Berzon v. Commissioner, 66 T. C. 707 (1976)

The value of stock subject to transfer restrictions is not solely determined by the agreed-upon price in a shareholders' agreement, and gifts of income interests in non-dividend-paying stock may not qualify for annual exclusions if the income is not reasonably susceptible to valuation.

Summary

Fred and Gertrude Berzon transferred shares of their closely held company, Simons Co. , to trusts for their family members and claimed annual gift tax exclusions. The IRS challenged the valuation of the shares, which were subject to a shareholders' agreement, and the classification of the gifts as present interests. The Tax Court held that the stock's value should not be limited to the price set in the shareholders' agreement due to transfer restrictions, and the income interests from the non-dividend-paying stock were not reasonably susceptible to valuation, thus disallowing the annual exclusions.

Facts

Fred A. Berzon, president and controlling shareholder of Simons Co. , a closely held corporation, and his wife Gertrude made gifts of Simons Co. stock to eight trusts for their children and grandchildren between 1962 and 1968. The stock was subject to a shareholders' agreement that imposed restrictions on its transfer and required redemption at a set price upon certain events. The Berzons claimed $3,000 annual exclusions for these gifts on their tax returns. The IRS determined that the stock's value was understated and the gifts were of future interests, not qualifying for exclusions.

Procedural History

The Berzons filed petitions with the Tax Court after receiving notices of deficiency from the IRS. The court reviewed the valuation of the Simons Co. stock, the nature of the interests transferred to the trusts, and the applicability of annual gift tax exclusions under Section 2503.

Issue(s)

1. Whether the value of the Simons Co. stock, subject to a shareholders' agreement, should be determined solely by the price set in that agreement for gift tax purposes.
2. Whether the Berzons are entitled to annual gift tax exclusions under Section 2503 for transfers of Simons Co. stock to the trusts.
3. Whether prior annual exclusions claimed for similar transfers in 1962-1964 may be disregarded in determining the gift tax due for the years 1965-1968.

Holding

1. No, because the court held that the restrictions on transfer are only one factor in determining the stock’s value, and other factors, including the fair market value of the company’s assets, must be considered.
2. No, because the income interests in the non-dividend-paying stock were not reasonably susceptible to valuation, and the corpus interests were future interests, thus not qualifying for exclusions.
3. Yes, because the court determined that the prior exclusions for 1962-1964 were erroneously allowed and should be disregarded in calculating the gift tax for 1965-1968.

Court’s Reasoning

The court applied the Second Circuit’s ruling in Commissioner v. McCann, which held that stock value is not solely determined by a shareholders’ agreement’s price when subject to transfer restrictions. The court considered the fair market value of Simons Co. ‘s assets, particularly its real estate, and the lack of dividends as factors in determining the stock’s value. For the annual exclusions, the court found that the income interests from the non-dividend-paying stock were not reasonably susceptible to valuation under Leonard Rosen, and the corpus interests were future interests under Section 2503. The court also followed Commissioner v. Disston in disregarding prior erroneously allowed exclusions.

Practical Implications

This decision impacts the valuation of closely held stock for gift tax purposes, emphasizing that transfer restrictions do not solely determine value. Practitioners must consider all relevant factors, including asset values and dividend history, when valuing such stock. The ruling also clarifies that gifts of income interests in non-dividend-paying stock may not qualify for annual exclusions if the income cannot be reasonably valued. This affects estate planning strategies involving trusts and closely held stock. Later cases have followed this approach in valuing restricted stock and determining the applicability of gift tax exclusions.