

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

*Jeffrey B. Wolpin, CBA, CREA, CCRA, MBA:*

## **PLANNING WITH & VALUATION OF FLPs & LLCs**

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# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

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## *Benefits of FLPs & LLCs Planning with Strong Business Purposes*

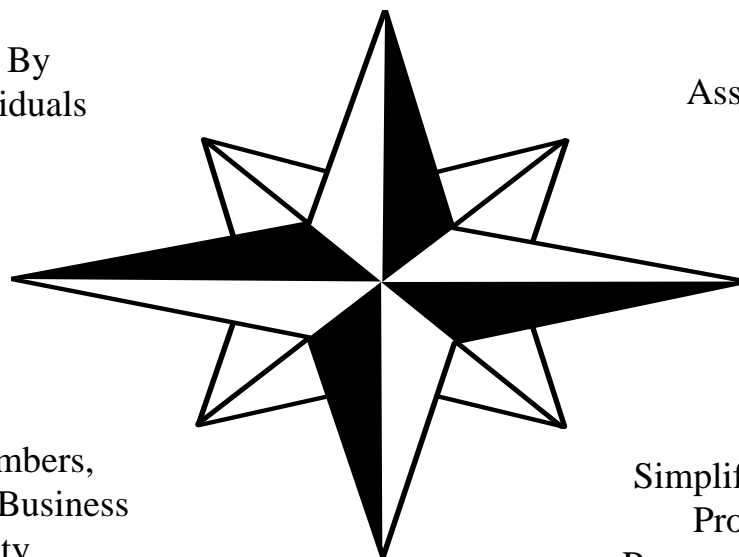
Maintaining Control & Protecting Privacy.

Reduce Income Taxes By  
Shifting Income to Individuals  
In Lower Brackets

Assuring Lifestyle

Avoid Gift & Estate Tax,  
Discounting.

Protect Assets from  
Government, Lawsuits,  
& Divorce Actions.



Build Character in Family Members,  
Educate Family Members about Business  
Affairs, & Help Community

Simplifies Gifting to Family Members,  
Protect Against Administrative  
Paperwork, Expenses, Delays & Probate

Assure Business Continuity,  
Keeps Family Assets w/in Family,  
Consolidation of Family Assets  
for Operational Cost Savings

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## *Valuation Background*

- Article 1, Section 9, Clause 3 of the U.S. Constitution prohibits the direct taxation of property by the Federal Government.
- Therefore the Estate and Gift Tax are **Excise Taxes** on the transfer property by gift or at death.

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## *Valuation Background*

### Standard of Value

**The hypothetical willing buyer and willing seller test  
– No compulsion, both have reasonable  
knowledge of facts.**

See: Revenue Ruling 59-60. Gift Tax Reg. 25.2512-1. Estate Tax Reg. 20.2031-1

- **For estate tax purposes, the focus is on what is actually transferred.**
  - See: Ahmanson Foundation v. U.S. 674 F. 2d 761 (9<sup>th</sup> Cir. 1981)
    - Bright v. U.S., 658 F.2d 999 (5<sup>th</sup> Cir. 1981)
- **For gift tax purposes, the focus is on what is actually received by the transferee.**
  - See: Estate of Chenoweth v. Comm., 88 T.C. 1588 (1982)

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## *Valuation Background*

### **Family Attribution Rule:**

- At one point the IRS asserted that the family represented a “unity of interests”, so the interest of one family member must be attributable to other family members. (See: Estate of Murphy, 60 TCM 645)
- However, the IRS conceded on the “family attribution” concept and adopted Revenue Rule 93-12 when the holding in Bright stated it was not applicable.
- The demise of the “family attribution rule marks the beginning of the explosion in the use of FLPs and LLCs in family estate planning.

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## *Basic Valuation Principals & Theory:*

### **FLP Objective Is To:**

- ➔ **Value the LP or LLC interest on the basis of distributable cash flow, not its liquidated value. This entails consideration of:**
  - ➔ **An Income Approach, and/or**
  - ➔ **Market Approach, and/or**
- ➔ **A Net Asset Value Approach (which is most common for asset holding companies.)**

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## *Basic Valuation Principals & Theory:*

### **MICHELANGELO'S STATUE OF DAVID ANALOGY**

- The Statue of David due to its unique form has a considerably high intrinsic value.
- However, if shattered, the individual value of each piece would be considerably less than the pro-rata value of each piece as part of the Statue of David in its original form.
- In other words, the sum of each individual part is worth less than the whole.

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## *Basic Valuation Principals & Theory:*

- ☞ Minority interest values in going concerns are substantially less than net asset value of the entity's assets. For example REITS and Closed End Mutual Funds often sell at discounts to their underlying asset values, as do public L.P.s traded on the secondary markets.
  - **See: Estate of Gallo, V. Comm., 50 TCM (CCH) 470 (1985)**
  - **See: Watts v. Comm., 823 F. 2d 483 (11<sup>th</sup> Cir. 1987)**



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## *Basic Valuation Principals & Theory:*

### Requirements for Determining the Discount

- Have the underlying assets appraised for their Fee Simple or Control Values, prior to their transfer to the FLP or LLC entity.

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## *Basic Valuation Principals & Theory:*

### Tiered Discounts or Double Discounts

- If assets to be transferred to FLP or LLC are undivided interests in real property or minority interests in an operating business, then these should be appraised for their partial interest discounted value prior to transferring them to the FLP or LLC.

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## *Basic Valuation Principals & Theory:*

### Other Potential Tiered Discounts:

- Portfolio Discounts
- Blockage or Absorption Discounts – Georgia O’Keeffe, 63 TCM 2699 (1992)
- Built-In Capital Gains Discounts
- Key man Discounts

### Watch Out for Swing Votes:

- Where a small voting block can decide the outcome of competing voting blocks – This may get a premium.

### Watch Out for Rights to Amend Partnership:

- To replace GP with Taxpayer LP or to reach assets for liquidation – This will reduce discounts.

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## *Basic Valuation Principals & Theory:*

### HOW HIGH THE DISCOUNT?

1. In theory (intuitively) the Discounts Should Be Very High because no one will buy into a LP/LLC:
  - a) In which they are at the whim of someone else.
  - b) Which has low cash flows or yields.
  - c) With which one cannot access books and records.
  - d) Which has an uncertain future.
  - e) Which cannot be quickly liquidated.
2. Unfortunately, sometimes the BV and marketability data proves this indirectly or ambiguously, giving fuel to the IRS to argue for low discounts.

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## ***Determining Basic FLP or LLC Discounts:***

### **Step One: Minority Discounts**

- ❑ Minority or Lack of Control Discounts arise due to the limited partner's or member's restrictions or inability to effect management of the assets or influence decisions as to the operation of the business of the LP or LLC.**
- ❑ However, when the LP or LLC is structured solely to attain a minority discount, the courts have sometimes disallowed the discount.**
  - See: Estate of Murphy, 60 TCM 645 (near death case, this case was prior to Rev. Ruling 93-12, but still raised under the sham transaction, lack of economic substance or business purpose arguments)**

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

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## ***Determining Basic FLP or LLC Discounts:***

### **Does Assignee Status Earn an Additional Discount?**

- ❑ Succeeding to an Assignee status, in which one does not have the right to vote or review the books and records of a limited partner, probably does get an additional discount. However, there is little marketplace support for such a discount.**
- ❑ Voting vs. non-voting stock is current available support for such a discount. This amounts to an additional 3-5% discount on average.**
- ❑ However, voting vs. non-voting stock does not reflect the non-access to books and records, which is an additional deterrent to succeeding to an assignee position.**
- ❑ See: McLendon V. Comm., 96 1USTC ¶ 60,220 (5<sup>th</sup> Cir., 12/28/95) rev'g in part and remanded w/o published opinion, 66 TCM (CCH) 946 (9/30/93).**
- ❑ See: Watts v. Comm., 823 F.2d 483 (8<sup>th</sup> Cir.) (8/4/87) aff'd 51 TCM (CCH) 60 (12/9/85) – 85.62% discount.**
- ❑ See: Novak v. U.S., 87.2, USTC ¶ 13,728 (6/29/87) – 45.97% Discount,**
- ❑ See: Est. of Daniel Harrison, Jr. v. Comm., 52 TCM (CCH) 1306 (1/6/87) – 44.59% Discount.**

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## ***Determining Basic FLP or LLC Discounts:***

### **Sources for Minority Discounts**

- 1. For Real Estate Holdings:**
  - a) Public Limited Partnerships.**
  - b) REITs.**
- 2. For Public Securities or Closely Held Business Holdings:**
  - a) Closed End Stock and Bond Funds**
- 3. By comparing, among other value drivers, the differences between yields on above comparables and the subject.**

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## ***Determining Basic FLP or LLC Discounts:***

