The Cannon Estate Planning Teleconference Series

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Recent Developments in Valuation and Inclusion in the Gross Estate

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Charles A. Redd is a partner in the St. Louis, Missouri, office of the law firm of STINSON LLP. Mr. Redd concentrates his practice in estate planning, estate and trust administration and estate and trust-related litigation. Prior to joining Stinson, Mr. Redd was a partner in and Vice Chairman of the Trusts & Estates Practice Group at the law firm of SNR Denton US LLP (now Dentons US LLP). Mr. Redd was also previously a partner in the law firm of Armstrong, Teasdale, Schlafly & Davis (now Armstrong Teasdale LLP) and was Chairman of that firm's Trusts & Estates Department. He was previously employed as a Trust Administrator by First Wisconsin Trust Company (now U.S. Bank, N.A.), Milwaukee, Wisconsin, and as an Assistant Counsel by Centerre Trust Company of St. Louis (now Bank of America Private Bank).

Mr. Redd has extensive experience and expertise in: (a) the drafting of wills, trust instruments, durable powers of attorney, marital agreements and other estate planning documents; (b) pre- and post-death tax planning for individuals, trusts and estates; (c) preparation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (d) representation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (e) representation of individual and corporate fiduciaries and (f) litigation in the Probate Division and other equity divisions of the Circuit Court. Mr. Redd has worked on estates and estate planning projects, some involving assets valued at over a billion dollars, and has successfully handled numerous estate tax, gift tax and generation-skipping transfer tax matters, will and trust construction cases, will contests, contests of trust agreements, alleged breach of fiduciary duty cases and other types of cases involving estates and trusts.

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Mr. Redd was Chairman of the Missouri Bar's Health Care Durable Power of Attorney Subcommittee, and he played a significant role in the drafting and enactment of the Missouri Durable Power of Attorney for Health Care Act. In 1991, Mr. Redd received The Missouri Bar President's Award. Mr. Redd was the principal draftsman of the Missouri Family Trust Company Act.

Mr. Redd is an elected member of The American Law Institute and a Fellow of The American College of Trust and Estate Counsel (Past Missouri State Chair; Past Regent; Estate and Gift Tax Committee; and Fiduciary Litigation Committee). He was an adjunct professor of law (Estate Planning) at Northwestern University School of Law for fifteen years. He serves as Co-Chair of the Editorial Advisory Board of, and writes a regular column in, TRUSTS & ESTATES magazine. In 2018, he was inducted into the Estate Planning Hall of Fame® by the National Association of Estate Planners and Councils. Mr. Redd is listed in The Best Lawyers in America and is "Band 1" ranked by Chambers and Partners in their High Net Worth guide. He frequently writes and lectures nationally on topics in the trusts and estates field.

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I. INTRODUCTION

The Internal Revenue Service and the judiciary have been exceptionally busy over the past few years evaluating and ruling on matters of interest to estate planners and professionals who administer trusts and estates. Particularly active areas of developing law have been the valuation of property potentially subject to gift or estate tax and determining what assets are properly includable in a decedent's gross estate.

II. CONTINUING EXPANDED REACH OF IRC SECTION 2036(a)

A. *Estate of Powell v. Commissioner*, 148 T.C. No. 18 (May 18, 2017)

Using *Estate of Strangi v. Commissioner*[1] as its foundation, the U.S. Tax Court took a quantum leap in its Internal Revenue Code Section 2036(a) jurisprudence when it handed down its decision in *Powell*.

1. Facts

On August 8, 2008, one of the decedent's two sons ("S"), acting as the decedent's agent under a power of attorney, transferred a little over $10,000,000 in cash and securities from decedent's revocable trust to a family limited partnership ("FLP") in exchange for a 99% limited partner interest. The FLP had been formed by the decedent's sons two days earlier. The FLP could be dissolved by agreement of all the partners. The partnership agreement gave S, as the general partner, sole authority regarding distributions.

On the same day as the transfer, S transferred the decedent's 99% limited partner interest to a charitable lead annuity trust ("CLAT"), the governing instrument of which directed the Trustee to pay an annuity to a charity for the remainder of decedent's life and, at the decedent's death, to distribute the remaining trust property to the decedent's descendants. The power of attorney, however, permitted gifts only to the principal's descendants and only in amounts that did not exceed the federal gift tax annual exclusion. The decedent died on August 15, 2008.

