McCord to Holman

Five Years of Value Judgments

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I. Introduction.

McCord[1], Lappo[2], Peracchio[3], Green,[4] Thompson,[5] Kelley,[6] Temple,[7] Kohler,[8] Gimbel,[9] Jelke,[10] Astleford[11] and Holman[12] are recent valuation cases, principally addressing the valuation of interests in family limited partnerships, family limited liability companies or closely held corporations (except that Gimbel dealt with the valuation of restricted shares of a publicly-traded company). Most of these cases originated in the Tax Court, except for Temple which was U.S. District Court case. These decisions clearly illustrate that courts, while willing to consider the testimony of each party's valuation expert, are not bound to adopt the valuation of either party's expert; rather, courts ultimately base their conclusions on their own analysis of the evidence. The following discussion summarizes the valuation issues in each case. Specifically, the analysis focuses on the valuation methodologies used by the various experts, the experts' applications of those methodologies, the conclusions drawn by the experts and finally, the court's response to, and criticism of, the experts' analyses. We discuss primarily discount issues, particularly the discounts for lack of control and lack of marketability. The McCord and Jelke cases, however, are also significant for their treatment of other issues with important implications in the valuation area, such as the effect to be given to "defined value" provisions and how to account for built-in capital gain tax, and those issues are also discussed here to some degree, particularly from the standpoint of the appellate decisions that reversed or vacated the Tax Court's determinations.

II. McCord.

A. Facts.[13]

The relevant facts are as follows. Charles and Mary McCord, their four sons and an existing partnership formed McCord Interests, Ltd., L.L.P. in 1995 ("MIL"). The four sons were the general partners of MIL. Each son owned a 0.268% general partner interest. The separate, preexisting partnership, owned equally by the four sons, owned a 16.594% limited partner interest in MIL. Charles and Mary owned the remaining limited partner interests. On January 12, 1996, Charles and Mary entered into an assignment agreement covering their entire limited

[1] McCord v. Commissioner, 120 T.C. 358 (2003), reversed and remanded, 461 F.3d 614 (5th Cir. 2006).
[2] Lappo v. Commissioner, 86 T.C.M. 333 (2003).
[3] Peracchio v. Commissioner, 86 T.C.M. 412 (2003).
[4] Estate of Green v. Commissioner, 86 T.C.M. 758 (2003).
[5] Estate of Thompson v. Commissioner, 88 T.C.M. 48 (2004), vacated and remanded, 499 F. 3d 129 (2d Cir. 2007), cert. denied, 128 S. Ct. 2932 (2008).
[6] Estate of Kelley v. Commissioner, 90 T.C.M. 369 (2005).
[7] Temple v. United States, 423 F. Supp. 2d 605 (E.D. Tex. 2006)
[8] Kohler v. Commissioner, 92 T.C.M. 48 (2006).
[9] Estate of Gimbel v. Commissioner, 92 T.C.M. 504 (2006).
[10] Estate of Jelke v. Commissioner, 89 T.C.M. 1397 (2005), vacated and remanded, 507 F. 3d 1317 (11th Cir. 2007), petition for cert. filed June 19, 2008.
[11] Astleford v. Commissioner, 95 T.C.M. 1497 (2008).
[12] Holman v. Commissioner, 130 T.C. No. 12 (2008).
[13] Judge Halpern wrote the opinion in McCord.

partner interests with their sons and two charities. As of the valuation date, MIL's net asset value ("NAV") was $17,673,760. The various asset classes of MIL were as follows:

- Asset Type: Equities portfolio Value: $3,641,956 % of Total: 20.6
- Asset Type: Bond portfolio Value: $8,040,220 % of Total: 45.5
- Asset Type: Real estate partnership Value: $ 5,194,933 % of Total: 29.4
- Asset Type: Real estate Value: $581,553 % of Total: 3.3
- Asset Type: Oil and gas interest Value: $215,098 % of Total: 1.2

Total: $17,673,760 100.0

There were several issues in the case, including what effect, if any, should be given for gift tax purposes to a post-gift "confirmation agreement" among the donees (discussed further below in conjunction with the Fifth Circuit's reversal of the Tax Court), but the focus of our discussion here is on the discounts applicable in determining the federal gift tax values of the January 12, 1996 gifts.

B. Valuation Issues in the Case.

1. Taxpayer's Expert.

The taxpayers offered William H. Frazier ("Mr. Frazier") as an expert witness to testify concerning the valuation of the limited partner interests that were the subject of the gifts.[14] Mr. Frazier concluded that a 22% lack of control discount was appropriate, a 35% lack of marketability discount was appropriate, and based on such discounts the fair market value of a 1% limited partner interest in MIL (on the valuation date) was $89,505.

2. Service's Expert.

The Service offered Mukesh Bajaj, Ph. D. ("Dr. Bajaj") as an expert witness.[15] Dr. Bajaj concluded that an 8.34% lack of control discount was appropriate, a 7% lack of marketability discount was appropriate, and based on such discounts that the fair market value of a 1% limited partner interest in MIL (on the valuation date) was $150,665,64.

3. Methodologies.

The experts agreed that in the case of an investment company, the lack of control discount should equal the weighted average of the lack of control discounts for each asset class (or each type of investment) held by MIL. The use of closed-end investment company data as support for quantifying minority interest discounts (for investment holding entities funded

[14] At the time of trial, Mr. Frazier was a principal of Howard Frazier Barker Elliott, Inc., a Houston based valuation consulting firm. Judge Halpern noted that Mr. Frazier was a senior member of the American Society of Appraisers and had been involved in valuation and general investment banking activities since 1975.

[15] At the time of trial, Dr. Bajaj was the managing director of the finance and damages practice of LECG, LLC. Judge Halpern noted that Dr. Bajaj had experience as a university professor of finance and business economics, had lectured extensively on valuation issues, and had testified as an expert in several valuation cases.

chiefly with marketable securities) is widely accepted and both experts analyzed data on publicly traded closed-end funds.[16]

With respect to MIL's equity portfolio, both experts determined the lack of control discount based on publicly traded closed-end equity investment funds. Both experts derived a range of discounts by determining for their sample of funds the discount at which a share of each fund trades relative to its pro rata share of the NAV of such fund. With respect to MIL's bond portfolio, both experts determined the lack of control discount by reference to publicly traded, closed-end municipal bond investment funds. With respect to MIL's real estate partnership holdings, the experts disagreed on the general type of publicly traded entity from which to base their discount. Dr. Bajaj used a diversified group of real estate investment trusts ("REITS").[17] The taxpayer's expert argued that the use of REITS was inappropriate because REITS are required by law to pay out annually a large portion of their earnings to shareholders and are therefore priced on a current yield basis. The taxpayer's expert instead used publicly traded real estate companies for his sample group. The taxpayer's expert was able to come up with 5 comparable companies. He derived his range of discounts from 3 of those companies. Dr. Bajaj's sample consisted of 62 companies. With respect to MIL's direct real estate holdings, the IRS accepted the taxpayer's 40% lack of control discount. The IRS likewise accepted the taxpayer's 33.5% lack of control discount with respect to MIL's oil and gas holdings. Within each of the other asset classes, the taxpayer's expert selected discounts at the upper end of the range, and the Service's expert selected discounts at the lower end of the range.

Both experts agreed that a lack of marketability discount was appropriate. Mr. Frazier utilized four restricted stock studies and pre-IPO studies.[18] Dr. Bajaj used his own private placement study, the Wruck study, and the Hertzel and Smith study. Dr. Bajaj argued that private placement studies used to quantify discounts for lack of marketability should include both registered and unregistered private placements.

C. Tax Court's Conclusions.

The Tax Court rejected both experts' proposed discounts with respect to the equity, bond and real estate asset classes. As is typical in valuation cases, the points of contentions were (1) the appropriate measurement date, (2) the appropriate sample funds, and (3) the appropriate representative discount within the range of the sample fund discounts. With respect to the experts' analyses of MIL's equity portfolio, the Tax Court sided with the Service's expert as to the appropriate measurement date based on the fact that the Service's expert selected data closer to the valuation date.[19] As for sample funds, the Tax Court again sided with the Service's expert

[16] Publicly traded closed-end funds typically trade at price discounts from their NAVs.

[17] A real estate investment trust ("REIT") is a tax-favored vehicle through which numerous investors can invest in real estate by pooling their resources.

[18] Including the SEC study, the Silber study, the Standard Research Consultants study, and the Hertzel and Smith study. The pre-IPO approach refers to studies which compare (i) the private market price of shares sold before a company goes public with (ii) the public market price obtained in the company's initial public offering.

[19] The taxpayer's expert calculated the discounts for his sample of closed-end funds using 1/11/96 trading prices and 1/12/96 (the valuation date) NAVs. The Service's expert used data from 1/12/96.

based on the larger size of his sample.[20] As previously noted, the taxpayer's expert argued for a discount at the higher end of his range, and the Service's expert argued for a discount at the lower end of his range.[21] In determining the appropriate discount, the Tax Court did not side with either expert. The Tax Court used the Service's expert's measurement dates and sample funds (with one addition) and took the average of those funds' discounts. In the end, the Tax Court concluded a 10% lack of control discount was appropriate for the equities portfolio.

The Tax Court found both experts' analyses flawed with respect to MIL's bond portfolio. The taxpayer's expert derived his sample of closed-end municipal bond funds from Morningstar's Mutual Funds Guide. He then excluded funds with scheduled liquidation dates. The taxpayer's expert also excluded single-state funds notwithstanding the fact that MIL's bond portfolio consisted of 75% Louisiana bonds. The Tax Court agreed that funds with scheduled liquidation dates should be excluded but disagreed with the taxpayer's expert's exclusion of single-state funds. Based on the actual holdings of the partnership, the Tax Court reasoned that an appropriate sample group should consist entirely of single-state funds. The Service's expert derived his sample funds from a list of 140 funds set forth in the 1/15/96 edition of the Wall Street Journal. He excluded 6 funds, leaving a sample of 134 funds (including funds that had scheduled liquidation dates). The Tax Court created its own sample consisting of 62 single-state funds pulled from the Service's expert's sample (excluding those funds that had scheduled liquidation dates). Again, the Tax Court was unpersuaded by the arguments of both experts and concluded the appropriate lack of control discount was 10%.[22]

With respect to the experts' analyses of MIL's real estate partnership holdings, the Tax Court rejected the taxpayer's expert's argument regarding the use of REITS (noted previously) because the funds the taxpayer's expert used in his own equity and bond samples were likewise required to distribute substantially all of their earnings as regulated investment companies ("RIC's"). In addition, the taxpayer's expert relied on 3 real estate investment companies which the Tax Court considered insufficient. The Tax Court did agree with the Service's expert that the difference between the trading price of a REIT and its NAV is attributable to (i) a positive amount for the liquidity premium (a secondary market exists for REITS), and (ii) a negative amount reflecting a lack of control discount. However, the Tax Court did make adjustments to the numbers used by the Service's expert and concluded a 23.3% lack of control discount was appropriate.

[20] The taxpayer's expert derived his sample from a list of domestic equity funds from Morningstar's Mutual Fund Guide. He then screened those funds, ending up with 14 funds. The Service's expert derived his sample funds from the list of general equity funds set forth in the 1/12/96 edition of the Wall Street Journal. He excluded two, which left him with a sample of 20 funds. The court ultimately added one fund to the Service's expert's sample to create its own sample.

[21] The taxpayer's expert argued that MIL's equity portfolio would not compare favorably to an interest in an institutional fund. the Service's expert argued that MIL was similar to a new investment, which traditionally trade at lower discounts than seasoned funds.

[22] The Tax Court rejected the Service's expert's "new investment" argument because MIL's bond portfolio had been in place (in the hands of the contributing partners) for years. The Tax Court criticized the taxpayer's expert for failing to provide data which showed a correlation between the variables he used (in determining a higher than median discount within his range) and the sample fund discounts.

The Tax Court accepted (as did the Service) the taxpayer's expert's 40% lack of control discount with respect to MIL's direct real estate holdings and also accepted the taxpayer's expert's 33.5% lack of control discount with respect to MIL's oil and gas holdings.

As for the lack of marketability discount, the Tax Court rejected as unreliable those portions of the taxpayer's expert's analysis based on the pre-IPO approach. The Tax Court agreed with the Service's expert that private placement studies used to quantify discounts for lack of marketability should include both registered and unregistered private placements, but the Tax Court saw no reason to choose a lack of marketability discount from the "low" category within the Service's expert's study. Instead, the Tax Court chose a discount from the "middle" group of private placements in the Service's expert's sample. The average discount of such group was 20.36%. The Tax Court concluded that a 20% lack of marketability discount was appropriate.[23]

McCord illustrates the Tax Court's willingness to pick and choose portions of each side's experts' opinions.

D. Fifth Circuit Decision on Appeal.

The taxpayers appealed the Tax Court's decision to the Fifth Circuit. The Court of Appeals held that the approach used by the Tax Court majority in determining the taxable and nontaxable values of the various gifts (relying in part on a post-gift "confirmation agreement" among the charitable and noncharitable donees) constituted legal error, and therefore that the results of the Tax Court's valuation of the transferred interests in MIL were irrelevant to the amount of gift taxes owed by the taxpayers. The assignment agreement had expressed the noncharitable gifts and one of the charitable gifts as dollar amounts, i.e., interests in MIL having specified dollar values, not percentage interests in MIL. In other words, the assignment agreement took what practitioners often refer to as a defined value approach. The confirmation agreement, which was entered into two months after the gifts were made and to which the donees but not the taxpayers were parties, translated the transferred interests into percentage interests in MIL so as to determine the relative interests of the donees among themselves. According to the Fifth Circuit, the Tax Court was mistaken in using the after-the fact confirmation agreement to transform the dollar value gifts stated in the assignment agreement into gifts of percentage interests in MIL. The appeals court also held that the Tax Court erred in not allowing a reduction in the taxable gifts for the actuarially determined present value of the noncharitable donees' assumption of liability for estate taxes that would come due under I.R.C. §2035(b) if the taxpayers failed to survive the gifts by three years. Although McCord was an unusual case because of the defined value gift involved and the noncharitable donees' assumption of the donors' potential I.R.C. §2053(b) estate tax liability, and the Tax Court's valuation analysis ended up not being pertinent to the taxpayers' gift tax liability, the case is included in this article because the Tax Court's analysis of the lack of control and lack of marketability discounts is illustrative of its approach in this area.

[23] Specifically, this number was derived from the average of the middle 29 discounts from a total of 88 private placements taken, as previously noted, from Dr. Bajaj's own study.

III. Lappo.

A. Facts.[24]

Lappo was a gift tax case. The relevant facts are as follows: In 1995, Clarissa Lappo ("Lappo") and Clarajane Middlecamp ("Middlecamp") formed the Lappo Family Limited Partnership (the "Lappo Partnership") which consisted of marketable securities (primarily municipal bonds) and real estate. Lappo owned a 1% general partner interest and a 98.7% limited partner interest. Middlecamp owned a 0.2% general partner interest and a 0.1% limited partner interest. On April 19, 1996, Lappo made a gift of a 66.8% limited partner interest to Middlecamp as trustee of a trust and a 0.668% limited partner interest to each of her four grandchildren. In July, Lappo gave her remaining limited partner interest to Middlecamp. The asset classes of the Lappo Partnership at the time of the gifts were as follows:

- Asset Type: Marketable Securities — Value on 4/19/96: $1,296,882; Value on 7/02/96: $1,379,531
- Asset Type: Real Estate — Value: $1,860,000

B. Valuation Issues in the Case.

1. Taxpayer's Expert.

The taxpayer offered Robert P. Oliver ("Mr. Oliver") as an expert witness.[25] Mr. Oliver concluded that a 7.5% lack of control discount was appropriate with respect to the marketable securities. He concluded that a 35% lack of control discount was appropriate with respect to the real estate component for the 4/19/96 gift. He concluded that a 30% lack of control discount was appropriate with respect to the real estate component for the 7/02/96 gift. Mr. Oliver concluded that a 35% lack of marketability discount was appropriate for each gift.

