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## Tax Valuation E-Flash

### Estate of Trompeter v. Commissioner, US Court of Appeals for the Ninth Circuit, Tax Ct. No. 11170-95, January 30, 2002

The United State Court of Appeals for the Ninth Circuit vacated and remanded *Estate of Trompeter*, T.C. Memo 1998-35. Citing *Leonard Pipeline Contractors* 142 F.3d 1133, 1135-36 (9th Circuit 1998), the Ninth Circuit said the Tax Court failed to articulate its rationale with respect to the valuation of certain closely held stock.

Decedent Emanuel Trompeter founded Trompeter Electronics, Inc. (TEI) in 1960. In 1989,

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Sterling Holding Co. (Sterling) acquired a controlling interest in TEI for cash and shares of Sterling's newly created preferred stock. Mr. Trompeter received 1,533.48 of these shares and he still owned them at his death on March 18, 1992. The shares were subject to a redemption agreement with Sterling.

On the September 18, 1992, alternate valuation date, the estate tax return valued these shares at \$15,335 even though the estate's accountant had valued them at \$462,000 a month earlier. There was \$2.8 million of "accrued but undeclared dividends" and \$3.1 million of accrued interest due on these shares at the alternate date. Despite these amounts, in January 1994, the estate agreed to a redemption offer by Sterling of \$1,947,845. This was the value argued by the IRS.

The estate valuation expert argued in Tax Court that the 1994 redemption was irrelevant because it was not foreseeable in light of Sterling's prior financial condition. This expert valued the stock at \$184,018 based on comparable public companies. The Tax Court, after analyzing the public companies and Sterling's financial status rejected this expert's conclusion. The Ninth Circuit said, "On this point the Tax Court's rationale is clear and its findings are well-

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grounded and not clearly in error."

The Tax Court assigned a value of \$2,708,536 to the Decedent's shares. In arriving at this value, the Tax Court relied on the mandatory redemption agreement, which required the redemption to be carried out over 3 years. The Tax Court then calculated the present value of the three

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payments using a four percent discount rate. The Ninth Circuit accepted the Tax Court's reasoning for all but the four percent discount rate, noting, "On its face, it seems a bit of a stretch to conclude that a buyer would have accepted a discount of only four percent to account for the time value of money and the risk that Sterling would not meet its contractual obligations. On remand, therefore, we direct the Tax Court to clarify its methodology, and document the rationale for its present value calculations."

There was also a substantial fraud penalty involved based on unreported assets and valuation understatements. The Ninth Circuit said, "Although it may be reasonable in some circumstances for a taxpayer to rely on an accountant's advice about the intricacies of tax law, see, e.g., *United States v. Boyle*, 469 U.S. 241, 251 (1985), that presumption only attaches to valuations when the taxpayer 'exercises due care in obtaining an appraisal of fair market value' and presents 'some proof in support of the asserted' valuation. *Sammons v. Comm'r*, 838 F.2d 330, 337 (9th Cir. 1988) (internal quotation marks and citations omitted). Here, the Tax Court appropriately noted that Trompeter's daughters are well-educated, sophisticated, and knowledgeable about various of the Estate's holdings, and thus should not have blindly accepted expert conclusions at face value - especially when those conclusions may have been contradicted by other appraisals prepared by the Estate."

*[Editor's note - This is a continuation of a string of cases where the Ninth Circuit has been very critical of the Tax Court for undertaking its own analysis rather than relying on the experts. I believe the Tax Court will be less and less likely to "split the baby" in valuation cases]*