

Estate of Simplot v. Commissioner, 112 T. C. 130 (1999)

A premium may be warranted for voting stock in closely held corporations based on its potential influence and control, even if it does not constitute a majority.

Summary

Upon Richard Simplot's death, his estate contested the IRS's valuation of his 18 shares of voting and 3,942.048 shares of nonvoting stock in the family-owned J. R. Simplot Co. The Tax Court determined that a 3% premium should be applied to the voting stock's value due to its potential influence, despite not granting control. The court valued the voting stock at \$215,539.01 per share and the nonvoting stock at \$3,417.05 per share after applying marketability discounts. This decision underscores the significance of voting rights in valuation, even in minority holdings, and highlights the complexities of valuing stock in closely held companies with unique capital structures.

Facts

Richard Simplot owned 18 of the 76,445 outstanding voting shares and 3,942.048 of the 141,288,584 nonvoting shares of J. R. Simplot Co., a private family-owned corporation. The voting shares were subject to a 360-day transfer restriction. Both classes of stock were entitled to the same dividends and had similar rights in liquidation, except nonvoting shares had a preference. The estate reported a value of \$2,650 per share for both classes, but the IRS contended the voting shares should be valued at \$801,994.83 per share due to a voting premium.

Procedural History

The estate filed a federal estate tax return valuing the stock at \$2,650 per share. The IRS issued a notice of deficiency, significantly increasing the voting stock's value and asserting penalties. The estate petitioned the Tax Court, which determined the voting stock should receive a premium, valued the voting shares at \$215,539.01 per share after discounts, and upheld the estate's reliance on professional appraisers to avoid penalties.

Issue(s)

1. Whether a premium should be accorded to the voting privileges of the class A voting stock of J. R. Simplot Co. ?
2. If so, what is the appropriate amount of the premium for the voting privileges of the class A voting stock?
3. What is the fair market value of the class A voting and class B nonvoting stock as of the date of Richard Simplot's death?

Holding

1. Yes, because the potential influence and control associated with the voting stock justify a premium.
2. The appropriate premium is 3% of J. R. Simplot Co. 's equity value, reflecting the potential influence of the voting stock but not control.
3. The fair market value of the class A voting stock was determined to be \$215,539.01 per share after applying a 35% marketability discount, and the class B nonvoting stock was valued at \$3,417.05 per share after a 40% marketability discount.

Court's Reasoning

The court applied a valuation methodology that considered the unique capital structure of J. R. Simplot Co. , where the ratio of voting to nonvoting shares was 1 to 1,848. The court determined that even though the voting stock did not grant control, its potential influence warranted a premium. This premium was calculated as a percentage of the company's equity value rather than per share of nonvoting stock, reflecting the court's view that the voting stock's value stemmed from its potential to influence future corporate decisions. The court rejected the estate's argument that no premium was warranted, citing the inherent value of having a voice in a resource-rich company like J. R. Simplot Co. The court also considered the foreseeability of future scenarios where the voting stock could become more influential, such as the passing of shares to the next generation.

Practical Implications

This decision informs the valuation of stock in closely held corporations, particularly where voting and nonvoting shares exist in significantly different proportions. It establishes that even minority voting shares may warrant a premium due to their potential influence on corporate decisions. For legal practitioners, this case emphasizes the importance of considering the unique characteristics of a company's capital structure and the potential future scenarios that could affect stock value. Businesses should be aware that the structure of their stock classes can impact estate planning and tax liabilities. Subsequent cases have cited Estate of Simplot when addressing the valuation of voting and nonvoting stock in closely held corporations, often using the methodology of calculating premiums as a percentage of equity value.