

T&E - Alert October 14, 2010

Estate of Marie J. Jensen, Virginia Maurer, Executrix v. Commissioner of Internal Revenue, U.S. Tax Court TC Memo. 2010-182 filed August 10, 2010

The Court's decision represents a victory for the estate, as a discount was allowed equal to approx. 100% of the Built-In Gains tax ["BIG tax."] On the other hand, the lack-of-marketability discount ["LOMD"] allowed by the Court was a low 5%. The case is interesting because at issue is a control bloc of shares in a private entity which owns a summer camp, i.e. a real estate intensive business often owned for non-financial reasons. The real estate appraiser determined the fair market value of the underlying property by averaging relatively close market and cost values for an FMV of \$3.77 million, or well over basis. He included the scrap value of the personal property located on the property - see below.

The Service's expert attempted to calculate the BIG tax discount based on the discount at which other investments such as closed-end mutual funds invested in securities or real estate trade relative to net asset values. In the end, he could not and chose 10% of value as appropriate for a discount of \$424 thousand.

The estate's business appraiser first calculated the net asset value of the entity at \$4.24 million [it was quite liquid] and calculated the BIG tax/discount as per applicable tax regulations at \$1.13 million. He indicated that such adjusted net asset value method [NAV less BIG discount] is consistent with a sales situation resulting in a clear tax liability. An income approach could not be used because camp results had historically been low and inconsistent, suggesting that the best use would be to sell the underlying land. He also criticized his counterpart for using closed-end fund data, and for using like-kind exchange data under IRC 1031.

Previous decisions which allowed dollar-for-dollar discounts equal to the tax include the Estate of Dunn [affirmed by the 5th Circuit 2002] and Estate of Jelke [vacated by the 11th Circuit 2007.] The Court first decided to reject the method based on closed-end funds data, even when limited to funds invested in real estate assets.

The Court then prepared its own estimate of the BIG tax using a projection much like that in Estate of Borgatello [TC memo 2000-264] using growth assumptions gleaned from the real estate appraisal and other sources. Since that estimate was close to that of the estate's expert calculation, the latter's dollar-for-dollar determination was selected by the Court. The Court's opinion does not elaborate on the selection of 5% for the DLOM.

The decision can be found on the U.S. Tax Court's website and at <http://www.NYNJCT-BV.com/EstateJensen.TCM.WPD.pdf> Please do not hesitate to call or e-mail to discuss this or any other valuation issue.

J.L. PIERSON, ASA
Business Valuation
mailto:jlpl@NYNJCT-BV.COM
http://www.NYNJCT-BV.COM
(203) 325-2703 Office
(203) 504-7925 Fax
203) 434-4648 Cell

P.O. Box 2392 Darien CT 06820-0392

NYNJCT-BV.com
(203) 325-2703 (203) 434-4648