### **2 Methodologies - Paired Analysis vs. Statistical Analysis:**

#### **Paired Analysis – Full Narrative Report – Most Expensive:**

Analyzing & Adjusting Individual Comparables to the Subject by Various Value Drivers in a Side By Side Chart Format, Applying Individual % Adjustments to Each Value Driver Difference:

#### **Some Typical Value Drivers:**

1. Debt Levels.
2. Quality of Cash Flows:
3. Partnership Size.
4. Quality of Assets.
5. Quality of Management.
6. Partnership Restrictions
7. Diversification
8. Liquidity & Holding Period



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## *Determining Basic FLP or LLC Discounts:*

### Statistical Analysis:

#### Summary Report – Less Expensive

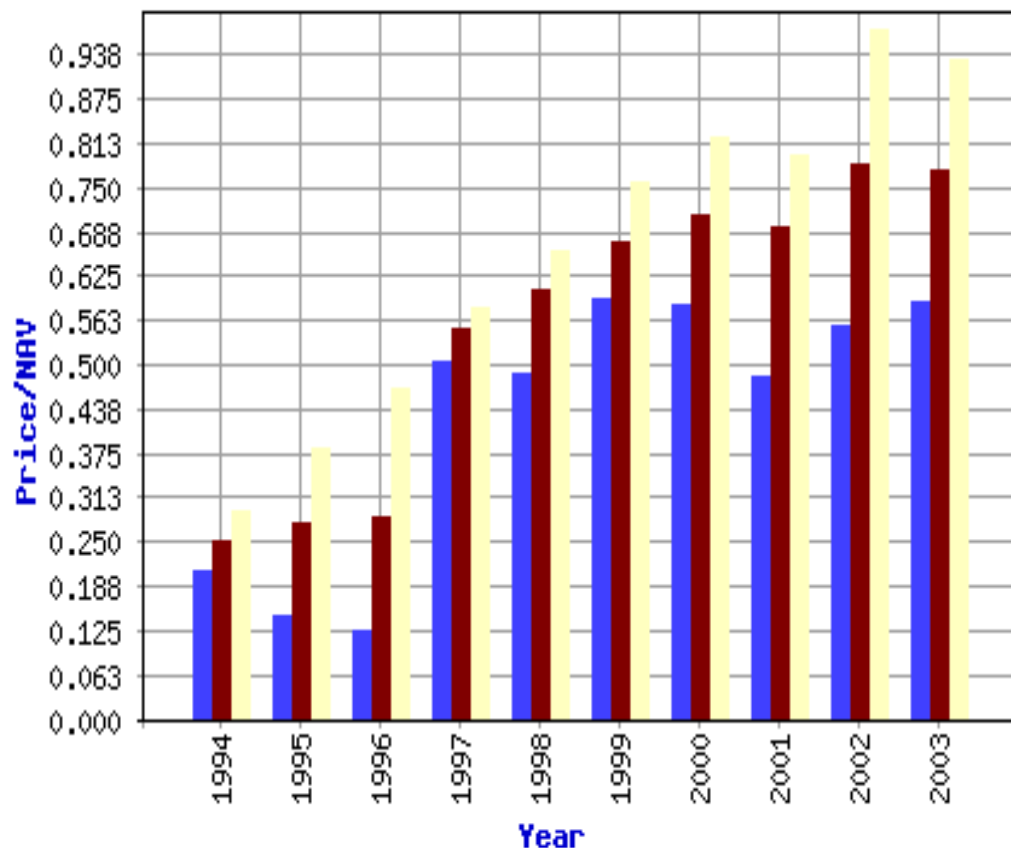
1. Less Stringent, Less Rigorous Approach:
2. Looks at averages and ranges of empirical data and rationalizes where in the range the subject should fall.
3. Relies heavily on averages and medians which may or may not be representative of any specific subject or comparable.
4. Implicitly uses same reasoning as Paired Analysis Method but does not apply % adjustments for each value driver difference and does not bring in as much support.

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## Determining Basic FLP or LLC Discounts:

Price to NAV for 18 Selected Partnerships



■ Minimum	Public LP Retail Properties
■ Average	
■ Maximum	

Year	Min	Avg	Max
1994	20.8%	25.0%	29.2%
1995	14.6%	27.8%	38.2%
1996	12.6%	28.4%	46.8%
1997	50.6%	55.0%	58.1%
1998	48.6%	60.7%	66.1%
1999	59.3%	67.3%	75.7%
2000	58.3%	71.2%	82.0%
2001	48.3%	69.5%	79.7%
2002	55.6%	78.2%	97.3%
2003	58.8%	77.6%	93.0%

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*Determining Basic FLP or LLC Discounts:*

## *Differences between Public LPs & FLPs*

- 1) DIVERSIFICATION,
- 2) SIZE,
- 3) QUALITY OF UNDERLYING ASSETS,
- 4) QUALITY OF MANAGEMENT & MANAGEMENT DEPTH,
- 5) LEVERAGE, PROFITABILITY & OTHER OPERATING RATIOS,
- 6) CONSISTENCY AND QUALITY OF DIVIDEND DISTRIBUTIONS,
- 7) MORE RESTRICTIVE PARTNERSHIP OR OPERATING AGREEMENTS,
- 8) ASSIGNEE STATUS – UNCERTAINTY OF ADMISSION AS SUBSTITUTE LP,
- 9) UNCERTAINTY OF § 754 ELECTION (STEP-UP IN BASIS),
- 10) RIGHTS OF FIRST REFUSAL,
- 11) UNCERTAINTIES OF FUTURE INVESTMENTS,
- 12) LIQUIDITY AND HOLDING PERIOD,
  - a) Small Shareholder base,
  - b) No Secondary Public Markets.

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*Determining Basic FLP or LLC Discounts:*

## *Differences between REITs & Public LPs*

- 1) REITs must be widely held with no fewer than 100 shareholders - more marketable,
- 2) The institutional character of the underlying real estate held by REITs,
- 3) The considerably greater diversification across property types and location,
- 4) REITs generally have higher historical long term growth rates than private real estate holdings by as much as 10% compound annual rates over the long term. This higher growth rates may be due to keeping properties maximally productive, younger in age and in better condition.
- 5) More sophisticated/professional management.

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*Determining Basic FLP or LLC Discounts:*

## *Differences between REITs & Public LPs*

- 6) Access to public market financing.
- 7) Shorter holding periods or higher turnover and liquidation rate on the underlying real estate held by REITs relative to private limited partnerships.
- 8) There tends to be a maximum age for the underlying real estate held by REITs beyond which these properties are no longer maximally productive. Consequently, there is considerable incentive among REIT managers to acquire newer properties and new acquisitions with strong distribution potential so as to keep their portfolios attractive to public investors, which in turn keeps REIT stock prices up, which in turn is necessary to attract new equity capital to fund both newer acquisitions and necessary expenses to keep the properties well maintained and maximally productive.

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*Determining Basic FLP or LLC Discounts:*

*Minority Interest Discounting By Asset Class*

X Family Holdings LLC as of 1/31/03							
X FLP as of 1/31/03	Gross \$	% of	Net	Estimated \$	Estimated %	Minority	Weighted
	<u>Value</u>	<u>Portfolio</u>	<u>Asset Value</u>	<u>Annual Income</u>	<u>Annual Income</u>	<u>Discounts</u>	<u>Disc. Value</u>
Money Market Funds	\$ 444,784	10.93%	\$ 444,784	\$ 5,337	1.20%	0.0%	\$ 444,784
Equities	\$ 5,816	0.14%	\$ 5,816	\$ 257	4.42%	9.2%	\$ 5,280
Corporate Bonds	\$ 296,793	7.29%	\$ 296,793	\$ 19,800	6.67%	4.0%	\$ 284,921
Municipal Bonds	\$1,770,781	43.50%	\$1,770,781	\$ 92,084	5.20%	20.0%	\$1,416,625
Certificate of Deposits	\$ 452,389	11.11%	\$ 452,389	\$ 27,000	5.97%	0.0%	\$ 452,389
Indian Ranch Corp.	\$ 399,000	9.80%	\$ 399,000	\$ 7,043	1.77%	10.2%	\$ 358,302
Horse Farm	<u>\$ 701,000</u>	<u>17.2%</u>	<u>\$ 701,000</u>	<u>\$ 24,950</u>	<u>5.65%</u>	11.3%	<u>\$ 621,787</u>
Total	\$4,070,563	100%	\$4,070,563	\$ 176,471	4.34%		\$3,584,088
Less Minority Discount			88.0%				
Estimated Minority Value			\$3,584,088	\$ 176,471	4.92%		

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## ***Determining Basic FLP or LLC Discounts:***