The decedent's 2008 gift tax return reported the gift to the CLAT of her 99% limited partner interest and reflected an aggregate 25% valuation discount for lack of control and lack of marketability. The Internal Revenue Service issued a notice of deficiency asserting $5,870,226 in federal estate tax due and another notice of deficiency asserting $2,961,366 in federal gift tax due. The estate moved for summary judgment, claiming there was no deficiency in the estate or gift

[1] *Estate of Strangi v. Commissioner*, T.C. Memo. 2003-145, *aff'd*, 416 F.3d 468 (5th Cir. 2005).

tax. The IRS moved for summary judgment as well, asserting that the value of cash and securities transferred from the decedent's revocable trust to the FLP in exchange for a 99% limited partner interest was includable in the value of the decedent's gross estate under IRC Section 2036(a)(1) and (2) and that the transfer to the CLAT was invalid because S did not have the authority to transfer the interest to a CLAT.

2. IRC Section 2036(a) Analysis

The Tax Court ultimately sided with the IRS but did not base its decision on the IRS' position that IRC Section 2036(a)(1) was applicable. Rather, the court held that the value of the assets that had been transferred to the FLP was included in the decedent's gross estate under IRC Section 2036(a)(2), which provides that:

> [t]he value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life or for any period not ascertainable without reference to his death or for any period which does not in fact end before his death—
>
> (1)…
>
> (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

In the view of the Tax Court, IRC Section 2036(a)(2) applied[2] because, at the moment of her death, the decedent had the power, along with her sons, to terminate the FLP and, through S, had the ability to control FLP distributions. Thus, according to the court, the decedent had the right, in conjunction with all the other partners (her sons), "to designate the persons who shall possess or enjoy the property or the income therefrom." The court arrived at this conclusion notwithstanding that: (a) the decedent was **<u>never more than a limited partner</u>**[3]; and (b) S had transferred the 99% limited partner interest to the CLAT before the decedent died (because that transfer was void or voidable under applicable state (California) law).[4]

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[2] Inexplicably, the taxpayer had conceded that the "bona fide sale for an adequate and full consideration in money or money's worth" exception did not apply.

[3] In *Strangi*, *supra*, *note 1*, the decedent was a limited partner only, but *Strangi* was decided on Internal Revenue Code Section 2036(a)(1) (**<u>not</u>** IRC Section 2036(a)(2)) grounds.

[4] The Tax Court observed that, even if the transfer to the CLAT had been valid, the value of the 99% limited partner interest would have been includable in the decedent's gross estate under IRC Section 2035(a) because that transfer was made within three years before the decedent's death and the value of the transferred property would have been includible in the decedent's gross estate under IRC Section 2036 if the transfer had not been made.

B. *Estate of Streightoff v. Commissioner*, T.C. Memo 2018-178 (October 24, 2018), *aff'd* 954 F.3d 713 (5th Cir. March 31, 2020)

Just as the estate planning world was pondering how the *Powell* court's application of IRC Section 2036(a)(2) could **ever** be avoided in a case in which the decedent held **any interest** in an FLP at death or relinquished such an interest within three years of death, the Tax Court decided *Streightoff*.

1. Facts

On October 1, 2008, Frank Streightoff, acting though his daughter, as his attorney-in-fact, formed an FLP with several family members as well as a revocable trust. Frank transferred cash and marketable securities to the FLP and received in exchange an 88.99% limited partner interest, which he immediately assigned to the Trustee of his revocable trust. The partnership agreement contained restrictions on the transferability of limited partner interests and conferred rights of first refusal. The partnership agreement provided that limited partners owning a 75% or greater limited partner interest could, among other things, approve the admission of additional limited partners, remove the general partner (which would terminate the partnership), reconstitute the partnership and elect a new general partner.

Frank died on May 6, 2011. In valuing the 88.99% interest for federal estate tax purposes, Frank's estate asserted that the interest was an assignee interest and claimed a 13.4% lack of control discount and a 27.5% lack of marketability discount. The IRS countered by characterizing the 88.99% interest as a limited partner interest giving rise to no lack of control discount and an 18% lack of marketability discount.

2. Analysis

The Tax Court determined that the 88.99% interest was a limited partner interest – both in form and in substance. Not only did the assignment paperwork indicate that the decedent had conveyed to the Trustee of his revocable trust all of his 88.99% interest and "all and singular the rights and appurtenances thereto in anywise belonging," but the decedent, up to the moment of his death, could have revoked his transfer to his trust of the 88.99% interest, which would have caused that interest to be held by the decedent undeniably as a limited partner interest. Accordingly, the Tax Court ruled there was no valuation discount for lack of control.

Since Frank's estate had offered no evidence as to valuation of the 88.99% interest as a limited partner interest, the Tax Court accepted the IRS' valuation expert's conclusion that an 18% discount for lack of marketability should be allowed.