2. Service's Expert.

The Service offered Dr. Alan C. Shapiro ("Dr. Shapiro") as an expert witness.[26] Dr. Shapiro concluded that an 8.5% lack of control discount was appropriate and an 8.35% lack of marketability discount was appropriate.

3. Methodologies.

The lack of control discount was again determined by using a weighted average of the individual discount factors for each category of asset owned by the partnership. Both experts

[24] Judge Thornton wrote the opinion in Lappo.

[25] Mr. Oliver was an accredited appraiser and had been with Management Planning, Inc. ("MPI") since 1975 and had served as its president since 1996. The Tax Court noted that MPI had been in the business of preparing financial analyses of closely held businesses and in evaluating securities of such businesses since 1939. The court also noted that Mr. Oliver was an author and speaker on valuation and related topics.

[26] At the time of trial, Dr. Shapiro was the Ivadelle and Theodore Johnson Professor of Banking and Finance at the University of Southern California. He was also an outside director of LECG, LLC, an economic and financial consulting company. He had taught at a number of prestigious universities and was the author of numerous academic articles and books on corporate finance.

applied the closed-end fund analysis in determining the lack of control discount with respect to the marketable securities component. With respect to the real estate component of the partnership, both experts agreed that REITS were the appropriate starting point. As is typical, they disagreed on which REITS should be used for comparison and on the appropriate analysis of the REITS data. Mr. Oliver started with 400 REITS and real estate companies listed in Moody's Bank and Finance Manual. He then eliminated all but 7 (leaving 3 REITS and 4 companies). Dr. Shapiro started with 62 companies provided by Green Street Advisors, Inc.[27] Dr. Shapiro then eliminated 10 companies because they were not REITS.

To determine the NAV of his 7 guideline companies, Mr. Oliver started with book value and made certain upward adjustments to reflect "appraised values disclosed by management." Mr. Oliver then compared NAV to share price and determined the median share-to-NAV discounts for his guideline companies. Mr. Oliver then reasoned that the partnership's real estate portfolio would likely trade at a deeper discount than the guideline median price-to-NAV discount because it was inferior in certain respects to the REITS used in his sample group (e.g., smaller size of partnership's holdings, concentration in a few parcels, dependence on one tenant, untested entity, and unlike the REITS had no performance track record).

Dr. Shapiro compared the market prices of his Green Street REITS to their NAVs and found the median price-to-NAV premium. He then looked below the median (to the 15th percentile) because the partnership unlike the REITS was not required to pay large and regular distributions to its interest holders. Dr. Shapiro adjusted these percentages to remove a liquidity premium.[28]

To determine the lack of marketability discount, both experts used private placement studies as their starting point. The experts disagreed on the appropriate private placements to consider and what is measured by such comparisons. Mr. Oliver used a "restricted stock approach." Specifically, Mr. Oliver used a preexisting MPI study that analyzed 197 private transactions in common stocks of actively traded corporations from 1980 through 1995. Mr. Oliver then determined a guideline group of 39 transactions in unregistered (i.e., restricted) stock from which he determined the median discount. Dr. Shapiro used a "private placement" approach. Dr. Shapiro relied on Dr. Bajaj's private placement study (used by Dr. Bajaj in McCord). As noted previously, the Baja study analyzes discounts observed in private placements of registered shares as well as private placements of unregistered shares. This is a means of isolating that portion of the discount attributable solely to a lack of marketability.

C. Judge Thornton's Conclusions.

Judge Thornton reasoned that "fairness" dictated the use of Dr. Sharpiro's 8.5% lack of control discount rate (as opposed to Mr. Oliver's 7.5% discount rate) for the marketable securities component of the partnership since the parties had agreed to use the IRS's higher NAV

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[27] Green Street Advisors, Inc. is an independent research and consulting firm concentrating on REITS and other publicly traded real estate companies which make up 80% of the market capitalization of the overall market of about 200 REITS.

[28] The liquidity premium exists because the REIT interests, unlike their underlying assets, are publicly traded in reasonably liquid markets.

for such component. The opinion did not further explore the experts' approaches with respect to this component. With respect to the real estate component of the partnership, Judge Thornton determined his own discount by reference to comparable publicly traded REITS coupled with the guidance of several academic studies on private placement discounts. Judge Thornton concluded that a 19% lack of control discount was appropriate for this component. Applying the weighted averages of the two lack of control discount factors, Judge Thornton held that an overall lack of control discount of 15% was appropriate.

In determining the appropriate lack of marketability discount, Judge Thornton relied on the raw data of the private placement analyses prepared by Dr. Bajaj and Hertzel & Smith (as did the Tax Court in McCord). The median discount of such studies was 21%. Judge Thornton adjusted this number upward by 3% resulting in a marketability discount of 24%. Judge Thornton stated that he was hesitant to rely solely on a study which the expert had not participated in preparing and was therefore unable to elaborate on first hand. Applying his own lack of control discount and lack of marketability discount sequentially, Judge Thornton held that a combined discount of approximately 35.4% was appropriate.

Judge Thornton spent considerable time comparing the characteristics of the guideline companies used by the experts to the actual characteristics of the partnership being valued. The opinion clearly illustrates the Tax Court's willingness to pick and choose those portions of the experts' reports which it likes and discard those portions which it dislikes. As in McCord, one sees a retooling of the experts' analyses. This is especially evident when the Judge Thornton "creates" his own ideal sample, picking and choosing among experts' guideline companies those which he considers the most comparable to the subject asset class of the partnership.

IV. Peracchio.

A. Facts.[29]

This was a gift tax case. The relevant facts are as follows: In November of 1997 (the valuation date), John R. Peracchio created the Peracchio Family Trust (the "Trust"). On the same day, Mr. Peracchio, the Trust, and Mr. Peracchio's son created a limited partnership known as Peracchio Investors, L.P. Mr. Peracchio contributed cash and securities worth $2,013,765 in exchange for a 0.5% general partner interest and a 99.4% limited partner interest (collectively representing 2,013.765 partnership units). Mr. Peracchio's son contributed $1,000 in cash to the partnership in exchange for a .05% general partner interest. The Trust also contributed $1,000 in cash in exchange for a .05% limited partner interest. On the valuation date, Mr. Peracchio made three transfers. He gave 9.0788 partnership units to his son (to be held in his capacity as a general partner). He gave 916.667 partnership units to the Trust (to be held in its capacity as a limited partner). He sold 1,077.9409 partnership units to the Trust in exchange for the Trust's promissory note in the amount of $646,764. The partnership's assets consisted of cash and marketable securities.[30] At issue in the case were the fair market values of (i) the interest gifted to the Trust, and (ii) the interest sold to the Trust. On the valuation date, the NAV of the

[29] Judge Halpern wrote the opinion in Peracchio.
[30] Judge Halpern noted that the partnership's equity portfolio consisted of 44 companies, with no apparent concentration in any particular industry.

partnership was $2,010,370. The partnership's securities were held indirectly through investment funds, including open-end investment funds.[31] Mr. Peracchio reported the amount of the gift after applying a combined 40% discount (for lack of control and lack of marketability).

B. Valuation Issues in the Case.

1. Taxpayer's Expert.

The taxpayer offered Timothy R. Dankoff ("Mr. Dankoff") and Charles H. Stryker ("Mr. Stryker") as expert witnesses.[32] Mr. Dankoff concluded that a 7.7% lack of control discount was appropriate and a 35% lack of marketability discount was appropriate. Mr. Stryker concluded that a 5% lack of control discount was appropriate and a 40% marketability discount was appropriate.

2. Service's Expert.

The IRS offered Francis X. Burns ("Mr. Burns") as an expert witness.[33] Mr. Burns concluded that a 4.4% lack of control discount and a 15% lack of marketability discount were appropriate.

3. Methodologies.

Mr. Dankoff's first mistake (in the eyes of Judge Halpern) was he determined the NAV of the partnership based on brokerage account statements issued 5 days after the valuation date. Both experts determined a minority interest discount factor for each type of investment held by the partnership, based on discounts observed in shares of closed-end funds holding similar assets. They then determined their respective minority interest discounts by calculating the weighted average of such factors, based on the partnership's relative holdings of each asset type (both Mr. Dankoff and Mr. Burns divided the assets of the partnership into 5 basic categories with Judge Halpern further dividing the "municipal bonds" category for a total of 6 asset classes). Both experts used data from tables prepared by Lipper Analytical Services and published in Barron's. However, Mr. Burns used more contemporary data.

Interestingly, Mr. Dankoff calculated the mean discount and the median discount with respect to each of his fund samples. The median discount was always greater than the mean discount. Mr. Dankoff used the median rather than the mean for each sample (for purposes of

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[31] Shares of open-end funds are not themselves publicly traded, however a shareholder can typically liquidate his or her investment at any time simply by tendering his or her shares to the fund for repurchase at a price equal to their pro rate share of the fund's NAV.

[32] At the time of trial, Mr. Dankoff was a partner at Plante & Morgan, LLP, an accounting and management consulting firm. He was an accredited senior appraiser by the American Society of Appraisers and had been involved in business valuation activities since 1986. At the time of trial, Mr. Stryker was a partner in the valuation and appraisal group of BDO Seidman, LLP, an accounting and consulting firm. He had been performing valuation services for approximately 25 years.

[33] Mr. Burns was managing director of InteCap, Inc., a financial consulting firm that specializes in valuation services. He had been performing valuation services for approximately 15 years and had testified as an expert in several valuation cases.

determining the lack of control discount factor for each corresponding asset category of the partnership), but he conceded at trial that he did not have a valid reason for doing so. The opinion does not address further the individual discounts asserted by the experts for each asset class. This might be because Judge Halpern (applying the general methodology used by the experts) went on to calculate his own lack of control discounts for each asset category.

With respect to the lack of marketability discounts, Mr. Dankoff started with a benchmark discount or range of discounts and then, based on factors Judge Laro analyzed in Mandelbaum v. Commissioner,[34] determined whether the marketability discount for the subject interest should be greater than, less than, or equal to the benchmark range.[35] Mr. Stryker asserted that he used the "restricted stock" approach. However, as Judge Halpern noted, he failed to analyze the data from the studies as they might have related to the transferred interests. Mr. Burns briefly analyzed 6 factors to come up with a discount range of 5-25%.

C. Judge Halpern's Conclusions.

Judge Halpern began with the now standard observation that the Tax Court may be selective in determining what portions of each expert's opinion, if any, to accept and ends with a statement to the effect that as long as the figure arrived at is within the range of values that may be properly derived from consideration of all the evidence such figure need not be directly traceable to specific testimony. Judge Halpern agreed that the use of publicly traded, closed-end mutual funds was an appropriate method by which to determine the lack of control discount. Judge Halpern summarily dismissed Mr. Stryker's opinion because his methodology was both "imprecise and incomplete."[36] Judge Halpern used Mr. Burn's price/NAV data because it was more contemporaneous. Judge Halpern then began the process of scrutinizing each sample of funds used by the experts for each asset category. In the end, Judge Halpern created his own fund samples. Judge Halpern then determined the mean lack of control discount factor for each asset category. Based on those discount factors, Judge Halpern determined the weighted average and held that a 6.02% lack of control discount was appropriate.

As for the lack of marketability discount, Judge Halpern concluded that a 25% discount was warranted. With respect to the lack of marketability discount, Judge Halpern was dissatisfied with both experts' analyses. Judge Halpern noted that Mr. Burns stated in his written report that a lack of marketability discount above 25% would not be justified for an entity with

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[34] 69 T.C.M. 2852 (1995), aff'd, 91 F.3d 124 (3d Cir. 1996).

[35] The factors contained in Mandelbaum include: (1) the value of the subject corporation's privately traded securities vis-a-vis its publicly traded securities; (2) the corporation's financial statements; (3) the corporation's dividend paying capacity, its history of paying dividends, and the amount of its prior dividends; (4) the nature of the corporation, its history, its position in the industry , and its economic outlook; (5) the corporation's management; (6) the degree of control transferred with the block of stock to be valued; (7) any restriction of the transferability of the corporation's stock; (8) the length of time an investor must hold the subject stock to realize a sufficient profit; (9) the corporation's redemption policy; and (10) the cost of effecting a public offering of the stock to be valued, e.g., legal, accounting and underwriting fees. With respect to Mr. Dankoff's reliance on Mandelbaum, Judge Halpern rather harshly stated that Mr. Dankoff was mistaken to the extent he believed the range of discounts utilized in that case was in any way controlling.

[36] Judge Halpern noted the following two points: (i) Mr. Stryker did not statistically derive his discount from observed discounts, and (ii) he considered only domestic equity funds.

the characteristics of the partnership. Judge Halpern treated this statement as a concession that a marketability discount up to 25 % would be appropriate. However, because the taxpayer failed to meet his burden of proof of persuading Judge Halpern that a figure in excess of 25% would be appropriate, Judge Halpern utilized the 25% marketability discount.

The novel aspect of the opinion in Peracchio is the Tax Court's willingness to treat the upper end of an expert's suggested range of discounts as essentially a concession on the part of the expert that a discount up to that percentage would be appropriate. The Tax Court appears especially willing to take this approach when the expert has failed to provide qualitative support for a conclusion regarding the appropriate discount within a specified range.

V. Green.

A. Facts.[37]

Green was an estate tax case. The relevant facts are as follows: Mildred Green died on September 26, 1997 (the "Decedent"). At the time of her death, the Decedent owned 3,276 (the "Shares") of the 64,372 shares of issued and outstanding common stock of Royal Bancshares, Inc. ("RBI"). The Decedent's Shares represented 5.09% of the outstanding shares of RBI (the fifth largest holding of RBI shares by any one shareholder). On September 26, 1997 there were a total of 62 RBI shareholders. RBI's shares had never been listed on any securities exchange. At the time, RBI had total assets of $172,613,000 and between 1993and 1997, RBI declared cash dividends ranging from $1.68 to $4.06 per share. Royal Banks of Missouri was a wholly owned subsidiary of RBI. In 1996, Royal Banks loaned $1.6 million to the Havrillas. A printing company guaranteed the loan by a deed of trust granting Royal Banks a security interest in certain real property it owned. The Havrillas' note was current through July of 1997. However, no payments were made on the note in either August or September and on the Decedent's date of death the note was in default. In August of 1997, the printing company declared bankruptcy and in September of 1997 Royal Banks filed a notice of appearance in the bankruptcy case.

The estate's tax return was filed on November 9, 1998. The Decedent's estate reported the value of the Shares as $163,800 (or $50 per share). On August 30, 1999, the Service determined a $1,205,541 deficiency and issued a notice of deficiency. The Service determined the Shares had a fair market value of $1,048,320 (or $320 per share) as opposed to $163,800 as reported on the estate's return. At the time of trial the gap had closed somewhat with the Service contending the Shares had a fair market value of $860,000 (or $262.52 per share) and the estate contending the Shares had a fair market value of $655,200 (or $200 per share).

B. Valuation Issues in the Case.

1. Estate's Expert.

[37] Judge Thornton wrote the opinion in Green.

The estate offered Gary L. Schroeder ("Mr. Schroeder") as an expert witness.[38] Mr. Schroeder concluded that a 17% lack of control discount was appropriate and a 40% lack of marketability discount was appropriate.

2. Service's Expert.

The Service offered William C. Herber ("Mr. Herber") as an expert witness.[39] Mr. Herber concluded that a 15% lack of control discount was appropriate and a 25% lack of marketability discount was appropriate.

