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VALUATION OF THE FAMILY CONTROLLED BUSINESS FOR ESTATE TAX PURPOSES

JAMES O. WYNN *

The starting point in the determination of the federal estate tax is the valuation of the property included in the gross estate.¹ While the Internal Revenue Code does not use the term "fair market value" in defining the gross estate, the regulations promulgated by the Commissioner of Internal Revenue as an interpretation of the estate tax provisions of the Code provide that "the value of every item of property includible in the gross estate is the fair market value thereof."² While a creditable argument could be made that Congress, in using the term "value" in defining the gross estate, intended something different from "fair market value," this discussion will assume that the terms are synonymous.

Fair market value is the price at which a seller willing to sell at a fair price and a buyer willing to buy at a fair price, both having a reasonable knowledge of the facts, and neither being under any compulsion, will trade.³

Since the question of the price at which such a buyer and such a seller will trade is one of fact, what is the excuse for an article discussing the valuation problems of the family controlled business? The answer lies in the absence of a market place for the family controlled business.

In the case of an estate consisting of a portfolio of listed securities, or even of securities traded "over the counter," few problems arise. There is a market place—and what a willing buyer will pay to a willing seller is a reasonably demonstrable fact. In the case of the family controlled business on the other hand, there being no market place, the determination of fair market value is essentially a matter of opinion upon which reasonable and honest men may and do differ.

At the risk of being accused of introducing a species of levity into a dignified journal of legal opinion, I will illustrate my point as follows: Gene Tunney defeated Jack Dempsey in the prize ring; that was an accomplished fact, as to which no opinion is of any validity. Whether Joe Louis would have defeated Jack Dempsey is of necessity entirely a matter of opinion, upon which sports enthusiasts will always argue, bringing to bear all of the subsidiary facts which they think will support their several opinions.

* Member of The Bars of New York and The District of Columbia; co-author, MONTGOMERY'S FEDERAL TAXES—ESTATES, TRUSTS AND GIFTS, 1948-49.

1. INT. REV. CODE § 811.

2. U. S. Treas. Reg. 105 § 81.10.

3. T. B. R. 57, 1 CUM. BULL. 40 (1919); Chicago Ry. Equipment Co. v. Blair, 20 F. 2d 10 (C. C. A. 7th 1937); Rheinstrom v. Willcuts, 26 F. Supp. 306 (D. Minn. 1938).

Where there is a market place, we have a situation like the prize ring at Philadelphia, where an ultimate fact was proved. Where there is no market place, we have a situation where the ultimate result is always an opinion and nothing more, an attempt to approximate what would have happened if something else had happened—what a price would have been had there been a sale between a willing buyer and a willing seller.

So much is the question of fair market value a matter of opinion that the trier of the facts must attempt the appraisal by reference to what the sales price would have been in the event of a sale, even though an actual sale for one reason or another could not have taken place. For example, a claim for refund of federal taxes, which cannot legally be sold, must be valued as if it might be sold.⁴

Opinion not based on inference or reasoning is intuition. Whatever value intuition may have in other phases of life, for the purposes of this discussion it is valueless. Only opinions which logically and reasonably flow from subsidiary facts can be validly considered in determining value.

This discussion is designed as an informal consideration of the subsidiary facts which may and should be taken into consideration in determining values and from which there would be reasonably and logically inferred the ultimate determination of what value would prove to be were there a market place. It will be less a discussion of decided cases than an attempt at an objective study of how values, in the absence of a market place, should be logically and reasonably determined.

Let it be understood in the beginning that a "family controlled business" is not necessarily a "small business." The late Henry Ford left an estate which represented one of the greatest industrial empires in history. But that empire was not publicly owned. There was no market place. The problems of valuation which faced the Ford executors were essentially the same problems which face the legal representatives of a deceased merchant whose most remote customer lives a mile from his store.

The problem of the valuation of the family controlled business should be attacked as soon as possible after personal representatives are appointed. Expedition is far more important in such a case than it would be in the case of an estate possessed only of assets having a readily realizable market value. The interval of fifteen months⁵ between the date of death and the due date of the return proves to be frequently only too short. It should be used to assemble as much information as possible to guide the personal representatives of the decedent in determining the values they are to include in the

4. *Bank of California v. Commissioner*, 133 F. 2d 428 (C. C. A. 9th 1943); *H. E. Barneson*, 4 T. C. M. 427 (1945).

