Northern Trust Co. v. Commissioner, 87 T. C. 349 (1986)

The fair market value of minority stock in a closely held corporation is determined without regard to the effect of simultaneous transfers into trusts as part of an estate freeze plan.

Summary

In *Northern Trust Co. v. Commissioner*, the Tax Court addressed the valuation of minority interests in a closely held corporation following an estate freeze plan. The court rejected the bifurcation theory, ruling that the value of the stock should not be reduced by the effect of placing the remaining shares in trusts. The court found a 25% minority discount and a 20% lack of marketability discount appropriate, valuing each share at $389. 37. The decision underscores the importance of considering all relevant factors in stock valuation and the inappropriateness of discounting based on hypothetical post-transfer scenarios.

Facts

John, William, Cecilia, and Judy Curran owned shares in Curran Contracting Co. (CCC) and its subsidiaries, which they reorganized into voting and nonvoting common stock and nonvoting preferred stock. On May 7, 1976, they transferred their voting stock to irrevocable trusts (76-1 trusts) and nonvoting stock to separate trusts (76-2 trusts) as part of an estate freeze plan. Cecilia died three days after the transfer. The IRS challenged the valuation of the stock for estate and gift tax purposes.

Procedural History

The IRS issued notices of deficiency for estate and gift taxes based on the valuation of the stock. The taxpayers contested these valuations in the Tax Court, which consolidated the cases. The court received expert testimony on valuation and issued its decision after considering the evidence presented.

Issue(s)

1. Whether the fair market value of the stock should be reduced by considering the effect of placing the remaining shares in trusts as part of an estate freeze plan?
2. What is the appropriate valuation method for the stock?
3. What discounts should be applied for minority interest and lack of marketability?

Holding

1. No, because the gift tax is an excise tax on the transfer and not on the property transferred, and the value of the stock should be determined without considering hypothetical post-transfer scenarios.
2. The discounted cash-flow method was deemed appropriate for valuing the

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operational components of CCC, while book value and liquidation value were used for other subsidiaries.
3. A 25% minority discount and a 20% discount for lack of marketability were applied, resulting in a value of $389. 37 per share.

Court’s Reasoning

The court rejected the bifurcation theory, citing *Ahmanson Foundation* and *Estate of Curry*, and held that the stock’s value should be determined as of the date of the gift without considering the effect of the trusts. The discounted cash-flow method was preferred over market comparables because it considered the company’s earnings, economic outlook, financial condition, and dividend-paying capacity. The court applied a 25% minority discount, considering the lack of control and the fiduciary duties of corporate officers, and a 20% lack of marketability discount, balancing the difficulty in selling unlisted stock against the company’s financial strength and earnings potential.

Practical Implications

This decision informs attorneys that the value of stock for tax purposes should not be discounted based on hypothetical post-transfer scenarios, such as the creation of trusts. It emphasizes the importance of using valuation methods that consider the company’s earnings and financial health. Practitioners should apply appropriate discounts for minority interests and lack of marketability, considering the specific circumstances of the company. This case has been cited in subsequent valuations of closely held corporations, reinforcing the anti-bifurcation rule in estate and gift tax contexts.

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