Frank's estate appealed the Tax Court's decision to the U.S. Court of Appeals for the Fifth Circuit. On appeal, the estate argued strenuously that the 88.99% interest, properly evaluated under applicable state (Texas) law, was an assignee interest. The Court of Appeals staunchly defended the Tax Court's contrary conclusion. In so doing, the Court of Appeals not only noted that the Tax Court appropriately applied the substance over form doctrine but also pointedly observed that the FLP's general partner affirmatively consented to substitution of a limited partner interest to Frank's revocable trust.

Though Frank Streightoff's surviving family members were surely disappointed in the Tax Court's decision and Fifth Circuit's affirmation, clearly the estate could have suffered a much worse fate. Given the facts, it is remarkable that the estate emerged with an 18% discount for lack of marketability with respect to the 88.99% FLP interest Frank held in his revocable trust at his death. As discussed above, the FLP consisted exclusively of cash and marketable securities, and, up to the moment of his death, Frank had unilateral control, through his attorney-in-fact, over his 88.99% limited partner interest.

In *Powell*, the Tax Court ruled that the entire, undiscounted net asset value of an FLP was to be included in the decedent's gross estate under IRC Section 2036(a)(2) because the decedent, up to the moment of her death, could have joined with all the other partners and dissolved the FLP and, through her effective control of the general partner, could have controlled FLP distributions. Frank Streightoff had an even more direct route to control because he didn't have to join with anyone. One is left to wonder whether *Streightoff* is an anomaly. Astoundingly, IRC Section 2036(a)(2), which should have been dispositive of the case, is not mentioned in either the Tax Court's opinion or the Fifth Circuit's opinion. If IRC Section 2036(a)(2) was irrelevant in *Streightoff*, how was it relevant in *Powell*?

III. "TAX-AFFECTING" IN VALUATION OF PASS-THROUGH ENTITY EQUITY

Two recent cases, one from a federal district court and the other from the U.S. Tax Court, have had a notable effect on how equity in pass-through entities is properly valued for gift (and, presumably, estate) tax purposes. Until 2019, the IRS was almost always successful in fending off so-called "tax-affecting" in valuing such equity, but these two cases seem to have turned the tide in favor of taxpayers. As will be seen below, while the essence of the decisions is the same (validation of "tax-affecting"), the approaches adopted in the two cases is a bit different.

A. *Kress v. United States*, 372 F. Supp.3d 731 (E.D.Wis. March 26, 2019)

1. Facts

The taxpayers were shareholders in Green Bay Packaging, Inc. ("GBP"), a family-owned subchapter S corporation, and they gifted minority interests in GBP stock to their children and grandchildren in 2006, 2007 and 2008. The taxpayers filed gift tax returns for those years, and the IRS challenged the amounts reported on the gift tax returns. The taxpayers paid the gift tax deficiencies and filed amended gift tax returns seeking refunds for the additional taxes and interest they paid. The IRS denied the taxpayers' requests for refunds, and the taxpayers sued for the refunds in U.S. District Court in Wisconsin.

2. Analysis

The sole issue before the District Court was the fair market value of the GBP stock the taxpayers gifted to their children and grandchildren in 2007, 2008 and 2009. Part of the analysis contained in the taxpayers' valuation expert's reports involved valuing GBP shares in relation to comparable C corporation stock and then adjusting the values of the GBP shares to account for the fact that GBP's earnings, while not subject to income tax at the corporate level, is not tax-free but, rather, is taxable at the shareholder level. This adjustment is commonly referred to among valuation experts as "tax-affecting." The government's valuation expert also engaged in tax-affecting," but, in addition, he also applied an adjustment, a "subchapter S premium," to account for the tax characteristics associated with subchapter S status.

The court accepted the concept of tax-affecting but rejected application of a "subchapter S premium." In so doing, the court stated: "The court finds GBP's subchapter S status is a neutral consideration with respect to the valuation of its stock. Notwithstanding the tax advantages associated with subchapter S status, there are also noted disadvantages, including the limited ability to reinvest in the company and the limited access to credit markets. It is therefore unclear if a minority shareholder enjoys those benefits."

The *Kress* court's willingness to adopt tax-affecting in valuing equity in an S corporation (the form in which countless family businesses exist) is significant. Taxpayers have been striving for many years to validate use of tax-affecting in the valuation of equity in pass-through entities, and the battle has at times seemed almost useless.[5] The taxpayers in *Kress* are to be congratulated for their perseverance.

