Estate of Saul R. Gilford, Deceased, Lauren E. Wurster, Executor, Petitioner v. Commissioner of Internal Revenue, Respondent, 88 T. C. 38 (1987)

The fair market value of restricted stock for estate tax purposes is determined by applying a discount to the mean of the bona fide bid and asked prices on the date of death, reflecting the stock's restricted nature.

Summary

Saul R. Gilford, the largest shareholder of Gilford Instrument Laboratories, Inc. , died owning 381,150 shares of restricted stock. The estate valued these shares at $7. 35 each, while the IRS claimed a value of $24 per share, citing a subsequent merger. The court determined that the merger was not foreseeable at the time of death and thus irrelevant to valuation. Instead, it upheld a 33% discount from the mean bid and asked price of $11. 31 per share on the date of death, resulting in a fair market value of $7. 58 per share, due to the stock's restricted nature under securities laws.

Facts

Saul R. Gilford died on November 17, 1979, owning 381,150 shares (about 23%) of Gilford Instrument Laboratories, Inc. , a company he founded and led as president and chairman. The stock was restricted under Federal securities laws. On the date of death, the stock's bid and asked prices were $11. 50 and $12. 25, respectively. Approximately six months later, the estate agreed to sell the shares to Corning Glass Works for $24 per share as part of a merger.

Procedural History

The estate filed a federal estate tax return valuing the shares at $7. 35 each. The IRS issued a notice of deficiency, valuing the shares at $24 each based on the merger price. The estate petitioned the U. S. Tax Court, which held that the merger price was not relevant to the valuation on the date of death and upheld a discounted value of $7. 58 per share.

Issue(s)

1. Whether the fair market value of the decedent's restricted stock should be determined by the mean of the bona fide bid and asked prices on the date of death, discounted due to the stock's restricted nature?
2. Whether the subsequent merger price of $24 per share was a reasonably foreseeable event that should be considered in determining the fair market value on the date of death?

Holding

1. Yes, because the fair market value of over-the-counter stock, in the absence of

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actual sales, is generally the mean of the bona fide bid and asked prices on the date of death, subject to a discount for the restricted nature of the stock.
2. No, because there was no reasonable or intelligent expectation of a merger on the date of death, making the subsequent merger price irrelevant to the valuation.

Court's Reasoning

The court applied the estate tax regulations, which state that the fair market value of stock traded over-the-counter is the mean between the highest and lowest quoted bid and asked prices on the valuation date. The court found that a 33% discount was appropriate due to the stock's restricted nature under SEC rules, which limit its resale. The court rejected the IRS's argument that the subsequent merger price should be considered, as there was no evidence of a willing buyer and seller at $24 per share on the date of death. The court also dismissed the IRS's contention that the stock's value should be enhanced due to its size, as no evidence supported this claim. The court emphasized that valuation is inherently imprecise and that subsequent events should not be considered unless they were reasonably foreseeable at the time of valuation.

Practical Implications

This decision clarifies that for estate tax valuation of restricted stock, the mean of the bid and asked prices on the date of death should be used, with an appropriate discount reflecting the stock's restricted nature. It reinforces that subsequent events, such as mergers, are not to be considered unless they were reasonably foreseeable at the time of valuation. This ruling impacts how estates and their advisors value restricted stock, emphasizing the need to focus on the stock's market conditions at the time of death. It also affects IRS valuation practices, requiring them to justify any reliance on post-death events. Later cases have followed this precedent, particularly in distinguishing between foreseeable and unforeseeable events in stock valuation.

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