



Litigation Outlook:

Estate Tax Rulings Underscore Importance of Expertise

Who's winning in tax court? Michael Gregory, an IRS employee and valuation expert, recently conducted a study comparing the statistics of recent tax court rulings with those of a prior era. His findings suggest that the courts are now less likely to "split the difference" in litigation, and are instead leaning more toward a "one-side-wins" result.

What does this trend mean to those involved in business valuations? According to Gregory, it means that experience counts more than ever. Several recent court cases underscore Gregory's assertion.

Estate of Thompson v. Commissioner

In the case of Thompson v. Commissioner, the court was so unimpressed by the expert witnesses called by both the estate and the IRS that it threw out their work and made its own valuation calculation.

At issue was the value of the decedent's 20 percent interest in a publishing company. The estate's expert claimed a fair market value of about \$1.75 million, while the IRS expert suggested a value in the \$32 million range.

According to the court, the estate's experts were "too inexperienced, accommodating and biased in favor of the estate," and the IRS experts' numbers were "incorrect and overstated." The court found both experts' valuations to be "deficient and unpersuasive."

Eventually the court arrived at a value of around \$13.5 million for the interest, and decided that no penalties could be assessed because of errors.

The lesson learned: Make sure you use experts with experience and credibility that will stand up in court.

Estate of True v. Commissioner

This case focused on the power of a buy-sell agreement to determine the value of a family business relative to estate and gift taxes.

The True estate argued that the book value price specified in terms of a buy-sell agreement — a value considered too low by the IRS — should control estate and gift tax values. The IRS argued that the buy-sell agreement was merely a “testamentary” document and that it was not supported by the full and adequate consideration necessary to make it binding in terms of valuation.

The tax court sided with the IRS, and held that buy-sell agreements do not fix estate and gift tax values. The decision resulted in enormous undervaluation penalties for the estate. The judge wrote that the Trues took an aggressive position on their returns and “did not rely on professional appraisals or obtain professional advice” regarding the effects of prior gift tax cases.

The lesson learned: Professional valuation expertise is absolutely necessary to validate amounts specified in buy-sell agreements.

Estate of Noble V. Commissioner

This case centered on the value of Helen Noble’s closely held interest in a bank. The estate valued her interest as of the date of death at about \$904,000. The IRS asserted that the interest was worth \$1.1 million because that’s what it actually sold for about a year later.

While several appraisals were presented, the court disregarded them and found the subsequent sale of the shares to be the determining factor in fair market value. The court cited a lack of factual testimony and information on the record, noting that neither party called a “fact witness” to testify, nor did they present any information other than expert reports.

The lesson learned: Make sure there’s enough evidence presented to make a reasonable case.

Overall, these cases illuminate the need for valuation expertise. Among other recommendations, IRS expert Gregory suggests that litigators hire experienced valuation experts, give them plenty of time to develop their facts, research the judges they will appear before, and ensure that they are trained as expert witnesses.

Be sure you're working with valuation experts whose work will stand up to the scrutiny of litigation. To find out more about our firm's valuation and expert witness credentials, please contact us.