McMillan v. Commissioner, 4 T.C. 263 (1944)

For gift tax purposes, the fair market value of a large block of publicly traded stock should reflect the price a willing buyer would pay for the block as a whole, considering the impact its size has on market price, and not simply the mean between the high and low prices on the exchange for a single share on the date of the gift.

Summary

The taxpayer made gifts of large blocks of Montgomery Ward & Co. and United States Gypsum Co. stock to two trusts, each benefiting his daughter and her husband. The Commissioner determined the gift tax based on the average of the high and low trading prices on the gift date. The taxpayer argued the value should be lower, reflecting the discount necessary to sell such large blocks. The Tax Court held that while there were four separate gifts (one to each beneficiary), the valuation should consider the impact of the block size on the market, allowing for a discount to reflect the realities of selling large quantities of stock.

Facts

The petitioner, McMillan, created two trusts on December 31, 1940. One trust benefited his daughter, Arla, and her husband, William. The other benefited his other daughter and her husband. Each trust received 13,000 shares of Montgomery Ward stock and 8,000 shares of United States Gypsum stock. The trust agreements specified that each daughter and her husband were to receive income from one-half of the assets held in their respective trust. Montgomery Ward stock was trading between $37 and $38 on the New York Stock Exchange on the date of the gift. United States Gypsum was trading at $64-$65 per share. The taxpayer argued that these large blocks could only be sold via secondary distribution at a discounted price.

Procedural History

The Commissioner assessed a gift tax deficiency based on valuing the stock at the average of the high and low prices on the exchange. The taxpayer petitioned the Tax Court for a redetermination of the deficiency, arguing for a lower valuation based on the block size.

Issue(s)

1. Whether the gifts should be valued as four separate gifts, one to each beneficiary, or as two gifts, one to each trust, or as a single gift of the aggregate shares.
2. Whether the fair market value of the stock should be determined based on the average of the high and low prices on the exchange on the date of the gift, or whether the valuation should consider the impact of the large block size on market price.

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Holding

1. Yes, because the trust instruments clearly created separate trusts for each beneficiary, and the Supreme Court has established that such separate beneficial interests constitute separate gifts.
2. No, because the valuation must account for the impact of the block size on the market price; the average of the high and low price on the exchange may not accurately reflect the price a willing buyer would pay for such a large block.

Court's Reasoning

The court determined that the trust agreements created four separate gifts, emphasizing the language specifying separate trusts for each daughter and her husband. The court cited *Helvering v. Hutchings*, 312 U.S. 393, and *United States v. Pelzer*, 312 U.S. 399, to support the conclusion that separate beneficial interests constitute separate gifts for gift tax purposes.

Regarding valuation, the court recognized that the size of the block of stock could affect its per-share value, citing *Helvering v. Maytag*, 125 F.2d 55. It stated that "either secondary distribution or sales over a reasonable period of time after the basic date would have been resorted to to dispose of blocks of stock of the size of the four gifts here in question. To have offered it on the open market in one day would have demoralized the market." The court determined values for the stock that took into account market trends, various valuation theories, the experience of other vendors making comparable offerings, and expert opinion.

Practical Implications

McMillan establishes that when valuing large blocks of publicly traded stock for gift tax purposes, the size of the block and its potential impact on the market price must be considered. This decision rejected a purely mechanical application of the average of high and low trading prices on the exchange. Instead, the court emphasized a more realistic assessment of what a willing buyer would pay for the entire block. This case provides a basis for arguing for valuation discounts in similar situations involving large blocks of stock or other assets. Later cases have cited *McMillan* for the proposition that fair market value considers all relevant factors, especially the impact of the block size on pricing, influencing subsequent valuation disputes. This approach can be used in estate tax or other contexts where fair market value is relevant.

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