UPDATE ON COURT CASES – RECENT AND PRECEDENT

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Curtis R. Kimball, CFA, ASA

National Trust Closely Held Business Association
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September 19, 2023

Willamette Management Associates

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Executive Summary

- Review of the current court case decisions on valuation or related fiduciary matters
  - Facts and circumstances drive decisions.
  - The IRS has not changed its posture on major issues, but the Tax Court has.
- Significant case decisions were filed in the following areas:
  - Tax-affecting pass-through entities
  - Buy-sell agreements and life insurance
  - Reasonable compensation
  - Defined value clauses
  - Adequate disclosure compliance
  - Charitable donations and anticipatory assignment of income

Cecil v. Comm

- ESTATE OF WILLIAM A.V. CECIL, SR., DONOR, DECEASED, WILLIAM A.V. CECIL, JR., CO-EXECUTOR, Petitioner et al., v. COMMISSIONER OF INTERNAL REVENUE, Respondent
- T.C. Memo 2023-24 (February 28, 2023)
- In a long-awaited decision, the U.S. Tax Court accepted tax-affecting minority S corporation stock for gift tax purposes.
- The case dragged on so long that the donors did not live to see their victory.

Cecil v. Comm – Recent Precedent Cases

- Estate of Michael Jackson v. Commissioner, T.C Memo 2021-48 (May 3, 2021).
- Estate of Aaron U. Jones v. Commissioner, T.C. Memo 2019-101 (August 19, 2019).
- James F. Kress and Julie Ann Kress, Plaintiffs, v. United States of America, Defendant. Case No. 16-C-795, U.S. District Court, E.D. Wisconsin (March 25, 2019).

Cecil v. Comm – Past Precedent Cases

- Estate of Louise Paxton Gallagher v. Commissioner, T.C. Memo 2011-148 (June 28, 2011).
- Estate of Natalie B. Guistina et al. v. Commissioner, TC Memo 2011-141 (June 22, 2011).
- Dallas v. Commissioner, T.C. Memo 2006-212 (September 28, 2006).
- Adams v. Commissioner, T.C. Memo. 2002-80, Filed March 28, 2002.
- Heck v. Commissioner, T.C. Memo. 2002-34, Filed February 5, 2002.
- Wall v. Commissioner, T.C. Memo 2001-75 (March 27, 2001).
- Gross v. Commissioner, U.S. Tax Court, T.C. Memo. 1999-254, affd. 272 F.3d 333 (6th Cir. November 19, 2001).

Sorensen v. Comm

- Robin Sorensen et al. v. Commissioner of Internal Revenue
- T.C. Docket Nos. 24797-18, 24798-19, 24284-19, 20285-19
- Case filings and documents discovered and published by Bloomberg
- Gifts made in 2014 and early 2015 of Firehouse Subs minority stock by brothers Chris and Robin Sorensen
- IRS opposed tax-affecting the stock valuation
- Case settled circa June 2022, docketed for trial in Atlanta on July 18, 2022

Sorensen v. Comm (continued)

- Taxpayer’s valuation and filing
- The IRS audit
- The IRS appraisal review and valuation
- Willamette Management Associates appraisal review and valuation
- The audit conference
- Appeals Office submissions
  - IRS Outside Business Valuation Expert
  - Willamette Management Associates Rebuttal
  - IRS Expert’s Rebuttal
- Appeals Office conference
- The negotiated outcome

Connelly v. U.S.

- Thomas A. Connelly, in his Capacity as Executor of the Estate of Michael P. Connelly, Sr., Plaintiff - Appellant v. United States of America, Department of Treasury, Internal Revenue Service, Defendant – Appellee
- U.S. Supreme Court, Docket No. 23-146 (August 16, 2023)
- U.S. Court of Appeals, No. 21-3683 8th Cir., affrd. (June 2, 2023)
- U.S. District Court, 4:19-CV-01410-SRC, Eastern District, Missouri (September 21, 2021)
- Appeal cites split in district circuits on adding life insurance proceeds to the value of a company for a buy-sell valuation.
- See: Estate of Blount v. Commissioner, 428 F.3d 1338 (11th Cir. 2005)

Clary Hood, Inc. v. Comm

- CLARY HOOD, INC., Petitioner-Appellant, v. COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee
- U.S. 4th Circuit Appeals, No. 22-1573 (January 27, 2023)
- T.C. Memo 2022-15 (March 22, 2022)
- Reasonable compensation matter for 2015 and 2016, accuracy-related penalties, failure to pay dividends as a contributing factor
- Return on shareholders' investment versus market statistics on compensation for company founder and chief executive

Nelson v. Commissioner

- Mary P. Nelson; James C. Nelson, Petitioners—Appellants, versus Commissioner of Internal Revenue, Respondent—Appellee
- U.S. Court of Appeals, 17 F.4th 556, 5th Cir. No. 20-61068, affrd (November 3, 2021)
- T.C. Memo 2020-81 (June 10, 2020)
- Defined value clause issues
- Those 10 missing words: “as finally determined for federal estate and gift tax purposes”

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Nelson v. Commissioner (continued)

- Precedent defined value clause cases include:
- Wandry v. Commissioner, T.C. Memo 2012-88 (March 26, 2012)
- Petter v. Commissioner, T.C. Memo 2009-280 (December 7, 2009)
- Christiansen Estate v. Commissioner, 130 T.C.1, 16-18 (2008); affirmed on appeal 586 F.3d 1061, 8th Cir. (November 13, 2009)
- McCord v. Commissioner, 461 F.3d 614, 5th Cir. (2006), reversing U.S. Tax Court, 120 T.C. 358 (2003)
- King v. U.S., U.S. District Court, 545 F.2d 700, 10th Cir. (1976)

Schlapfer v. Commissioner

- RONALD SCHLAPFER, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent
- T.C. Memo 2023-65 (May 22, 2023)
- Addresses issues of what constitutes “adequate disclosure” compliance under the IRC Gift Tax Regulations

Hoensheid v. Comm

- ESTATE OF SCOTT M. HOENSHEID, DECEASED, ANNE M. HOENSHEID, PERSONAL REPRESENTATIVE, AND ANNE M. HOENSHEID, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent
- T.C. Memo 2023-34 (March 15, 2023)
- Charitable donation of closely held business stock shortly before the sale of the company in 2015 was deemed to be an anticipatory assignment of the deal income, and no charitable deduction was allowed.
- Accuracy-related penalties due to lack of a qualified appraisal and other deficiencies were proposed, but the court did not apply penalties due to the reliance on professional advice by the taxpayer.

Brooks v. Commissioner

- KENNETH M. BROOKS AND ANITA WOLKE BROOKS, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent
- T.C. Memo 2022-122 (December 19, 2022)
- Conservation easement valuation and resulting deduction, accuracy-related penalty
- A property bought for $1.35 million a year prior generated a $5.1 million conservation easement charitable contribution deduction for 2007.

Rothwell v. Rothwell

- SHAUN ROBERT ROTHWELL, Appellant, v. JENEA ROTHWELL, Appellee.
- Utah Court of Appeals, 2023 UT App. 50; 2023 Utah App. LEXIS 51; 2023 WL 3360879 (May 11, 2023)
- Effect and calculation of personal goodwill in valuing private businesses in divorce
- Jointly retained appraiser
- Tax-affecting (the sale of the business)

Jemison v. Jemison

- STEVEN C. JEMISON, an individual, v. Defendant/Appellee: MICHAEL S. JEMISON, in his capacity as trustee for the Jemison Family Trust and in his capacity as president and co-chairman of the board of directors of JJKL, Inc. f/k/a Heyco, Inc. and WILLIAM D. JEMISON, in his capacity as trustee for the Jemison Family Trust and in his capacity as co-chairman of the board of directors of JJKL, Inc. f/k/a Heyco, Inc.
- U.S. Court of Appeals, 2022 US App. LEXIS 18258, 3rd Cir. (July 1, 2022)
- Business judgment rule protects officers and directors from breach of duty claims but does not bar claims against same persons in their capacities as trustees

Endless River v. Trans Union

- Endless River Technologies LLC, Plaintiff, v. Trans Union LLC, Defendant
- U.S. District Court, 2023 US Dis LEXIS 725; 2023 WL 24101 (July 26, 2023)
- Damages claims, failure to return source code after a canceled contract, Illinois law
- Damages waiver in a contract precludes the damaged party from collecting indirect "consequential" damages such as projected lost profits.

Walsh v. Preston

- MARTIN J. WALSH, Secretary of Labor, United States Department of Labor, Plaintiff, v. ROBERT N. PRESTON, et al., Defendants
- U.S. District Court, 1:14-CV-04122-ELR; 2022 US Dist LEXIS 232248; 2022 17959237 (September 20, 2022)
- In a lengthy opinion, the court determined that the defendants did breach fiduciary duties and did engage in prohibited transactions. It decided that there was no coliability among the defendants, but it did not allow an offset of payments on debt of TPP Preston personally made
- In determining FMV, the court did not allow a minority interest discount. In so doing, the resulting damages determined were minimal.

Walsh v. Bowers

- Precedent case:
- MARTIN J. WALSH, Secretary of Labor, United States Department of Labor, Plaintiff, v. BRIAN BOWERS, an individual; DEXTER C. KUBOTA, an individual; BOWERS + KUBOTA CONSULTING, INC., a corporation; BOWERS + KUBOTA CONSULTING, INC. EMPLOYEE STOCK OWNERSHIP PLAN, Defendants
- U.S. District Court, 2021 US Dist LEXIS 177184 (September 17, 2021)
- The district court ruled "decisively" against the Department of Labor ("DOL") in an ESOP valuation case, stressing that the DOL failed to follow standard valuation practices.

Source Acknowledgements

- *The Past Year's Significant, Curious, or Downright Fascinating Fiduciary Cases (2022 Edition)*At least it seems to me. Your mileage may vary*. Dana G. Fitzsimons Jr., managing director and senior fiduciary counsel, Bessemer Trust (Updated through 12/31/2022)
- Business Valuation Resources – BVLaw – www.bvresources.com
- National Center for Employee Ownership - https://www.nceo.org/r/litigation
- Various trust litigation attorneys

Presenter - Disclaimer

Curtis R. Kimball, CFA, ASA – Senior Managing Director, Willamette Management Associates – crkimball@willamette.com 404-475-2300

Willamette Management Associates – www.willamette.com

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Prepared by

Curtis R. Kimball, CFA, ASA, ARM-BV
Senior Managing Director

Willamette Management Associates
1355 Peachtree Street, NE Suite 1470
Atlanta, Georgia 30309
404-475-2307
404-475-2310 [fax]
crkimball@willamette.com

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EXECUTIVE SUMMARY – RECENT CASES UPDATE

Review of the current court case decisions on valuation or related fiduciary matters

- Facts and circumstances drive decisions.
- The IRS has not changed its posture on major issues, but the Tax Court has.

Significant case decisions were filed in the following areas:

- Tax-affecting pass-through entities
- Buy-sell agreements and life insurance
- Reasonable compensation
- Defined value clauses
- Adequate disclosure compliance
- Charitable donations and anticipatory assignment of income

Nothing new was decided in the following areas:

- Split-dollar life insurance transfers and gift tax
- Discount for lack of control
- Discount for lack of marketability

The taxpayer generally has the burden of adequately disclosing credible evidence in order to establish the taxpayer's valuation position. Without a well-documented, complete, and thorough appraisal report, the taxpayer has no basis to dispute what may be an unrealistic IRS valuation claim upon audit.

The burden of proof shifts to the IRS, however, if the taxpayer satisfies the following conditions:

1. The taxpayer must comply with the substantiation and recordkeeping requirements of the Internal Revenue Code and regulations;

2. The taxpayer must cooperate with reasonable requests by the IRS for witnesses, information, documents, meetings and interviews; and

3. Taxpayers other than individuals must have a net worth of less than $7 million. (I.R.C. §7491)

The existence of a credible valuation report from a qualified appraiser can often prevent a valuation challenge. The Service must make a cost-benefit analysis to determine whether it has a strong case against the taxpayer. A good report makes it more likely that the Service will have to expend more resources to assert its case, and will have a more difficult time trying to show that the taxpayer's position is somehow wrong. With a good report, the chances are higher that the Service will not challenge the valuation.

And if the Service does challenge the valuation report, the burden falls on the IRS to prove its case by retaining its own expert.

A sound valuation report is a prophylactic—it prevents and wards off IRS disputes. Bringing the expert in after the Service has challenged the taxpayer also makes it more difficult for the appraiser, particularly because the valuation may have to be performed years after the transfer took place.

Although there can be no guarantee that the appraisal will withstand the scrutiny of a Court, it puts the client in a better position to defend a challenge against discounts for lack of control and lack of marketability. Additionally, the latest version of IRS Form 709 regarding generation-skipping transfer tax

issues requires the taxpayer to indicate whether a valuation discount has been applied and provide substantiation for the amount of the discount. An appraisal would supply that substantiation.

Also, a fully disclosed gift tax filing, with a qualified appraisal report attached, must be audited by the IRS within three years—or it must be accepted as filed, under the Taxpayer Relief Act of 1997 (see Chief Counsel Advice 200221010 regarding lack of disclosure on an LLC gift, which kept the statute of limitations open).

CECIL V. COMMISSIONER

ESTATE OF WILLIAM A.V. CECIL, SR., DONOR, DECEASED, WILLIAM A.V. CECIL, JR., CO-EXECUTOR, Petitioner et al., v. COMMISSIONER OF INTERNAL REVENUE, Respondent
T.C. Memo 2023-24 (February 28, 2023)

In a long-awaited decision, the U.S. Tax Court accepted tax-affecting minority S corporation stock for gift tax purposes.

The case dragged on so long that the donors did not live to see their victory.

Case decision attached.

CECIL – PRECEDENT CASES

Estate of Michael Jackson v. Commissioner, T.C Memo 2021-48 (May 3, 2021). No tax-affecting allowed for holding company.

Estate of Aaron U. Jones v. Commissioner, T.C. Memo 2019-101 (August 19, 2019). Tax-affecting allowed for operating companies, including timberlands inventory supplier.

James F. Kress and Julie Ann Kress, Plaintiffs, v. United States of America, Defendant. Case No. 16-C-795, U.S. District Court, E.D. Wisconsin (March 25, 2019). Tax-affecting allowed for an operating company.

Estate of Louise Paxton Gallagher v. Commissioner, T.C. Memo 2011-148 (June 28, 2011).

Estate of Natalie B. Guistina et al. v. Commissioner, TC Memo 2011-141 (June 22, 2011).

Dallas v. Commissioner, T.C. Memo 2006-212 (September 28, 2006).

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SORENSEN V. COMM

Robin Sorensen et al. v. Commissioner of Internal Revenue

T.C. Docket Nos. 24797-18, 24798-19, 24284-19, 20285-19

Case filings and documents discovered and published by Bloomberg

Gifts made in 2014 and early 2015 of Firehouse Subs minority stock by brothers Chris and Robin Sorensen
IRS opposed tax-affecting the stock valuation

Case settled circa June 2022, docketed for trial in Atlanta on July 18, 2022

CONNELLY V. US

Thomas A. Connelly, in his Capacity as Executor of the Estate of Michael P. Connelly, Sr., Plaintiff - Appellant v. United States of America, Department of Treasury, Internal Revenue Service, Defendant – Appellee

U.S. Supreme Court, Docket No. 23-146 (August 16, 2023)

U.S. Court of Appeals, No. 21-3683 8th Cir., affrd. (June 2, 2023)

U.S. District Court, 4:19-CV-01410-SRC, Eastern District, Missouri (September 21, 2021)

Appeal cites split in district circuits (8th versus 11th) on adding life insurance proceeds to the value of a company for a buy-sell valuation.

See: Estate of Blount v. Commissioner, 428 F.3d 1338 (11th Cir. 2005), in which the court did not add back life insurance proceeds

CLARY HOOD, INC. V. COMM

CLARY HOOD, INC., Petitioner-Appellant, v. COMMISSIONER OF INTERNAL REVENUE, Respondent-Appellee

U.S. 4th Circuit Appeals, No. 22-1573 (January 27, 2023)

T.C. Memo 2022-15 (March 22, 2022)

Reasonable compensation matter for 2015 and 2016, accuracy-related penalties, failure to pay dividends as a contributing factor

Return on shareholders' investment versus market statistics on compensation for company founder and chief executive

NELSON V. COMM

Mary P. Nelson; James C. Nelson, Petitioners—Appellants, versus Commissioner of Internal Revenue, Respondent—Appellee

U.S. Court of Appeals, 17 F.4th 556, 5th Cir. No. 20-61068, affrd (November 3, 2021)

T.C. Memo 2020-81 (June 10, 2020)

Defined value clause issues

Those 10 missing words: “as finally determined for federal estate and gift tax purposes”

Precedent defined value clause cases include:

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King v. U.S., U.S. District Court, 545 F.2d 700, 10th Cir. (1976)

SCHLAPFER V. COMM

RONALD SCHLAPFER, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent

T.C. Memo 2023-65 (May 22, 2023)

Addresses issues of what constitutes "adequate disclosure" compliance under the IRC Gift Tax Regulations

HOENSHEID V. COMM

ESTATE OF SCOTT M. HOENSHEID, DECEASED, ANNE M. HOENSHEID, PERSONAL REPRESENTATIVE, AND ANNE M. HOENSHEID, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

T.C. Memo 2023-34 (March 15, 2023)

Charitable donation of closely held business stock shortly before the sale of the company in 2015 was deemed to be an anticipatory assignment of the deal income, and no charitable deduction was allowed.

Accuracy-related penalties due to lack of a qualified appraisal and other deficiencies were proposed, but the court did not apply penalties due to the reliance on professional legal advice by the taxpayer.

BROOKS V. COMM

KENNETH M. BROOKS AND ANITA WOLKE BROOKS, Petitioners v. COMMISSIONER OF INTERNAL REVENUE, Respondent

T.C. Memo 2022-122 (December 19, 2022)

Conservation easement valuation and resulting deduction, accuracy-related penalty

A property bought for $1.35 million a year prior generated a $5.1 million conservation easement charitable contribution deduction for 2007.

ROTHWELL V. ROTHWELL

SHAUN ROBERT ROTHWELL, Appellant, v. JENEA ROTHWELL, Appellee.

Utah Court of Appeals, 2023 UT App. 50; 2023 Utah App. LEXIS 51; 2023 WL 3360879 (May 11, 2023)

Effect and calculation of personal goodwill in valuing private businesses in divorce

Jointly retained appraiser

Tax-affecting (the sale of the business)

JEMISON V. JEMISON

STEVEN C. JEMISON, an individual, v. Defendant/Appellee: MICHAEL S. JEMISON, in his capacity as trustee for the Jemison Family Trust and in his capacity as president and co-chairman of the board of directors of JJKL, Inc. f/k/a Heyco, Inc. and WILLIAM D. JEMISON, in his capacity as trustee for the Jemison Family Trust and in his capacity as co-chairman of the board of directors of JJKL, Inc. f/k/a Heyco, Inc.

U.S. Court of Appeals, 2022 US App. LEXIS 18258, 3rd Cir. (July 1, 2022)

Business judgment rule protects officers and directors from breach of duty claims but does not bar claims against same persons in their capacities as trustees

ENDLESS RIVER V. TRANS UNION

Endless River Technologies LLC, Plaintiff, v. Trans Union LLC, Defendant

U.S. District Court, 2023 US Dis LEXIS 725; 2023 WL 24101 (July 26, 2023)

Damages claims, failure to return source code after a canceled contract, Illinois law

Damages waiver in a contract precludes the damaged party from collecting indirect "consequential" damages such as projected lost profits.

WALSH V. PRESTON

MARTIN J. WALSH, Secretary of Labor, United States Department of Labor, Plaintiff, v. ROBERT N. PRESTON, et al., Defendants

U.S. District Court, 1:14-CV-04122-ELR; 2022 US Dist LEXIS 232248; 2022 17959237 (September 20, 2022)

In a lengthy opinion, the court determined that the defendants did breach fiduciary duties and did engage in prohibited transactions. It decided that there was no coliability among the defendants, but it did not allow an offset of payments on debt of TPP Preston personally made

In determining FMV, the court did not allow a minority interest discount. In so doing, the resulting damages determined were minimal.

VALUATION ISSUES FROM THE COURT'S PERSPECTIVE

Supreme Court Cases

Daubert v. Merrell Pharmaceuticals, Inc.;[1]
General Electric Company et al. v. Robert K. Joiner et ux.[2]
Kumho Tire Company, Ltd., et al., v. Patrick Carmichael, etc., et al.[3]

These cases confirmed once and for all that the judges' role as gatekeeper applies to *all* expert evidence and testimony, not just "scientific" testimony. Federal Rule of Evidence 704 requires the court to exclude any expert evidence that is not both "reliable" and "relevant."

In *Daubert*, the Court specified four tests by which to judge experts and their testimony:

- **Testing—**Can the theory or technique be tested, or has it been tested?
- **Peer reviews**—Has the theory been subjected to peer review or publication, which aids in determining flaws in the method?
- **Error rates**—Are there established standards to control the use of the technique?
- **Acceptability**—Is the technique generally accepted in the relevant technical community?[4]

Judge Laro's Views on Fair Market Value and Valuation Reports[5]

- Each valuation case is unique. Although guidance can be obtained from earlier cases, one case is rarely on point with another, and a significant differentiation of the facts can usually be made.
- In valuation there are no absolutes. There are only general guidelines to which individual judgments must be applied.
- There is no irrefutable "right" answer.
- Experts will and do differ.
- There are available methods which are generally recognized and accepted by the appraisal profession and the courts.
- A marketability discount may inhere in the value of an interest in a corporation regardless of the interest holder's percentage ownership of the ownership stock.
- In a recent survey 65.2 percent of the Tax Court's decisions did not coincide with the conclusions of any of the expert witnesses.
- At trial, two principal inquiries are always before the court.
    - Is the expert qualified?
    - Is the evidence to be admitted relevant and helpful?

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[1]*Daubert v. Merrell Pharmaceuticals, Inc., 509 U.S. 572 (1993).*
[2] *General Electric Company et al.* v. *Robert K. Joiner et ux.,* 66 U.S.L.W. 4036 (U.S. Dec. 15, 1997).
[3] *Kumho Tire Company, Ltd., et al., v. Patrick Carmichael, etc., et al. 1999 WL 152455 (U.S.).*
[4] Robert F. Reilly, "Supreme Court Applies *Daubert*-type Screening to All Experts' Work," *Shannon Pratt's Business Valuation Update*, July 1999, pp. 1, 3.
[5] Excerpted from a two-part report, "Judge Laro's Views on 'Fair Market Value,'" The Honorable David Laro, Tax Court Judge, *Judges & Lawyers Business Valuation Update*, May 1999, p. 1–3; and "Judge Laro's Views on Discounts & Valuation Reports," The Honorable David Laro, Tax Court Judge, *Judges & Lawyers Business Valuation Update*, June 1999, p. 1–4. The full text of Judge Laro's presentation is on *BVLibrary.com*.

- Always read the opinions on valuation that were written by the judge handling the case.
- Read and understand the recent opinions of the Court written by other judges on a related topic.
- Make known clearly the qualifications of the expert.
- Make special efforts to make sure that the expert's data is highly relevant and empirical in nature.
- Make sure the expert prepares a very cogent and credible valuation report.
- If the appraisal reflects real world values and supports its conclusions with relevant empirical data about real world situations, it likely will be accepted.

FOR FURTHER READING

The Past Year's Significant, Curious, or Downright Fascinating Fiduciary Cases (2022 Edition)*At least it seems to me. Your mileage may vary. Dana G. Fitzsimons Jr., managing director and senior fiduciary counsel, Bessemer Trust (Updated through 12/31/2022)

Business Valuation Resources – BVLaw – www.bvresources.com

National Center for Employee Ownership - https://www.nceo.org/r/litigation

Case Decision Filings Attached:

- Cecil v. Comm
- Connelly v. Comm
- Nelson v. Comm
- Schlapfer v. Comm
- Hoensheid v. Comm
- Jemison v. Jemison

PRESENTER BIOGRAPHY

Curtis R. Kimball, CFA, ASA - Mr. Kimball is a senior managing director of Willamette Management Associates, a nationally prominent valuation and financial advisory firm. He acts as WMA's national director for wealth management valuations including estate, gift, buy-sell agreement, trust, fiduciary liability, marital and charitable issues. He works out of WMA's Atlanta regional office. He is a Chartered Financial Analyst (CFA) of the CFA Institute, an Accredited Senior Appraiser (ASA) of the American Society of Appraisers in business valuation. He has been valuing companies and interests in companies, intangible assets and other property for a variety of purposes for over thirty years and was formerly with Wachovia Bank and, later, the Citizens & Southern Trust Company (now Bank of America) prior to joining WMA in 1988. He holds a B.A. in Economics from Duke University and an M.B.A. from Emory University. He is a contributing author to several standard reference works on private business valuation including: *Valuing a Business*, *Valuing Small Businesses and Professional Practices*, *Financial Valuation: Businesses and Business Interests (1997 Update)*, *Business Valuation Discounts and Premiums* and *The Business Valuation Handbook (2nd Edition).* Mr. Kimball has appeared as an expert witness on valuation issues in U.S. District Court, U.S. Tax Court, U.S. Bankruptcy Court and other venues. His most recent appearances include the U. S. Tax Court cases: *Estate of Anna Mirowski* (Mirowski Family Ventures, LLC), *Estate of Georgina T. Gimbel* (Reliance Steel and Aluminum Company), *Estate of H. A. True, Jr. and Jean D. True et al v. Commissioner* (True Ranches and True Oil Company) and *Estate of Harriet Mellinger v. Commissioner* (Frederick's of Hollywood).
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Willamette Management Associates
1355 Peachtree Street, NE Suite 1470
Atlanta, Georgia 30309

404-475-2307
404-475-2310 [fax]

crkimball@willamette.com
www.willamette.com

United States Tax Court

T.C. Memo. 2023-24

ESTATE OF WILLIAM A.V. CECIL, SR., DONOR, DECEASED,
WILLIAM A.V. CECIL, JR., CO-EXECUTOR,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

ESTATE OF MARY R. CECIL, DONOR, DECEASED, WILLIAM A.V. CECIL, JR., CO-EXECUTOR,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

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Docket Nos. 14639-14, 14640-14. Filed February 28, 2023.

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David D. Aughtry and *John W. Hackney*, for petitioners.

Joel D. McMahan, *Christopher A. Pavilonis*, and *A. Gary Begun*, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

ASHFORD, *Judge*: William A.V. Cecil, Sr., and Mary Ryan Cecil (collectively, petitioners; respectively, Mr. Cecil and Mrs. Cecil) petitioned the Court separately to redetermine respondent's determination of a $13,022,552 deficiency in his or her federal gift tax

[*2] for 2010.[1] On November 18 and 19, 2010 (valuation dates), Mr. Cecil caused a transfer of his revocable trust's class B (generally nonvoting) stock in the Biltmore Company (TBC) to petitioners' five grandchildren, and Mrs. Cecil transferred class A (voting) stock in TBC to petitioners' two children. Petitioners timely reported to the Internal Revenue Service (IRS) on Forms 709, United States Gift (and Generation-Skipping Transfer) Tax Return, that these transfers were gifts during 2010, and they reported a fair market value for each gift as of the time of the corresponding transfer.

The deficiencies result from respondent's determination that petitioners' reported fair market values were too low. Petitioners allege in their Petitions that the values were actually too high and, accordingly, that they are entitled to refunds. We consolidated the cases for trial, briefing, and opinion and now decide the fair market value of the transferred TBC stock (subject stock) on the valuation dates.

FINDINGS OF FACT

The parties have stipulated some facts, and the stipulated facts are so found. The Stipulation of Facts and the attached Exhibits are incorporated herein by this reference. Petitioners, now deceased, were husband and wife during all relevant times, and they resided in North Carolina when their Petitions were timely filed.

I. *Family Background*

Petitioners have two adult children, Bill Cecil and Diana Cecil Pickering (Dini Pickering). Bill Cecil and his wife, Virginia Rott Cecil, have three children: Ryan Jordan Vanderbilt Cecil, Aubrey Lea Amherst Cecil, and Willam Robert Vanderbilt Cecil. We refer to these five individuals collectively as the Cecil family. Dini Pickering and her husband, George W. Pickering II, have two children: Chase Kennedy Cecil Pickering and Devon Lee Cecil Pickering. We refer to these four individuals collectively as the Pickering family.

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[1]Petitioners later died and were substituted for this proceeding by their co-executor, William A.V. Cecil, Jr. (Bill Cecil). Additionally, some monetary amounts are rounded to the nearest dollar.

[*3] II. *TBC*

A. *Background*

1. *The Biltmore House*

Between 1889 and 1895, George W. Vanderbilt built the Biltmore House in the Blue Ridge Mountains in Asheville, North Carolina. The Biltmore House is a French Renaissance chateau that consists of over four acres of floor space and remains the largest privately owned house in the United States. Mr. Vanderbilt died in 1914, and he left the Biltmore House and its surrounding acreage to his only child, Cornelia Cecil née Vanderbilt (Mr. Cecil's mother).

2. *TBC*

TBC, a Delaware corporation, was formed on March 30, 1932, by Cornelia Cecil and others, and during the same year, it became eligible to conduct business in North Carolina. Also in 1932 the Biltmore House and its surrounding acreage (Estate) were contributed to TBC. In 1979 Mr. Cecil and his brother, George Cecil, then TBC's owners, disagreed on TBC's future. They ended up breaking up TBC, with George Cecil surrendering all of his shares in TBC in exchange primarily for TBC's dairy operations inclusive of 3,000 acres of the Estate. TBC elected to be taxed as an S corporation in 1982 and continues to be characterized as such.

B. *Operations and Relevant Financial Information*

1. *Roles of Dini Pickering and Bill Cecil*

Dini Pickering is vice chairman of TBC's board of directors. She has worked for TBC for approximately 32 years and has served in that position over approximately the last 15 of those years.

Bill Cecil is TBC's (and its related entities') president and chief executive officer. He has served in those positions for over 20 years.

2. *Business Operations*

TBC operates primarily in the travel and tourism/historic hospitality industry. The heart of its business is offering its guests the opportunity to go back in time and experience the Gilded Age. Originally, TBC only offered tours of the Biltmore House and the

[*4] adjoining gardens, and the tours were considered a roadside attraction. In 1995 TBC instituted a long-range plan to become a multiday destination and eventually expanded the Estate to include hotels, restaurants, retail stores, and various outdoor activities. During 2010 TBC operated at least 17 lines of business and employed 1,304 employees (over 1,800 combined full-time and part-time employees including associated businesses).

3. *Revenue Sources*

TBC's paying visitors may access five main areas of the Estate: the Estate entrance, including the Gate House Shop, Lodge Gate, Group Sales Office, and Reservations and Ticket Center; Biltmore House and Gardens; Antler Hill Village and Winery; Inn on Biltmore Estate; and Deerpark, including the Deerpark Restaurant, Lioncrest, and carriage and trail ride barns. TBC generates revenue from five retail outlets; eight restaurants, one of which is a catering facility; landscaping; tickets and tours (including segway tours); Land Rover driving experience and school; river rafting; fly fishing; equestrian training; timber production; and farming. During 2010 TBC generated most of its revenue from admissions to its premises and from restaurant and merchandise sales.

With the exception of 2008, a year within the Great Recession of 2007 through 2009 and for which TBC realized a $1,459,000 loss, TBC has realized a profit every year since 1995. During its fiscal year ended June 30, 2010, adult visitors paid between $35 and $69 for admission depending on the time of the year. In 2010 TBC reported that it realized approximately $70 million in revenue. Of that total revenue, TBC realized $38,437,950 from admission tickets.

4. *Estate's Ranges*

The Estate has a West Range (approximately 3,000 acres of land) and an East Range. The West Range contains all the forestry and farming, and it is used for agricultural, forestry, and recreational activities. Busbee Mountain, one of TBC's operating and income-generating assets, is on the West Range. Busbee Mountain is the main source of water for the Estate, and it generates annually 28 million gallons of water and $110,000 in water savings. TBC also conducts timber operations and leases cell phone towers on Busbee Mountain.

In 1993 TBC sold the West Range to Bill Cecil and Dini Pickering for $6 million and as part of that sale leased back the West Range. This transaction was meant to ensure that the West Range remained in

[*5] petitioners' extended family forever. TBC received a 30-year installment note as payment for the sale. On the valuation dates, $2,700,000 of that note's principal remained unpaid.

TBC owns the East Range. The East Range includes places for equestrian, hiking, biking, farming, and timber activities. Also on the East Range are the Biltmore House, formal gardens, Antler Hill Village, a vineyard, the Inn on Biltmore Estate, Deerpark, retail shops, restaurants, and a ticket center. TBC uses all of the East Range to generate earnings.

5. *2010 Assets and Liabilities*

TBC's reported assets and liabilities were $53,580,000 and $33,349,000, respectively, on November 30, 2010. Included in its assets were agricultural land in North Carolina and a multimillion dollar portfolio of fine art, antiques, and other collectibles. Its artwork included the following valuable paintings: (1) the Portrait of Frederick Law Olmsted by John Singer Sargent; (2) the Waltz by Anders Zorn; (3) Mrs. George W. Vanderbilt by Giovanni Boldini; (4) Rosita by Ignacio Zuloaga y Zabaleta, and (5) Angelique and Roger on the Hippogriff by Antoine-Louis Barye.

TBC has 46 trademarks and a trade name registered with the U.S. Patent and Trademark Office.

III. *Ownership and Related Agreements*

A. *1989 Ownership and 1989 Shareholders' Agreement*

Mrs. Cecil, Bill Cecil, and Dini Pickering were three of TBC's shareholders on December 26, 1989, each owning 1 share of its then class B common stock. On that day, they entered into a Shareholders' Agreement. As of that time, TBC had three classes of stock.

B. *1997 Amendment to Certificate of Incorporation*

On August 8, 1997, TBC's Certificate of Incorporation was amended to reclassify TBC's three existing classes of stock into two classes of common stock inclusive of seven issued shares of class A common stock and 9,993 issued shares of class B common stock. These two classes of stock differ only in their voting rights. The amendment states as to their voting rights:

[*6] Class A Common: Each holder of class A Common Stock shall be entitled to one vote for each share of such stock standing in his name on the books of the Corporation. Said voting rights shall be with respect to all matters that may be subject to a vote of stockholders under the Bylaws of the Corporation, under the General Corporation Law of the State of Delaware, or otherwise.

> Class B Nonvoting Common: The holders of class B Nonvoting Common Stock of the Corporation shall not be entitled to vote on any matter except as to matters in respect of which they shall be indefeasibly vested by statute with such right.

C. *Voting Trust Agreement*

On June 30, 1999, TBC, petitioners, Bill Cecil, and Dini Pickering, as the corporation and its shareholders, respectively, and Henry P. Hoffstot, Jr., as an "independent trustee," entered into a Voting Trust Agreement (1999 Voting Trust Agreement). The 1999 Voting Trust Agreement was meant:

> to secure continuity and stability in the Company's policies and management and to coordinate the Company's policies and management with other Biltmore Estate Business Entities, the stock of which is owned by some or all of the Shareholders, and in order to provide that the four Shareholders who sign this Agreement and the lineal descendants of these four Shareholders, will control for the maximum time legally permissible all the development, use and management of the Company as well as policy and management decisions pertaining to other Biltmore Estate Business Entities, these Shareholders have determined to place all their shares of voting stock in the Company with the Trustees and their successors in Trust as hereafter provided.

In accordance with the 1999 Voting Trust Agreement, each signatory shareholder deposited his or her stock in a trust and acted as trustee. The only persons eligible to later become a trustee were lineal descendants of Bill Cecil and Dini Pickering. While petitioners are trustees, all decisions had to be made by a majority of the trustees. If petitioners were not trustees, decisions would be made by a majority of

[*7] each side of the two families (the Cecils and the Pickerings) with each family having a 50% voting strength. The trust had a ten-year term.

Any decision to sell any land, structure, assets or stock of TBC or any present or future Estate business entity required the vote of two-thirds of the Cecil family trustees and two-thirds of the Pickering family trustees. The trustees set TBC's policies and general operating procedures relating to the operation of TBC and the Estate. The Trustees elected the board of directors and confirmed the appointment of senior officers.

IV. *Family Business Preservation Program*

A. *Background*

In or around 2000 or 2001 Dini Pickering met Craig Aronoff, a consultant with the Family Business Consulting Group. Mr. Aronoff encouraged Dini Pickering to hold family meetings and to create a structure for her family that would allow them to operate TBC more efficiently. Dini Pickering began exploring family business planning. She read books on the subject as well as material from the Family Business Consulting Group.

Dini Pickering later started the Family Business Preservation Program for TBC in 2003. As a part of the program, petitioners, the Cecil family, and the Pickering family would hold two meetings annually. During these meetings they would work on policies and educational programs for the benefit of their families, which were intended to help them become more effective owners of TBC.

The children of Bill Cecil and Dini Pickering attended these meetings. Those children were 8 to 15 years old as of the first meeting. In the early years Dini Pickering strived innovatively to keep the children focused in the meetings and participating in the business discussions. As the children grew older, they attended educational seminars that focused on topics such as financial literacy or family-based money management. These meetings and seminars were intended to prepare the next generation to take over TBC's management.

[*8] B. *Policies*

Petitioners, the Cecil family, and the Pickering family adopted the following three policies as a result of these meetings. The first policy, the premarital policy, requires that each family member enter into a prenuptial agreement before marriage. The prenuptial agreement must ensure that all separate property remain separate during the marriage and not be subject to a division in the event of a divorce. This policy is intended to ensure that all TBC stock remain in the Cecil and the Pickering families. The second policy, the family employment policy, requires that any Cecil or Pickering family member seeking employment in TBC must have a four-year college degree and at least one year of outside employment. The third policy, a family code of conduct, requires that members of the Cecil and the Pickering families treat others with respect, act ethically, obey the law, respect confidentiality, avoid conflicts of interest, protect family business property, represent the best interests of the family and family business, and practice open, honest, and effective communication. The three oldest of the five children of the Cecil and the Pickering families have adhered to these policies. None of these three children has any desire to ever sell the TBC shares he or she would later receive (see further discussion *infra* p. 28), or to vote to liquidate TBC's assets.

V. *2009 Shareholders' Agreement*

On December 16, 2009, the shareholders that owned all issued and outstanding shares of TBC stock entered into the 2009 Shareholders' Agreement. The 2009 Shareholders' Agreement states:

> [T]he Parties agree that the success of the Corporation requires the active interest, support, and the personal attention of the Shareholders and for that reason it is not advisable to permit the stock of the Corporation to go upon the open market for sale except as otherwise permitted under the terms of this Agreement.

TBC and its shareholders confirmed the purpose of the 2009 Shareholders' Agreement as providing (i) the continued ownership and control of all issued and outstanding TBC shares; (ii) the harmonious and future conduct of the business; and (iii) a stock transfer mechanism to operate when a shareholder dies, becomes incapacitated, or otherwise needs to sell company stock.

[*9] Under the terms of the 2009 Shareholders' Agreement, a shareholder may transfer, with or without consideration, his or her shares to any other shareholder who is a party to the agreement or to any of the shareholder's lineal descendants. As to a proposed transfer to a nonfamily member, the transferor must first notify the other shareholders and TBC of the proposed transfer and receive a notice of consent from each shareholder. If a shareholder receives an offer from a nonfamily member to buy shares from the shareholder, the shareholder must notify the other shareholders and TBC within ten days at which point the other shareholders may purchase all but not less than all of the shares at the lesser of the purchase price or the price set forth by a valuation method contained in the 2009 Shareholders' Agreement. As a condition of a transfer to any person who is not bound by the 2009 Shareholders' Agreement, the transferee must agree to be bound by the terms of that agreement.

VI. *Gift Transfers*

A. *2010*

Immediately before November 18, 2010, TBC's outstanding stock was owned as follows:

Owner	*Number of Shares*	*Percentage*[2]
Class A Common Stock		
Mr. Cecil, Trustee under the William A.V. Cecil Revocable Trust Agreement dated August 13, 1999	3	42.86%
Mrs. Cecil	1	14.29%
Bill Cecil	1	14.29%
Dini Pickering	1	14.29%
Bill Cecil and Dini Pickering, as tenants in common	1	14.29%
Total Shares	7	
Class B Common Stock		
Mr. Cecil, Trustee under the William A.V. Cecil Revocable Trust Agreement dated August 13, 1999	9,337	93.37%
Bill Cecil	328	3.28%
Dini Pickering	328	3.28%
Total Shares	9,993	

[2]These percentages are the percentages which the parties stipulated.