5. *INT. REV. CODE* § 821(a), (b); *U. S. Treas. Reg.* 105 § 81.63.

return. In the first instance, those values—the values included in the return—are crucial.

Seldom is a case settled or finally determined on the basis of values less than those included in the return. Such values have almost the status of an admission against interest. While a returned value is not conclusive,⁶ great weight will be given to such values.⁷ Such values are often increased; they are seldom reduced.

There is another reason why the values to be included in the return should be determined with the utmost care. For income tax purposes, in the event that a sale of the business or any part thereof is necessary or advisable, the basis for determining gain or loss is the value as of the date of death,⁸ and, if the assets are included in the gross estate at their values as of that date, such values as finally determined are *prima facie* the basis for income tax purposes.⁹ Even if the assets are included in the gross estate at their values on the anniversary of death,¹⁰ it is necessary to include in the return values as of both the date of death and the anniversary of death. The values so included as of the date of death are very likely to be used against the executor if assets are sold and an attempt is made to use other values as a basis for determining gain or loss.

For example: Suppose an asset is valued as of the date of death in the estate tax return at \$50,000. After the estate tax return is filed, the same asset is sold for \$150,000. The taxable gain for income tax purposes is *prima facie* \$100,000. While the executor or the beneficiary making the sale may establish a higher income tax basis (and hence a lower taxable gain) by clear and convincing evidence, the inclusion of the \$50,000 in the estate tax return will render his task the more difficult.

Since the date of any sale made under the circumstances described above ordinarily will be six months or more after the death of the decedent, the gain will be a long-term capital gain, the maximum tax upon which will be at the rate of 25%.¹¹ The warning herein given against undervaluing an asset which it is anticipated will be sold is valid only when the estate tax rate is 25% or less.

For example, let us assume that the family controlled business is the sole asset of the estate, or rather, that the value of the assets other than the family controlled business exactly equals the allowable deductions including the marital deduction but not including the specific exemption. If the

6. E. R. Bernstein, 3 B. T. A. 1280 (1926).

7. *Andrews v. Commissioner*, 38 F. 2d 55 (C. C. A. 2d 1930).

8. INT. REV. CODE § 113(a)(5).

9. O. D., I. T. 1562, II-1 CUM. BULL. 33 (1922); S. M. 1609, III-1 CUM. BULL. 48 (1924); E. J. Bray, 4 B. T. A. 42 (1926); *Bankers' Trust Co. v. Bowers*, 23 F. 2d 941 (S. D. N. Y. 1928).

10. See p. 261 *infra*.

11. INT. REV. CODE § 117.

value on the date of death of the family controlled business, under such circumstances, is less than \$478,571.32, the effective estate tax rate will always be less than 25%—the income tax rate on a capital gain—*i.e.*, the total estate tax will be less than one-fourth of the value of the net taxable estate before the deduction of the specific exemption. If the value of the net estate before the deduction of the specific exemption is \$478,571.55 or more, the estate tax will exceed one-fourth of the net taxable estate before the deduction of the specific exemption.¹²

The foregoing refers to the *effective* estate tax rate. An estate reaches a *bracket* rate of 25% when the net estate, after the deduction of the specific exemption, is \$50,000; it continues in the 25% bracket until the value of the estate is \$60,000.

If it is reasonably certain that a family controlled business, which substantially represents the net taxable estate before the deduction of the specific exemption, will be sold at \$110,000 or less either by the personal representatives of the decedent or by the persons entitled thereto as heirs or legatees, there is no reason whatever for attempting to *undervalue* in the estate tax return.

For example: The value of the assets of the estate, other than the family controlled business, exactly equals the allowable deductions, including the marital deduction but not including the specific exemption. It is known that the business will be sold. It is reasonably anticipated that the sales price of the business will be between \$110,000 and \$120,000. In preparing the estate tax return the personal representatives of the estate, realizing that a revenue agent will probably attempt to raise any value put on the business in the return, include the business in the return at a value of \$100,000. On the audit of the return, the internal revenue agent proposes to raise the returned value to \$110,000. The business is eventually sold for \$120,000. If the personal representatives of the estate go to the trouble and expense of successfully convincing the agent that their value of \$100,000 is correct and his of \$110,000 is wrong, they will pay \$4,800 in estate taxes and \$5,000 in capital gains taxes,—a total of \$9,800. If they permit the agent

12. The statements made in the paragraph in the text assume that state death duties will not exceed the eighty per cent credit allowed by the Internal Revenue Code.