### **Step Two: Lack of Marketability Discounts**

- **Lack of Marketability Discounts arise due to the LP or LLC interest having no ready access to the public or open markets for instantaneous sale or liquidation. They are not SEC Registered and do not have ready access to the public secondary markets for public limited partnerships. Additionally, the public pool of buyers tend to find private partnerships in which they have no control and limited knowledge of management objectionable.**
  - See: Estate of Strangi v Comm., TC 2000-242 (2000) (original Strangi)
  - See: Knight v. Comm., 115 TC No. 36 (2000)
  - See: Estate of Jones II v. Comm., 116 TC No. 11 (2001)

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## ***Determining Basic FLP or LLC Discounts:***

### **Sources of Marketability Discounts:**

- **Restricted Stock Studies – Small Sample Issues.**
- **IPO Studies – Statistical Sampling Issues, See: McCord.**
- **Present Value Analysis of Returns Till Projected Liquidation or Holding Period – QMD Method – Subjectivity Issues.**

### **Marketability Issues vs Data or Comp Sources:**

- **Will 754 (step up in basis) election be made?**
  - **How easy is it to sell or liquidate?**
- **Restricted Stock and IPO Studies are being challenged.**
- **What is the expected holding period? Comparable holding periods over past 8 years have declined from 10 years to 4 years, reducing discounts.**



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## *Determining Basic FLP or LLC Discounts:*

IPO SAMPLE STUDIES - Median Marketability Discounts By IPO Year						
<u>IPO Year</u>	<u>0-3 Months</u>	<u>4-6 Months</u>	<u>7-9 Months</u>	<u>10-12 Months</u>	<u>1-2 Years</u>	<u>Count</u>
1999	30.6%	54.2%	75.0%	76.9%	82.2%	695
2000	28.7%	45.1%	61.5%	68.9%	76.6%	653
2001	14.7%	33.2%	33.4%	52.1%	51.6%	115
2002	6.2%	1.8%	2.2%	39.5%	55.0%	81
Involving 2,400 transactions over the measured time periods.						
An individual IPO may have multiple pre and post IPO.						

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## *Determining Basic FLP or LLC Discounts:*

<b><u>Restricted Stock Studies</u></b>		
<u>Study</u>	<u>Years Covered</u>	<u>Avg. or Median Discount</u>
SEC Institutional Investor	1966-69	32.60%
Milton Gelman Study	1638-70	33.00%
Robert Trout Study	1968-72	33.50%
Robert Moroney Study	1969-72	35.60%
J. Michael Maher Study	1969-73	35.40%
Standard Research Consultants	1978-82	45.00%
Willamette Management Assoc. Study	1981-84	31.20%
William Silber Study	1981-89	34.00%
FMV Study	1979-92	23.00%

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## ***Determining Basic FLP or LLC Discounts:***

### **Step Three: Applying the Discounts**

Discounts are applied sequentially not additively.

Example:

**30% Minority Discount**

**+ 30% Lack of Marketability Discount**

**= 49% Total Discount**

**Because the Lack of Marketability Discount is taken on the already discounted value of the minority interest.**

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*Determining Basic FLP or LLC Discounts:*

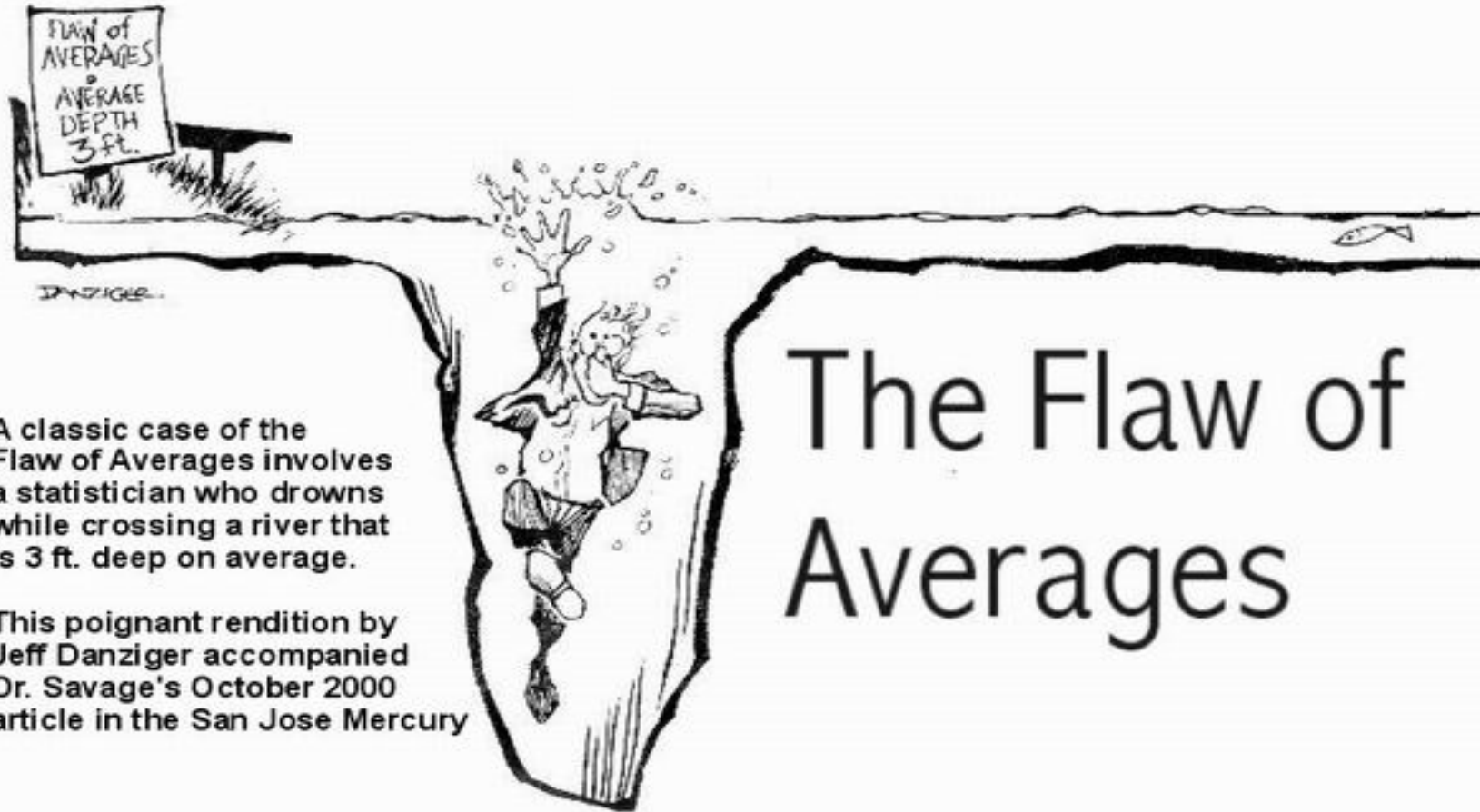
## Valuation Methodology

### Considerations & Cautions:

- Appraisers are essentially evaluating relative risk & uncertainty.
- Therefore one should beware of the appraisal which bases its conclusions on averages.

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A classic case of the Flaw of Averages involves a statistician who drowns while crossing a river that is 3 ft. deep on average.

This poignant rendition by Jeff Danziger accompanied Dr. Savage's October 2000 article in the San Jose Mercury

*Published Sunday, October 8, 2000, in the San Jose Mercury News  
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The  
State of  
the drunk  
at his **AVERAGE**  
position  
is **ALIVE**.

The Best Guess for the  
position of the drunk is  
the center line.