[*10] B. *Gifts*

On November 18, 2010, Mrs. Cecil transferred, by gift and in undivided equal shares, her interest in one share of TBC class A common stock to Bill Cecil and Dini Pickering. Two new stock certificates were created for Bill Cecil and Dini Pickering, each certificate stating that "[t]he sale, transfer, assignment or pledge of this stock certificate is restricted pursuant to the terms of a Shareholder Agreement dated the 16 day of December 2009."

On November 19, 2010, Mr. Cecil, in his capacity as trustee of the William A.V. Cecil Revocable Trust, transferred 9,337 shares of TBC class B common stock to himself. On the same day, he transferred by gift his interest in those shares to petitioners' five grandchildren, in separate trusts, as follows:

Donee	*Class B Common Stock*	
	Shares	*Percentage*[3]
William A.V. Cecil Irrevocable Qualified Subchapter S Trust for Ryan Cecil	1,556.16 and 2/3	15.57%
William A.V. Cecil Irrevocable Qualified Subchapter S Trust for Aubrey Cecil	1,556.16 and 2/3	15.57%
William A.V. Cecil Irrevocable Qualified Subchapter S Trust for Robert Cecil	1,556.16 and 2/3	15.57%
William A.V. Cecil Irrevocable Qualified Subchapter S Trust for Chase Pickering	2,334.25	23.36%
William A.V. Cecil Irrevocable Qualified Subchapter S Trust for Devon Pickering	2,334.25	23.36%
Total Shares	9,337	

Each stock certificate stated that "[t]he sale, transfer, assignment or pledge of this stock certificate is restricted pursuant to the terms of a Shareholder Agreement dated the 19th day of November 2010." This Shareholder Agreement added the trusts for the grandchildren as signatories.

Each gift of the class A and B common stock imposed upon the shareholder the obligation to pay tax on his or her distributive share of TBC's income, with no guaranty of sufficient dividend distributions to pay that tax.

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[3]These percentages are the percentages which the parties stipulated.

[*11] VII. *Voting Rights and Stock Transfer Restrictions*

TBC's Articles of Incorporation, TBC's Amended and Restated By-Laws as of August 21, 2009 (By-Laws), and the 2009 Shareholders' Agreement set out rights and powers with respect to the TBC stock as of the valuation dates.

The By-Laws regulate how shareholders, board members, and executives control TBC. Each class A common stock shareholder receives one vote per share, with decisions made by the majority of the votes cast. A quorum generally requires the presence of two-thirds of all outstanding class A common stock to be present in person or by proxy.

TBC's board of directors (Board) manages its business and affairs. Class A common stock shareholders elect directors by a majority vote. The presence in person of a majority of the Board constitutes a quorum to transact business. The Board generally acts by a majority vote of the directors. The Board elects officers by majority vote. By majority vote, the Board decides when and whether to make the accounts, books, minutes, and other records of TBC available to stockholders. The Board declares dividends by majority vote.

VIII. *Notices of Deficiency*

Each petitioner timely filed Form 709 for 2010. On the Forms 709, petitioners properly elected to treat the transfers of their stock as split gifts under section 2513.[4] Each form included as an attachment an appraisal of the gifts by Dixon Hughes based on a weighted average of the subject shares (using an asset approach and an income approach). Petitioners commissioned the Dixon Hughes appraisal for purposes of reporting their gift tax liabilities on their Forms 709. Petitioners reported a value of $3,308 per share for class A common stock and $2,236 per share for class B common stock. Each petitioner reported total taxable gifts of $10,438,766.

Petitioners' Forms 709 were selected for audit, and respondent ultimately issued petitioners separate notices of deficiency on March 24, 2014. The notices of deficiency disregarded the existence of TBC and attributed no weight to its going-concern value. The numerical

[4]Unless otherwise indicated, all statutory references are to the Internal Revenue Code, Title 26 U.S.C., in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[*12] adjustments in the notices of deficiency reflect the enterprise value of TBC based solely on an asset liquidation assumption.

OPINION

I. *Burden of Proof*

Except as otherwise provided by statute or determined by the Court, the Commissioner's determinations are presumed correct, and taxpayers bear the burden of proving that the determinations are erroneous. Rule 142(a); *Welch v. Helvering*, 290 U.S. 111, 115 (1933). The burden of proof (or a portion thereof) may sometimes shift to the Commissioner. *See, e.g.*, § 7491(a) (providing that the burden of proof in a gift tax setting such as here may shift to the Commissioner as to discrete factual issues if certain conditions are met); *Helvering v. Taylor*, 293 U.S. 507, 515 (1935) (holding that the burden of going forward with evidence to establish the amount of a deficiency may shift to the Commissioner where determination is arbitrary and excessive). The record at hand allows us to decide these cases on the basis of a preponderance of the evidence, without regard to which party bears the burden of proof. We therefore proceed to do so and need not and do not decide which party actually bears the burden of proof. *Cf. Blodgett v. Commissioner*, 394 F.3d 1030, 1039 (8th Cir. 2005), *aff'g* T.C. Memo. 2003-212; *Polack v. Commissioner*, 366 F.3d 608 (8th Cir. 2004), *aff'g* T.C. Memo. 2002-145; *Knudsen v. Commissioner*, 131 T.C. 185, 189 (2008), *supplementing* T.C. Memo. 2007-340; *Deskins v. Commissioner*, 87 T.C. 305, 322 n.17 (1986).

II. *Gift Valuation*

A. *In General*

A tax is imposed on the transfer of property by gift during a calendar year. § 2501. The value of a gift made in property is "the value thereof at the date of the gift." § 2512(a). That value is "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 to sell, and both having reasonable knowledge of relevant facts." Treas. Reg. § 25.2512-1; *see also* Rev. Rul. 59-60, 1959-1. C.B. 237. The willing buyer and the willing seller are hypothetical persons rather than specific individuals or entities, and the characteristics of these hypothetical persons are not necessarily the same as the personal characteristics of the actual seller or a particular buyer. *Estate of Newhouse v. Commissioner*, 94 T.C. 193, 218 (1990). The valuation of stock is

[*13] ultimately a question of fact in which the trier of fact must weigh all relevant evidence and draw appropriate inferences. *CSX Transp., Inc. v. Ga. State Bd. of Equalization*, 552 U.S. 9, 18 (2007); *Hamm v. Commissioner*, 325 F.2d 934, 938 (8th Cir. 1963), *aff'g* T.C. Memo. 1961-347; *Bank One Corp. v. Commissioner*, 120 T.C. 174, 306 (2003), *aff'd in part, vacated in part on other grounds, and remanded in part sub nom. JPMorgan Chase & Co. v. Commissioner*, 458 F.3d 564 (7th Cir. 2006).

B. *Valuation Approaches*

1. *Overview*

Generally, three approaches are used to determine the fair market value of property: (1) the market approach, (2) the income approach, and (3) the asset-based approach. The question of which of these approaches to apply in a given case is a question of law. *Bank One Corp.*, 120 T.C. at 306–07.

2. *Market Approach*

The market approach compares the subject property with similar property sold in an arm's-length transaction in the same timeframe. *Id.* at 307. This approach values the subject property by taking into account the sale price of the comparable property and the differences between the comparable property and the subject property. *Id.* This approach measures value properly only when the comparable property has qualities substantially similar to those of the subject property. *Id.*

3. *Income Approach*

The income approach capitalizes income and discounts cashflow. *Id.* This approach values property by computing the present value of the estimated future cashflow as to that property. *Id.* The estimated cashflow is ascertained by taking the sum of the present value of the available cashflow and the present value of the residual value. *Id.*

4. *Asset-Based Approach*

The asset-based approach generally values property by determining the cost to reproduce it. *Id.* One example of an asset-based approach in the setting of a nonpublicly traded corporation is to value the corporation on the basis of the fair market value of its net assets (i.e., the fair market value of its assets less its liabilities). *See, e.g.,*

[*14] *Estate of Jones v. Commissioner*, T.C. Memo. 2019-101, at *29; *Estate of Noble v. Commissioner*, T.C. Memo. 2005-2, slip op. at 17.

C. *Split Gifts*

Section 2513(a) provides: "A gift made by one spouse to any person other than his spouse shall, for the purposes of this chapter, be considered as made one-half by him and one-half by his spouse," as long as both spouses have properly signified their consents to that treatment. Section 2512, which governs the valuation of gifts, is found in chapter 12 of subtitle B of the Internal Revenue Code, which is the chapter containing section 2513. Consistent with petitioners' proper election to treat each gift here as a split gift under section 2513, we consider those gifts as made one half by Mr. Cecil and one half by Mrs. Cecil.

III. *Experts*

A. *General*

The parties dispute the value of the subject stock, and each party has retained and at trial called experts to testify in support of their or his proffered value of the stock. In deciding valuation cases, courts often hear the views of expert witnesses. *See generally* Rule 143(g) (providing that an expert's direct testimony in a proceeding in this Court is generally "heard" by way of his or her expert report). We are not bound by the opinion of an expert witness, and we may accept or reject expert testimony in the exercise of our sound judgment. *Helvering v. Nat'l Grocery Co.*, 304 U.S. 282, 295 (1938); *Bank One Corp.*, 120 T.C. at 332; *Estate of Newhouse*, 94 T.C. at 217. We may accept the opinion of one expert over that of another, *see Buffalo Tool & Die Mfg. Co. v. Commissioner*, 74 T.C. 441, 452 (1980), and we may select what portions of each expert's opinion, if any, to accept, *Parker v. Commissioner*, 86 T.C. 547, 562 (1986). Because valuation involves an approximation, the figure at which we arrive need not be directly traceable to specific testimony if it is within the range of values that may be properly derived from consideration of all the evidence. *Estate of True v. Commissioner*, T.C. Memo. 2001-167, slip op. at 171 (citing *Silverman v. Commissioner*, 538 F.2d 927, 933 (2d Cir. 1976), *aff'g* T.C. Memo. 1974-285), *aff'd*, 390 F.3d 1210 (10th Cir. 2004).

[*15] B. *Petitioners' Experts*

Petitioners' experts are David Adams and George Hawkins.

1. *Mr. Adams*

a. *Overview*

Mr. Adams works for Adams Capital, Inc., as a business valuation appraiser. He founded Adams Capital, Inc., and beforehand was engaged in business valuation services with Coopers & Lybrand, LLP, and KPMG Peat Marwick, LLP. He has a master's in business administration from Georgia State University and is a member of the American Society of Appraisers. He appraised the subject stock relying exclusively on TBC's representations and financial documentation.

Mr. Adams appraised the stock using the income approach and the market approach. As to the former, he applied the discounted cashflow (DCF) method. As to the latter, he applied the guideline public company (GPC) method and the similar transactions method. He rejected the asset-based approach of valuing TBC's assets directly because the number of shares was too small to force a liquidation and he had heard from TBC's owners and management that TBC would not be liquidated in the foreseeable future. He concluded that TBC is unlikely to be sold within the next 30 years.

b. *DCF*

Mr. Adams concluded for purposes of his DCF analysis that a discount rate of 15% was appropriate based on TBC's weighted average cost of capital. He predicted that TBC would grow by 1% in 2010, 5% in 2011, 5% in 2012, 5% in 2013, 4% in 2014, and 3% in 2015. He totaled his forecasted cashflows, subtracted interest-bearing debt, added back the value of any nonoperating asset, and applied a 30% discount for a lack of marketability to arrive at $9,030,059.

c. *GPC*

The GPC is used to calculate the fair market value of a business on the basis of comparison to publicly traded companies in similar lines of business. The conditions and prospects of companies in similar lines of business depend on common factors such as overall demand for their products and services. Comparable company values are measured on the basis of stock prices. The comparable company value is divided by

[*16] an earnings parameter (e.g., sales, net income, earnings before interest and taxes (EBIT)) or balance sheet parameter (e.g., total shareholder's equity, assets) to arrive at a valuation multiple. The resulting multiple is applied to the subject company to arrive at its fair market value.

Mr. Adams identified five companies as comparable companies. One company, Peak Resorts, Inc., operates 13 ski resorts in the Midwest and Northeast United States. It offers activities, services, and amenities, such as skiing, snowboarding, dining, lodging, equipment rental and sales, and ski and snowboard instruction. It manages hotels in New Hampshire and Vermont and a restaurant in Pennsylvania. The second company, Pairi Daiza SA, operates a park in Belgium that houses approximately 4,000 animals. It also participates in approximately 30 scientific programs for the conservation of endangered species. The third company, Premier Exhibitions, Inc., presents museum quality touring exhibitions to the public worldwide. It also develops, deploys, operates, and presents exhibition products in exhibition centers, museums, and nontraditional venues; sells merchandise through the internet; publishes exhibition catalogs; and provides ancillary services such as audio tours. The fourth company, Vail Resorts, Inc., operates mountain resorts and urban ski areas in the United States. Its resorts offer various winter and summer recreational activities (such as skiing, snowboarding, sightseeing, and guided hiking), and offer skiing and snowboarding lessons, equipment rentals, retail merchandise services, dining services, and private club services. Vail Resorts, Inc., also owns and leases commercial real estate and provides real estate brokerage services, and owns and/or manages various luxury resorts and condominiums. The fifth company, Whistler Blackcomb Holdings, Inc., operates a four season mountain resort in Canada and offers a variety of summer and winter activities such as mountain biking, hiking, fishing, golfing, kayaking, tennis, snowmobiling, cross-country skiing, and horseback riding. It also operates 18 bars and restaurants, 19 retail shops, and 22 rental shops.

Mr. Adams's GPC analysis looked at the size, growth, and liquidity of TBC and his comparable companies. It used the last 12 months' (LTM) earnings before income tax, depreciation, and amortization (EBITDA) and LTM EBIT multiples because, he rationalized, TBC is less profitable than the comparable companies because of their larger scale. He applied a 15% discount to the multiples because of TBC's lack of diversification and resistance to technological development. He added cash and subtracted debt from the enterprise

[*17] value to arrive at a 100% equity value on a noncontrolling, marketable basis and then applied a 30% discount for a lack of marketability to arrive at $10,540,694 on a noncontrolling, nonmarketable basis.

d. *Similar Transactions*

Under the similar transactions method, a value estimate for the subject company is developed by using information obtained from various databases on actual sales of closely held and public businesses. The goal is to define the market for companies operating in the same industry as a subject company by considering the data as a statistical ensemble of value multiples that are representative of the entire market. These valuation multiples are ratios that compare the numerator or the price paid for a controlling interest in a closely held corporation with various measures of operating results in the financial position in the denominator.

Mr. Adams selected six acquisitions as similar transactions. The first acquisition was that of USJ Co., Ltd., which operated a theme park in Japan. Its amenities included restaurants, riding and show attractions, hotels, and shopping and entertainment facilities. The second acquisition was that of Paramount Canada's Wonderland Park, which owns and operates an amusement park. It offers thrill rides, family rides, shopping, splash works, live entertainment, and dining activities. The third acquisition was that of Festival Fun Parks, LLC, which owns and operates family entertainment centers and water parks in the United States. The fourth acquisition was that of American Golf Corp., which owns 22 fee simple and 6 leasehold golf clubs. The fifth acquisition was that of Northern Racing, PLC, which acquires, manages, and develops horseracing courses in the United Kingdom. The company's nine horseracing courses stage various events ranging from large-scale conferences and banquets to business meetings and music events. The sixth acquisition was that of Sydney Attractions Group, Pty Ltd., which offers management and operation of the Sydney Aquarium in Australia. It also operates Manly Oceanworld, an aquarium; Skywalk, an outdoor viewing adventure; Wildlife World, a zoo; and Koala Gallery, a small wildlife park; and it offers Shark Dive Xtreme, a product for scuba divers to swim with sharks, and OzTrek, a virtual reality ride through Australia's cultural history and geography.

Mr. Adams analyzed and computed purchase price multiples from the revenue, EBITDA, and EBIT of these six companies. After applying

[*18] the multiples, he added cash and subtracted debt from the indicated enterprise value to arrive at the indicated equity value of 100% on a controlling, marketable basis. He applied a 20% discount for a lack of control and a 30% discount for a lack of marketability to arrive at a 100% equity noncontrolling, nonmarketable basis of $12,161,048.

e. *Final Values*

Mr. Adams chose a combination of the income and market approaches to ascertain the fair market value of the subject stock because, he concluded, a buyer of a restricted minority interest would assume continuation of TBC based on existing dividend trends, rather than assume any liquidation in the face of the opposition to liquidation. He gave each of his methods a weighted average. He gave the DCF method a weighted average of 50% because it was based on TBC's financial projections, expectations, and risk factors. He gave each of the GPC and the similar transactions methods an equal weighted average of 25%. His analysis also included looking at various methods to apply "tax affecting" (discussed *infra* pp. 25–27), and he arrived at one value for each class of stock if he took tax affecting and the 2009 Shareholders' Agreement into account and another value if he did not. His final values included a 30% discount for a lack of marketability and a 20% discount for a lack of control. He concluded that the class A common stock and the class B common stock had a fair market value of $1,019 per share on November 18, 2010, with tax affecting and the shareholder agreement in effect, and that the class B shares of TBC were worth $1,614.71 per share without tax affecting and the shareholder agreement in effect.

2. *Mr. Hawkins*

a. *Background*

Mr. Hawkins of Bannister Financial in Charlotte, North Carolina, specializes in business valuation of closely held companies and the type of stock interest at issue. He holds a bachelor's in economics from the University of North Carolina at Chapel Hill and a master's in business administration from Wake Forest University. He is an accredited senior appraiser in business valuation and a chartered financial analyst.

b. *Capitalization of Net Cashflow*

Mr. Hawkins valued the subject stock using the income approach's capitalization of net cashflow method. This method

[*19] measures the dividend or distribution paying capacity of the company being valued by applying an appropriate capitalization rate that incorporates the investor's required rates of return for risk and a factor for future growth in earnings (or net cashflow). He ascertained that TBC has a net cashflow of $1,162.60 and a capitalization rate of 0.107. Dividing the net cashflow by the capitalization rate rendered a preliminary value of equity of $10,865.40 as if TBC was a C corporation.

Mr. Hawkins then tax affected the preliminary value using the S Corporation Economic Adjustment Model (SEAM). The SEAM values the S corporation's shares as if the S corporation paid the same level of taxes as a C corporation. He used TBC's dividend/distribution payout ratio, the taxes that would be paid on its income, dividends, and any capital gains on shares to calculate the difference in the net tax benefit realized by the company as a C corporation and as an S corporation. He ascertained that there would be a 24.6% greater after tax benefit of an S corporation in these cases. He tax affected what he had ascertained was the preliminary value of equity by a rate of 24.6% to arrive at an adjusted S corporation value of common equity of $13,638.30. After dividing the adjusted S corporation value of common equity by the number of outstanding shares, he arrived at a preliminary fair market value per share of $1,353.83.

c. *GPC*

Mr. Hawkins also used the market approach's GPC method to value the subject shares. He used Cedar Fair, L.P. (Cedar Fair), as a comparable company because theme parks are a competitor of TBC and it is similarly aligned with the services offered. Cedar Fair operates in the United States 11 amusement parks, 6 water parks, and 5 hotels. Of Cedar Fair's total 2009 revenues, 58.2% came from admissions, 34.5% from food, drink, and games, and the remaining 7.3% from accommodation and other. He viewed these percentages as similar to TBC's 2009 revenues from admissions, restaurants and merchandise, and from all other sources, respectively.

After comparing the size, profitability, return on equity, growth trends, business opportunities, diversification, financial strength, and distributions of Cedar Fair and TBC, Mr. Hawkins selected the Market Value of Invested Company to Earnings Before Income Taxes, Depreciation, and Amortization (MVIC/EBITDA) value multiple. He applied the MVIC/EBITDA value multiple to two time frames: (1) the EBITDA of the trailing 12 months (TTM) of the valuation date and

[*20] (2) the median of 2006 to TTM. He applied the multiples to TBC's adjusted EBITDA to arrive at the preliminary values of $1,508.10 and $1,661.53.

He applied a 25% discount for a lack of marketability and a 2% discount for a lack of voting rights to the GPC method. He concluded that the applicable fair market value of the class A common stock was $1,131 per share and that the applicable fair market value of the class B common stock was $1,108 per share.

d. *Asset-Based Valuation*

Mr. Hawkins chose not to value the subject stock on the basis of TBC's assets because he was valuing a minority issue with no power to force a liquidation. He rationalized that TBC's shareholders would not liquidate given that TBC had survived through four generations of the family of Cornelia Cecil and was the subject of the 2009 Shareholders' Agreement. He concluded that a willing buyer with knowledge of these facts would assume that it was too speculative to believe that he or she would realize anything significant from the underlying assets.

C. *Respondent's Experts*

Respondent's experts are Gretchen Wolf and Robert Morrison.

1. *Ms. Wolf*

Ms. Wolf appraises art for the IRS Office of Art Appraiser Services. She has a certification in appraisal studies for fine and decorative arts from George Washington University and attended programs at the University of Virginia's Rare Book School and Georgetown University for continuing coursework in rare books and fine arts. She has completed valuation training with the American Society of Appraisers.

Ms. Wolf valued the five aforementioned works of art owned by TBC using the market comparison approach. She looked at comparable sales that had taken place in high-end auction houses and the retail market where private sales take place. She did not value the artwork using the income approach because the artwork has little income-

[*21] producing value to TBC. She appraised the artwork at a total of $13,250,000 as of November 19, 2010.[5]

2. *Mr. Morrison*

a. *Background*

Mr. Morrison works for Morrison Valuation and Forensic Services as a forensic accountant and business appraiser. He has a bachelor's of science in finance from Miami University (Ohio) and a master's in business administration from the University of Central Florida. He has an accredited senior appraisers certification and an intangible asset certification.

b. *NAVM*

Mr. Morrison appraised the subject stock using the asset-based approach's net asset value method (NAVM). The general premise of the NAVM is that value equals the sum of the market values of all assets, including those assets which may not be recorded on the company's balance sheet, less the share of the market values of liabilities. He applied the NAVM in two steps. First, he identified all assets and liabilities of TBC regardless of whether they were recorded on the balance sheet and ascertained the fair market value of the assets and liabilities identified. Second, he ascertained an appropriate adjustment to reflect the noncontrolling nature of the subject stock.

TBC's reported assets were $53,580,000 and its liabilities were $33,349,000 on November 30, 2010. The difference of $20,231,000 is the net asset value (NAV) before adjustments. Mr. Morrison made two types of adjustments: reclassification adjustments (which do not affect the NAV) and valuation adjustments. He made the following valuation adjustments.

Real Estate. Mr. Morrison relied on a real estate appraisal report prepared by Ducksworth, Jacobs, Naeger, Swicegood & Thrash, LLC (Duckworth Appraisal). The effective date of the Duckworth Appraisal is December 31, 2009, almost 11 months before the valuation date. During those 11 months, the value of agricultural land in North Carolina declined approximately 2%. Mr. Morrison adjusted the Duckworth Appraisal downward by 2% which resulted in a real estate

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[5]As indicated *infra* p. 22, Mr. Morrison, in taking into account TBC's collectible portfolio, relied on Ms. Wolf's appraisal.

[*22] value of $95,922,000. This resulted in an increase of $71,652,000 to his NAV.

Collectible Portfolio. Mr. Morrison took into account TBC's portfolio of fine art, antiques, and other collectibles. He relied on an appraisal report from Christie's Appraisal, Inc., which estimated that those items had a total fair market value of $37,947,000 on December 31, 2009 (Christie's Appraisal). The appraisal was later supplemented to include additional collectibles valued at $3,474,000 (Christie's Supplement). He also relied on Ms. Wolf's appraisal. His combining the Christie's Appraisal value (unadjusted for Ms. Wolf's appraisal value) with the Christie's Supplement value resulted in a total value of $41,421,000 for TBC's collection. This resulted in an increase of $41,421,000 to his NAV.

Installment Note Receivable. TBC reported on its balance sheet that the installment note that it received in the West Range sale/leaseback transaction had a value of $554,000, the amount deferred on the gain. Mr. Morrison adjusted the value of the note to $2,700,000, the amount of the remaining payments. This resulted in an increase of $2,146,000 to his NAV.

Trademarks and Trade Name. Mr. Morrison employed the Relief from Royalty Method (RFRM) to value TBC's trademarks and trade name. The premise of the RFRM is that the value of the asset is equal to the present value of future royalties to license and use the asset as if it did not own the asset (hence, relief from royalty). Using the RFRM, he estimated the value of TBC's trademarks and trade name was $9,514,000. This resulted in an increase of $9,514,000 to his NAV.

Workforce-in-Place. Mr. Morrison estimated that TBC had 1,700 workers in place and rationalized that, while many of these workers were unskilled, hourly employees, the assemblage of this workforce-in-place had value. He ascertained the value using the replacement cost method (RCM). The premise of the RCM is that the value today equals the cost to reproduce/replicate the asset. He ascertained that the value of the workforce-in-place was $1,624,000. This resulted in an increase of $1,624,000 to his NAV.

After he made the valuation adjustments, the NAV was $146,587,000. The NAVM assumes a marketable, liquid, and controlling interest whereas the subject stock is nonmarketable, illiquid, and noncontrolling. To adjust for this, Mr. Morrison looked in markets

[*23] for noncontrolling interests and chose real estate limited partnerships (RELP) and closed-end funds (CEF). He rationalized that his observed prices to NAV (P/NAV) of RELPs and CEFs that held assets similar to TBC's provided some guidance as to a proper adjustment. For purposes of this analysis, he considered all of the operating assets (excluding real estate) as a portfolio of assets, then considered each asset individually. After he estimated the P/NAV of RELPs and CEFs, the value indicated by the NAVM is $92 million on a noncontrolling but marketable and liquid basis.

c. *DFBM*

Mr. Morrison also valued the subject stock using the income approach's discounted future benefits method (DFBM). The DFBM values a company at the present value of expected future periodic income benefit stream during a discrete time plus residual value at the end of the period and discounts for the relative risk of expected future returns. He employed the following seven steps to ascertain value under the DFBM: (1) selected the benefit stream to be used; (2) projected the future annual benefit streams until the company reaches stabilization; (3) estimated the residual or terminal value of the company at the end of the discrete projection period; (4) estimated an appropriate discount rate for the company that compensates both the equity holders and the debt holders of the company and a stabilized long-term rate of growth; (5) discounted all future benefit streams, including the residual value, to present value; (6) adjusted, as appropriate, for nonoperating assets and/or liabilities; and (7) applied any necessary valuation adjustment.

Mr. Morrison chose an after-tax net cashflow to equity (NCF) benefit stream because the data used to develop capitalization rates and discount rates are based on after-tax cashflows. After projecting the future annual benefit streams, he used the single-period capitalization model (SPCM) to estimate the residual or terminal value. He opined that the premise of the SPCM is that the stabilized NCF at the end of the discrete projection period will grow into perpetuity at some stabilized level of annual growth. He ascertained that the terminal value as of the end of the discrete period is determined by capitalizing that stabilized NCF; and by using a growth rate of 3%, he ascertained that the stabilized benefit stream of the last year of the discrete projection period was $1,773,000. He used a 16% cost of equity as his discount rate. After discounting the future benefits streams, the sum of all present values of all cashflows is $12,931,000. Because TBC is an S corporation, Mr. Morrison used the SEAM method to tax affect at a

[*24] premium of 17.6%. He next added the values for various nonoperating assets. Using the DFBM, he reached a value of $36 million.

d. *Reconciliation of Two Approaches*

In reconciling his two approaches, Mr. Morrison concluded that the P/NAVs may not actually reflect TBC's circumstances because TBC, contrary to RELPs and CEFs, does not seek to maximize its assets. He also recognized that the DFBM is superior but chose to incorporate the NAVM into his final evaluation. Ultimately, he assigned a 90% weight to the DFBM and assigned a 10% weight to the NAVM. He also ascertained and took into account discounts for a lack of marketability of 19% for the class A common stock, 22% for the smaller block of class B common stock, and 27% for the larger block of class B common stock. His resulting values were $4,000 per share for the class A common stock, $3,066 per share for the 2,334.25 larger block of class B common stock, and $3,276 per share for the 1,556.16 2/3 smaller block of class B common stock.

D. *Summary*

Below is a summary of the fair market values ascertained by each expert less Ms. Wolf (three relevant experts):

Class of Stock	Adams	Hawkins	Morrison
Class A Common	$1,019.00 (with tax affecting)	$1,131 (with tax affecting)	$4,000 (with tax affecting)
Class B Common (Smaller Block)	1,019.00 (with tax affecting) 1,614.71 (without tax affecting)	1,108 (with tax affecting)	3,276 (with tax affecting)
Class B Common (Larger Block)	1,019.00 (with tax affecting) 1,614.71 (without tax affecting)	1,108 (with tax affecting)	3,066 (with tax affecting)

[*25] IV. *Tax Affecting*

With the exception of Ms. Wolf, whose appraisal was limited to the five pieces of artwork, all experts agree that "tax affecting" must be considered to ascertain the fair market value of the subject stock because an S corporation such as TBC, unlike a C corporation, generally does not pay income tax. Where, as here, the data used to value an S corporation are largely based on the data from C corporations, proponents of tax affecting believe that the mismatch from pretax cashflows and after-tax discount rates must be adjusted through tax affecting to ascertain the fair market value of the S corporation. *See Dallas v. Commissioner*, T.C. Memo. 2006-212, slip op. at 7 n.3 (stating that "in the context of valuation of stock of an S corporation, 'tax affecting' is the discounting of estimated future corporate earnings on the basis of assumed future tax burdens imposed on those earnings, such as from the loss of S corporation status and imposition of corporate-level tax").

In *Gross v. Commissioner*, T.C. Memo. 1999-254, *aff'd*, 272 F.3d 333 (6th Cir. 2001), we held that tax affecting was improper in valuing an S corporation. There, the taxpayer sought tax affecting and the Commissioner argued against it. We held that "[a]s a theoretical matter, we do not believe that 'tax-affecting' an S corporation's projected earnings is an appropriate measure to offset that potential burden associated with S corporations." *Id.* slip op. at 24. We concluded that

> the principal benefit that shareholders expect from an S corporation election is a reduction in the total tax burden imposed on the enterprise. The owners expect to save money, and we see no reason why that savings ought to be ignored as a matter of course in valuing the S corporation.

Id. slip op. at 27.

We continued to reject applying tax affecting to determine an S corporation's fair market value. *See Estate of Gallagher v. Commissioner*, T.C. Memo. 2011-148, slip op. at 32, *supplemented by* T.C. Memo. 2011-244 (finding tax affecting not appropriate where appraiser failed to explain his reasoning for tax affecting); *Dallas*, T.C. Memo. 2006-212 (finding tax affecting not appropriate when the taxpayer presumed that an S corporation would lose its S corporation status after a sale); *Wall v. Commissioner*, T.C. Memo. 2001-75, slip op. at 27 n.19 ("[T]ax-effecting an S corporation's income, and then

[*26] determining the value of that income by reference to the rates of return on taxable investments, means that an appraisal will give no value to S corporation status."); *see also Estate of Giustina v. Commissioner*, 586 F. App'x 417 (9th Cir. 2014), *rev'g and remanding* T.C. Memo. 2011-141.

In *Estate of Jones*, T.C. Memo. 2019-101, however, we concluded that tax affecting was appropriate in that setting. There, the parties agreed that a hypothetical buyer and seller would take into account the entity's business form when determining the value of a limited partner interest; they simply disagreed on how to account for it. The Commissioner argued that a zero percent tax rate should apply. The Commissioner disagreed with his experts, who were largely silent except to point out that the taxpayer's tax affecting was improper, not because the business paid entity level tax, but because the nature of the business meant that its rates of return were closer to the property rates of tax. Thus, we did "not have a fight between valuation experts but a fight between lawyers." *Id.* at *39.

Most recently, in *Estate of Jackson v. Commissioner*, T.C. Memo. 2021-48, we did not find tax affecting appropriate. There, all of the estate's experts agreed that the buyer would be a C corporation and that the value should be tax affected to account for the tax liability of the C corporation. Each expert, however, used a different tax rate. The Commissioner's experts strongly disagreed that tax affecting was appropriate. We distinguished *Estate of Jones* by noting that *Estate of Jones* was a situation where the experts agreed to take into account the form of the business entity and agreed on the entity type. We held that tax affecting would not be appropriate because the estate's experts had not persuaded us that the buyers would be C corporations. *Id.* at *82. We also stated, though, that

> [w]e do not hold that tax affecting is never called for. But our cases show how difficult a factual issue it is to demonstrate even a reasonable approximation of what that effect would be. In *Estate of Jones*, there was expert evidence on only one side of the question, and that made a difference.

Id. at *82–83.

Here, experts on both sides agree that tax affecting is necessary to value the subject stock. Messrs. Morrison and Hawkins also agree

[*27] that the SEAM method is the appropriate method to employ in the setting at hand to account for tax affecting and that a factor of at least 17.6% applies here for that purpose. As we observed in *Estate of Jackson*, there is not a total bar against the use of tax affecting when the circumstances call for it. Now given that each side's experts (with the exception of Ms. Wolf who did not opine on this point) totally agree that tax affecting should be taken into account to value the subject stock, and experts on both sides agree on the specific method that we should employ to take that principle into account, we conclude that the circumstances of these cases require our application of tax affecting. While Messrs. Morrison and Hawkins do not agree on the specific rate that applies here to implement tax affecting (Mr. Hawkins determined the rate to be 24.6% while Mr. Morrison determined the rate to be 17.6%), we consider it appropriate on the basis of the record (and relying on Mr. Morrison's opinion in this regard) to set that rate at 17.6%. We emphasize, however, that while we are applying tax affecting here, given the unique setting at hand, we are not necessarily holding that tax affecting is always, or even more often than not, a proper consideration for valuing an S corporation.

V. *Our Impression of the Experts*

A. *Mr. Morrison*

We are unpersuaded by Mr. Morrison's opinion on the fair market value of the subject stock. In that TBC is an operating company whose existence does not appear to be in jeopardy, and not a holding company, we believe that TBC's earnings rather than its assets are the best measure of the subject stock's fair market value. *See Estate of Ford v. Commissioner*, T.C. Memo. 1993-580, 1993 Tax Ct. Memo LEXIS 595, at *14 (1993) ("[P]rimary consideration is generally given to earnings in valuing the stock of an operating company, while asset values are generally accorded the greatest weight in valuing the stock of a holding company."), *aff'd*, 53 F.3d 924 (8th Cir. 1995).

Mr. Morrison's reliance on the asset-based approach also appears to be inconsistent with the Uniform Standards of Professional Appraisal Practice (USPAP). USPAP Standards Rule 9-3 states:

> In developing an appraisal of an equity interest in a business enterprise with the ability to cause liquidation, an appraiser must investigate the possibility that the business enterprise may have a higher value by liquidation

[*28] of all or a part of the enterprise . . . . However, this typically applies only when the business equity being appraised is in a position to cause liquidation.

That is not the setting here. The liquidation of TBC is most unlikely (if likely at all) in that a hypothetical buyer and seller would need to (1) acquire additional shares in order to cause TBC's liquidation; (2) convince other shareholders to vote for a liquidation; or (3) wait until the shareholders or their heirs decide to liquidate TBC, and we consider each of these three events unlikely to occur. Bill Cecil, Dini Pickering, Chase Pickering, Aubrey Cecil, and Ryan Cecil all credibly testified that they had no intention of selling their TBC stock or liquidating TBC, and we find that testimony as a fact. In so doing, we decline respondent's request to disregard that testimony as self-serving. The mere fact that a witness's testimony may serve his or her interests does not necessarily mean that we will disregard that testimony as untrustworthy. *See, e.g.*, *Diaz v. Commissioner*, 58 T.C. 560, 564 (1972). Our acceptance of their credible "self-serving" testimony is even more appropriate here, where documentary and other evidence supports that testimony. The 2009 Shareholders' Agreement and the 1999 Voting Trust sufficiently established that petitioners, their children, and their grandchildren aspired to keep TBC in their family by restricting the transfer of stock outside of the family. We also understand the family's holding of the annual meetings to serve strategically to minimize and control business disputes that could occur within the family, to obviate any TBC shareholder's rogue attempt to sell his or her TBC shares to an outsider, and to make most unlikely any breakup of TBC similar to the breakup effected by Mr. Cecil and his brother in 1979. These meetings also serve to groom TBC's shareholders to manage TBC as a family asset. The fact that TBC has been in the family since its incorporation in 1932 also speaks loudly to the fact that the Cecil and the Pickering families are committed to maintaining TBC as a family business.

We assign zero weight to Mr. Morrison's valuation opinion.

B. *Mr. Hawkins*

We also have concerns with the thrust of Mr. Hawkins's valuation opinion. In using the GPC method to value the subject stock, he relied on a single company, Cedar Fair. We have previously held that it is inconceivable that a hypothetical buyer would consider only a single alternative comparable. *See Estate of Hall v. Commissioner*, 92 T.C. 312, 339–40 (1989). Although Cedar Fair does operate competitors of TBC,

[*29] the lack of multiple comparable companies renders his GPC appraisal suspect. Furthermore, TBC lacks the traditional features of its competitors such as diversification. Cedar Fair is larger, more diversified, and more profitable than TBC.

Nor did we view Mr. Hawkins during his trial testimony to express much confidence in his GPC analysis. He acknowledged that Cedar Fair operates at a national level while TBC operates at a regional level. He acknowledged that Cedar Fair's 2009 admissions revenue is significantly greater than TBC's 2009 admissions revenue. He acknowledged that Cedar Fair's 2009 pretax profit was significantly greater than TBC's 2009 pretax profit. While multiples could be found that would have made Cedar Fair more comparable, the fact that Cedar Fair is the only comparable company Mr. Hawkins used and that it is so different renders questionable his decision to give the GPC method a 50% weight.

We also find fault with Mr. Hawkins's application of the capitalization of net cashflow method. In his calculations, he used TBC's median 2006 to TTM 2010 EBT. Between 2007 and 2009, the United States and much of the world experienced the Great Recession, the worst economic downturn since the Great Depression. Given the timing of the Great Recession and TBC's loss for 2008, the only year since 1995 that TBC had realized a loss, we consider the 2008 loss to be an aberration in TBC's financial operations and do not think it was appropriate for Mr. Hawkins to have included TBC's 2008 financial information in his analysis. While we recognize that his use of the median rather than the average helps mitigate the distortion caused by the Great Recession, the distortion is large enough that it renders his analysis on this point unpersuasive.

C. *Mr. Adams*

Mr. Adams's application of the GPC and similar transactions methods also has flaws. In his GPC valuation, he found five comparable companies. Two of those companies are not comparable at all. TBC is in the business of historic hospitality. Its guests enjoy retail shopping, restaurants, and various outdoor activities in an environment reminiscent of the Gilded Age. While Peak Resorts, Inc., Vail Resorts, Inc., and Whistler Blackcomb Holdings, Inc., operate resorts that similarly offer various outdoor activities in the hospitality business, the same is not true as to Pairi Daiza SA and Premier Exhibitions, Inc. The former operates a park which houses thousands of animals, and it does

[*30] so at a location (in Belgium) that is vastly different from western North Carolina. The latter presents museum exhibitions outside of the hospitality industry and does that worldwide while TBC's operation is limited to a single city, Asheville, and the surrounding area.

With regard to Mr. Adams's similar transactions valuation, two of the six transactions occurred during the Great Recession. American Golf Corp. was acquired on October 29, 2008, and Sydney Attractions Group, Pty Ltd., was acquired on February 29, 2008, and we find it most likely that the Great Recession affected the purchase prices in those two transactions. We also add that American Golf Corp. and Sydney Attractions Group, Pty Ltd., are not in the same hospitality industry as TBC. The former owns and operates golf courses. The latter primarily operates the Sydney Aquarium. We fault Mr. Adams for including those two transaction in his analysis.

Notwithstanding the flaws in Mr. Adams's applications of the GPC and similar transactions methods, however, we do not find those flaws to be fatal to his overall opinion. It is abundantly clear that TBC is a unique company and finding an exact match would be near to impossible. We consider it noteworthy that Mr. Adams assigned only a 25% weight to each method, which as we see it, adds a degree of reliability to his application of the GPC and similar transactions method.

Most importantly, the thrust of his overall opinion is his application of the DCF method, an application with which we find no fault. Indeed, on brief, respondent urges us to adopt Mr. Adams's valuation based on his DCF analysis with one correction. After determining the MVIC, Mr. Adams added back the value of TBC's nonoperating asset, which was TBC's excess debt-free working capital. Respondent contends that the installment note from the West Range transaction, accounts receivable from the shareholders, and Busbee Mountain were nonoperating assets whose value should also be added back. We disagree. Mr. Adams included the excess debt-free working capital because it added value to the TBC stock in that TBC funds would be available for distribution to the shareholders at the end of the year. TBC's underlying assets did not add any value to the TBC stock.

