Estate of Elizabeth M. Lee, Deceased, Rhoady R. Lee, Sr. , Executor, and Rhoady R. Lee, Sr. , Individually, Petitioners v. Commissioner of Internal Revenue, Respondent, 69 T. C. 860 (1978)

The fair market value of a decedent's minority interest in a closely held corporation for estate tax purposes should be determined based on the specific rights attached to the stock and the lack of control inherent in a minority interest, not as part of a controlling interest.

Summary

Elizabeth Lee and her husband owned a majority of the stock in F. W. Palin Trucking, Inc. , as community property, with the stock split into common and preferred shares. Upon her death, Elizabeth bequeathed her interest in the common stock to her husband and the preferred stock to charities. The issue before the U. S. Tax Court was the fair market value of her interest for estate tax purposes. The court held that her interest should be valued as a minority interest, focusing on the rights attached to her shares and the lack of control over the corporation. The court determined that the fair market value of her interest was $2,192,772, and the value of the preferred stock bequeathed to charity was $1,973,494. 80.

Facts

Elizabeth M. Lee and Rhoady R. Lee, Sr. , owned as community property 80% of the common stock and 100% of the preferred stock in F. W. Palin Trucking, Inc. , a closely held corporation primarily holding real estate for future development. Upon Elizabeth's death in 1971, she bequeathed her interest in the common stock to her husband and the preferred stock to eight Catholic charities. The Lees' interest in the corporation was restructured prior to her death, with the preferred stock having a preference in liquidation and limited voting rights, while the common stock controlled the corporation's management.

Procedural History

The executor of Elizabeth Lee's estate filed a Federal estate tax return claiming a value for her interest in Palin Trucking based on the full value of the corporation's assets. The Commissioner of Internal Revenue determined a deficiency in estate taxes, valuing the estate's interest differently. The case was appealed to the U. S. Tax Court, where the parties stipulated to the net asset value of Palin Trucking but disagreed on the valuation of Elizabeth's interest in the corporation's stock.

Issue(s)

1. Whether the fair market value of Elizabeth Lee's interest in the 4,000 shares of common stock and 50,000 shares of preferred stock in Palin Trucking, Inc. , owned as community property, should be determined as a minority interest rather than part of a controlling interest?

© 2025 SCOTUSreports.com. All rights reserved.

2. Whether the fair market value of the 25,000 shares of preferred stock bequeathed to charity should be valued independently of the common stock?

Holding

1. Yes, because under Washington State law, each spouse's community property interest is an undivided one-half interest in each item of community property, making Elizabeth's interest a minority interest without control over the corporation.
2. Yes, because the preferred stock's value should be determined based on its specific rights and limitations, separate from the common stock's control over corporate management.

Court's Reasoning

The court applied the fair market value standard from the estate tax regulations, considering the specific rights attached to the common and preferred stock and the degree of control represented by the blocks of stock to be valued. The court rejected the Commissioner's valuation method, which treated the Lees' combined interest as a controlling interest, emphasizing that under Washington law, each spouse's interest must be valued separately as a minority interest. The court also considered the speculative nature of the common stock's value, given the preferred stock's priority in liquidation up to $10 million. The court's valuation of the preferred stock bequeathed to charity took into account its lack of control over corporate operations and its limited rights to dividends and liquidation proceeds.

Practical Implications

This decision clarifies that for estate tax purposes, the value of a decedent's interest in a closely held corporation should be determined based on the rights attached to the specific shares owned, particularly when the interest is a minority one. Practitioners should consider the impact of state community property laws on valuation, as these laws may require treating each spouse's interest separately. The decision also underscores the importance of considering the lack of control and marketability inherent in minority interests when valuing stock for estate tax purposes. Subsequent cases have cited Estate of Lee for its approach to valuing minority interests in closely held corporations, emphasizing the need to focus on the specific rights and limitations of the stock in question.

© 2025 SCOTUSreports.com. All rights reserved.