3. Methodologies.

To determine the aggregate value of RBI (before applying any discounts) both experts used an income and a market approach. Under the income approach the experts arrived at nearly identical values. Mr. Schroeder determined an aggregate undiscounted value of $23,370,000 and Mr. Herber determined an aggregate undiscounted value of $23,300,000. Under the market approach, both experts performed a guideline analysis of publicly held banks and a transaction analysis of privately held banks. Under this approach, Mr. Schroeder determined an aggregate undiscounted value of $28,330,000 and Mr. Herber determined an aggregate undiscounted value of $28,000,000.

With respect to the transaction analysis, both experts identified a number of transactions involving the acquisition of privately held banks which the experts determined were similar to RBI's banking company. Mr. Schroeder identified five banks located in either Illinois or Missouri that were acquired within the 9-month period prior to the Decedent's death. Mr. Schroeder then determined a range of multiples based on the price-to-earnings, price-to-equity and price-to-assets ratios of the acquired banks. Mr. Schroeder selected multiples between the median and the low end of the range taking into consideration (1) the fact that Royal Banks was located in a more urban area than the acquired banks, and (2) "the potential of a significant pending loan impairment." Based on these factors, Mr. Schroeder determined an aggregate controlling interest value of $25,920,000 for RBI's stock.

Mr. Herber's transaction analysis focused on privately held commercial banks with assets between $20 and $200 million whose sales were announced and completed between January 1996 and September 26, 1997. Mr. Herber identified nine banks he determined were comparable. Mr. Herber then determined the average and median price-to-earnings, price-to-equity and price-to-assets ratios of the acquired banks. He compared these ratios to RBI's ratios. As Judge Thornton noted, Mr. Herber did <u>not</u> take into consideration the effects of any potential loan impairment. Mr. Herber determined an aggregate controlling interest value of $28,500,000 for RBI's stock.

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[38] Mr. Schroeder was accredited by the American Society of Appraisers as a senior appraiser in the valuation of businesses and intangible assets and had been active in the appraisal and consulting profession since 1981.

[39] Mr. Herber was an associate member of the American Society of Appraisers and a member of the Institute of Business Appraisers, Inc. He specialized in the valuation of real estate, business enterprises and intangible property rights. He had been active in the valuation business since 1985.

The experts agreed that lack of control and lack of marketability discounts were appropriate in the valuation of the Decedent's Shares. Both experts determined the lack of control discount by calculating the inverse of what they considered to be the appropriate control premium. Mr. Schroeder relied on data contained in Mergerstat Review 1998 regarding offers to acquire a majority interest in (or total ownership of) public companies. Mr. Schroeder calculated a control premium of 20% based on the "size, financial performance and geographic location of Royal Banks" and an implied lack of control discount of 17%. Mr. Herber relied on a study of minority interest discounts by Christopher Mercer in Quantifying Marketability Discounts. The Mercer study indicated a median and an average lack of control discount of 19%. Mr. Herber also conducted his own study of control premiums based on transactions involving banking companies. Based on his study, he determined a range of median and average lack of control discounts from 18.4% to 19.6%. Mr. Herber also considered the following additional factors: (1) the Decedent's 5.09% interest in RBI was a "substantially larger interest than typical minority interests in publicly traded shares in banks," (2) because the banking industry was highly regulated, banking companies were "transparent,"[40] and (3) RBI was well capitalized, had high returns on equity and assets, maintained a high rating in comparison to other banking companies and had offered a "favorable dividend" over the past five years. Taking into consideration these additional factors, Mr. Herber determined a lack of control discount of 15%.

To determine the appropriate lack of marketability discount, Mr. Schroeder relied on restricted stock studies and pre-IPO studies. The restricted stock studies indicated discounts in the range of 31.2 to 45% and an overall average discount of 34.9%. The pre-IPO studies indicated discounts in the range of 43% to 45.7% and an overall average discount of 44.4%. Mr. Schroeder considered the following additional factors: (1) the potential loan impairment and (2) the pending bankruptcy of the printing company. Mr. Schroeder also considered seven prior transactions involving shares of RBI. As Judge Thornton noted, however, six of the seven transactions occurred more than 3 years before the Decedent's death and the remaining transaction occurred post death (in January of 1998). Mr. Schroeder did not provide Judge Thornton with any specifics regarding these transactions.

Mr. Herber relied on restricted stock studies which indicated median discounts ranging from 24% to 45%. Judge Thornton noted that Mr. Herber placed "considerable reliance" on a MPI study, which indicated an overall discount range of 26.2% to 32.7% with a central tendency of 30.5%. Mr. Herber also considered (1) RBI's relatively smaller gross income and earnings and (2) the fact that the companies in the study tended not to pay dividends. Mr. Herber also considered certain factors identified in Mandelbaum for determining whether an appropriate lack of marketability discount should be higher than, the same as, or lower than the indicated range of discounts. Mr. Herber concluded that the appropriate lack of marketability discount in terms of the Decedent's Shares "would have a strong central tendency relative to the overall studies." Taking into account RBI's risk as a bank, however, Mr. Herber recommended a 25% discount which he characterized as being at the "slightly lower end" of the indicated range of median discounts.

C. Judge Thornton's Conclusions.

[40] Mr. Herber contended that shareholders of a banking company had access to a great deal of information regarding the company's performance.

With respect to the income approach, Judge Thornton quoted the following portion of the Service's brief: "The experts offered by the parties are in agreement as to the value of the Royal Bancshares derived from the discounted net income method." In light of this concession and in fairness to the estate, Judge Thornton accepted Mr. Herber's estimated value of $23,300,000. With respect to the experts' guideline analysis, Judge Thornton again quoted the Service which stated in its brief, "[t]he experts offered by the parties are in agreement on the value of Royal Bancshares suggested by publicly-traded guideline banks." Similarly, in light of this concession and in fairness to the estate, Judge Thornton accepted Mr. Herber's estimated value of $28,000,000.

With respect to the experts' transaction analysis, Judge Thornton was unpersuaded by Mr. Schroeder's analysis with respect to the impact of the loan impairment because Mr. Schroeder failed to articulate whether, or to what extent, it depressed his appraisal. Accordingly, Judge Thornton concluded that Mr. Herber's failure to consider the potential loan impairment did not "materially undermine" his valuation recommendations. Judge Thornton then determined in summary fashion that the transaction analysis indicated a value of $27,500,000. Giving equal weight to these three values, Judge Thornton determined the appropriate aggregate undiscounted value of the RBI's stock was $26,266,667.

With respect to the appropriate lack of control discount, Judge Thornton stated that neither expert adequately supported his recommended discount. Mr. Herber started with an initial range of 18.4% to 19.6%. However, Judge Thornton felt that Mr. Herber failed to support the downward adjustments he made to arrive at a discount below this initial range (i.e., 15%). In response to Mr. Herber's claim that a lower discount was appropriate taking into consideration the fact that the Decedent's 5.09% interest was a "substantially larger interest than typical minority interests," Judge Thornton stated Mr. Herber failed to offer any "independent evidence or empirical data" to verify this conclusion and therefore was unpersuaded that he "appropriately relied on this factor in his discount analysis." With respect to Mr. Herber's "transparency" factor, Judge Thornton noted that the initial 18.4% to 19.6% range (indicated by Mr. Herber's own study) involved banking companies and presumably already factored in issues relating to the regulation of banking companies. Finally, with respect to the remaining factors Mr. Herber considered (i.e., RBI's capitalization, high returns, high ratings and its "favorable dividend" history), Mr. Thornton felt Mr. Herber again failed to provide "independent evidence" or verification regarding the comparisons between RBI and other banking companies and also failed to quantify the effects of those factors. In the end, Judge Thornton was unpersuaded that those factors supported a lower lack of control discount. Because Mr. Schroeder's recommended discount fell below the initial range indicated by Mr. Herber's study, Judge Halpern accepted Mr. Schroeder's recommendation of a 17% lack of control discount.

With respect to Mr. Schroeder's lack of marketability analysis, Judge Thornton believed Mr. Schroeder demonstrated an "incomplete knowledge" of the potential loan impairment and the pending bankruptcy, failed to verify the seven transactions involving RBI stock or quantify the affects of such information. Moreover, Judge Thornton pointed out that while the existence of prior transactions is a factor which usually decreases the lack of marketability discount, these particular transactions were at prices significantly below the appraisal value at issue which is typically a factor that would increase the lack of marketability discount. In short, Judge Thornton felt Mr. Schroeder's discount was "overstated" based on those factors. Finally, Judge Thornton noted that the remaining factors cited in Mr. Schroeder's report actually supported a lower lack of marketability discount.

With respect to Mr. Herber's lack of marketability discount analysis, Judge Thornton criticized Mr. Herber's application of the analysis found in the MPI study. Mr. Herber compared RBI with the grouping of companies with gross incomes of $10 to $30 million. The transactions involving those companies had an overall average lack of marketability discount of 30.8%. Of this group, only two transactions involved companies with revenues comparable to RBI's relatively small revenues. Judge Thornton made a point to note that the MPI study indicated a "clear correlation" between the size of a company's gross income and the size of the lack of marketability discount. Judge Thornton went on to use Mr. Herber's own statement against him quoting the following portion of Mr. Herber's report, "in other words, restricted shares of companies with higher gross income tended to sell for lower discounts than the restricted share of companies with lower gross income." Accordingly, because RBI had gross income at the lower end of the range indicated in the MPI study, Judge Thornton reasoned an appropriate discount for RBI would be higher than the overall average lack of marketability discount (i.e., 30.8%) indicated for the relevant grouping of companies. In the end, Judge Thornton determined that the appropriate lack of marketability discount was 35%. This was at the higher end of the narrow range that Mr. Herber identified in his report and was consistent with the average discount Mr. Schroeder derived from the restricted stock studies. Judge Thornton therefore concluded that the fair market value of the Decedent's shares of RBI was $721,297 (or $220.18 per share).

Green is interesting because of the Tax Court's willingness to base its conclusions on MPI's restricted stock study considering it could have utilized the same study in its analysis in Lappo but chose not to do so. On closer analysis, however, there is a key difference between Green and Lappo. In Lappo, the Tax Court had the option of utilizing the Service's expert's private placement approach (as embodied in the Bajaj study and utilized by the Tax Court in McCord).[41] The Tax Court's analysis is limited to the evidence contained in the record. Viewed in context, the Tax Court's reliance on MPI's restricted stock study in Green was not contradictory to its preferences in Lappo, but rather consistent with the analytical approach currently taken by Tax Court.

VI. Thompson.

A. Facts.[42]

Thompson was an estate tax case. At issue in the case was the fair market value of 487,440 shares (the "Shares") of the voting common stock of Thomas Publishing Co., Inc. ("TPC") owned by the estate of Josephine T. Thompson (the "Decedent"). The relevant facts are as follows: The Decedent died on May 2, 1998 a resident of New York. The Decedent's Shares

[41] Not that this approach is correct. For a criticism of Dr. Bajaj's analysis, see Pratt, "Defending Discounts for Lack of Marketability," ACTEC Journal 276 (2004).
[42] Judge Swift wrote the opinion in Thompson.

represented approximately 20% of TPC's total outstanding common stock and constituted the largest block of TPC common stock owned by any single shareholder. Under the terms of the Decedent's Will, the Shares passed to her son, Carl T. Holst-Knudsen ("Carl"). Prior to his mother's death, Carl owned 162,000 shares of the voting common stock of TPC. These shares coupled with the Shares inherited under his mother's Will resulted in Carl owning approximately 27% of the total outstanding common stock of TPC. During the 10 year period prior to the Decedent's death, approximately 13% of the total outstanding common stock of TPC was owned by a New York Stock Exchange traded company (the "Outside Shareholder"). The remaining outstanding common stock was owned by approximately 20 other relatives of TPC's founder, Harvey Mark Thomas. TPC's stock had never been publicly traded nor had there been any sales of the stock in the 10 year period prior to the Decedent's death or in the years subsequent to the Decedent's death through the time of trial.

TPC's primary business was the production and sale of industrial and manufacturing business guides and directories. Secondary publication lines included a variety of news magazines, software comparison guides, and a magazine relating to factory automation. TPC was regarded as a successful and profitable company.

The development and expansion of the Internet allowed the traditional buyers of TPC's print directories to locate and purchase products on their own without reference to TPC's print directories. In response, TPC began publishing and offering some of its business-to-business buying directories on CD-ROM. TPC sought to secure a dominant position in the electronic interchange of information among industrial buyers and sellers comparable to that which it had enjoyed in the hard copy realm.

Historically, TPC's revenue was generated from the sale of subscriptions to, and advertising in, its print directories. Over 90% of TPC's revenue was generated from the sale of advertising. Increases in advertising revenue more than offset decreases in TPC's subscription revenue when it began to make information available on CD-ROM and on the Internet. TPC invested approximately $36 million on technology-related projects.

TPC owned substantial liquid short-term investment and marketable securities (close to $100,000,000 in 1998). TPC had a long history of paying annual cash dividends to its shareholders. As of the date of the Decedent's death, TPC's management had no plans to liquidate or to sell TPC.

Carl and The Bank of New York were appointed Co-Executors of the Decedent's Will. The Executors hired Mr. Goerig ("Goerig"), an Alaskan attorney, to prepare the valuation report for the Shares. Goerig was assisted by Mr. Wichorek ("Wichorek"), an Alaskan accountant (collectively, the "estate's experts"). Goerig was also granted limited estate administrative powers for the purpose of representing the estate in connection with the anticipated audit of the Federal estate tax return including any negotiations over the fair market value of the Shares. Apparently, the Executors hired Goerig in anticipation of requesting a transfer in the event of an IRS audit from the Service's New York City office to their Alaska office. Goerig believed, and apparently represented to the Executors, that he would be able to obtain a more favorable valuation of the Shares if the audit was conducted out of the Service's Alaska office.

Based on a valuation report prepared by the estate's experts, the estate tax return reported the fair market value of the Shares as $1,750,000 (or $3.59 per share). On audit, based on a valuation report dated November 9, 2000, the Service determined the Shares had a fair market value of $35,273,000 (or $72.36 per share). Judge Swift determined the Shares had a fair market value of $13,525,240 (or $27.75 per share). Few valuation cases have presented the startling disparity in value that Thompson presents.

B. Valuation Issues in the Case.

1. Estate's Experts.

The estate's experts concluded that a 40% lack of control discount was appropriate and a 45% lack of marketability discount was appropriate.

2. Service's Expert.

The Service offered Brian C. Becker ("Mr. Becker") as an expert witness. Mr. Becker concluded that a 30% lack of marketability discount was appropriate. Mr. Becker did not apply a lack of control discount in his valuation of the Shares. Mr. Becker believed his discounted cash flow method of valuation inherently reflected a minority interest in TPC and therefore an additional lack of control discount would be inappropriate.

3. Methodologies.

After concluding there were no comparable companies, the estate's experts valued the Shares under the capitalization of income valuation method. Mr. Becker used two valuation methods. He used the discounted cash flow method and a guideline (or comparable public) company analysis under a market approach.

Under a capitalization of income method, the company is valued based on a projected stream of "normalized" or sustainable income, capitalized by a risk-adjusted rate of return. Following are the basic steps involved in this valuation method:

- A capitalization rate for the business is selected;
- The company's sustainable income is projected;
- The capitalization rate is applied to the projected sustainable income to determine an operating value for the business; and
- The amount, or value, of the company's non-operating assets is added to operating value of the company.

The estate's experts applied a capitalization rate of 30.5%. This rate was calculated by adding together the following risk factors and percentages:

- 6% to reflect a risk-free rate of return;

- 7.8% to reflect an equity risk premium; [43]
- 4.7% to reflect a small stock risk; [44] and
- 12% primarily to reflect risks relating to the Internet and other technology, the loss of advertising revenue related thereto and perceived risks in the management structure of TPC.