B. *Estate of Jones v. Commissioner,* T.C. Memo. 2019-101 (August 19, 2019)

1. Facts

Aaron Jones established Seneca Sawmill Co. ("SSC") in 1954. SSC was a lumber manufacturer. In 1996, SSC elected to be taxed as an S corporation. In 1992, Jones formed Seneca Jones Timber Co. ("SJTC"), a limited partnership, to own and manage timberlands. SSC and SJTC were interdependent companies. The entities had the same management teams. SSC was the sole general partner of SJTC. The vast majority of the timber harvested by SJTC was sold to SSC. SSC obtained financing by using SJTC's timber as collateral. Financing utilized by SSC was treated as a loan from SJTC. SSC would pay back SJTC or loan money to SJTC when SSC generated enough revenue to do so. The loans between SSC and SJTC did not require collateral, and SSC was charged the same interest charged by its third-party lender.

Jones owned most of the shares in SSC and the limited partner units in SJTC, while Jones' daughters owned small interests in both entities. SSC issued both voting and nonvoting stock. Transfers of interests in either entity were subject to a buy-sell agreement. Proposed transfers to a non-family member were subject to rights of first refusal held by the entity at issue and the other interest holders. The buy-sell agreements required that fair market value be determined after considering cash distributions allocable to the interests and discounts for lack of marketability, lack of control and lack of voting rights.

[5] *See Gross v. Commissioner*, T.C. Memo 1999-254, *aff'd* 272 F.3d 333 (6th Cir. 2001).

On May 28, 2009, Jones transferred limited partner units in SJTC as well as voting and nonvoting stock in SSC to several trusts for the benefit of his descendants. Jones entered into net-net gift agreements with each of his daughters in which his daughters assumed liability for the gift tax and estate tax associated with the transfers.[6]

The IRS issued a notice of deficiency in 2013 challenging the valuation of each of the transfers made in 2009. Jones died in 2014.

The estate provided an expert valuation report for the SSC shares transferred and the SJTC units transferred. The estate's expert relied on an income approach, *i.e.*, the discounted cash flow ("DCF") method, and a market approach in valuing all the transfers. The estate claimed a value of $380 per limited partner unit in SJTC. Regarding SSC, the estate asserted a value of $390 per share of voting stock and $380 per share of nonvoting stock.

The IRS submitted its own expert valuation report for the SJTC units transferred. The IRS' expert relied on an asset-based approach, *i.e.*, the net asset value ("NAV") method, and a market approach in valuing the SJTC limited partner units transferred. The IRS claimed a value of $2,530 per limited partner unit. The IRS did not submit a valuation report for the SSC shares transferred but did provide a rebuttal to the estate's valuation report.

2. *Analysis*

The Tax Court first concluded that SJTC should be valued based on the DCF method of valuation rather than the NAV method asserted by the IRS. The estate asserted that, since SJTC was an operating company selling products to consumers, an income-based approach like the DCF method was most appropriate. The IRS asserted that SJTC was an investment company, and so an asset-based approach like the NAV method should be utilized. The court stated that SJTC had characteristics of both an operating company and an investment company but that the NAV method would be appropriate only if it were likely that SJTC would sell its timberlands, as opposed to its timber, and the court found there was no indication that SJTC would do so.

The estate's valuation reports for SJTC and SSC tax-affected its earnings by using a 38% tax rate to adjust its net cash flow and the cost of debt capital. The valuation reports then applied a 22% premium to reflect the benefit of the dividend tax avoided by not being a C corporation. The IRS argued that tax-affecting inappropriately favors the hypothetical buyer over the hypothetical seller by abandoning the arms-length formulation component of the definition of fair market value. The IRS asserted that a zero tax rate better reflects the entities' flow-through status for income tax purposes.

The Tax Court agreed with the estate's tax-affecting in its valuations. The court reviewed three of its prior cases, all of which rejected the use of tax-affecting[7] and stated that those

[6] The Internal Revenue Service initially challenged these agreements but later conceded they were permissible.
[7] *Gross v. Commissioner*, T.C. Memo. 1999-254; *Estate of Gallagher v. Commissioner*, T.C. Memo. 2011-148, *supplemented by* T.C. Memo. 2011-244; *Estate of Guistina v. Commissioner*, 101 T.C.M. (CCH) 1676.

cases did not reject tax-affecting but, rather, rejected how tax-affecting was applied in those cases. The court said, "[t]he question in those cases, as here, was not whether to take into account the tax benefits inuring to a flowthrough entity but how." The court found that the estate's valuation reports have "more accurately taken into account the tax consequences of [the entities'] flowthrough status."