D. *Conclusion*

We find flaws with Mr. Hawkins's and Mr. Morrison's analyses that lead us to disregard the thrust of their opinions on the fair market

[*31] value of the subject stock. While there are issues with Mr. Adams's application of the GPC and similar transactions methods, we find that his valuation (exclusive of the discounts discussed below), with one adjustment, is the truest value of the subject stock's prediscount fair market value. The single adjustment, as discussed above, is that tax affecting should be reflected at a rate of 17.6%.

VI. *Applicable Discounts*

A. *Discount for a Lack of Control*

Mr. Adams applied a discount for a lack of control to the similar transactions method because, he surmised, a prudent investor would not pay full value for a noncontrolling interest. TBC's owners also made no effort to sell TBC in the marketplace and had previously rejected overtures to sell TBC. Mr. Adams reviewed publicly announced transactions of noncontrolling interests and arrived at a 20% discount for a lack of control.

Mr. Morrison looked at various RELPs and CEFs, which often trade at discounts for a lack of control, and arrived at a 38% discount. We disagree with Mr. Morrison's discount because his analysis focused on businesses holding investments rather than on operating companies like TBC. We accept Mr. Adams's discount rate of 20% for a lack of control.

B. *Discount for a Lack of Voting Rights*

Mr. Hawkins applied a 2% discount in valuing the class B common stock because, he concluded, that stock lacked voting rights. That conclusion is not totally accurate in that class B shareholders can vote in limited circumstances. Mr. Hawkins also misrelied on two studies which analyzed data from 1994 and 1999. Those data are too old. Furthermore, in arriving at their values, each of the three relevant experts already accounted for the fact that he was valuing a nonvoting minority interest. We decline to apply a discount for a lack of voting rights.

C. *Discount for a Lack of Marketability*

Each of the three relevant experts applied a discount for a lack of marketability because the shares are not registered for public sale or sold on public markets. Mr. Adams applied a discount rate of 30% to each method he used. Mr. Hawkins applied a 25% discount rate. Mr.

[*32] Morrison applied a discount rate of 19% to the class A common stock, of 22% for the smaller block of class B common stock, and of 27% for the larger block of class B common stock.

In arriving at his discount rate, Mr. Adams looked at studies of the sales of temporarily restricted shares of otherwise publicly traded companies (letter stock) and sales of closely held companies before subsequent initial public offerings (IPO). He also conducted a put option analysis. We are not sold on that process. The studies that Mr. Adams relies on analyze data that are too old, e.g., the latest study looks at data from 1969 to 1992, and most of the studies look at data from the 1970s and 1980s. He also admits that the pre-IPO studies are unreliable and may overestimate or underestimate actual marketability discounts. And as for his put option analysis, which produced a range of discount rates from 11.6% to 22.6%, we cannot fathom how that analysis supports his final discount rate of 30%.

We turn to the discount rates ascertained by Mr. Hawkins and Mr. Morrison. We conclude that the appropriate discount rates are the three rates that Mr. Morrison ascertained. It is logical for us to conclude that the smaller blocks of class B common stock would be more easily marketed than the larger blocks of the class B common stock. We also agree with Mr. Morrison that different discount rates should apply to the two classes of stock because the voting rights that attach to the class A stock should make that class of stock more marketable than the class B common stock.

VII. *Conclusion*

We accept the valuation reached by Mr. Adams before he took into account any tax affecting and before he applied any discounts. We accept Mr. Adams's 20% discount for a lack of control and Mr. Morrison's discount rates of 19%, 22%, and 27% for a lack of marketability.

We have considered all of the arguments made by the parties and, to the extent they are not addressed herein, we find them to be moot, irrelevant, or without merit.

To reflect the foregoing,

Decisions will be entered under Rule 155.

United States Court of Appeals
For the Eighth Circuit

No. 21-3683

Thomas A. Connelly, in his Capacity as Executor of the Estate of Michael P. Connelly, Sr.

Plaintiff - Appellant

v.

United States of America, Department of Treasury, Internal Revenue Service

Defendant - Appellee

Appeal from United States District Court
for the Eastern District of Missouri - St. Louis

Submitted: December 14, 2022
Filed: June 2, 2023

Before SMITH, Chief Judge, GRUENDER and STRAS, Circuit Judges.

GRUENDER, Circuit Judge.

Brothers Michael and Thomas Connelly were the sole shareholders of a corporation. The corporation obtained life insurance on each brother so that if one died, the corporation could use the proceeds to redeem his shares. When Michael died, the Internal Revenue Service assessed taxes on his estate, which included his stock interest in the corporation. According to the IRS, the corporation's fair market

value includes the life insurance proceeds intended for the stock redemption. Michael's estate argues otherwise and sued for a tax refund. The district court[1] agreed with the IRS, and so do we.

I.

Before Michael died, he and Thomas owned Crown C Corporation, a building-materials company in St. Louis. Michael owned 77.18 percent of the 500 shares outstanding (385.9 shares); Thomas owned 22.82 percent (114.1 shares). To provide for a smooth transition of ownership upon either's death, the brothers and Crown together entered into a stock-purchase agreement. If one brother died, the surviving brother had the right to buy his shares. If the surviving brother declined, Crown itself had to redeem the shares. In this way, control of the company would stay within the family. The brothers always intended that Crown, not the surviving brother, would redeem the other's shares.

The stock-purchase agreement provided two mechanisms for determining the price at which Crown would redeem the shares. The principal mechanism required the brothers to execute a new Certificate of Agreed Value at the end of every tax year, which set the price per share by "mutual agreement." If they failed to do so, the brothers were supposed to obtain two or more appraisals of fair market value. The brothers never executed a Certificate of Agreed Value or obtained appraisals as required by the stock-purchase agreement. At any rate, to fund the redemption, Crown purchased $3.5 million of life insurance on each brother.

After Michael died in 2013, Crown received the life insurance proceeds and redeemed his shares for $3 million. The actual redemption transaction was part of a larger, post-death agreement between Thomas and Michael's son, Michael Connelly, Jr., resolving several estate-administration matters. No appraisals were obtained

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[1]The Honorable Stephen R. Clark, Chief Judge, United States District Court for the Eastern District of Missouri.

pursuant to the stock-purchase agreement. Instead, the Connellys declared that they had "resolved the issue of the sale price of [Michael's] stock in as amicable and expeditious [a] manner as is possible" and that they "have agreed that the value of the stock" was $3 million. That figure effectively valued Crown, based on Michael's 77.18 percent share, at $3.89 million. The rest of the proceeds, about $500,000, went to fund company operations.

Thomas is the executor for Michael's estate. In 2014, the estate filed a tax return reporting that Michael's shares were worth $3 million. To value the shares, Thomas relied solely on the redemption payment, rather than treating the life insurance proceeds as an asset that increased the corporation's value and hence the value of Michael's shares. All told, this resulted in an estate tax of about $300,000, which was paid.

The IRS audited the estate's return. It concluded that the estate had undervalued Michael's shares by simply relying on the $3 million redemption payment instead of determining the fair market value of Crown, which should include the value of the life insurance proceeds. Taking the proceeds into account, Crown was worth $3 million more than the estate had determined—about $6.86 million.[2] So according to the IRS, just before redemption, Michael's estate actually had a 77.18 percent stake in a $6.86 million company—worth about $5.3 million. As a result, the IRS sent a notice of deficiency to the estate for $1 million in additional tax liability. The estate paid the deficiency and sued for a refund. *See* 26 U.S.C. § 7422; 28 U.S.C. § 1346(a)(1).

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[2]This figure comes from the IRS's own valuation of Michael's interest in Crown plus the $3 million in proceeds used for redemption. The IRS independently determined that Michael's shares were worth $2,982,000 exclusive of the proceeds. At Michael's 77.18 percent share, that represents a company value of $3.86 million—slightly less than the $3.89 million figure arrived at by deeming Michael's shares to be worth $3 million as the redemption transaction effectively did. Because the estate does not challenge this *sans*-proceeds value on appeal, we accept it for our purposes. In any event, it does not affect the issue of how to treat the life insurance proceeds used for stock redemption.

The estate claims that the redemption transaction, made in furtherance of the stock-purchase agreement, determined the value of Crown for estate-tax purposes, so there is no need to conduct a fair-market-value analysis. Alternatively, the estate argues that Crown's fair market value should not include the life insurance proceeds used to redeem Michael's shares because, although the proceeds were an asset, they were immediately offset by a liability—the redemption obligation. In other words, the proceeds added nothing to Crown's value. By contrast, the IRS argues that the stock-purchase agreement should be disregarded and that any calculation of Crown's fair market value must account for the proceeds used for redemption.

The district court granted summary judgment to the IRS. The court first concluded that the stock-purchase agreement did not affect the valuation. The court then determined that a proper valuation of Crown must include the life insurance proceeds used for redemption because they were a significant asset of the company. In doing so, the district court declined to follow *Estate of Blount v. Commissioner*, 428 F.3d 1338 (11th Cir. 2005), relying instead on the tax code, Treasury regulations, and customary valuation principles. The estate appeals.

II.

A federal tax applies to the transfer of a decedent's estate, which comprises the gross estate minus applicable deductions. 26 U.S.C. §§ 2001, 2051; *Comm'r v. Est. of Hubert*, 520 U.S. 93, 99-100 (1997). A decedent's gross estate includes "the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated" in which he had an interest. §§ 2031(a), 2033. Property includes stocks. *See* 26 C.F.R. §§ 20.2031-1, 20.2031-2. For Michael's gross estate, the only issue on appeal is the value of his Crown shares.

The parties dispute whether Crown's value, and hence the value of Michael's shares, should include the life insurance proceeds used for redemption. If not, then the estate is entitled to a refund. If the proceeds should be included, as the district court determined, then the IRS is correct and summary judgment was proper. With

this in mind, we review the district court's grant of summary judgment *de novo*. *Westerman v. United States*, 718 F.3d 743, 746 (8th Cir. 2013). In refund actions, "[t]he [IRS's] determination of a tax deficiency is presumptively correct, and the taxpayer bears the burden of proving that the determination is arbitrary or erroneous." *Day v. Comm'r*, 975 F.2d 534, 537 (8th Cir. 1992).

We first consider whether the stock-purchase agreement controls how the company should be valued. Finding that it does not, we then consider whether a fair-market-value analysis of Crown must include the life insurance proceeds used for redemption. It must.

A.

Generally, the value of any property for tax purposes is determined "without regard to any option, agreement, or other right to acquire . . . the property at a price less than the fair market value" or to "any other restriction on the right to sell or use such property." 26 U.S.C. § 2703(a). These sorts of agreements are commonly used by closely held corporations to keep control among a small group of people. *See* 3 James D. Cox & Thomas Lee Hazen, *Treatise on the Law of Corporations* § 18:13 (3d ed. Dec. 2022 update). Section 2703(a) tells us to ignore these agreements unless they meet the criteria in subsection (b). Under § 2703(b), to affect valuation, the agreement must (1) be a bona fide business arrangement, (2) not be a device to transfer property to members of the decedent's family for less than full and adequate consideration, and (3) have terms that are comparable to other similar arrangements entered into in arm's length transactions. Here, the estate argues that we should look to the stock-purchase agreement to value Michael's shares because it satisfies these criteria.

But the estate glosses over an important component missing from the stock-purchase agreement: some fixed or determinable price to which we can look when valuing Michael's shares. After all, if § 2703 tells us when we may "regard" agreements to acquire stock "at a price less than the fair market value," we naturally

would expect those agreements to say *something* about value in a definite or calculable way. *See Est. of Lauder v. Comm'r*, 64 T.C.M. (CCH) 1643, 1656 (1992) ("It is axiomatic that the offering price must be fixed and determinable under the agreement."); *see also Est. of Amlie v. Comm'r*, 91 T.C.M. (CCH) 1017, 1027 (2006) (reviewing the comparability of *price terms* to determine whether the agreement satisfied § 2703(b)(3)). Otherwise, why look to the agreement to value the shares?

Further, the Treasury regulation that clarifies how to value stock subject to a buy-sell agreement refers to the *price* in such agreements and "[t]he effect, if any, that is given to the . . . price in determining the value of the securities for estate tax purposes." 26 C.F.R. § 20.2031-2(h). The regulation also states that "[l]ittle weight will be accorded a price" in an agreement where the decedent was "free to dispose of" the securities at any price during his lifetime. *Id.* Courts thus recognize that an agreement must contain a fixed or determinable price if it is to be considered for valuation purposes. *Est. of Blount v. Comm'r*, 428 F.3d 1338, 1342 (11th Cir. 2005); *Est. of True v. Comm'r*, 390 F.3d 1210, 1218 (10th Cir. 2004); *Est. of Gloeckner v. Comm'r*, 152 F.3d 208, 213 (2d Cir. 1998); *see also St. Louis Cnty. Bank v. United States*, 674 F.2d 1207, 1210 (8th Cir. 1982) (describing when restrictive buy-sell agreements "may *fix the value* of property for estate-tax purposes" (emphasis added)). Congress enacted § 2703 against the backdrop of 26 C.F.R. § 20.2031-2(h), which has remained substantially unchanged, and courts have since interpreted the two in tandem. *See Amlie*, 91 T.C.M. (CCH) at 1024 ("[R]egardless of whether section 2703 applies to a restrictive agreement, the agreement must satisfy the requirements of pre-section-2703 law to control value for Federal estate tax purposes."); *Blount*, 428 F.3d at 1343 n.4 ("[C]ourts generally agree that the limitation in . . . § 2703 should be read in conjunction with the court-created rule."); *True*, 390 F.3d at 1231 (describing § 2703 as "essentially codif[ying] the rules laid out in § 20.2031-2(h)" that had existed before § 2703 was added in 1990).

We need not resolve the precise contours of what counts as a fixed or determinable price because, wherever that line may be, the stock-purchase agreement here falls short given that the brothers and Crown ignored the agreement's

pricing mechanisms. It suffices for our purposes to think of a determinable price as one arrived at by "formula," *see Gloeckner*, 152 F.3d at 213, as by a "fair, objective measure," *see Lauder*, 64 T.C.M. (CCH) at 1659, or "calculation," *see True*, 390 F.3d at 1213.

Here, the stock-purchase agreement fixed no price nor prescribed a formula for arriving at one. It merely laid out two mechanisms by which the brothers might agree on a price. One was the Certificate of Agreed Value, which appears to be nothing more than price by "mutual agreement"—essentially, an agreement to agree. The other was an appraisal process for determining the fair market value of Crown. Although this second mechanism seems to carry more objectivity, there is nothing in the stock-purchase agreement, aside from minor limitations on valuation factors, that fixes or prescribes a formula or measure for determining the price that the appraisers will reach. Instead, the agreement required only that the appointed appraisers "independently determine and submit" their "appraisal[s] of the fair market value of the Company." The brothers were then supposed to average the results or consult a third appraiser as a tiebreaker. None of this was ever done. *See St. Louis Cnty. Bank*, 674 F.2d at 1211 (noting that upon death, the provisions of the stock-purchase agreement were not invoked and that post-death conduct may be relevant to understanding the nature of the agreement). Thus, "under the circumstances of th[is] particular case," neither price mechanism constituted a fixed or determinable price for valuation purposes. *See* 26 C.F.R. § 20.2031-2(h). If anything, the appraisal mechanism calls for a rather ordinary fair-market-value analysis, which § 2031 and § 2073(a) essentially require anyway. Nothing therefore can be gleaned from the stock-purchase agreement.[3]

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[3]The estate does not argue that the stock-purchase agreement otherwise controls the fair market value of Crown by virtue of its restriction on the transfer of shares (i.e., through non-price-related means). *Compare* § 2703(a)(2), *with* § 2703(a)(1). And even if we understood the estate to make this argument, we find it indistinguishable from the estate's fair-market-value argument that we address in Part II.B below.

Thomas tries to get around this problem by directing us to the price fixed by the redemption transaction—the $3 million that Crown actually paid for Michael's shares. In his view, this is an appropriate valuation because the redemption transaction links back to the stock-purchase agreement and was done pursuant to it. We are not convinced. For one, the $3 million price was chosen *after* Michael's death. *See* 26 U.S.C. § 2031(a) (requiring that value be determined "at the time of [the decedent's] death"); *True*, 390 F.3d at 1218 (noting that "the terms of the agreement [must be] binding throughout life and death"). And second, the $3 million price came not from the mechanisms in the stock-purchase agreement but rather from Thomas and Michael Connelly, Jr.'s "amicable agreement" resolving outstanding estate-administration matters. Thus, Crown's value must be determined "without regard" to the stock-purchase agreement. *See* § 2703(a).

B.

We now consider the fair market value of Michael's shares. The key question is whether the life insurance proceeds received by Crown and intended for redemption should be taken into account when determining the corporation's value at the time of Michael's death.[4] Two principles guide the analysis. The first deals with valuing property in general, and the second addresses companies whose stock prices cannot be readily determined from an exchange, as is the case with closely held corporations.

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[4]We focus on this moment in time—after Michael's death but before his shares are redeemed. *See Bright's Est. v. United States*, 658 F.2d 999, 1006 (5th Cir. 1981) (en banc) ("[T]he estate tax is an excise tax on the transfer of property at death and accordingly . . . the valuation is to be made as of the moment of death and is to be measured by the interest that passes, as contrasted with the interest held by the decedent before death or the interest held by the legatee after death."). Regardless of the timing, no one argues that the proceeds were ever in doubt. Crown expected to receive $3.5 million from the policy, most of which would be used to buy Michael's shares.

Generally, the value of property in the gross estate is "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." 26 C.F.R. § 20.2031-1(b); *see also United States v. Cartwright*, 411 U.S. 546, 551 (1973) ("The willing buyer-willing seller test of fair market value is nearly as old as the federal income, estate, and gifts taxes themselves . . . .").

To this end, for closely held corporations, the share value "shall be determined by taking into consideration, in addition to all other factors, the value of stock or securities of corporations engaged in the same or a similar line of business which are listed on an exchange." 26 U.S.C. § 2031(b). Treasury regulations have interpreted this as a "fair market value" analysis. 26 C.F.R. § 20.2031-2(a). The fair market value depends on the company's net worth, prospective earning power and dividend-paying capacity, and other relevant factors like "the good will of the business; the economic outlook in the particular industry; the company's position in the industry and its management; [and] the degree of control of the business represented by the block of stock to be valued." 26 C.F.R. § 20.2031-2(f)(2); *see also Est. of Huntsman v. Comm'r*, 66 T.C. 861, 876 (1976) ("[W]e . . . determine the fair market value of the decedent's stock . . . by applying the customary principles of valuation . . . ."). Setting aside for the moment the life insurance proceeds used to redeem Michael's shares, so far as Crown's operations, revenue streams, and capital are concerned, we know its value—about $3.86 million. *See supra* n.2.

But in valuing a closely held corporation, "consideration shall also be given to nonoperating assets, including proceeds of life insurance policies payable to or for the benefit of the company, to the extent such nonoperating assets have not been taken into account in the determination of net worth, prospective earning power and dividend-earning capacity." 26 C.F.R. § 20.2031-2(f)(2). This need to "take[] into account" life insurance proceeds appears again in a nearby regulation, 26 C.F.R. § 20.2042-1(c)(6). That regulation clarifies 26 U.S.C. § 2042, which has to do with life insurance proceeds that go to beneficiaries other than the decedent's estate. Understanding the relationship between § 2031 (defining the gross estate) and

§ 2042, along with their corresponding regulations, helps further illuminate what it means to "take[] into account" life insurance proceeds.

Section 2042 says that the value of a decedent's gross estate includes life insurance proceeds received directly by the estate as well as proceeds received by other beneficiaries under insurance policies in which the decedent "possessed at his death any of the incidents of ownership." For example, if Michael obtained a life insurance policy for the benefit of Crown, the value of that policy's proceeds would be included in Michael's gross estate. *See* § 2042(2). Yet here, Crown obtained the policy for its own benefit.

Now, there might be a plausible argument that under § 2042 Michael possessed "incidents of ownership" in the life insurance policy through his controlling-shareholder status. If that were the case, then § 2042 would *require* that Michael's gross estate include the proceeds used for his stock redemption. But that is not the case. Treasury regulation § 20.2042-1(c)(6) clarifies that a decedent does not possess the "incidents of ownership" described in § 2042 merely by virtue of being a controlling shareholder in a corporation that owns and benefits from the policy.

Still, although § 2042 does not require that the proceeds be included here, it does not *exclude* them either. We are cautioned to "[s]ee § 20.2031-2(f) for a rule providing that the proceeds of certain life insurance policies shall be considered in determining the value of the decedent's stock." 26 C.F.R. § 20.2042-1(c)(6). Thus, although the life insurance proceeds intended for redemption do not directly augment Michael's gross estate by way of § 2042, they may well do so indirectly through a proper valuation of Crown. Indeed, the $500,000 of proceeds *not* used to redeem shares and which simply went into Crown's coffers undisputedly increased Crown's value according to the principles in § 2031 and 26 C.F.R. § 20.2031-2(f)(2).

We must therefore consider the value of the life insurance proceeds intended for redemption insofar as they have not already been taken into account in Crown's

valuation and in light of the willing buyer/seller test. In this sense, the parties agree that this case presents the same fair-market-value issue as *Estate of Blount v. Commissioner*, 428 F.3d at 1345-46, from the Eleventh Circuit. But they disagree on whether *Blount* was correctly decided. Like here, *Blount* involved a stock-purchase agreement for a closely held corporation. Although the court referenced the requirement in 26 C.F.R. § 20.2031-2(f)(2) that proceeds be "taken into account," it concluded that the life insurance proceeds *had* been accounted for by the redemption obligation, which a willing buyer would consider. 428 F.3d at 1345. In balance-sheet terms, the court viewed the life insurance proceeds as an "asset" directly offset by the "liability" to redeem shares, yielding zero effect on the company's value.[5] The court summarized its conclusion with an appeal to the willing buyer/seller concept: "To suggest that a reasonably competent business person, interested in acquiring a company, would ignore a $3 million liability strains credulity and defies any sensible construct of fair market value." *Id.* at 1346.

Like the estate in *Blount*, Thomas argues that life insurance proceeds do not augment a company's value where they are offset by a redemption liability. In his view, the money is just passing through and a willing buyer and seller would not account for it. The IRS counters that this assumption defies common sense and customary valuation principles, as reflected in Treasury regulations.

The IRS has the better argument. *Blount*'s flaw lies in its premise. An obligation to redeem shares is not a liability in the ordinary business sense. *See* 6A Fletcher Cyclopedia of the Law of Corporations § 2859 (Sept. 2022 update) ("The redemption of stock is a reduction of surplus, not the satisfaction of a liability.").

[5]*Blount* cited favorably the Ninth Circuit's decision in *Estate of Cartwright v. Commissioner*, 183 F.3d 1034, 1038 (9th Cir. 1999), which employed similar reasoning. Like the Eleventh Circuit in *Blount*, the Ninth Circuit's analysis was limited—one paragraph citing 26 C.F.R. § 20.2031-2(f)(2) and the tax-court decision in *Estate of Huntsman v. Commissioner*, 66 T.C. at 875, which merely emphasized that life insurance proceeds are to be considered according to § 20.2031-2(f)(2).

Treating it so "distorts the nature of the ownership interest represented by those shares." *See Est. of Blount v. Comm'r*, 87 T.C.M. (CCH) 1303, 1319 (2004), *aff'd in part and rev'd in part*, 428 F.3d at 1338. Consider the willing buyer at the time of Michael's death. To own Crown outright, the buyer must obtain all its shares. At that point, he could then extinguish the stock-purchase agreement or redeem the shares *from himself*. This is just like moving money from one pocket to another. There is no liability to be considered—the buyer controls the life insurance proceeds. A buyer of Crown would therefore pay up to $6.86 million, having "taken into account" the life insurance proceeds, and extinguish or redeem as desired. *See* 26 C.F.R. § 20.2031-2(f)(2). On the flip side, a hypothetical willing seller of Crown holding all 500 shares would not accept only $3.86 million knowing that the company was about to receive $3 million in life insurance proceeds, even if those proceeds were intended to redeem a portion of *the seller's own shares*. To accept $3.86 million would be to ignore, instead of "take[] into account," the anticipated life insurance proceeds. *See id.*

To further see the illogic of the estate's position, consider the resulting windfall to Thomas. If we accept the estate's view and look to Crown's value exclusive of the life insurance proceeds intended for redemption, then upon Michael's death, each share was worth $7,720 before redemption.[6] After redemption, Michael's interest is extinguished, but Thomas still has 114.1 shares giving him full control of Crown's $3.86 million value. Those shares are now worth about $33,800 each.[7] Overnight and without any material change to the company, Thomas's shares would have quadrupled in value.[8] This view of the world

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[6]$3.86 million divided by 500 shares.

[7]$3.86 million divided by 114.1 shares.

[8]No one has argued that Michael's death and Thomas's subsequent sole ownership of Crown accounts for such an increase. *Cf. Huntsman*, 66 T.C. at 879 ("The decedent was the dominant force in both businesses, and his untimely death obviously reduced the value of the stock in the two corporations.").

contradicts the estate's position that the proceeds were offset dollar-by-dollar by a "liability." A true offset would leave the value of Thomas's shares undisturbed. *See* Cox & Hazen, *supra*, § 21:2 ("When a corporation purchases its own stock, it has depleted its assets by whatever amount of money or property it gave in exchange for the stock. There is, however, an increase in the proportional interest of the nonselling shareholders in the remaining assets of the corporation."). In sum, the brothers' arrangement had nothing to do with corporate liabilities. The proceeds were simply an asset that increased shareholders' equity. A fair market value of Michael's shares must account for that reality.

III.

For the foregoing reasons, we affirm the district court's grant of summary judgment to the IRS.

United States Court of Appeals for the Fifth Circuit

United States Court of Appeals
Fifth Circuit
FILED
November 3, 2021
Lyle W. Cayce
Clerk

No. 20-61068

Mary P. Nelson; James C. Nelson,

Petitioners—Appellants,

versus

Commissioner of Internal Revenue,

Respondent—Appellee.

Appeal from a Decision of the
United States Tax Court
Tax Court Nos. 27321-13 and 27313-13

Before King, Smith, and Haynes, *Circuit Judges*.

King, *Circuit Judge*:

Mary P. Nelson and James C. Nelson appeal from the Tax Court's denial of their petition for a redetermination of a deficiency of gift tax issued by the Commissioner of Internal Revenue for the tax years 2008 and 2009. For the following reasons, we AFFIRM.

I. FACTS & PROCEDURAL HISTORY

Mary P. Nelson ("Mary Pat") and James Nelson, a married couple with four daughters, sought to plan their estate. To that end, they formed a limited partnership, Longspar Partners, Ltd. ("Longspar"), in 2008. Mary

Pat and James named themselves general partners of Longspar, each with a 0.5% general partner interest. The limited partners were Mary Pat and various trusts and accounts that had been established for the Nelsons' daughters. The majority of Longspar's assets were shares of stock in Warren Equipment Company, a holding company for several businesses founded by Mary Pat's father.

As part of their estate plan, Mary Pat and James also formed a trust in 2008. Mary Pat was the settlor, James was the trustee, and James and the Nelsons' daughters were the beneficiaries. In late 2008 and early 2009, Mary Pat transferred her limited partner interests in Longspar to the trust in two separate transactions—a gift and then a sale. The transfer agreement for the gift stated that:

> [Mary Pat] desires to make a gift and to assign to [the trust] her right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS ($2,096,000.00) as of December 31, 2008 (the "Limited Partner Interest"), as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.

The transfer agreement for the sale used largely similar language, transferring "a limited partner interest having a fair market value of . . . $20,000,000" and providing for a determination by appraisal within 180 days.

As called for by the transfer documents, Mary Pat and James (through their attorney) contracted with an accountant to appraise the value of a 1% limited partnership interest in Longspar. On September 1, 2009 (outside of the time period required by each transfer document), the accountant provided a report valuing a 1% limited partner interest in Longspar at $341,000. The Nelsons' attorney then used the fair market value as

determined by the accountant to convert the dollar values in the transfer agreements to percentages of limited partner interests—6.14% for the gift and 58.65% for the sale. Those percentages were then listed on Longspar's records, included in Longspar's amended partnership agreement, and listed on the Nelsons' Form 709 gift tax returns.[1]

The IRS then audited the Nelsons' tax returns. In anticipation of a settlement that would have included a higher valuation of the Longspar interests, the Nelsons amended the relevant records and reallocated previous distributions to match that valuation. However, when no settlement was actually reached, the Commissioner issued Notices of Deficiency listing $611,708 in gift tax owed for 2008 and $6,123,168 for 2009. The Nelsons challenged the deficiencies in the Tax Court. They argued that their initial valuation was correct and, even if it was not, that they had sought to transfer specific dollar amounts through a formula clause and that the amount of interests transferred should be reallocated should the valuation change.

The Tax Court rejected both arguments. It first found that the proper valuation of a 1% limited partner interest in Longspar was $411,235, not $341,000. The court also found that the language in the transfer documents was not a valid formula clause that could support reallocation. Instead, Mary Pat had transferred the percentage of interests that the appraiser had determined to have the values stated in the transfer documents; those percentages were fixed once the appraisal was completed. Accordingly, the Tax Court held that Mary Pat and James each owed $87,942 in gift tax for 2008 and $920,340 in gift tax for 2009. The Nelsons timely appeal the

[1] Consistent with its treatment as a sale, the Nelsons did not list the second transfer on their gift tax return.

court's finding that the transfers consisted of percentage interests, rather than fixed dollar amounts.

II. STANDARD OF REVIEW

"An appellate court reviews a trial court's conclusions of law *de novo* and draws its own conclusions in place of those of the trial court." *Succession of McCord v. Comm'r*, 461 F.3d 614, 623 (5th Cir. 2006). The same standard of review also applies to "a question of fact, such as valuation" that "requires legal conclusions" and "determination of the nature of the property rights transferred" that are "question[s] of state law." *Id.*

III. DISCUSSION

We are asked to determine whether the two transfer documents transferred specific percentages of limited partner interests or the amount of interests that equal fixed dollar amounts. The latter theory would allow the percentage of interests transferred to be reallocated should the valuation change, as was the case here. The former would render the percentage of interests transferred fixed even in the face of a changed valuation.

When determining the amount of gift tax, if any, that applies to a transfer, the nature of that transfer is ascertained by looking to the transfer document and its language, rather than subsequent events. *Succession of McCord*, 461 F.3d at 626-27; *Est. of Petter v. Comm'r*, T.C. Memo. 2009-280, 2009 Tax Ct. Memo LEXIS 285, at *36 (citing *Ithaca Tr. Co. v. United States*, 279 U.S. 151, 155 (1929)), *aff'd*, 653 F.3d 1012 (9th Cir. 2011). The language that the Nelsons used in the gift instrument stated that they were transferring:

> [Mary Pat's] right, title, and interest in a limited partner interest having a fair market value of TWO MILLION NINETY-SIX THOUSAND AND NO/100THS DOLLARS

> ($2,096,000.00) as of December 31, 2008 (the "Limited Partner Interest"), *as determined by a qualified appraiser within ninety (90) days of the effective date of this Assignment.*

This additional (i.e., emphasized) language expressly qualifies the definition of "fair market value" for the purposes of determining the interests transferred. By its plain meaning, the language of this gift document and the nearly identical sales document transfers those interests that the qualified appraiser determined to have the stated fair market value—no more and no less.

The specific qualification added by the Nelsons separates their agreement from the formula clauses considered in other cases. Most formula-clause cases featured transfer instruments that defined the interests transferred as the fair market value as determined for federal-gift or estate-tax purposes. *See Est. of Petter v. Comm'r*, 653 F.3d 1012, 1015-16 (9th Cir. 2011); *Est. of Christiansen v. Comm'r*, 586 F.3d 1061, 1062 (8th Cir. 2009); *Wandry v. Comm'r*, T.C. Memo. 2012-88, 2012 Tax Ct. Memo LEXIS 89, at *4-5, *nonacq.*, 2012-46 I.R.B. 543 (Nov. 13, 2012). Those that did not defined fair market value through reference to the "willing-buyer/willing-seller" test that is used to define fair market value in the relevant Treasury regulation. *Succession of McCord*, 461 F.3d at 619 (citing 26 C.F.R. § 25.2512-1 (2005)); *Hendrix v. Comm'r*, T.C. Memo. 2011-133, 2011 Tax Ct. Memo LEXIS 130, at *8. The Nelsons defined their transfer differently; they qualified it as the fair market value that was determined by the appraiser. Once the appraiser had determined the fair market value of a 1% limited partner interest in Longspar, and the stated dollar values were converted to percentages based on that appraisal, those percentages were locked, and remained so even after the valuation changed.

Additionally, this case is not like *Succession of McCord*, where the definition of fair market value was unqualified. *See McCord v. Comm'r*, 120 T.C. 358, 419 (2003) (Foley, J., concurring in part and dissenting in part), *rev'd sub nom. Succession of McCord*, 461 F.3d at 614.[2] Instead, the transfer agreement specifically qualified fair market value by reference to the appraiser, rather than to a final determination or to gift tax principles. Following the Nelsons' reading of the clause would give effect only to the first part (referencing fair market value) and not the second (referencing a qualified appraiser). Such a reading does not comport with the plain meaning of the language used.

Moreover, the transfer documents in every other formula-clause case contained crucial language that the Nelsons' instruments lacked: specific language describing what should happen to any additional shares that were transferred should the valuation be successfully challenged. Some cases provided for excess interests to go to charity. *See Est. of Petter*, 653 F.3d at 1016; *Succession of McCord*, 461 F.3d at 619; *Hendrix*, 2011 Tax Ct. Memo. LEXIS 130, at *8. Another case involved an instrument that stated that "the number of gifted Units shall be adjusted . . . so that the value of the number of Units gifted to each person equals the amount set forth above." *Wandry*, 2012 Tax Ct. Memo LEXIS 89, at *6. The Nelsons' agreements contain no such language. Nothing in the agreements compels the trust to return excess units, or do anything with excess units, should the valuation change. The fact that the trust did return excess units is irrelevant; that fact is the type of "subsequent occurrence[]" that this court has said was "off limits" when determining the value of a gift. *Succession of McCord*, 461 F.3d at 626.

[2] While this court overturned the Tax Court's decision in *McCord*, we extensively cited Judge Foley's partial concurrence and dissent with approval. *See Succession of McCord*, 461 F.3d at 627-28.

As the government well-analogized, if a farmer agrees to sell the number of cows worth $1,000 as determined by an appraiser, and the appraiser determines that five cows equals that stated value, then the sale is for five cows. If a later appraisal determined that each cow was worth more, and that two extra cows had been included in the sale, nothing in the agreement would allow the farmer to take the cows back. The parties would be held to what they agreed—a transfer of the number of cows determined by the appraiser to equal $1,000. So too here. No language in the transfer agreements allows the Nelsons to reopen their previously closed transaction and reallocate the limited partner interests based on a change in valuation.

While the formula-clause cases might give the appearance of reopening a transaction in just such a fashion, that is not the case. A gift is considered complete, and thus subject to the gift tax, when "the donor has so parted with dominion and control as to leave in him no power to change its disposition, whether for his own benefit or the benefit of another." 26 C.F.R. § 25.2511-2(b) (2021). For tax purposes, the "value . . . at the date of the gift shall be considered the amount of the gift." 26 U.S.C § 2512(a). With a formula clause, the transaction is still closed even if a reallocation occurs. That reallocation simply works to ensure that a specified recipient "receive[s] those units [he or she was] already entitled to receive." *Est. of Petter*, 653 F.3d at 1019. Similarly, the value of the gift existed and could be determined at the time of the transfer. "The number of . . . units" transferred is "capable of mathematical determination from the outset, once the fair market value [is] known." *Id.* The reallocation clauses thus allow for the proper number of units to be transferred based on the final, correct determination of valuation.

The Nelsons did not include such a clause. Instead, the trust has already received everything it was entitled to—the number of units matching the stated value as determined by a qualified appraiser. Both parties agree

with the Tax Court's conclusion that the gift was complete, and that Mary Pat parted with dominion and control, on the date listed in each transfer agreement. On those dates, Mary Pat irrevocably transferred the number of units the appraiser determined equaled the stated values. No clause in the transfer documents calls for a reallocation to ensure the trust received a different amount of interests if the final, proper valuation was different than the appraiser's valuation. The percentage of interests was transferred on the listed dates, even if those percentages were indefinite until the appraisal was completed. *Cf. Robinette v. Helvering*, 318 U.S. 184, 187 (1943) (holding that a gift was complete even in the face of "indefiniteness of the eventual recipient"). The gift tax is assessed as of the date of the transfer and on the value of those percentages, whatever that value may be. Simply put, while the Nelsons may have been attempting to draft a formula clause, they did not do so.

The interpretation of the transfer documents is not changed by looking to any objective facts outside of the language the Nelsons used. First and foremost, under Texas law, "extrinsic evidence may only be used to aid the understanding of an unambiguous contract's language, not change it or 'create ambiguity.' " *URI, Inc. v. Kleberg Cnty.*, 543 S.W.3d 755, 757 (Tex. 2018) (quoting *Cmty. Health Sys. Pro. Servs. Corp. v. Hansen*, 525 S.W.3d 671, 688 (Tex. 2017)). "If a written contract is so worded that it can be given a definite or certain legal meaning when so considered and as applied to the matter in dispute, then it is not ambiguous." *Id.* at 765.

Here, the transfer agreements are not ambiguous; the meaning of the language prescribing that an appraiser will determine the percentage of interests to be transferred is definite and certain. "An ambiguity does not arise simply because the parties advance conflicting interpretations of the contract[;]" "for an ambiguity to exist, both interpretations must be *reasonable*." *Columbia Gas Transmission Corp. v. New Ulm Gas, Ltd.*, 940

S.W.2d 587, 589 (Tex. 1996). Given the clarity of the language of the contracts as written, the Nelsons' interpretation is not reasonable as a matter of law; as stated earlier, that interpretation would read out the reference to the appraisal in its entirety. "Surrounding facts and circumstances can inform the meaning of the language but cannot be used to augment, alter, or contradict the terms of an unambiguous contract." *URI*, 543 S.W.3d at 758 (citation omitted). The Nelsons' reading, based on their subjective intent, would go beyond elucidating contractual language to changing and overriding it. Texas contract law does not allow for that.

Even if the contracts are ambiguous, there are no *objective* facts or circumstances surrounding the transfer that counsel a different result. Under federal gift tax law, "the application of the tax is based on the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor." 26 C.F.R. § 25.2511-1(g)(1) (2021). Texas contract law commands the same. *URI*, 543 S.W.3d at 767 ("[T]he parol evidence rule prohibits extrinsic evidence of *subjective* intent that alters a contract's terms. . . ."). The evidence the Nelsons point to all concerns their subjective intent; we cannot look to what the Nelsons had in their minds when drafting the contracts. Rather than subjective intent, it is "objective manifestations of intent [that] control, not 'what one side or the other alleges they intended to say but did not.' " *Id.* at 763-64 (citation omitted) (quoting *Gilbert Tex. Constr., L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118, 127 (Tex. 2010)). Objective considerations include the "surrounding circumstances that inform, rather than vary from or contradict, the contract text." *Hous. Expl. Co. v. Wellington Underwriting Agencies, Ltd.*, 352 S.W.3d 462, 469 (Tex. 2011).

The only objective circumstance the Nelsons can point to in support of their reading is the setting of the transfer, as part of the Nelsons' estate planning that aimed to protect their assets while also avoiding as much tax

liability as possible. *See URI*, 543 S.W.3d at 768 ("Setting can be critical to understanding contract language, as we found in cases involving the lawyer-client relationship and construction of an arbitration agreement." (citations omitted)); *Hous. Expl. Co.*, 352 S.W.3d at 469 (stating that objective circumstances include "the commercial or other setting in which the contract was negotiated" (quoting 11 RICHARD A. LORD, WILLISTON ON CONTRACTS § 32.7 (4th ed. 1999))). Consideration of the estate-plan context still hews too closely to consideration of the Nelsons' subjective intent to alter the understanding of the contractual language. For an arbitration agreement or a contract between a lawyer and a client, one can tell the setting from fully objective facts—normally, by looking at the plain text of the agreement. For the Nelsons' transfers, however, consideration of the estate-plan setting still requires determining what was in their minds at the time of the transfers. One would still need to determine that, in transferring assets from Mary Pat to the trust, the Nelsons had the *subjective* intent of minimizing their tax liability. While that might be fairly obvious, it still requires consideration of subjective intent, rather than objective facts. This goes beyond the scope of the parol evidence rule under Texas law.

