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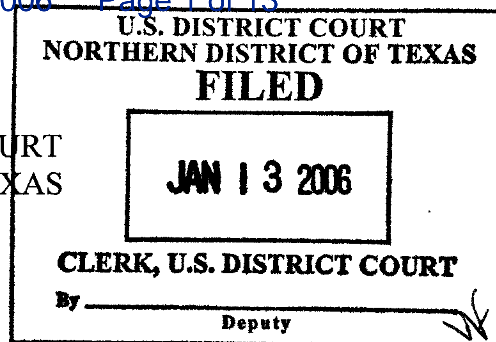


IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

LEONARD A. ROBERTSON, as Trustee of the David M. & Mary C. Crowley Charitable Lead Non-Exempt Trust f/b/o Donald Carter Jr.	§	Civil Action No. 3-03-CV-2113-BD
Plaintiff,	§	(Consolidated with Nos. 3-03-CV-2114-L, 3-03-CV-2115-R, and 3-03-CV-2116-L)
v.	§	
UNITED STATES OF AMERICA,	§	
Defendant.	§	

Findings of Fact and Conclusions of Law

A. Posture of the Case

1. This is a lawsuit by the United States to collect generation skipping transfer ("GST") taxes from the Third-Party Defendants (collectively, the "Taxpayers", or individually, "Taxpayer"). This case involves the determination of the "taxable amount" under 26 U.S.C. § 2621(a)(1) of distributions from certain trusts to the Taxpayers on December 13, 2002 for GST tax purposes. To reach the taxable amount, the Court must determine the value (as of the date of the distribution) of the limited partnership units of DMC Non-Exempt Partnership, Ltd. (the "Partnership") that were distributed by the trusts to the Taxpayers. The Court must also determine whether the Taxpayers are entitled to deduct certain attorney, appraisal and accounting fees and related expenses under 26 U.S.C. § 2621(a)(2) in calculating the Taxpayer's GST taxable amount.

2. The parties agree that the Taxpayers are liable for GST tax on the value of the

limited partnership units in the Partnership under Section 26 U.S.C. § 2603(a)(1), net of deductible expenses determined by the Court under 26 U.S.C. § 2621(a)(2). In addition, the parties agree that the appropriate valuation date is December 13, 2002. Moreover, the parties agree that the net asset value of the Partnership's assets as of December 13, 2002 was $47,548,145. The parties also agree that the Court has jurisdiction to determine increases or decreases to the amount of GST tax liability reported on the Forms 706-GS(D) filed by the Taxpayers.

B. Government's Contentions

3. The Third-Party Plaintiff (the "Government") contends that each Taxpayer under-reported the value of the shares of stock in the David and Mary Crowley Corporation (the "Corporation") and the limited partnership units in the Partnership that were distributed to the Taxpayers on December 13, 2002 on their respective Forms 706-GS(D) and, therefore, each of the Taxpayers under-reported their GST tax on their respective Forms 706-GS(D). The Government contends that each of the Taxpayers should have reported a distribution of $9,640,977 on their respective Forms 706-GS(D) and paid a tax of $4,820,489.

4. The parties have stipulated that the value of the shares in the Corporation distributed to each Taxpayer was $47,624. However, the parties disagree on the value of the Partnership units distributed to each Taxpayer.

5. With respect to the valuation of the Partnership units, the Government has a primary and a secondary position. The Government's primary position is that the market approach should apply and the Partnership units should be valued at the Partnership's assets (net of any liabilities) and without any discounts on such date divided by the number of units then

outstanding (the "Net Asset Value of the Units"). The Government contends that the Partnership, and its identical predecessor, engaged in certain transactions with its partners during 2001 at full net asset value without any discounts. The Government contends these transactions, when viewed together, establish that the value of the limited partnership units in the Partnership on December 13, 2002 should have been based on the Net Asset Value of Units without any discounts.

6. For its secondary position, the Government contends that the limited partnership units in the Partnership should be valued at one of the two alternative figures outlined in an appraisal prepared by Francis X. Burns and dated January 26, 2005 (the "Burns Appraisal"). The first value in the Burns Appraisal is the Net Asset Value of the Units discounted by 14.9% under the right of first refusal approach. Alternatively, the second value in the Burns Appraisal is that the limited partnership units in the Partnership should have been valued using the Net Asset Value of the Units discounted by a combined effective discount of 17.925% for lack of control (6.2%) and lack of marketability (12.5%) of such units.

7. Finally, the United States contends that the Taxpayers are not entitled to deduct their claimed expenses for attorneys fees, appraisals, and other costs related to the determination of their GST tax liability for the December 13, 2002, distributions because some of those expenses were previously deducted by the Partnership and Taxpayers on income tax returns.