Of particular interest is the Tax Court's chiding of the IRS' rejection of tax-affecting:

> While respondent objects vociferously in his brief to petitioner's tax-affecting, his experts are notably silent. The only mention comes in [the IRS' expert's] rebuttal report, in which he argues that [the estate's expert's] tax-affecting was improper, not because SJTC pays no entity level tax, but because SJTC is a natural resources holding company and therefore its "rate of return is closer to the property rates of return". They do not offer any defense of respondent's proposed zero tax rate. Thus, we do not have a fight between valuation experts but a fight between lawyers.

The Tax Court accepted the estate's treatment of the intercompany loans from SSC to SJTC and SSC's general partner interest in SJTC as operating assets. The estate's treatment of these items properly reflected the fact that SSC and SJTC were "interdependent parts of a single business enterprise" rather than separate business entities.

Finally, the Tax Court concluded that a 35% discount for lack of marketability, asserted by the estate, was reasonable.

IV. THE SPECTER OF "DOUBLE INCLUSION" IN THE GROSS ESTATE

A. Tax Court's Initial Acknowledgment of the Problem

In *Powell*,[8] the Tax Court not only staked out new ground in its IRC Section 2036(a)(2) analysis, but it also tackled what is often referred to among estate planning professionals as the "double inclusion" anomaly. The court explained that its approach to determining the includable amount under IRC Section 2036 has been simply to disregard the existence of an FLP and hold that the value of the FLP's assets themselves is included in the decedent's gross estate. Applying that theory, there is no concern with double taxation, *i.e.*, subjecting to estate tax **both** the value of a retained FLP interest **and** the value of the FLP's underlying assets. The court opined that, while interpreting the applicable statutes to avoid double taxation leads to the correct result, the reason for so doing has gone "unarticulated."

The Tax Court then proceeded to "fill that lacuna and explain why a double inclusion in a decedent's estate is not only illogical, it is not allowed." The court observed that a decedent's gross estate should include, under IRC Section 2033, the value of the FLP interest held at date of

[8] *Estate of Powell v. Commissioner*, 148 T.C. No. 18 (May 18, 2017).

death (taking into consideration proper valuation discounts)[9] **plus**, under IRC Section 2036(a), the value of the assets that had been transferred to the FLP **less**, under IRC Section 2043(a), the value of the FLP interest the decedent received in exchange for his or her transfer of assets into the FLP (again, taking into consideration proper valuation discounts), determined at the time it was received (not at date of death).

In a case in which values don't change between the date of transfer of assets into the FLP and the decedent's date of death, as in *Powell*, the **net** result is that the gross estate includes only the value of the assets held in the FLP at date of death, the expected, if not necessarily fair, result.

The difficulty with the Tax Court's analysis (as the court itself acknowledged in footnote 7) is that, in a case in which asset values **increase** from the date of transfer of assets into the FLP up until the decedent's date of death, the **net** result is the double taxation that the court said is "not allowed." In such a circumstance, the value of the FLP interest held at date of death and included in the gross estate under IRC Section 2033 is **not** fully offset by the subtraction, under IRC Section 2043(a), of the value of the FLP interest the decedent received in exchange for his or her transfer of assets into the FLP, **determined at the time it was received**.[10]

B. Example

Assume X transfers assets having a value of $150 into an FLP in exchange for FLP units having a properly discounted value of $120. In Scenario 1, there is no change in value between the date the FLP was created and funded and X's date of death. In Scenario 2, values increased by 10% between the date of FLP creation and funding and X's date of death.

	Scenario 1	Scenario 2
FLP units' value (IRC § 2033)	$120	$132
FLP's assets' value (IRC § 2036(a))	$150	$165
Consideration paid (IRC § 2043(a))	$120	$120
Net includable amount	**$150**	**$177**

C. *Moore v. Commissioner*, T.C. Memo. 2020-40 (April 29, 2020)

1. *Facts*

Moore starts out as a "classic" FLP case. Howard Moore, shortly after he emerged from the hospital having had a heart attack, created five trusts and an FLP. He transferred 80% of his farm to the FLP. Five days later, he sold the farm to an unrelated party pursuant to a pre-existing contract. Nevertheless, he retained a life estate in the farm and continued to live on the

[9] In *Powell*, the invalidity of the transfer of the FLP interest to the CLAT caused the date-of-death value of the 99% FLP interest to be included in the decedent's gross estate.