Further, the fact that the language *differs* from other, similar contracts in the same setting is significant. This is not a case where we would be reading the contracts in line with numerous other, similar contracts that are regular parts of a given industry or setting, such as arbitration. To support the Nelsons' reading, we would be required to disregard significant differences between these contracts and the transfer documents used in similar cases. That would be an improper use of facts and circumstances surrounding the contract. *Cf. Hous. Expl. Co.*, 352 S.W.3d at 469-72 (holding that deletions from a form contract should be considered when judging the parties' intent for the agreement). The fact that the transfers involved a family trust and

family assets and were made in the setting of estate planning should not be used to interpret the Nelsons' intent.

The Nelsons also point to the fact that the appraisal was not completed within the allotted times specified in the agreements. That fact does not change the result. The delay in the appraisal does not demonstrate anything about the nature of the transfers; it only means that the trust would potentially have had a claim against Mary Pat (since the language of the agreement was violated) and that both the trust and Mary Pat might have had a claim against the appraiser (depending on the nature of their agreement with him). However, the transfers were still completed on the dates listed in the transfer documents and in accordance with the language used. And the lack of concern demonstrated for the tardy appraisal is yet another indicium of subjective intent which similarly cannot be considered under Texas's parol evidence rule.

The transfer documents clearly and unambiguously state that Mary Pat was gifting and selling the percentage of limited partner interests that an appraiser determined to have a fair market value equal to a stated dollar amount. The transfer agreements must be interpreted as written. The Nelsons therefore transferred what the plain language of their transfer instruments stated—$2,096,000 and $20,000,000 of limited partner interests in Longspar as determined by a qualified appraiser to be 6.14% and 58.65% of such interests. Thus, when the Tax Court found the fair market values of those percentages to actually be $2,524,983 and $24,118,933, respectively, the Nelsons were left with a gift tax deficiency.[3] Therefore, the

[3] The gift tax deficiency on the sale results from the excess value of the interests transferred that were not the subject of due consideration from the $20,000,000 promissory note issued by the trust; gifts include "sales, exchanges, and other dispositions of property for a consideration to the extent that the value of the property transferred by

Tax Court was correct in determining that Mary Pat and James Nelson each owes $87,942 in gift tax for 2008 and $920,340 in gift tax for 2009.

IV. CONCLUSION

For the foregoing reasons, the judgment of the Tax Court is AFFIRMED.

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the donor exceeds the value . . . of the consideration given therefor." 26 C.F.R. § 25.2512-8 (2021).

United States Tax Court

T.C. Memo. 2023-65

RONALD SCHLAPFER,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 419-20. Filed May 22, 2023.

Scott D. Michel, *Ross R. Sharkey*, *Christopher S. Rizek*, and *Jeffrey S. Stephens*, for petitioner.

Blake J. Corry, *William Benjamin McClendon*, and *Randall S. Trebat*, for respondent.

MEMORANDUM OPINION

BUCH, *Judge*: This case is before the Court on Cross-Motions for Summary Judgment. Ronald Schlapfer was the policyholder of a life insurance policy issued in 2006. The policy was funded by stock and cash from European Marketing Group, Inc. (EMG), an entity solely owned by Mr. Schlapfer. Mr. Schlapfer assigned ownership of the policy to his mother, aunt, and uncle.

In 2013, Mr. Schlapfer submitted a disclosure packet to the Internal Revenue Service (IRS) Offshore Voluntary Disclosure Program (OVDP). In this packet, he included a gift tax return for 2006 that informed the IRS that he had made gifts of EMG stock to his mother, aunt, and uncle. The IRS concluded that he made the gifts in 2007, not 2006, and that because he failed to file a gift tax return for that year, he did not adequately disclose the gift to commence the period of limitations on assessment.

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[*2] The Commissioner generally has three years from the filing of a gift tax return to assess additional tax. If no return is filed, or if the gift is not adequately disclosed on or with the gift tax return, then the Commissioner may assess at any time. But the adequate disclosure of a completed gift on a gift tax return will commence the running of the period of limitations for assessment of gift tax on the transfer even if the transfer is ultimately determined to be an incomplete gift.

Mr. Schlapfer adequately disclosed the gift on his 2006 gift tax return. The documents he attached to, and referenced in, his return provided the Commissioner with enough information to satisfy adequate disclosure. Therefore, the period of limitations to assess the gift tax commenced when the return was filed; and because the Commissioner issued the notice of deficiency more than three years after the filing, the Commissioner is barred from assessing gift tax.

Background

Ronald Schlapfer has ties to both the United States and Switzerland. He was born in Switzerland in 1950 and remained there until 1978. While in Switzerland, he began a career in banking and finance, working at Bank Vontobel and then Citibank. In 1979 he moved to the United States with his first wife, whom he met while working in Tokyo. He moved to the United States to continue his career at Citibank. Through Citibank, Mr. Schlapfer obtained a nonimmigrant visa, which required a declaration that he did not intend to permanently reside in the United States. He later obtained a U.S. green card. Other than his wife, Mr. Schlapfer's immediate family, which included his mother, brother, aunt, and uncle, remained in Switzerland.

Mr. Schlapfer and his first wife had two daughters, who were born in 1979 and 1981. They all lived together in the United States until 1989 when Mr. Schlapfer and his first wife divorced. Thereafter, his first wife and their two daughters moved to Switzerland. His daughters returned to the United States in the mid-1990s for school.

Mr. Schlapfer married his current wife, Linda Schlapfer (Mrs. Schlapfer), in 1990. Like Mr. Schlapfer, she had been married previously. She and her first husband moved to the United States in 1978 and had a daughter in 1979. They divorced in the late 1980s. Mrs. Schlapfer married Mr. Schlapfer in 1990, and they had a son together in 1992.

[*3] After leaving Citibank in 1998, Mr. Schlapfer started his own businesses. First, he started a currency trading company in the United States called Tradex. Then in 2002, he formed EMG. EMG was a Panamanian corporation that managed investments, holding marketable securities and cash. Mr. Schlapfer owned all of its issued and outstanding shares (namely, 100 shares of common stock).

On May 18, 2007, Mr. Schlapfer applied for U.S. citizenship, and in 2008 he became a U.S. citizen.

I. *The Life Insurance Policy*

On July 7, 2006, Mr. Schlapfer applied for a LifeBridge Universal Variable Life Policy (UVL Policy) offered by swisspartners Insurance Company SPC Ltd. (Swisspartners). Mr. Schlapfer's stated purpose for doing so was to create and fund a policy that his mother, aunt, and uncle could use to benefit his nephews, whose dad (Mr. Schlapfer's brother) had died in 1994. The application listed Mr. Schlapfer as the policyholder, his mother, aunt, and uncle as the insured lives, Mr. Schlapfer and Mrs. Schlapfer as the primary beneficiaries, and Mr. Schlapfer's three children and stepchild as the secondary beneficiaries. It also indicated that AIG Private Bank, Zurich (AIG) had been selected as custodian, meaning policy assets would be held there. On September 22, 2006, UVL Policy No. XXX-X03-06 was issued bearing the same policyholder, insured lives, primary and secondary beneficiaries, and custodian as requested in the application.

Mr. Schlapfer funded the UVL Policy premium with $50,000[1] and 100 shares of EMG.[2] The assets were held in an account at AIG titled "swisspartners Insurance Company SPC Ltd. Rubric: XXX-X03-06" (AIG Account). The initial premium payment was made on August 21, 2006, when EMG transferred $50,000 to the AIG Account. The next premium payment was made on September 22, 2006, when EMG issued a share certificate showing the AIG Account as the owner of all 100 shares of

[1] All monetary amounts are shown in U.S. dollars and rounded to the nearest dollar. Unless otherwise indicated, all statutory references are to the Internal Revenue Code, Title 26 U.S.C. (I.R.C.), in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[2] Shares of an entity called FX Funds, Ltd., were also contributed to the UVL Policy. However, because FX Funds is a dormant entity with no assets, those shares are not relevant.

[*4] EMG stock. Those shares were transferred to the AIG Account on November 8, 2006.

Mr. Schlapfer eventually substituted his mother, aunt, and uncle for himself as the policyholders. On January 23, 2007, Mr. Schlapfer initially requested that Swisspartners assign the policy to his mother as the policyholder with immediate effect. The next day, his mother signed a revised term sheet that made her the policyholder. Then on April 23, 2007, Mr. Schlapfer and his mother jointly requested that Swisspartners assign the policy so that Mr. Schlapfer's mother, aunt, and uncle would be joint policyholders. They also requested that the beneficiary designations be made irrevocable. These changes were executed on May 31, 2007. All other terms of the policy remained the same.

II. *The Offshore Voluntary Disclosure Program*

In 2012, Mr. Schlapfer entered into the OVDP. The OVDP "offered U.S. taxpayers with undisclosed income from offshore assets a compliance avenue to resolve income tax liabilities" and "tax information reporting obligations." *See Internal Revenue Manual* 4.63.3.1 (Apr. 27, 2021). When disclosing assets, the OVDP required that taxpayers disregard all entities through which undisclosed assets were held. It also required taxpayers to pay all tax, interest, and penalties related to undisclosed assets during the most recent eight years, regardless of the statute of limitations. *See* I.R.S., *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers 2012*, Q7, Q9, Q42, https://www.irs.gov/individuals/international-taxpayers/offshore-voluntary-disclosure-program-frequently-asked-questions-and-answers-2012 (last updated June 27, 2021).

On November 20, 2013, Mr. Schlapfer, through counsel, submitted a disclosure packet to participate in the OVDP. The submission included the following items:

- Original Forms 1040, U.S. Individual Income Tax Return, for tax years 2004 through 2009;
- Forms 1040X, Amended U.S. Individual Income Tax Return, for tax years 2004 through 2009;
- Forms CT–1040, Connecticut Resident Income Tax Return, and Forms CT–1040X, Amended Connecticut Income Tax Return for Individuals, for tax years 2004 through 2009;

[*5]

- Forms 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations;
- Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, for 2006;[3]
- Reports of Foreign Bank and Financial Accounts (FBARs) for tax years 2004 through 2009;
- Bank Statements;
- Foreign Account or Asset Statements;
- A completed Penalty Computation Worksheet;
- A copy of OVDI Prepayment Check No. 2318 to the Department of the Treasury for $6 million for tax years 2004 through 2011;
- Consents, (i) Form 872, Consent to Extend the Time to Assess Tax, and (ii) Consent to Extend the Time to Assess Civil Penalties Provided by 31 U.S.C. § 5321 for FBAR Violations;
- An Offshore Entity Statement;
- An Offshore Voluntary Disclosure Letter with Required Attachments; and
- Copies of Forms 2848, Power of Attorney and Declaration of Representative, for Ronald Schlapfer and Linda Schlapfer.

With this submission, Mr. Schlapfer attempted to comply with applicable U.S. tax laws. For 2004, 2005, and 2006, he provided amended income tax returns that included Forms 5471 for EMG. Those forms provided information regarding the number and type of issued and outstanding shares, the number of shares held by Mr. Schlapfer, and EMG's income statement, balance sheet, and earnings and profits for the respective tax years. Mr. Schlapfer also provided an Offshore Entity Statement detailing his control over EMG, which stated:

> EMG was established by the Taxpayer in 2003, and was beneficially owned by the Taxpayer until July 6, 2006, at

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[3] The gift tax return was attached to Mr. Schlapfer's 2006 amended return.

[*6] which time the Taxpayer gifted his entire interest in EMG to his mother. The Taxpayer is taking into account all of the income earned by the accounts underlying EMG in the enclosed Amended U.S. Individual Tax Returns during the years he controlled and beneficially owned EMG.

Mr. Schlapfer also included a Form 709 for 2006 with his submission. Attached to the Form 709 was a protective filing that stated:

> A PROTECTIVE FILING IS BEING SUBMITTED. ON JULY 6, 2006, TAXPAYER MADE A GIFT OF CONTROLLED FOREIGN COMPANY STOCK VALUED AT $6,056,686.
>
> PER U.S. TREASURY REGULATION 25.2501-1(B), THE TAXPAYER IS NOT SUBJECT TO U.S. GIFT TAX AS HE DID NOT INTEND TO RESIDE PERMANENTLY IN THE UNITED STATES UNTIL CITIZENSHIP WAS OBTAINED IN 2008.

This gift stemmed from Mr. Schlapfer's assignment of the UVL Policy. He reported the gift as stock rather than the UVL Policy because the 2012 OVDP instructions required taxpayers to disregard certain entities that hold underlying assets, and he believed the policy was such an entity.[4] He also contends that he prepared the 2006 gift tax return in accordance with the investor control doctrine. The Commissioner does not dispute that Mr. Schlapfer filed a gift tax return for 2006 when he submitted the disclosure packet to the OVDP.

On June 4, 2014, after reviewing the 2006 gift tax return in Mr. Schlapfer's OVDP submission, an IRS revenue agent issued him an information document request (IDR). The IDR asked Mr. Schlapfer to provide documentation (1) of the gift of EMG to his mother, including the transfer of ownership of the entity as well as the transfer of the ownership of foreign accounts related to the entity, and (2) to substantiate his claim that in 2006 he did not have an intent to remain in the country and is therefore exempt from paying gift tax.

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[4] The Commissioner does not consider a life insurance policy an "entity" as defined under the 2012 OVDP instructions.

[*7] Mr. Schlapfer promptly responded. He provided the following documents to show the transfer of his entire ownership interest in EMG to the AIG Account:

(1) a copy of the September 22, 2006, share certificate showing the AIG Account as the owner of all issued and outstanding shares in EMG;

(2) a copy of an AIG statement dated August 8, 2006, showing the initial premium payment of $50,000 to the AIG Account;

(3) a copy of an AIG statement showing EMG's portfolio valuation as of September 22, 2006; and

(4) a copy of the Bearer Share of FX Fund, Ltd., which was held in the AIG Account.

He provided the following additional documents to show that he made a gift to his mother:

(5) a copy of the updated UVL Policy term sheet signed by his mother on January 24, 2007;

(6) a copy of Mr. Schlapfer's signed instructions to Swisspartners to change the policyholder of the UVL Policy to his mother; and

(7) copies of the UVL Policy chart.

In addition to providing these documents, with his response Mr. Schlapfer explained his position as to the date of the gift transfer. He asserted that the gift was made on July 6, 2006, when he instructed Swisspartners to transfer ownership of the UVL Policy to his mother, aunt, and uncle as soon as the policy was issued. However, he also agreed to a revised gift date of September 22, 2006, the date the policy was issued. He explained that Swisspartners' naming him as a policyholder was a scrivener's error, and that the requests made in January and April 2007 were merely intended to correct that error. After his initial response to the IDR, Mr. Schlapfer quickly followed up with documents to substantiate his claim that he did not intend to remain in

[*8] the United States, in the form of affidavits from family members and business partners, in July 2014.[5]

Following his response to the IDR, the IRS had little contact with Mr. Schlapfer about his 2006 gift tax return until 2016, when it opened an examination of the return. On January 6, 2016, an IRS estate tax attorney notified Mr. Schlapfer of the examination and requested to meet with him to discuss his claim of nondomiciliary status in the United States for 2006. On May 17, 2016, an IRS estate tax attorney interviewed Mr. Schlapfer. Although most of the questions related to Mr. Schlapfer's domicile, there were also questions regarding the nature of the gift, when it was made, and the reported value of the gift. On June 14, 2016, Mr. Schlapfer signed a Form 872 for his 2006 gift tax return. He agreed to extend the time to assess tax to November 30, 2017.

In August 2016, the IRS issued Mr. Schlapfer a Form 3233, Report of Gift Tax Examination, for his 2006 gift tax return. In that report, the IRS concluded that there was no taxable gift in 2006 because Mr. Schlapfer made an incomplete transfer. It explained that because Mr. Schlapfer failed to relinquish dominion and control of the UVL Policy as the policyholder until May 31, 2007, the gift was not completed in 2006. Because Mr. Schlapfer refused to concede that the gift was made in 2007, he was given the choice to opt out of or be removed from the OVDP. He withdrew.

After Mr. Schlapfer formally withdrew from the OVDP, the Commissioner prepared a substitute gift tax return for 2007 pursuant to section 6020(b). On October 17, 2019, the Commissioner issued Mr. Schlapfer a notice of deficiency for 2007 determining a gift tax liability of $4,429,949, and additions to tax under section 6651(a)(2) and (f) of $4,319,200. While residing in Florida, Mr. Schlapfer filed a Petition challenging the Commissioner's determinations.

The Commissioner filed a Motion for Summary Judgment asking the Court to find as a matter of law that (1) Mr. Schlapfer made a taxable gift of an insurance policy in 2007 and (2) that he is liable for additions to tax under section 6651(f), or in the alternative section 6651(a)(1) and (2). Mr. Schlapfer filed a Cross-Motion for Summary Judgment asking the Court to find as a matter of law that the Commissioner's period of limitation to assess the gift tax expired before the notice of deficiency

[5] For purposes of this Opinion, we need not resolve Mr. Schlapfer's domiciliary status.

[*9] was issued because Mr. Schlapfer adequately disclosed the gift on his 2006 gift tax return. Mr. Schlapfer supplemented his Motion, and the Commissioner responded to the Supplement.

Discussion

Before the Court are the parties' Cross-Motions for Summary Judgment. We are asked to decide whether the period of limitations to assess the 2007 gift tax expired before the Commissioner issued the notice of deficiency. To answer this question, we must decide whether Mr. Schlapfer adequately disclosed his gift on his gift tax return.

I. *Summary Judgment Standard*

We may grant summary judgment when there is no genuine dispute as to any material fact and a decision may be rendered as a matter of law. Rule 121(a)(2); *Sundstrand Corp. v. Commissioner*, 98 T.C. 518, 520 (1992), *aff'd*, 17 F.3d 965 (7th Cir. 1994). The moving party bears the burden of showing that there is no genuine dispute as to any material fact. *Sundstrand Corp.*, 98 T.C. at 520. When a motion for summary judgment is properly made and supported, an opposing party may not rest on mere allegations or denials. Rule 121(d). Rather, the party's response, by affidavits or declarations, or as otherwise provided in Rule 121, must set forth specific facts showing there is a genuine factual dispute for trial. *Id.* In deciding whether to grant summary judgment, we view the facts and make inferences in the light most favorable to the nonmoving party. *Sundstrand Corp.*, 98 T.C. at 520.

II. *Gift Tax*

Section 2501(a)(1) imposes a tax on the transfer of property by gift. A gift is generally defined as any transaction where property is gratuitously passed to or conferred upon another for less than full and adequate consideration. I.R.C. § 2512(b); Treas. Reg. § 25.2511-1(c)(1). The amount of tax imposed is based on the value of the property transferred on the date the gift is complete.[6] I.R.C. § 2512(a); Treas. Reg. § 25.2511-2(a). The gift tax applies to a transfer regardless of whether the gift is direct or indirect, whether the property is real or personal, whether the property is tangible or intangible, or whether the transfer is in a trust or otherwise. I.R.C. § 2511(a). Individuals subject to the gift

[6] Treasury Regulation § 25.2511-2(b) provides that the transfer of property is not a complete gift unless the donor parts with dominion and control over the property with no power to change its disposition.

[*10] tax who make a transfer by gift must file a gift tax return, Form 709, for the year the transfer is made. I.R.C. § 6019; Treas. Reg. § 25.2501-1(a)(1).

Mr. Schlapfer filed Form 709 for 2006 on which he reported a transfer of stock by gift, but the Commissioner disagrees as to the characterization of the transferred property (EMG stock vs. UVL Policy) and the timing of the transfer (2006 vs. 2007). For purposes of this Opinion, we make no determination as to whether the gift is the EMG stock or the UVL Policy. We will analyze the applicable law under both. Additionally, for reasons discussed below, the timing issue is immaterial.

III. *Statute of Limitations for Gift Tax Assessment*

Subject to various exceptions, the Commissioner generally has three years after a gift tax return is filed to assess any gift tax. I.R.C. § 6501(a), (c); *Estate of Brown v. Commissioner*, T.C. Memo. 2013-50, at *8–9. Section 6501(c)(9) provides an exception for certain gifts not shown on returns. It provides that the Commissioner may assess gift tax at any time for any gift of property, the value of which is required to be shown on a gift tax return and is not shown on such a return. I.R.C. § 6501(c)(9). This exception applies unless the gift has otherwise been "disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item." *Id.*; Treas. Reg. § 301.6501(c)-1(f)(1). If a gift has been adequately disclosed on the gift tax return, or a statement attached to the return, that was filed for the year the transfer occurred, then the ordinary three-year period for assessment commences upon filing. I.R.C. § 6501(c)(9); Treas. Reg. § 301.6501(c)-1(f)(1) and (2).

This is true even if the gift disclosed is ultimately determined to be an incomplete transfer under Treasury Regulation § 25.2511-2 so long as there was adequate disclosure. Treasury Regulation § 301.6501(c)-1(f)(5) provides that

> [a]dequate disclosure of *a transfer that is reported as a completed gift on the gift tax return will commence the running of the period of limitations for assessment of gift tax on the transfer, even if the transfer is ultimately determined to be an incomplete gift* for purposes of § 25.2511-2 . . . . For example, if an incomplete gift is reported as a completed gift on the gift tax return and is

> **[*11]** adequately disclosed, the period for assessment of the gift tax will begin to run when the return is filed . . . .

(Emphasis added.) Hence, under this Treasury regulation, for purposes of commencing the period of limitations, the focus is on when the transfer was reported, not when the transfer was completed.

Here we will focus on whether Mr. Schlapfer adequately disclosed the gift transfer reported on his 2006 gift tax return. The Commissioner determined that the gift transfer was completed in 2007, and his notice is predicated on that determination. However, when the transfer was completed is immaterial. Even if we were to decide that the gift was completed in 2007, Mr. Schlapfer's adequate disclosure of the gift on his 2006 return would suffice to commence the three-year period of limitations upon the filing of that return. *See* Treas. Reg. § 301.6501(c)-1(f)(5).

IV. *Adequate Disclosure*

"A disclosure is 'adequate' if it is 'sufficiently detailed to alert the Commissioner and his agents as to the nature of the transaction so that the decision as to whether to select the return for audit may be a reasonably informed one.'" *Thiessen v. Commissioner*, 146 T.C. 100, 114 (2016) (quoting *Estate of Fry v. Commissioner*, 88 T.C. 1020, 1023 (1987)). The Commissioner directs us to the reporting requirements for strict compliance. *See, e.g.*, Treas. Reg. § 25.6019-4. But Treasury Regulation § 301.6501(c)-1(f)(2) provides that transfers reported on a gift tax return will be considered adequately disclosed if the return (or a statement attached to the return) provides the following information:

> (i) A description of the transferred property and any consideration received by the transferor;
>
> (ii) The identity of, and relationship between, the transferor and each transferee;
>
> (iii) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument;
>
> (iv) Except as provided in § 301.6501(c)-1(f)(3), a detailed description of the method used to determine the fair market value of property transferred, including any financial data (for

[*12] example, balance sheets, etc. with explanations of any adjustments) that were utilized in determining the value of the interest, any restrictions on the transferred property that were considered in determining the fair market value of the property, and a description of any discounts, such as discounts for blockage, minority or fractional interests, and lack of marketability, claimed in valuing the property. . . . ; and

> (v) A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer . . . .

These requirements can be satisfied by filing Form 709 with the required information, or if needed, an amended Form 709 with the required information. Rev. Proc. 2000-34, §§ 3 and 4, 2000-2 C.B. 186, 186. However, if an amended return is the one that satisfies adequate disclosure, then the period of limitations commences with the filing of the amended return, not the original return. *Id.*

Whether a statement attached to a gift tax return adequately discloses a gift is a question of fact. *Estate of Hicks Sanders v. Commissioner*, T.C. Memo. 2014-100, at *7. Mr. Schlapfer argues that the period to assess gift tax has expired because he adequately disclosed the gift on his 2006 gift tax return. He points to four documents to support this claim: (1) the gift tax return; (2) a protective filing attachment; (3) Schedule F of Form 5471 for his 2006 tax return; and (4) the Offshore Entity Statement. The Commissioner argues that the period to assess gift tax did not expire because Mr. Schlapfer did not adequately disclose the gift. Specifically, he asserts that (1) the Offshore Entity Statement is not part of the 2006 gift tax return and it should not be considered to determine whether Mr. Schlapfer made an adequate disclosure of the gift; and (2) even if the Offshore Entity Statement is considered, Mr. Schlapfer still failed to adequately disclose the gift because he failed to satisfy all applicable requirements of Treasury Regulation § 301.6501(c)-1(f)(2).

A. *Disclosure Contents We Can Consider*

The Commissioner argues that the Offshore Entity Statement is not among the documents we should consider in determining whether the gift was adequately disclosed. We disagree.

[*13] We have addressed the question of what documents to consider for adequate disclosure in cases interpreting section 6501(e)(1) (regarding substantial income omissions), and we find that the rationale used in those cases applies with equal force here. Under section 6501(c)(9), the Commissioner may assess a gift tax at any time if a gift is not shown on a return unless the gift is "*disclosed in such return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item*." (Emphasis added.) Section 6501(e)(1)(B)(iii) has similar wording, providing that the period of limitations for the Commissioner to determine the amount omitted from gross income will extend to six years unless "*such amount is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item*." (Emphasis added.) "Where the same word or phrase appears multiple times within a statutory text, it is generally presumed to have the same meaning each place it appears." *Whistleblower 22716-13W v. Commissioner*, 146 T.C. 84, 92–93 (2016) (citing *Atl. Cleaners & Dyers, Inc. v. United States*, 286 U.S. 427, 433 (1932) ("Undoubtedly, there is a natural presumption that identical words used in different parts of the same act are intended to have the same meaning.")). A review of applicable IRS guidance and a plain reading of the statute do not warrant a conclusion that Congress intended the similar phrases in section 6501(c)(9) and (e)(1) to be interpreted differently. Therefore, we look to adequate disclosure caselaw decided under section 6501(e)(1) for guidance in determining what documents can be used to prove adequate disclosure under section 6501(c)(9).

This Court has frequently looked beyond a taxpayer's return for purposes of determining adequate disclosure, especially where the return references a separate document. *See Reuter v. Commissioner*, T.C. Memo. 1985-607, 51 T.C.M. (CCH) 99, 102 (discussing *Benderoff v. United States*, 398 F.2d 132 (8th Cir. 1968), *Walker v. Commissioner*, 46 T.C. 630 (1966), *Roschuni v. Commissioner*, 44 T.C. 80 (1965), and *Rose v. Commissioner*, 24 T.C. 755 (1955)). For example, when the taxpayer's individual return references an information return (such as a partnership or S corporation return), we may look to those information returns to determine whether items were adequately disclosed. *See Reuter*, 51 T.C.M. (CCH) at 102. When deciding whether an item has been adequately disclosed, we may consider not only a return, but also documents attached to the return plus informational documents referenced in the return.

[*14] The Offshore Entity Statement provided with the gift tax return must be considered in determining adequate disclosure. It was submitted to the OVDP in a disclosure packet that included the gift tax return. Furthermore, the protective filing attached to the gift tax return referenced controlled foreign company (CFC) stock, which alerted the IRS to look to the Offshore Entity Statement for information on the gift referred to in the gift tax return. We will consider the return and all documents accompanying the return. Therefore, the documents we will consider in determining whether Mr. Schlapfer adequately disclosed the gift are the gift tax return, the protective filing, all relevant Forms 5471, and the Offshore Entity Statement.

B. *Strict vs. Substantial Compliance*

The Commissioner argues that Mr. Schlapfer did not adequately disclose the gift because he failed to strictly satisfy all applicable requirements of Treasury Regulation § 301.6501(c)-1(f)(2). Mr. Schlapfer disagrees, arguing that he strictly, or at least substantially, complied with all applicable requirements of the Treasury regulation.

The Commissioner may insist that taxpayers strictly comply with regulatory requirements, but in certain circumstances we have held that regulatory requirements can be satisfied by substantial compliance. *See, e.g.*, *Am. Air Filter Co. v. Commissioner*, 81 T.C. 709, 719 (1983). The question the Court must ask in determining whether to apply substantial or strict compliance to regulatory requirements is whether the requirements relate "to the substance or essence of the statute." *Bond v. Commissioner*, 100 T.C. 32, 41 (1993) (quoting *Taylor v. Commissioner*, 67 T.C. 1071, 1077 (1977)). If the requirement is essential, then strict adherence to all regulatory requirements is a precondition to satisfying the statute. *Id.* However, if the requirement is "procedural or directory in that [it is] not of the essence of the thing to be done . . . [it] may be fulfilled by substantial . . . compliance." *Id.* (quoting *Taylor*, 67 T.C. at 1077–78). This test requires us to examine section 6501(c)(9) to determine whether the adequate disclosure requirements of Treasury Regulation § 301.6501(c)-1(f)(2) go to the essence of the statute or are merely procedural or directory.

Section 6501(c)(9) provides that the Commissioner may assess a gift tax at any time if a taxpayer fails to report a gift on a gift tax return, unless the gift is otherwise adequately disclosed on the return or a statement attached to it. Its essence is to provide the Commissioner with a viable way to identify gift tax returns that should be examined with

[*15] minimum expenditure of resources. T.D. 8845, 1999-2 C.B. 683, 684. The purpose of the adequate disclosure requirements in the regulation is to provide taxpayers with guidance on what constitutes adequate disclosure for purposes of section 6501(c)(9).

The Department of the Treasury has acknowledged that substantial compliance can satisfy the adequate disclosure requirements. In Treasury Decision 8845, which promulgated Treasury Regulation § 301.6501(c)-1(f), Treasury specifically addressed substantial compliance. It rejected a recommendation that the regulation should expressly allow substantial compliance because of "the difficulty in defining and illustrating what would constitute substantial compliance." T.D. 8845, 1999-2 C.B at 685. It went on to note, however, that its rejection of the suggestion did not mean "that the absence of any particular item or items would necessarily preclude satisfaction of the regulatory requirements, depending on the nature of the item omitted and the overall adequacy of the information provided." *Id.* That statement describes, and accepts, the very essence of substantial compliance. Therefore, we conclude that the adequate disclosure requirements can be satisfied by substantial compliance.[7]

C. *Whether Mr. Schlapfer Strictly or Substantially Complied With the Adequate Disclosure Requirements*

Under Treasury Regulation § 301.6501(c)-1(f)(2), a transfer will be considered adequately disclosed if the taxpayer provides the following information on a gift tax return or statement attached to it: (i) a description of the gift and consideration received for the gift; (ii) the identities of and relationship between the transferor and transferee; (iii) if the gift is transferred in trust, the trust tax identification number and a description of the terms of the trust; (iv) a detailed description of the method used to determine the fair market value of the gift; and (v) a statement describing any position taken that is contrary to Treasury regulations or revenue rulings published at the time of the transfer. Here, we need to decide only whether Mr. Schlapfer strictly or substantially satisfied requirements (i), (ii), and (iv). A taxpayer will be

[7] Generally, "[s]tatutes of limitation sought to be applied to bar rights of the Government, must receive a strict construction in favor of the Government." *Badaracco v. Commissioner*, 464 U.S. 386, 391 (1984) (quoting *E.I. Dupont de Nemours & Co. v. Davis*, 264 U.S. 456, 462 (1924)). However, we have applied the substantial compliance doctrine to situations where we are tasked in determining whether a return was sufficient to commence the running of the statute of limitations. *See, e.g.*, *Gen. Mfg. Corp. v. Commissioner*, 44 T.C. 513, 523–24 (1965).

[*16] deemed to have substantially complied with a requirement if it is procedural and the taxpayer fulfilled all other essential purposes of the requirement. *See Am. Air Filter Co.*, 81 T.C. at 719. Therefore, if Mr. Schlapfer fails to strictly comply with a requirement, we will find that he substantially complied with it if he has fulfilled all essential purposes of the requirement. We will look to the gift tax return, the protective filing, all relevant Forms 5471, and the Offshore Entity Statement to determine compliance.

1. *Description of the Property and Consideration Received*

Assuming the gift is the EMG stock, Mr. Schlapfer has strictly satisfied this requirement. Treasury Regulation § 301.6501(c)-1(f)(2)(i) requires that Mr. Schlapfer's gift tax return, or a statement attached to it, provide a description of the transferred property and any consideration he received.[8] The 2006 Instructions for Form 709 instructed taxpayers to "[d]escribe each gift in enough detail so that the property can be easily identified." 2006 Instructions for Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return, at 8. For stock, the instructions specify that the taxpayer should disclose the number of shares and identify whether they are common or preferred. *Id.* Mr. Schlapfer provided the required information via three attachments: the protective filing, the Offshore Entity Statement, and the 2006 Form 5471. On the protective filing attached to the return, Mr. Schlapfer stated that he made a gift of CFC stock valued at $6,056,686. On the Offshore Entity Statement, he stated that "EMG was established by the Taxpayer in 2003, and was beneficially owned by the Taxpayer until July 6, 2006, at which time the Taxpayer gifted his entire interest in EMG to his mother." Lastly, on the 2006 Form 5471, he disclosed the number of and type of EMG shares. Together, these statements provided the IRS with a description of the property.

However, if the gift is the UVL Policy, Mr. Schlapfer did not strictly satisfy this requirement. He did not provide any information on his gift tax return, or on documents attached to it, that directly referenced or described a transfer of a life insurance policy. But this failure does not preclude him from satisfying adequate disclosure. As previously mentioned, disclosure is adequate if it is sufficiently detailed to alert the Commissioner to the nature of the transaction so that the decision to select a return for audit is reasonably informed. *Thiessen*,

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[8] Mr. Schlapfer transferred his shares of EMG stock for no consideration.

[*17] 146 T.C. at 114. And when finalizing the adequate disclosure regulations, Treasury provided "that the absence of any particular item or items would [not] necessarily preclude satisfaction of the regulatory requirements, depending on the nature of the item omitted and the overall adequacy of the information provided." T.D. 8845, 1999-2 C.B at 685. Thus, these "regulatory requirements" are not actually required. A requirement does not have to be satisfied depending on the importance of the requirement and what information is provided by the taxpayer. Furthermore, the Treasury Regulations provide that "[a] transfer will be adequately disclosed . . . *only if* it is reported in a manner adequate to apprise the [IRS] of the nature of the gift . . . . Transfers reported on the gift tax return as transfers of property by gift *will be* considered adequately disclosed . . . if the return . . . provides the following information." Treas. Reg. § 301.6501(c)-1(f)(2) (emphasis added). The difference between the wording used in these two sentences informs us that the requirements are not mandatory, but act as guidance to taxpayers to inform them on a way to satisfy adequate disclosure. Thus, we must determine whether Mr. Schlapfer's description of the property transferred was sufficient to alert the Commissioner to the nature of the gift.

Mr. Schlapfer provided enough information to satisfy this requirement through substantial compliance. While he may have failed to describe the gift in the correct way (assuming the gift is the UVL Policy), he did provide information to describe the underlying property that was transferred. Mr. Schlapfer asserts that he chose to disclose the assets held in the insurance policy instead of the actual policy because the OVDP required him to disregard entities holding foreign assets. The UVL Policy's value comes primarily from EMG stock, so Mr. Schlapfer's describing the transferred property as EMG stock goes to the nature of the gift. Because this description was sufficient to alert the Commissioner to the nature of the gift, Mr. Schlapfer substantially complied with this requirement.

2. *Identity of the Parties*[9]

Mr. Schlapfer did not strictly satisfy this requirement. Treasury Regulation § 301.6501(c)-1(f)(2)(ii) requires that Mr. Schlapfer provide the identity of, and his relationship to, each transferee. Mr. Schlapfer has stated various times that he transferred property by gift to his

[9] For this requirement, it is immaterial whether the gift is the stock or the life insurance policy; therefore we do not analyze it separately for each gift.

[*18] mother, aunt, and uncle. However, the Offshore Entity Statement states that he "gifted his entire interest in EMG to his mother;" there was no mention of his aunt or uncle. Because his return and documents attached thereto failed to identify his aunt and uncle as transferees, he did not strictly comply with this requirement.

But Mr. Schlapfer substantially complied with this requirement. This requirement was procedural, and a failure to list the identity and relationship of each transferee was not essential to the overall purpose of the requirement, which was to provide the IRS with enough information to understand the nature of the transfer. Mr. Schlapfer's statement on the Offshore Entity Statement listing his mother as the transferee provided the IRS with enough to understand the relationship between Mr. Schlapfer and the transferee, a member of his family. His failure to provide the names of his aunt and uncle does not make a meaningful difference in understanding the nature of the transfer. Therefore, we find that he substantially complied with the requirement when he identified his mother as the transferee.

3. *Description of Method Used to Determine FMV of Gift*

Mr. Schlapfer did not strictly satisfy this requirement. Treasury Regulation § 301.6501(c)-1(f)(2)(iv) requires that Mr. Schlapfer provide a detailed description of the method used to determine the fair market value of property transferred, including any financial data (balance sheets, etc. with explanations of any adjustments). Mr. Schlapfer did not provide any statement describing how he determined the fair market value of the gift, regardless of whether it is the EMG stock or the UVL Policy. Therefore, he failed to strictly satisfy this requirement.

However, Mr. Schlapfer substantially complied with this requirement. Assuming the gift is the EMG stock, Mr. Schlapfer provided enough financial information to apprise the Commissioner of the method used to determine its fair market value. The 2006 instructions for Form 709 explained that the purpose of this requirement is to provide the IRS with information on how the taxpayer determined the gift's fair market value. *See* 2006 Instructions for Form 709, at 8. The instructions also identified documents that could be submitted to satisfy this requirement. *Id.* ("For stock of close corporations or inactive stock, attach balance sheets, particularly the one nearest the date of the gift, and statements of net earnings or operating results and dividends paid for each of the 5 preceding years.").

[*19] Mr. Schlapfer provided all the documents identified in the instructions. His Forms 5471 for 2004, 2005, and 2006 enclosed balance sheets, statements of net earnings, dividends paid, and operating results. Furthermore, his Offshore Entity Statement stated that "[t]axpayer is taking into account all of the income earned by the accounts underlying EMG in the enclosed Amended U.S. Individual Tax Returns during the years he controlled and beneficially owned EMG." Although Mr. Schlapfer did not provide all the financial documentation listed in the regulation, he provided the information identified in the 2006 Form 709 instructions, which was enough to show the IRS how he determined the fair market value of the EMG stock. Therefore, he substantially complied with this requirement.

Furthermore, Mr. Schlapfer substantially complied even if the gift is the UVL Policy. The UVL Policy's principal asset is the EMG stock, and the documents we considered above were enough to apprise the Commissioner of the method used to determine the fair market value of the EMG stock. Because the UVL Policy's value stems primarily from the EMG stock, those same documents can be used to illustrate the method used to determine the fair market value of the UVL Policy. Accordingly, we find that Mr. Schlapfer substantially complied with this requirement.

V. *Conclusion*

Mr. Schlapfer strictly or substantially complied with Treasury Regulation § 301.6501(c)-1(f)(2)(i), (ii), and (iv) by way of his gift tax return, protective filing, Offshore Entity Statement, and Forms 5471. As a result, he adequately disclosed the gift on his 2006 gift tax return, causing the three-year assessment period to commence on November 20, 2013, when he submitted his disclosure package to the OVDP, and end on November 30, 2017 (three years after that date including extensions). Therefore, we conclude that the period of limitations to assess the gift tax expired before the Commissioner issued the notice of deficiency. Accordingly, we will deny the Commissioner's Motion for Summary Judgment and grant Mr. Schlapfer's Cross-Motion for Summary Judgment.

To reflect the foregoing,

An appropriate order and decision will be entered.

United States Tax Court

T.C. Memo. 2023-34

ESTATE OF SCOTT M. HOENSHEID, DECEASED, ANNE M. HOENSHEID, PERSONAL REPRESENTATIVE, AND ANNE M. HOENSHEID,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 18606-19. Filed March 15, 2023.

Steven S. Brown, *William Gibbs Sullivan*, and *Adam M. Ansari*, for petitioners.

Megan E. Heinz, *Alexandra E. Nicholaides*, and *Lauren M. Simasko*, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

NEGA, *Judge*: This case is before the Court on a Petition filed in response to a statutory notice of deficiency issued to petitioners for the tax year 2015. It involves the contribution of appreciated shares of stock in a closely held corporation to a charitable organization that administers donor-advised funds for tax-exempt purposes under section 501(c)(3).[1] The contribution was made near contemporaneously with the

[1] Unless otherwise indicated, all statutory references are to the Internal Revenue Code (Code), Title 26 U.S.C., in effect at all relevant times, all regulation references are to the Code of Federal Regulations, Title 26 (Treas. Reg.), in effect at all relevant times, and all Rule references are to the Tax Court Rules of Practice and Procedure.