C. Taxpayers' Contentions

8. The Taxpayers contend that the limited partnership units in the Partnership should be valued as of December 13, 2002 using the Net Asset Value of the Units discounted by a combined effective discount of 41.5% for lack of control and lack of marketability of such units

as outlined in the appraisal report prepared by Peter J. Phalon, one of the Taxpayers' expert witnesses.

9. Alternatively, the Taxpayers contend that the limited partnership units in the Partnership should be valued on December 13, 2002 using the Net Asset Value of the Units discounted by a combined effective discount of 36% for lack of control and lack of marketability of such units as outlined in the appraisal report prepared by Gerry A. Keller, who is an expert witness for the Taxpayers (the "Keller Appraisal"). The Taxpayers contend that the methodology used in the Keller Appraisal was the methodology used in valuing the limited partnership units distributed to the Taxpayers for purposes of preparing and filing their respective Forms 706-GS(D).

D. Findings and Conclusions

10. Donald Carter, Jr., Christina Urschel, Ron Carter, and David Shanahan (i.e., the Taxpayers) are named herein as a Third-Party Defendants because they are the beneficiaries of four separate charitable lead non-exempt trusts established by David M. and Mary C. Crowley for each of their benefit (separately, "Trust", and collectively, the "Trusts"), and because each of their respective Trusts made a distribution to the Taxpayers on December 13, 2002, which was taxable for GST tax purposes under 26 U.S.C. §§ 2601, 2603(a)(1), and 2611(a)(1) and 2612(b).

11. The Trusts are governed by a Trust Agreement dated August 14, 1986 by David M. Crowley as grantor.

12. The grantor of the Trusts was the husband of Mary C. Crowley, who was the grandmother of the Taxpayers.

13. On December 31, 1996, the four Trusts, and a fifth trust for the benefit of Jeanine Lusk, contributed assets to a partnership known as the David and Mary Crowley Family

Partnership Ltd. (the "1996 Partnership").

14. As of October 25, 2001, two trusts for the benefit of Jeanine Lusk (the "Lusk Trusts") together owned approximately 20% of the interests in the 1996 Partnership.

15. On October 25, 2001, the 1996 Partnership entered into a Plan of Partial Liquidation and redeemed the Lusk Trusts' partnership interests in 1996 Partnership for an amount equivalent to their pro rata share of the 1996 Partnership's net asset value.

16. On November 30, 2001, Terry Arledge contributed $30,000 in cash to the Partnership in exchange for 28,833 limited partnership units in the Partnership. The value of each unit received by Mr. Arledge in exchange for his contribution to the Partnership was based on the value of the Partnership's assets (net of any liabilities) divided by the number of units then outstanding. Each unit in the Partnership that Mr. Arledge received in exchange for his capital contribution to the Partnership was valued at $1.04048.

17. Also, on November 30, 2001, the Foundation contributed $70,000 in cash to the Partnership in exchange for 67,277 limited partnership units in the Partnership. The value of each unit received by the Foundation in exchange for its contribution to the Partnership was based on the value of the Partnership's assets (net of any liabilities) divided by the number of units then outstanding. Like Mr. Arledge, each unit in the Partnership that the Foundation received in exchange for its capital contribution to the Partnership was valued at $1.04048.

18. On December 13, 2002, the Trusts owned approximately 80% of the stock in the Corporation.

19. On December 13, 2002, the Corporation, the Trusts, Mr. Arledge and the Foundation owned the following interests in the Partnership:

Partners	Partnership Units	Interest Percentage
GENERAL PARTNER:		
David and Mary Crowley Corporation	613,255	1.2304
LIMITED PARTNERS:		
Non-Exempt Trust FBO Donald Carter, Jr.	9,803,581	19.6686
Non-Exempt Trust FBO Ronald Carter	9,803,581	19.6686
Non-Exempt Trust FBO David Shanahan	9,803,581	19.6686
Non-Exempt Trust FBO Christina C. Urschel	9,803,581	19.6686
Terry Arledge	28,833	0.0578
Crowley Carter Foundation	67,277	0.1350

20. On December 13, 2002, the remaining limited partnership units in the Partnership were owned by the following trusts: David M. and Mary C. Crowley Charitable Lead Exempt Trust FBO: Donald Carter, Jr.; David M. and Mary C. Crowley Charitable Lead Exempt Trust FBO: Ronald Carter; David M. and Mary C. Crowley Charitable Lead Exempt Trust FBO: David Shanahan; and David M. and Mary C. Crowley Charitable Lead Exempt Trust FBO: Christina C. Urschel (collectively, the "Exempt Trusts").