When the value of the net estate before the deduction of the specific exemption is intermediate \$478,571.32 and \$478,571.54, the total estate tax is exactly 25% of the net estate before the deduction of the specific exemption, except that because of the necessity for disregarding fractions of a cent which are less than one-half of a cent and for treating fractions of a cent which are one-half a cent or more as the equivalent of a whole cent, when the net taxable estate, before the deduction of the specific exemption is \$478,571.34, \$478,571.35, \$478,571.38, \$478,571.39, or \$478,571.42, the total estate tax is one cent less than one-fourth of the net estate before the deduction of the specific exemption; and except that, for the same reasons, when the net taxable estate, before the deduction of the specific exemption, is \$478,571.49, \$478,571.52, or \$478,571.53, the total estate tax is one cent more than one-fourth of the net taxable estate before the deduction of the specific exemption.

to increase the value as of the date of death to \$110,000, they will pay \$7,000 in estate taxes and \$2,500 in capital gains taxes,—a total of \$9,500. Their successful efforts to keep the estate tax value low will have cost the estate, or its beneficiaries, \$300 in taxes.

Even if the value of the net estate after the deduction of the specific exemption is in excess of \$60,000,—the amount at which the estate enters a bracket in excess of 25% (the income tax rate on a capital gain),—the personal representatives of the decedent must keep in mind that, in the case of any asset which it is known will be sold by the estate or its beneficiaries, the estate tax bracket is only one of the factors to be considered.

For example: Let us again assume an estate the value of the assets of which, other than the family controlled business, is exactly equal to the allowable deductions, including the marital deductions but not including the specific exemption. The family controlled business, which will either have to be sold, or which it is likely will be sold, by either the estate or the beneficiaries of the estate, has a fair market value estimated to be between \$400,000 and \$600,000.¹³ The personal representatives of the estate, with the knowledge that a revenue agent will almost certainly attempt to increase any value at which the business is appraised in the estate tax return, list it in the return at \$400,000. On the audit of the return the revenue agent insists that the business should be valued as of the date of death, for estate tax purposes, at \$525,000. The business is eventually sold, perhaps four or five years after death (too long a period for the sales price to have any considerable probative force as to the value at the time of death) for \$550,000.

The personal representatives of the estate, in determining whether they should contest the revenue agent's valuation, and if they decide to do so, in determining the extent to which they should commit the estate to expenditures for fees and disbursements incident to such a contest, should examine not only the estate tax aspects of the matter but also the income tax features.

If as a result of the contest, the personal representatives succeed in establishing \$350,000 as the value of the business on the date of death, the estate will pay estate taxes of \$78,500, or 22.43% of the value of the business. When the property is sold for \$550,000, a capital gain will be realized of \$200,000 upon which the income tax will be \$50,000. Thus the total taxes, income and estate, will be \$128,500.

On the other hand, if the revenue agent is permitted to value the business at \$525,000, the estate tax will be \$134,500,—or 25.62% of the agent's valuation. The capital gain, however, will be only \$25,000, and the capital gains tax only \$6,250, making the aggregate taxes \$140,750, only \$12,250 more than the tax would have been had the personal representatives successfully contested the revenue agent's appraisal.

13. So great a difference in estimates is not unusual.

In the illustrations thus far given, the net estate before the deduction of the specific exemption has consisted of the family controlled business. Under such circumstances, unless the value of the business is \$60,000 (the amount of the specific exemption) or less, the business, or a part of it, will have to be liquidated in order to raise the money to pay the estate tax.¹⁴ In such cases it is of the utmost importance that the personal representatives of the estate,—and their attorneys,—carefully appraise the relative importance of estate and capital gains taxes in order to avoid wasting the assets of the estate in needlessly attempting to justify a low value for estate tax purposes. No two situations will be exactly alike. Sound conclusions will only be reached if fair estimates of probable minimum and maximum sales prices are made as soon after death as possible.

There are two prime factors in the valuation of the family controlled business,—(1) the appraisal of the component parts of the business, tangible and intangible; and (2) the valuation of the business as a whole. It is true, of course, that the valuation of the business as a whole is the ultimate fact to which the entire matter of appraisal is directed; it is also true, contrary to the laws of mathematics, that here the whole,—the value of the business as a whole,—is seldom exactly equal to the sum of its parts.¹⁵ The fact remains that to arrive at a fair value for the business, it is almost always necessary to have as complete knowledge as possible of the value of the assets of which the business consists.

