

T& E Alert 5/31/05

Estate of Frazier Jelke III et al v. Commissioner, T.C. Memo 2005-131 (filed May 31, 2005)

When Mr. Jelke died in 1999, he owned a 6% interest in a C corporation whose other shareholders were trusts for relatives. While the C corporation had started life as a chemical manufacturing business, that asset had long been sold. Instead, the corporation owned a professionally managed securities portfolio, had been in existence for a long time, and had achieved excellent long term returns.

On balance, the estate did not do all that well in court. First the built-in gains discount, which its expert had calculated on a dollar-for-dollar basis assuming an immediate portfolio liquidation, was, instead, pegged by the Court at a historical sales level more in keeping with the corporation's practice of relatively low turnovers in its investments. This reduced the discount from \$55.6 million to \$21.1 million corporation-wide. We can only surmise that the estate's legal representatives perhaps got a tad too aggressive here.

The estate's expert had pegged the discount for lack-of-control at 20%. It was reduced to 10% by the Court, due to the fact that this well-managed family portfolio did not provide control to any of its shareholders, being instead managed by professional third parties. [The IRS expert had testified that 5% was reasonable.] The Court disagreed with both experts' use of closed end funds data.

The estate's expert calculated the lack-of-marketability discount at a rather "standard" 35% based on restricted stock studies; it was reduced to 15% by the Court principally through its interpretation of the Mandelbaum factors.[T.C. Memo 1995-255, affirmed 91 F.3d 124 (3d Circuit 1996.) The IRS expert also interpreted Mandelbaum incorrectly, according to the court [he testified to 10%.]

Combined, the control and marketability discounts were thus reduced from 48% to 23.5%. Ouch !

The court's decision is at:

<http://www.ustaxcourt.gov/InOpHistoric/EstateofJelke.TCM.WPD.pdf>

or at:

<http://www.NYNJCT-BV.com/EstateofJelke.TCM.WPD.pdf>

J.L. PIERSON, ASA
Business Valuation
<mailto:jlp@NYNJCT-BV.com>
<http://www.NYNJCT-BV.com>
Voice + fax: 203-325-2703
Cell when traveling: 203-434-4648
P.O. Box 2392 Darien CT 06820-0392