21. On December 13, 2002, the Trusts owned the following shares of stock in the Corporation:

Shareholders	Shares
Non-Exempt Trust FBO Donald Carter, Jr.	132,200
Non-Exempt Trust FBO Ronald Carter	132,200
Non-Exempt Trust FBO David Shanahan	132,200
Non-Exempt Trust FBO Christina C. Urschel	132,200

22. On December 13, 2002, the remaining shares of stock in the Corporation were owned by the Exempt Trusts.

23. On December 13, 2002, the Trustees of the Trusts distributed to their respective remainder beneficiaries (i.e., the Taxpayers) substantially all of the assets of the Trusts.

24. As part of the December 13, 2002 distribution, each Trust distributed 132,200 shares of stock in the Corporation, valued at $47,624 for GST tax purposes, to its respective remainder beneficiary (i.e., Taxpayer).

25. Also, as part of the December 13, 2002 distribution, each Trust distributed 9,803,581 limited partnership units in the Partnership to its respective remainder beneficiary (i.e., Taxpayer).

26. The net asset value of the Partnership as of December 13, 2002 is $47,548,145.

27. On October 15, 2003, each Taxpayer filed a Form 706-GS(D), Generation-Skipping Transfer Tax Return for Distributions, reporting $6,210,628 in distributions from their respective Trusts and $3,090,314 in GST tax for each Trust.

28. On their respective Forms 706-GS(D), each Taxpayer reported the value of 132,200 shares of stock in the Corporation at $34,372. An appraisal of the value of a share of stock in the Corporation by Hill Schwartz Spilker Keller, LLC ("HSSK") was attached to each Form 706-GS(D).

29. On their respective Forms 706-GS(D), each Taxpayer reported the value of 9,803,581 limited partnership units in the Partnership at $6,176,256. An appraisal of the value of a limited partnership unit in the Partnership by HSSK was attached to each Form 706-GS(D).

30. The Internal Revenue Service assessed the full amount of tax due per the Form 706-GS(D), including related interest and penalties against the Taxpayers, and mailed each Taxpayer a notice of tax due and request for payment.

31. The Internal Revenue Service has subsequently audited the Forms 706-GS(D) filed by the Taxpayers, and has concluded that each of the Third Party Defendants should have reported a distribution of $9,640,977.

Issue 1: Value of the Limited Partnership Units

32. The IRS regulations define "fair market value" as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts." Treas. Reg. §§ 20.2031-1(b) and 25.2512-1. Prior to trial, the parties stipulated that on December 13, 2002, each of the four Taxpayers received 9,803,581 limited partnership units, or a 19.6686% interest in the Partnership. (Jt. PTO at 6-8, Stip. #10, 14). The parties further stipulated that the net asset value of the Partnership as of December 13, 2002, was $47,548,145.00. (*Id.* at 8, Stip. #15). Therefore, the Court must decide how to value these limited partnership units.

33. In determining the "fair market value" of the limited partnership units, the Court

heard testimony from three appraisers. The Court rejects entirely the testimony of Gerald A. Keller, as his methodology was difficult to follow and the Government effectively impeached his credibility by pointing out several errors in his calculations.

34. The Court also rejects the Government's market approach to valuation under these facts, because that theory was disavowed by all of the testifying experts in determining their valuations in this case.

35. The Court rejects Burns' alternative "right of first refusal" analysis as speculative because it assumes, without any evidentiary support, that the Partnership or its partners would exercise their option to purchase an offered interest under hypothetical conditions.

36. That leaves the testimony of the Government's expert, Francis X. Burns, and the Taxpayers' expert, Peter J. Phalon, both of whom offer opinions regarding the lack of control discount and lack of marketability discount applicable to the limited partnership units. Both experts were qualified to render opinions on the valuation issues presented in this case and used similar methodologies in formulating their opinions. The Court therefore must determine the proper weight to give the testimony of Burns and Phalon in light of the underlying data considered, analysis used, and overall credibility of each expert.

Lack of Control Discount.

37. Although both experts considered the nature of the Partnership assets by comparison to closed-end funds, the Court finds the analysis used and data considered by Phalon to be more thorough. By way of example, Phalon properly determined a discount for the Brandes account based on World Equity Closed-End Fund data, whereas Burns erroneously included the Brandes account in his equities classification and used General Equity Closed-End Fund data to determine a discount for that account. In addition, Burns analyzed closed-end funds using a mean rather an a median

approach, which exaggerated the impact of outliers. The Court finds that the median approach utilized by Phalon to be more indicative of market factors. Therefore, the Court allows an 8% discount for lack of control based on Phalon's closed-end fund analysis.

38. Phalon then examined the legal structure of the Partnership to determine whether additional discounts apply. By comparing closed-end funds invested in real estate with publicly traded partnerships invested in real estate, Phalon determined there was an additional 22% discount attributable to structural differences between investment companies and limited partnerships. Of that amount, he conservatively estimated that 50% of the difference, or an additional 11%, was attributable to control. Burns employed no such analysis. Nor did he offer any compelling reason why Phalon's upward adjustment should be rejected. The Court therefore accepts Phalon's testimony on this issue.