In estimating TPC's sustainable annual net income (against which to apply the cap rate), the estate's experts adjusted TPC's historical income by subtracting $10 million per year from TPC's pretax income to reflect projected expenditures to maintain and further TPC's presence on the Internet and to develop additional technology-related projects.[45] The estate's experts determined the average sustainable annual net income for TPC was $25,784,000. Based on this value, the estate's experts determined an undiscounted value of the Estate's 20% interest in TPC of $5,304,000. The estate's experts then applied a 40% lack of control discount and a 45% lack of marketability discount, resulting in the discounted value of $1,750,000.

The estate's experts based their 40% lack of control discount on their reading of general valuation texts. Their 45% lack of marketability discount was based on the following factors: (1) the stated intent of management that TPC would not be going public; (2) the fact that no sales of TPC stock had occurred in the 10 years prior to the date of the Decedent's death; (3) the fact that a 20% interest in TPC was not a controlling interest; and (4) the fact that a shareholder holding 20% of the outstanding shares of TPC could not force a liquidation.

Judge Swift dismissed Mr. Becker's entire analysis. Due to significant errors and numerous "suspect recalculations" on the part of Mr. Becker, Judge Swift rejected Mr. Becker's discounted cash flow analysis. Similarly, Judge Swift declined to accept Mr. Becker's market analysis because his guideline group of companies was not sufficiently comparable to TPC. Mr. Becker identified 11 publicly traded companies comparable to TPC based on the following two broad criteria: (1) the guideline companies were classified under the same general U.S. Department of Labor Standard Industrial Code and (2) each company reported positive cash flows for 1995-97.

Mr. Becker determined a 30% lack of marketability discount was appropriate. Mr. Becker based his marketability discount, as opposed to a higher discount, on the following factors: (1) TPC was not publicly traded; (2) TPC was historically profitable; (3) investment risks associated with TPC were moderate; (4) TPC had consistently paid cash dividends; (5) TPC held more than $137 million in liquid assets; and (6) the estate owned the single largest block of TPC stock. Mr. Becker did not apply a lack of control discount because he believed his discounted cash flow analysis inherently incorporated a lack of control discount.

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[43] This compensates an investor for the risk of investing in stocks as compared to long-term U.S. government securities.

[44] This compensates an investor for the risk of investing in stock of a small corporation as compared to a large corporation.

[45] The Estate's experts also made an adjustment to reflect a disconnect between the reported rate of depreciation and the actual economic depreciation.

C. Judge Swift's Conclusions.

Judge Swift had the following general criticisms of both parties' experts. With respect to the qualifications and credibility of the estate's experts, Judge Swift took issue with the dual roles played by Goerig, noting what he believed to be an inherent tension between Goerig's role as a purported "independent valuation expert" and his role as a special administrator hired to handle the anticipated estate tax audit. Judge Swift also commented on the qualifications, or lack thereof, of the estate's experts, stating they were "too inexperienced, accommodating, and biased in favor of the estate."[46] With respect to the Service's expert, Judge Swift criticized Mr. Becker for the "casual manner" in which he selected his comparable companies, the significant errors in his calculations and analysis and the questionable and inadequately explained adjustments he made in his discounted cash flow analysis. As noted above, Judge Swift rejected Mr. Becker's cash flow analysis and his guideline company analysis. Judge Swift also disagreed with Mr. Becker that a lack of control discount was inappropriate.

That left the estate's experts' reports and testimony. While Judge Swift did admit into evidence the estate's experts' valuation reports, he regarded their reports as well as their testimony "marginally credible." In essence, Judge Swift believed the estate's experts (1) overestimated the risks associated with the Internet and technology and (2) applied excessive lack of control and lack of marketability discounts.

Judge Swift utilized the capitalization of income method to value TPC, but determined his own capitalization rate, finding the estate's experts' capitalization rate unjustifiable. Judge Swift made the following comment regarding the importance of a reasonable capitalization rate:

> Obviously, the particular capitalization rate that is selected has a significant impact on the ultimate valuation and is intended to reflect risks or volatility associated with a company's income stream and seeks to reflect what a stockholder would require for a rate of return on an investment in the company being valued. The more risky and volatile the income stream is perceived to be, the higher the capitalization rate. Conversely, the more stable the income stream is perceived to be, the lower the capitalization rate.

Specifically, Judge Swift considered the 12% risk factor used by the estate's experts to reflect the risks associated with the Internet, technology and TPC's management structure excessive. Judge Swift was willing to accept the fact that the Internet posed certain risks to TPC, but noted that it also provided TPC with significant new business and financial opportunities to increase its revenues. In addition, Judge Swift reasoned that if TPC's management actually thought TPC faced additional risky technology expenditures, TPC would not have paid out cash dividends in excess of $7 million in 1998 (an increase from prior years) noting an increase in cash dividends typically indicates an optimistic outlook on the part of management. In addition,

[46] Goerig was an attorney with an audit and tax dispute resolution practice. He also prepared tax returns and occasionally undertook valuations for small businesses and private individuals and, as Judge Swift noted, had attended limited appraisal courses. Wichorek provided accounting and tax preparation services, business consulting and similarly undertook occasional valuations for small businesses, generally in the context of divorce and property settlement disputes.

Judge Swift did not like the fact that the estate's experts factored into their projections an additional $10 million per year in technology-related expenditures but failed to project any additional income as a result such expenditures. Finally, Judge Swift regarded TPC as an extremely well managed company, with top quality managers at each level of the management structure. Accordingly, Judge Swift rejected this element of the 12% risk factor. Judge Swift concluded that TPC should be valued under a capitalization of income method but reduced the estate's experts' capitalization rate by 12%, from 30.5% to 18.5%.

Judge Swift allowed a 15% lack of control discount and a 30% lack of marketability discount. Judge Swift scaled backed the estate's experts' discounts, concluding they were "arbitrary" and unsupported. In arriving at these discounts, Judge Swift took into consideration the existence of the Outside Shareholder. With respect to the lack of control discount, Judge Swift reasoned that the existence of a longstanding unrelated shareholder reflected contentment on the part of minority shareholders which supported a lower discount. With respect to the lack of marketability discount, Judge Swift again scaled back the estate's experts' discount but effectively treated Mr. Becker's 30% lack of marketability discount as a floor.

Thompson illustrates many of the same Tax Court tendencies the other cases illustrate (e.g., the importance of articulating, quantitatively, the effects of specific factors relied upon by an expert). In addition, Thompson highlights that accuracy in an expert's report is essential as are the credentials and objectivity of an expert. If not already obvious, this case confirms that the Tax Court does not take kindly to a witness who appears to be more of an advocate than an expert.

D. Second Circuit Decision on Appeal.

The estate appealed to the Second Circuit, primarily on the ground that under I.R.C. §7491, the burden of proof on the valuation issue shifted to the Service when the estate introduced credible evidence on the issue. The estate argued that the Tax Court therefore was required to adopt the estate's valuation once it rejected the Service's. The Service also appealed, principally on the ground that the Tax Court erred in refusing to imposed an underpayment penalty.

The Court of Appeals rejected the estate's I.R.C. §7491 argument. According to the appeals court, the Tax Court was not required to adopt the taxpayer's valuation whenever it rejected the Service's proposed value; rather, the burden of disproving the taxpayer's valuation "can be satisfied by evidence in the record that impeaches, undermines or indicates error in the taxpayer's valuation." In the view of the appeals court, there was record evidence to indicate flaws in the estate's valuation approach; moreover, I.R.C. §7491 did not alter the long-standing rule that the Tax Court was not bound by the opinion of any expert witness, but rather was free to reach a determination of value based on its own analysis of the evidence in the record. The Court of Appeals noted that because the Tax Court adopted some of the Service's arguments in opposition to the estate's valuation, it was unnecessary for the appeals court to decide whether I.R.C. §7491 would require a court to adopt a taxpayer's valuation if the court rejected all arguments advanced by the Service in opposition to that valuation.

In the alternative, the estate argued that the Tax Court erred by counting certain short-term investments as non-operating assets and omitting a technology-related risk factor from the capitalization rate that the Tax Court adopted. The Court of Appeals declined to overturn the Tax Court's analysis in the absence of clear error, except that it did remand the case for the Tax Court to correct a double-counting of short -term investments that both the estate and the Service agreed was a calculation mistake.

Also, the Second Circuit concluded that the Tax Court's findings were insufficient to support its determination that the I.R.C. §6664 reasonable cause exception to the I.R.C. §6662 accuracy-related penalty applied, so this portion of the Tax Court's decision was vacated and remanded so that the Tax Court could determine whether the estate's reliance on its appraisers was reasonable and in good faith.

VII. Kelley.

A. Facts.[47]

Kelley was an estate tax case. Webster E. Kelley (the "Decedent") died on December 8, 1999. The sole issue for decision was the fair market value of the Decedent's 94.83% limited partner interest in a family limited partnership ("KLLP") and his 33.33% interest in a limited liability company ("KLBP LLC"). On the Decedent's date of death, the partnership held assets totaling $1,226,421, which consisted of $807,271 in cash and $419,150 in certificates of deposit. The partnership had no liabilities. The sole asset of the limited liability company was its 1% general partner interest in the limited partnership. The estate employed Appraisal Technologies, Inc. ("ATI") to prepare a valuation of the decedent's interests in KLLP and KLBP LLC. The estate filed its 706 and the Service challenged the discounts claimed by the estate.

B. Valuation Issues in the Case.

1. Estate's Expert.

The estate offered Ron Lint ("Mr. Lint"), the founder and president of ATI,[48] as an expert witness. Mr. Lint concluded that a 25% lack of control discount and a 38% lack of marketability discount were appropriate.

2. Service's Expert.

The Service offered Raymond F. Widmer ("Dr. Widmer") as an expert witness.[49] Dr. Widmer concluded that a 12% lack of control discount was appropriate and a 15% lack of marketability discount were appropriate.

3. Methodologies.

[47] Judge Vasquez wrote the opinion in Kelley.
[48] Mr. Lint had the designation of senior accredited appraiser from the American Society of Appraisers.
[49] Dr. Widmer had an M.B.A. with a concentration in economics and quantitative methods and a Ph.D. in economics. The opinion does not indicate his specific credentials or affiliations as an appraiser.

Both experts used the NAV approach. Mr. Lint also employed the income approach. Mr. Lint gave 80% weight to the NAV approach and 20% weight to the income approach. Both experts determined the discount for lack of control by reference to general equity closed-end funds and both experts divided the comparable closed-end funds into quartiles by price to NAV ratios. The first quartile represented funds that are in high demand and therefore trade at premiums or low discounts. The fourth quartile represented funds that are in low demand and trade at higher discounts.

With respect to the estate's lack of control discount, Mr. Lint determined that KLLP would be most comparable to the closed-end funds in the fourth quartile with price to NAV discounts in the range of 21.8% to 25.5%. Once the appropriate discount range was determined, Mr. Lint further adjusted the discount for lack of control based on several factors and restrictions inherent in KLLP. In addition, Mr. Lint referred to certain partnership studies. The average discount to NAV was 27% for the transactions studied. Based on those factors and the transactions studied, Mr. Lint concluded a 25% lack of control discount was appropriate. Mr. Widmer determined his lack of control discount by calculating an arithmetic mean of the entire data set for closed-end funds, not only the fourth quartile. Dr. Widmer determined that it was essential to use the whole array of closed-end funds to remove the marketability element in the discounts/premiums.

With respect to the lack of marketability discount, both experts agreed that a discount for lack of marketability should apply. However, they disagreed on the magnitude of that discount. In determining the discount for lack of marketability, Mr. Lint relied on restricted stock studies. In addition, Mr. Lint listed a number of additional factors specific to an interest in KLLP that would be barriers to marketability. After considering these factors and the restricted stock studies, Mr. Lint concluded that a 38% discount for marketability was appropriate.

The Service's expert relied utilized the IPO approach to determine a 15% discount for lack of marketability. Dr. Widmer relied on Dr. Bajaj's private placement study, which found that the private placement of unregistered shares has an average discount of about 14.09% higher than the average discount on registered placements. Dr. Widmer also based his lack of marketability discount on the low risk of the partnership's portfolio.

C. Judge Vasquez's Conclusions.

Judge Vasquez was not persuaded that the estate's expert's exclusive use of the fourth quartile of closed-end funds was proper, noting that while the court had utilized small samples in other valuation contexts, the court also recognized the basic premise, cited also in McCord, that as similarity to the company to be valued decreases, the number of required comparables increases. Judge Vasquez also felt that Mr. Lint's analyses of the partnership studies was less than accurate, primarily because Mr. Lint admitted that the discounts contained some element of a discount for lack or marketability. As a result, Judge Vasquez concluded Mr. Lint's results overstated the lack of control discount. Judge Vasquez preferred the approach of the Service's expert, which was to take the arithmetic mean of all of the closed-end funds, as shareholders in all closed-end funds lack control. In the end, Judge Vasquez determined that a 12% discount for lack of control was appropriate for the following reasons: (1) the Service effectively conceded that a discount factor of up to 12% would be appropriate and (2) the estate failed to prove that a figure greater than 12% would be appropriate.

Judge Vasquez did not agree with Mr. Lint's determination of a 38% marketability discount, as the restricted stock studies referred to in Mr. Lint's valuation report examined mostly operating companies, which Judge Vasquez felt were fundamentally different from an investment company holding "easily valued and liquid assets (cash and certificates of deposit), such as KLLP." In addition, Judge Vasquez was not convinced that Mr. Lint analyzed the data from these studies as they related to the transferred interests and as a result, was unwilling to accept the premise that the average discount was appropriate. With respect to the Service's expert, Judge Vasquez agreed that Dr. Bajaj's private placement study was an appropriate tool in determining the lack of marketability discount. Unfortunately for the Service, Judge Vasquez did not believe that Dr. Widmer's conclusions based on that study were accurate. In the end, Judge Vazquez, citing McCord and Lappo, concluded that a 20% initial discount for lack of marketability was appropriate to which he made an upward adjustment of 3% to "incorporate characteristics specific to the partnership."

Kelley exemplifies many of the same tendencies as the other recent Tax Court valuation cases, such as the Court's willingness to scrutinize, and accept and reject portions of, the experts' analyses. Of note also is Judge Vasquez's comment that restricted stock studies of operating companies may be of limited relevance in determining lack of marketability discounts for interests in an entity holding highly liquid, easily valued assets.

VIII. Temple.

A. Facts.[50]

Temple was a gift tax case involving the valuation of 1997 and 1998 gifts by Arthur Temple, deemed to be made one-half by his wife Lottie by virtue of the split gift election. The subjects of the gifts were interests in Ladera Land, Ltd. ("Ladera"), Boggy Slough West, LLC ("Boggy Slough"), Temple Interests, L.P. ("Temple Interests") and "Temple Partners, L.P." ("Temple Partners"). Ladera was formed to own and operate a ranch in south Texas. Boggy Slough was formed to own and operate a winery in Napa County, California. Temple Interests and Temple Partners were formed to own stock in Temple-Inland and Tim Warner, both of which were publicly traded Fortune 400 companies. Arthur in 1997 made gifts of limited partner interests in Ladera to his son Buddy, to Buddy's wife Ellen and to Arthur's grandchildren; gifts of LLC units in Boggy Slough to his daughter Charlotte and to trusts for his grandchildren; gifts of limited partner interests in Temple Interests to Buddy and to a charity; and gifts of limited partner interests in Temple Partners to Charlotte and to a charity. In 1998 Arthur made additional gifts of limited partner interests in Temple Interests and Temple Partners to Buddy and Charlotte and to Arthur's grandchildren. On audit, the Service increased the value of the gifts. The Temples paid the additional gift taxes assessed and sued for refunds.

B. Valuation Issues in the Case.

[50] Judge Thad Heartfield of the U.S. District Court for the Eastern District of Texas wrote the opinion in Temple.