But the **AVERAGE** state  
of the drunk is **DEAD**

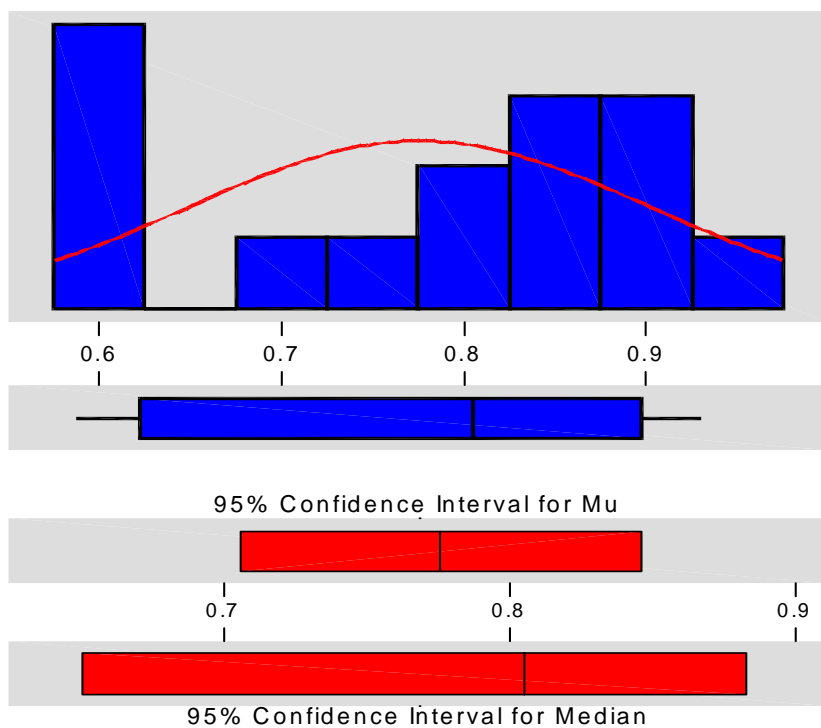
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## Determining Basic FLP or LLC Discounts – Dealing with Uncertainty:

### Descriptive Statistics



Variable: Public LP - Discount

#### Anderson-Darling Normality Test

A-Squared: 0.594  
P-Value: 0.101

Mean 0.775600  
StDev 0.126645  
Variance 1.60E-02  
Skewness -4.1E-01  
Kurtosis -1.37005  
N 15

Minimum 0.588000  
1st Quartile 0.622000  
Median 0.805000  
3rd Quartile 0.897000  
Maximum 0.930000

95% Confidence Interval for Mu  
0.705466 0.845734

95% Confidence Interval for Sigma  
0.092720 0.199732

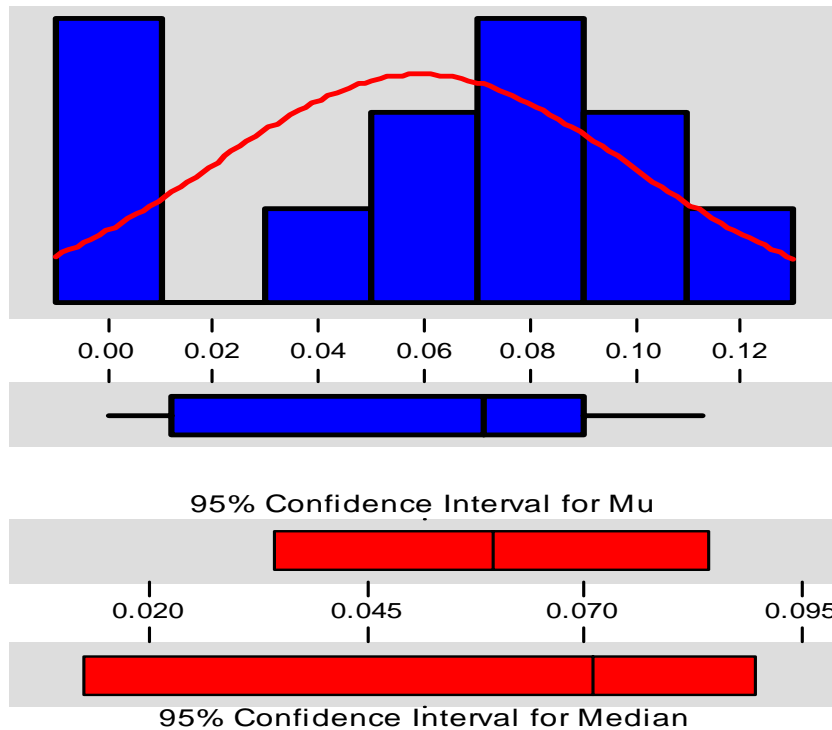
95% Confidence Interval for Median  
0.650760 0.882433

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## Determining Basic FLP or LLC Discounts – Dealing with Uncertainty:

### Descriptive Statistics



Variable: Public LP - Yld/Price

Anderson-Darling Normality Test

A-Squared: 0.674  
P-Value: 0.058

Mean 5.93E-02  
StDev 3.95E-02  
Variance 1.56E-03  
Skewness -6.6E-01  
Kurtosis -9.0E-01  
N 12

Minimum 0.000000  
1st Quartile 0.011750  
Median 0.071000  
3rd Quartile 0.090000  
Maximum 0.113000

95% Confidence Interval for Mu

0.034217 0.084449

95% Confidence Interval for Sigma

0.028003 0.067117

95% Confidence Interval for Median

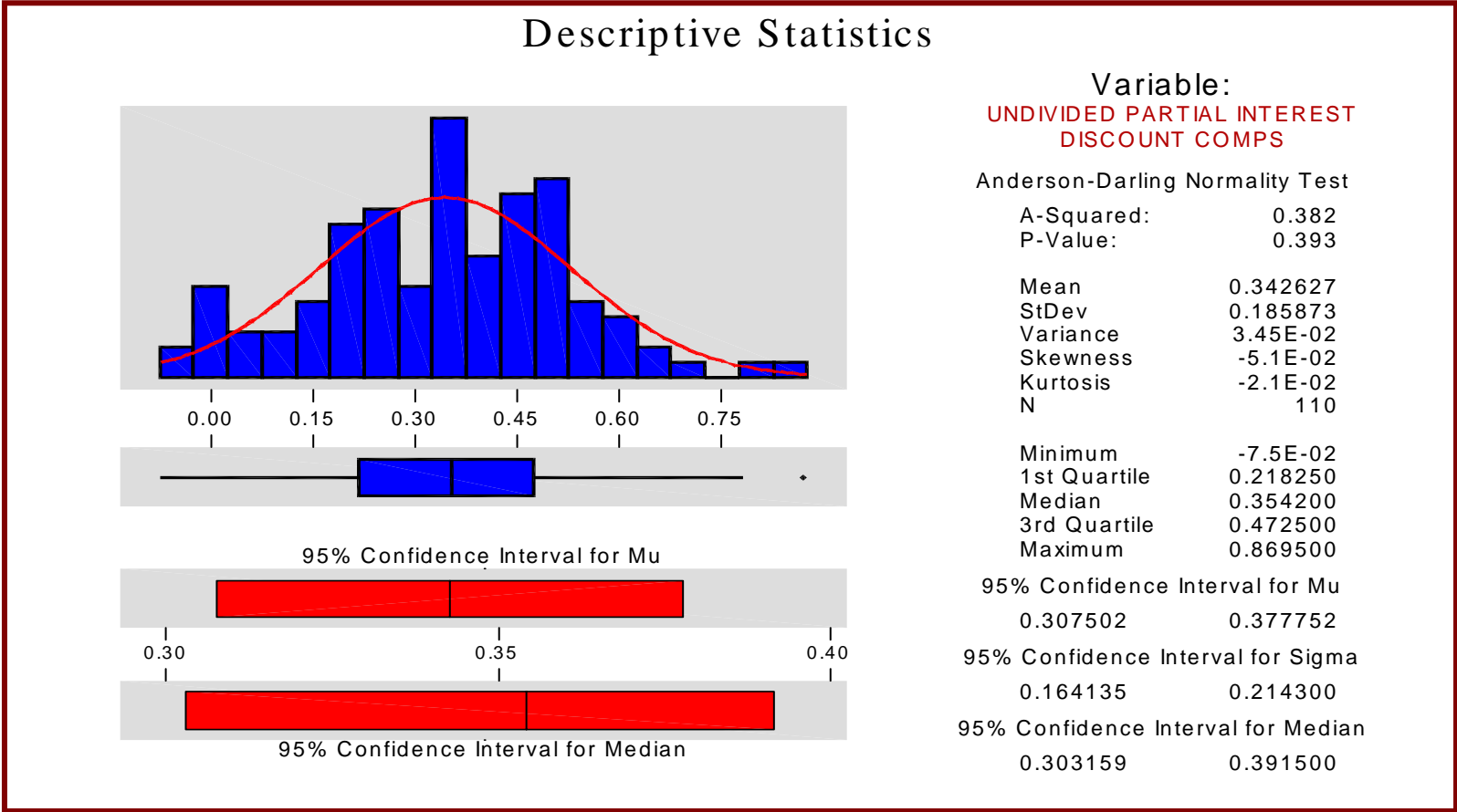
0.012367 0.089948



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## Determining Basic FLP or LLC Discounts – Dealing with Uncertainty:



