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

When valuing large blocks of publicly traded stock for gift tax purposes, the fair market value should reflect the impact of the block's size on the market, considering methods like secondary distribution or sales over a reasonable period, rather than assuming a single-day open market sale.

Summary

The case concerns the valuation of Montgomery Ward & Co. and United States Gypsum Co. stock that the petitioner gifted to trusts for his daughters and their husbands. The Commissioner assessed gift taxes based on the mean between the highest and lowest quoted selling price on the date of the gifts. The petitioner argued that the large blocks of stock should be valued considering the impact of their size on the market, specifically through secondary distribution. The Tax Court determined that for gift tax purposes, there were four separate gifts, but that valuation should consider how such large blocks would realistically be sold, not on a single day on the open market.

Facts

The petitioner made gifts of Montgomery Ward & Co. and United States Gypsum Co. stock on December 31, 1940, placing the stock in trust for his two daughters and their respective husbands. The total gift consisted of 26,000 shares of Montgomery Ward and 16,000 shares of Gypsum stock. The trust agreements specified separate trusts for each daughter and her husband, with each trust receiving half of the stock. The stock was publicly traded. The Commissioner determined the value of the stock based on the average of the high and low trading prices on the date of the gift.

Procedural History

The Commissioner assessed gift taxes based on a valuation of the stock using the average trading price on the date of the gift. The petitioner contested the Commissioner's valuation in the Tax Court, arguing that the valuation should reflect the impact of the large block size. The Tax Court reviewed the Commissioner's determination.

Issue(s)

1. Whether the gifts should be considered as one, two, or four separate gifts for valuation purposes under gift tax statutes.
2. Whether the fair market value of the stock should be determined based on the mean between the highest and lowest quoted selling price on the date of the gift, or whether the size of the stock blocks necessitates consideration of alternative valuation methods.

Holding

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1. Yes, because the trust instruments specifically created separate trusts for each daughter and her husband, the gifts should be considered four separate gifts for valuation purposes.
2. No, because the sheer size of the stock blocks would have a depressing effect on the market if sold at once, the fair market value should be determined considering alternative methods like secondary distribution or sales over a reasonable period.

Court's Reasoning

The court reasoned that the trust agreements explicitly created separate trusts for each daughter and her husband, indicating the donor's intent to make individual gifts to each beneficiary. Citing *Helvering v. Hutchings*, the court emphasized that the number of donees is determined by the trust instrument. Regarding valuation, the court acknowledged the Commissioner's reliance on regulations dictating the use of average trading prices for listed stocks. However, the court also recognized the principle that the size of the block can impact the per-share value, citing *Helvering v. Maytag*. The court stated that "the correct criterion is the fair market value of all of the stock comprising the gift, not merely a single share thereof." The court found that selling such large blocks on the open market on a single day would have demoralized the market. Instead, the court considered the likelihood of secondary distribution or sales over a reasonable period. The court considered expert testimony and the trend of prices to determine the fair market value, which was lower than the Commissioner's assessment.

Practical Implications

This case provides guidance on valuing large blocks of stock for gift tax purposes. It highlights that the size of the block is a critical factor that cannot be ignored when valuing stock gifts, particularly when dealing with significant holdings that would affect market prices. Practitioners must consider alternative valuation methods beyond the simple average of high and low trading prices, such as secondary distributions or sales over a reasonable time frame. The case emphasizes the importance of presenting expert testimony to support alternative valuation methods. It also reinforces the principle that gift tax is applied to the donee rather than the trust itself, solidifying the legal implications of clearly drafted trust documents that clearly outline the intended beneficiaries. Later cases would cite this one when considering blockage discounts.

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