[*2] selling of those shares to a third party. After concessions,[2] the issues for decision are (1) whether and when petitioners made a valid contribution of the shares of stock; (2) whether petitioners had unreported capital gain income due to their right to proceeds from the sale of those shares becoming fixed before the gift; (3) whether petitioners are entitled to a charitable contribution deduction; and (4) whether petitioners are liable for an accuracy-related penalty under section 6662(a) with respect to an underpayment of tax.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The Stipulations of Facts and the attached Exhibits are incorporated herein by this reference. Petitioners resided in Michigan when their Petition was timely filed.

I. *Commercial Steel Treating Corp. (CSTC)*

CSTC was founded in 1927 by Ralph Hoensheid (Mr. Hoensheid) and members of the Hoensheid family. CSTC has historically engaged in the business of heat-treating metal fasteners for use in automobiles and other commercial vehicles. Mr. Hoensheid's son, Merle, later established a separate manufacturing facility in order to provide engineered coatings for fasteners, which was incorporated as a subsidiary of CSTC, named Curtis Metal Finishing Co. The ownership of CSTC remained in the family, and as of January 1, 2015, CSTC was owned by Mr. Hoensheid's grandchildren Scott Hoensheid (petitioner) and his two brothers Craig P. Hoensheid and Kurt L. Hoensheid (two brothers) with each holding an equal one-third share of the outstanding stock. As of June 11, 2015, petitioner, his two brothers, Jack R. Howard, and William A. Penner made up the board of directors of CSTC.

II. *Fidelity Charitable*

Fidelity Charitable Gift Fund (Fidelity Charitable) is a tax-exempt charitable organization under section 501(c)(3). Fidelity Charitable is primarily engaged in administering donor-advised funds as a sponsoring organization. Under Fidelity Charitable's donor-advised fund program, donors can establish a giving account with Fidelity Charitable by completing and submitting a donor application

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[2] Respondent has conceded that petitioners are not liable for a penalty under section 6662(a) with respect to the underpayment determined in the notice of deficiency resulting from a disallowed charitable contribution deduction.

[*3] and making an irrevocable cash or noncash asset contribution. After a giving account is established and a contribution made, donors have retained advisory privileges over three things: (1) how to invest the funds, (2) which public charities will receive grants, and (3) the timeline for making grants, subject to some minimum activity requirements. Fidelity Charitable typically requires proof of transfer in the form of a stock certificate and formal acceptance by Fidelity Charitable to complete a contribution of shares of a privately held corporation that issues stock certificates. The general policy of Fidelity Charitable is to liquidate noncash contributed assets as quickly as possible after contribution.

III. *The Transaction & Contribution*

In the fall of 2014 Kurt informed petitioner and Craig of his intention to retire from CSTC. Petitioner and Craig did not want CSTC to incur debt to finance a redemption of Kurt's 33% interest in CSTC, so they instead decided to pursue a potential sale of CSTC.[3] As of December 12, 2014, CSTC had established an amended Change in Control Bonus Plan, which granted certain employees a potential right to bonus compensation in the event of a change in control of CSTC, such as a transfer of more than 80% of CSTC's stock to third parties.

In the end, CSTC chose to engage FINNEA Group as its financial adviser in connection with a sale of CSTC. FINNEA Group is a sell-side investment banking firm. Brian Dragon, senior managing director of FINNEA was the main collaborator for CSTC and petitioner. Both petitioner and Mr. Dragon considered $80 million to be a fair target price for CSTC. Thus, the engagement letter executed by petitioner on behalf of CSTC stated that CSTC would pay FINNEA a fee of 1% of the ultimate transaction's value up to $80 million and 5% of the ultimate transaction's value over $80 million. The engagement letter, however, did not include any mention of appraisal or valuation services in connection with the transaction.

In early 2015 FINNEA began soliciting bids for CSTC and received several letters of intent to purchase the company from interested private equity firms. HCI Equity Partners (HCI), a Washington, D.C. based private equity firm which focuses in part on acquiring companies in the automotive industry, was one of the

[3] Two other brothers, Mark Hoensheid and Ralph Hoensheid, had retired from CSTC in previous years.

[*4] interested parties. On April 1, 2015, HCI submitted a letter of intent to acquire CSTC for total consideration of $92 million.

Meanwhile, in mid-April 2015, petitioner began discussing the prospect of establishing a Fidelity Charitable donor-advised fund to make a presale charitable contribution of some of his CSTC stock with his wealth advisers, Richard Balamucki and Casey Bear, and Andrea Kanski, his longtime tax and estate planning attorney at Clark Hill PLC.

On April 16, 2015, Ms. Kanski emailed John Hensien, a corporate attorney at Clark Hill and CSTC's merger and acquisition partner. In the email, Ms. Kanski mentioned that petitioner was considering donating some of his CSTC stock to charity "to avoid some capital gains" and noted that "the transfer would have to take place before there is a definitive agreement in place." Ms. Kanski also requested that Mr. Hensien inquire as to FINNEA's capability to prepare a qualified appraisal to establish the value of the charitable gift; "since they have the numbers, it would seem to be the most efficient method."

On April 20, 2015, after discussions with representatives of Fidelity Charitable, Mr. Balamucki emailed petitioner and Ms. Kanski to inform them that Fidelity Charitable had brought up a "concept called the 'anticipatory assignment of income' which makes the timing of the gift very important." Mr. Balamucki added that "it must be a completed gift before any purchase agreement is executed or else the IRS can come back and try and impose the capital gains tax on the gift." Fidelity Charitable provided petitioners' wealth advisers with a Letter of Understanding to be executed in advance of the gift. On April 21, 2015, Ms. Kanski responded to Mr. Balamucki and petitioner, stating that "the deadline to assign the stock to a donor advised fund is prior to execution of the definitive purchase agreement" and suggesting that they "gather the forms and documents from Fidelity so we're ready to go and the paperwork is done well before the signing of the definitive purchase agreement." Petitioner responded in an email to Ms. Kanski with the following:

> Anne and I have agreed that we want to put 3.5MM in the fund, but I would rather wait as long as possible to pull the trigger. If we do it and the sale does not go through, I guess my brothers could own more stock than I and I am not sure if it can be reversed. I have not definitively given Richard a number. Please know this and help us plan accordingly.

[*5] On April 23, HCI, CSTC, petitioner, and his two brothers executed a nonbinding letter of intent,[4] establishing the parties' mutual interest in HCI's acquisition of CSTC for total consideration of $107 million. The letter of intent did not include any breakup fee provision to compensate HCI if the transaction was not finalized. After the execution of the letter of intent, HCI began the process of conducting due diligence into CSTC's business and financial operations.

In mid-May counsel for HCI and CSTC began negotiating a contribution and stock purchase agreement based on the terms of the letter of intent. Ms. Kanski was not involved in the drafting process but was provided with copies of each draft and was kept up to date on the progress of the negotiations. On May 21, 2015, Ms. Kanski noted in an email to Messrs. Balamucki and Bear and petitioner: "We now have a draft purchase and sale agreement; do you have the information from Fidelity for my review?" Petitioner responded that he had not yet signed the Letter of Understanding document provided by Fidelity Charitable; Ms. Kanski replied that she "want[ed] to make sure that nothing slips and all of your advisors are on the same page so that there are no issues with the charitable deduction." On May 22, pursuant to 16 C.F.R. § 803.5(b), petitioner executed a notarized Affidavit of Acquired Person on behalf of CSTC, representing that CSTC had "a good faith intention of completing the transaction."

On June 1, Mr. Bear emailed to Kurt Chisholm, a representative of Fidelity Charitable, a Letter of Understanding signed by petitioner which described the planned donation as being of shares of CSTC stock but did not specify the number of shares. The terms and conditions of that Letter of Understanding stated inter alia that (1) "As holder of the Asset, Fidelity Charitable is not and will not be under any obligation to redeem, sell, or otherwise transfer the asset" and (2) "No contribution is complete until formally accepted by Fidelity Charitable." Furthermore on June 1, 2015, petitioner emailed Ms. Kanski requesting that she prepare a shareholder consent agreement allowing him to transfer a portion of his stock to Fidelity Charitable.[5] In the email, petitioner reiterated to Ms. Kanski that "I do not want to transfer the stock until we are 99% sure we are closing."

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[4] The letter of intent was binding on the parties with respect to confidentiality and a 60-day exclusivity period for negotiations.

[5] Petitioner and his two brothers were parties to a Buy-Sell Agreement that restricted their ability to dispose of their shares of CSTC stock.

[*6] On June 11, 2015, CSTC held its annual shareholders meeting, at which petitioner and his two brothers were present and unanimously approved petitioner's request for "ratification of the sale of all outstanding stock of Commercial Steel Treating Corporation to HCI." As part of that approval, petitioner and his two brothers "acknowledge[d] that they have been involved throughout the process, understand and accept all terms associated with the transaction;" the minutes also noted that "a formal Consent Resolution authorizing the recapitalization will be developed as part of the closing documents" and "will be distributed for all Board members [sic] signature." Craig and Kurt also unanimously approved petitioner's request to be able to transfer a portion of his stock to Fidelity Charitable and executed a Consent to Assignment agreement to that effect. The Consent to Assignment agreement had a blank space for the parties to specify the number of shares and stated that the consent governed "only the number of shares identified above." However, that field was left blank and not filled in on June 11, when the parties signed the agreement, nor on June 15, 2015, when petitioner emailed a copy of the signed agreement to Ms. Kanski.[6]

Immediately following the shareholder meeting, CSTC held a board meeting. The directors unanimously approved petitioner's request to be able to transfer a portion of his shares to Fidelity Charitable. The directors also unanimously approved a resolution to dissolve CSTC's Incentive Compensation Plan for executives and to distribute all remaining balances "prior to the recapitalization of the corporation." At some point after the June 11, 2015, board meeting, petitioner had a stock certificate partially prepared for the eventual transfer to Fidelity Charitable. Petitioner kept the incomplete stock certificate on his office desk until July 9 or 10, 2015, when he dropped it off at Ms. Kanski's office.

On June 12, 2015, HCI's Investment Committee and managing partners unanimously approved the acquisition of CSTC, subject to completion of their financial and business due diligence. On June 30, consultants hired by HCI completed and delivered a due diligence report

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[6] During the examination of petitioners' 2015 return, Ms. Kanski produced to the examining revenue agent a copy of the Consent to Assignment agreement, with a number of "1380" shares hand-written onto the blank line. At trial petitioner confirmed his handwriting inserting the number of shares and testified that he had prepared and signed the agreement on June 11, 2015, before his two brothers signed it.

[*7] addressing potential environmental liability issues arising out of CSTC's existing facilities.

Negotiations between CSTC and HCI began to gather steam. On July 1, HCI's counsel prepared a revised draft of the Contribution and Stock Purchase Agreement. This draft, dated July 1, 2015, included a new, partially blank recital (share contribution provision) stating in relevant part: "On June 2015, Scott M. Hoenshied [sic] transferred . . . shares of Common Stock to . . . ." Furthermore, on July 1, HCI prepared and circulated the initial draft of the Minority Stock Purchase Agreement for a purchase of shares from Fidelity Charitable. The draft Minority Stock Purchase Agreement included a clause appointing petitioner as seller's representative with authority to, inter alia, (1) accept delivery of, on behalf of the Seller [Fidelity Charitable], all such documents as may be deemed . . . to be appropriate to consummate this Agreement;" and (2) "to endorse and to deliver on behalf of the Seller [Fidelity Charitable], certificates representing the Shares." Counsel for CSTC forwarded the draft to petitioner with this message: "Attached is the initial draft of the purchase agreement for the shares you have/intend to gift."

On July 6, 2015, HCI caused the organization of a Delaware corporation, CSTC Holdings, Inc., for the purpose of acquiring shares of CSTC. That same day petitioner emailed Messrs. Bear, Balamucki, and Hensien and Ms. Kanski, circulating the draft Minority Stock Purchase Agreement and stating inter alia: "We are not totally sure of the shares being transferred to the charitable fund yet" and "[h]opefully, and based on the closing documents, we will have a much better handle on this come Wednesday or Thursday of this week." Petitioner added: "Once we know the share values, I am confident Andrea will execute the stock assignment as required." The next day, July 7, petitioner emailed Mr. Bear to inform him that CSTC would "sweep the cash from the company prior to closing and distribute it to the brothers." That same day, Mr. Bear emailed Mr. Chisholm and Ryan Boland, Fidelity Charitable' s vice president for national corporate and executive giving. In the email Mr. Bear noted that he was "concerned" with the clause in the Minority Stock Purchase Agreement appointing petitioner as seller's representative for Fidelity Charitable; Mr. Bear suggested that the clause instead appoint one of CSTC's corporate attorneys as seller's representative. Also on July 7, petitioner executed an amendment to CSTC's Change in Control Bonus Plan, specifying that the impending sale to HCI would constitute a change in control and thus trigger bonus payments to key employees.

[*8] On July 9, 2015, CSTC prepared a revised draft of the Contribution and Stock Purchase Agreement. In this revised draft, counsel for CSTC had partially filled in the recital relating to the gift transfer to read in relevant part: "On July . . . 2015, [petitioner] transferred 1,380 shares of Common Stock to The Fidelity Investments Charitable Gift Fund." Furthermore, the revised draft added that one of the conditions precedent to the obligations of the buyer was that "[t]he Fidelity Investments Charitable Gift Fund shall have executed and delivered to HCI and the Buyer the Minority Stock Purchase Agreement."[7]

In a reply to Mr. Bear's email the same day, Mr. Boland agreed that "[o]ne of the corporate attorneys would be a much better fit, from our perspective." Later that same day, Mr. Bear informed Mr. Boland in an email that "it looks like Scott has arrived at 1380 shares—which will come out to about $3,000,000" and that Mr. Bear would "have the stock certificate shortly." Petitioner in a subsequent email to Messrs. Bear and Balamucki noted that "Andrea is completing the Stock transfer of 1380 shares to the Charitable account" and requested his account number from Fidelity Charitable. Mr. Bear then forwarded the email to Messrs. Boland and Chisholm and requested the account number. Mr. Chisholm replied to Mr. Bear the following morning, Friday, July 10, noting that "it appears as though Scott does not yet have a Giving Account created with us" and providing a link to the account setup process on Fidelity Charitable's website. Later that day, petitioner set up an online giving account with Fidelity Charitable.

Additionally, on July 10, 2015, HCI prepared a revised draft of the Contribution and Stock Purchase Agreement. Nevertheless, the share contribution provision was still missing a specific date when petitioner transferred the shares to Fidelity Charitable. However, this draft update did propose to resolve the environmental liability issue by including a provision by which the sellers would indemnify HCI and CSTC Holdings for any damages arising out of matters or liabilities identified in the environmental due diligence report.[8] The

[7] The July 9, 2015, draft also proposed to resolve issues relating to the postclosing bonus and equity participation plans of CSTC and the postclosing treatment of any excess real property.

[8] The draft also accepted CSTC's proposed addition of provisions addressing the postclosing bonus and equity participation plans and the postclosing treatment of excess real property, with minor changes.

[*9] environmental indemnification provision was the primary substantive addition made in the July 10 draft.

Three significant actions were taken on July 10. First, CSTC paid out employee bonuses totaling $6,102,862 pursuant to its newly amended Change in Control Bonus Plan. Second, CSTC submitted to the Michigan Department of Licensing and Regulatory Affairs an amendment to its Articles of Incorporation, signed by petitioner, which provided for actions requiring a shareholder meeting and vote to be taken upon written consent of the shareholders—a change requested by HCI. Third, Ms. Kanski forwarded to Mr. Bear the updated draft of the Minority Stock Purchase Agreement dated July 15 and asked Mr. Bear to forward it to Fidelity Charitable for signature; the next morning (Saturday, July 11), Mr. Bear forwarded the email from Fidelity Charitable to Messrs. Boland and Chisholm. In Ms. Kanski's initial email to Mr. Bear, Ms. Kanski noted that "the closing has been pushed back to Tuesday, at the earliest." Ms. Kanski also noted that "the definition of seller's representative will be revised from Scott to Clark Hill." The draft Minority Stock Purchase Agreement was dated July 13 and included a warranty that Fidelity Charitable "is the record and beneficial owner of and has good and valid title to the Shares, free and clear of any and all Liens."

At 4:38 a.m. on July 13, 2015, the Contribution and Stock Purchase Agreement underwent a redline comparison against the prior revised updated draft on behalf of HCI. This revised draft had already accepted the environmental liability provision into the text. The share contribution provision still did not specify the date on which petitioner transferred the shares to Fidelity Charitable. Later that morning, at 7:56 a.m., Mr. Bear once more emailed Mr. Boland to request signatures from Fidelity Charitable on the Minority Stock Purchase Agreement, as the parties were "hoping to close . . . the next day." At 9:08 a.m., Mr. Boland responded: "It is important that we receive the stock certificate before we reach a conclusion on the sale/redemption. Did the stock certificate go out yet?" At 9:13 a.m., Mr. Bear swiftly alerted Ms. Kanski to the problem, informing her that "Fidelity will not sign off on anything until they see the stock certificate. As far as they know, they don't have any shares to sell." At Mr. Bear's request, Ms. Kanski emailed him a PDF stock certificate, which Mr. Bear forwarded by email to Mr. Boland at 9:30 a.m. The stock certificate was numbered 1670, was signed by

[*10] petitioner but undated, and stated that 1,380.40 shares of CSTC common stock were owned by Fidelity Charitable.[9]

At 1:21 p.m., counsel for HCI emailed counsel for CSTC, noting that "I know CSTC will be issuing a certificate to the Gift Fund" and asking whether "the transfer to the gift fund has occurred yet." At 3:24 p.m., counsel for CSTC responded that "[y]es, the transfer to the Gift Fund has occurred" and attached a printout spreadsheet that purported to list CSTC shareholders, numbers of shares held, and dates of issuance. The relevant page of the printout was dated July 13, 2015, and displayed a disposition entry for certificate No. 1654 with a date of "7/10/2015" and a note stating: "Cancelled: Scott transferred 1,380.50 Fidelity Investments."[10] The printout also displayed an issuance entry for certificate No. 1670 stating that 1,380 shares had been issued to Fidelity Charitable. At 5:22 p.m., Mr. Boland emailed Mr. Bear with an attached signature page, signed by Mr. Boland on behalf of Fidelity Charitable, for the Minority Stock Purchase Agreement. At 6:43 p.m., counsel for CSTC forwarded signature pages for a number of transaction-related documents, including the written consents by the board of CSTC, to petitioner and his two brothers requesting their signatures.

Early on the morning of July 14, Mr. Bear forwarded the signature pages from Fidelity Charitable to Ms. Kanski, who forwarded them to CSTC's counsel. Later that day, counsel for CSTC circulated a revised draft of the Contribution and Stock Purchase Agreement, which filled in the share contribution provision to specify that petitioner had transferred the shares on July 10, 2015. The final draft made minimal changes to the prior circulated drafts.[11] Additionally, on July 14, CSTC made a pro rata distribution, characterized as a dividend, of $4,796,352 to petitioner and his two brothers; Fidelity Charitable did not

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[9] During the examination of petitioners' 2015 return, Ms. Kanski produced a copy of a stock certificate stamped "cancelled," which she received from petitioner that included an additional typewritten date field of June 11, 2015.

[10] The fractional amount of .50 appears to have been a clerical error.

[11] The primary change was a slight revision to a provision for payment of compensation to the retired brothers Mark and Kurt Hoensheid to cover the cost of their health insurance, specifying that compensation would terminate upon either (1) the retirees' becoming eligible for Medicare or (2) a defined liquidity event's occurring.

[*11] participate in the distribution. The distribution represented nearly all of the remaining cash within CSTC.

On July 15, HCI, CSTC Holdings, petitioner, and his two brothers executed signatures on a final Contribution and Stock Purchase Agreement, which was approved by CSTC's shareholders and board that same day. The final agreement included the share contribution provision, which specified that petitioner had transferred 1,380 shares to Fidelity Charitable on "July 10, 2015." The final agreement provided for petitioner and his two brothers to exchange shares in CSTC for shares in the new CSTC Holdings, in an amount sufficient to constitute 51% ownership of CSTC Holdings. HCI agreed to contribute cash to CSTC Holdings in exchange for shares in a number sufficient to constitute 49% ownership of the common stock of CSTC Holdings.[12] CSTC Holdings then agreed to purchase the remainder of the outstanding shares of CSTC owned by petitioner and his two brothers, as well as the 1,380 shares owned by Fidelity Charitable. On July 15, a representative from Clark Hill signed on behalf of Fidelity Charitable a document titled "Irrevocable Stock Power." The document represented that Fidelity Charitable "does hereby sell, assign and transfer" the 1,380 shares to CSTC Holdings. The document also stated that Fidelity Charitable "does hereby irrevocably constitute and appoint (blank space) as attorney to transfer the said stock on the books of the Corporation with full power of substitution in the premises." Fidelity Charitable received $2,941,966 in cash proceeds from the sale, which was deposited into petitioners' giving account.

At closing, petitioners received $21,330,818 in cash, 50,000 shares of CSTC Holdings common stock, and a subordinated promissory note of $5 million. In October 2015 petitioner and his two brothers received a postclosing distribution of excess working capital from CSTC totaling $1,093,878. Additionally, in August, October, and November 2016, petitioner and his two brothers received another distribution relating to CSTC's 2015 tax refunds.

IV. *The Contribution Confirmation Letter, Tax Return, & Appraisal*

On November 18, 2015, Fidelity Charitable sent petitioners a contribution confirmation letter acknowledging a charitable

[12] The agreement also provided for HCI to receive shares of nonvoting convertible preferred stock in CSTC Holdings and a subordinated promissory note for $2 million.

[*12] contribution from them of 1,380.400 shares of CSTC stock.[13] The letter indicated, inter alia, that Fidelity Charitable received the shares of CSTC stock on June 11, 2015, and stated that "Fidelity Charitable has exclusive legal control over the contributed asset, and this contribution is irrevocable and cannot be refunded." The letter further stated that "Fidelity Charitable did not provide any goods or services in exchange for or in consideration of this contribution." Fidelity Charitable also provided petitioners with a yearend account statement, which reported a received date of June 11, 2015, for the shares of CSTC stock and stated that "[a]ny error must be reported to Fidelity Charitable within 60 days."

On November 30, 2015, petitioner emailed Ms. Kanski, asking: "What date did we donate the stock to Fidelity Charitable?" He stated that "FINNEA is playing dumb toward providing the appraisal and I have asked Plante Moran." Several minutes later, petitioner sent a subsequent email to Ms. Kanski: "I think I found it: 6/11/15," and copying text that appeared to be from Fidelity Charitable's documentation. On December 18, Ms. Kanski emailed petitioner to inform him that she had asked Mr. Hensien of Clark Hill "to light a fire under FINNEA regarding the appraisal."

Ms. Kanski supervised the preparation of petitioners' 2015 federal income tax return and signed the return as the preparer. The return was timely filed with the Internal Revenue Service (IRS) on April 14, 2016. Petitioners did not report any capital gains associated with the sale of the 1,380 shares and claimed a noncash charitable contribution deduction of $3,282,511.

Petitioners attached to their return a Form 8283, Noncash Charitable Contributions, reporting a contribution of $3,282,511 relating to the 1,380 shares of CSTC stock and a date of contribution of June 11, 2015. The declaration of appraiser section on the Form 8283

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[13] On July 15, 2015, Fidelity Charitable apparently sent petitioners an initial contribution confirmation letter for the receipt of the shares of CSTC stock. By unsigned letter dated November 18, 2015, Fidelity Charitable informed petitioners that "[d]ue to an error made by one of our contribution representatives, a contribution confirmation dated July 15, 2015 was mailed to you noting the incorrect party for tax deduction purposes." That letter further stated that "[t]his error has now been corrected," that "a new confirmation letter has been mailed," and that petitioners "must disregard the contribution confirmation letter that was previously sent to you, dated July 15, 2015." Petitioners did not produce a copy of the initial, apparently erroneous, contribution confirmation letter.

[*13] was signed by Brian Dragon as appraiser, and the donee acknowledgment section was signed by a representative of Fidelity Charitable. Attached to the Form 8283 was a document entitled "CSTC Fidelity Gift Fund Valuation," which purported to be a qualified appraisal that Mr. Dragon prepared with respect to the "CSTC Fidelity Gift Fund." According to the appraisal, Mr. Dragon determined that the 1,380 shares of CSTC stock had a value of $3,282,511 as of June 11, 2015, which was $340,545 higher than the actual proceeds Fidelity Charitable received from the sale of those shares to HCI on July 15, 2015. The appraisal included a brief biography of Mr. Dragon (which did not address whether Mr. Dragon had appraisal experience or qualifications), a valuation summary, the Forms 8283 and 8282, Donee Information Return, and a number of transactional documents relating to the acquisition by HCI. The appraisal attached a final version of the Minority Stock Purchase Agreement, which included an amended clause appointing Clark Hill as seller's representative.

The valuation summary page included three columns with different valuation scenarios. Each valuation started with an enterprise value of $105 million (the total consideration per the Contribution and Stock Purchase Agreement) and then made various adjustments. The first scenario added to the value the amount of capital expenditure reimbursement and subtracted the amount of transaction fees (both of which were accounted for in the transaction with HCI) to arrive at a value of $103,118,311 and thus a proportional value of $2,941,966 (i.e., the actual amount of proceeds received by Fidelity Charitable). The second scenario also added to the value the amount of additional postclosing payments received by petitioner and his two brothers (but not Fidelity Charitable), which related to excess working capital and CSTC's tax refunds, and subtracted minor adjustments, to arrive at a value of $105,697,329 and thus a proportional value of $3,015,546. Finally, the third scenario also added to the value $9,357,335 of "Cash & Equivalents," to arrive at a value of $115,054,664 and thus a proportional value of $3,282,511 (i.e., the claimed appraisal value).

The appraisal report valued the CSTC stock as of June 11 but did not expressly disclose a date of contribution for the shares. The appraisal included a page that listed a number of traditional valuation approaches and quoted from a section of Rev. Rul. 59-60, 1959-1 C.B. 237, that discusses valuation of securities. On the following page the appraisal stated that FINNEA "elected not to contemplate the aforementioned traditional valuation methods in favor of the empirical valuation resulting from its thorough marketing efforts below." In the

[*14] space below, the appraisal contained the scope of services for which FINNEA had been engaged, copied from the text of its letter of engagement with CSTC. The appraisal did not further explain the empirical method used in the appraisal. Neither did it include a statement that it was prepared for federal income tax purposes.

Mr. Dragon had previously performed valuations on a limited basis, including one estate tax valuation, but had not previously prepared an appraisal substantiating a charitable contribution of shares in a closely held corporation. Mr. Dragon did not charge an additional fee for the appraisal in addition to what he and FINNEA had already received as fees in the transaction with HCI; nor did Mr. Dragon and petitioners execute a separate engagement letter for him to perform the appraisal. While petitioners received a quote from a national accounting firm, Plante Moran, to complete an appraisal, they ultimately decided to have Mr. Dragon prepare the report instead.

A Form 8282 was prepared for petitioners. Signed by a representative of Fidelity Charitable, it reported the receipt of petitioners' entire interest in 1,380.400 shares of CSTC stock on June 11, 2015. A representative of Fidelity Charitable later signed an amended Form 8282, which reflected the receipt of 1,380 shares of CSTC stock from petitioners, rather than 1,380.400.

V. *The Examination & Notice of Deficiency*

By letter dated December 19, 2017, petitioners were informed that the Commissioner had selected their 2015 return for examination. Ms. Kanski represented petitioners during the examination. On December 6, 2018, John Copenhagen, an IRS group manager, electronically signed a Civil Penalty Approval Form approving the assessment of a penalty under section 6662 against petitioners. By letter dated December 6, 2018, respondent proposed to disallow in full petitioners' charitable contribution deduction and to assess a penalty under section 6662.

On October 9, 2019, respondent issued to petitioners a notice of deficiency, determining a deficiency of $647,489, resulting from the disallowance of the claimed charitable contribution deduction, and a penalty of $129,498 under section 6662(a).

Petitioner's timely Petition was filed on October 15, 2019. On December 16, 2019, respondent filed an Answer. Respondent's counsel received approval to request assessment of an additional penalty under

[*15] section 6662(a) on February 19, 2020, in an email from, her immediate supervisor at the IRS Office of Chief Counsel. On August 25, 2020, respondent filed an amended Answer, asserting an increased deficiency and an increased section 6662(a) penalty, due to application of the anticipatory assignment of income doctrine.

OPINION

In general, the Commissioner's determinations in a notice of deficiency are presumed correct, and the taxpayer bears the burden of proving that those determinations are erroneous. Rule 142(a)(1); *Welch v. Helvering*, 290 U.S. 111, 115 (1933); *Kearns v. Commissioner*, 979 F.2d 1176, 1178 (6th Cir. 1992), *aff'g* T.C. Memo. 1991-320. Moreover, deductions are a matter of legislative grace, and taxpayers must demonstrate their entitlement to the deductions claimed. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992). However, the Commissioner bears the burden of proof with respect to new matters or increases in deficiency pleaded in his answer. Rule 142(a)(1). In his amended Answer, respondent first asserted an increase in deficiency on the grounds that petitioners made an anticipatory assignment of income of their proceeds from the sale of CSTC shares to HCI. Consequently, the burden is on petitioners only with respect to (1) whether they made a valid gift of shares to Fidelity Charitable and (2) whether they are entitled to a charitable contribution deduction. Respondent bears the burden with respect to whether petitioners realized and recognized gains pursuant to the anticipatory assignment of income doctrine.

The burden of proof on factual issues may be shifted to the Commissioner if the taxpayer introduces "credible evidence" with respect thereto and satisfies recordkeeping and other requirements. *See* § 7491(a)(1) and (2). Petitioners have not sought to shift the burden with respect to any factual issue.

Gross income means "all income from whatever source derived," including "[g]ains derived from dealings in property." § 61(a)(3). In general, a taxpayer must realize and recognize gains on a sale or other disposition of appreciated property. *See* § 1001(a)–(c). However, a taxpayer typically does not recognize gain when disposing of appreciated property via gift or charitable contribution. *See Taft v. Bowers*, 278 U.S. 470, 482 (1929); *Guest v. Commissioner*, 77 T.C. 9, 21 (1981); *see also* § 1015(a) (providing for carryover basis of gifts). A taxpayer may also generally deduct the fair market value of property contributed to a qualified charitable organization. *See* § 170(a)(1); Treas. Reg.

[*16] § 1.170A-1(c)(1). Contributions of appreciated property are thus tax advantaged compared to cash contributions; when a contribution of property is structured properly, a taxpayer can both avoid paying tax on the unrealized appreciation in the property and deduct the property's fair market value. *See, e.g.*, *Dickinson v. Commissioner*, T.C. Memo. 2020-128, at *5. The use of a donor-advised fund further optimizes a contribution by allowing a donor "to get an immediate tax deduction but defer the actual donation of the funds to individual charities until later." *Fairbairn v. Fid. Invs. Charitable Gift Fund*, No. 18-cv-04881, 2021 WL 754534, at *2 (N.D. Cal. Feb. 26, 2021).

We apply a two-part test when determining whether to respect the form of a charitable contribution of appreciated property followed by a sale by the donee. The donor must (1) give the appreciated property away absolutely and divest of title (2) "before the property gives rise to income by way of a sale." *Humacid Co. v. Commissioner*, 42 T.C. 894, 913 (1964). The first prong incorporates the section 170(c) requirement that the taxpayer make a valid gift[14] of property, *see Jones v. Commissioner*, 129 T.C. 146, 150 (2007), *aff'd*, 560 F.3d 1196 (10th Cir. 2009), while the second prong incorporates the anticipatory assignment of income doctrine, *see Dickinson*, T.C. Memo. 2020-128, at *8. Accordingly, we first must determine whether petitioners made a valid gift of the CSTC shares to Fidelity Charitable and, if so, on what date the gift was made. We must then determine the tax consequences, including eligibility for a charitable contribution deduction, of any gift by petitioners.

I. *Valid Gift of Shares of Stock*

"Ordinarily, a contribution is made at the time delivery is effected." Treas. Reg. § 1.170A-1(b). The regulations further provide that "[i]f a taxpayer unconditionally delivers or mails a properly endorsed stock certificate to a charitable donee or the donee's agent, the gift is completed on the date of delivery."[15] *Id.* However, the regulations do not define what constitutes delivery. *See, e.g.*, *Dyer v. Commissioner*,

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[14] We use the term "gift" synonymously here with the term "charitable contribution." *See Seed v. Commissioner*, 57 T.C. 265, 275 (1971).

[15] The regulations alternatively provide, in relevant part, that "[i]f the donor delivers the stock certificate to his bank or broker as the donor's agent, or to the issuing corporation or its agent, for transfer into the name of the donee, the gift is completed on the date the stock is transferred on the books of the corporation." Treas. Reg. § 1.170A-1(b).

[*17] T.C. Memo. 1990-51, 58 T.C.M. (CCH) 1321, 1323; *Brotzler v. Commissioner*, T.C. Memo. 1982-615, 44 T.C.M. (CCH) 1478, 1480; *Alioto v. Commissioner*, T.C. Memo. 1980-360, 40 T.C.M. (CCH) 1147, 1154, *aff'd*, 692 F.2d 762 (9th Cir. 1982). Accordingly, we must first look to state law for the threshold determination of whether petitioners divested themselves of their property rights via gift.[16] *See United States v. Nat'l Bank of Com.*, 472 U.S. 713, 722 (1985) (concluding that state law determines property rights and federal law classifies them for appropriate tax treatment); *Jones*, 129 T.C. at 150 ("In order to make a valid gift for Federal tax purposes, a transfer must at least effect a valid gift under the applicable State law."); *Greer v. Commissioner*, 70 T.C. 294, 304 (1978) (applying state gift law requirements to charitable contribution of property), *aff'd on another issue*, 634 F.2d 1044 (6th Cir. 1980); *Kissling v. Commissioner*, T.C. Memo. 2020-153, at *22 ("Whether delivery is effected is a question of state law."). In doing so, we apply state law in the manner in which the highest court of the state has indicated that it would apply the law. *See Commissioner v. Estate of Bosch*, 387 U.S. 456, 465 (1967). Where the state's highest court is silent, we must discern and apply the state law, giving "proper regard" to the state's lower courts. *See Julia R. Swords Tr. v. Commissioner*, 142 T.C. 317, 342 (2014) (quoting *Commissioner v. Estate of Bosch*, 387 U.S. at 465).

As to the choice of state law, both parties focused their state law briefing on Michigan law, and we cannot discern a choice of law principle that would suggest the parties' understanding is incorrect. Accordingly, we apply the law of the state of petitioners' domicile, Michigan, with respect to whether and when petitioners made a valid gift of the CSTC shares. *See Macatawa Bank v. Wipperfurth*, 822 N.W.2d 237, 238 (Mich. Ct. App. 2011) ("The longstanding rule in Michigan is that 'the situs of intangible assets is the domicile of the owner unless fixed by some positive law.'" (quoting *Brown v. O'Donnell* (*In re Rapoport's Est.*), 26 N.W.2d 777, 781 (Mich. 1947))); *see also Malkan v. Commissioner*, 54

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[16] This Court has at times applied its own longstanding test for a valid inter vivos gift. *See Guest*, 77 T.C. at 16 (quoting *Weil v. Commissioner*, 31 B.T.A. 899, 906 (1934), *aff'd*, 82 F.2d 561 (5th Cir. 1936)). This test, while more extensive on its face than what is required under Michigan law, shares the same core elements: "donative intent, delivery by the donor and acceptance by the donee." *Goldstein v. Commissioner*, 89 T.C. 535, 542 (1987) (distilling the *Weil* test); *see Estate of Sommers v. Commissioner*, T.C. Memo. 2013-8, at *43 n.20 (analyzing validity of gift under principles consistent with both federal and state law); *Estate of Dubois v. Commissioner*, T.C. Memo. 1994-210, 1994 WL 184393, at *2 (reaching conclusion that no valid gift was made under both federal and state law).

[*18] T.C. 1305, 1314 n.3 (1970) (applying law of the situs to determine validity of gift of shares of stock).

In determining the validity of a gift, Michigan law requires a showing of (1) donor intent to make a gift; (2) actual or constructive delivery of the subject matter of the gift; and (3) donee acceptance.[17] *See Davidson v. Bugbee*, 575 N.W.2d 574, 576 (Mich. Ct. App. 1997) (citing *Molenda v. Simonson*, 11 N.W.2d 835, 836 (Mich. 1943)); *see also United States v. Four Hundred Seventy Seven (477) Firearms*, 698 F. Supp. 2d 894, 902 (E.D. Mich. 2010) (applying Michigan law).

Petitioners and respondent each advance different dates for when petitioners made a gift to Fidelity Charitable of the CSTC shares. Petitioners argue that a gift was made on June 11, 2015, and they point to petitioner's testimony and Fidelity Charitable's corrected contribution confirmation letter, which both claim June 11 as the date of the gift. Respondent argues that a valid gift was not made until at least July 13, 2015, when Fidelity Charitable first received a stock certificate from petitioners' representatives.[18] We will examine each of three required elements for a valid gift in turn.

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[17] Petitioners alternatively direct us to Article 8 of the Uniform Commercial Code (UCC), as adopted by Michigan, which on its face is applicable to gift transfers of certificated securities. *See* Mich. Comp. Laws § 440.1201(2)(cc) (2015) ("'Purchase' means taking by sale, lease, discount, negotiation, mortgage, pledge, lien, security interest, issue or reissue, *gift*, or any other voluntary transaction creating an interest in property." (Emphasis added.)); *id.* (dd); *id.* § 440.8301(1)(a) and (b) (delivery of certificated security occurs when purchaser or third party acting on their behalf "acquires possession of the security certificate"). While the Michigan Supreme Court does not appear to have expressly addressed the issue, we do not read the UCC provisions as disturbing the longstanding Michigan common law test. *See id.* § 440.8302 cmt. 2 ("Article 8 does not determine whether a property interest in certificated or uncertificated security is acquired under other law, such as the law of gifts, trusts, or equitable remedies."); *id.* § 440.1103(2) (stating that "principles of law and equity" supplement UCC provisions); *see also Young v. Young*, 393 S.E.2d 398, 401 (Va. 1990) ("The common law requirements of delivery and acceptance are not removed by those provisions of the [UCC] pertaining to the transfer of securities.").

[18] Respondent raises a separate issue with regard to the dividend paid out by CSTC on July 14 to petitioner and the two brothers, but not paid to Fidelity Charitable, speculating that petitioners did not make a valid gift of the shares. Respondent's contention appears to be foreclosed by Michigan law, which provides that retention of a dividend does not preclude a valid gift of the underlying shares. *See Cook v. Fraser*, 299 N.W. 113, 114 (Mich. 1941) (citing *Ford v. Ford*, 259 N.W. 138 (Mich. 1935)); *In re Estate of Prinstein*, No. 252682, 2005 WL 1459575, at *1 (Mich. Ct. App. June 21, 2005) ("[T]he fact that a donor collects dividends on a security does not make an inter-vivos gift of that security invalid.").

[*19] A. *Present Intent*

The determination of a party's subjective intent at some historical point is necessarily a highly fact-bound issue. When deciding such an issue, we must determine "whether a witness's testimony is credible based on objective facts, the reasonableness of the testimony, the consistency of statements made by the witness, and the demeanor of the witness." *Ebert v. Commissioner*, T.C. Memo. 2015-5, at *5–6*; see also Estate of Kluener v. Commissioner*, 154 F.3d 630, 636 (6th Cir. 1998), *aff'g in relevant part* T.C. Memo. 1996-519. If contradicted by the objective facts in the record, we will not "accept the self-serving testimony of [the taxpayer] . . . as gospel." *Tokarski v. Commissioner*, 87 T.C. 74, 77 (1986); *see Davis v. Commissioner*, 88 T.C. 122, 143 (1987), *aff'd*, 866 F.2d 852 (6th Cir. 1989).

We start with petitioner's contemporaneous emails and the contemporaneous transactional documents, which we consider to be especially probative evidence with respect to his intent. On June 1, petitioner first expressed in an email that he wanted to wait to make the gift of the shares to Fidelity Charitable until the last possible moment, when he was "99% sure" that the sale to HCI would close. Petitioner's subsequent actions and communications were consistent with that intent. On June 11, petitioner and his two brothers executed the Consent to Assignment agreement, an act that demonstrated petitioner's generalized future intent to make a gift. However, the Consent to Assignment cannot establish that, as of June 11, such an intent was sufficiently present and specific. *See Czarski v. Bonk*, 124 F.3d 197, 1997 WL 535773, at *4 (6th Cir. 1997) (unpublished table decision) (applying Michigan law and finding no evidence establishing purported donor's "specific intent" with respect to the particular property). On its face, the Consent to Assignment agreement failed to specify a number of shares to be contributed, suggesting that petitioner had not yet decided that key detail. Similarly, the original stock certificate, which was prepared on or sometime after June 11, failed to specify an effective date, again suggesting that a date would be decided upon later.[19] On July 6, petitioner stated in an email that he was still

[19] We note that copies of the Consent to Assignment agreement and stock certificate that were produced to the Commissioner during the examination appear to have been modified and backdated to specify, respectively, a number of shares and an effective date that were not originally present at the time of the transaction. We find such inconsistencies to be significant in evaluating petitioners' claim that the gift was made on June 11. *Cf. Ferguson v. Commissioner*, 174 F.3d 997, 1000 (9th Cir. 1999)

[*20] "not totally sure of the shares being transferred to the charitable fund yet." That email confirms that, as of July 6, the details of the contribution were still in flux. Indeed, three days later, on July 9, Mr. Bear emailed Mr. Boland to inform him that "it looks like Scott has arrived at 1380 shares."