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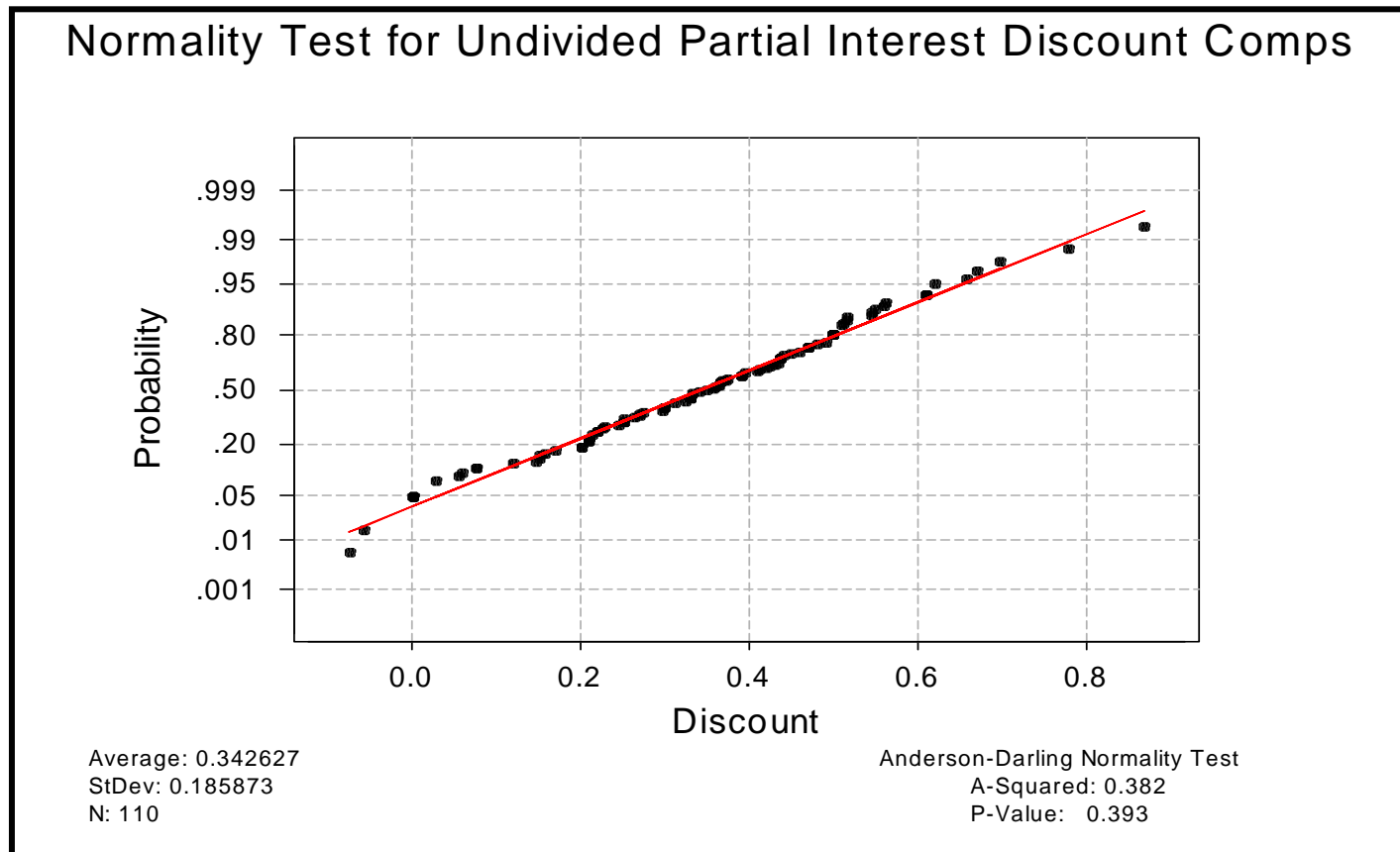
## *Determining Basic FLP or LLC Discounts – Dealing with Uncertainty:*

- The flatter the curve, the greater the margin for error, or the less reliable the data.
- The less reliable the data, the more room for alternative or competing arguments, i.e., the more room for the IRS to develop plausible arguments minimizing the discounts.
- See, McCord.

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## Determining Basic FLP or LLC Discounts – Dealing with Uncertainty:



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## *Determining Basic FLP or LLC Discounts – Dealing with Uncertainty:*

### Notes to Statistical Graphs (from Minitab) :

- **The Anderson-Darling statistic** is a measure of how far the plot points fall from the fitted line in a probability plot. The statistical program uses an adjusted Anderson-Darling statistic, in which points in the tails are weighted more. A smaller Anderson-Darling statistic indicates that the distribution fits the data better. For least squares estimation, the statistical program calculates a Pearson correlation coefficient. If the distribution fits the data well, then the plot points will fall on a straight line. The correlation measures the strength of the linear relationship between the X and Y variables. The correlation will range between 0 and 1, and higher values indicate a better fitting distribution.
- The above statistics and two graphs indicate a reasonably narrow range for the discounts seen in the undivided partial interest comps. Additionally the comps fall very close to a normal distribution with a small margin for error giving further support for the narrow range and the high probability that the discounts seen are a fair representation of discounts for undivided partial interests in the total population.
- The more normal the distribution the more one should rely on the average vs. the median, as the base from which to make adjustments.

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## *Determining Basic FLP or LLC Discounts – Dealing with Uncertainty:*

### More Notes to Statistical Graphs (from Minitab) :

- **Kurtosis** is one measure of how different a distribution is from the normal distribution. A positive value typically indicates that the distribution has a sharper peak, thinner shoulders, and fatter tails than the normal distribution. A negative value means that a distribution has a flatter peak, fatter shoulders, and thinner tails than the normal distribution.
- **Skewness** is a measure of asymmetry. A value more than or less than zero indicates skewness in the data. But a zero value does not necessarily indicate symmetry.
- **P-Value or Goodness-of-Fit Tests**- Use this procedure to test the normality assumption. The goodness-of-fit tests, with p-values indicate whether there is insufficient evidence to claim that the model does not fit the data adequately. If the p-value is less than your accepted  $\alpha$ -level, the test would reject the null hypothesis of an adequate fit or normal distribution. In other words, the higher the p-value the more normal the distribution. The common null hypothesis for these three tests is  $H_0$ : data follow a normal distribution. If the p-value of the test is less than your  $\alpha$  level, reject  $H_0$ . The more normal the distribution the more one should rely on the average vs. the median.

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## ***Determining Basic FLP or LLC Discounts:***

### **CURRENT CONTROVERSIES IN BUSINESS (FLP) VALUATION:**

- 1. Adequate Sample Size. [Lappo, TCM 2003-258 & Peracchio, TCM 2003-280.]**
- 2. Data Reliability & Expectations**
- 3. Reconciling Financial Theory to Empirical Data.**
- 4. What is the statistical validity of the various marketability studies and the extent to which they can be relied upon for discounts? [McCord, 120 TC #13 (2003)]**

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***Determining Basic FLP or LLC Discounts:***

### **Adequate Sample Size**

***“We have also recognized the basic premise that as similarity to the company valued decreases, the number of required comparables increases.”***

***(Court in Heck, TC Memo 2002-34 & McCord, Lappo & Peracchio).***

$$n = (z_{\alpha/2} \cdot \sigma \div E)$$

**The above formula states that the required samples size ( $n$ ) is a function of the sample standard deviation ( $\sigma$ ) and the required margin of error ( $E$ ) when the sample is normally or symmetrically distributed ( $z_{\alpha/2}$ ). [See above risk graphs.]**

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***Determining Basic FLP or LLC Discounts:***

### **Data Reliability - Differences Between Business and Real Estate Appraisal:**

#### **Limits to the Data:**

- 1. Real Estate Comparables vs. Business Comparables.**
  - a) Real Estate Comparables are more reliable.**
  - b) Real Estate Comparables are more verifiable.**
  - c) Real Estate Comparables tend to exhibit lower variation or narrower ranges.**
  - d) Real Estate Comparables tend to be more representative of the population.**
  - e) Real Estate Comparables tend to be more time relevant.**
  - f) Real Estate Comparables tend to confirm real estate theory.**
- 2. All appraisal work Requires Knowledge of Statistics and Statistical Reasoning, perhaps more so in BV due to less reliable data.**
- 3. Relative to Real Estate Appraisal, flexibility towards Business Appraisal Conclusions is recommended.**



# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***Determining Basic FLP or LLC Discounts:***

### **Reconciling Financial Theory with Empirical Data & Comparables**

- 1. Relative to real estate comparables, business comparable data used in the market approach (as opposed to the income approach) is frequently opaque or ambiguous. It doesn't always conform to standard financial theory. Consequently, attempts to reconcile the data to the theory is often problematic. (Exception: public partnership data is pretty good.)**
- 2. Intuitively, no one wants a minority interest in a closely held FLP/LLC. It is a highly risky endeavor for any minority investor. It is very difficult if not impossible to sell. Unfortunately, the lack of marketability data is frequently amorphous and does not with any high degree of specificity support this intuitive fact. Consequently, one can use the comparable data to develop theories in support of the IRS position. (McCord)**

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***Determining Basic FLP or LLC Discounts:***

### **Challenges to the Traditional Lack of Marketability Studies: McCord, 120 TC #13 (2003)**

Since small sample sizes and sampling techniques are flawed increasing the uncertainty about the various discount studies, the IRS used these flaws to find statistical loopholes and speculated:

1. Buyers of IPO's are insiders with special knowledge, buying unusually low, or getting soft dollar compensation. This overstating the size of the discount.
2. Only successful firms have IPOs. This results in high IPO prices after issue relative to price before the issue – overstating the discount.
3. However, IRS' statistical analysis used to prove their low discount hypothesis had a very low correlation and high error rate.
4. In other words, the unreliable data from the start permitted the IRS to turn the basic theory and arguments upside down.
5. You need an appraiser who understands statistical language to counter this IRS obfuscation. Fortunately, the Court still gave a large discount.