Regardless of the form in which the family controlled business has been conducted,—*i.e.*, whether it is a sole proprietorship, a partnership or a corporation, the first process in the process of valuation should be the preparation of a detailed statement of the assets and liabilities. A statement taken from the books of account may or may not be sufficient. Assets may have been written off the books as a matter of conservative accounting; other assets still in use and still having value may have been fully depreciated.

Each of the assets listed on such a detailed statement should first be valued separately. Some of the facts to be taken into consideration, and some of the methods of valuation, will be discussed below.

14. Of course, the amount of the estate tax may be borrowed, in which event if the business or a part of it is not liquidated, the debt will have to be paid out of earnings. Or an extension of time for payment, up to ten years, may be secured, and the tax paid out of earnings. In either event, the dependents of the decedent are deprived of the income used to pay the debt or the tax.

15. The whole may be more or less than the sum of the parts. Actually the mathematical law is just as sound here as it is in any other analysis. The fact that the value of the business as a whole is seldom identical with the sum of the value of the component parts is merely an indication that the value of each of the component parts changes,—sometimes increasing, sometimes decreasing,—when considered as a part of the whole. To use an admittedly farfetched example: To a book dealer a *set* of the original Audubon has a certain value in dollars. To an art dealer, the *individual plates* cut from the set will each have a value, and the sum of the values of the individual plates will seldom, if ever, be identical with the value of the set.

It will be helpful, though it is not essential, if the unadjusted balance sheet has been audited by independent certified public accountants.

No one of all the factors to be considered is, in and of itself, determinative. This article will in more than one place stress the importance of opinion evidence. The fact is, however, that competent opinion evidence has frequently been rejected where other factors seemed to the trier of the facts to be more important.¹⁶

The valuation is to be made as of the date of death. Theoretically, therefore, the appraisal should be made in the light of facts known to exist on the date of death. However, events occurring after death may and should be taken into consideration if they could have been or should have been reasonably anticipated on the date of death.¹⁷ For example, if death occurs in a period of violent inflation or deflation, either general or merely affecting the asset being valued, this should be taken into consideration.¹⁸

The location and physical condition of the asset are factors in the determination of its value.¹⁹ While this principle applies with peculiar force to real estate, it should not be overlooked in the case of other physical assets. For example, machinery located in a place where the product thereof cannot be marketed economically cannot be as valuable as it would be if located in a better economic situation.

The state of the market for identical or similar assets must be considered: if the market is active, prices realized in that market are to be given great weight;²⁰ if the market is sluggish, the value of such evidence is correspondingly diminished. It must be remembered, however, that even when the market is so sluggish as to be non-existent, an effort must be made, and in the first instance by the representatives of the estate, to determine what a sales price might have been if a sale (even an impossible sale) had taken place.²¹

Any of the assets which are a part of the business, which are of such a kind that they are regularly and consistently bought and sold from day to day so that there is an ascertainable market value, should be appraised by reference to such market prices. For example, stocks and securities which are regularly traded, an inventory of lead, or copper, or grain, should be valued by reference to the market values of such commodities on the regular

16. E. R. Bernstein, 3 B. T. A. 1280 (1926); Carl Rosenbaum, 3 T. C. M. 925 (1944); P. P. Martinez, P-H 1939 TC MEM. DEC. SERV. ¶ 39,222 (1939).

17. Couzens v. Commissioner, 11 B. T. A. 1040 (1928) (income tax case); Wilson v. Commissioner, 5 B. T. A. 615 (1926).

18. Cathcart v. Schwaner, P-H 1929 FED. TAX SERV. ¶ 1352 (U. S. Dist. Ct., D. Ill. 1929).

19. Galt v. United States, P-H 1938 FED. TAX SERV. ¶ 5,523 (U. S. Dist. Ct., D. Hawaii 1938); Emilie Baer and Mark Hyman, 3 B. T. A. 881 (1926).

20. Galt v. United States, *supra* note 19; Emilie Baer and Mark Hyman, 3 B. T. A. 881 (1926); Wilson v. Commissioner, 5 B. T. A. 615 (1926).

21. See *supra* p. 251.

exchanges, or in accordance with the published quotations for such commodities.²² The family owned business may own stocks or securities that are regularly traded in on a stock exchange, in which event the values so established should be used.