At trial, petitioner testified that he believed the number of shares to be donated was set at 1,380 on June 11. That testimony is squarely contradicted by the Consent to Assignment agreement, petitioner's July 6 email, and Mr. Bear's July 9 email. *See, e.g.*, *Richardson v. Commissioner*, T.C. Memo. 1984-595, 49 T.C.M. (CCH) 67, 73–74 (concluding that taxpayer's characterization of date of contribution was not credible where in conflict with "documents written contemporaneously with the donation"). Petitioner also testified that his July 6 email was referring to a potential donation of a second tranche of shares, a theoretical event which apparently never took place. The record contains no evidence supporting the claim that petitioners attempted to make (or even contemplated) two separate gifts of CSTC shares. We find petitioner's self-serving testimony as to his intent to be incredible.

The record does not support a finding of present intent to make a gift until July 9 when petitioner settled on a number of 1,380 shares. From that point on, petitioner took a number of actions that confirmed his present intent to transfer. On July 9 or 10 petitioner delivered the physical stock certificate to Ms. Kanski's office. Similarly, on July 10 petitioner created an online giving account with Fidelity Charitable. Taken together, these actions provide sufficient credible evidence of petitioner's intent. We conclude that, as of July 9, petitioner had present intent to make a gift.

B. *Delivery*

At bottom, the delivery requirement generally contemplates an "open and visible change of possession" of the donated property. *Shepard v. Shepard*, 129 N.W. 201, 208 (Mich. 1910); *Davis v. Zimmerman*, 40 Mich. 24, 27 (1879). As the term itself suggests, manually providing tangible property to the donee is the classic form of delivery. *See, e.g.*, Restatement (Second) of Property § 31.1 cmt. b (Am. L. Inst. 1992) (describing the "simplest" form of delivery as the donor's

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(questioning purported date of contribution where "the original handwritten date in a printed box entitled 'date of donation' . . . had been completely scratched out" and a new date written next to it), *aff'g* 108 T.C. 244 (1997).

[*21] "plac[ing] the subject matter of the gift in the hands of the intended donee"). Similarly, manually providing to the donee a stock certificate that represents intangible shares of stock is traditionally sufficient delivery. *See* Philip Mechem, *Gifts of Corporation Shares*, 20 Ill. L. Rev. 9, 15–16 (1925–1926) (collecting cases). However, the determination of what constitutes delivery is inherently context-specific and depends upon the "nature of the subject-matter of the gift" and the "situation and circumstances of the parties." *Shepard*, 129 N.W. at 208 ("[N]o absolute rule can be laid down as to what will constitute a sufficient delivery . . . .").

Delivery need not necessarily be actual. Constructive delivery may be effected where property is delivered into the possession of another on behalf of the donee. *See, e.g.*, *In re Van Wormer's Estate*, 238 N.W. 210, 212 (Mich. 1931) (finding constructive delivery where stock certificate was issued in the name of donee and deposited at bank). Whether constructive or actual, delivery "must be unconditional and must place the property within the dominion and control of the donee" and "beyond the power of recall by the donor." *In re Casey Estate*, 856 N.W.2d 556, 563 (Mich. Ct. App. 2014) (citing *Osius v. Dingell*, 134 N.W.2d 657, 659 (Mich. 1965)); *see Geisel v. Burg*, 276 N.W. 904, 908 (Mich. 1937) (finding no valid gift where certificates of deposit were never placed beyond donor's control). If constructive or actual delivery of the gift property occurs, its later retention by the donor is not sufficient to defeat the gift. *See Estate of Morris v. Morris*, No. 336304, 2018 WL 2024582, at *5 (Mich. Ct. App. May 1, 2018) (citing *Jackman v. Jackman*, 260 N.W. 769, 770 (Mich. 1935)); *see also Garrison v. Union Tr. Co.*, 129 N.W. 691, 692 (Mich. 1911).

With respect to delivery, neither Mr. Hoensheid nor Ms. Kanski was able to credibly identify a specific action taken on June 11 that placed the shares within Fidelity Charitable's dominion and control.[20] *See Czarski*, 1997 WL 535773, at *4 (finding no evidence that donor took any action that would constitute delivery or place gift property in donee's dominion and control); *see also Reed Smith Shaw & McClay v. Commissioner*, T.C. Memo. 1998-64, 1998 WL 62393, at *8 (declining to credit uncorroborated self-serving testimony regarding actions

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[20] In his testimony, petitioner implied a belief that the execution of the Consent to Assignment agreement had effected a transfer. Execution of the Consent to Assignment agreement did not purport to transfer ownership of any portion of petitioner's shares; instead, it merely allowed him the ability to transfer shares in the future.

[*22] purportedly taken to effect transfer of shares to trust). Instead, petitioner's and Ms. Kanski's trial testimony suggested that the physical, partially completed stock certificate remained on petitioner's desk until July 9 or 10, 2015, at which point it was dropped off at Ms. Kanski's office. Consequently, delivery to Fidelity Charitable could not have taken place before July 9 or 10, because petitioner retained dominion and control of the shares while the physical certificate was sitting on his desk. *Cf. In re Casey Estate*, 856 N.W.2d at 563 (finding no delivery where donor retained property in his safe and could thus change the combination at any time to preclude access by purported donee).

The same principle is applicable to the three or four days when the physical certificate was in Ms. Kanski's office, before the forwarding of the PDF share certificate to Fidelity Charitable. The Minority Stock Purchase Agreement's seller representative clause, as executed, named Ms. Kanski's firm, Clark Hill, as the seller's representative of Fidelity Charitable. That designation raises the question of whether Ms. Kanski's possession of the certificate constituted delivery to Fidelity Charitable. However, we cannot conclude that providing the certificate to Ms. Kanski removed the shares from petitioner's power of recall. Petitioners have not provided any evidence to indicate that Ms. Kanski could have disregarded an instruction from petitioner—her client—to return or simply discard the stock certificate before July 13. *See Osius*, 134 N.W.2d at 656 (stating that a valid gift "must invest ownership in the donee beyond the power of recall by the donor"); *Snyder v. Snyder*, 92 N.W. 353, 354 (Mich. 1902) ("The retaining of any control in the hands of the donor over the subject of the gift renders it invalid."); *see also Londen v. Commissioner*, 45 T.C. 106, 109 (1965) (finding it "unlikely" that corporation's secretary "would have refused to honor a countermand of the transfer instructions issued by [the taxpayer]"); *Morrison v. Commissioner*, T.C. Memo. 1987-112, 53 T.C.M. (CCH) 251, 255 (finding no evidence that if taxpayer had "countermanded her instructions to transfer the stock, [her broker] would have refused to halt the transfer"). Thus, we conclude that the stock certificate, while in the possession of Ms. Kanski, was subject to recall by petitioner at any time and was not within the dominion and control of Fidelity Charitable, precluding delivery. *See Londen*, 45 T.C. at 109; *Zipp v. Commissioner*, 28 T.C. 314, 324–25 (1957) (finding retention of stock certificates by donor's attorney to preclude a valid gift), *aff'd*, 259 F.2d 119 (6th Cir. 1958); *Bucholz v. Commissioner*, 13 T.C. 201, 204 (1949) (finding no valid gift where taxpayer instructed custodian of corporate

[*23] books to prepare stock certificates but remained undecided about ultimate gift).

In some jurisdictions, transfer of shares on the books of the corporation can, in certain circumstances, constitute delivery of an inter vivos gift of shares. *See, e.g.*, *Wilmington Tr. Co. v. Gen. Motors Corp.*, 51 A.2d 584, 594 (Del. Ch. 1947); *Chi. Title & Tr. Co. v. Ward*, 163 N.E. 319, 322 (Ill. 1928); *Brewster v. Brewster*, 114 A.2d 53, 57 (Md. 1955). However, the Michigan Supreme Court does not appear to have addressed whether transfer on the books of a corporation alone can constitute delivery of a valid gift of certificated shares of stock. In several older tax cases, the U.S. Court of Appeals for the Sixth Circuit—to which an appeal in this case would lie, absent stipulation to the contrary—has stated that transfer on the books of a corporation constitutes delivery of shares of stock, apparently as a matter of federal common law. *See Lawton v. Commissioner*, 164 F.2d 380, 384 (6th Cir. 1947), *rev'g* 6 T.C. 1093 (1946); *Bardach v. Commissioner*, 90 F.2d 323, 326 (6th Cir. 1937), *rev'g* 32 B.T.A. 517 (1935); *Marshall v. Commissioner*, 57 F.2d 633, 634 (6th Cir. 1932), *aff'g in part, rev'g in part* 19 B.T.A. 1260 (1930). We have previously observed that, in this line of cases, the transfers on the books of the corporation were bolstered by other objective actions that evidenced a change in possession and thus a gift. *See Jolly's Motor Livery Co. v. Commissioner*, T.C. Memo. 1957-231, 16 T.C.M. (CCH) 1048, 1073 (distinguishing *Bardach* and *Marshall* and instead concluding that taxpayer failed to make a valid gift under Tennessee law); *see also Bucholz*, 13 T.C. at 204; *Campbell v. Commissioner*, T.C. Memo. 1979-411, 39 T.C.M. (CCH) 287, 289. We would thus be hesitant to conclude that transfer on the books of CSTC would be sufficient here as a matter of law, given the apparent split of authorities on the issue and lack of state law precedent. *See Fletcher Cyclopedia of the Law of Corporations* § 5684 (West 2022) ("Generally, a transfer of stock from the donor to the donee on the corporate books, standing alone, is not sufficient to constitute a valid gift, at least with regard to a close corporation where the donor is in control[.]"); Mark S. Rhodes, *Transfer of Stock* § 6:3 (7th ed. 2021) ("There is a division of authority as to whether a mere transfer on the books of the corporation without delivery of the certificate constitutes a valid gift of stock."); Mechem, *Gifts of Corporation Shares*, *supra*, at 25–26 (describing view that transfer on the books of the corporation effects only the relationship between new shareholder and corporation, while delivery of certificate separately transfers ownership of shares as property between persons).

[*24] However, even assuming arguendo that a transfer on the corporate books is sufficient to constitute delivery of certificated shares of stock in Michigan, we are still unable to find on the record before us that such a transfer occurred. The primary relevant evidence produced by petitioners is the printout of a purported stock ledger. The printout, which has a report date of July 13, shows an entry issuing 1,380 shares to Fidelity Charitable on July 10. At trial, however, petitioner testified that the printout was not from CSTC's official stock ledger but appeared to him instead to have been prepared by one of CSTC's attorneys. Indeed, petitioners themselves have at no point asserted that a gift occurred on July 10 and have not produced any evidence to corroborate such a transfer on the books of CSTC. We thus attribute little weight to the printout, given petitioners' failure to corroborate it with credible evidence. *See Sellers v. Commissioner*, T.C. Memo. 1977-70, 36 T.C.M. (CCH) 305, 312 (observing that self-serving corporate records are relevant evidence but "the weight to be accorded them is dependent upon their completeness and credibility"), *aff'd*, 592 F.2d 227 (4th Cir. 1979). Consequently, the record is insufficient to support a conclusion that delivery of the shares was made on July 10 via transfer on the books of CSTC.

Finally, we look to Mr. Bear's July 13 email of the PDF stock certificate to Fidelity Charitable. That email provides the strongest documentary evidence of the shares' leaving petitioner's dominion and control. Providing Fidelity Charitable with a copy of a stock certificate issued in its name was an objective act evidencing an "open and visible change of possession." *Shepard*, 129 N.W. at 208. Further, we find that this act placed the shares of CSTC in Fidelity Charitable's dominion and control, by providing Fidelity Charitable with an instrument that it could present to CSTC and exercise its rights as shareholder. Nor did any postdelivery retention by petitioner of a stock certificate render delivery ineffectual. *See id.* (stating that donor's postdelivery retention of stock certificates was "immaterial" to validity of gift). On the basis of the foregoing, we conclude that delivery of the shares of CSTC did not occur before July 13.

C. *Acceptance*

Donee acceptance of a gift is generally "presumed if the gift is beneficial to the donee." *Davidson*, 575 N.W.2d at 576; *see Osius*, 134 N.W.2d at 660; *Dunlap v. Dunlap*, 53 N.W. 788, 790 (Mich. 1892) ("The donation being for [the donees'] advantage, they will be deemed to have accepted it, unless the contrary appears."). Petitioners seek to reinforce

[*25] that presumption by relying on the corrected contribution confirmation letter and yearend account statement from Fidelity Charitable, both of which stated that the shares were contributed (and thus presumably accepted by Fidelity Charitable) on June 11. Both Fidelity Charitable's guidelines and the yearend account statement note that donors are able to request corrections of both contribution confirmation letters and account statements. Petitioners did not produce a copy of the original contribution confirmation letter, dated July 15, 2015, that they received from Fidelity Charitable. Such evidence could have confirmed whether Fidelity Charitable consistently understood the date of contribution to be June 11 and what errors were present in the original letter. Petitioners' failure to produce such evidence within their control gives rise to a presumption that it would be unfavorable to their case. *See Wichita Terminal Elevator Co. v. Commissioner*, 6 T.C. 1158, 1165 (1946), *aff'd*, 162 F.2d 513 (10th Cir. 1947). Given our conclusions above that neither the present intent nor the delivery requirement was met on June 11, we do not consider the corrected documentation from Fidelity Charitable to be reliable evidence with respect to the date of acceptance.

In contrast, Mr. Boland's July 13 email is the more convincing evidence and rebuts any presumption that acceptance took place on an earlier date. In that email Mr. Boland represented that he would need the stock certificate before he could take action with respect to the sale of shares to HCI. As Mr. Boland later testified, Fidelity Charitable typically required receipt of a stock certificate as a precondition to its acceptance of a gift when dealing with a contribution of closely held, certificated securities. Later on July 13, after receiving the stock certificate, Mr. Boland on behalf of Fidelity Charitable executed the Minority Stock Purchase Agreement under warranty of good title. That act is sufficient to establish acceptance by Fidelity Charitable. We conclude that acceptance occurred on July 13.

D. *Conclusion*

Petitioners have failed to establish that any of the elements of a valid gift was present on June 11, 2015. Instead, as a matter of state law, we find that petitioners made a valid gift of CSTC shares by effecting delivery on July 13. We thus conclude that petitioners divested themselves of title to the shares on July 13. *See Humacid Co.*, 42 T.C. at 913.

[*26] II. *Anticipatory Assignment of Income*

The anticipatory assignment of income doctrine is a longstanding "first principle of income taxation." *Commissioner v. Banks*, 543 U.S. 426, 434 (2005) (quoting *Commissioner v. Culbertson*, 337 U.S. 733, 739–40 (1949)). The doctrine recognizes that income is taxed "to those who earn or otherwise create the right to receive it," *Helvering v. Horst*, 311 U.S. 112, 119 (1940), and that tax cannot be avoided "by anticipatory arrangements and contracts however skillfully devised," *Lucas v. Earl*, 281 U.S. 111, 115 (1930). A person with a fixed right to receive income from property thus cannot avoid taxation by arranging for another to gratuitously take title before the income is received. *See Helvering v. Horst*, 311 U.S. at 115–17; *Ferguson*, 108 T.C. at 259. This principle is applicable, for instance, where a taxpayer gratuitously assigns wage income that the taxpayer has earned but not yet received, *see Lucas v. Earl*, 281 U.S. at 114–15, or gratuitously transfers a debt instrument carrying accrued but unpaid interest, *see Austin v. Commissioner*, 161 F.2d 666, 668 (6th Cir. 1947), *aff'g* 6 T.C. 593 (1946).

We deem the donor to have effectively realized income and then assigned that income to another when the donor has an already fixed or vested right to the unpaid income. *See Cold Metal Process Co. v. Commissioner*, 247 F.2d 864, 872–73 (6th Cir. 1957) (focusing on whether right to future income from assigned property was contingent or vested at the time of assignment), *rev'g* 25 T.C. 1333 (1956); *Estate of Applestein v. Commissioner*, 80 T.C. 331, 342 (1983); *Friedman v. Commissioner*, 41 T.C. 428, 435 (1963) (describing doctrine as focused on "whether the income had been earned so that the right to payment at a future date existed when the gift was made"), *aff'd*, 346 F.2d 506 (6th Cir. 1965). The same principle is often applicable where a taxpayer gratuitously transfers shares of stock that are subject to a pending, pre-negotiated transaction and thus carry a fixed right to proceeds of the transaction. *See Ferguson*, 108 T.C. at 259; *Rollins v. United States*, 302 F. Supp. 812, 817–18 (W.D. Tex. 1969); *see also Commissioner v. Court Holding Co.*, 324 U.S. 331, 334 (1945) ("A sale by one person cannot be transformed for tax purposes into a sale by another by using the latter as a conduit through which to pass title.").

In determining whether an anticipatory assignment of income has occurred with respect to a gift of shares of stock, we look to the realities and substance of the underlying transaction, rather than to formalities or hypothetical possibilities. *See Jones v. United States*, 531 F.2d 1343, 1345 (6th Cir. 1976) (en banc); *Allen v. Commissioner*, 66 T.C.

[*27] 340, 346 (1976) (adopting *Jones*'s approach); *see also Cook v. Commissioner*, 5 T.C. 908, 911 (1945). In general, a donor's right to income from shares of stock is fixed if a transaction involving those shares has become "practically certain to occur" by the time of the gift, "despite the remote and hypothetical possibility of abandonment." *Jones*, 531 F.2d at 1346. In contrast, "[t]he mere anticipation or expectation of income" at the time of the gift does not establish that a donor's right to income is fixed. *Ferguson*, 108 T.C. at 257; *see S.C. Johnson & Son, Inc. v. Commissioner*, 63 T.C. 778, 785 (1975) (rejecting Commissioner's argument that right to income was fixed when there was only a "reasonable probability" of income from appreciated property).

As a preliminary matter, petitioners seek to rely on our recent nonprecedential decision in *Dickinson*, T.C. Memo. 2020-128. There, the taxpayer made several contributions to Fidelity Charitable of shares in a privately held corporation of which he was the chief financial officer. *Id.* at *2–3. On each occasion, the taxpayer's contributions to Fidelity Charitable were shortly followed by redemptions of those shares by the corporation. *Id.* at *3. Applying the *Humacid* test, we looked to whether the redemption "was practically certain to occur at the time of the gift" and "would have occurred whether the shareholder made the gift or not." *Id.* at *8. We determined to respect the form of the transaction, because the redemption "was not a fait accompli at the time of the gift" and thus the taxpayer "did not avoid receipt of redemption proceeds" by contributing his shares. *Id.* at *9.

In reaching this holding, we found it evident from the record in *Dickinson* that the redemptions would not have occurred but for the taxpayer's charitable contributions; thus there could be no "practically certain to occur" realization event for the taxpayer to avoid at the time of the gift. *Id.* This point is the key distinguishing factor between *Dickinson* and petitioners' case. Here, the record establishes that petitioners' charitable contribution would not have been made but for the impending sale to HCI. Unlike in *Dickinson*, the timing of the sale and petitioners' gift raises a question as to whether at the time of gift the sale was virtually certain to occur. Thus, *Dickinson*'s rationale does not avail petitioners.

We must also initially address the role of the Commissioner's prior issued guidance, which petitioners have raised. In *Rauenhorst v. Commissioner*, 119 T.C. 157, 173 (2002), we held that, "[u]nder the circumstances" of that case, the Commissioner was bound not to argue

[*28] against his own subregulatory guidance, as expressed in Rev. Rul. 78-197, 1978-1 C.B. 83.[21] In *Rauenhorst*, we treated Rev. Rul. 78-197 as a binding concession by the Commissioner that precluded him from relying in that case on factors other than the donee's obligation to sell contributed property in his anticipatory assignment argument.

However, we also recognized in *Rauenhorst*, 119 T.C. at 171, the axiom that "revenue rulings are not binding on this Court, or other Federal courts." *See Dickinson*, T.C. Memo. 2020-128, at *10 ("This Court has not adopted Rev. Rul. 78-197 as the test for resolving anticipatory assignment of income issues and does not do so today." (citations omitted)). For a taxpayer to rely on a revenue ruling, the facts of the taxpayer's transaction must be "substantially the same as those considered in the revenue ruling." *Barnes Grp., Inc. v. Commissioner*, T.C. Memo. 2013-109, at *37–38, *aff'd*, 593 F. App'x 7 (2d Cir. 2014); *see Syzygy Ins. Co. v. Commissioner*, T.C. Memo. 2019-34, at *47–48; *see also* Statement of Procedural Rules, 26 C.F.R. § 601.601(d)(2)(v)(*a*), (*e*). On the particular facts of this case, we do not find respondent's arguments to be sufficiently contrary to Rev. Rul. 78-197 to constitute a disavowal of his published guidance. *See* Rev. Rul. 78-197, 1978-1 C.B. at 83 (describing its application as only to "proceeds of a redemption of stock under facts similar to those in *Palmer*"); *cf. Rauenhorst*, 119 T.C. at 182–83 (focusing on Commissioner's argument that courts are not bound by revenue rulings and his reliance on a case[22] that had been distinguished by the Commissioner in a prior private letter ruling).

While we consider a donee's legal obligation to sell as "significant to the assignment of income analysis," *Ferguson*, 108 T.C. at 259, it "is only one factor to be considered in ascertaining the 'realities and substance' of the transaction," *Allen*, 66 T.C. at 348 (quoting *Jones*, 531 F.2d at 1345). Instead, "the ultimate question is whether the transferor, considering the reality and substance of all the circumstances, had a fixed right to income in the property at the time of transfer." *Ferguson*,

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[21] In Rev. Rul. 78-197, 1978-1 C.B. at 83, in the wake of our decision in *Palmer v. Commissioner*, 62 T.C. 684 (1974), *aff'd on other issue*, 523 F.2d 1308 (8th Cir. 1975), the Commissioner advised that, "under facts similar to those in *Palmer*," he would treat a charitable contribution of stock followed by a redemption as an anticipatory assignment of income "only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption." *Palmer* involved a taxpayer's contribution of shares of stock in his controlled corporation to a charitable foundation of which he was a trustee, followed by a redemption of the shares by the corporation.

[22] *Blake v. Commissioner*, 697 F.2d 473, 480–81 (2d Cir. 1982) (declining to rely on Rev. Rul. 78-197), *aff'g* T.C. Memo. 1981-579.

[*29] 108 T.C. at 259; *see Dickinson*, T.C. Memo. 2020-128, at *10. We thus look to several other factors that bear upon whether the sale of shares was virtually certain to occur at the time of petitioners' gift. In this case the relevant factors include (1) any legal obligation to sell by the donee, (2) the actions already taken by the parties to effect the transaction, *see Ferguson*, 106 T.C. at 264, (3) the remaining unresolved transactional contingencies, *see Robert L. Peterson Irrevocable Tr. #2 v. Commissioner*, T.C. Memo. 1986-267, 51 T.C.M. (CCH) 1300, 1316, *aff'd sub nom. Peterson v. Commissioner*, 822 F.2d 1093 (8th Cir. 1987), and (4) the status of the corporate formalities required to finalize the transaction, *see Estate of Applestein*, 80 T.C. at 345–46.

A. *Fidelity Charitable's Obligation to Sell*

We turn first to whether Fidelity Charitable did in fact have an obligation to sell the CSTC shares. We conclude that respondent has not established that Fidelity Charitable had any legal obligation to sell the shares.[23] As petitioners point out, the terms and conditions of Fidelity Charitable's Letter of Understanding expressly disclaimed any such obligation. In addition, respondent has not sufficiently established the existence of any informal, prearranged understanding between petitioners and Fidelity Charitable that might otherwise constitute an obligation. *See Greene v. United States*, 13 F.3d 577, 583 (2d Cir. 1994); *see also Chrem*, T.C. Memo. 2018-164, at *13. This factor weighs against an anticipatory assignment of income but is not dispositive. *See Ferguson*, 108 T.C. at 259.

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[23] In *Chrem v. Commissioner*, T.C. Memo. 2018-164, we suggested that a donor-advised fund's sponsoring organization may be subject to fiduciary duties that might impose a legal obligation to sell contributed shares constituting a small minority interest in a closely held corporation. *Id.* at *15 ("If it refused to tender its shares and the entire transaction were scuttled, [the sponsoring organization] would apparently be left holding a 13% minority interest in a closely held Hong Kong corporation, the market value of which might be questionable."); *see also Grove v. Commissioner*, 490 F.2d 241, 248 (2d Cir. 1973) (Oakes, J. dissenting) (looking to New York trust law and observing that offering donated shares for redemption was "the only practice which a university treasurer could correctly take and still meet his own statutory obligations as a fiduciary"), *aff'g* T.C. Memo. 1972-98. Respondent did not present arguments or testimony as to what, if any, fiduciary duties Fidelity Charitable might have owed that would compel it to sell the CSTC shares to HCI. Accordingly, lacking the benefit of meaningful briefing on the subject, we cannot find that Fidelity Charitable was in fact legally obligated to sell the contributed shares by way of fiduciary duty.

[*30] B. *Bonuses & Shareholder Distributions*

Next, we look to what acts CSTC and HCI took to effect the transaction before the July 13, 2015, gift. As of that date, a number of acts had already taken place that may suggest the transaction was a virtual certainty. One week before the gift, HCI had caused the incorporation of a new holding company subsidiary to acquire the CSTC shares. Three days before the gift, CSTC had amended its Articles of Incorporation to allow for written shareholder consent, an action requested by HCI. Most significantly, however, the "cash sweeping" actions taken by CSTC strongly suggest that the transaction with HCI was a virtual certainty before the gift on July 13.

On July 7, 2015 petitioner amended CSTC's Change in Control Bonus Plan in order to specify that CSTC "desire [sic] that the consummation of the Investment Transaction result in payments to eligible Grantees under the Plan." That same day, petitioner stated in an email that CSTC would "sweep the cash from the company prior to closing and distribute it to the brothers." As of July 7, CSTC and petitioner thus considered the transaction with HCI so certain to occur that they took action to trigger the bonus payouts, consistent with the plan to sweep CSTC's cash before closing. On July 10, 2015, CSTC then paid out approximately $6.1 million in employee bonuses and, a few days later on July 14, distributed approximately $4.7 million to petitioner and his two brothers as shareholders. While the July 14 distribution took place the day after the gift, petitioner's statement on July 7 evidences that the decision to make the distribution had already been made as of that date, if not well formally authorized by CSTC. *See* Mich. Comp. Laws § 450.1345(1) and (2). We thus find that, before July 13, CSTC and petitioner had distributed and/or determined to distribute over $10 million out of the corporation.

Moreover, we consider it highly improbable that petitioner and his two brothers would have emptied CSTC of its working capital if the transaction had even a small risk of not consummating. Absent its working capital, CSTC was no longer a going concern until the transaction was finalized. *See Cook*, 5 T.C. at 911 (finding assignment of income where donor of shares was "well aware that the corporate activities had all but ceased except for the actual distribution in liquidation"); *see also Apt v. Birmingham*, 89 F. Supp. 361, 393 (N.D. Iowa 1950) (stating that gain may be realized when "for all practical purposes corporate stock had no further purposes to fulfill" aside from underlying transaction). The bonus payouts and distributions do not

[*31] appear from the record to have been in any way contingent on the final execution of the purchase agreement. Accordingly, we conclude that, once made, the bonus payouts and distributions could not be clawed back and had tax consequences upon receipt for the participating employees and shareholders, including petitioner himself.

In the reality of the transaction, the cash sweeps were thus highly significant conditions precedent to consummating the transaction with HCI. *Cf. Kinsey v. Commissioner*, 58 T.C. 259, 265–66 (1972) (finding right to income on shares from liquidation was fixed where "a substantial portion of [corporation's] assets were distributed prior to the date of the gift"), *aff'd*, 477 F.2d 1058 (2d Cir. 1973). As of July 13, 2015, the CSTC shares were essentially "hollow receptacles" for conveying proceeds of the transaction with HCI, "rather than an interest in a viable corporation." *Estate of Applestein*, 80 T.C. at 345–46; *see Hudspeth v. United States*, 471 F.2d 275, 279 (8th Cir. 1972) (describing donated shares as "merely empty vessels by which the taxpayer conveyed the liquidation proceeds"). The cash sweep strongly weighs in favor of a conclusion that the sale was a virtual certainty and thus petitioners' right to income from the shares was fixed as of July 13, 2015.

C. *Unresolved Sale Contingencies*

Next, we look to what unresolved sale contingencies remained between the parties as of the July 13, 2015, gift. *See Robert L. Peterson Irrevocable Tr. #2*, 51 T.C.M. (CCH) at 1316–19 (focusing on various contingencies that taxpayers argued precluded their right to sale proceeds from becoming fixed before a gift). Petitioners argue that the transaction with HCI was still being negotiated up until the closing on July 15. Petitioners rely on petitioner's trial testimony, where he identified several negotiated issues, including an environmental liability, employee compensation arrangements, and excess real estate. At trial petitioner testified that he and HCI "basically negotiated right up until the day before we closed"—i.e., July 14, 2015.

However, the record does not bear out the substance of petitioner's characterization. The identified employee compensation and excess real estate issues appear to have been resolved in drafts of the agreement prepared before July 13, 2015. At trial, a representative of HCI characterized the environmental liability issue as "the one probably biggest item of negotiation" resolved before closing. On July 10, 2015, HCI's counsel prepared a draft with a new seller indemnity provision addressing the environmental liability issue. By 4:38 a.m. on

[*32] the morning of July 13, when HCI's counsel next ran a redline comparison of a new draft, the environmental liability provision had already been accepted into the draft agreement. Given that the written drafts memorialized the negotiations between the parties, we find that the parties had resolved the environmental liability issue before the contribution to Fidelity Charitable.

Moreover, the only substantive change made to the drafts after the contribution to Fidelity Charitable was a minor revision to the provision for ongoing compensation to Mark and Kurt to cover the cost of their health insurance. We thus find that none of the unresolved contingencies remaining on July 13, 2015, were substantial enough to have posed even a small risk of the overall transaction's failing to close. *See Robert L. Peterson Irrevocable Tr. #2*, 51 T.C.M. (CCH) at 1319 (concluding that remaining contingencies "at best . . . represent remote and hypothetical possibilities that the stock purchase would be abandoned"); *cf. Martin v. Machiz*, 251 F. Supp. 381, 389 (D. Md. 1966) (finding no assignment of income where, at time of gift of shares, parties had "substantial" disagreements about closing date and buyer's insistence on a surety bond as security for breach of warranty). We find that petitioner, consistent with his "99% sure" statement, waited until all material details had been agreed to with HCI before he transferred the shares to Fidelity Charitable. *See Malkan*, 54 T.C. at 1314 ("Even though [the taxpayer] had discussed creating the trusts for several months, he did not establish them until the parties had agreed upon the details of the sale."). The absence of significant unresolved contingencies also weighs in favor of the sale of shares to HCI being a virtual certainty.

D. *Corporate Formalities*

Finally, we look to the status of the corporate formalities necessary for effecting the transaction. *See Estate of Applestein*, 80 T.C. at 345–46 (finding that taxpayer's right to sale proceeds from shares had "virtually ripened" upon shareholders' approval of proposed merger agreement). Under Michigan law, a proposed plan to exchange shares must generally be approved by a majority of the corporation's shareholders. *See* Mich. Comp. Laws § 450.1703a(2)(d); *id.* § 450.1407(1). Formal shareholder approval of a transaction has often proven to be sufficient to demonstrate that a right to income from shares was fixed before a subsequent transfer. *See Ferguson*, 108 T.C. at 262; *see also Hudspeth*, 471 F.2d at 279. However, such approval is not necessary for a right to income to be fixed, when other actions taken

[*33] establish that a transaction was virtually certain to occur. *See Ferguson*, 104 T.C. at 262–63 (rejecting taxpayer's "attempt to impose formalistic obstacle[]" of formal shareholder approval); *see also Hudspeth*, 471 F.2d at 280 (describing final resolution to dissolve corporation as a "mere formality" where shareholders and board had already approved plan of liquidation, despite "remote, hypothetically possible abandonment[]" of that plan); *Kinsey*, 58 T.C. at 265–66.

On June 11, 2015, petitioner and his two brothers (the sole shareholders of CSTC) unanimously approved pursuing a sale of all outstanding stock of CSTC to HCI. On July 15 they provided written consent to the final Contribution and Stock Purchase Agreement with HCI. However, viewed in the light of the reality of the transaction, the record shows that final written consent was a foregone conclusion. As a practical matter, finalizing the transaction with HCI presented petitioner and his two brothers with the opportunity to partially (or fully, as in Kurt's case) cash out of CSTC at a significant premium over their initial target price of $80 million. *See Ferguson v. Commissioner*, 174 F.3d at 1004–05 (considering formal shareholder approval to be unnecessary where shareholders were receiving substantial premium). From HCI's perspective, it also believed it was acquiring CSTC at a fair price and, as of July 13, had resolved the environmental liability issue, its final significant due diligence concern. *See id.* at 1005. All three Hoensheid brothers, and particularly petitioner, were involved in negotiating the transaction, making their approval all but assured as of July 13, 2015. *Cf. Perry v. Commissioner*, T.C. Memo. 1976-381, 35 T.C.M. (CCH) 1718, 1724 (concluding that shareholder approval of sale was not just a "rubber stamp" where corporation was not "a closely held corporation controlled by the same individuals who negotiated the [a]greement"). We conclude that formal shareholder approval was purely ministerial, as any decision by the brothers not to approve the sale was, as of July 13, "remote and hypothetical." *Jones*, 531 F.2d at 1346; *see Allen*, 66 T.C. at 347 (finding assignment of income despite parties not completing "purely ministerial act of executing quitclaim deed" before transfer). This factor is neutral as to whether petitioners' right to income was fixed.

E. *Conclusion*

To avoid an anticipatory assignment of income on the contribution of appreciated shares of stock followed by a sale by the donee, a donor must bear at least some risk at the time of contribution that the sale will not close. On the record before us, viewed in the light

[*34] of the realities and substance of the transaction, we are convinced that petitioners' delay in transferring the CSTC shares until two days before closing eliminated any such risk and made the sale a virtual certainty. Petitioners' right to income from the sale of CSTC shares was thus fixed as of the gift on July 13, 2015. We hold that petitioners recognized gain on the sale of the 1,380 appreciated shares of CSTC stock.

We echo prior decisions in recognizing that our holding does not specify a bright line for donors to stop short of in structuring charitable contributions of appreciated stock before a sale. *See Allen*, 66 T.C. at 346 (rejecting proposed bright-line rule approach and noting that "drawing lines is part of the daily grist of judicial life"); *see also Harrison v. Schaffner*, 312 U.S. 579, 583–84 (1941). However, as petitioners' tax counsel seems to have recognized in her advice to petitioner, "any tax lawyer worth [her] fees would not have recommended that a donor make a gift of appreciated stock" so close to the closing of a sale. *Ferguson v. Commissioner*, 174 F.3d at 1006; *see Allen*, 66 T.C. at 346 (recognizing that realities and substance approach puts "a premium on consulting one's lawyer early enough in the game"). By July 13, 2015, the transaction with HCI had simply "proceeded too far down the road to enable petitioners to escape taxation on the gain attributable to the donated shares." *Allen*, 66 T.C. at 348.

III. *Charitable Contribution Deduction*

We have concluded that petitioners did make a valid gift, and although we have determined that gift to be an assignment of income, petitioners may nevertheless be entitled to a charitable contribution deduction under section 170. Section 170(a)(1) allows as a deduction any charitable contribution (as defined in subsection (c)) payment of which is made within the taxable year. "A charitable contribution is a gift of property to a charitable organization made with charitable intent and without the receipt or expectation of receipt of adequate consideration." *Palmolive Bldg. Invs., LLC v. Commissioner*, 149 T.C. 380, 389 (2017) (citing *Hernandez v. Commissioner*, 490 U.S. 680, 690 (1989)). Section 170(f)(8)(A) provides that "[n]o deduction shall be allowed . . . for any contribution of $250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgement of the contribution by the donee organization that meets the requirements of subparagraph (B)." For contributions of property in excess of $500,000, the taxpayer must also attach to the

[*35] return a "qualified appraisal" prepared in accordance with generally accepted appraisal standards. § 170(f)(11)(D) and (E).

Here, the contributed CSTC shares had a value in excess of $500,000, and petitioners were thus required to substantiate their claimed deduction with both a contemporaneous written acknowledgement (CWA) and a qualified appraisal. Respondent asserts that petitioners have failed to satisfy both requirements and thus are not entitled to a charitable contribution deduction for the gift of the CSTC shares to Fidelity Charitable.

A. *CWA*

A CWA must include, inter alia, the amount of cash and a description of any property contributed. § 170(f)(8)(B). A CWA is contemporaneous if obtained by the taxpayer before the earlier of either (1) the date the relevant tax return was filed or (2) the due date of the relevant tax return. § 170(f)(8)(C). Section 170(f)(18)(B) adds a specific requirement for donor-advised funds that any CWA include a statement that the donee "has exclusive legal control over the assets contributed." We construe the requirements of section 170(f)(8)(B) strictly and do not apply the doctrine of substantial compliance to excuse defects in a CWA. *See 15 W. 17th St. LLC v. Commissioner*, 147 T.C. 557, 562 (2016). The contribution confirmation letter issued by Fidelity Charitable was contemporaneous, acknowledged receipt of 1,380.400 shares of CSTC stock, and contained the applicable statements required by the statute, including the "exclusive legal control" statement.

Respondent argues that the contribution confirmation letter failed to satisfy section 170(f)(8)(B) because it described petitioners' contribution as shares of stock rather than cash. Respondent's argument conflates the issues in this case. As a matter of state law, we have held that petitioners made a valid gift of CSTC shares to Fidelity Charitable. However, for federal income tax purposes, we have classified those shares as carrying a fixed right to income as of July 13, 2015, such that petitioners effectively realized and recognized gains before transfer. That second holding does not disturb our conclusion that petitioners made a valid gift of stock. *See Commissioner v. Tower*, 327 U.S. 280, 287–88 (1946) (citing *Lucas v. Earl*, 281 U.S. at 114–15) (distinguishing between gift of stock's validity under state law and its treatment for federal tax purposes); *see also Vercio v. Commissioner*, 73 T.C. 1246, 1253 (1980) (observing that anticipatory assignments of

[*36] income "are not recognized as dispositive for Federal income tax purposes despite their validity under applicable State law").

We construe the section 170(f)(8)(B) requirement that a CWA include a description of the "property" contributed in the light of the settled principle that the Code "creates no property rights but merely attaches consequences, federally defined, to rights created under state law." *Nat'l Bank of Com.*, 472 U.S. at 722 (quoting *United States v. Bess*, 357 U.S. 51, 55 (1958)). While the ultimate question of "whether a state-law right constitutes 'property' or 'rights to property' is a matter of federal law," *id.* at 727, the answer to that question "largely depends upon state law," *see United States v. Craft*, 535 U.S. 274, 278 (2002); *see also Patel v. Commissioner*, 138 T.C. 395, 403–04 (2012) (applying state law as to whether contributed property was a partial interest for purposes of section 170(f)(3)). We do not interpret section 170(f)(8)(B) to require that a donee ascertain and correctly describe a contributed property interest in accordance with how that interest should be classified for federal tax law purposes. It is sufficient here that the CWA provided by Fidelity Charitable described the contributed property as shares of stock. We conclude that the CWA issued by Fidelity Charitable satisfied the requirements of section 170(f)(8)(B).