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### *Methods of IRS Attack – General:*

- 1) The FLP is invalid under State Law:
  - a) Failure or late filing of Certificate of LP. See: Church v. U.S.
  - b) Parties to LP lack or have diminished capacity, related to death bed transfers.
  - b) Corporate G.P. was not formed prior to FLP formation.
  - c) FLP formed by attorney under Durable Power of Attorney but where DPA did not expressly provide the power to form the FLP.
- 2) The assets have not been properly transferred to the FLP under state law. Specific rules for transfer, timing of transfers and funding have not been followed.
- 3) The sole purpose of the FLP was Tax Avoidance. See: TAM 9730004 & Murphy v. Comm., 60 TCM (CCH) 645 (1986)

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## *Methods of IRS Attack – General:*

- 4) The Step-Transaction Doctrine – Formation of the FLP and the subsequent transfer of FLP interests at decedent's death are treated as a single transaction, thus resulting in disregarding the FLP entity. (Too many steps taken to transfer assets.)
- 5) The FLP lacked a valid business purpose – Test: Would you be doing the FLP/LLC if you couldn't get a discount? A taxpayer's subjective, intent test. However, See: *Strangi v. Comm.* – So long as the FLP was validly formed under state law and all i's & t's dotted and crossed, the FLP will be recognized for federal estate tax purposes. No business purpose required.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## *Methods of IRS Attack – General:*

- 6) The FLP lacked economic substance. A broader objective test. The parties must end up with the same economic interests with or without a transaction for it to be disregarded. FLPs however pass the test because partners have contributed assets to a FLP and have lost various rights in ownership. See: Murphy, Reichardt, Jones II, Knight & Church.
- 7) The gifts of FLP interests were gifts of future interests and therefore ineligible for the \$10,000 annual gift tax exclusion under IRC § 2503 (b).

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### *Methods of IRS Attack – Chapter 14:*

- 8) § 2703 Restriction on right to sell property can be ignored: What Property is Being Valued - The Partnership Interest of the Underlying Assets of the Partnership?
  - a) IRS has taken the position that the mere existence of a FLP was sufficient for it to fail the “Test for § 2703.” Whereas taxpayers assert that the mere existence of the FLP entity does not make § 2703 applicable,
  - b) Court Answer: It is the partnership interest not the underlying assets of the partnership to which § 2703 applies, therefore the mere fact that a partnership is formed does not create a § 2703 problem.
  - c) Selected § 2703 Cases: Church v. U.S., 88 AFTR 2d Por 2001-5142 (5<sup>th</sup> Cir. 2001). Strangi I, Jones II, and Knight.

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### *Methods of IRS Attack – Chapter 14:*

- 9) § 2704 (b) - Applicable Restrictions on the Right to Liquidate are to be Ignored: Restrictions greater than state default law restrictions would be disregarded.
- a) The basic idea is: How hard is it to get the money out of the partnership or LLC? How hard is it to liquidate”
  - b) Valuation discounts are generally based on distributable cash flow, not on the value of the underlying assets. Thus if it is easy to get to the underlying assets and liquefy them, then the discounts are eliminated.
  - c) See: Kerr, 113 TC 449 (1999)
- 10) Where decedent limited partner (not a G.P.) died owning a large voting block of limited partner interests, which could remove the G.P., the lack of marketability discount will be reduced or eliminated.

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### *Methods of IRS Attack – Chapter 14:*

#### Current Main Line of IRS Challenge:

- 11) IRC § 2036 (a)(1) permits inclusion of assets contributed to the FLP in the decedent's gross estate because a) decedent retained dominion and control over the assets until death, either as a nominee or in his or her individual capacity.
- 12) Under IRC § 2036 (a)(2), decedent retained the right, either alone or in conjunction with any person, to designate the person who shall possess or enjoy the property or the income from the property. Applies to decedent who:
  - a) owns an interest in the G.P. (even if a minority interest, ex: a minority shareholder in a corporate G.P.) that controls distributions or can participate in a vote on liquidation,
  - b) simply by being a L.P. who may join with the other partners to effect a liquidation of the partnership and thereby the distribution of the partnership assets.



# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### § 2036 (a) (1) Cases:

#### IRS Victories

- 1) **Schauerhamer, 73 TCM 2855 (1997)** – (Retention of property income stream an indication of retained enjoyment. No separate partnership records. Decedent's relationship to transferred assets was the same before and after the transfer.)
- 2) **Reichardt, 114 TC 144 (3/1/00)** – (Commingled Partnership & personal funds, transferred home to partnership & lived rent free.)
- 3) **Thompson, TCM 2002-246** – (Fortress FLP, Distributions did not follow ownership interests, Lack of independent trustee, Too Many Assets Placed in FLP, Sick or Death Bed Formation, Lack of Independent Trustee, Excessive Powers over Operations held by FLP Creator, FLP administered Like a trust than a business. No substantive change in investment strategies after transfer of securities.)
- 4) **Strangi II, TCM 2003-145** – (Fortress FLP, death bed transaction, recycling of value.)
- 5) **Harper, TC Memo #2002 – 121** – (Disproportionate distributions did not follow ownership interests, distributions from FLP to pay for estate taxes, implied agreement between Harper & children that Harper retain economic benefit of assets.)

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### *Strangi II vs. Stone, TCM 2003-309 - § 2036 (a) (1):*

#### Strangi II Facts – Unfavorable Taxpayer Decision:

- Strangi was terminally ill with cancer.
- Son-in-law (Gulig) had & used POA for all Strangi business affairs and to transfer assets to FLP.
- Gulig became manager of the FLP. Not a sufficiently independent trustee.
- Formed Corp. GP which had sole discretion to
- Fortress Financial (Pre-packaged) FLP.
- Too many assets placed in FLP – 98% - including personal residence - Insufficient assets outside FLP to pay personal expenses.
- Strangi lived rent free in FLPs personal residence.
- Strangi retained 99% LP interests.
- Strangi purchased 47% of Corp. G.P. & daughter had 53%,.
- FLP paid for Strangi's personal expenses & estate tax.
- Other family members had little input in FLP structure, and were quiet on its structure.

#### Stone Facts – Favorable Taxpayer Decision:

- 5 FLPs formed several months prior to death.
- Stone held majority of GP & LP interests in each FLP.
- Each of Stone children received small GP interests for their contributions.
- 4 of 5 FLPs paid for Stone's estate taxes.
- Each member of Stone family retained independent counsel & had input in structure of FLP.
- History of contention and litigation among Stone Family Members.
- Stones retained sufficient assets outside of FLP.
- Strong business purpose & economic substance to FLP beyond tax purpose.
- Pre-FLP Appraisals & Pre-FLP Cash Flow Analysis for personal expense needs outside of FLP.
- Strong appearance of arms-length negotiations between partners and non-tax business purpose.

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

Business & Real Estate Appraisals, & Business Brokerage

## § 2036 Facts & Issues – DON'TS:

### Some Common Issues In These Cases Were:

- Partnership was formed close to death of decedent – (raises IRS scrutiny but not in and of itself fatal to the LP/LLC).
- Do not put all or substantially all assets transferred to FLP
- Do not permit decedent to retain use of FLP assets, explicitly or implicitly.
- Do not commingle of FLP's and personal funds.
- Do not pay personal expenses or estate taxes from FLP.
- Do not permit decedent to receive rental income from FLP assets.
- Do not put residence in FLP or permit transferor to use residence in FLP w/o rent payments.
- Do not make non-pro rata distributions to owners, especially transferor.
- Do not permit LP creator unilateral or majority rights to amend the partnership.

