Havemeyer v. Commissioner, 12 T.C. 644 (1949)

When valuing large blocks of gifted stock, the fair market value may deviate from the mean between the highest and lowest quoted selling prices if evidence demonstrates that the market could not absorb the block at that price.

Summary

The petitioner contested the Commissioner's valuation of gifted Armstrong Cork stock. The Commissioner used the mean between the highest and lowest selling prices on the gift date. The petitioner argued for a lower value, considering the large block size and the market's inability to absorb it at the quoted prices. The Tax Court held that the Commissioner's method didn't reflect the fair market value. The court considered expert testimony and a "Special Offering" of the stock on the same date, concluding the stock's value was lower than the Commissioner's determination, thereby acknowledging that block size and market conditions can influence valuation.

Facts

On October 26, 1943, the petitioner made four separate gifts of Armstrong Cork Company stock, each consisting of 4,000 shares. The Commissioner determined a value of $37.25 per share based on the mean between the highest and lowest selling prices on the New York Stock Exchange that day. The petitioner argued the stock was worth $36.295 per share, accounting for the block size and the market's limited ability to absorb such quantities. A "Special Offering" of 4,000 shares of the same stock occurred on the same day. Only 600 shares were traded on the regular market that day, besides the special offering. The officials of the New York Stock Exchange concluded that the regular market could not absorb 4,000 shares within a reasonable time and at a reasonable price or prices.

Procedural History

The Commissioner assessed a gift tax deficiency based on a valuation of $37.25 per share. The petitioner challenged this valuation in the Tax Court. The Tax Court considered evidence presented by the petitioner, including expert testimony and details regarding a "Special Offering" of the stock. The Commissioner presented no evidence.

Issue(s)

Whether the Commissioner's method of valuation, using the mean between the highest and lowest quoted selling prices, accurately reflects the fair market value of the gifted Armstrong Cork stock, considering the large block size and market conditions?

Holding

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No, because the evidence presented demonstrated that the market could not absorb the large block of stock at the price determined by the Commissioner's method; therefore, the Commissioner's valuation did not reflect the fair market value.

Court's Reasoning

The court recognized that while the Commissioner's regulations (Regulations 108, sec. 86.19 (c)) generally consider the mean between high and low prices as fair market value, this isn't absolute. The court emphasized that fair market value is a question of fact, and other relevant factors should be considered if the standard formula doesn't reflect reality. The court gave weight to expert testimony, finding that the market was "thin" and couldn't absorb the 4,000-share blocks at the quoted prices. The court also distinguished between a "voluntary" market and a "solicited" market and noted that because the market on the 26th included a "Special Offering" that the market prices on the 25th were a better indication of how the market would react. Quoting Heiner v. Crosby, the court highlighted that it is proper to consider whether the circumstances under which sales are made at a certain price were unusual, and to the kind of market in which the sales were made. The court determined that the fair market value was $36.295 per share, lower than the Commissioner's $37.25, taking into account the block size, market thinness, and the "Special Offering".

Practical Implications

This case illustrates that the valuation of large blocks of stock for tax purposes requires a nuanced approach, going beyond simple reliance on stock exchange quotations. Attorneys must present evidence demonstrating the market's capacity to absorb the stock at the quoted prices. Factors like block size, market liquidity, and the presence of "Special Offerings" or secondary distributions are critical. The case highlights the importance of expert testimony in establishing the true fair market value. Later cases may cite Havemeyer to support the argument that mechanical application of valuation formulas is inappropriate when evidence suggests a different fair market value. It emphasizes that the regulations provide a guide, but factual evidence trumps a formulaic approach when there are marketability issues to consider.

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