1. Taxpayers' Expert.

The taxpayers' appraiser in connection with the preparation of the estate tax return, at least for the gifts of the Ladera and Boggy Slough interests, was Nancy M. Czaplinski ("Ms. Czaplinski"), who also testified at trial. The opinion does not discuss Ms. Czaplinski's credentials. Ms. Czaplinski determined a lack of control discount of 25% and a lack of marketability discount of 45% for Arthur's 1997 gifts of interests in Ladera and Boggy Slough. It is not clear from the opinion whether Ms. Czaplinski was also engaged to value the interests in Temple Interests and Temple Partners. At trial, Charles L. Elliot ("Mr. Elliot") was an expert witness for the taxpayers. The opinion does not discuss Mr. Elliot's credentials. Another expert witness for the taxpayers, apparently with respect to the Boggy Slough gifts only, was William J. Lyon ("Mr. Lyon"), a Senior Residential Appraiser, MAI and Senior Real Estate Analyst.

2. Service's Expert.

The Service's expert was Francis X. Burns ("Mr. Burns"), who also was the Service's expert in Peracchio, discussed above. For the gifts of interests in Temple Interests and Temple Partners, Mr. Burns concluded that the lack of control discounts should be 7.5%, 10.1% and 3.3% as of the three gift dates, and that a 12.5% lack of marketability discount should apply. Although the opinion refers in passing to Mr. Burns's methodology in valuing the Ladera and Boggy Slough gifts, it is not clear from the court's opinion what discounts he concluded were appropriate.

3. Methodologies.

Ms. Czaplinski used the NAV approach to value the Ladera Land gifts and apparently the Boggy Slough gifts, although the opinion does not discuss in detail her methodology with respect to the Boggy Slough gifts. She derived her 25% lack of control discount from a Mergerstat study of the inverse of premiums paid to acquire control of public companies. At trial, Ms. Czaplinksi acknowledged that the Mergerstat study involved operating companies, but that she classified Ladera as a holding company. Another of the taxpayers' experts, Mr. Elliot, recognized problems with the Mergerstat study, in that it involved sales of entire public companies rather than specified percentage interests, and he testified that he did not use the Mergerstat study to value interests in a real estate limited partnership. Ms. Czaplinski also characterized Ladera as weak on 9 out of 10 attributes normally associated with investment companies, but she did not interview anyone involved in Ladera operations when preparing her analysis. Ms. Czaplinski calculated her 45% lack of marketability discount for the Ladera gifts based on the "Quantitative Marketability Discount Model" developed by Z. Christopher Mercer. In applying that model, Ms. Czaplinski made several assumptions regarding the holding period of an interest in Ladera, the return on investment that an investor would require, the distribution yield of Ladera and the expected rate of appreciation in its real property, but she did not discuss these assumptions with anyone associated with Ladera, nor, for example, was the assumed expected rate of appreciation tied to specific instances of south Texas real estate holdings similar to those of Ladera.

With respect to the Ladera gifts, Mr. Burns examined average discounts for real estate limited partnerships. It is not entirely clear from the court's opinion Mr. Burns drew from this analysis.

As to the valuation of the Boggy Slough gifts, since Boggy Slough could be dissolved by a vote of 51% in interest of the members, the Service sought to deny a lack of control discount for the 76.6% Boggy Slough interest that Arthur gave to his daughter Charlotte. The Boggy Slough operating agreement, however, left the members who voted to dissolve the LLC free either to sell the underlying property or distribute it in kind. Any distribution in kind would be of undivided interests to the members as tenants in common. Mr. Lyon testified that co-ownership of the Boggy Slough property could create numerous problems, and that because of zoning restrictions, the property could only be divided into two tracts. The property contained three types of land with varying values. In fact, Mr. Lyon could not determine a partitioning approach, by value or area, that would comply with the zoning restrictions. Mr. Lyon's valuations supported Ms. Czaplinski's conclusions of a 25% lack of control discount and a 45% lack of marketability discount for the Boggy Slough gifts.

Mr. Burns used the NAV approach in valuing the gifts of interests in Temple Interests and Temple Partners. To derive a lack of control discount, he relied on a published weekly list of closed-end funds, and determined lack of control discounts of 7.5%, 10.1% and 3.3% as of the three gift dates. Mr. Elliot used a similar approach but excluded some of the funds used by Mr. Burns. Mr. Elliot also testified that a sale of stocks by Temple Interests or Temple Partners would subject the donees to a large capital gains tax. The court, however, found this testimony inconsistent with I.R.C. §704(c)(1), providing for built-in capital gain in property contributed to a partnership to be allocated to the contributing partner. Mr. Elliot also testified that the stock held by Temple Interests and Temple Partners could not be sold to diversify the portfolio, but in fact Temple Partners did sell some of its stock for diversification. Mr. Burns calculated a 12.5% lack of marketability discount for the interests in Temple Interests and Temple Partners by considering restricted stock studies, academic research, the costs of going public, secondary market transactions, asset liquidity, partnership interest transferability and whether distributions were made. Temple Partners and Temple Interests held highly liquid stocks and had distributed to the partners nearly all of the dividends that they received. Partners could transfer their interests to third parties, subject to a right of first refusal in the other partners. Mr. Elliot and Mr. Burns disagreed on whether a discount for built-in capital gains was applicable. They had taken the same respective positions in Estate of Jones v. Commissioner, 116 T.C. 121 (2001), in which the Tax Court held that because the hypothetical buyer and seller would likely negotiate with the understanding that the partnership would make an election under I.R.C. §754, no discount for built-in capital gains was appropriate.

C. Judge Heartfield's Conclusions.

Judge Heartfield concluded that the Ladera gifts should be discounted by 33% for a combined lack of marketability and lack of control and that an additional incremental lack of marketability discount of 7.5% applied because the partnership interests were private and unregistered. Therefore, the total discount applicable to the Ladera gifts was 38%. Judge Heartfield did not go into detail regarding how he derived these discounts, except to say that he considered the preponderance of the evidence, and to indicate that he found Mr. Burns's analysis more persuasive than Ms. Czaplinski's, particularly in view of some of the assumptions that Ms. Czaplinski had made. Judge Heartfield did not allow any discount for built-in capital gains, reasoning that a buyer of an interest would negotiate for an election under I.R.C. §754 by the partnership.

As to the Boggy Slough gifts, Judge Heartfield was persuaded by Mr. Lyon's report and testimony, and concluded that a 60% total discount should apply to the 76.6% interest given to Charlotte Temple. The Judge alluded to a "sales comparison approach" used by Mr. Lyon, but did not elaborate on what approach involved. Here again, the Judge concluded that no discount for built-in capital gains should apply. He concluded that for the gifts of much smaller interests in Boggy Slough to Arthur's grandchildren, a 33% combined lack of control and lack of marketability discount, and a 7.5% incremental lack of marketability discount, were appropriate, resulting in a total discount of 38%.

For the interests in Temple Partners and Temple Interests, Judge Heartfield agreed with the approach, used in principle by both Mr. Burns and Mr. Elliot, of examining transactions involving closed-end funds in order to derive the lack of control discount. The Judge criticized Mr. Elliot, however, for choosing the discount represented by the 75th percentile of a restricted group of funds, for excluding some funds without explanation or justification, and for failing to exclude funds that used substantial leverage. Judge Heartfield agreed with Mr. Burns's methodology, considering restricted stock studies and several other factors, in calculating the lack of marketability discount. The Judge criticized Mr. Elliot for simply listing the studies that he reviewed and picking a discount based on the range of numbers in the studies, rather than explaining the relationship of the restricted stock data to the interests being valued. According to Judge Heartfield, a discount for built-in capital gains did not apply, for reasons discussed above. Finally, the Judge concluded that the lack of control discounts should be 7.5%, 10.1% and 3.3% as of the three gift dates, and that a 12.5% lack of marketability discount applied.

Temple illustrates that federal district courts may be just as inclined as the Tax Court to critique in detail the opinions of valuation experts.

IX. Kohler.

A. Facts.[51]

Kohler was an estate tax case. Frederic C. Kohler (the "Decedent") died on March 4, 1998, owning approximately 12.85% of the stock of Kohler Co. ("Kohler"), a privately held international manufacturer of plumbing and other products that also owned and operated hospitality and real estate businesses. Kohler had a stated policy of reinvesting at least 90% of its earnings in the business and paying 7-10% out in dividends each year. The estate reported its Kohler stock as worth $47,009,625 on the alternate valuation date. Upon audit, the Service determined the value to be $144.5 million.

B. Valuation Issues in the Case.

[51] Judge Kroupa wrote the opinion in Kohler.

1. Estate's Expert.

The estate engaged Willamette Management Associates ("WMA") to value the Kohler stock. WMA had periodically appraised the company in the past and was familiar with its business. Robert Schweihs ("Mr. Schweihs") was the WMA appraiser who handled the valuation; he had been specifically involved in WMA's previous work for Kohler. The estate also presented a Mr. Grabowski as an expert witness at trial.

2. Service's Expert.

The Service's valuation of the stock at $144.5 million was based on an appraisal by Richard May of Valumetrics Advisors, Inc. At trial, the service presented Dr. Scott Hakala ("Dr. Hakala") of CBIZ as an expert witness.

3. Methodologies.

The Service's expert Dr. Hakala used both the income approach and the market approach. Under the income approach, he used only a discounted cash flow ("DCF") method, which discounts to present value the expected future income of a company; he did not use a dividend-based method. In forecasting the cash flow for the DCF method, Dr. Hakala did not use the expense projections that Kohler provided him, but instead made his own assumptions about expenses. He did not discuss those expenses with anyone at Kohler. Dr. Hakala gave the "management plan" based model, which the Court characterized as more "realistic," a 20% weighting within the DCF model, and he gave the "operations plan" based model, which the Court viewed as more "aspirational," an 80% weighting, because he thought the operations plan was a more likely scenario. Under the market approach, Dr. Hakala used both the guideline company method, which examines financial information and market prices of publicly traded comparable companies, and the transaction method, which focuses on comparable companies that have recently been acquired and compares the financial information to the price obtained in the transaction, rather than the market price. Within his market approach analysis, Dr. Hakala gave the guideline company method an 80% weighting and the transaction method a 20% weight. After weighting the values that he found under the income and market approaches, Dr. Hakala averaged the approaches and applied a 25% discount for lack of marketability.

The estate's expert Mr. Schweihs used the income approach and the market approach. Under the income approach, he employed the discounted dividend and dividend capitalization methods as well as the DCF method. Under the market approach, Mr. Schweihs used the guideline company method. Unlike Dr. Hakala, he did not use the transaction method, because he could not find transactions in companies sufficiently similar to Kohler where there was adequate information available. Mr. Schweihs did not take into account prior sales of Kohler stock, because he determined that those sales involved a premium, which could not be quantified, for being a shareholder in a prominent private company, and moreover the prices paid in the prior sales were not justified by an analysis of past and expected performance. Mr. Schweihs then applied a 45% lack of marketability discount to the values that he determined under the DCF method and the guideline company method, and a 10% lack of marketability discount to the values he determined under the discounted dividend method and the capitalization of dividends method. He used lower lack of marketability discounts under the dividend-based methods on the ground that those methods more directly reflected the share value. Mr. Schweihs also applied a 26% discount for lack of control to the value he determined under the DCF method. He weighted the DCF method and the guideline company method each 20%, and gave 30% weights to each of the dividend-based methods. Mr. Schweihs concluded that the estate's Kohler stock was worth $47,010,000 on the alternate valuation date. As noted above, Mr. Schweihs was already familiar with Kohler from WMA's previous work for the company.

Mr. Grabowski, the estate's other expert, spent three and a half days at Kohler and interviewed twelve employees, including the President and Chairman of the Board and General Counsel, as well as considering other company and industry information and general economic conditions. Mr. Grabowski used the income and market approach, and within the income approach he used the DCF method, the discounted dividend method and the adjusted discounted dividend method. Under the market approach Mr. Grabowski used the guideline company method. He found that the values he had determined under the various methods all came out fairly close to each other. He decided that the adjusted discounted dividend method was the most appropriate because it reflected the actual cash flows that a shareholder could expect to receive, and also reflected the remote possibility that the company would be sold or undergo and initial public offering. Mr. Grabowski then applied a 35% lack of marketability discount, based in part on restricted stock studies plus an upward adjustment to reflect the unlikelihood of Kohler's ever going public. He concluded that a 25% lack of control discount was appropriate only in considering the value of the Hospitality Group, a proportionally small portion of Kohler's overall operations, and in considering the price paid to dissenting shareholders in a reorganization that occurred shortly after the Decedent's death but prior to the alternate valuation date. Mr. Grabowski concluded that the estate's Kohler stock was worth $63,385,000 on the alternate valuation date.

C. Judge Kroupa's Conclusions.

Judge Kroupa noted that the Tax Court was not obligated to pay any regard to an expert report that lacked credibility, and that the Court might find evidence of valuation provided by one party to be so much more credible than that of the other party, that the Court's findings resulted in a significant victory for one side rather than a compromise between the two.

Judge Kroupa expressed, in her phrase, "grave concerns" about Dr. Hakala's valuation methods and conclusions. The Judge noted that Dr. Hakala was a chartered financial analyst but was not a member of the American Society of Appraisers nor the Appraisal Foundation. Moreover, Dr. Hakala's report was not submitted in accordance with the Uniform Standards of Professional Appraisal Practice ("USPAP"). Dr. Hakala met with Kohler management only once, for about two and a half hours, though he did consider both company financial information and industry information. Moreover, Dr. Hakala admitted that his original report submitted to the Tax Court before trial overvalued the estate's Kohler stock by $11 million, which further undermined the Judge Kroupa's confidence in him. The Judge was convinced from his report and testimony that Dr. Hakala did not understand Kohler's business. For example, as noted above, he did not discuss his invented set of expense projections with anyone in company management, and within the income approach he gave the company's "operations plan" model an 80% weighting even though management told him that the operations plan projections could only be achieved in a perfect environment. Judge Kroupa also criticized Dr. Hakala for not using a dividend-based method under the income approach, even though dividends were the primary means of obtaining a return on Kohler. Judge Kroupa found that Dr. Hakala's conclusions were "incredible" and should be given no weight.

The estate's experts, in Judge Kroupa's view, had provided "thoughtful, credible" valuations. Since the Service had failed to meet its burden of proof under I.R.C. §7491, the Judge found the value of the estate's Kohler stock to be the amount it reported on its return, $47,009,625.

As illustrated by Kohler, the Tax Court remains willing to in effect throw out a valuation expert's report that it finds lacking credibility.

X. Gimbel.

A. Facts.[52]

Gimbel was an estate tax case involving the valuation of restricted shares of the common stock of Reliance Steel and Aluminum Company ("Reliance"), a New York Stock Exchange traded company. Georgina T. Gimbel (the "Decedent") died on June 5, 2000. The Decedent's gross estate included shares of Reliance held by trusts created by her predeceased husband, by her account in Reliance's ESOP, by her IRA and by her individually. Of the 3,601,267 Reliance shares included in her gross estate, which represented about 13% of the outstanding common stock of Reliance, approximately 3,548,450 shares were unregistered. Owing to the large number of the Decedent's Reliance shares (including those attributed to her as trustee and beneficiary of the trusts and those that she owned through her ESOP account and IRA, as well as her individually owned shares, all of which are sometimes referred to collectively here as the estate's Reliance shares), she was considered an affiliate of Reliance under the federal securities laws. Under the SEC Rule 144 volume limitations, the sale of the 3,601,267 shares in the public market would have taken a minimum of 39 months (the "dribble-out" method). Although the estate's Reliance shares could have been sold to certain kinds of investors in a private placement or under SEC Rule 144A without being limited by the volume restrictions, a purchaser in such a transaction would have been subject to the same public resale restrictions as the estate.