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

Business & Real Estate Appraisals, & Business Brokerage

## § 2036 – DO'S:

- Do create a strong business purpose with nontax reasons. Operate FLP/LLC as a business.
- GP only manages FLP – Consider Using Unrelated Party GP.
- GP respects fiduciary duties to partners and partnership, including obligation to distribute income properly. (Byrum)
- Do make distributions carefully and regularly.
- Do properly maintain FLP books & records.
- Do leave sufficient % of assets outside of FLP/LLC to support expenses and lifestyle of taxpayer. How much (15%, 20%, 25%...)? Get a written professional's estimate of what is sufficient.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## *§ 2036 – DO'S:*

- Do give the other interest holders more than a de minimus interest in the entity.
- Do consider including an unrelated party to support reality of transaction.
- Do comply with all state law formalities.
- Do comply with the operative agreement.
- Do properly re-title assets transferred to the entity.
- When claiming a discount on estate tax return use an experienced appraiser from the filing of the return.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

Business & Real Estate Appraisals, & Business Brokerage

## ***Avoiding Strangi II and § 2036 (a) (2):***

### **Suggestions for Solving the § 2036(a)(2) Problem:**

- 1) Eliminate creator's right to vote on liquidation. (Ex: Make taxpayer shareholder in a Corp. G.P. lacking right to vote for corp. liquidation and partnership liquidation.)
- 2) Create different classes of interests.
- 3) Transfer voting rights to IDIGTs.
- 4) Retain G.P. Interests and only gift L.P. Interests to IDIGT.
- 5) Sell interests to IDIGT in exchange for note or private annuity.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***Avoiding Strangi II and § 2036 (a) (2):***

- 6) Have taxpayer transfer LP interests to trust with independent trustee (Byrum).
- 7) In conjunction with above, do not permit the taxpayer any L.P. rights to amend the partnership agreement to either participate in distributions or liquidate the partnership. (However, such stringent restrictions above on the taxpayer and transfer of rights to the unrelated G.P. may cause the “gift upon formation” issue to arise, unless IDIGT is used.)
- 8) Have the taxpayer transfer interests in the partnership to a trust having an independent person who controls all trust distributions.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***KEY VALUATION CASES & ISSUES 1997-2001:***

### Many have been Taxpayer Favorable

1. **Schauerhamer, 73 TCM 2855** – [2036(a)(1), FLP lacked separate set of books and bank accounts, Co-mingling of Funds, Disproportionate distributions made to Senior Partners for personal expenses.]
2. **Strangi I, 115 TC 35 (11/30/00)** - [2703(a), and 2704] [Business Purpose & Economic Substance – So long as LP is validly formed under state law, LP will be recognized, regardless of bus. purpose.]
3. **Kerr V. Comm., 113 TC 30 (12/23/99)** - [2704(b)] [LP valid under state law concurring with Strangi I.]
4. **J.C. Shephard, 115 TC #30 (10/26/00)** - Poor timing of asset transfers and FLP formation.



# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***KEY VALUATION CASES & ISSUES 1997-2001:***

5. **Reichardt, 114 TC 144 (3/1/00)** - [2036(a)] [Sham Transaction, Nearly all assets transferred to FLP, Disproportionate distributions made to Senior Partners for personal expenses.]
6. **Knight, 115 TC 36 (11/30/00)** - [2704(b)] [Economic Substance, FLP lacked separate set of books] [LP valid under state law concurring with Strangi I.]
7. **Jones II, 116 TC No. 11 (2001)** - [2704(b), and 2703] [Economic Substance] [LP valid under state law concurring with Strangi I.]
8. **Church, 85 AFTR 2<sup>nd</sup> 2000-804, 2001-1 USTC ¶ 60,369 (WD Tex. 2000)** – [2036(a), 2703(a)] Relationship and character of assets did change after transfer of assets to FLP. Taxpayer wins.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***KEY VALUATION CASES & ISSUES 2002-2003:***

- 1) **Strangi II, TCM 2003-145** – [2036(a)(1) & (2), Sick or Death Bed Formation, Lack of Independent Trustee, FLP administered more like a trust than a business.] [On Appeal]
- 2) **Thompson, TCM 2002-246** – [2036(a)(1), Fortress FLP Plan, Economic Substance, Too Many Assets Placed in FLP, Sick or Death Bed Formation, Lack of Independent Trustee, Excessive Powers over Operations held by FLP Creator, Disproportionate distributions to Senior Partners, FLP Assets Managed by Transferor, FLP Administered Like a trust than a business.] [On Appeal]

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***KEY VALUATION CASES & ISSUES 2002-2003:***

- 3) **Stone, TCM 2003-309** [Counterpoint to Strangi II, 2036(a)(1) – Favorable Taxpayer Decision – Record of contentious siblings with individual legal counsel proving arms-length negotiations, children funded the FLP with their own assets, Bone fide consideration was received and strong business purpose for FLP.]
- 4) **Harper, TCM 2002-121** [2035(a), 2036(a), Delay in Funding, Recycling of Value, Sick or Death Bed Formation, Lack of Independent Trustee, Excessive Powers over Operations held by FLP Creator. Similar to Schauerhamer & Reichardt – commingling of funds, history of disproportionate distributions, & testamentary nature of the arrangement.]

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***Other Key 2003 FLP Valuation Cases:***

**Deputy, TCM 2003-176** – [Excellent read to understand how appraiser's will differ as to value conclusions.]

**“We have also recognized the basic premise that as similarity to the company valued decreases, the number of required comparables increases.”**

**McCord, 120 TC No. 13, (5/14/03)** – [Court criticizes IPO studies. Poor statistical reasoning] [On Appeal]

**Lappo, TCM 2003-258.** – [Poor statistical reasoning, Economic Substance & Business Purpose.]

**Peracchio, TCM 2003-280.** – [Poor statistical reasoning, Economic Substance, 2703(a)(2), 2704(b).]

**Lappo & Peracchio should never have been litigated.**

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

Business & Real Estate Appraisals, & Business Brokerage

## *2004 FLP Valuation Cases:*

1. **Hillgren, TCM 2004-46** – [Too many assets put in FLP, Sick or Death Bed Formation, , Lack of Independent Trustee, Implied & Express Agreement that FLP Creator would enjoy all Income, No Separate Books or Bank Accounts, Actual FLP Asset Mgt by Transferor FLP administered more like a trust than a business.]
2. **Senda, TCM 2004-160** – [Failure to follow in proper, timely steps the completion of documentation, formation, and funding of FLP.]
3. **Kimball, U.S. Court of Appeals, 5<sup>th</sup> Cir. (5/20/04)**

District Court found:

- that the FLP formation and asset transfers did not meet the “bona fide” sale for full and adequate consideration requirement, and
- that Ruth Kimball, by owning 99% LP interests, retained the full enjoyment of the transferred assets because the partnership agreement permitted a 70% LP owner to remove the GP and appoint herself as GP. Therefore, the assets are includable in the estate under 2036 (a)(1) & (2).

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

Business & Real Estate Appraisals, & Business Brokerage

## *2004 FLP Valuation Cases - Kimball:*

Fifth Circuit Court of Appeals found:

- Citing *Wheeler v. US*, a bona fide sale did occur even though it was between family members because:
  - Stated purpose of FLP as set forth in the FLP agreement.
  - Decedent received pro rata shares of FLP interests for asset contributions.
  - The decedent and other partners formed the FLP to continue a business enterprise (unlike *Thompson, Harper & Strangi*).
  - Decedent retained sufficient assets (15%) outside of FLP to support herself.
  - FLP formalities were followed
  - The FLP accomplished goals that her original trust could not, like creditor protection.
- Decedent's indirect 50% LLC GP interest was not sufficient for unilateral control and imposition of 2036(a)(2).
- Remanded to district court to decide whether interest transferred was a limited partnership or assignee interest.

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

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## *2004 FLP Valuation Cases - Thompson:*

- **Thompson, US Court of Appeals, 3<sup>rd</sup> Cir., No. 03-3173, 9/1/04:**

Finding application of § 2036(a), Fortress FLP, largely marketable securities in FLP with some real estate, insufficient assets held outside of FLP for living expenses (as determined by actuarial life of decedent), FLP run as personal assets not as a business, loans to partners forgiven, distributions made to decedent transferor for personal expenses and gifts, implied agreement to retain lifetime enjoyment & economic benefit of transferred assets, recycling of value – no real business purpose for asset transfer other than tax benefits, nothing beyond formal title changed in decedent's relationship to his assets, no bone fide sale for full and adequate consideration exception because of weak business purpose, operations, and failure to pool assets.

