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Estate of Louise Gallagher, deceased v. Commissioner, T.C. Memo 2011-148 filed June 28, 2011

At issue is the value of a 15% non-marketable minority interest in a Kentucky LLC which had elected to be taxed as an S corporation. The entity's principal assets were various newspapers, specialty magazines and a TV station operating in small markets. The case represents, on balance, a victory for the estate as the Court determined value [\$32.6 million] much closer to the latter's litigation value of \$28.2 million than the IRS' revised litigation value of \$40 million. However, both experts ran afoul of Judge Halpern, at times because the Judge's position was barely more supported than the positions of the experts he disagreed with.

The Service and the Estate disagreed about almost every aspect of the valuation such as the date of the relevant financial information to be used, the normalization adjustments, the propriety of relying on a market-based approach through the value of public guideline companies, the specific application of the DCF method, the appropriate adjustments to enterprise value and the nature and size of the valuation discounts.

The decedent died on July 5, 2004. The Court reasonably decided that it was appropriate to use end of June financial information for both the Company and the public guideline companies. The Estate's appraiser has used end of May and end of March data, respectively, in an overreaching effort to use only what was known on the Valuation Date. All normalization adjustments of the Estate's appraiser were rejected because the latter did not explain them; some did sound quite plausible. Only the IRS appraiser used the public guideline company method, but the Court disagreed that it should be applied at all, since it only found one public firm, though larger than the subject, which was sufficiently comparable based on its own criterion. Projections used by a 3rd party lender in preparing a debt memorandum - the most sensible set of projections to use - were disregarded by both appraisers and the Court. Accordingly, both appraisers and the Court actually reconstructed their own set of projections based on respective judgement calls on likely future results. The theoretical basis of doing so is very thin, indeed.

Finally, the Court refused to tax-effect results in spite of there being several available models since *Gross* [T.C. 1999-254] which calculate the benefits of the S election [in fairness, none of the experts has used such models.] The reason given by the Court is that the estate's appraiser did not consistently use one tax rate. This opinion thus conflicts with common sense [who would buy equity which, in effect, belongs to the tax authority ?] and thus may very well be revisited by the 11th Circuit Court of Appeals. Further inconsistencies noted by the Court: the estate's appraiser [who did not use the public guideline method] was chastised for using the industry's percentage of equity versus debt in the calculation of Weighted Average Cost of Capital. The Court still does not like using WACC methodology "for a relatively small company," but in the end used it because both appraisers had. Another phobia is the CAPM, which the Court simply refused to sanction despite common use by practitioners.

Finally, despite admitting that his DCF approach produced a minority value, the Service's appraiser took a 17% lack-of-control discount which the Court proceeded to approve and increase to 23%, while criticizing the approach as simplistic [the expert had used the inverse of the control premium data published by Mergerstat.] Finally, both appraisers determined the LOMD at 30% based on a benchmark analysis; faced with rare consistency across parties, the Court agreed but criticized the theory used without going into details.

While it does not sound like the experts were using the latest in their tool boxes, the Court's refusal to use common techniques well past the acceptance stage is disturbing.

The Court decision can be found at <http://www.ustaxcourt.gov>. Click on **Opinions Search**, then enter "Gallagher." The file's name is GallagherEst.TCM.WPD.pdf. The decision is also available at <http://www.NYNJCT-BV.com/GallagherEst.TCM.WPD.pdf>. Please do not hesitate to call or e-mail to discuss this or any other business valuation issue.

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