B. *Qualified Appraisal*

In the early 1980s Congress was made aware of significant abuse of section 170 stemming from overvaluation of property contributed to charities. *See Abusive Tax Shelters: Hearing Before the S. Subcomm. On Oversight of the Internal Revenue Serv. of the S. Comm. on Fin.*, 98th Cong. 71 (1983) (statement of Robert G. Woodward, Acting Tax Legis. Couns., Dep't of Treasury) ("We are very concerned with the problem of the widespread abuse of the charitable contribution provision."); *id.* at 151 (statement of M. Bernard Aidinoff, Chairman, Section of Tax'n of Am. Bar Ass'n) ("Inflating the value of assets has been a particular abuse in the charitable area, and I have got to say that it is an abuse engaged in by ordinary taxpayers."); Staff of J. Comm. on Tax'n, 98th Cong., Background on Tax Shelters, JCS-29-83, at 34 (J. Comm. Print 1983) (detailing high volume of charitable contribution deduction audits and noting difficulty for IRS in detecting instances of excessive deductions at the administrative level). Congress responded by enacting new substantiation requirements, in order to assist the IRS in detecting overvalued contributions and to deter taxpayers from playing the "audit lottery." *See* Staff of S. Comm. on Fin., Explanation of Provisions Approved by the Committee on March 21, 1984, S. Prt. 98-169 (Vol. I),

[*37] at 444–45 (S. Comm. Print 1984); H.R. Rep. No. 98-861, at 998 (1984) (Conf. Rep.), *as reprinted in* 1984-3 C.B. (Vol. 2) 1, 252; *see also* Staff of J. Comm. on Tax'n, General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, JCS-41-84, at 504 (J. Comm. Print 1984) (describing new substantiation requirements as intended to be "more effective in deterring taxpayers from inflating claimed deductions than relying solely on the uncertainties of the audit process and on penalties"). In particular, Congress added an off-Code provision directing the Secretary of the Treasury to promulgate regulations requiring taxpayers to obtain and attach to their returns a "qualified appraisal" when claiming deductions for charitable contributions of property exceeding certain dollar amounts. *See* Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, § 155(a), 98 Stat. 494, 691–93. In DEFRA, Congress defined a qualified appraisal as an appraisal prepared by a qualified appraiser that included certain enumerated information and "such additional information as the Secretary prescribes in such regulations." *Id.* § 155(a)(4), 98 Stat. at 692. Temporary regulations swiftly followed, *see* Temp. Treas. Reg. § 1.170A-13T (1984), setting out extensive requirements with respect to what constituted a qualified appraisal; final regulations were later issued with similarly extensive requirements, *see* Treas. Reg. § 1.170A-13.

Twenty years later, Congress amended section 170 to codify a qualified appraisal requirement. *See* § 170(f)(11) (as amended by American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 883, 118 Stat. 1418, 1631–32); H.R. Rep. No. 108-755, at 746 (2004) (Conf. Rep.), *as reprinted in* 2004 U.S.C.C.A.N. 1341, 1784. Two years after that, Congress again acted in response to publicized reports of questionable appraisal practices, amending section 170 to enumerate requirements for an individual to be a qualified appraiser. *See* Pension Protection Act of 2006, Pub. L. No. 109-280, § 1219(b)(1), 120 Stat. 780, 1084–85; Staff of J. Comm. on Tax'n, 109th Cong., General Explanation of Tax Legislation Enacted in the 109th Cong., JCS-1-07, at 606 (J. Comm. Print 2007).

Section 170(f)(11)(A)(i) now provides that "no deduction shall be allowed . . . for any contribution of property for which a deduction of more than $500 is claimed unless such person meets the requirements of subparagraphs (B), (C), and (D), as the case may be." Subparagraph (D) is the relevant one here, requiring that, for contributions for which a deduction in excess of $500,000 is claimed, the taxpayer attach a

[*38] qualified appraisal to the return. Section 170(f)(11)(E)(i) provides that a qualified appraisal means,

> with respect to any property, an appraisal of such property which—
>
> > (I) is treated for purposes of this paragraph as a qualified appraisal under regulations or other guidance prescribed by the Secretary, and
> >
> > (II) is conducted by a qualified appraiser in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed under subclause (I).

The regulations in turn provide that a qualified appraisal is an appraisal document that, inter alia, (1) "[r]elates to an appraisal that is made" no earlier than 60 days before the date of contribution and (2) is "prepared, signed, and dated by a qualified appraiser." Treas. Reg. § 1.170A-13(c)(3)(i). Treasury Regulation § 1.170A-13(c)(3)(ii) requires that a qualified appraisal itself include, inter alia:

(1) "[a] description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was (or will be) contributed;"

(2) "[t]he date (or expected date) of contribution to the donee;"

(3) "[t]he name, address, and . . . identifying number of the qualified appraiser;"

(4) "[t]he qualifications of the qualified appraiser;"

(5) "a statement that the appraisal was prepared for income tax purposes;"

(6) "[t]he date (or dates) on which the property was appraised;"

(7) "[t]he appraised fair market value . . . of the property on the date (or expected date) of contribution;" and

(8) the method of and specific basis for the valuation.

[*39] Turning back to the statute, section 170(f)(11)(E)(ii) provides that a "qualified appraiser" is an individual who

> (I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations,
>
> (II) regularly performs appraisals for which the individual receives compensation, and
>
> (III) meets such other requirements as may be prescribed . . . in regulations or other guidance.

An appraiser must also demonstrate "verifiable education and experience in valuing the type of property subject to the appraisal." *Id.* cl. (iii)(I). The regulations add that the appraiser must include in the appraisal summary a declaration that he or she (1) "either holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis;" (2) is "qualified to make appraisals of the type of property being valued;" (3) is not an excluded person specified in paragraph (c)(5)(iv) of the regulation; and (4) understands the consequences of a "false or fraudulent overstatement" of the property's value. Treas. Reg. § 1.170A-13(c)(5)(i). Finally, the regulations prohibit a fee arrangement for a qualified appraisal "based, in effect, on a percentage . . . of the appraised value of the property." *Id.* subpara. (6)(i).

Respondent contends that petitioners' appraisal is not a qualified appraisal because it (1) did not include the statement that it was prepared for federal income tax purposes; (2) included the incorrect date of June 11 as the date of contribution; (3) included a premature date of appraisal; (4) did not sufficiently describe the method for the valuation; (5) was not signed by Mr. Dragon or anyone from FINNEA; (6) did not include Mr. Dragon's qualifications as an appraiser; (7) did not describe the property in sufficient detail; and (8) did not include an explanation of the specific basis for the valuation. Aside from petitioners' already-rejected claim that the June 11 date of contribution was correct, petitioners do not meaningfully dispute that their appraisal had at least some defects. As a consequence, petitioners do not argue that they strictly complied with the qualified appraisal requirement. Instead, they rely on the doctrine of substantial compliance and the statutory reasonable cause defense to excuse any defects.

[*40] 1. *Substantial Compliance*

We have previously held that the qualified appraisal requirements are directory, rather than mandatory, as the requirements "do not relate to the substance or essence of whether or not a charitable contribution was actually made." *See Bond v. Commissioner*, 100 T.C. 32, 41 (1993). We thus may apply the doctrine of substantial compliance to excuse a failure to strictly comply with the qualified appraisal requirements. *See id.* As demonstrated by the relevant legislative history, the purpose of the qualified appraisal requirements is "to provide the IRS with information sufficient to evaluate claimed deductions and assist it in detecting overvaluations of donated property." *Costello v. Commissioner*, T.C. Memo. 2015-87, at *17; *see Cave Buttes, LLC v. Commissioner*, 147 T.C. 338, 349–50 (2016); *Hendrix v. United States*, No. 2:09-CV-132, 2010 WL 2900391, at *6 (S.D. Ohio July 21, 2010) ("[T]he purpose of the qualified appraisal is to 'show the work' so as to obviate the injection of unfounded guessing into the tax scheme."). Accordingly, if the appraisal discloses sufficient information for the Commissioner to evaluate the reliability and accuracy of a valuation, we may deem the requirements satisfied. *Bond*, 100 T.C. at 41–42; *see Hewitt v. Commissioner*, 109 T.C. 258, 265 & n.10 (1997) (describing substantial compliance as applicable where the taxpayer has "provided most of the information required" or made omissions "solely through inadvertence"), *aff'd*, 166 F.3d 332 (4th Cir. 1998). Substantial compliance allows for minor or technical defects but does not excuse taxpayers from the requirement to disclose information that goes to the "essential requirements of the governing statute." *Estate of Evenchik v. Commissioner*, T.C. Memo. 2013-34, at *12 (quoting *Estate of Clause v. Commissioner*, 122 T.C. 115, 122 (2004)). We thus generally decline to apply substantial compliance where a taxpayer's appraisal either (1) fails to meet substantive requirements in the regulations or (2) omits entire categories of required information. *See Costello*, T.C. Memo. 2015-87, at *24; *see also Alli v. Commissioner*, T.C. Memo. 2014-15, at *54 (observing that substantial compliance "should not be liberally applied").

Petitioners' appraisal is deficient with respect to several key substantive requirements. We start with Mr. Dragon's status as an appraiser. We have previously described the requirement that an appraiser be qualified as the "most important requirement" of the regulations. *Mohamed v. Commissioner*, T.C. Memo. 2012-152, 2012 WL 1937555, at *4. Respondent argues that Mr. Dragon was not a qualified appraiser, asserting that Mr. Dragon performed valuations

[*41] infrequently, did not hold himself out as an appraiser, and has no certifications from a professional appraiser organization.[24] Petitioners counter that Mr. Dragon was qualified because he has prepared "dozens of business valuations" over the course of his 20+ year career as an investment banker, including some valuations of closely held automotive businesses.

Mr. Dragon's mere familiarity with the type of property being valued does not by itself make him qualified. *See, e.g.*, *Brannan Sand & Gravel Co. v. Commissioner*, T.C. Memo. 2020-76, at *9–10, *15 (finding that attorney's familiarity with type of property being valued and awareness of typical asking price was insufficient to satisfy qualified appraiser requirement). Mr. Dragon does not have appraisal certifications and does not hold himself out as an appraiser. We found Mr. Dragon's own words at trial about his appraisal experience to be particularly instructive. Mr. Dragon testified that he conducted valuations "briefly" and only "on a limited basis" before starting at FINNEA in 2014—the year before the appraisal. Mr. Dragon also testified that he now performs (presumably gratis) business valuations for prospective clients "once or twice a year" in order to solicit their business for FINNEA. We find Mr. Dragon's uncontroverted testimony sufficient to establish that he does not "regularly perform[] appraisals for which [he] receives compensation." *See* § 170(f)(11)(E)(ii)(II). Petitioners have failed to show that Mr. Dragon was a qualified appraiser.

We have previously described the requirement that an appraiser be qualified as one of the substantive requirements of the regulations. *See Alli*, T.C. Memo. 2014-15, at *56–57 ("[O]btaining an appraisal from a nonqualified appraiser does not constitute substantial compliance.") Absent an appraisal prepared by a qualified appraiser, the Commissioner cannot effectively verify whether a reported charitable contribution has been properly valued. *See Mohamed v. Commissioner*,

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[24] Respondent also argues that Mr. Dragon is precluded under the fee arrangement rule in Treasury Regulation § 1.170A-13(c)(6)(i) from serving as a qualified appraiser because of the value-based fee he and FINNEA received from CSTC for effecting the transaction with HCI: 1% of the transaction's value up to $80 million and 5% of the transaction's value over $80 million. By its plain terms, the fee arrangement rule is limited to fees that are effectively based on an appraised value (i.e., where the appraiser is incentivized to inflate a valuation in order to receive a higher fee); there was no such fee in this case, and we do not understand the rule to apply to a fee, like the one Mr. Dragon received, that is based on actual value received in a separate arm's-length transaction.

[*42] 2012 WL 1937555, at *7–8. We find that consideration to be heightened in the context of valuing a minority interest in a closely held family corporation, which often presents difficult questions for even an experienced appraiser. *See, e.g.*, *Rabenhorst v. Commissioner*, T.C. Memo. 1996-92, 1996 WL 86215, at *2. We thus conclude that in engaging a nonqualified appraiser, petitioners failed to demonstrate substantial compliance.

Next, leaving aside the separate issue of whether Mr. Dragon was actually qualified, the appraisal itself failed to sufficiently describe any of Mr. Dragon's relevant qualifications and valuation experience. *See* Treas. Reg. § 1.170A-13(c)(3)(ii)(F). Mr. Dragon's biography provided no information relevant to his valuation experience and described only general corporate finance experience and his business school education. As noted above, Mr. Dragon testified at trial that he did have some limited experience in valuation before the appraisal at issue. The failure to include a description of such experience in the appraisal was a substantive defect. We have previously described the qualifications requirement as important because it "provide[s] necessary context permitting the IRS to evaluate a claimed deduction." *Alli*, T.C. Memo. 2014-15, at *35 (first citing *Hendrix*, 2010 WL 2900391, at *5 ("Without, for example, the appraiser's education and background information, it would be difficult if not impossible to gauge the reliability of an appraisal that forms the foundation of a deduction."); and then citing *Bruzewicz v. United States*, 604 F. Supp. 2d 1197, 1205 (N.D. Ill. 2009) (describing qualifications requirement as providing IRS with ability to "determine whether the valuation in an appraisal report is competent and credible evidence")). The absence of Mr. Dragon's relevant qualifications further confirms our conclusion that petitioners' appraisal failed to substantially comply, as the defect deprived the Commissioner of information necessary to evaluate whether the appraisal was reliable.

Lastly, petitioners' appraisal is substantively deficient in stating an incorrect date of contribution. We have described the date requirement as intended to enable the Commissioner "to compare the appraisal and contribution dates for purposes of isolating fluctuations in the property's fair market value between those dates." *Rothman v. Commissioner*, T.C. Memo. 2012-163, 2012 WL 2094306, at *15, *supplemented and vacated on other grounds*, T.C. Memo. 2012-218. An incorrect date of contribution may be excused if it reflects only a minor typographical error. *See Friedberg v. Commissioner*, T.C. Memo. 2011-238, 2011 WL 4550136, at *10 (finding substantial compliance where date discrepancies were "merely typographical errors"), *supplemented*

[*43] *by* T.C. Memo. 2013-224. However, omission of the correct date of contribution is generally significant and will weigh against a conclusion of substantial compliance. *See, e.g.*, *Presley v. Commissioner*, T.C. Memo. 2018-171, at *78, *aff'd*, 790 F. App'x 914 (10th Cir. 2019); *Costello*, T.C. Memo. 2015-87, at *24–25; *Alli*, T.C. Memo. 2014-15, at *24; *Smith v. Commissioner*, T.C. Memo. 2007-368, 2007 WL 4410771, at *18–19, *aff'd*, 364 F. App'x 317 (9th Cir. 2009).

Petitioners' reported June 11, 2015, date of contribution was incorrect, and thus the June 11 valuation date was premature by approximately a month. In *Cave Buttes, LLC*, 147 T.C. at 355, we concluded that a taxpayer's appraisal was in substantial compliance, despite finding a several-week discrepancy between the actual date of contribution and the date of valuation. That conclusion, however, was conditioned on the fact there was no "significant event that would obviously affect the value of the property in those two or three weeks." *Id.* Here, in contrast, the period between June 11 and July 13, 2015, encompassed CSTC's initial bonus payouts of approximately $6.1 million, which had a significant effect on the value of the shares. In addition, as we have concluded above, the underlying transaction with HCI became virtually certain to occur in the period after June 11. The significance of these intervening developments is clear in part from the $340,545 discrepancy between the June 11 appraised value and the actual proceeds received by Fidelity Charitable for the shares on July 15. The misreporting of the date of contribution prevented the Commissioner from effectively double-checking the accuracy of the appraised value—a concern that relates to the "essential requirements of the governing statute" and thus further confirms that petitioners cannot demonstrate substantial compliance. *See Estate of Evenchik*, T.C. Memo. 2013-34, at *12.

This is not the rare case "where a taxpayer does all that is reasonably possible, but nonetheless fails to comply with the specific requirements of a provision." *Durden v. Commissioner*, T.C. Memo. 2012-140, 103 T.C.M. (CCH) 1762, 1763 (citing *Samueli v. Commissioner*, 132 T.C. 336, 345 (2009)). Petitioners' failure to satisfy multiple substantive requirements of the regulations, paired with the appraisal's other more minor defects, precludes them from establishing substantial compliance.

[*44] 2. *Reasonable Cause*

Although petitioners are unable to establish substantial compliance, their defective appraisal may nevertheless be excused if petitioners had reasonable cause for their noncompliance. Taxpayers who fail to comply with the qualified appraisal requirements may still be entitled to charitable contribution deductions if they show that their noncompliance is "due to reasonable cause and not to willful neglect." § 170(f)(11)(A)(ii)(II). We have construed the reasonable cause defense in section 170(f)(11)(A)(ii)(II) similarly to the defense applicable to numerous other Code provisions that prescribe penalties and additions to tax. *See* § 6664(c)(1); *see also Chrem*, T.C. Memo. 2018-164, at *18–19; *Crimi v. Commissioner*, T.C. Memo. 2013-51, at *98–99. Reasonable cause thus requires that a taxpayer "have exercised ordinary business care and prudence as to the challenged item." *Crimi*, T.C. Memo. 2013-51, at *99 (citing *United States v. Boyle*, 469 U.S. 241 (1985)). To show reasonable cause due to reliance on a professional adviser, we generally require that a taxpayer show (1) that their adviser was a competent professional with sufficient expertise to justify reliance; (2) that the taxpayer provided the adviser necessary and accurate information; and (3) that the taxpayer actually relied in good faith on the adviser's judgment. *See Neonatology Assocs., P.A. v. Commissioner*, 115 T.C. 43, 99 (2000), *aff'd*, 299 F.3d 221 (3d Cir. 2002).

Respondent argues that petitioners cannot show reliance in good faith, because petitioner—not Ms. Kanski—made the decision to have Mr. Dragon perform the appraisal without verifying that he was sufficiently qualified. Respondent suggests that petitioner's decision to have Mr. Dragon perform the appraisal, despite receiving a quote from a national accounting firm, was largely motivated by the fact that Mr. Dragon would not charge an additional fee for the work. Petitioners argue that they have satisfied each factor of the *Neonatology* test with respect to the defective appraisal. Petitioners argue that Ms. Kanski was closely involved in reviewing the appraisal, meeting with Mr. Dragon, and advising petitioners that the appraisal met the statutory and regulatory requirements.

Petitioners have established that Ms. Kanski was competent and professionally experienced in tax and estate planning issues. *See 106 Ltd. v. Commissioner*, 136 T.C. 67, 77 (2011) (finding taxpayer's longtime personal attorney and return preparers to be adequately competent professionals with respect to taxpayer), *aff'd*, 684 F.3d 84 (D.C. Cir. 2012). In addition, Ms. Kanski was involved both in reviewing

[*45] drafts of the transactional documents and in the ongoing discussions with petitioners' wealth advisers about the contribution. She thus had the underlying knowledge necessary to procure a qualified appraisal of the shares.

However, Ms. Kanski's handling of the process does not necessarily insulate petitioners from the consequences of the defective appraisal. *See Stough v. Commissioner*, 144 T.C. 306, 323 (2015) ("Unconditional reliance on a tax return preparer or C.P.A. does not by itself constitute reasonable reliance in good faith; taxpayers must also exercise '[d]iligence and prudence'." (quoting *Estate of Stiel v. Commissioner*, T.C. Memo. 2009-278, 2009 WL 4877742, at *2)). Petitioner is an experienced and sophisticated businessman. *See* Treas. Reg. § 1.6664-4(c)(1) (stating that "[a]ll facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice" and that "the taxpayer's education, sophistication and business experience will be relevant"). Petitioner made a business decision to have CSTC's transactional adviser conduct the appraisal gratis, rather than engage a national accounting firm on a paid basis. Given Mr. Dragon's admittedly limited experience and unfamiliarity with the qualified appraisal process, such a decision did not demonstrate ordinary business care and prudence. *See, e.g.*, *Webster v. Commissioner*, T.C. Memo. 1992-538, 1992 WL 220112, at *4 (describing taxpayer's decision to engage unqualified adviser as "not a technical matter, but one calling for ordinary human wisdom and careful deliberation"). Petitioners have not provided credible evidence, aside from self-serving uncorroborated testimony, that they reasonably relied upon Ms. Kanski's judgment in proceeding with that unwise course of action.[25]

In addition, petitioner's close involvement in the contribution and transaction requires us to cast a skeptical eye to his claim that he relied in good faith on Ms. Kanski as to the appraisal's incorrect date of contribution. The record firmly establishes that petitioner did not transfer the shares to Fidelity Charitable on June 11. The transactional

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[25] We do not ignore Ms. Kanski's email of April 16, in which she asked Mr. Hensien to inquire whether FINNEA could perform the appraisal as it "would seem to be the most efficient method." Ms. Kanski's preliminary inquiry to a colleague on behalf of petitioners does not speak to whether she ultimately exercised her judgment to advise petitioners that Mr. Dragon was qualified to conduct the appraisal nor to whether petitioners actually relied on that judgment. *See, e.g.*, *Pankratz v. Commissioner*, T.C. Memo. 2021-26, at *26. The record is devoid of credible evidence on this point.

[*46] documents, petitioner's contemporaneous emails, and the retention of the undated physical stock certificate strongly suggest that petitioner knew or at least should have known that the shares were not contributed to Fidelity Charitable on June 11. *See* Treas. Reg. § 1.6664-4(c)(1)(ii) (stating that for reliance to constitute reasonable cause "the advice must not be based upon a representation or assumption which the taxpayer knows, or has reason to know, is unlikely to be true"); *see also Exelon Corp. v. Commissioner*, 906 F.3d 513, 529 (7th Cir. 2018), *aff'g* 147 T.C. 230 (2016); *Blum v. Commissioner*, 737 F.3d 1303, 1318 (10th Cir. 2013), *aff'g* T.C. Memo. 2012-16. Consequently, we also conclude that petitioners have failed to establish good faith reliance on Ms. Kanski's judgment that the appraisal properly reported the required information, because petitioner knew or should have known that the date of contribution (and thus the date of valuation) was incorrect.

We find that petitioners did not have reasonable cause for their failure to procure a qualified appraisal. Consequently, we must sustain respondent's determination to disallow their charitable contribution deduction.

IV. *Section 6662(a) Penalty*

Section 6662(a) and (b)(1) and (2) imposes a 20% penalty on any underpayment of tax required to be show on a return that is attributable to negligence, disregard of rules or regulations, or a substantial understatement of income tax. Negligence includes "any failure to make a reasonable attempt to comply" with the Code, § 6662(c), or a failure "to keep adequate books and records or to substantiate items properly," Treas. Reg. § 1.6662-3(b)(1). An understatement of income tax is "substantial" if it exceeds the greater of 10% of the tax required to be shown on the return or $5,000. § 6662(d)(1)(A).

Respondent argues that petitioners are liable for a penalty under section 6662(a) on the basis of both negligence and a substantial understatement of income tax. Generally, the Commissioner bears the initial burden of production of establishing via sufficient evidence that a taxpayer is liable for penalties and additions to tax; once this burden is met, the taxpayer must carry the burden of proof with regard to defenses such as reasonable cause. § 7491(c); *see Higbee v. Commissioner*, 116 T.C. 438, 446–47 (2001). However, the Commissioner bears the burden of proof with respect to a new penalty or increase in the amount of a penalty asserted in his answer. *See Rader*

[*47] *v. Commissioner*, 143 T.C. 376, 389 (2014) (citing Rule 142(a)), *aff'd in part, appeal dismissed in part*, 616 F. App'x 391 (10th Cir. 2015); *see also RERI Holdings I, LLC v. Commissioner*, 149 T.C. 1, 38–39 (2017), *aff'd sub nom. Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019).

Respondent has conceded that petitioners are not liable for the section 6662(a) penalty determined in the notice of deficiency, which related to the disallowed charitable contribution deduction. Instead, in his amended Answer, respondent asserted a new section 6662(a) penalty, which relates to his argument that petitioners underreported capital gains because of an anticipatory assignment of income. Consequently, respondent bears the burden of proving that no affirmative defense, such as reasonable cause, exculpates petitioners from a section 6662(a) penalty. *See Full-Circle Staffing, LLC v. Commissioner*, T.C. Memo. 2018-66, at *43, *aff'd in part, appeal dismissed in part*, 832 F. App'x 854 (5th Cir. 2020).

As part of the burden of production, respondent must satisfy section 6751(b) by producing evidence of written approval of the penalty by an immediate supervisor, made before formal communication of the penalty to petitioners. *See Graev v. Commissioner*, 149 T.C. 485, 493 (2017), *supplementing and overruling in part* 147 T.C. 460 (2016); *see also Clay v. Commissioner*, 152 T.C. 223, 246 (2019), *aff'd*, 990 F.3d 1296 (11th Cir. 2021). Here, the emailed approval by the immediate supervisor of respondent's counsel is sufficient to establish compliance with section 6751(b) before formal communication to petitioners of the section 6662(a) penalty. *See Estate of Morrissette v. Commissioner*, T.C. Memo. 2021-60, at *119 ("Emails may constitute written supervisory approval.").

However, section 6664(c)(1) provides that a section 6662 penalty will not be imposed for any portion of an underpayment if the taxpayers show that (1) they had reasonable cause and (2) acted in good faith with respect to that underpayment. A taxpayer's mere reliance "on an information return or on the advice of a professional tax adviser or an appraiser does not necessarily demonstrate reasonable cause and good faith." Treas. Reg. § 1.6664-4(b)(1). That reliance must be reasonable, and the taxpayer must act in good faith. *Id.* In evaluating whether reliance is reasonable, a taxpayer's "education, sophistication and business experience will be relevant." *Id.* para. (c)(1). A taxpayer's "honest misunderstanding of fact or law that is reasonable in light of all

[*48] of the facts and circumstances" may also constitute reasonable cause. *Id.* para. (b).

While we have held that petitioners did not have reasonable cause for their failure to comply with the qualified appraisal requirement, petitioners' liability for an accuracy-related penalty presents a separate issue—and one for which respondent bears the burden of proof. Accordingly, respondent must show that (1) Ms. Kanski was not a competent professional with sufficient expertise to justify reliance; (2) petitioners failed to provide her with necessary and accurate information; or (3) petitioners did not actually rely in good faith on her judgment. *See Neonatology Assocs., P.A.*, 115 T.C. at 99; *see also Full-Circle Staffing, LLC*, T.C. Memo. 2018-66, at *43–44.

We have already found that Ms. Kanski was competent and experienced and that she was provided with the necessary details of the transaction and contribution. The record establishes that Ms. Kanski advised petitioners that their deadline to contribute the shares and avoid capital gains was "prior to execution of the definitive purchase agreement." Petitioner did not follow Ms. Kanski's supplemental advice to have the paperwork for the contribution ready to go "well before the signing of the definitive purchase agreement." Petitioner's statements that he "would rather wait as long as possible to pull the trigger" until he was "99% sure" the sale would close suggest some disregard of his counsel's advice as to the timing of the contribution. *See, e.g.*, *Medieval Attractions N.V. v. Commissioner*, T.C. Memo. 1996-455, 1996 WL 583322, at *61 ("[The taxpayers] cannot claim reliance on their advisers' advice if they failed to follow it."). However, while petitioners disregarded Ms. Kanski's cautionary note as to the timing, they did adhere to the literal thrust of her advice: that "execution of the definitive purchase agreement" was the firm deadline to contribute the shares and avoid capital gains. The anticipatory assignment of income issue (and thus the underlying accuracy of Ms. Kanski's advice) was the subject of contention by the parties in this case. We do not consider the anticipatory assignment of income issue to be so clear cut that petitioner should have known it was unreasonable to rely on Ms. Kanski's advice. *See Robert L. Peterson Irrevocable Tr. #2*, 51 T.C.M. (CCH) at 1321 (finding reasonable cause for accuracy-related penalty where anticipatory assignment of income issue was "vigorously litigated" with "facts going in both directions"). While Ms. Kanski's advice on an issue of substantive tax law was ultimately incorrect, we conclude that it was reasonable for petitioner to rely on it. *See Boyle*, 469 U.S. at 251.

[*49] Further, respondent has failed to establish any bad faith with respect to petitioners' reliance on the advice.

We conclude that respondent has failed to establish that petitioners did not have reasonable cause under section 6664(c)(1) for their underpayment of tax. We will not sustain respondent's determination of a section 6662(a) penalty.

V. *Conclusion*

For the foregoing reasons, we hold that (1) petitioners made a valid gift of the CSTC shares on July 13, 2015; (2) petitioners realized and recognized gain because their right to proceeds from the sale became fixed before the gift; (3) petitioners are not entitled to a charitable contribution deduction; and (4) petitioners are not liable for a section 6662(a) penalty. We have considered all of the arguments made and facts presented by the parties in reaching our decision and, to the extent they are not addressed herein, we find them to be moot, irrelevant, or without merit.

To reflect the foregoing,

Decision will be entered under Rule 155.

NOT PRECEDENTIAL

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 21-1805

STEVEN C. JEMISON, an individual,

Appellant

v.

MICHAEL S. JEMISON, in his capacity as trustee for the Jemison Family Trust and in his capacity as president and co-chairman of the board of directors of JJKL, Inc., f/k/a Heyco, Inc.; WILLIAM D. JEMISON, in his capacity as trustee for the Jemison Family Trust and in his capacity as co-chairman of the board of directors of JJKL, Inc. f/k/a Heyco, Inc.

Appeal from the United States District Court
for the District of New Jersey
(D.C. Civil Action No. 3-17-cv-13571)
District Judge: Honorable Freda L. Wolfson

Submitted Under Third Circuit L.A.R. 34.1(a)
on March 1, 2022

Before: McKEE, AMBRO, and SMITH, Circuit Judges

(Opinion filed: July 1, 2022)

OPINION[*]

AMBRO, Circuit Judge

Business (meaning money) can degrade many a relationship. When those relationships are familial, the fraying of bonds is particularly personal. This appeal is one such story. Steven Jemison—a shareholder of JJKL, Inc. f/k/a Heyco, Inc. ("Heyco" or the "Company") and co-trustee and beneficiary of the Jemison Family Trust—challenges the District Court's grant of summary judgment for his brothers, William and Michael Jemison, in their capacities as co-chairmen of Heyco's Board of Directors (the "Board") and as trustees of the Jemison Trust.[1]

On appeal, Steven argues his brothers breached their fiduciary duties as corporate directors and trustees and were unjustly enriched in connection with three transactions: (1) Heyco's issuance and subsequent forgiveness of $500,000 loans to William and Michael; (2) commission payments to William and Michael stemming from the sale of a Heyco subsidiary, Heyco Products, Inc. ("Products"); and (3) the sale of another Heyco subsidiary, Heyco Metals, Inc. ("Metals"), to Hummock Holdings, a company owned by Michael and his children.

[*] This disposition is not an opinion of the full Court and pursuant to I.O.P. 5.7 does not constitute binding precedent.

[1] The District Court had jurisdiction under 28 U.S.C. § 1332. We have jurisdiction under 28 U.S.C. § 1291.

We affirm the judgment of the District Court as to the corporate director and unjust enrichment claims, as well as the trustee claims relating to the loans and commissions. But though the Court took an intuitive and practical approach to Steven's trustee claims stemming from the Metals sale, New Jersey trust law requires a different tack. Hence we must reverse its judgment on that issue and remand for further proceedings.

I.

The Jemison Trust was formed by the parties' father, who served as the initial trustee. The brothers, along with their sister Susan Jemison (a non-party), are beneficiaries of and hold equal interests in the Trust's assets. After their father's death, while retaining their status as beneficiaries, the siblings became co-trustees of the Trust. The Trust's primary asset is a majority of the voting shares of Heyco, a holding company co-founded by the siblings' grandfather. Heyco had two wholly owned subsidiaries: Products and Metals. Metals manufactured rolled-strip products from copper and copper alloys, mainly for the electronic connector market. Products made electrical connectors from raw materials supplied by Metals and other sources.

Heyco's Board, which held annual board meetings, had four members: William, Michael, Hank Klumpp, and Harry Largey. William had worked for Products since 1981 and was its president. Michael, in turn, had worked for Metals since 1979 and was the president of that subsidiary. Both brothers had been longtime members of Heyco's Board. Steven and Susan did not serve on the Board.

Steven first challenges the issuance and later forgiveness of $500,000 loans by Heyco to William and Michael separately. The loans required them to repay with interest in yearly $50,000 instalments; but the loans were, at the Board's annual meetings between 2012 and 2015, incrementally forgiven by the Company, purportedly as a form of director compensation. Heyco consistently issued dividends to shareholders during the years it forgave the loans.

Steven also challenges commission payments from the Company to his brothers in connection with the 2016 sale of Products to Penn Engineering for $130 million. That sale price exceeded 2013 and 2015 valuations of the subsidiary by investment banking firm Dunn Rush & Co. of between $80 and $100 million and between $100 and $120 million, respectively. After the 2015 valuation, the Board decided to explore selling both Products and Metals. It also issued a Unanimous Written Consent stipulating that senior management should receive a bonus from potential sales of either entity, as "the expectation of large values for [Products] and [Metals] [was] due to management's sustaining and increasing gross margins, mitigating overhead and innovating into new product lines while never failing to pay a dividend or decreasing the dividend paid over that paid in the preceding year." App. at 6. Accordingly, the Consent provided that William and Michael would together receive a total closing bonus of 7.5% of the net proceeds from the sale of either subsidiary.[2] Directors Klumpp and Largey would each

[2] William and Michael would split the 7.5% commission among themselves depending on which subsidiary sold. In a sale of Products, William, as its head, would receive 80%, and Michael 20%, of the commission; conversely, Michael would receive 80%, and William 20%, of the commission in a sale of Metals.

receive commissions of .68% of any sale. Although Steven objected, the sale to Penn Engineering was approved by William, Michael, and Susan on behalf of the Jemison Trust. Heyco's other shareholders also voted in favor of the sale. William and Michael received commissions of $7.8 million and $1.95 million, respectively; Klumpp and Largey each received a commission of around $884,000.

Steven further challenges the sale of Metals to Hummock, an entity owned by Michael and his children, for $17.65 million. Between 2015 and 2016, Heyco discussed selling the subsidiary with three potential suitors and explored the feasibility of an Employee Stock Ownership Plan ("ESOP"). After these options fell through, Michael, through Hummock, made an offer of $15 million, which was rejected. Accepted, however, was his subsequent offer of $17.65 million. The Board—minus Michael, who had recused himself from the vote—unanimously approved the sale. Although entitled to commissions per the 2015 Unanimous Written Consent, the directors waived them for the sale. As with the sale of Products, Michael, William, and Susan, without Steven's consent, voted the Trust's shares to approve. Heyco's other shareholders likewise approved.

The parties contest whether the sale price of $17.65 million reflected Metals' true value. Steven's expert posited the subsidiary was worth about $54 million. William and Michael, on the other hand, pointed to valuations contemporaneous to the sale, including two 2016 valuations of between $18 million and $21 million (using the subsidiary's projected 2016 earnings), and between $11.5 million and $14 million (using Metals' complete financial data for 2013 to 2015), in connection with the potential ESOP

transaction. They also alleged that, during Steven's 2016 divorce proceedings, Metals was valued by Steven and his ex-wife at negative $31.8 million and positive $12.3 million, respectively (facts which Steven disputes).

Following the sale of Metals, Steven sued his brothers, alleging they violated their fiduciary duties as corporate directors and trustees and were unjustly enriched at his expense. The District Court granted summary judgment for William and Michael on all counts. Steven now appeals.

II.

We review motions for summary judgment anew, or *de novo*, applying the same standard as the District Court applied to determine whether summary judgment was appropriate. *Norfolk S. Ry. Co. v. Basell USA Inc.*, 512 F.3d 86, 91 (3d Cir. 2008). We thus give "the non-moving party[] the benefit of every favorable inference that can be drawn from the record to determine if there are any remaining genuine issues of material fact that would enable [it] to prevail." *Robertson v. Cent. Jersey Bank & Tr. Co.*, 47 F.3d 1268, 1273 (3d Cir. 1995). Summary judgment is appropriate only if the record "show[s] that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Norfolk*, 512 F.3d at 91 (quoting Fed. R. Civ. P. 56(c)).

III.

We first consider Steven's claims that William and Michael breached their fiduciary duties of loyalty and care as corporate directors. The New Jersey Business Corporation Act ("NJBCA") requires corporate directors to "discharge their duties in

good faith and with that degree of diligence, care and skill which ordinarily prudent people would exercise under similar circumstances." N.J. Stat. Ann. § 14A:6-14(1). New Jersey courts rely on the business judgment rule to "protect[] a board of directors from being questioned or second-guessed on conduct of corporate affairs except in instances of fraud, self-dealing, or unconscionable conduct." *Maul v. Kirkman*, 637 A.2d 928, 937 (N.J. Super. Ct. App. Div. 1994). The rule provides that "[a] decision made by a board of directors pertaining to the manner in which corporate affairs are to be conducted should not be tampered with by the judiciary so long as the decision is one within the power delegated to the directors and there is no showing of bad faith." *In re PSE&G S'holder Litig.*, 801 A.2d 295, 306 (N.J. 2002).

The rule is in effect "a rebuttable presumption" that "places an initial burden on the person who challenges a corporate decision to demonstrate the decision-maker's 'self-dealing or other disabling factor.'" *Id.* (quoting *Maul*, 637 A.2d at 937). "If a challenger sustains that initial burden, then the presumption of the rule is rebutted, and the burden of proof shifts to the defendant or defendants to show that the transaction was, in fact, fair to the corporation." *Id.* at 306–07 (cleaned up). To determine whether the business judgment rule applies, courts ask "(1) whether the actions were authorized by statute or by charter, and if so, (2) whether the action is fraudulent, self-dealing or unconscionable." *Seidman v. Clifton Sav. Bank, S.L.A.*, 14 A.3d 36, 52 (N.J. 2011) (quoting *Green Party of N.J. v. Hartz Mountain Indus. Inc.*, 752 A.2d 315, 326 (N.J. 2000)).

A.

Steven first asserts his brothers breached their fiduciary duties of loyalty and care as corporate directors of Heyco by (1) issuing and later forgiving the $500,000 loan to each of them, and (2) authorizing their commissions in connection with the sale of Heyco Products. The District Court determined the business judgment rule insulated William and Michael's decisions on these transactions. We agree.[3]

We start with whether these transactions were breaches of the duty of loyalty. The NJBCA provides that "[t]he board, by the affirmative vote of a majority of directors in office and irrespective of any personal interest of any of them, shall have authority to establish reasonable compensation of directors for services to the corporation as directors, officers, or otherwise." N.J. Stat. Ann. § 14A:6-8(3). It also permits a corporation to "lend money to, or guarantee any obligation of, or otherwise assist, any director, officer or employee of the corporation or of any subsidiary, whenever, in the judgment of the directors, such loan, guarantee or assistance may reasonably be expected to benefit the corporation." *Id.* § 14A:6-11. Corporations are given wide leeway to set the terms for such loans, which "may be made with or without interest, and may be unsecured, or secured in such manner as the board shall approve, . . . and may be made upon such other terms and conditions as the board may determine." *Id.*

[3] As this is a breach of fiduciary duty, we would expect these corporate law claims to be brought as derivative actions. *Strasenburg v. Staubmuller*, 683 A.2d 818, 829–30 (N.J. 1996) ("Claims of breach of a fiduciary duty on the part of the directors will also be generally regarded as derivative claims unless the injury to shares is distinct."). But because William and Michael fail to challenge that here, we will assume the claims are properly brought as individual claims.

Because the NJBCA authorized Heyco's Board to set director compensation and issue loans to its directors, Steven bears the burden to rebut the presumption that these transactions fall within the scope of the Board's business judgment. He contends the business judgment rule does not apply because the transactions were "clearly self-interested." Op. Br. at 13. But the NJBCA explicitly states that a director approving his own compensation is *not* a conflict of interest, *id*. § 14A:6-8(3), and grants boards the discretion to lend money to directors, *id.* § 14A:6-11. And the transactions were approved by Klumpp and Largey, Heyco's two disinterested directors, thereby cleansing any potential conflict of interest. *See id.* § 14A:6-8(1)(b) (permitting transactions that would otherwise be void or voidable due to a conflict of interest if the board is aware of the conflict and nonetheless "authorizes, approves, or ratifies the . . . transaction . . . by unanimous written consent, provided at least one director so consenting is disinterested, or by affirmative vote of a majority of the disinterested directors, even though the disinterested directors be less than a quorum").

Steven further contends the District Court's grant of summary judgment was inappropriate because "it was impossible to determine without a trial whether the compensation [including the loans] was reasonable and for the 'benefit of the corporation.'" Op. Br. at 19 (quoting N.J. Stat. Ann. § 14A:6-11). Such an approach, however, would undermine the purpose of the business judgment rule—that corporate boards should be free to exercise their discretion unless engaged in fraudulent, self-dealing, or bad faith conduct. As Steven has not sufficiently alleged such conduct, we affirm the District Court's application of the business judgment rule and conclude

William and Michael did not breach their duty of loyalty as to the loans and commissions.