If identical or similar property has been sold in an arm's length transaction within a reasonable time either before or after the date of death, the value established by such sale may be used. The difficulty is in attempting to determine what is "similar property." In the case of real estate particularly, it is usually possible and usually desirable to present evidence of the sales prices of property in the same general locality as the property to be valued,²³ but honest differences of opinion will arise as to the force to be given such evidence, difference of opinion which it is the duty of the trier of the facts to resolve.

However, a forced sale does not determine value.²⁴ A forced sale is any sale where the seller is under compulsion to sell. Under such circumstances the sales price is very likely to be lower than it would be were the compulsion absent.

If the buyer is under a compulsion to purchase, the sales price is just as suspect as in the case of a forced sale.²⁵ For example, let us assume that one of the assets of the family controlled business is an inventory of lead, a commodity the supply of which is far less than the demand, the personal representatives of the estate have knowledge of a sale of lead to a user who was desperately in need in order to fulfill contracts. The price established by such a purchase will ordinarily be too high and should not be used.

The question of whether a sale was made within a "reasonable" time before or after death is as much a matter for the determination of the trier of the facts as is the question of value.²⁶

If identical or similar property is sold partly or entirely on credit within a reasonable period before or after death, the fair market value of notes or other evidences of the indebtedness of the purchaser must be taken into consideration in determining the value of the asset.²⁷ Obviously, if an asset is sold in an arm's length transaction for \$100, \$5 of which is paid in cash and the balance in notes, the value established by the sale is only \$5 plus the value of the notes.

A sale is usually preceded by an offer, either an offer on the part of the owner to sell or on the part of a prospective buyer to purchase. If such

22. Carl Rosenbaum, P-H 1944 TC MEM. DEC. SERV. ¶ 44,289 (1944).

23. Galt v. United States, P-H 1938 FED. TAX SERV. ¶ 5,523 (U. S. Dist. Ct., D. Hawaii 1938); Emilie Baer and Mark Hyman, 3 B. T. A. 881 (1926).

24. U. S. Treas. Reg. 105 § 81.10(a); Galt v. United States, P-H 1938 FED. TAX SERV. ¶ 5,523 (U. S. Dist. Ct., D. Hawaii 1938).

25. Galt v. United States, *supra* note 24.

26. Sugerman v. Commissioner, 20 B. T. A. 960 (1930).

27. *Ibid.*

an offer is accepted, a sale results,—an accomplished fact of undoubted probative force—but if such an offer is made but is not accepted,—how much weight is to be given to the price specified in the offer? If the rejected offer was made by an owner under no compulsion to sell, it is easy to reason that the stipulated price was in excess of market value. If it was the owner who rejected the offer, it is difficult, if not impossible, to refute the proposition that the price stipulated in the offer was too low.²⁸

The liens against an asset may have a bearing on the value of the asset, particularly if the loan was made within a reasonable period before or after the date of death. Thus, if it can be established that it is the practice of the lender not to lend more than a given percentage of the estimated value of assets pledged as security, the loan itself has some probative force as to the value of the asset. In *Estate of C. Rosenbaum*,²⁹ the executors, during the period preceding final determination of the estate tax, paid off a mortgage on real estate for less than the amount which they contended to be the value of the property. The Tax Court refused to value at less than the amount paid on the mortgage.

The value at which assets are appraised for the purposes of local property taxation is seldom, if ever, determinative of value for estate tax purposes.³⁰ Even the regulations provide that property should not be returned at the local assessed value unless such value represents the fair market value.³¹ This does not mean that such appraised values are not evidentiary. They are. But such an appraised value is merely one of the elements to be taken into consideration in determining fair market value—an element which has considerably less weight than others because of the notorious fact that such appraisals are seldom if ever accurate.

In many jurisdictions, local statutes or court rules require an appraisal of all assets to be filed with the court having jurisdiction over the administration of the estate. Sometimes such appraisers are appointed by the court. In other cases they are selected by the personal representatives of the estate. The appraisal made by them is frequently looked upon as being purely formal and perfunctory. Such an analysis of their appraisal may be entirely justified by the ability (or lack of it) of the appraisers. To let such an appraisal stand as a court record without protest and without attempting to have it as accurate as possible is a mistake which may prove to be embarrassing in the estate tax proceeding.³² Neither the Commissioner nor any federal court is

28. *Cf. Wilson v. Commissioner*, 5 B. T. A. 960 (1930).