[10] Interestingly, the Tax Court's opinion in *Powell* does not represent anything close to a unified voice on "double inclusion." Seven judges agreed with Judge Halpern's opinion for the court. Judge Lauber authored a concurring opinion, with which six judges agreed, expressing the view that, in ascertaining what values must be considered as includable in the gross estate in a case such as *Powell*, the FLP is merely an "empty box" that can be ignored, and so there is no "double inclusion."

farm and manage it. He used FLP funds to pay his legal bills and his living expenses. He died within four months after the transfer.

2. *Analysis*

The Tax Court held the value of the farm was includable in Howard's gross estate under IRC Section 2036(a)(1). The transfer of the farm to the FLP wasn't a bona fide sale for full and adequate consideration because the FLP wasn't created for a legitimate and significant nontax reason.[11] There was no business to run after the farm was sold, and there was no proof that the decedent or his children had any legitimate creditor concerns. Furthermore, the decedent retained possession and enjoyment of the farm after the transfer by continuing to live on the property and manage the farm.

In addition, the court took up the "double inclusion" question where it left off in *Powell*.[12] The court embarked on an exceptionally detailed discussion, accompanied by numerous examples, of how the estate tax law mandates inclusion in the gross estate of both the value of property a decedent had transferred into an FLP[13] plus the value of FLP interests held by a decedent at death[14] and then subtraction of any consideration that had been received by the decedent in exchange for his transfer(s) into the FLP.[15] The court admits some of its examples "lead to what may seem odd results" and "might be thought to be less sensible" but doesn't offer any solution to the often anomalous interaction of the relevant statutory provisions.

V. MISAPPLICATION OF WILLING BUYER-WILLING SELLER TEST

A. CCA 201939002 (September 27, 2019)

Chief Counsel Advice 201939002 addressed how properly to value for gift tax purposes publicly-traded stock transferred to a grantor retained annuity trust ("GRAT"). This would seem to be a rather straight-forward exercise, following the formula set out in Treas. Reg. Section 25.2512-2(b)(1),[16] but the IRS didn't see it that way.

1. *Facts*

The settlor of the GRAT was a founder and the chairman of the board of the company ("Corporation A") whose stock he transferred to the GRAT. Before the transfer, Corporation A had been involved in exclusive merger negotiations with another company ("Corporation B"). Those negotiations were apparently successful. The merger of Corporation A

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[11] *See Estate of Bongard v. Commissioner*, 124 T.C. No. 8 (March 15, 2005).
[12] That *Moore* is a memorandum opinion could be read to imply the Tax Court believes it is settled law that "double inclusion" occurs in FLP cases.
[13] *See* IRC Section 2036(a).
[14] *See* IRC Section 2033.
[15] *See* IRC Section 2043(a).
[16] The general rule of Treas. Reg. Section 25.2512-2(b)(1) is that the fair market value of stock traded on a stock exchange is the mean between the highest and the lowest quoted selling prices on the date of the gift.

and Corporation B was announced after the transfer, and, immediately after the announcement, the value of Corporation A's stock increased substantially.

2. *Analysis*

The IRS asserted that the general rule outlined in Treas. Reg. Section 25.2512-2(b)(1) didn't govern valuation of the stock for gift tax purposes but, rather, that the merger being negotiated on the date of the transfer had to be considered. As part of its support for this conclusion, the IRS cited and quoted from Treas. Reg. Section 25.2512-2(e), which states in relevant part that "[I]n cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices…does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value." After kicking Treas. Reg. Section 25.2512-2(b)(1) to the curb, the IRS opined that the willing buyer, willing seller standard[17] articulated in Treas. Reg. Section 25.2512-1 and Rev. Rul. 59-60[18] would control.

Application of the willing buyer, willing seller test in this case may have been inherently unfair. While the settlor (the "willing seller") presumably had full knowledge of the merger discussions on the date of the transfer, a "willing buyer" quite possibly would not have had such knowledge. The settlor admittedly would have had an economic incentive to inform a prospective buyer about the merger that was in the works, but the settlor, as a corporate insider, may have been legally prohibited from so doing. Additionally, it is clear in CCA 201939002 that the IRS assumed that, on the date of the transfer, the merger was "practically certain to go through," but CCA 201939002 recites no facts to support that assumption.

B. *Grieve v. Commissioner*, T.C. Memo. 2020-28 (March 2, 2020)

1. *Facts*

Pierson Grieve made gifts of a 99.8% member interest in Rabbit 1 LLC to a GRAT on October 9, 2013 and a 99.8% member interest in Angus MacDonald LLC to the Grieve 2012 Family Irrevocable Trust on November 1, 2013. These gifted member interests were non-voting. PMG, a management company that was the general partner of the Grieve Family Limited Partnership, owned the 0.2% voting member interests in both LLCs. Pierson's eldest child, Margaret, was the sole owner of PMG. The IRS issued a notice of deficiency regarding the donor's 2013 gifts. The taxpayer's valuations and the IRS' determinations of value differed by an aggregate of about $11,000,000.00.

