***Vernon v. Commissioner, 66 T. C. 484 (1976)***

The value of a gift is determined by subtracting the value of the donor's retained interest from the value of the property transferred, using the prescribed method in the Gift Tax Regulations.

**Summary**

Mary E. Vernon transferred Younkers stock to a trust for her mother's benefit, retaining the right to the principal upon her mother's death or after 10 years. The issue was how to value this gift for tax purposes. The court held that the method prescribed in the Gift Tax Regulations, which subtracts the value of the donor's retained interest from the transferred property's value using a 6% interest rate, must be used unless a more reasonable method is shown. Vernon's proposed alternative, valuing the income interest directly with a lower interest rate, was rejected.

**Facts**

On December 31, 1971, Mary E. Vernon transferred 9,600 shares of Younkers stock, valued at $28 per share, to a trust. Her mother, Ethel F. Metcalfe, was the sole income beneficiary. Upon Metcalfe's death or after 10 years, whichever came first, the trust would terminate, and Vernon would receive the principal. The trustee had broad powers to manage the trust assets, including selling the Younkers stock if deemed prudent. Vernon's father had been a Younkers executive, and she inherited most of his estate, which was primarily Younkers stock, after his death.

**Procedural History**

The Commissioner determined gift tax deficiencies for Vernon and her husband, who had consented to gift splitting. Vernon petitioned the Tax Court for a redetermination of the gift tax. The court heard arguments on the valuation method to be used for the gift and rendered its decision.

**Issue(s)**

1. Whether the gift should be valued using the method in section 25. 2512-9(a)(1)(i) and (e) of the Gift Tax Regulations, which subtracts the value of the donor's retained interest from the value of the property transferred, or whether another method should be used.
2. Whether the annual interest rate used in valuing the gift should be 6%, as provided in the regulations, or 3. 75%, as proposed by Vernon based on historical dividend yields.

**Holding**

1. No, because the method prescribed in the Gift Tax Regulations must be used

 

unless a more reasonable and realistic method is shown.
2. No, because Vernon failed to prove that using a 3. 75% interest rate was more reasonable than the 6% rate provided in the regulations.

**Court’s Reasoning**

The court emphasized that the Gift Tax Regulations’ method for valuing gifts, which involves subtracting the value of the donor’s retained interest from the value of the property transferred, is presumptively correct. Vernon’s proposed method of valuing the income interest directly was rejected because it was not shown to be more reasonable or realistic. The court noted that the regulations provide administrative convenience and uniformity. Regarding the interest rate, the court found Vernon’s proposed 3. 75% rate based on historical dividends to be inadequate because it was an average over a short period, the company had significant retained earnings, and the trustee had the power to sell and reinvest the trust assets. The court distinguished Vernon’s case from others where alternative valuation methods were accepted due to different factual circumstances.

**Practical Implications**

This decision reinforces the importance of following the Gift Tax Regulations’ prescribed method for valuing gifts with retained interests unless a more reasonable alternative is clearly demonstrated. It highlights the need for taxpayers to provide substantial evidence to deviate from the regulations’ 6% interest rate when valuing retained interests. Practitioners should be cautious when proposing alternative valuation methods and ensure they have strong evidence to support their position. The decision also underscores the significance of the trustee’s fiduciary duties and powers in determining the appropriate valuation method, particularly when the trust assets may be sold and reinvested.

 