FCG VALUATION CASE E-FLASH

Authored by John Walker and Chris D. Treharne, ASA, MCBA, BVAL of Gibraltar Business Appraisals, Inc. a member firm of FCG

Issue 14:4

Estate Of Alfred J. Richard, Deceased, Gary H. Richard And Peter C. Richard, Co-Executors, Petitioners V. Commissioner Of Internal Revenue, Respondent

T.C. Memo. 2012-173, Docket No. 9876-09, Filed June 20, 2012, Judge Joseph Robert Goeke

In an unusual case, a wife owning preferred shares in a closely-held company predeceased her husband. Almost six years after her husband's death, his personal representatives discovered the wife's will 13 years after her death. At issue for the court is whether the wife's shares are includable in the husband's estate.

TAKEAWAY

The estate valued the Decedent's preferred stock at its par value, $1,000 per share. In contrast, the IRS valued the preferred shares at $192,166.22 per share. While the valuation dispute will be settled subsequent to this case, readers can nonetheless benefit by realizing that the fair market value of closely-held preferred shares likely will not be par value. Many factors (including contemporaneous market rates for preferred stock, cumulative versus noncumulative dividends, call features, convertibility, etc.) may affect fair market value in relation to par value

THE FACTS

Ms. Victoria Richard ("Mrs. Richard") died in 1997 owning 140 shares of Class A preferred stock in a closely-held company ("Company") of which her husband was chairman of the board of directors while her sons were the only other directors. Although Mrs. Richard executed a will in 1991, it was not discovered until September 2010 and was not offered for probate until November of the same year.

At the time of his death in 2004 (i.e., after Mrs. Richard's death but before the discovery of her will), Mr. Alfred J. Richard ("Mr. Richard" or the "Decedent") directly owned 600 Class A preferred shares of the Company. Upon the filing of his estate tax return, the Company's CFO assumed Mrs. Richard's shares had passed to Mr. Richard upon her death. The Decedent's personal representatives and his attorney all signed the Form 706 which stated Mr. Richard owned 740 Class A preferred shares. The value shown for the shares was determined to the $740,000 which represented the number of shares the representatives believed the Decedent owned multiplied by the $1,000 per share par and redemption value.

However, according to the stock ledger of the Company, Mrs. Richard continued to own the 140 shares. In addition, there were no votes of shareholders at which the 140 shares could have voted between Mrs. Richard's death and Mr. Richard's death.

During 2005, the Decedent's will was probated, and the assets were distributed according to his will during 2006.

The IRS (or the "Service") reviewed the husband's 706 during 2008 and determined the 740 Class A preferred shares had a fair market value of $142,203,000 as of the Decedent's date of death. The following year, the IRS issued a notice of deficiency of more than $68 million and penalties of more than $27 million. Mr. Richard's estate contested the finding of deficiency. However, the subsequent discovery of Mrs. Richard's will in 2010 raised the issue of whether the shares owned by Mrs. Richard during her lifetime were properly includable in Mr. Richard's estate. Accordingly, the estate amended its filing after the probate of Mrs. Richard's estate, asserting Mr. Richard owned only 600 shares at the date of his death and reducing the value of the shares owned from $740,000 to $600,000.

DISCUSSION
Though the IRS did not contest the validity of Mrs. Richard's will, it did assert that probate of her will did not affect the 140 shares that had already been distributed according to the Decedent's will. As a result, the Service claimed the shares "were never owned by or includable in [Mrs. Richard's] estate."

The court disagreed and found that Mr. Richard never owned the shares in question and they are more properly included in Mrs. Richard's estate. As basis for the decision, the court noted that title to the shares remained in Mrs. Richard's name from the time of her death through the death of the Decedent, Mr. Richard never took an action that contravened the terms of Mrs. Richard's will, and took no action to indicate he was the owner of the 140 shares.

The IRS attempted to assign the shares to the Decedent's estate through its faulting Mrs. Richard's personal representatives for acts they took (or failed to take) after her death. The Service made several arguments to advance this line of evidence. However, the court determined that the representatives' actions did not warrant including Mrs. Richard's shares in the Decedent's estate.

The Service further attempted to make three additional arguments:

- The Decedent's personal representatives were violating state law by attempting to remove an asset from an estate.
- The Decedent exercised dominion and control over the 140 shares during his lifetime.
- The position taken by the estate on the Form 706 was binding.

For the reasons discussed previously, all of the arguments advanced by the IRS failed. Accordingly, the court determined the 140 Class A preferred shares were properly includable in Mrs. Richard's estate and were not part of the Decedent's estate.

CONCLUSION
Although the personal representatives believed the shares in question were includable in Mr. Richard's estate, the terms of Mrs. Richard's will - and Mr. Richard's actions with respect to the shares between her death and his - caused the court to determine the shares were not includable in his estate.
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