29. 3 T. C. M. 925 (1944).

30. Francis J. Moors, P-H 1940 TC MEM. DEC. SERV. ¶ 40,520 (1940); *Galt v. United States*, P-H 1938 FED. TAX SERV. ¶ 5,523 (U. S. Dist. Ct., D. Hawaii 1938).

31. U. S. Treas. Reg. 105 § 81.10(b).

32. *E. H. Dillon*, 3 B. T. A. 1139 (1926); *Nicholson v. Commissioner*, 21 B. T. A. 795 (1930).

bound by the findings of fact of a local tribunal.³³ But such findings unquestionably have probative value as evidence.

Expert testimony is valuable in the case of *any* asset for which there is no established market value,³⁴ and is essential in the valuation of many such assets. The selection of experts should be made with great care, and the kind of expert will differ with the nature of the asset. An expert who cannot, or who does not, give the reasons for his conclusions, whether his testimony is by affidavit or by oral examination in court, is of little use. The personal representatives of the estate should therefore furnish their prospective expert with all the facts pertinent to the value of the asset as soon after death as possible. The expert should then be asked to express himself fully. In many instances it will be necessary for the attorney for the estate to turn "devil's advocate" and cross-examine the expert. If the reasons for the appraisal as thus elicited from the expert are not convincing, another expert or experts should be sought.

An expert, no matter what the nature of the asset, should be impressed that it is an appraisal of fair market value that is desired. Real estate appraisers all too frequently do not seem to realize this. In one case in the author's experience when appraisals of real estate were received, the experts were instructed to try to find buyers at the value named by them. Their response was that this would be impossible notwithstanding the fact that there had been no appreciable change in market conditions.

The question arises, not infrequently, as to whether the value of a fractional part of an asset is to be discounted because it is only a partial interest. Thus, to cite a simple example, the family controlled business may be a tenant in common as to an undivided one-half of a parcel of real estate. Assuming the entire parcel to have a value of \$100,000 is the value of the undivided one-half interest \$50,000 or a lesser figure? Again, we have a question of fact to be determined by the trier of the facts. The representatives of the estate should be prepared to present evidence, and should present it, if it is available, that a fractional interest has a value less than the proportion of the whole represented by the fraction.³⁵

Among the assets of the family controlled business there may be stock or securities, or both, for which there is no regularly established market place. In any such case, such stock or securities should, as component parts of the family controlled business, be valued in accordance with exactly the same standards as are herein specified for the family controlled business, with

33. *Nicholson v. Commissioner*, 21 B. T. A. 795 (1930).

34. *Francis J. Moors*, P-H 1940 TC MEM. DEC. SERV. ¶ 40,520 (1940); *Overlander v. United States*, 67 Ct. Cl. 531 (1929); *Galt v. United States*, P-H 1938 FED. TAX SERV. ¶ 5,523 (U. S. Dist. Ct., D. Hawaii 1938); *Emilie Baer and Mark Hyman*, 3 B. T. A. 881 (1926).

35. *Emilie Baer and Mark Hyman*, 3 B. T. A. 881 (1926).

the additional specification that, "in addition to all other factors"³⁶ the value is to be determined by reference to the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on an exchange.³⁷

For example: The family controlled business, the value of which is the ultimate object of investigation, owns, as an investment, the stock of a local telephone company. The stock of the local telephone company is not listed upon any exchange, and there have been no sales of such stock within any period near enough to the date of death to furnish any criterion of value as of such date. Congress has directed that the telephone shares "shall be determined taking into consideration . . . the value of stock or securities of corporations engaged in the same or similar line of business which are listed on an exchange."³⁸ It is fortunate that the direction provides for taking into consideration "all other factors"; obviously to value the stock of a local telephone company by reference to the market value, as established on the New York Stock Exchange of the American Telephone and Telegraph Company, is little short of ridiculous.

In almost every case in which the testimony of an investment banker is employed, he will, whenever possible, take into consideration the established sales prices of listed stocks of corporations engaged in a similar business, but such an expert will not make comparisons or base his estimate of value upon the proved value of stocks of other corporations in the same or a similar line of business. He will, on the contrary, make his comparisons and base his estimate, if possible, upon the listed values of stocks of corporations which are, for one reason or another, similar to the corporation the stock of which he is appraising. Obviously, a corporation with assets, say, of \$100,000,000 cannot be intelligently compared with one having assets of \$1,000,000. Section 811(k) of the Internal Revenue Code, which is unquestionably intended as a relief to estates, is actually of little practical use. Long before the enactment of the section, stocks were being valued in accord with its intent.

