Estate of Estella Keller v. Commissioner, 6 T.C. 1039 (1946)

For estate tax purposes, the fair market value of an undivided fractional interest in real estate may be discounted below its proportionate share of the whole property's value to reflect the lack of control and marketability inherent in such an interest.

Summary

The Tax Court addressed the valuation of an undivided one-third interest in real estate held by the decedent for estate tax purposes. The Commissioner argued for valuing the interest at one-third of the total property value. The estate contended that a discount was necessary due to the challenges of selling a fractional interest. The court agreed with the estate, allowing a 12.5% discount on the proportionate value, recognizing the practical difficulties in managing and selling such interests.

Facts

The decedent, Estella Keller, held a one-third undivided interest in several parcels of real estate in New York. The remaining interests were held by other family members. In determining the estate tax, the Commissioner valued the decedent's interest at one-third of the fair market value of each entire parcel. The estate argued that this valuation was too high, claiming that an undivided fractional interest is less marketable and less valuable than its proportionate share of the whole property.

Procedural History

The Commissioner assessed a deficiency in the estate tax. The Estate of Estella Keller petitioned the Tax Court for a redetermination of the deficiency, contesting the valuation of the real estate interest. The Tax Court reviewed the evidence and arguments presented by both sides.

Issue(s)

1. Whether the Tax Court erred in allowing a 12.5% discount on the fair market value of the decedent's undivided one-third interest in several parcels of real estate, for estate tax purposes.
2. Whether the transfer was intended to take effect in possession and enjoyment at or after death because of the existence of a possibility of reverter.

Holding

1. Yes, because the court found that the fair market value of an undivided fractional interest is less than the proportionate value of the whole due to difficulties in management, operation, and sale of the property.
2. No, because the gift of the remainder was absolute and unconditional. The decedent reserved no power of appointment, either contingently or otherwise, nor did she hold any strings by which the corpus could be drawn back to her or

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her estate.

Court’s Reasoning

The court relied on testimony from a New York real estate expert who stated it was common practice to discount fractional interests due to the lack of control and marketability. The court cited New York authorities recognizing the propriety of such deductions for inheritance tax purposes. The court distinguished the case from situations where the grantor retained significant control or a power of appointment. It emphasized that the gift was intended to be complete during the decedent’s lifetime. The court found that purchasers are interested in buying minority interests only when they could obtain all of the fractional interests making up the whole parcel. Reference was made to *William Rhinelander Stewart, 31 B. T. A. 201*, where a 15% discount was approved. The court stated, “We think the material evidence supports a conclusion that the fair market value of decedent’s interest was less than the proportionate value of the whole parcel and that a reduction of 12½ percent is reasonable.”

Practical Implications

This case establishes a practical approach to valuing fractional real estate interests for estate tax purposes. It acknowledges that such interests are inherently less valuable than their proportionate share of the whole due to the lack of control and marketability issues. Attorneys should consider this case when advising clients on estate planning involving fractional real estate interests and when litigating valuation disputes with the IRS. Appraisers should take this ruling into account when valuing similar interests. Subsequent cases have cited *Estate of Keller* as precedent for applying discounts to fractional interests, although the specific discount rate will depend on the unique facts of each case. This case highlights the importance of expert testimony in establishing the appropriate discount rate.

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