39. However, the Court rejects Phalon's testimony that an additional 3% discount for lack of control, over and above the 19% benchmark, is warranted. This testimony was allegedly based on six factors unique to the Partnership, none of which are quantifiable using empirical data. Moreover, it appears that some of these factors may have been previously considered by Phalon in his closed-end fund analysis.

40. In sum, the Court allows a 19% discount for lack of control.

Lack of Marketability.

41. Both Burns and Phalon begin their lack of marketability discount analysis by reference to restricted stock studies. The underlying data used by the experts is not in dispute. Nor is the downward trend in restricted stock discounts since 1990 due to the removal of restrictions on the purchase and sale of such stock.

42. Where the experts differ is in attributing the benchmark discounts distilled from these

restricted stock studies to marketability factors. Burns relied on academic research and available data in determining that a 12.5% discount for lack of marketability was warranted. By contrast, Phalon used subjective factors, not supported by any empirical data, in reaching his conclusion that a 25% marketability discount was appropriate. When questioned by the Court, Phalon failed to adequately explain how he arrived at that percentage and admitted it was subject to some upward or downward adjustment.

43. The Court therefore credits the testimony of Burns over Phalon and allows a 12.5% discount for lack of marketability.

Issue 2: Deduction for Expenses

44. In a supplemental stipulation filed on the date of trial, the parties agreed that various lawyers, appraisers, and accountants were paid a total of $602,159.76 in connection with the determination of the GST tax liability at issue in this proceeding. (Supp. Stip. at 1, 1 & Gov't Exh 27). Of those fees and expenses, $125,155.34 was deducted by the Partnership on its 2003 and 2004 income tax returns, and $53,602.44 was deducted by one or more Taxpayers on their 2002, 2003, and 2004 income tax returns. The remaining $416,245.08 was not deducted by the Partnership or any Taxpayer on prior tax returns. (Gov't Exh. 27).

45. The Internal Revenue Code provides, in pertinent part, that the expenses deducted by the Partnership and the Taxpayers are not deductible for income tax purposes "unless there is filed, within the time and in the manner and form prescribed by the Secretary, a statement that such amounts have not been allowed as deductions [against GST tax] and a waiver of the right to have such amounts allowed at any time as deductions [against GST tax]." *See* 26 U.S.C. § 642(g).

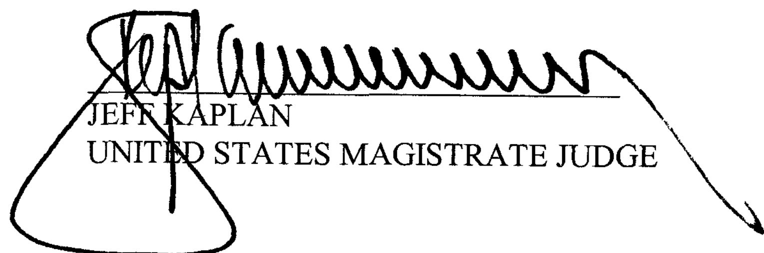
46. Here, no such statement or waiver was ever filed by the Partnership or the Taxpayers.

In addition, it is undisputed that expenses paid by the Partnership were borne by the individual Taxpayers.

47. The Court therefore finds that the Taxpayers are entitled to deduct the attorney, appraisal, and accounting fees incurred in determining their GST tax liability, provided the Partnership and Taxpayers file amended income tax returns to remove the previously claimed expense deductions.

48. Pursuant to Joint Stip. # 23, the Taxpayers have submitted an additional $268,854 in expenses they claim to have incurred between October 31, 2005, and the present date for deduction against their GST tax in accordance with the Court's ruling above. The United States has reviewed these expenses and agrees that these expenses were related to the determination of the GST tax. The United States agrees these additional expenses would be deductible against the Taxpayers' GST Tax at issue in this case. Consistent with the Parties' Joint Stip. # 23, the Court's finding on this issue in paragraphs 46 and 47 for the expenses which were submitted at the time of trial controls the resolution of this question. Accordingly, these additional expenses are also deductible against the GST Tax.

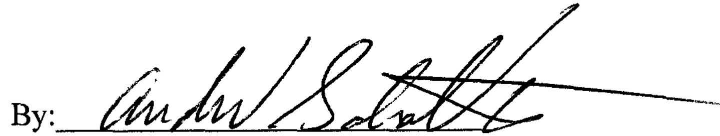
IT IS SO ORDERED, this Jan. 13, 2006.



JEFF KAPLAN
UNITED STATES MAGISTRATE JUDGE

Approved as to Form Only:

FOR THE THIRD-PARTY PLAINTIFF:

By: 

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