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## Tax Valuation E-Flash

### Estate of Kelley v. Commissioner, T.C. Memo, 2005-235, October 11, 2005

The Tax Court allowed a 32% combined discount for lack of control and marketability for a decedent's 94.83% limited partnership interest in a family limited partnership owning only cash and certificates of deposit. The Court allowed the same discount for decedent's one third interest in the LLC that owned the 1% general partnership interest.

Decedent and his daughter and son-in-law formed KLLP in 1999. Each contributed cash or certificates of deposit in exchange for limited partner interests. KLBP, LLC, owned one-third by decedent and two-thirds by his daughter and son-in-law, held the 1% general partner interest in KLLP. Decedent died a few months after formation and there were no transfers of interests after the initial formation. The taxpayers claimed a 53.5% combined discount for lack of control and marketability while the IRS claimed a 25.2% combined discount.

#### Taxpayer Expert

The taxpayer appraiser gave an 80% weight to the net asset value and 20% to the income approach. He then applied a discount for lack of control based on general equity closed-end mutual funds. It was his opinion that KLLP was most similar to the closed-end funds with price to net asset value discounts of 21.8% to 25.5% in the 4th quartile. The appraiser then reviewed

The taxpayers claimed a 53.5% combined discount for lack of control and marketability while the IRS claimed a 25.2% combined discount.

the data from Partnership Profiles that showed the discount to net asset value for 18 publicly registered partnerships was 29% and the data for 100 publicly registered partnerships that had a 27% average discount. He concluded a 25% discount for lack of control was appropriate.

The expert based his discount for lack of marketability on restricted stock studies. The expert also discussed eight factors that provided barriers to marketability for limited partnership interests. Based on this analysis, the expert determined a 38% discount for lack of marketability was appropriate.

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## IRS Expert

The IRS expert relied solely on the net asset value. He used the arithmetic mean discount to net asset value for closed-end funds of 12% to determine his discount for lack of control. He believed using the mean removed the marketability element in the discounts or premiums.

For the discount for lack of marketability, the IRS expert relied on a study by Dr. Mukesh Bajaj

The Court also believed that the Partnership Profiles data overstates the discount because they contain some element of marketability.

and determined a 15% discount was appropriate considering the low risk of the partnership's investment portfolio.

## The Court

The Court relied solely on the net asset value, believing the income approach was not appropriate for a partnership holding only cash and certificates of deposit. For the discount for lack of control, the Tax Court believed that KLLP's lack of similarity to the closed-end mutual funds required the use of more than just the 4th quartile. The Court also believed that the Partnership Profiles data overstates the discount because they contain some element of marketability. The

The Court also rejected the IRS expert's conclusion, but did conclude that the Bajaj study was an appropriate tool for determining the discount for lack of control.

Court found neither expert particularly persuasive, but determined a 12% discount for lack of control was appropriate.

For the discount for lack of marketability, the Court believed that there are fundamental differences between operating companies used in the discount studies and an entity holding easily valued and liquid interests like cash and certificates of deposit. The Court was also troubled that the taxpayer expert did not analyze the data from the studies and rejected the taxpayer expert's conclusion.

The Court also rejected the IRS expert's conclusion, but did conclude that the Bajaj study was an appropriate tool for determining the discount for lack of marketability. The Court did not

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believe the expert properly applied the study. The Bajaj study divided the discount into three groups with the middle group having a discount of 20.36%. The Court relied on *McCord v. Commissioner*, 120 T.C. No. 13, which used this middle group, rounded to 20%. The Court further cited the analysis in *Lappo v. Commissioner*, T.C. Memo 2003-258, in which an additional 3% marketability discount was allowed because of characteristics specific to the partnership and added the same 3%, resulting in a total discount for lack of marketability of 23%.

The Court allowed the same discounts for the decedent's 33.33% interest in KLBP, the LLC that owned a one percent general partner interest in KLLP. The discounts were applied directly to the one percent general partner interest without allocation between the limited partnership and LLC ownership interests.