5 T.C. 904 (1945)

In the absence of exceptional circumstances, the prices at which shares of stock are traded on a free public market at the critical date is the best evidence of the fair market value for estate tax purposes.

Summary

The Estate of Caroline McCulloch Spencer disputed the Commissioner of Internal Revenue's valuation of 3,100 shares of Hobart Manufacturing Co. Class A common stock for estate tax purposes. The estate tax return valued the stock at $35 per share based on the Cincinnati Stock Exchange price on the date of death. The Commissioner increased the value to $50 per share. The Tax Court held that, absent exceptional circumstances, the stock exchange price accurately reflected the fair market value, finding no such circumstances existed in this case. Therefore, the court valued the stock at $35 per share.

Facts

Caroline McCulloch Spencer died on October 1, 1940, owning 3,100 shares of Hobart Manufacturing Co. Class A common stock. The stock was listed on the Cincinnati Stock Exchange. On the date of death, 4 shares were sold at $35 per share. The company manufactured and sold electric food cutting and mixing machines. The Class A shares were widely held, but directors and their families owned approximately 36% of the shares. Sales volume on the Cincinnati Stock Exchange was relatively low, but comparable to similar industrial companies.

Procedural History

The Estate filed an estate tax return valuing the Hobart Manufacturing Co. stock at $35 per share. The Commissioner of Internal Revenue assessed a deficiency, increasing the valuation to $50 per share. The Estate petitioned the Tax Court for a redetermination of the deficiency.

Issue(s)

Whether the Commissioner erred in determining that the fair market value of 3,100 shares of Class A common stock of the Hobart Manufacturing Co. was $50 per share at the time of the decedent's death, when the stock traded at $35 per share on the Cincinnati Stock Exchange on that date.

Holding

No, because in the absence of exceptional circumstances, which did not exist here, the price at which stock trades on a free public market on the critical date is the best evidence of fair market value for estate tax purposes.

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Court’s Reasoning

The court relied on Treasury Regulations regarding the valuation of stocks and bonds, particularly Section 81.10, which defines fair market value as “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell.” The court acknowledged that while the regulations allow for modifications to the stock exchange price if it doesn’t reflect fair market value, the general rule is that the exchange price is the best evidence. The court noted expert testimony that the Cincinnati Stock Exchange was a free market and that the prices reflected the fair market value of the shares. The court found no evidence of facts or elements of value unknown to buyers and sellers. “The prices at which shares of stock are actually traded on an open public market on the pertinent date have been held generally to be the best evidence of the fair market value on that date, in the absence of exceptional circumstances.” The court cited John J. Newberry, <span normalizedcite="39 B.T.A. 1123“>39 B.T.A. 1123; Frank J. Kier et al., Executors, <span normalizedcite="28 B.T.A. 633“>28 B.T.A. 633; and Estate of Leonard B. McKitterick, <span normalizedcite="42 B.T.A. 130“>42 B.T.A. 130. The court determined the fair market value to be $35 per share.

Practical Implications

This case underscores the importance of stock exchange prices in determining fair market value for estate tax purposes. It establishes a strong presumption that the exchange price is accurate, absent compelling evidence to the contrary. Attorneys must thoroughly investigate whether any exceptional circumstances exist that would justify deviating from the market price. Such circumstances might include manipulation of the market, thin trading volume coupled with evidence suggesting a higher intrinsic value, or a lock-up agreement preventing sale of the stock. Subsequent cases have cited Estate of Spencer for the proposition that market prices are generally the best indicator of fair market value, placing a heavy burden on the Commissioner to prove otherwise.

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