

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

Montana (Great Falls)

John R. Gilbert ABV, ASA
406.453.1800

Please contact us via
email:

info@fvinternational.com

Tax Valuation E-Flash

Estate of Paul Mitchell v. Commissioner, T.C. Memo 2002-98, April 9, 2002

The Tax Court reaffirmed its holding in T.C. Memo 1997-461 after that opinion was remanded by the Court of Appeals for the Ninth Circuit ([E-flash 3-10](#)). The Ninth Circuit directed the Tax Court to shift the burden of proof to the IRS and to explain its calculation of fair market value, which differed from the calculations by the testifying experts.

In T.C. Memo 1997-461, the Tax Court determined the fair market value of 1,226 shares (49.04%) of John Paul Systems was \$41,532,600 at Paul Mitchell's death on April 21, 1989. The estate valued these shares at \$28.5 million while the IRS valued them at \$105 million.

The Tax Court based its calculation on an offer by Gillette Co. to purchase the Company before Mr. Mitchell's death for \$150 million. The Tax Court reduced the \$150 million by \$15 million to reflect the loss of Paul Mitchell to the Company and then applied a 35% combined discount for

The Tax Court based its calculation on an offer by Gillette Co. to purchase the Company before Mr. Mitchell's death for \$150 million.

lack of marketability and control. There was a further reduction in the fair market value of the 49.04% interest for the possibility of a lawsuit. The Court of Appeals for the Ninth Circuit said it was unclear whether the 35% combined discount for lack of control and marketability fell within a range that was supported on the record.

The experts for the estate and the IRS calculated fair market value using the discounted cash flow and guideline public companies methods. The Tax Court termed these methods as "theoretical valuation methods" and believed that "real world" offers were more appropriate, especially since the offers were so much higher than the theoretical calculations.

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The Tax Court recognized that the acquisition value reflected a premium over the publicly traded minority value and produced a "control nonmarketable value." To adjust the \$150 million for lack of control, the Tax Court used a discount of 29% because the estate's 49.04% ownership had "some power but less than control." The Tax Court said, "...the minority discount should be increased by 6 percentage points (a total of 35 percent) to reflect the additional lack of marketability attributable to a minority interest."

The Tax Court concluded, "On the basis of a thorough review of the entire record before us, we believe that we correctly arrived at a 35-percent discount rate that combines the lack of control

"...the minority discount should be increased by 6 percentage points (a total of 35 percent) to reflect the additional lack of marketability attributable to a minority interest."

and any additional lack of marketability attributable to that lack of control that is not reflected in the \$150 million control, nonmarketable acquisition value."