Charles T. McCord, Jr. , et ux. v. Commissioner of Internal Revenue, 120 T. C. 358 (U. S. Tax Court 2003)

In McCord v. Commissioner, the U. S. Tax Court addressed the valuation of family limited partnership interests and the limits on charitable deductions. The court determined the fair market value of the gifted interests in McCord Interests, Ltd. , L. L. P. , applying a 15% minority interest discount and a 20% marketability discount. It also ruled that the formula clause in the assignment agreement did not allow for an increased charitable deduction based on a higher valuation determined by the court, limiting the deduction to the value of the interest actually received by the charity.

Parties

Charles T. McCord, Jr. , and Mary S. McCord (petitioners) were the donors in the case, challenging deficiencies in Federal gift tax determined by the Commissioner of Internal Revenue (respondent) for the year 1996.

Facts

Charles T. McCord, Jr. , and Mary S. McCord formed McCord Interests, Ltd. , L. L. P. (MIL), a Texas limited partnership, on June 30, 1995, with their sons and a partnership formed by their sons as partners. On January 12, 1996, petitioners assigned 82. 33369836% of their class B limited partnership interests in MIL to their sons, trusts for their sons, and two charitable organizations—Communities Foundation of Texas, Inc. (CFT) and Shreveport Symphony, Inc. —via an assignment agreement. The agreement included a formula clause designed to allocate the interests based on a set fair market value. The sons and trusts were to receive interests up to $6,910,933 in value, the Symphony up to $134,000 in excess value, and CFT any remaining value. The gifted interests were valued by the assignees at $7,369,277. 60 based on an appraisal report, and subsequently, MIL redeemed the interests of the charitable organizations.

Procedural History

The Commissioner issued notices of deficiency on April 13, 2000, determining that the petitioners undervalued their gifts and improperly claimed charitable deductions and reductions for their sons’ assumed estate tax liabilities. Petitioners contested these determinations in the U. S. Tax Court, which held a trial and reviewed the case, leading to a majority opinion with concurrences and dissents.

Issue(s)

1. Whether the gifted interests were properly valued at $7,369,277. 60 as reported by the petitioners or at a higher value as determined by the Commissioner?
2. Whether the formula clause in the assignment agreement allowed for an increased charitable deduction based on a higher valuation determined by the

court?
3. Whether the petitioners could reduce their taxable gifts by the actuarial value of the estate tax liability their sons assumed?

Rule(s) of Law

1. *26 U. S. C. § 2501* imposes a tax on the transfer of property by gift. The value of the property at the time of the gift is the measure of the gift tax.
2. *26 U. S. C. § 2512(a)* states that the value of property transferred by gift is its fair market value on the date of the gift.
3. *26 U. S. C. § 2522* allows a deduction for gifts made to charitable organizations, but the deduction is based on the fair market value of the property actually transferred to the charity.
4. *26 C. F. R. § 25. 2512-1* defines fair market value as "the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts. "

Holding

1. The court held that the fair market value of the gifted interests was $9,883,832, applying a 15% minority interest discount and a 20% marketability discount.
2. The court held that the formula clause in the assignment agreement did not allow for an increased charitable deduction based on the court's higher valuation, limiting the deduction to the value of the interest actually received by the charity.
3. The court held that the petitioners could not reduce their taxable gifts by the actuarial value of the estate tax liability their sons assumed, as such a reduction was too speculative.

Reasoning

The court's valuation of the gifted interests involved a detailed analysis of the underlying assets and the application of appropriate discounts. The court rejected the petitioners' valuation based on a flawed analysis and instead relied on a comprehensive evaluation of the assets, applying a 15% minority interest discount and a 20% marketability discount.

Regarding the charitable deduction, the court interpreted the assignment agreement's formula clause and determined that it did not contemplate an allocation based on a value determined years later for tax purposes. The clause's language and the subsequent actions of the assignees were seen as fixing the allocation at the time of the agreement, not allowing for adjustments based on a court's valuation.

On the issue of the estate tax liability, the court found that the potential liability was too speculative to be considered as a reduction in the value of the gift. The court rejected the petitioners' actuarial calculations as not providing a reliable basis for such a reduction.

The court also considered and rejected the application of the substance over form and public policy doctrines raised by the respondent, finding that the transaction did not warrant disregarding its legal form or the charitable nature of the gifts to CFT and the Symphony.

The dissenting opinions criticized the majority's interpretation of the assignment agreement and its refusal to apply doctrines that could have resulted in a different outcome regarding the charitable deduction.

Disposition

The court affirmed the deficiency in gift tax, determining the fair market value of the gifted interests and limiting the charitable deduction to the value of the interests actually received by CFT and the Symphony. The case was remanded for further proceedings consistent with the court's opinion.

Significance/Impact

McCord v. Commissioner is significant for its detailed analysis of valuation methods for family limited partnership interests and its interpretation of formula clauses in gift agreements. The decision underscores the importance of precise language in such clauses and the limitations on charitable deductions based on later judicial valuations. The case also reaffirms the principle that speculative future liabilities cannot be used to reduce the value of a gift for tax purposes. Subsequent cases have cited McCord for its valuation methodology and its stance on charitable deductions in the context of family limited partnerships.