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

Business & Real Estate Appraisals, & Business Brokerage

## *Selected FLP/LLC Cases & Their Discounts*

<u>Tax Case</u>	<u>Partnership Assets</u>	<u>Discount</u>
Strangi, 115 TC 478 (2000)	Securities	31.0%
Knight, 115 TC 506 (2001)	Securities & Real Estate	15.0%
Jones II, 116 TC 121 (2001)	Real Estate	44.0%
Dailey, TCM 2001-263	Securities	40.0%
Adams, CA-5, 2002-2 USTC ¶ 60,376, 218 F3d 383, on remand, DC Tex., 2001-2 USTC ¶ 60,418.	Securities, Real Estate & Minerals	5.4%
Church DC Tex, 2001-1 USTC 60,369, aff'd, CA-5 (unpublished Opin), 2001-2 USTC 60,415, 268 F3d 1063.	Securities & Real Estate	58.0%
McCord, Jr., 120 TC 358 (2003)	Securities & Real Estate	32.0%
Lappo, TCM 2003-258	Securities & Real Estate	35.4%
Peracchio, TCM 2003-280	Securities	29.5%



# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

Business & Real Estate Appraisals, & Business Brokerage

## Selected Undivided Partial Interests in Real Estate Cases:

<u>Tax Case</u>	<u>Discount</u>
Baird v. Comm., TCM 2001-258	60%
Brocato v. Comm., TCM 1999-424	20%
Busch v. Comm., TCM 2000-3	10%
Stevens v. Comm., TCM 2000-53	25%
Williams v. Comm., TCM 1998-59	44%
Barge v. Comm., TCM 1997-188	27%
Lefrak v. Comm., TCM 1993-526	30%

<u>Tax Case</u>	<u>Discount</u>
Wildman, TCM 1989-667	15%
Van Loben Sels, TCM 1986-50	60%
Cervin v. Comm., TCM 1994-550	20%
Mooneyham v. Comm., TCM 1991-178	15%
Forbes v. Comm., TCM 2001-72	30%
Wineman v. Comm., TCM 2000-193	15%
Propstra, 680 F.2d 1248	15%
(sometimes considered a safe harbor disc. by IRS and taxpayer attorneys- no guarantees.)	

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***MISCELLANEOUS:***

### **FAVORABLE STATE LAW LIMITED PARTNERSHIP ACTS:**

**ALASKA**

**DELAWARE**

**NEVADA**

**OKLAHOMA**

**TEXAS**

**WASHINGTON**

**WYOMING**

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### *Why A Professional Appraiser & Appraisal is Required:*

- Revised Form 709 states: “Does the value of any item listed on Schedule A reflect any valuation discount? If Yes, attach an explanation giving the factual basis for the claimed discounts and the amount taken.
- Treas. Reg. § 301.6501(c)-1(e)(2) – Adequate disclosure of gifts – requires essentially a full appraisal.
  - “A description of the transaction, including a description of transferred and retained interests and the method(s) used to value each.”
  - A detailed description (including all actuarial factors and discount rates used) of the method used to determine the amount of the gift arising from the transfer...
- Treas. Reg. § 301.6501(c)-1(f) - Requires that a gift be “adequately disclosed” in order to begin the 3 year statute of limitation running from the filing of the return.
- **In the cases which follow the court criticized or disregarded values which were not determined by professional appraisers. The courts are also highly critical of CPA’s performing appraisals if they do not have appraisal credentials.**

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### *Why A Professional Appraiser & Appraisal is Required:*

**IRS Perspective: From the National Coordinator of FLP Settlement at Appeals, Mary Lou Edelstein.**

- Based on IRS discount settlement statistics since April 1999, FLP cases fall into four categories:
  - Active Assets
  - Passive Assets
  - Death bed cases (set at 6 months)
  - Non-death bed cases
- Garden Variety non-death bed FLPs with no § 2036 issues and all passive assets should settle for 25% discounts.
- Death-bed FLPs will settle for 0-15% discounts, due to strong § 2036 arguments.
- FLPs created more than 6 months prior to death:
  - Active Asset FLPs are eligible for a 35-40% discount.
  - Passive Asset FLPs are eligible for a 25-30% discount.
- No discount will be applied for “Built-In Gain Tax Liability because § 754 allows basis adjustment, despite the fact that there is no certainty that the § 754 election will be made.
- If a fractional interest discount issue is taken to Appeals, the taxpayer must be prepared to provide expert testimony as to the nature of the discount and Appeals is willing to settle based on the hazards of litigation, notwithstanding the Service’s official position that the discount is limited to Costs of Partition.
- Small FLPs with assets under \$2.8MM are singled out under the assumptions that the Taxpayer will not have the funds to invest to fight the IRS (\$100,000 or more), and small FLPs may have cut corners during formation, operation and appraisal reports.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***SETTLEMENTS – A RECENT CASE:***

Subject FLP formed 5 years ago contained \$15,000,000 in assets of which 76% was marketable securities, 13% was fee simple real estate, and 11% was limited partnership interests in real estate limited partnerships. I argued for a 40% discount. Case settled for a 30% discount.

- IRS is rigorously sticking to the National Office directive on settlements.
- IRS carefully scrutinized the following factors:
  - Whether Transferor actually give up authority and control over the assets or whether control was implicitly retained.
  - Whether the FLP/LLC contained only marketable securities – See 721(a)&(b) FLP treated as an Investment Company if 80% of assets are marketable securities.
  - Whether there are sufficient assets held outside of the FLP/LLC.
  - Whether distributions were timely and properly made according to the actual % of ownership.
- No penalties, but \$8,000 in interest and \$82,000 in gift tax was assessed.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***SETTLEMENTS – A RECENT CASE:***

The above case and possible trend suggests that the Appraiser needs to know up front how the client wishes to deal with the IRS risk.

What is client's risk tolerance.

Although the data may argue for discounts higher than the settlement range, a strategy for dealing with the potential of audit and settlement needs to be discussed up front with the Appraiser.

Should the Appraiser ignore the higher discounts and come in within the settlement range, or should the higher discounts be taken for leverage in any potential negotiation or with the potential that the FLP/LLC will not be audited? One potential risk is that the IRS can assess generation skipping tax is gifts are made over the exclusion amount.

# ACCREDITED BUSINESS APPRAISALS & BROKERAGE

## Business & Real Estate Appraisals, & Business Brokerage

### *Why A Professional Appraiser & Appraisal is Required:*

- *True, Jr., 2001-167* – Failure to seek professional valuation advice in selecting formula price for Buy/Sell Agreements.
- *Estate of Berg, 61 TCM 2949 (6/20/91)* – merely quoting prior case law discounts is unacceptable. CPA's were criticized for no formal valuation training.
- *Estate of Joyce Hall, 92 T.C. 312, 336 (1989)*
- *Estate of Margaret Jann, T.C.M. 1990-333 CCH Dec. 45,692 (1990)*
- *Estate of Ray A. Ford, v. Commissioner, T.C.M. 1993-580, filed 12-8-93*
- *Estate of Samuel J. LeFrak and Ethel LeFrak v. Commissioner T.C.M. 1993-526, filed 11-16-93*
- *Mad Auto Wrecking, Inc. v. Commissioner, No. 1950-94, T.C.M. 1995-153, filed 4-5-95*
- *Laureys v. Commissioner, 92 T.C.M. 101, 126-129*
- *Pabst Brewing Company v. Commissioner, No. 18466-92 (USTCM) 1996-506*
- *Furman v. Commissioner, Nos. 11568-96 - 11569-96, 1998 WL 209265 (U.S. Tax Court, 4-30-98)*
- *Thompson, T.C.M. 2004-174 (7/26/04)* – Attorney & CPA with no valuation experience or appraisal organization membership were determined to be unqualified to perform and submit an appraisal.

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***Appraiser Qualifications***

- ***Credentials:*** Certified Business & Real Estate Appraiser – 25 Years Experience.
  - ***Experienced:*** Valued thousands of small businesses, real estate, FLPs & LLCs.
  - ***Proprietary Data:*** Proprietary database of over 100 undivided partial interest comparables.
  - ***Published:*** Articles published in Valuation and Legal Journals.
    - “Should You Rely on the Transaction Data Bases to Determine Fair Market Value”; Valuation Strategies, July/August 2002.
    - “Examining The Reliability of the Small Business Transaction Databases”, Valuation Strategies, Nov./Dec. 2003.
    - “Statistical Reasoning in Family Limited Partnership Appraisals: New Tax Court Scrutiny”; Probate & Property, May/June 2004.
    - “Statistical Reasoning in Family Limited Partnership Appraisals: New Tax Court Scrutiny”; The Appraisal Journal, Autumn 2004.
    - “Small Business Databases & Guideline Company Method”, Valuation Strategies, Sept./Oct. 2004.
- Persuasive:*** Logical approaches based on fact and not subjective hearsay.



# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

## ***What's Needed For An Appraisal***

- ✓ **3-5 Years of Tax Returns or Financial Statements on FLP or LLC or Underlying Holdings.**
- ✓ **FLP or LLC Operating Agreement**
- ✓ **Appraisals of Underlying Holdings**
- ✓ **Stock Brokerage Statements**
- ✓ **Signed Contract & Check**

# **ACCREDITED BUSINESS APPRAISALS & BROKERAGE**

**Business & Real Estate Appraisals, & Business Brokerage**

***Jeffrey B. Wolpin, CBA, CREA, CCRA, MBA***

***CBA – Certified Business Appraiser***

***CREA – Certified Residential Property Appraiser***

***CCRA – Certified Commercial Real Estate Appraiser***

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