After the component parts of the business have been separately valued, a balance sheet should be prepared in which the values so determined should be substituted for book values. The liabilities shown on this adjusted balance sheet will ordinarily be identical with book values. However, if for any reason a liability per books is in either less or more than the actual liability an adjustment should be made.

The balance sheet referred to in the preceding paragraph, together with

36. INT. REV. CODE § 811(k).

37. *Ibid.*

38. *Ibid.*

the income accounts of the business for an appropriate number of years,³⁹ will form the basis for a valuation of the business as a whole.

It has been previously indicated that the opinion of experts is valuable and in many instances essential in the valuation of the component parts of the business. When the task of valuing the business as a whole is undertaken, there are few instances in which the opinion of experts is not necessary. It is best to have more than one expert. Each should be generally familiar with the type of business he is asked to value. He should not, however, in the opinion of the author, be connected with the business. In the first place, an executive of the business being valued will find it difficult to be entirely objective. In the second place, an executive of the business, no matter how able and no matter how objective he tries to be, is likely to be either too optimistic or too pessimistic. He is too close to the situation to be valuable as an expert.

The expert or experts who value the business as a whole should be furnished with all of the data with respect to the fair market value of the component parts of the business. The importance of giving the expert *all* of the information cannot be overemphasized. The affidavit of the expert will be carefully scrutinized by representatives of the Commissioner of Internal Revenue, and if it becomes necessary to submit the issue of value to a court, the expert will be cross-examined. If the government can show that the opinion of the expert was arrived at without a consideration of *any* pertinent fact, the value of his testimony will be destroyed or greatly reduced.

If the business is incorporated, the stock must be valued in accord with the provisions of section 811(k) of the Internal Revenue Code.⁴⁰ In other words, in addition to all other facts, the value must be determined by reference to the value of stocks of corporations engaged in the same or a similar line of business which are listed on a stock exchange.

Unless it is apparent without detailed examination of the facts that the value of the entire estate as of the date of death is less than the value on the first anniversary of death, another and similar valuation should be made as of the latter date.

If it appears that an appraisal should be made as of the anniversary of death, *i.e.*, unless it is obvious that the value of the estate as a whole is greater on the anniversary of death than it was on the date of death, the second appraisal should be prepared for and should be made in the same way as was the first with two exceptions.

(1) If any asset of the estate was disposed of by the personal representa-

39. The number of years to be taken into consideration will vary with the type of business. If the earnings are stable, from three to five years are sufficient. If the earnings vary materially from year to year, a longer period, say, ten years, should be used.

40. See p. 260 *supra*.

tives of the decedent in the period between the two valuation dates, that asset should be reappraised, not at its value on the anniversary of death, but at its value on the date disposed of.⁴¹ (2) Any asset the value of which is affected by the mere lapse of time (a patent, for instance) must be valued as of the anniversary of death at its value on the date of death, with an adjustment for any difference in its value as of the anniversary of death not due to mere lapse of time.⁴²

The application of the two exceptions just stated to the family controlled business requires some further discussion. If the business itself is disposed of, whether by sale, exchange, distribution or otherwise, the first exception applies. The business should be valued as of the date of distribution, not the anniversary of death. If the value of the business itself, as distinguished from one or more of its component parts, is affected by the mere lapse of time,⁴³ the second exception applies.

But if only a component part of the business is disposed of within a year after death, the first exception should not be applied. For example, to state a very simple case: Suppose the business to be that of retail merchandising. Sales of component parts of the business will presumably be made regularly every business day during the year following death. The business as a whole will nevertheless be valued as of the anniversary of death, without regard to such sales.

If, as a result of the two valuations, it appears that the estate as a whole has a value on the date of death which was less than its value a year later, the return need only reflect the appraisal as of the date of death. On the other hand, if the value of the entire estate on the first anniversary of death is less than its value on the date of death, both valuations must be included in the return but the computation of tax will be made on the smaller of the two appraisals.⁴⁴

After the estate tax return is filed, the task of the representatives of the estate is to convince the representatives of the Commissioner of Internal Revenue (that is, the examining revenue agent, his superiors in the office of the Revenue Agent in Charge, the Valuation Section and the Technical Staff) of the correctness of the values included in the return. These negotiations are of the utmost importance. Representatives of estates and their counsel sometimes are inclined to neglect this phase of the procedure, principally as to preparation and, to a lesser extent, as to presentation. It is mistakenly thought that detailed preparation can wait until it becomes necessary to present the matter in court. Such an attitude overlooks the fact that

41. INT. REV. CODE § 811(j).

42. *Ibid.*

43. For example, the business might consist of the exploitation of patents and the entire value thereof might be represented by the patents being exploited.

