Estate of Jung v. Commissioner, 101 T. C. 412 (1993)

The court determined the fair market value of closely held stock using the discounted cash flow method and applied a 35% marketability discount but no minority discount.

Summary

The case involved determining the fair market value of 168,600 shares of Jung Corp. stock owned by the decedent at her death. The court used the discounted cash flow (DCF) method, valuing Jung Corp. at $32-34 million, and applied a 35% marketability discount, concluding the shares were worth $4. 4 million. No minority discount was applied, as the DCF method inherently values the stock on a minority basis. The IRS's refusal to waive a valuation understatement penalty was found to be an abuse of discretion.

Facts

At her death on October 9, 1984, Mildred Herschede Jung owned 168,600 voting shares of Jung Corp. , representing 20. 74% of the company's shares. Jung Corp. was a privately held company involved in manufacturing and distributing health care and elastic textile products. The company was not for sale at the time of Jung's death, and her death had no impact on its operations. The estate initially valued the shares at $2,671,973 based on an appraisal. The IRS challenged this valuation, asserting a deficiency and a valuation understatement penalty.

Procedural History

The estate filed a timely federal estate tax return, reporting the Jung Corp. stock value as $2,671,973. The IRS issued a notice of deficiency, valuing the shares at $8,330,448 and asserting an additional tax and a valuation understatement penalty under Section 6660. The estate petitioned the Tax Court, which held a trial and considered expert testimony on the stock's value. The court ultimately valued the shares at $4,400,000 and found the IRS's refusal to waive the penalty to be an abuse of discretion.

Issue(s)

1. What was the fair market value of decedent's 168,600 shares of Jung Corp. stock on October 9, 1984?
2. Was the estate liable for an addition to tax under Section 6660 for a valuation understatement?

Holding

1. Yes, because the court determined the fair market value to be $4,400,000, based on the DCF method and applying a 35% marketability discount but no minority

discount.
2. No, because the court found that the IRS abused its discretion in refusing to waive the addition to tax under Section 6660, as the estate had a reasonable basis for its valuation and acted in good faith.

Court's Reasoning

The court rejected the market comparable approach due to the difficulty in finding companies similar to Jung Corp. Instead, it adopted the DCF method, valuing Jung Corp. at $32-34 million. The court applied a 35% marketability discount, consistent with expert testimony on discounts for lack of marketability, but did not apply a minority discount because the DCF method already reflects a minority interest valuation. The court also considered the 1986 sale of Jung Corp. 's assets as evidence of value but not as affecting the October 1984 value. Regarding the Section 6660 penalty, the court found that the estate acted in good faith and had a reasonable basis for its valuation, and the IRS's refusal to waive the penalty was an abuse of discretion given the IRS's own overvaluation.

Practical Implications

This case provides guidance on valuing closely held stock for estate tax purposes, emphasizing the use of the DCF method when comparable companies are not readily available. It also highlights the importance of considering marketability discounts while understanding that the DCF method inherently accounts for minority interest. For legal practice, this decision underscores the need for thorough and well-documented appraisals to support estate tax returns. The case also sets a precedent for challenging IRS valuation understatement penalties, suggesting that a reasonable basis and good faith effort to value assets can lead to penalty waivers. Subsequent cases involving similar issues have often cited Estate of Jung to support the use of DCF and the application of marketability discounts.