In late 1994, about five and a half years before the Decedent's death, Reliance had adopted a stock repurchase plan which allowed for the repurchase of up to 2.25 million shares. In 1998, the number of shares that Reliance was authorized to repurchase under the plan was increased by the board of directors to 6 million. Between 1994 and the Decedent's death, Reliance purchased in the public market about 2.7 million shares (after adjustment for a tock split) for approximately $27 million. The largest repurchase during that period involved 646,200 shares repurchased for $11,090,017. About 10 days before the Decedent's death, Reliance's CEO stated in a presentation at a steel industry conference that 1999 had been a "record year" for

52 Judge Swift wrote the opinion in Gimbel.

Reliance and that the company would consider repurchasing shares at around $19 per share, as it had done in the recent past. The Decedent had not discussed with management the possibility of a repurchase of her shares upon her death. Shortly after her death, her estate inquired of Reliance's management whether there might be investors purchasing some of the estate's shares. After efforts to identify private investors who might be interested in such a purchase proved unsuccessful, the Reliance board began discussing the possibility of the company's repurchasing some of the estate's shares. At an October 18, 2000 meeting, a little over four months after the Decedent's death, the board approved the repurchase of up to $50 million worth of the estate's reliance shares at $19.53 per share. There was testimony that in arriving at this price, management considered advice from Reliance's investment banking firm, DLJ, that the repurchase price should reflect a 10-15% discount from the trading price. On October 30, 2000, Reliance privately repurchased 2.27 million of the estate's shares (representing 63% of the estate's Reliance shares) at $19.53 per share, for a total price of $43,924,500.

On the estate tax return, the Reliance stock was valued at the $20.8125 date of death trading price for publicly traded Reliance shares, less a 20.72% discount for lack of marketability and liquidity in view of the resale restrictions and the size of the estate's block of Reliance shares. On audit, the Service determined that the estate's Reliance shares should be discounted by only 8% from the date of death trading price. The record in the case did not indicate how the Service determined the 8% discount.

B. Valuation Issues in the Case.

1. Estate's Experts.

In connection with the preparation of the estate tax return, the estate's attorney retained Mr. Gregory Range ("Mr. Range"), who reached the conclusions discussed above under "Facts." At trial, the estate offered Curtis Kimball ("Mr. Kimball") as its expert. He concluded that the estate's Reliance shares should be valued at the trading price discounted by 17.4%.

2. Service's Expert.

At trail, the Service offered Ken Nunes ("Mr. Nunes") as its expert. He concluded that the estate's Reliance shares should be valued at the trading price discounted by 9%.

3. Methodologies.

Both parties' experts considered four possible kinds of transactions -- a secondary public offering of the estate's Reliance shares, a private placement with a third party or a sale under Rule 144A, a repurchase by Reliance, and open market sales subject to the Rule 144 dribble out rule. The experts agreed that Reliance, for business reasons, probably would not have approved a secondary public offering. The experts also generally agreed that a private placement or a sale under Rule 144A would not have been feasible because there were no prospective strategic investors for the estate's Reliance shares, and even if a strategic investor existed, the estate's block was a minority interest that likely would not have been marketable to such an investor. The resale restrictions on the estate's Reliance shares, which would also have applied to a purchaser in a private placement or Rule 144A sale, would also have made the shares unattractive to an institutional investor.

Mr. Kimball concluded that as of the date of the Decedent's death, it was not reasonably foreseeable that Reliance would repurchase any of the estate's shares, and therefore he did not factor that possibility into his valuation. Mr. Nunes, on the other hand, concluded that as of the date of the Decedent's death, it was reasonably foreseeable that Reliance would repurchase 50% of the estate's shares and that the discount on the purchase price would be 13.9%. Mr. Nunes arrived at the repurchase discount as follows. First, he assumed that on the date of death, DLJ would have suggested to Reliance the same 10-15% discount range that DLJ in fact suggested in connection with the repurchase of shares from the estate four months later. Mr. Nunes then chose the 12.5% midpoint of that range. Next, he discounted the estimated sales proceeds that would be realized on the repurchase, to account for holding costs and the time value of money during the three-month period that he estimated it would have taken to complete the repurchase. Mr. Nunes calculated that this adjustment increased the repurchase discount from 12.5% to 13.9%. Again, this portion of Mr. Nunes' discount analysis just related to the 50% of the estate's Reliance shares that would hypothetically have been repurchased by Reliance.

The experts agreed that under the Rule 144 dribble-out method, it would have taken 39 months to liquidate all of the estate's Reliance shares, but they disagreed on how to discount the dribble-out sales proceeds to reflect the time value of money and the risk of a decline in the stock price during the dribble-out period. Mr. Range used a risk-free rate of return to discount the sale proceeds to present value as of the date of the Decedent's death, and he also concluded that a hypothetical investor dribbling out the shares would buy put options to hedge the risk of a decline in the stock value. He calculated a cost for the hypothetical put options and subtracted it from the present value of the dribble-out sale proceeds. The result was a 24.5% overall discount from the date of death trading value. Mr. Kimball, on the other hand, added to the dribble-out sales proceeds the estimated dividends that would be paid on the shares during the dribble-out period (Mr. Range had also taken the estimated future dividends into account, but he included them as an element in the pricing of the put options). Mr. Kimball then discounted this total amount to present value using a discount factor equal to a 13.2% expected rate of return on Reliance equity. He arrived at a 17.4% overall discount from the date of death trading value. While Mr. Range and Mr. Kimball applied the dribble-out analysis to all or substantially all of the estate's Reliance shares, Mr. Nunes applied a dribble-out analysis only to the 50% of the estate's Reliance shares remaining after his hypothetical share repurchase by Reliance. Mr. Nunes took the view that to protect against the risk of a decline in the stock price during the dribble-out period, a hypothetical investor would have entered into hedging contracts, such as cashless collars or prepaid variable forward contracts, and he subtracted the estimate cost of those contracts from the dribble-out sales proceeds, arriving at a 5% discount from the date of death trading value. Mr. Nunes' 13.9% discount for the hypothetically repurchased shares and 5% discount for the hypothetically dribbled-out shares translated into a combined 9.5% discount from the date of death trading value for the estate's Reliance shares. (Elsewhere in the opinion it is stated that Mr. Nunes arrived at a 9.0% discount from the trading price. It is not clear why there is a discrepancy in the references.)

C. Judge Swift's Conclusions.

Judge Swift agreed with the experts that as of the date of the Decedent's death, Reliance probably would not have approved a secondary public offering, particularly since Reliance would then have been required to disclose a pending acquisition of another company, in violation of a confidentiality agreement. Judge Swift also agreed with the general view of the experts that a private placement or Rule 144A sale would not have been feasible.

The Judge agreed with Mr. Nunes that as of the date of the Decedent's death, a repurchase by Reliance of some of the estate's shares was reasonably foreseeable, since the company had a track record for repurchasing shares, but the Judge disagreed that it was reasonably foreseeable that Reliance would repurchase 50% of the estate's shares. Judge Swift pointed out that at the time, Reliance was negotiating a large company acquisition which, if successful, would have required significant cash and credit. Also, a repurchase of 50% of the estate's Reliance shares would have cost the company approximately three times as much as the largest previous repurchase. Judge Swift concluded that as of the time of the Decedent's death, it as reasonably foreseeable that Reliance would be financially able and willing to repurchase 20%, or 720,253, of the estate's 3,601,267 Reliance shares. Although Judge Swift stated that he found some flaws in Mr. Nunes' discount methodology, neither of the estate's experts had offered a methodology for estimating the repurchase discount, and Judge Swift concluded that it was appropriate to use Mr. Nunes' 13.9% repurchase discount in valuing the 20% (as opposed to 50%) of the estate's Reliance shares that Judge Swift thought it was foreseeable would have been repurchased by Reliance.

With respect to the balance of the estate's Reliance shares, Judge Swift applied a dribble-out analysis. He concluded, however, that the hedging contracts assumed by Mr. Range and Mr. Nunes would have been unavailable for a block of stock such as the estate's Reliance shares, in view of the size of the block and the Rule 144 resale restrictions. Mr. Kimball had testified to this effect. Judge Swift adopted Mr. Kimball's dribble-out valuation methodology, but applied it only to 80% of the estate's Reliance shares, since he had found it reasonably foreseeable that Reliance would have repurchased 20% of the estate's shares. Applying the dribble-out analysis to the lesser number of shares shortened the dribble-out period from 39 to 31 months.

Overall, Judge Swift arrived at a value of $64,320,892 for the estate's Reliance shares, reflecting a 14.2% discount from the trading value. This compared with a value of $59,420,918 reported on the estate tax return and a value of $68,964,263 asserted by the Service in its deficiency notice.

Gimbel is noteworthy for Judge Swift's willingness to make his own determination, which differed from that of either party's expert, concerning how many shares it was reasonably foreseeable that Reliance would repurchase from the estate.

XI. Jelke.

A. Facts.[53]

[53] Judge Gerber wrote the opinion of the Tax Court and Judge Hill wrote the opinion of the Eleventh Circuit Court of Appeals in Jelke.

Jelke was an estate tax case. Frazier Jelke, III (the "Decedent"), died on March 4, 1999, owning 3,000 shares, representing a 6.44% stock interest, in a closely held investment holding company called Commercial Chemical Company ("CCC"), which in turn owned appreciated marketable securities. Specifically, at the date of the Decedent's death, 92% of CCC's stock portfolio consisted of "blue chip" domestic equities and 8% consisted of international equities with readily available market values. CCC had a net asset value of approximately $188.6 million, before any reduction for built-in capital gain tax. It was a C corporation. If CCC's marketable securities had been sold on the date of the Decedent's death, there would have been a capital gain tax liability of about $51.6 million. On the estate tax return, the Decedent's stock in CCC was valued at $4,588,155, which was computed by reducing CCC's net asset value by the built-in capital gain tax liability and then applying discounts of 20% for lack of control and 35% for lack of marketability. The Service in its notice of deficiency valued the Decedent's CCC stock at $9,111,111, applying no discount for built-in capital gain tax and what the Service referred to as "reasonable" discounts for lack of control and lack of marketability.

B. Valuation Issues in the Case.

1. Estate's Expert.

The estate's expert was a Mr. Frazier who is not otherwise identified in the Tax Court opinion, though he may have been the same William H. Frazier who was an expert witness for the estate in McCord. Mr. Frazier applied a dollar for dollar discount for the built-in capital gains tax of $51.6 million, and then applied a 25% discount for lack of control and a 35% discount for lack of marketability.

2. Service's Expert.

The Service's expert was a Mr. Shaked who was not otherwise identified in the Trial Court opinion. At trial, the Service admitted that some reduction or discount was appropriate for the built-in capital gain tax liability. Mr. Shaked did not apply a dollar for dollar discount, however, but rather applied a discount of $21.1 million for this element, based on a present value analysis of the built-in capital gain tax. Mr. Shaked then applied a 5% discount for lack of control and a 10% discount for lack of marketability.

3. Methodologies.

The estate's expert, used what he described as a combination of the market and asset approaches. He used the market approach to value CCC's securities, but then, stating that he was using the asset approach, he reduced the aggregate market price of CCC's securities by the liabilities shown on the books of CCC and also by the full amount of the built-in capital gain tax liability.

The Service's expert started with the same market value for CCC's securities as did Mr. Frazier, and likewise subtracted the liabilities on CCC's books. With respect to the built-in capital gain tax liability, however, the Service's expert took a more complex approach. Based on data for 1994-1998, the Service's expert computed an average annual turnover rate of 5.95% in CCC's securities portfolio. The use of the 5.95% turnover rate would result in incurrence of the built-in capital gain tax over a 16.8 year span. The Service's expert then calculated the average annual capital gain tax liability over an assumed 16 year period, and selected a 13.2% discount rate based on the average annual rate of return for large-capitalization stocks in the period 1926-1998. He used that rate to discount the assumed annual capital gain tax liabilities to present value, arriving at a present value of approximately $21.1 million, which he applied as a subtraction from the net asset value of CCC (as contrasted with the approximately $51.6 million subtraction made by the estate's expert based on the entire built-in capital gains tax as if CCC had been liquidated immediately upon the Decedent's death).

The estate's expert argued that it was inappropriate for the Service's expert to discount the built-in capital gain tax liability to present value, because the securities held by CCC could be expected to appreciate, thereby increasing the future tax payments. The Service's expert's response to this argument was that he was simply calculating the built-in capital tax liability by determining when it would likely be incurred; if he were to consider possible future appreciation, then he would be inappropriately considering a tax that was not "built in" as of the valuation date.

In calculating his 25% lack of control discount, Mr. Frazier compared CCC to a closed-end, not widely traded investment fund holding publicly traded securities. He concluded that because closed-end funds were flow-through entities for income tax purposes, the discounts reflected in those funds did not includ any reduction for built-in capital gain tax, and he also reasoned that because closed-end funds are publicly traded in most cases, none of the discounts relating to them would be attributable to lack of marketability. Mr. Frazier reviewed 44 domestic equity funds and selected 15 that were comparable; he then removed eight of these from the sample because they had guaranteed payouts. The remaining seven funds had an average discount rate of 14.8%, a median discount rate of 17.2% and a 75th percentile discount rate of 17.3%. Mr. Frazier eliminated the two funds with the lowest discounts because he concluded that the low discounts resulted from consistently high returns. In his view, CCC was more similar to the funds in the upper end of the discount range because CCC's inconsistent returns and relatively small size. He concluded that an investor would demand a higher rate of return or a larger discount for CCC than for his comparables, in view, for example, of CCC's size and the fact that CCC paid lower dividends than was true on average for the comparables. Within the upper quartile of his seven comparables, the average discount rate was 18.3%. Mr. Frazier concluded that a hypothetical buyer would seek a 25% lack of control discount.

Mr. Shaked, in arriving at his 5% lack of control discount, began with an 8.61% average discount for closed-end funds that he obtained from an article in the Journal of Economics. Since CCC held a diversified portfolio of marketable securities, Mr. Shaked reasoned that management decisions were less critical for CCC than for an operating company, and therefore that a hypothetical investor would be less concerned about lack of control. Indeed, Mr. Shaked thought that an investor in CCC, like a mutual fund investor, would prefer not to have control. Mr. Shaked viewed CCC's performance record more favorably than did Mr. Frazier.

Mr. Frazier, in calculating his 35% discount for lack of marketability, considered studies of operating companies with a minimum resale restriction of at least two years. Although he conceded that operating companies are riskier than holding companies, he considered the marketability discount for CCC comparable to that of an operating company because CCC was not expected to liquidate for at least 20 years. Mr. Frazier believed that CCC's dividend pattern and the fact that it was an investment company argued for an average to below average discount, but on the other than the long holding period and the absence of any prospect of CCC's gong public supported a higher discount.

In arriving at his 10% discount for lack of marketability, Mr. Shaked analyzed the factors that Judge Laro considered in Mandelbaum.[54] Mr. Shaked took the view that CCC's diversified portfolio resulted in low price volatility and suggested a lower discount, and that it would be easier to find a willing buyer for CCC than for a riskier company. The Service argued that the estate's expert's analysis of restrictions on transferability was misguided, because CCC stock could be sold in the private market. Also, the Service contended that were was a market for CCC shares, because even though none of the shareholders had any contractual right to have his or her shares redeemed, the minutes of the board of directors indicated that the company "did maintain a sufficient cash position in the event that the estate requested redemption of its shares."