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[17] Fair market value is the price that a hypothetical willing buyer would pay a hypothetical willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts.
[18] Rev. Rul. 59-60, 1959-1 C.B. 237.

2. *Analysis*

The Tax Court's opinion contains a great deal of analytical data that the taxpayer's and IRS' respective valuation experts compiled and presented to the court. In the end, however, the case boiled down to whether the IRS' expert, Mr. Mitchell, when valuing the gifted non-voting member interests, properly took into consideration the theoretical possibility that the holder of those interests would purchase the voting member interests. The lynchpin of Mitchell's analysis was that a hypothetical willing buyer of the gifted non-voting member interests would consider the likelihood of purchasing the voting interests and that such a buyer would reasonably believe he or she would be able to acquire the voting interests by paying a 5% premium for them. To support that point, Mitchell said "economic realities have to be taken into consideration," and the economic stake of the non-voting member interest holder "dwarfs" that of the voting member interest owner. Margaret testified, however, that she had no intention of selling the voting member interests and that, if she were ever to consider selling them, she would require a far higher premium than 5%.

The court ruled that the non-voting member interests couldn't be valued by hypothesizing that the holder of those interests would buy the voting interests. Such a valuation methodology would involve engaging in impermissible speculation concerning an event that was by no means certain to occur. The opinion states: "The facts do not show that it is reasonably probable that a willing seller or a willing buyer of the [non-voting member interests] would also buy the [voting member interests] and that the [voting member interests] would be available to purchase." The court ruled that the value of the gifted interests should be based on the entities' underlying net asset values, and the court accepted the taxpayer's expert's proposed discounts: lack of control: 13.4% for Rabbit and 12.7% for Angus MacDonald; and lack of marketability: 25% for both Rabbit and Angus MacDonald.

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We would love to hear your feedback for today's teleconference:

Recent Developments in Valuation and Inclusion in the Gross Estate

February 23, 2021
Please use this link to tell us what you think.

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Any questions regarding CE credit, please contact Laurie Sebestyen at (706) 389-7645
Email lsebestyen@CannonFinancial.com
649 S. Milledge Ave., Ste. 4, Athens, Georgia 30605

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February 23, 2021

Laurie Frye

Laurie Frye
Professional Education Coordinator

Continuing Education Credits for this course are as follows:

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February 23, 2021

CANNON FINANCIAL INSTITUTE, INC. CORPORATE SEAL GEORGIA

Laurie Frye

Laurie Frye
Professional Education Coordinator

Continuing Legal Education Credits for this course are as follows:
The following states have been approved for 1.5 hours of General Credit: (Course number is indicated in parenthesis):Alabama, Arkansas (TWE73840), California, Delaware, Georgia, Idaho, Illinois, Iowa (357002), Kansas, Kentucky(225613), Louisiana, Maine (057854), Minnesota (336441), Mississippi, Montana (32651), Nebraska(207932), Nevada, New Mexico, New York, North Carolina, North Dakota, Ohio, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee (Distance Ed), Texas (174114186), Utah, Vermont, Virginia, Washington, Wisconsin, & Wyoming

These states have been approved for the following General Credit: Colorado – 2 hours, Florida - 2 hours (2008257N), Missouri –1.8 hours (663455), Oklahoma – 2 hours, West Virginia – 1.8 hours

The following states either do not require/do not accept outside CLE Credit/or do not accept teleconference calls for CLE Credit: District of Columbia, Maryland, Massachusetts, Michigan & South Dakota
The following states have special circumstances:
Alaska-Attorneys can use this certificate to submit to Alaska State Bar
Arizona-On honor system
Connecticut-Attorneys can use this certificate to submit to Connecticut MCLE
Hawaii- Attorneys can use this certificate for Hawaii CLE for 1.5 General credits (Reciprocity Rule)
Indiana-Site Coordinators must apply for credit as the sponsor for participants to receive credit
New Hampshire- *NHMCLE does not approve or accredit CLE activities for the NH Minimum CLE requirement. NH attendees must self-determine whether a program is eligible for credit and self-report their attendance.*
New Jersey-Attorneys can use this certificate for New Jersey CLE for 1.5 General credits (Reciprocity Rule)
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****As required by the following State Bars, Cannon will submit the mandatory attendance rosters for the attorneys seeking CLE credits **ONLY** in the following states: Alabama, Delaware, Georgia, Idaho, Illinois, Kansas, Louisiana, Montana, Nebraska, Nevada, New Mexico, North Carolina, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Washington, and West Virginia. ****