We likewise affirm the Court's determination that William and Michael did not breach their duty of care in authorizing these transactions. Under New Jersey law, the duty of care requires that directors "discharge their duties in good faith and act as ordinarily prudent persons would under similar circumstances in like positions." *Francis v. United Jersey Ban*k, 432 A.2d 814, 821 (N.J. 1981). Accordingly, they must "obtain all material information reasonably available to them when making the decision, and act with the requisite care in the discharge of their duties." *Seidman v. Clifton Sav. Bank, S.L.A.*, 2009 WL 2513797, at *10 (N.J. Super. Ct. App. Div. Aug. 12, 2009) (per curiam) (citing *Francis*, 432 A.2d at 821–23). To assess whether a director acted with due care, our "inquiry is not into the substantive decision of the [director], but rather is into the procedures employed by the board in making its determination. In that regard, there is no prescribed procedure that a [director] must follow." *Jurista v. Amerinox Processing, Inc.*, 492 B.R. 707, 760 (D.N.J. 2013) (alterations in original) (quoting *PSE&G*, 801 A.2d at 315).

The District Court, in applying the business judgment rule and granting summary judgment, ruled that Steven failed to "identif[y] any facts suggesting that the Board of Directors was anything less than fully informed when it approved the issuance and forgiveness of the loans, as well as the commissions paid to," his brothers. App. at 19. The Court, moreover, held that the Board's annual review and incremental forgiveness of the loans—as well as its decision to set a shared commission of 7.5% for William and

Michael in the "expectation of the large values for" contemplated sales of Products and Metals and to recognize the pair's successful efforts to boost the values of the subsidiaries—satisfied the duty of care. App. at 20–21 (internal quotations omitted). We see no error here and so affirm the judgment of the District Court.

B.

Steven next contends his brothers breached their fiduciary duties of loyalty and care as corporate directors in connection with the sale of Metals to Hummock, which is owned by Michael and his family. The District Court likewise applied the business judgment rule to these claims and entered summary judgment for Appellees. We again affirm.

As for the duty of loyalty, "[d]irectors are considered to be 'interested' if they either appear on both sides of a transaction or expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." *Jurista*, 429 B.R. at 761 (cleaned up). The NJCBA, however, provides that transactions otherwise void or voidable due to a conflict of interest are permitted if

> [t]he fact of the common directorship or interest is disclosed or known to the board[,] . . . and the board . . . authorizes, approves, or ratifies the . . . transaction by unanimous written consent, provided at least one director so consenting is disinterested, or by affirmative vote of a majority of the disinterested directors, even though the disinterested directors be less than a quorum.

N.J. Stat. Ann. § 14A:6-8(1)(b). The District Court concluded there was no violation of the NJBCA because Michael recused himself from the vote to approve the sale; the other directors (William, Klumpp, and Largey) were aware of Michael's relationship with

Hummock and still unanimously approved the transaction; Klumpp and Largey were disinterested; and Steven did not allege a dispute of material fact that would show otherwise. Because the undisputed facts indicate that the Board followed the correct procedure to approve the sale of Metals, we agree with the Court's application of the business judgment rule and its conclusion that William and Michael satisfied their duty of loyalty as corporate directors in connection with the transaction.

Steven then argues William and Michael breached their duty of care by selling Metals for a price significantly lower than its value and also that the District Court erred in granting summary judgment because he has shown a material dispute of fact as to the true value of Metals.

As noted above, New Jersey's duty-of-care analysis focuses on "the procedures employed by the board in making its determination." *Jurista,* 492 B.R. at 760. The duty of care requires directors to "discharge their duties in good faith and with that degree of diligence, care and skill which ordinarily prudent people would exercise under similar circumstances in like positions," N.J. Stat. Ann. § 14A:6-14(1), and extends to actions by directors "which may involve or relate to a change or potential change in the control of the corporation,"[4] *id*. § 14A:6-14(4). The brothers' actions met this standard.

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[4] In this context, "'control' means the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the corporation, whether through the ownership of voting shares, by contract or otherwise." N.J. Stat. Ann. § 14A:6-14(4). Accordingly, the sale of Metals, alleged to be Heyco's "only [remaining] substantial asset," App. at 50 (Compl. ¶ 28), is a change-in-control transaction contemplated by § 14A:6-14(4).

We note, however, that the Delaware courts—which New Jersey courts often look to on issues of corporate law, *see, e.g.*, *Balsamides v. Protameen Chem. Inc.*, 734 A.2d 721, 732 (N.J. 1999)—apply a heightened standard when analyzing transactions, such as this one, that would result in a sale of substantially all of a company's assets. *See Paramount Commc'ns Inc. v. QVC Network Inc.*, 637 A.2d 34, 44–45 (Del. 1994). In those circumstances, the company's "directors must focus on one primary objective—to secure the transaction offering the best value reasonably available for the stockholders." *Id*. at 44. To that end, the directors' actions are subject to an enhanced scrutiny test involving "(a) a judicial determination regarding the adequacy of the decisionmaking process employed by the directors, including the information on which the directors based their decision[,] and (b) a judicial examination of the reasonableness of the directors' action in light of the circumstances then existing." *Id*. at 45. Though the directors "have the burden of proving that they were adequately informed and acted reasonably," Delaware courts do not question their decision so long as it was "within a range of reasonableness." *Id*.

The parties do not mention Delaware's heightened standard, let alone ask us to apply it. Still, the record suggests it too was met. The evidence indicates the Board was adequately informed and acted reasonably during the sales process. Before starting negotiations with Hummock, it considered an ESOP transaction and engaged in sale discussions with at least three potential purchasers, all of which fell through. In considering the ESOP transaction, the Board commissioned two independent valuations of Metals, which valued the subsidiary between $18 million and $21 million, and

between $11.5 million and $14 million, respectively. It then engaged in vigorous negotiations with Hummock, rejecting the firm's first offer and reaching a final sale price that was $2.65 million above that initial offer. And as the District Court correctly noted, the final sale price of $17.65 million was consistent with the independent valuations stemming from the potential ESOP transaction. This record persuades us that the Board was adequately informed and acted reasonably under the circumstances it faced.

We are also unpersuaded by Steven's argument that summary judgment was improper because of a disputed issue of material fact on whether the sale of Metals was "fair and reasonable." Op. Br. at 45. In support, he contends the Board "never took [Metals] out to market" and failed to hire an independent third party to market the company. *Id.* But, as noted above, the Board had sale discussions with three potential buyers and considered an ESOP transaction before turning to Hummock. And Steven cites no case showing William and Michael's duty of care required them to hire an independent third party to help sell Metals. Moreover, because disinterested directors Klumpp and Largey approved the sale, William and Michael did not need to show the transaction was "fair and reasonable" to Heyco. *See* N.J. Stat. Ann. § 14A:6-8(a)–(b) (transaction that would otherwise be void or voidable due to a conflict of interest is permitted if "fair and reasonable" to the company *or* if the board, while aware of the conflict, approves the transaction "by unanimous written consent, provided at least one director so consenting is disinterested, or by affirmative vote of a majority of the disinterested directors, even though the disinterested directors be less than a quorum").

Because the Board's decision to sell Metals was procedurally sound, we affirm the District Court's application of the business judgment rule and grant of summary judgment rejecting Steven's duty-of-care claim.

IV.

We next consider Steven's claim that his brothers breached their fiduciary duties as trustees with respect to the sale of Metals to Michael-controlled Hummock.[5] In dismissing the trustee counts, the District Court took a practical route suggested by corporate law: because the Trust Agreement allowed all four Jemison siblings, as trustees, to vote the Trust's shares and did not require them to act unanimously,[6] William and Michael did not breach their fiduciary duties as trustees by voting their shares in favor of the transaction. However, the relevant legal standard is one of New Jersey trust law.

Section 3B:31 of the New Jersey Uniform Trust Code ("NJUTC") sets out default rules governing the conduct of trustees absent conflicting terms in the trust agreement. It

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[5] Steven also attempts to revive trustee claims arising from his brothers' actions as to their loans and commissions. The District Court held that these claims were not properly pled, and we agree. The relevant counts allege only that William and Michael breached their fiduciary duties as trustees in relation to the sale of Metals. Because Steven was not permitted to "amend [his] pleading[] in a summary judgment motion," the District Court was right to limit the scope of his trustee claims to Metals. *HFGL Ltd. v. Alex Lyon & Son Sales Managers & Auctioneers, Inc.*, 700 F. Supp. 2d 681, 683 n.7 (D.N.J. 2010).

[6] The District Court correctly observed that the Trust Agreement did not require the co-trustees to act unanimously. Absent a provision requiring unanimity, New Jersey law allows "[c]o-trustees who are unable to reach a unanimous decision [to] act by majority decision." N.J. Stat. Ann. § 3B:31-48(a).

requires trustees to "administer the trust with undivided loyalty to and solely in the best interests of the beneficiaries." N.J. Stat. Ann. § 3B:31-55(a). This duty to act in the beneficiaries' best interest extends to when trustees "vot[e] shares of stock of a corporation or . . . exercis[e] powers of control over similar interests in other forms of enterprise." *Id.* § 3B:31-55(f). Accordingly,

> [a] sale . . . or other transaction involving the investment or management of trust property is presumed to be affected by a conflict between personal and fiduciary interests if it is entered into by the trustee with . . . a corporation or other . . . enterprise in which the trustee . . . has an interest that might affect the trustee's judgment.

Id. § 3B:31-55(c)(4).[7]

William and Michael concede that the sale of Metals was "presum[ably] . . . affected by conflict" because Michael controlled Hummock, the buyer. *Id.* § 3B:31-55(c). Because the parties concede that § 3B:31-55(c) governs this action, we must determine if they cured the presumed conflict. This presumption could have been rebutted in one of five ways:

> (1) the transaction was authorized by the terms of the trust; (2) the transaction was approved by the court; (3) the beneficiary did not commence a judicial proceeding within the time allowed by [N.J. Stat. Ann.] 3B:31-74; (4) the beneficiary consented to the trustee's conduct, ratified the transaction, or released the trustee in compliance with [N.J. Stat. Ann.] 3B:31-78; or (5) the transaction involves a contract entered into or a claim acquired by the trustee before the person became a trustee.

[7] Because "every trustee shall exercise reasonable care to: (1) prevent a co-trustee from committing a breach of trust[,] and (2) compel a co-trustee to redress a breach of trust," if Michael breached his fiduciary duties as trustee by voting the trust's shares to approve the sale of Metals to a company he owned, so too did William in consenting to the sale. N.J. Stat. Ann. § 3B:31-48(g).

Id. § 3B:31-55(b).

William and Michael argue only the first way—that the terms of the Trust Agreement, in both its structure and specific language, authorized the sale. They point to the "broad discretionary rights and powers" afforded to the trustees under the Trust Agreement, including "the ability to vote to exercise or sell any rights," and "consent to . . . any contract, . . . sale or action by any corporation." Appellees' Supp. Br. at 3 (quoting App. at 2318).[8] These generalized terms, however, are silent as to the ability of the trustees to vote shares of Heyco, so that Heyco sells its assets to the trustees or entities they control, and so fail to overcome the NJUTC's default rules to "administer the trust with undivided loyalty to . . . the beneficiaries," N.J. Stat. Ann. § 3B:31-55(a), and prohibit sales "presum[ably] . . . affected by a conflict," *id*. at § 3B:31-55(c).

The brothers also argue their conduct was permissible under Article IX of the Trust Agreement, which provides that the trustees "shall not be liable for any loss or depreciation in the value of the trust estate occurring by reason of error of judgment in making any sale . . ., unless willful misconduct shall be proven by affirmative evidence." Appellees' Supp. Br. at 3 (quoting App. at 2320). But this provision offers no such protection here, as its plain language merely shields trustees from liability for "error[s] of judgment" and makes no reference to conflicted transactions. Likewise, our review of

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[8] Appellees also cite their powers to "sell, mortgage, or otherwise dispose of realty and personalty, publicly, privately, wholly or partly on credit," and "invest and reinvest in assets not ordinarily considered proper investments for trusts, including but not limited to securities offered by new and unseasoned ventures." Appellees' Supp. Br. at 3 (quoting App. at 2318–19). These powers are facially irrelevant to the issue of whether William and Michael could sell trust property to themselves.

the Trust Agreement shows no authorization for the sort of deemed-conflicted vote alleged by Steven.

William and Michael contend that because the Trust Agreement (1) did not limit their ability to serve both as co-trustees and as directors of Heyco, (2) allowed all four Jemison siblings, as co-trustees, to vote the Trust's shares, and (3) did not require them to act unanimously, William and Michael had a right to vote their shares in favor of the transaction. This structural argument echoes the reasoning of the District Court. That reasoning, however, does not cure the presumed conflict. William and Michael's ability to serve simultaneously as co-trustees and directors of Heyco, or their general power to vote the Trust's shares, have little bearing on whether they could, as co-trustees, approve the sort of conflicted sale at issue here. The unanimity argument also misses the point: Steven's objections stem not from his rights as a co-trustee but as a beneficiary of the Trust.

Further, the District Court's reliance on *Rosencrans v. Fry*, 91 A.2d 162 (N.J. Super. Ct. Ch. Div. 1952), for its conclusion that the Trust Agreement "essentially sanctioned Defendants' dual roles as Trustees of the Jemison Family Trust and Directors of Heyco," App. at 33, is misplaced. The court there held that a trustee who owned shares of a company for which he also served as an executive did not breach his fiduciary duties by serving in both roles and purchasing company shares from the trust because (1) the testator knew the trustee was an executive of the company when he created the trust instrument, and (2) the trust instrument specified the trustee had an option to buy the shares. 91 A.2d at 164–69. *Rosencrans* does not fit here because the Trust Agreement,

unlike the instrument in that case, did not explicitly authorize trustees to purchase property from the trust. Though the District Court was correct that New Jersey law and the Trust Agreement generally allowed William and Michael to vote the shares of the Trust and hold positions on Heyco's Board, its *Rosencrans* analysis does not extend to the specific circumstances of William and Michael's exercising those rights to approve a conflicted transaction.

Tempting as it is, Steven cannot be faulted for trying to "side-step the business judgment rule in arguing that [William and Michael] breached their duties as trustees." App. at 34. To the contrary, in New Jersey trustees are subject to *stricter* fiduciary duties than corporate directors. *See In re Koretzky's Estate*, 86 A.2d 238, 249 (N.J. 1951) ("The most fundamental duty owed by the trustee to the beneficiaries of the trust is the duty of loyalty and he is not permitted to place himself in a position where it would be for his own benefit to violate that duty."); *see also* Restatement (Third) of Trusts § 78 cmt. b ("The fiduciary duty of undivided loyalty in the trust context . . . is particularly intense so that, in most circumstances, its prohibitions are absolute for prophylactic reasons."). Moreover, "the rule that fiduciaries are not to deal in their own behalf with respect to matters involved in their trusts operates irrespectively of the good faith or bad faith of such dealing." *Koretzky*, 86 A.2d at 249 (quoting *In re Kline*, 59 A.2d 14 (N.J. Ct. Err. & App. 1948) (per curiam)). Thus William and Michael, as trustees, could not cure the conflict in the same way they did as corporate directors.

Because the sale of Metals to an entity owned by Michael and his family was presumed conflicted under New Jersey trust law, and that presumption was not

successfully rebutted, summary judgment for William and Michael is not an option here. We thus, reluctantly, reverse and remand the Court's grant of summary judgment on this ground.

V.

Finally, Steven challenges the District Court's disposition of his unjust enrichment claim, which the Court determined was "duplicative of his claims for breach of fiduciary duty." App. at 35. To sustain this claim under New Jersey law, Steven had to show that "(1) at plaintiff's expense (2) defendant received [a] benefit (3) under circumstances that would make it unjust for defendant to retain [the] benefit without paying for it." *Maniscalco v. Brother Int'l Corp. (USA)*, 627 F. Supp. 2d 494, 505 (D.N.J. 2009) (quoting *In re K-Dur Antitrust Litig.*, 338 F. Supp. 2d 517, 544 (D.N.J. 2004)).

The Court entered summary judgment for William and Michael after determining that the challenged actions did not exceed their authority as directors and trustees, such that there was "no material dispute of fact with respect to whether [they] were entitled to the renumeration they received." App. at 35. We agree with its ruling as to their actions as corporate directors. And to the extent that Steven's unjust enrichment claim is based on his brothers' actions as trustees, it fails as well because the parties' relationship is governed by the Trust Agreement, and Steven has not alleged that agreement is void or sought rescission. *Van Orman v. Am. Ins. Co.*, 680 F.2d 301, 310 (3d Cir. 1982) (under New Jersey law, "recovery under unjust enrichment may not be had when a valid, unrescinded contract governs the rights of the parties").

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For these reasons, we affirm in part the District Court's grant of summary judgment for Appellees and reverse in part and remand for further proceedings.

CURTIS R. KIMBALL, CFA, ASA

Curtis Kimball is a senior managing director of Willamette Management Associates. In addition to his work on all types of valuation engagements for the firm, Mr. Kimball is also the firm's national director for wealth management valuation services. His standard hourly billing rate is $600.

Mr. Kimball supervises engagements for our clients in the valuation of business entities and business interests, in the analysis of publicly traded and private securities, the appraisal of intangible assets and intellectual property, and provides expert witness testimony to support the firm's analysis.

He has performed the following types of valuation assignments: estate and gift planning appraisals, estate tax (both date of death and alternate value date) appraisals, gift tax appraisals, generation-skipping tax appraisals, buy-sell agreement appraisals, income tax (including charitable deduction, capital gains tax, intangible asset basis and loss deduction) appraisals, transaction feasibility and appraisals, merger and acquisition valuations, fairness opinions, solvency analysis, ESOP feasibility and initial transaction appraisals, ESOP annual update valuations, insurance appraisals, divorce and pre-nuptial appraisals, various litigation support appraisals (including reviewing and rebutting the work of other experts), damages and lost profits analyses, bankruptcy and restructuring analysis and valuation, fair compensation and stock option valuations, and appraisals supporting collateral values for financing purposes.

Mr. Kimball has presented expert witness testimony in federal (U.S. Tax Court, U.S. District Court, U.S. Court of Federal Claims, and U.S. Bankruptcy Court) and various state courts and in alternate dispute resolution venues, including mediation and binding arbitration. Mr. Kimball acts as the firm's national director for wealth management valuation matters (including estate, gift, charitable, fiduciary, and marital planning, expatriation, buy-sell agreements, and related dispute resolutions and tax issues for high net worth families and their business interests) and has extensive experience with appearances in IRS appellate conferences.

Mr. Kimball has extensive experience in the appraisal of various types of business entities and interests. These include: private family-owned businesses, private multiple-investor businesses, minority interests, fifty-percent interests, restricted public stock, large blocks of publicly traded securities, preferred stock interests, multiple classes of preferred and common stock in complex capital structures, secured notes, subordinated debt interests, stock options, warrants and rights offerings, general and limited partnership interests, limited liability company membership interests, professional practices, new ventures, joint ventures, license agreements, franchises, and foreign-domiciled corporations.

In addition, his experience includes the valuation of various types of intangibles and intellectual properties. These include: patents, permits, copyrights, master recordings, television series library, core deposits, customer contracts, management employment contracts, noncompete clauses, rights and contract disputes, customer lists, assembled workforces, professional sports intangibles, trademarks, going-concern values, goodwill, tax issues, branching rights, regulatory accounting principles rights, and transfer price agreements.

PREVIOUS EXPERIENCE

Before joining Willamette Management Associates, Mr. Kimball was a vice president and manager of the Business Owners Services Group of the Citizens & Southern Trust Company, the trust subsidiary of the Citizens & Southern Corporation of Atlanta, Georgia (subsequently acquired by Bank of America). Mr. Kimball provided the C&S Corporation's trust and banking customer base throughout the Southeast with valuation and appraisal services. In addition, his area acted as the trust department's analyst and administrator in matters relating to the management, purchase, and sale of private business interests and illiquid securities held in estates and trusts. Mr. Kimball has managed closely held businesses after the founder's death and has

served as a member of the board of directors of a number of family-owned businesses in his capacity as representative of the bank as fiduciary.

Mr. Kimball also acted as part of C&S Trust's ESOP fiduciary services group, with input regarding the retention of independent appraisal firms to advise the bank as trustee on ESOP valuations and review of outside appraisers' work. Mr. Kimball's position at C&S included work as part of the team that acted as ESOP trustee for the leveraged buyout of AVIS Rent-a-Car, one of the largest and most successful employee-owned firms in the nation at that time.

Prior to joining C&S, Mr. Kimball was an Assistant Vice President with the Trust Department of Wachovia Bank & Trust Company, N.A., a major regional bank located in North Carolina (subsequently acquired by Wells Fargo). As the assistant manager of the closely-held business unit at Wachovia, Mr. Kimball managed the trust department's holdings of private business interests and conducted valuations of closely-held businesses and business interests for bank clients in the region. He also worked as a commercial loan administration officer and in the internal audit department at Wachovia.

Mr. Kimball joined the Portland, Oregon, office of Willamette in 1988 and moved to Atlanta in 1995 to open this regional office for the firm. He is a noted speaker and author on the subject of valuations for wealth planning and other purposes. He is also an accredited investor who has purchased and sold private company investments for his own account.

EDUCATION

Master of Business Administration, Emory University (1984)

Bachelor of Arts, Economics, Duke University (1972)

PROFESSIONAL AFFILIATIONS

Mr. Kimball holds the professional designation Accredited Senior Appraiser in business valuation and in appraisal review and management for business valuation (ASA) from the American Society of Appraisers. He is currently a member of the ASA's Board of Governors. He served as a member and the Treasurer of ASA's Business Valuation Committee, as a member of the ASA's International Ethics Committee, its Investment Policy Committee, and its International Board of Examiners. He was also a member of the ASA's Business Valuation Standards Sub-Committee. He has served as president, secretary, and treasurer of the Atlanta Chapter of the ASA. He is the past chair of the Atlanta Chapter's Business Valuation Committee. He has served as Treasurer of the Portland Chapter of the ASA.

Mr. Kimball also holds the Chartered Financial Analyst (CFA) professional designation from the CFA Institute (CFA-I). He was a member of CFA-I's Board of Examiners and was a senior grader for the examinations leading to the CFA designation. He served as a member of the Disciplinary Review Committee of CFA-I and served as a member of the disciplinary/ethics hearing panelist pool. He was a member of the Portland Society of Financial Analysts (CFA-I's Oregon chapter), for which he served as secretary and a member of the board of directors. He served on the board of trustees of the CFA Society Atlanta (CFA-I's Georgia chapter) and has also served as its Membership Chair.

He is also a member of the Institute of Management Accountants, the National Association of Corporate Directors, and the National Association of Business Economists, for which he held positions as president of the Portland chapter and treasurer of the Atlanta chapter.

PUBLICATIONS

In addition to acting as manuscript reviewer and contributor to various articles and books authored by members of Willamette Management Associates and other appraisal professionals, Mr. Kimball is the author of the following:

"Estate of Warne v. Commissioner: Valuation Discounts Allowed on Controlling Ownership Interests" Willamette Management Associates *Insights*, Summer 2021

"Estate of Aaron U. Jones v. Commissioner of Internal Revenue Service TCM 2019-101: Increasing Acceptance of Tax-Affecting" with Scott Miller, Willamette Management Associates *Insights*, Winter 2020.

"Valuation for the Expatriation Tax – "So Long, It's Been Good to Know Yuh," Willamette Management Associates *Insights*, Summer 2019.

"Proposed Section 2704 Regulations: Issues and Implications," Willamette Management Associates *Insights*, Winter 2017.

"Reviewing the Service's Job Aid on the Valuation of Noncontrolling Ownership Interests in S Corporations" Willamette Management Associates *Insights*, Winter 2016.

"Bankruptcy Court Addresses Challenges to a Right of First Offer in Revised Plan" Willamette Management Associates *Insights*, Summer 2014.

PRESENTATIONS

Mr. Kimball regularly teaches seminars to attorneys, accountants and business owners on the issues of valuation of closely held business interests particularly for wealth management purposes.

He has also taught courses on valuation for bar and CPA groups, including the American Law Institute, the Institute of Continuing Legal Education (University of Georgia Law School) for the Georgia Bar Association, Louisiana State University Law Center, and the University of Oregon Law School.

Mr. Kimball taught as an adjunct faculty member from 1989 through 1991 at the Southern Trust School in Birmingham, Alabama, sponsored by the Southern Bankers Association.

Mr. Kimball's recent speeches and presentations within the last 10 years include the following:

9/22 "Valuation Roundtable – Discussion of Current Valuation Issues"
Sponsor: National Trust Closely Held Business Association
46nd Annual Virtual Conference

9/22 "Update on S Corporation Valuation Issues"
Sponsor: National Trust Closely Held Business Association
46nd Annual Virtual Conference

11/21 "Estate Planning for the Family Business Owner" (with Steve Gorin)
Sponsor: American Law Institute – Continuing Legal Education
28th Annual Advanced Course and Live Video Webcast
Atlanta, Georgia

9/21 "Valuation Roundtable – Discussion of Current Valuation Issues"
Sponsor: National Trust Closely Held Business Association
45nd Annual Virtual Conference

7/20 "Valuation Roundtable – Hearing About Valuation Issues That all Fiduciaries Should Understand"
Sponsor: National Trust Closely Held Business Association
44nd Annual Virtual Conference

7/19 "Valuation Theory and Practice: Selecting and Working with Appraisers" (with Stephanie Loomis-Price)
Sponsor: American Law Institute-American Bar Association (ALI-ABA) Skills Training for Estate planners (STEP) conference, University of South Carolina Law School, Columbia, South Carolina

11/18 "Estate Planning for the Family Business Owner" (with Steve Gorin)
Sponsor: American Law Institute – Continuing Legal Education
27th Annual Advanced Course and Live Video Webcast
Atlanta, Georgia

10/18 "An Update on 50 Year's Worth of Valuation Issues"
Sponsor: Estate Planning Council of St. Louis
Monthly meeting presentation

9/18 "Valuation Roundtable – Hearing About Valuation Issues That all Fiduciaries Should Understand"
Sponsor: National Trust Closely Held Business Association
43nd Annual Conference, Cleveland, Ohio

9/18 "Valuation Court Case Update for 2017-2018"
Sponsor: National Trust Closely Held Business Association
43nd Annual Conference, Cleveland, Ohio

7/18 "Valuation Theory and Practice: Selecting and Working with Appraisers" (with Stephanie Loomis-Price)
Sponsor: American Law Institute-American Bar Association (ALI-ABA) Skills Training for Estate planners (STEP) conference, New York Law School, New York, New York

4/18 "TCJA and New Pass Through Entity Impacts" (co-presenter)
Sponsor: American society of Appraisers
ASA Tax Webinar Series

11/17 "Estate Planning for the Family Business Owner" (with Stephanie Loomis Price)
Sponsor: American Law Institute – Continuing Legal Education
26th Annual Advanced Course and Live Video Webcast
Charleston, South Carolina

9/17 "Valuation Roundtable Discussion Topics" (with Aaron Stumpf and David Pieton)
Sponsor: National Trust Closely Held Business Association
42nd Annual Conference, Milwaukee, Wisconsin

7/17 "Valuation Theory and Practice: Selecting and Working with Appraisers" (with Stephanie Loomis-Price)
Sponsor: American Law Institute-American Bar Association (ALI-ABA) Skills Training for Estate planners (STEP) conference, New York Law School, New York, New York

11/16 "Valuation Roundtable" (with Nick Sypniewski, Tim Muehler, and Todd Povlich)
Sponsor: National Trust Closely Held Business Association
41st Annual Conference, Webinar

10/16 "Appraisals for Tax Purposes: Selecting and Working with Appraisers"
Sponsor: Louisiana State University Law Center
LSU 46th Annual Estate Planning Seminar, Baton Rouge, Louisiana

10/16 "Valuation of Pass-Through Entities: 2016 Update"
Sponsor: National Trust Closely Held Business Association
41st Annual Conference, Charleston, South Carolina

10/16 "Expert Panel on Challenging Topics" (with Linda Trugman, Bob Morrison, and Robert Schlegel)
Sponsor: The Southeast Chapter of Business Appraisers'
2016 Annual Southeast Regional Conference
Atlanta, Georgia

9/16 "The IRS' Proposed Section 2704 Regulations: The Impact on and the Future of Estate and Gift Valuation" (with Z. Christopher Mercer)
Sponsor: Business Valuation Resources, Inc.
Webinar

7/16 "Valuation Theory and Practice: Family Business Planning" (with Hugh Drake)
Sponsor: American Law Institute-American Bar Association, Skills Training for Estate Planners (STEP)
New York Law School, New York, New York

4/16 "Appraising Private Business Interests for Estate Planning"
Sponsor: Georgia State University School of Law
Class Guest Lecture: Estate Planning for Family Business Owners (Professor Radford)
Atlanta, Georgia

3/16 "Litigating the Value of a Business: Trial Attorney Perspectives" (with W. Curtis Elliott, Jr.)
Sponsor: South Carolina Bar, Continuing Legal Education Division
Columbia, South Carolina

9/15 "IRS Job Aids on Closely Held Entity Issues: An Update"
Sponsor: National Trust Closely Held Business Association
Annual Workshop, New Orleans, Louisiana

7/15 "Valuation Theory and Practice: Family Business Planning" (with Hugh Drake)
Sponsor: American Law Institute-American Bar Association, Skills Training for Estate Planners (STEP), New York Law School, New York, New York

10/14 "Analysis of Recent Valuation Developments and Trends: Making the Best of the Relationship with Your Valuation Expert" (with David T. Lewis)

Sponsor: 36th Annual Duke Estate Planning Conference
Duke University School of Law, Durham, NC

7/14 "Valuation Theory and Practice: Family Business Planning" (with Hugh Drake)
Sponsor: American Law Institute-American Bar Association, Skills Training for Estate Planners (STEP), New York Law School, New York, New York

11/13 "Litigating the Value of Business Interests"
(with W. Curtis Elliott, Jr.)
Sponsor: myLaw – CLE
Webinar broadcast from: Charlotte, North Carolina

9/13 "Round Table Discussion: Valuation Issues"
Sponsor: National Trust Closely Held Business Association
Annual Workshop, Painesville, Ohio

7/13 "Valuation Theory and Practice: Family Business Planning" (with Hugh Drake)
Sponsor: American Law Institute-American Bar Association, Skills Training for Estate Planners (STEP), New York Law School, New York, New York

7/13 "Valuations vs. Calculations: Advice and Guidance from Professional Standards"
(with Linda Trugman and Edward Dupke)
Sponsor: Business Valuation Resources, Inc.
Webinar

9/12 "Update on Court Cases"
Sponsor: National Trust Closely Held Business Association
Annual Workshop, Itasca, Illinois

7/12 "Valuation Theory and Practice: Family Business Planning" (with Hugh Drake)
Sponsor: American Law Institute-American Bar Association, Skills Training for Estate Planners (STEP), New York Law School, New York, New York

6/12 "Valuation Issues with Family-Owned Business Interests"
Sponsor: American Institute on Federal Taxation, Birmingham, Alabama

COURT AND EXPERT WITNESS ENGAGEMENTS

In re Mark Hughes Family Trust, Case No. BP063500
Superior Court of the State of California for the County of Los Angeles, Central District
October 2021 – current
Damages in connection with the Co-Trustees' sale of real estate
Retained as expert by counsel for former Co-Trustees
Report and deposition

Bergeron Environmental and Recycling, LLC v. LGL Recycling, LLC, et al.—Case No. CACE-16000158
Circuit Court of the 17th Judicial Circuit in and for Broward County, Florida
July 2021
Damages in connection with an acquisition transaction

Retained as expert by counsel for LGL et al
Report, deposition and testimony

Debra Gray King, Petitioner v. Daniel Rosson King, Respondent, Civil Action File No: 2016CV281203
Superior Court of Fulton County, State of Georgia, Family Division
March 2021
Equitable Division – Fair market value of Atlanta Center for Cosmetic Dentistry and Dr. King's personal goodwill
Retained as expert by counsel for Dr. Debra King in a court-mandated arbitration
Report, deposition, and testimony

Citigroup Inc. and Subsidiaries, Including Citibank, N.A. as Successor in Interest to Glendale Federal Bank, FSB, Plaintiff v. The United States, Defendant No. 15-953 T
The United States Court of Federal Claims
February 2021 – March 2022
Income Tax – Fair market value of Regulatory Accounting Principles (RAP) rights – intangible asset allocations
Retained as expert for Department of Justice
Report and deposition

Ruby Tuesday, Inc., Petitioner v. Cede & Co.; Quadre Investments, LP; Lawrence N. Lebow; Jonathan Lebow; Miriam D. Roth; Powell Anderson Capital LP; and Leland Wykoff; Respondents. Civil Action File No. 2018CV304101
Superior Court of Fulton County, State of Georgia
September 2020 – Fair value under Georgia Dissenters' Rights, O.C.G.A. Sections 14-2-1301 to 1332
Retained as expert by counsel for Respondents
Report and rebuttal report

Laura Cowan Coffee v. David L. Coffee, individually and as trustee and executor, et al
Chancery Court, Knox County, State of Tennessee
September 2019 – Damages due to Executor's/Trustee's self-dealing with respect to private company
Retained as expert by counsel for Laura Coffee
Report, deposition, and testimony

Legacy Data Access, Inc., Plaintiff, v. Cadrillion, LLC, Defendant
United States District Court, Western District of North Carolina
January 2019 – Valuation of Call Option Price under an asset purchase agreement for damages calculation
Retained as expert by counsel for Defendant
Report, deposition, and testimony

Chet S. Huffman, Cindy L. Huffman, Infinity Aerospace Inc., R. Lloyd Huffman, Patricia Huffman, Petitioners, v. Commissioner of Internal Revenue, Respondent
United States Tax Court
April 2018 – Impact on the fair market value of private company stock due to Agreements to Purchase, standards of investment practice for arm's-length parties for transfer restrictions
Retained as expert by counsel for Petitioners
Report and testimony

Bibb Distributing Company, Plaintiff v. Dender Distributing Company, Inc., Defendant
Superior Court, Spalding County, State of Georgia
March 2018 – April 2023

Damages arising from Bibb's interference with the sale of Dender, escrow agreements
Retained as expert by counsel for Defendant
Report and deposition

Note: This list is limited to Mr. Kimball's testimony over approximately the past four years. Mr. Kimball has submitted testimony in over 70 court and binding alternative dispute resolution cases. This does not include various mediations or IRS audit/appellate conference appearances.

As of June 1, 2023

SAMUEL S. NICHOLLS

Sam Nicholls is a vice president with Willamette Management Associates. Sam manages engagements related to the valuation of business entities and business interests and the analysis of privately held and publicly traded equity and debt securities.

Sam has performed the following types of valuation and economic analyses: noncontrolling and controlling equity ownership in businesses; debt instruments; mergers and acquisitions (appraisal rights, breach of fiduciary duty, and fairness opinions); equity and debt security valuations for estates; equity and debt security valuations for gift tax purposes (business succession planning); family limited partnerships and holding companies; lost profits/economic damages claims for commercial disputes; buy-sell agreement valuations; restricted stock and blockage discount analysis; and employee stock ownership plan ("ESOP") formation and adequate consideration.

Sam has prepared these valuation and economic analyses for the following purposes: litigation (breach of fiduciary duty, adequate consideration for disputed mergers and acquisitions in Delaware Chancery Court and other state courts, federal tax disputes, trust disputes, forensic analysis, economic damages, and dispute resolution); taxation planning and compliance (federal income, gift, and estate tax); fairness opinions for transactions; transaction pricing and structuring; strategic planning and management information; ESOP transactions and annual ESOP valuation updates; and personal goodwill calculations for transactions.

Sam has valued the following types of business entities and securities: privately held business enterprises, fractional ownership interests in privately held businesses, publicly traded securities, multiple classes of preferred and common stock in complex capital structures, and interest-bearing debt instruments.

He has performed business valuations, economic analyses, and financial advisory services for clients in the following industries, among others: agricultural (automated inspection system manufacturing for quality control, fruit and vegetable wholesaling, poultry processing and wholesaling, and timberland and sawmills); basic materials (cement and asphalt production, chemicals, metals fabrication, polymer products, and sand and gravel mining for construction); consumer discretionary (automobile dealerships, cosmetics wholesaling, educational services, event planning, leisure product manufacturing, and national fast-casual and full-service restaurant chains); consumer staples (funeral homes); energy (electrical transmission and distribution equipment, oil and gas exploration and production platforms and equipment, pipeline construction and maintenance, and refineries); financial (hedge funds, insurance subrogation, investment management, mutual fund companies, and savings and loans); health care (biotech and diagnostics); industrial (agricultural equipment; aircraft maintenance, repair, and overhaul services; capital equipment; chemical manufacturing; construction and earthmoving equipment; defense and aerospace prime contracting and subcontracting; electrical transmission and distribution equipment; engineering and construction services; pollution control equipment; and road and highway paving services); real estate (real estate holding companies); and transportation (barge services, cruise ship chandlers, maritime ports, self-driving vehicles, and trucking).

Sam has significant experience in many areas of business valuation. He previously served for 12 years as an investment research analyst with investment banks and investment managers and for 3 years as a venture capital associate. He has been a professor of investment banking since 2012 for the Investment Banking Institute, teaching live, in-person courses for class sizes averaging 15 students. As an investment research analyst, Sam served as a generalist analyzing publicly traded companies in all sectors and as a sector expert focused on the industrial and life sciences sectors. As a venture capital associate, Sam performed research and valuations of prospective investments in early stage private companies, monitored existing holdings,

performed debt recapitalizations, structured transactions of limited partnership interests, and assisted with fund accounting.

PREVIOUS EXPERIENCE

Prior to joining Willamette Management Associates, Sam was a buyside investment research analyst at Carret Asset Management (founded by an early pioneer in value investing), a senior research analyst and director of research at W. Quillen Securities, an associate research analyst at Gerard Klauer Mattison (now part of Bank of Montreal), and a venture capital associate at Rockefeller & Company and Wolfensohn Partners. Sam wrote hundreds of research reports disseminated to institutional investors through Thomson/Reuters and has been interviewed on Bloomberg live TV.

EDUCATION

Master of Business Administration, finance, Yale School of Management

Bachelor of Arts, government, Hamilton College

PROFESSIONAL AFFILIATIONS

Sam is an Accredited Senior Appraiser ("ASA") of the American Society of Appraisers in business valuation.

Sam is a member of the National Center for Employee Ownership ("NCEO").

PUBLICATIONS

"Discount for Lack of Marketability in the Professional Practice Valuation." Willamette Management Associates *Insights*, Summer 2022.

"Criteria for Claiming a Worthless Security Loss Deduction." Willamette Management Associates *Insights*, Summer 2022.

"Service Alleges Taxable Gift for Exchange of Promissory Notes Based on Differences in Note Values." Willamette management Associates *Insights*, Summer 2021.

"The Role of the Investment Banker Compared to the Independent Valuation Analyst in M&A Transactions and Litigation." American Bar Association *Business Law Review*, December 2020.

"Flawed M&A Deal Processes That Can Lead to Litigation." American Bar Association *Business Law Review*, October 2020.

"The Roles of the Investment Banker and the Valuation Analyst in M&A Transactions and Litigation." Willamette Management Associates *Insights*, Autumn 2020.

"The Importance of the Subject Industry When Applying the Income Approach within a Family Law Valuation." Willamette Management Associates *Insights*, Winter 2019.

"The Perils of the 'Power of Substitution' for 'Intentionally Defective' Grantor Trusts." Willamette Management Associates *Insights*, Spring 2018.

"Dell Inc. Management Buyout—Why the Delaware Chancery Court Determined a Higher Fair Value after Appraisal Rights Proceeding." Willamette Management Associates *Insights*, Autumn 2017.

"Relief for Oppressed Minority Shareholders in Texas." *In-House Texas*, June 6, 2015.

"Texas Supreme Court Clarifies its Position on Shareholder Oppression." Willamette Management Associates *Insights*, Spring 2015.

"A Review of BMC Software, Inc. v. Commissioner of Internal Revenue: Should Intercompany Accounts Receivable Be Considered 'Debt'?" reprinted on www.expertwitnessblog.com dated March 4, 2015.

"A Review of BMC Software, Inc. v. Commissioner of Internal Revenue: Should Intercompany Accounts Receivable Be Considered 'Debt'?" Willamette Management Associates *Insights*, Winter 2015.

"The Valuation Analyst's Role in U.S. Tax Court Trials." *Trusts & Estates*, January 2015.

"The U.S. Tax Court Process: Practical Guidance for Valuation Analysts." Willamette Management Associates *Insights*, Autumn 2014.

Court and Expert Witness Engagements

Claudine Webb v. Fidelity Brokerage Services, LLC (FINRA Arbitration Number 19-01960).
Testimony on November 17, 2021 – Damages arising from the freezing of the plaintiff's brokerage account.