kansas City)

Terry J. Allen ABV, ASA
816.373.3340

Missouri (St. Louis)

Ralph Ostermueller ABV, ASA
314.965.5921

Montana (Great Falls)

John R. Gilbert ABV, ASA
406.453.1800

Please contact us via
email:

info@fvginational.com

Tax Valuation E-Flash

Jeffrey L. Okerlund et. al. v. U.S., United States Court of Federal Claims, Consolidated Nos. 99-133T & 99-134T, August 23, 2002

The United States Court of Federal claims determined the fair market value for non-voting shares of Schwan's Sales Enterprises, Inc. (SSE). The value was determined as of 1992 for gift tax purposes and as of 1994 for charitable donation purposes. The Court allowed discounts for lack of marketability of 40% and 45% on the respective dates and a 5% discount for non-voting stock on both dates.

SSE is a privately held wholesaler and retailer of various prepackaged food products. The company was capitalized with 7,610 shares of voting stock and 38,555,000 shares of nonvoting stock. In 1992, the taxpayers made gifts of nonvoting shares to their children's trusts. In 1994, one of the taxpayers made a gift of nonvoting shares to a §501(c)(3) nonprofit organization.

The taxpayers had obtained an appraisal for both of these transactions and filed the necessary tax returns. Because of litigation between the Schwan children and SSE following the unexpected 1993 death of the founder, Marvin Schwan, the taxpayers obtained an appraisal from a different

The taxpayers mounted a "Daubert" challenge against the IRS expert based on his qualifications and the number of hours this expert had spent on the valuation engagement relative to the hours spent by his assistants.

appraisal firm. This second appraisal resulted in a lower valuation than that used in the original tax returns. The taxpayers amended their original returns based on the new valuation and the IRS challenged these amendments.

Daubert Challenge

The taxpayers mounted a "Daubert" challenge against the IRS expert based on his qualifications and the number of hours this expert had spent on the valuation engagement relative to the hours spent by his assistants. The Court noted that both the IRS and taxpayer experts used the same

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widely accepted valuation methodologies. Based on this and the IRS expert's academic and professional credentials, the Court did certify him as an expert for his testimony about the value of SSE stock.

1992 Gift Tax Return

Market Approach

Both experts relied on essentially the same guideline companies in determining their market pricing multiples. The IRS expert chose multiples close to the mean of the public companies while the taxpayer expert chose multiples as the low end of the range. The Court accepted the IRS expert's multiples, believing that the taxpayer expert overstated 1992 risks by considering the unexpected death of the company founder in 1993.

Income Approach

The IRS expert used a 15.93% discount rate while the taxpayer expert used a 16.5% discount rate. The Court believed the taxpayer expert had made the same incorrect 1992 risk assessment under this approach as he had in the market approach and accepted the IRS expert's analysis.

Weighting of Approaches

The IRS expert weighted the income approach 70% and the market approach 30%, while the taxpayer expert weighted the two approaches approximately equally. The Court adopted the IRS expert's weighting and resulting indication of freely-traded value.

Discount for Lack of Marketability

Both experts relied on restricted stock and pre-IPO studies, with the taxpayer expert concluding a 45% discount was appropriate and the IRS expert concluding a 30% discount was justified. The Court noted the taxpayer expert's report contained a far more detailed analysis of the studies. *[Editor's note - The case contains a good analysis of the factors the experts considered in their*

The Court found the taxpayer expert's analysis to be more persuasive, including the higher reliance on the pre-IPO studies.

determination of the discount.] The Court found the taxpayer expert's analysis to be more persuasive, including his higher reliance on the pre-IPO studies. The Court reduced the discount for the 1992 valuation from 45% to 40% because some of the factors considered were based on the estate plan of Marvin Schwan whose death was unanticipated in 1992.

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Discount for Lack of Voting Rights

The taxpayer expert cited studies showing that discounts for lack of voting rights ranged between 3% and 10% while the IRS expert cited studies where the discount ranged from 4% to 5.44%. Both experts concluded a 5% discount was appropriate.

1994 Charitable Donation

The IRS did not present expert testimony to support its challenge to the value of the charitable donation on the taxpayers' individual income tax return. The Court accepted the value calculated by the taxpayer expert, including a 45% discount for lack of marketability and a 5% discount for lack of voting rights.

The taxpayer expert cited studies showing discounts for lack of voting rights ranged between 3% and 10% while the IRS expert cited studies where the discount ranged from 4% to 5.44%.