Any questions regarding CE credit, please contact Laurie Sebestyen at (706) 353-3346.
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(Participant Name)

____

(Colorado Attorney Registration #)

Has successfully completed the Cannon Financial Institute, Inc. course:

Recent Developments in Valuation and Inclusion in the Gross Estate

(792986)

February 23, 2021

Laurie Frye
Professional Education Coordinator

<u>Continuing Legal Education Credits for this course are as follows:</u>

Colorado – 2.0 General Credits

****As required by the State of Colorado, attorneys must submit their own credits.

Any questions regarding CE credit, please contact Laurie Sebestyen at (706) 353-3346.
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649-4 S. Milledge Ave., Athens, Georgia 30605

CERTIFICATE OF ATTENDANCE FOR CALIFORNIA MCLE

To be Completed by the Provider

Provider: Cannon Financial Institute (CA Provider #12179)

Subject Matter/Title: Recent Developments in Valuation and Inclusion in the Gross Estate

Date and Time of Activity: February 23, 2021 1:00-2:30 PM ET, 12:00-1:30 PM CT, 11:00AM-12: 30 PM MT,

10:00AM- 11:30 AM PT

Location: Teleconference

Length of Presentation: 1.5 Hours

ELIGIBLE CALIFORNIA MCLE CREDIT:

TOTAL HOURS: 1.5

Legal Ethics:

Elimination of Bias in the Legal Profession:

Competence:

To Be Completed by the Attorney after Participation in the Above-Name Activity

By signing below, I certify that I participated in the activity described above and am entitled to claim the following California MCLE credit hours:

TOTAL HOURS: ______________________

(You may not claim credit for the following sub-fields unless the provider is granting credit in these areas as listed above.)

Legal Ethics:______________________

Elimination of Bias in the Legal Profession:______________________

Competence: ______________________

Attorney Signature:

REMINDERS: Keep this record of attendance for four years. In the event that you are audited by the State Bar, you may be required to submit this record of attendance. Send this to the State Bar only if you are audited. You must sign in on the Official Record of Attendance for California MCLE maintained by this provider in order for these hours to qualify for California MCLE credit.

Virginia MCLE Board

CERTIFICATION OF ATTENDANCE (FORM 2D)

MCLE requirement pursuant to Paragraph 17, of Section IV, Part Six, Rules of the Supreme Court of Virginia and the MCLE Board Regulations.

Certify Your Attendance Online at www.vsb.org

MCLE Compliance Deadline - October 31. MCLE Reporting Deadline - December 15.
A $100 fee will be assessed for failure to comply with either deadline.

Member Name: ______________________________ **VSB Member Number:** ____________________

Address: ______________________________ **Daytime Phone:** ____________________

______________________________ **Email:** ____________________

____

City **State** **Zip**

Course ID Number: **NII0577**

Sponsor: **Cannon Financial Institute**

Course/Program Title: **Recent Developments in Valuation and Inclusion in the Gross Estate**

Live Interactive * **Approved CLE Credits (Ethics Credits): 1.5 (0.0)**

Date of telephone/webcast:______________________ **Location(s):** ______________________

By my signature below I certify

___ I attended a total of _____________ (hrs/mins) of **approved CLE**, of which (______) (hrs/mins) were in **approved Ethics**. Credit is awarded for actual time in attendance (0.5 hr. minimum) rounded to the nearest half hour. (Example: 1hr 15min = 1.5hr)

___ The sessions I am claiming had written instructional materials to cover the subject.

___ I participated in this program in a setting physically suitable to the course.

___ I was given the opportunity to interact with the presenter (in real time if live interactive or other method if pre-recorded).

___ I understand I may not receive credit for any course/segment which is not materially different in substance than a course/segment for which credit has been previously given during the same completion period or the completion period immediately prior.

___ I understand that a materially false statement shall be subject to appropriate disciplinary action.

* NOTE: A maximum of 8.0 hours from pre-recorded courses may be applied to meet your yearly MCLE requirement. Minimum of 4.0 hours from live interactive courses required.

____________________ ______________________________

Date Signature

This form may be mailed to:
Virginia MCLE Board
Virginia State Bar
1111 East Main Street, Suite 700
Richmond, VA 23219-0026
(804) 775-0577
www.vsb.org

[Office Use Only: Webcast]