C. Judge Gerber's Conclusions.

Judge Gerber criticized the estate's expert's dollar for dollar subtraction of the built-in capital gain tax. The Judge thought it significant that a hypothetical buyer of a 6.44% interest would be unable to cause a liquidation of CCC, and that there was no evidence of an intention to liquidate. Judge Gerber noted that since appeal in the case would not lie to the Fifth Circuit, the Tax Court was not bound to follow the Fifth Circuit's decision in Estate of Dunn, 301 F.3d 339 (5th Cir. 2002). Judge Gerber also suggested that the case before him might be distinguishable from Estate of Dunn because the Dunn case involved a majority interest. The estate had argued that CCC's relatively low earnings and modest dividends would cause a hypothetical buyer to prefer liquidation, but Judge Gerber considered this contention a "mere supposition" belied by the fact that CCC had performed well when one took capital appreciation into account. Judge Gerber also agreed with the Service's expert that in discounting to present value the built-in capital gain tax, possible future appreciation in the securities held by CCC should be disregarded, because if future appreciation were considered then one would be taking into account tax that was not "built in" on the valuation date. Judge Gerber found the Service's expert's 13.2% discount rate reasonable (the estate had conceded that the rate was reasonable if the premise were accepted that the built-in capital gain tax should be discounted). Judge Gerber determined that the subtraction for the discounted built-in capital gain tax liability should be approximately $21.1 million, as the Service's expert had concluded.

In connection with the lack of control discount, Judge Gerber agreed to some extent with the Service's expert's view that control would be less important to an investor in CCC than to an investor in an operating company or in a company without a diversified portfolio of marketable securities. Judge Gerber thought that the estate's expert did not provide enough justification for eliminating two funds as comparables, and that the estate's expert had ignored the fact that some

[54] See footnote 36 above.

of his chosen comparables appeared to be riskier than CCC because they held investments in small-capitalization stock funds or were less diversified than CCC. In Judge Gerber's view, CCC was most similar to a diversified stock fund in the estate's expert's sample that invested in New York Stock Exchange listed securities, and that fund had only a 7.3% discount. The Judge also perceived other flaws in the estate's expert's analysis of his comparables. For example, the Judge did not agree with the estate's expert's assumption that the discounts reflected in his comparables were due solely to lack of control, since other factors such as investment strategy risks, management quality issues or company-specific risks could also play a role. Finally, after considering a variety of factors including the fact that CCC did underperform some of the comparables, and was relatively small in relation to the comparables, but on the other hand was well-diversified, Judge Gerber concluded that a 10% lack of control discount was appropriate.

Judge Gerber found "critical errors" in both the estate's and the Service's analyses of the lack of marketability discount, found those analyses only "minimally helpful," and used his own methodology, guided by the Mandelbaum factors. The Judge thought that CCC's financial performance, given its history of long-term appreciation and its diversified portfolio of blue chip securities, justified a lower than average discount. There was, the Judge noted, no indication that CCC's portfolio or performance would change from the historical course. Also, there were no restrictions on transfers of CCC shares, though CCC was not a public company and the Judge thought that the Service had failed to demonstrate the existence of a private market for the shares. Factors weighing toward a higher discount, in Judge Gerber's view, included the fact that the relatively high dependence on long-term appreciation as an element of return would extend the necessary holding period to realize an investor's goals, and the lack of a corporate redemption policy. Overall, Judge Gerber concluded that a lower than average discount for lack of marketability was justified, and that the appropriate discount was 15%.

Accordingly, Judge Gerber found that the Decedent's CCC shares had an estate tax value of $8,254,696, compared with $4,588,155 reported on the estate tax return and $9,111,111 asserted in the Service's deficiency notice.

D. Eleventh Circuit Decision on Appeal.

The taxpayer appealed to the Eleventh Circuit. The case was heard by Judges Tjoflat, Carnes and Hill, and Judge Hill wrote the opinion. He focused on the issue of the discount for built-in capital gain tax liability, noting that this was an issue of first impression in the Eleventh Circuit.

The Eleventh Circuit Court of Appeals decided to follow the "simple yet logical" analysis of the Fifth Circuit in Estate of Dunn v. Commissioner, 301 F.3d 339 (5^{th} Cir. 2002), observing that this approach would provide "practical certainty." The appeals court's opinion reviewed the history of the built-in capital gain tax issue in the case law, beginning with the pre-1986 cases (which generally denied a discount for built-in capital gain tax unless a sale or liquidation was planned or imminent); then discussing the implications of the Tax Reform Act of 1986, the Tax Court's change of stance in Estate of Davis, 110 T.C. 530 (1998) (holding that built-in capital gains tax did not give rise to a separate discount but could be an element of the lack of marketability discount); the Second Circuit's holding in Estate of Eisenberg v. Commissioner, 155 F.3d 50 (1998) (holding that some discount at least should be allowed for built-in capital gains tax); Estate of Welch v. Commissioner, (unpublished) 208 F.3d 213 (6th Cir. 2000) (taking a similar approach to Estate of Eisenberg); Estate of Jameson v. Commissioner, 267 F.3d 366 (5th Cir. 2001) (vacating Tax Court decisions with instructions to reconsider amounts of discounts for built-in capital gains tax); and, finally, Estate of Dunn, supra, which involved a majority interest in a family-owned equipment rental company (but an interest that fell short of the 66.66% interest required under Texas law to liquidate the company). In Estate of Dunn, the Fifth Circuit held that a hypothetical buyer must always be assumed to liquidate the corporation immediately, triggering a tax on the built-in gains, and that the appropriate discount was 100% of the built-in capital gain tax liability.

The Eleventh Circuit in Estate of Jelke rejected the Tax Court's attempt to distinguish Estate of Dunn on the basis that the latter case involved a majority interest; in the view of the Eleventh Circuit, whether the interest being valued was a majority or minority interest made no difference, because either way the economic reality (that a hypothetical willing buyer of shares would adjust his or her purchase price to reflect his or her proportional share of the entire built-in capital gain tax) required taking a "snapshot" of value on the valuation date as though a liquidation took place then. Even though the Eleventh Circuit stated several times in its opinion that the Fifth Circuit in Estate of Dunn had made an "arbitrary" assumption of a liquidation on the valuation date, the Eleventh Circuit nevertheless thought that that approach offered important advantages of certainty, avoiding the need for prophecies about when assets would be sold, and avoiding "the unnecessary expenditure of judicial resources being used to wade through a myriad of divergent expert witness testimony, based upon subjective conjecture, and divergent opinions." Under a de novo review as a matter of law, therefore, the Eleventh Circuit vacated the judgment of the Tax Court and remanded with instructions that the Tax Court apply a dollar for dollar reduction to the net asset value of CCC for the entire built-in capital gain tax liability.

As to the lack of control and lack of marketability discounts, the Court of Appeals was satisfied that the Tax Court did not commit clear error, and therefore affirmed the Tax Court on those two issues without further discussion.

There was a sharp dissent by Judge Carnes concerning the built-in capital gain tax issue. He contended that the majority, in the interest of avoiding the effort required for a more accurate calculation of value, "simply assume[d] a result that we all know is wrong." He favored the Service's admitted "more complicated" approach over the "simple but arbitrary assumption' made by the estate and by the Eleventh Circuit majority. In response to the majority's rhetorical question why a buyer would not adjust his or her purchase price to reflect the entire built-in capital gain tax liability, Judge Carnes responded that the buyer could not reasonably expect the seller to agree to a price reduction that ignored the time value of money.

XII. Astleford.

A. Facts.[55]

[55] Judge Swift wrote the opinion in Astleford.

Astleford was a gift tax case involving interests in the Astleford Family Limited Partnership ("AFLP"). AFLP was formed on August 1, 1996, to facilitate the ownership, development and management of various real estate investments and partnership interests that the taxpayer, Jane Astleford, owned, and also to facilitate gifts to her three adult children. The partnership agreement provided for annual distributions of net cash flow to the partners. No one outside the family could become a partner, nor could a limited partner transfer any of his or her interest, without Jane's consent as general partner. On the same day as the formation of the partnership and its funding by the transfer of Jane's interest in an elder-care facility, Jane gave each of her children a 30% limited partner interest in AFLP, retaining a 10% general partner interest. On December 1, 1997, Jane made an additional capital contribution of an interest in a preexisting general partnership called Pine Bend (which in turn owned real estate), and 14 other real estate properties, to AFLP, substantially increasing her percentage general partner interest and reducing the children's percentage limited partner interests, but on the same day as that additional contribution, Jane gave each of her children additional limited partner interests so that her general partner interest was reduced once more to approximately 10% and the children's limited partner interests were increased to about 30% apiece. Jane filed gift tax returns for 1996 and 1997. On audit, the Service sought to increase the 1996 taxable gift from $277,441 to $626,898, and the 1997 taxable gift from $3,954,506 to $10,937,268. The dispute issues related to the value of the underlying property in Pine Bend, whether the Pine Bend interest should be valued as a general partner interest or as an assignee interest, and the lack of control and lack of marketability discounts that should apply to the Pine Bend interest that Jane contributed to AFLP and the limited partner interests in AFLP that Jane gave to her children. Our discussion here deals only with the discount issues. Judge Swift held that, in accordance with the government's contention and contrary to Jane's, the Pine Bend interest should be treated as a general partner interest and not a mere assignee interest, and the discussion below reflects that conclusion.

B. Valuation Issues in the Case.

1. Taxpayer's Expert.

Judge Swift's opinion notes that Jane had four expert witnesses at trial, but the opinion does not otherwise identify them. Jane's experts concluded that a 40% combined discount for lack of control and lack of marketability was appropriate for the 50% general partner interest in Pine Bend that Jane contributed to AFLP. As to the limited partner interests in AFLP, Jane's experts concluded that the lack of control discount should be 45% for 1996 and 40% for 1997, and that the lack of marketability discount should be 15% for 1996 and 22% for 1997.

2. Service's Expert.

Judge Swift's opinion states that the Service had two expert witnesses at trial, but the opinion does not further identify them. The Service's experts, as discussed below under "Methodologies," took the view that no discount was called for at the Pine Bend level. For the limited partner interests in AFLP, the Service determined lack of control discounts of 7.14% for 1996 and 8.34% for 1997, and a lack of marketability discount of 21.23% for 1996 and 22% for 1997.

3. Methodologies.

In calculating lack of control and lack of marketability discounts for the 50% general partner interest in Pine Bend that Jane contributed to AFLP, and the limited partner interests in AFLP that Jane gave to her children, Jane's experts relied on comparability data from sales of interests in registered real estate limited partnerships ("RELPs").

Jane's experts, in evaluating the lack of control and lack of marketability discounts for the 50% Pine Bend interest, identified trading discounts in 17 RELP comparables traded on the secondary market. Next, Jane's experts derived what they believed should be a lower limit of 22% and an upper limit of 46% for the combined discount, but then they "abruptly," in Judge Swift's words, concluded that a combined discount of 40% for lack of control and lack of marketability was appropriate, without explaining how they picked 40% rather than some other figure within the 22%-46% range. The Service's experts, by contrast, concluded that since the Pine Bend interest was an asset of AFLP, the discounts that those experts applied at the AFLP level eliminated the need to apply an additional, separate discount at the Pine Bend level.

In analyzing the lack of control discounts for the limited partner interests in AFLP, Jane's experts selected nine RELP comparables, and then narrowed the sample to four comparables which had trading discounts ranging from 40-47%. The Service's experts, on the other hand, studied trading prices and per share NAVs for about 75 REITs. Since REITs allow investors to own a noncontrolling but liquid investment in an otherwise illiquid asset, i.e. real estate, REIT investors are willing to pay a liquidity premium (relative to per share NAV). Therefore, in analyzing REIT comparables, one can calculate and then reverse out of the trading prices any liquidity premiums, and that calculation gives rise to a REIT discount for lack of control.

C. Judge Swift's Conclusions.

Judge Swift disagreed with the view of the Service's experts that no separate discount was warranted at the Pine Bend level. He cited several Tax Court cases in which two layers of discounts had been applied where a taxpayer held a minority interest in an entity that in turn owned a minority interest in another entity, though he acknowledged that other Tax Court cases had rejected multiple discounts to tiered entities where the lower level interest was a significant part of the parent entity's assets, or where the lower level entity was the parent's principal operating subsidiary. The Pine Bend interest made up less than 16% of the NAV of AFLP and was only one of 15 real estate investments held by AFLP. Therefore, in Judge Swift's view, lack of control and lack of marketability discounts at both the Pine Bend level and the AFLP level were appropriate.

As noted above, Jane's experts relied on RELP data and the Service's experts relied on REIT data. Judge Swift declined to declare either RELP or REIT date generally superior to the other. On the one hand, he thought that RELPs more closely resembled Pine Bend and AFLP than did REITs, and he did not think that the trading volume on the RELP secondary market was so low as to make the available RELP date unreliable; on the other hand, he also believed that the large number of sales of interests in REITs tended to produce more reliable data than did the limited number of RELP sales, and that the differences between REITs and partnerships such as

Pine Bend and AFLP could be minimized given the large number of REITs from which to select comparables.

Judge Swift eliminated four of the 17 RELP comparables that Jane's experts had considered in connection with the valuation of the Pine Bend interest, because the data in those four comparables was based on 1999 information whereas the gifts at issue were in 1996 and 1997. Based on the median and mean trading discounts in the remaining RELP comparables and additional RELP comparables considered by Judge Swift, he concluded that a combined discount of 30% for lack of control and lack of marketability was appropriate for the Pine Bend interest.

In considering the appropriate lack of control discounts for the limited partner interests in AFLP, Judge Swift pointed out that the RELP comparables selected by Jane's experts were much more leveraged than was AFLP. Therefore, he did not find the 45% and 40% discounts determined by Jane's experts to be credible. Jane's experts had also acknowledged that the higher an RELP's cash distribution rate, the lower the investor risk, which would suggest a lesser lack of control discount. AFLPs cash distribution rate was 10%, compared with the 6.7% cash distribution rate in the RELP comparables observed by Jane's experts. Judge Swift viewed more favorably the methodology used by the Service's experts, utilizing REIT data and reversing out of the trading prices any liquidity premiums, but he thought that the REIT liquidity premium determined by the Service's experts was too low. Some of the studies cited by the Service's experts suggested that liquidity premiums for publicly traded investments might be nearly twice the premiums that those experts used, and moreover, the lack of control discounts of 7.14% and 8.34% derived from reversing out the assumed liquidity premiums appeared to Judge Swift to be "unreasonably low" on their face. Therefore, Judge Swift looked to the difference in average discounts observed in private placements of registered and unregistered stock, based on the premise that such discounts reflected pure liquidity concerns. According to two studies cited by the Service's experts, the discount was about 14%, resulting in a general liquidity premium in publicly traded assets of 16.27% which Judge Swift thought would also be applicable to publicly traded REITs. Judge Swift then reversed that liquidity premium out of the data on the REIT comparables, and derived, for the limited partner interests in AFLP, lack of control discounts of 16.17% for 1996 and 17.47% for 1997.

Since the lack of marketability discount of 21.23% determined by the Service's expert for the 1996 gifts of limited partner interests in AFLP was greater than the 15% discount estimated by Jane's experts, Judge Swift adopted the 21.23% lack of marketability discount without further discussion. As to the 1997 gifts of limited partner interests in AFLP, both parties' experts agreed on a lack of marketability discount of 22%, which Judge Swift adopted.

<u>Astleford</u> illustrates once more the willingness of a Tax Court Judge to engage in his or her own valuation analysis, selectively agreeing and disagreeing with the methodologies of both parties' experts. The case is also worth reading for its discussion of, and review of case law in connection with, multiple discounts in tiered entity structures.

XIII. Holman.

A. Facts.[56]

Holman was a gift tax case. There were several issues in the case, but the valuation issues related to limited partner interests in The Holman Limited Partnership.

