TAX COURT CASE UPDATE

Citation:

Estate of Adell et al. v. Commissioner, T.C. Memo 2014-155, August 4, 2014.

Overview:

The Tax Court has determined the estate tax value of a decedent's 100 percent ownership interest in a corporation to be the amount originally reported by the estate. It rejected a lower value subsequently sought by the estate and a higher value claimed by the IRS. The Court also found that no undervaluation penalty applied.

The Facts:

In 1994, Franklin C. Adell ("the decedent") formed STN Satellite Television Network, Inc. ("STN Satellite"), a Nevada corporation that provided satellite uplinking services. In 1999, his son, Kevin ("the son"), saw an opportunity to create STN.Com, a new entity to operate the uplinking business.

The decedent incorporated STN.Com on June 29, 1999, as a C corporation in the State of Michigan. The decdent was STN.Com's sole shareholder until July 17, 2002, when he transferred his 100 percent interest in STN.Com, consisting of 1,000 shares of common stock to a trust he created on that date, the Franklin C. Adell Trust ("Adell Trust"). From the date of incorporation through the date of his death, STN.Com's board of directors included the decedent, the son and Ralph G. Lameti, the decedent's accountant. The son served as STN.Com's president, but he never had an employment agreement or a non-compete agreement with STN.Com. STN.Com's sole business purpose was to broadcast an urban religious program channel that the son named "The Word Network."

The decedent died on August 13, 2006. The son was the personal representative of the estate and the trustee of the Adell Trust. The decedent's estate tax return showed his transfers to the Adell Trust during his life including his shares in STN.Com, with a reported date-of-death value of $9.3 million. On a second amended return, the estate changed its original return position and reported that the STN.Com stock's date-of-death value was zero instead of $9.3 million.

On November 9, 2010, the IRS issued a notice of deficiency to the estate in which it determined an estate tax deficiency of nearly $40 million. In the notice, the IRS determined that the date-of-death value of the STN.Com stock that Franklin had transferred to the Adell Trust was over $92.2 million, instead of $9.3 million, as reported on the original Form 706. The estate filed a petition with the Tax Court.

Discussion:

The Court said it had to determine the fair market value of the decedent’s 100 percent interest in STN.Com on his date of death, and whether the estate was liable for a substantial estate tax valuation understatement penalty with respect to the STN.Com stock. The Court noted that the parties substantially changed their positions from those included in the notice of deficiency, the original petition, and the answer to the Court. Before the Court, the estate was arguing that the fair market value of the STN.Com stock on the valuation date was $4.3 million and the IRS was claiming that the fair market value of the stock was over $26 million.

At trial, the parties submitted expert reports providing valuations of the STN.Com stock. The reports of the estate's experts arrived at a value of $4.3 million, and that of the IRS's expert showed a value of over $26 million. For various reasons detailed in the opinion, the Court gave no weight to the expert valuations that the estate submitted at trial, except for the consistent treatment of the underlying value of STN.Com's assets. The Court also found that the IRS's expert valuation was not persuasive because it did not reasonably account for the son’s personal goodwill.

The Court therefore found that the estate failed to introduce any evidence or present any arguments to persuade the Court that the value reported on its original tax return was incorrect. Thus, the Court concluded that the valuation report on the STN.Com stock included with the original estate tax return was the most credible because it properly accounted for the son’s personal goodwill and appropriately used the discounted cash flow analysis of the income approach to value the STN.Com stock. Accordingly, the Court concluded that the fair market value of the STN.Com stock owned by the estate on August 13, 2006, was $9.3 million.

Because the Court found that the value of the STN.Com stock held by the estate was the value reported on its original estate tax return, it did not need to address whether the estate was liable for the substantial estate tax valuation understatement penalty under Code Section 6662. However, the Court noted that the penalty could apply to other items whose values the parties stipulated.

Conclusion:

The Court concluded that the value included with the original filing of Form 706 was correct because the expert used the proper methodology to value the stock of STN.com and considered the personal goodwill of the son. In addition, no persuasive evidence of a different value was submitted at trial. As a result, no underpayment penalty was appropriate.