44. INT. REV. CODE § 811(j).

the Commissioner's findings are presumptively⁴⁵ correct.⁴⁶ The estate must sustain the burden, in any subsequent proceedings, of proving that his conclusions are inaccurate.⁴⁷ It is, therefore, essential that one put one's best foot forward with the Commissioner's representatives, and all the time spent in preparation is time well spent. In the author's opinion, if the same effort were always put into preparing for the initial appearance of the revenue agent that is necessarily required for a subsequent trial in court, there would be many less trials in court.

The author does not intend to imply by the foregoing that trials can always be avoided. It must be remembered that the representatives of the Commissioner are administrative officials upon whom a semi-judicial duty is imposed. They have the almost impossible task of reconciling the administrative function of collecting taxes (with the natural inclination to resolve doubts in favor of the sovereign) with the judicial function of being perfectly objective and of resolving doubts in favor of the taxpayer. On the whole, they meet this impossible task remarkably well, particularly when the personal representatives of the estate and their counsel pay them the compliment of preparing a case for them as well as they would, as a matter of course, prepare a case for presentation in a court room.

If, notwithstanding careful preparation and expert presentation, the representatives of the Commissioner of Internal Revenue finally determine upon a value which is not satisfactory to the estate, it becomes necessary to proceed in the Tax Court of the United States, the appropriate district court of the United States, or the Court of Claims of the United States. One of these three is always the ultimate trier of the facts. No appellate court⁴⁸ has any right or duty to review a question of fact (such as a question of value) where the record of the trial court contains any substantial evidence to support the findings of the trier of the facts.⁴⁹ For practical purposes, therefore, in most cases the decision of the trial court is final. The case must be won in the trial court, if it is to be won at all.

45. The presumption is rebuttable [A. A. Philipp, 3 B. T. A. 697 (1926); Whorton v. Commissioner, 7 B. T. A. 771 (1927); Galt v. United States, P-H 1938 FED. TAX SERV. ¶ 5.523 (U. S. Dist. Ct., D. Hawaii 1938)], and may be refuted in a proper case by the Commissioner himself [M. S. McDonald, 2 B. T. A. 1295 (1925)].

46. *Mimnaugh v. United States*, 66 Ct. Cl. 411 (1928), *cert. denied*, 280 U. S. 563 (1929); *Emilie Baer and Mark Hyman*, 3 B. T. A. 881 (1926).

47. *Emilie Baer and Mark Hyman*, 3 B. T. A. 881 (1926); *Nicholson v. Commissioner*, 21 B. T. A. 795 (1930); *Sugerman v. Commissioner*, 20 B. T. A. 960 (1930); *Title Insurance & Trust Co. v. Welch*, 37 F. 2d 617 (S. D. Cal. 1929); *Hays v. Heiner*, P-H 1933 FED. TAX SERV. ¶ 1955 (U. S. Dist. Ct., D. Pa. 1933); *Galt v. United States*, P-H 1938 FED. TAX SERV. ¶ 5.523 (U. S. Dist. Ct., D. Hawaii 1938).

48. Decisions of the Tax Court of the United States and of the several district courts are reviewable as a matter of right, by the appropriate court of appeals of the United States. Decisions of the Court of Claims of the United States may be reviewed, as a matter of grace, but not of right, on a writ of certiorari, by the Supreme Court of the United States.

49. *Neal v. Commissioner*, 53 F. 2d 806 (C. C. A. 8th 1931); *First National Bank of Memphis v. Commissioner*, 125 F. 2d 157 (C. C. A. 6th 1942).

Estate tax valuation cases, however, are actually won during the period that the data necessary for the determination of value are collected. If, as soon as the personal representatives of the estate are appointed, the task is begun and if it is thereafter carefully continued, the probabilities are that it will be unnecessary to go to court; and if court proceedings do become necessary, the initial preparations, those conducted prior to the filing of the return, will go far toward establishing the estate's contentions.