Tom and Kim Holman were husband and wife. Tom was employed by Dell Computer Corporation ("Dell") and had received a substantial amount of Dell stock through exercise of options, and he and Kim had bought additional Dell stock. After about two years of discussion with estate planning advisors regarding their goals, which included promoting long-term asset growth, asset preservation and protection, and educating their children on business matters, Tom, and Kim and a trust for their children formed The Holman Limited Partnership. On November 2, 1999, Tom and Kim each contributed 625 shares of Dell stock to the partnership in exchange for a 0.89% general partner interest and 34,375 Dell shares in exchange for a 49.04% limited partner interest. The trust contributed 100 Dell shares in exchange for a 0.14% limited partner interest. Therefore, the partnership owned a total of 70,100 Dell shares.

The partnership agreement recited that the purposes of the partnership included, among other things, the preservation of family assets, restricting the right of non-family members to acquire interests in family assets, and protection of family assets from claims of family members' future creditors. Limited partners were generally prohibited from assigning their interests in the partnership without the prior consent of all partners. A limited partner could, however, assign his or her interest to a revocable trust of which he or she was sole beneficiary, to another family member, to a custodian for a family member under an applicable transfers to minors act, to another partner in the partnership, or to a trust for the benefit of family members even if the trust also included non-family members as beneficiaries. If a prohibited assignment turned out nevertheless to be effective according to then applicable law, the partnership had an option to reacquire the interest of the assignee for its fair market value based on the assignee's right to share in partnership distributions, as determined by an independent appraiser selected by the general partners. The purchase price upon exercise of this option could be paid 10% down with the balance over five years with interest at the applicable federal rate. Even if the partnership did not exercise its option to reacquire the interest, the assignee would not become a full limited partner unless all of the other partners consented. Under the partnership agreement, the partnership would be dissolved on December 31, 2049, or would be dissolved earlier with the written consent of all partners.

On November 8, 1999, Tom and Kim made gifts of limited partner interests to the trust for their children and to Tom's mother as custodian for their youngest child. Tom and Kim filed gift tax returns for 1999, making the split gift election, and reporting the value of the gifts from each of Tom and Kim as $601,827, based on an independent appraisal. The appraiser applied a discount of 49.25% to the partnership's net asset value (i.e., the value of the Dell shares). On December 13, 1999, custodial accounts for Tom's and Kim's four children, with Tom's mother as custodian, contributed a total of 30,120 Dell shares to the partnership in exchange for limited partner interests, so that the partnership owned 100,220 shares of Dell stock. On January 4, 2000, Tom and Kim gave small limited partner interests to the custodial accounts. Tom and Kim filed gift tax returns for 2000, making the split gift election, and reporting the value of the gifts

[56] Judge Halpern wrote the opinion in Holman.

by each of Tom and Kim as $40,000, based on an independent appraisal. As with the 1999 gift, the appraiser applied a discount of 49.25% to the partnership's net asset value. On January 5, 2001, Tom and Kim each contributed 5,440 shares of Dell stock to the partnership, so that the partnership owned 111,100 Dell shares. On February 2, 2001, Tom and Kim gave small limited partner interests to the custodial accounts. Tom and Kim filed gift tax returns for 2001, making the split gift election, and reporting the value of the gifts by each of Tom and Kim as $40,000, based on their estimate of value in light of the appraisals of the 1999 and 2000 gifts.

After all of these contributions and gifts, Tom and Kim each owned a 0.56% general partner interest and a 5.04% limited partner interest, the children's trust owned a 44.29% limited partner interest, and each of the four custodial accounts for the children owned a 11.13% limited partner interest. At the time of each of the gifts, the sole asset of the partnership was Dell stock.

B. Valuation Issues in the Case.

1. Taxpayers' Expert.

The Holmans offered Troy D. Ingham ("Mr. Ingham") as an expert witness.[57] Mr. Ingham concluded that the lack of control discount should be 13.4% for the 1999 gift, 16.3% for the 2000 gift and 10% for the 2001 gift.

2. Service's Expert.

The Service offered Francis X. Burns ("Mr. Burns") as an expert witness.[58] Mr. Burns concluded that the lack of control discount should be 11.2% for the 1999 gift, 13.4% for the 2000 gift and 5% for the 2001 gift.

3. Methodologies.

The parties' experts agreed that the starting point for valuing the limited partner interests should be the partnership NAV, which equaled the value of the Dell shares. The parties' experts disagreed, however, on the calculation of NAV on the dates of the 2000 and 2001 gifts. Mr. Burns calculated the NAV based on the averages of the high and low prices on those dates, in view of Treas. Reg. §25.2512-2(b)(1), which provides that if there is a market for stocks, the mean between the highest and lowest quoted selling prices on the gift date is generally the fair market value. Mr. Ingham, on the other hand, calculated NAV based on the closing values of the Dell stock on those gift dates. The Holmans argued that the regulation did not apply because the gifts being valued were gifts of limited partner interests, not marketable stocks, and moreover that Mr. Ingham's lack of control discount analysis used data showing that shares of publicly held investment companies generally traded at a discount from NAV, determined by comparing

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[57] Mr. Ingham was a vice president and director with Management Planning, Inc., had been performing valuation services since 1996, and was a candidate for the American Society of Appraisers.

[58] Mr. Burns was a vice president of CRA International, Inc., an international consulting firm that provided business valuation services, and was an accredited senior appraiser in business valuation within the American Society of Appraisers and a member of the Institute of Business Appraisers. Mr. Burns had been an expert witness for the Service in a number of valuation cases, including Peracchio and Temple, both discussed above.

the price of the company to its end-of-day NAV. As noted below, the Tax Court agreed with the Service on this issue.

Both parties' experts, in evaluating the lack of control discount, considered prices of shares of publicly traded closed-end investment funds with portfolios consisting predominantly of domestic common stocks. Each expert relied on three samples, one for the date of each gift, and the samples were similar in size between the experts. Mr. Burns relied solely on general equity funds, whereas Mr. Ingham included in his samples several specialized equity funds with investments in the health care, petroleum and resources, and banking industries. Mr. Burns computed, for his sample, the median, mean and interquartile mean discounts, while Mr. Ingham computed only the median discounts. Mr. Ingham considered adjustments to his median discount figures to reflect quantitative factors, namely the partnership size, the volatility of its portfolio, and measures of return and yield, but concluded that those factors were not significant. He also considered qualitative factors, namely the lack of diversification in the partnership's portfolio, the depth and qualify of the partnership's management and the partnership's income tax status, and concluded that a willing buyer of a limited partner interest would require a discount 10% greater than the median discounts that he had determined. Mr. Burns, by contrast, relied on the interquartile mean discount (i.e., the mean of the 50% of the data points falling between the 25th and 75th percentiles). He considered, but rejected, a downward adjustment in the discount to reflect the large proportional limited partner interest held by the trust for the children and any influence that that might give the trust over the general partners.

Concerning the lack of marketability discount, Mr. Ingham and Mr. Burns differed sharply over both the existence of a market for limited partner interests and the weight that should be given to various qualitative factors. Mr. Ingham relied on his own and others' studies of restricted stock transactions that compared the private-market prices of restricted shares of public companies with the coeval public market price. Based on both the restricted stock analysis and his analysis of the "investment quality" of the limited partner interests in the Holman partnership, he concluded that 35% was the appropriate lack of marketability discount.

Mr. Burns took a more complex approach to the lack of marketability discounts. He considered restricted stock studies from three different periods -- (i) prior to 1990, when the SEC adopted Rule 144A allowing institutional buyers to buy and sell restricted stock, (ii) 1990-1997, and (iii) 1997-1998, In 1997, the SEC reduced the required holding period under Rule 144 from two years to one. Based on the decline in average discounts over this period, Mr. Burns concluded that the main factors influencing investors were the limited access to a liquid market and the required holding period before the stock could be freely traded. Although Mr. Burns recognized that the Holman partnership was very different from the operating companies that were the subject of the restricted stock studies, he concluded that the 12 percentage point difference in average discount between the pre-1990 studies and the 1990-1997 studies was indicative of the portion of the discount attributable to lack of access to a ready resale market. Mr. Burns thought that the remaining 22 percentage points of the average pre-1990 discount of 34% were attributable to holding period restrictions and factors unrelated to marketability. He concluded that for investment companies such as the partnership, where there were no legally mandated holding periods and, in his view, the operating and financial risks of typical restricted shares were absent, an analysis of the restricted stock studies suggested a lack of marketability discount around 12%. Mr. Burns then considered factors specific to the Holman partnership, specifically, the failure to make distributions, the nondiversified portfolio, the restrictions on transfers of limited partner interests, the dissolution provisions of the partnership agreement (allowing dissolution with the consent of all partners) and the liquidity of Dell shares. In Mr. Burns's view, the last two factors increased the marketability of the limited partner interests. He concluded that the appropriate discount for lack of marketability was 12.5%.

C. Tax Court's Conclusions.

Though our discussion here focuses on the discount analysis, it is of interest that the Tax Court concluded that the transfer restrictions in the partnership agreement should be disregarded for valuation purposes under I.R.C. §2703. The Tax Court determined that these restrictions did not constitute a bona fide business arrangement within the meaning of I.R.C. §2703(b)(1), and did constitute a device, within the meaning of I.R.C. §2703(b)(2), to transfer limited partner interests to the natural objects of Tom's and Kim's bounty for less than adequate consideration.

With respect to the calculation of NAV on the dates of the 2000 and 2001 gifts, the Tax Court rejected the Holmans' argument that Treas. Reg. §25.2512-2(b)(1), requiring valuation of stocks based on the mean between the highest and lowest quoted selling prices for the date of each gift, did not apply and that reference should be made to the closing price for each date. The Tax Court held that the regulation could not be dismissed, and also concluded that the Holmans had failed to show that any statistical inference to be drawn from the data on publicly held investment company date would be any different if an average of the highs and lows of component securities, rather than end of day values, were used to determine NAVs.

In connection with the lack of control discounts and the composition of the samples of closed-end investment funds, Mr. Ingham agreed with the government's counsel on cross-examination that the specialized equity funds he had included in his samples resembled the Holman partnership only in that they were specialized in their investments. He had included no explanation in his report for the inclusion of the particular specialized funds. The Tax Court, noting (i) that the mean and median discounts for the specialized funds as of the first gift date were significantly greater than the mean and median discounts for the full sample and (ii) that Mr. Ingham and Mr. Burns agreed that a sample of general equity funds yielded useful information but disagreed over whether consideration of funds specializing in industries different from Dell's shed light on the appropriate discounts, concluded that a sample of general equity funds only was sufficiently reliable. Therefore, the Tax Court constructed samples for each gift valuation date from the overlap of the experts' data sets for that date.

Mr. Ingham had relied on the median of each sample to neutralize the effect of outliers, but in response to a question from the Court, he could not say whether outliers caused a significant difference between the means and the medians in his samples, because he had not computed the means. The Tax Court found the approach of Mr. Burns, who computed the mean, median and interquartile means, to be more thoughtful, and therefore followed Mr. Burns's lead of relying on the interquartile mean of each sample.

The Tax Court also agreed with Mr. Burns that no adjustment to the averages so obtained was appropriate. Mr. Ingham failed to convince the Court that lack of portfolio diversification and lack of professional management justified an increase in the lack of control discount. Mr. Ingham had conceded in his report that the partnership's simple portfolio negated the significance of lack of professional management. The Tax Court did not see how lack of diversification could warrant a greater lack of control discount "since the partnership was, on the valuation dates, transparently, the vehicle for holding shares of stock of a single, well-known corporation." The appropriate lack of control discounts, the Court concluded, were 11.32% for the 1999 gift, 14.34% for the 2000 gift and 4.63 for the 2001 gift.

As to the lack of marketability discount, the Tax Court noted that the parties' experts disagreed principally over the likelihood of a private market among the partners for limited partner interests. Mr. Burns argued that under Mr. Ingham's theory that there was no such market, it seemed arbitrary to stop at a 35% discount as Mr. Ingham did, since it would seem that if a limited partner interest could not be sold, its value would be near zero or it could not be valued at all. The Tax Court thought that Mr. Burns had a point here: "Mr. Ingham has not persuaded us that his stopping point, 35%, is anything but a guess." Mr. Ingham had failed to build from his observed sample median and mean discounts of 24.8% and 27.4%, respectively, to his 35% discount conclusion by quantitative means, and the Court found Mr. Ingham's analysis of qualitative factors inadequate and vague. The Tax Court found Mr. Burns's analysis of the lack of marketability discount much more persuasive. The Court noted that since the partnership held only Dell stock, a highly marketable and liquid asset, the remaining partners would appear to bear little or no economic risk in agreeing to a redemption of a limited partner interest in order to accommodate a partner who wanted to make an assignment. Interestingly, the Tax Court was relatively dismissive of the partnership's stated purpose of preserving family assets; the Tax Court thought that the partnership agreement provision allowing consensual dissolution showed that asset preservation "was not an unyielding purpose." The Tax Court agreed with Mr. Burns that the holding period component of the discount had little if any significance, and that the only truly relevant element of the lack of marketability discount was the market access component. Concluding that based on the record and the testimony, the Court could not improve upon Mr. Burns's estimate of the lack of marketability discount, the Tax Court determined that discount to be 12.5%.

The Tax Court's construction of its own data set, from the overlap of the experts' samples, in evaluating the lack of control discount is consistent with the "pick and choose" theme reflected in so many other recent cases. The Tax Court's acceptance of the lack of marketability discount analysis presented by Mr. Burns is both interesting and troubling, however. The assumption that the other partners would willingly redeem out a limited partner, and the Service's interpretation of the restricted stock studies, are certainly debatable, and the 12.5% lack of marketability discount is well below the range that many practitioners have considered relatively "safe."

XIV. Conclusion.

These twelve cases illustrate that the persuasiveness of an expert's analysis depends on whether or not the court concludes that (1) the size of the sample is sufficient; (2) the sample funds actually resemble, to the extent possible, the particular asset class owned by the partnership or other entity that is the subject of the valuation; and (3) the data relied on by the expert are contemporaneous (i.e., as close as possible to the valuation date). In addition, the expert must be able to explain the underlying data and methodologies used in the expert's analysis and be prepared to defend his or her opinion. Moreover, any internal inconsistencies will negatively affect the credibility of an expert's valuation analysis. Failure to quantify, or at least explain the significance of, "subjective" factors used when adjusting discounts, or choosing a representative discount from within a specific range of discounts, will likewise undercut the persuasiveness of an expert's opinion. At a bare minimum, an expert must select companies which relate to the company being valued in meaningful ways, base discounts on the specific facts of the case, and quantify, or at least articulate, the effects of any additional factors an expert chooses to rely on when making adjustments within a discount range.

The court may, depending on its assessment of the experts' credibility, choose to give little or no weight to the analysis and conclusions of one party's expert. The result may be a complete victory for the other party, as with the taxpayer win in Kohler, but that will not always be so. In Thompson, the Second Circuit held that because the Tax Court did adopt some of the Service's arguments despite the Tax Court's severe criticism of the Service's expert, the burden of proof provision, I.R.C. §7491, did not require the Tax Court to accept the taxpayer's valuation. Alternatively and more typically, a court may perceive strengths and weaknesses in the analyses by both parties' experts, leading it to construct its own analysis that draws selectively from the work of each expert. A court may even, as in Gimbel, make its own independent determination of how much of a deceased shareholder's stock it was reasonably foreseeable that the company would repurchase, based on the court's consideration of the company's policies and competing liquidity needs.

Taxpayers, especially in the Eleventh Circuit, with the built-in capital gain tax issue should be encouraged by the appellate decision in Jelke, although the recent filing of a petition for certiorari in the case raises the possibility that the U.S. Supreme Court may yet speak on the question.

Astleford is, among other things, a reminder that multi-level discounts for tiered entities may be allowed in appropriate circumstances. Holman may reflect a disturbing trend in the Tax Court concerning the analysis of lack of marketability discounts.