T&E - Tax Alert May 7, 2008

Jane Z. Astleford v. Commissioner of Internal Revenue, T.C. Memo 2008-128 filed May 5, 2008.

After the death of her husband, who had been acquiring real property directly or indirectly through partnerships, the petitioner formed a family limited partnership which she funded with her various inherited interests, then gave limited interests in the FLP to her children. The Court decided largely in favor of the petitioner in this gift tax case, and in the process provided a useful review of methods used to determine discounts.

The Court first reviewed the valuation of the underlying 1,187 acres of farmland by agreeing with the petitioner's expert that an absorption discount was needed to account for the large size, much like a blockage discount for securities. The Court, in the end, calculated the discount by reference to local rates of return on farmland in the 10% range, not the petitioner's 25%; this is particularly convincing because the property was largely leased to farmers, a relatively-low risk activity. Doing the math using costs and appreciation assumptions, the Court calculated the absorption discount at 20%.

A 50% general partnership interest was also transferred to the FLP, which the petitioner treated as an assignee interest because, under Minnesota law, its owner only has an interest in profits, not in management, assuming that the other original 50% general partner does not consent to the transfer. The court decided that actual general partnership interests subject to discounts were at issue, using the substance over form doctrine.

Despite few data points being available, the Court confirmed that registered real estate partnership [RELPs] resale information can legitimately be used to support GP discounts. The Court did its own analysis, comparing the FLP to fewer, more relevant RELPs, and reduced the combined discount to 30%.

At the gifted FLP interest level, the Court reviewed proprietary data, introduced by the Service, on publicly traded real estate investment trusts [REITs] because the FLP was on its record smaller, returned more cash and used less debt than the RELPs used as comparable. Using the respondent's methodology, the Court in the end judged its discounts as too low, and settled on the difference in average discounts between registered and unregistered stock of 14%. This translates into a 16% liquidity premium. When applied to the REIT data, this supports 16% and 17% discounts for lack-of-control. Finally, the Court picked 21-22% lack-of-marketability discounts because, despite being proposed by the respondent, it was higher than the discount proposed by the petitioner.

The decision is at: http://www.ustaxcourt.gov/InOpHistoric/astleford.TCM.WPD.pdf. A copy has been placed on my practice's website at http://www.NYNJCT-BV.com/astleford.TCM.WPD.pdf Please do not hesitate to call or e-mail to discuss this or any other valuation issue.

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