

Davis v. Commissioner

A Look at Davis v. Commissioner...and Its Implications

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The Davis v. Commissioner decision has brought support to discount adjustments for lack of marketability (DOLM) for certain assets held in an investment of holding company.

The Davis case involved ADDI&C, a closely held Florida corporation, two 25-share blocks of the company stock which represented 25.77% interest transferred to two sons approximately 21/2 years prior to their father's death. ADDI&C's main holding was 1,020,666 shares of 1.328% of the issued and outstanding common stock of Winn-Dixie a publicly held company traded on the NYSE. ADDI&C also held other minor assets, which are not relevant for the ensuing discussion. The stock was subject to SEC rule 144 restrictions relative to its sale.

The issue arises germane to the filing of the 1992 Form 709, United States Gift Tax Return and the valuation of the two 25-share blocks of stock transferred. The initial value filed on the return was \$7,444,250, or \$297,770 a share. The IRS and their expert challenged this value.

The net asset value contains \$70 million of Winn Dixie stock. The estate did have an additional expert whose analysis of the case did not appear to have any material affect on the outcome.

The following table outlines the comparative positions taken:

Please note that this table is a high level synopsis of the detail information provided for illustrative purposes.

	Estate's Expert "Pratt"	IRS Expert Thompson	IRS Position	Tax Court Findings
Net Asset Value	\$80 Million	\$80 Million	\$80 Million	\$80 Million
Blockage Discount	(\$7 Million)	0	0	0
Minority Discount	(\$15 Million)	(\$10 Million)	(\$12 Million)	(\$12 Million)
DOLM	(\$29 Million)	(\$27 Million)	(\$16 Million)	(\$28 Million)
Value - control	\$29 Million	\$43 Million	\$52 Million	\$40 Million

What the above attempts to describe is the comparative positions of the parties involved as follows:

- The estate expert applied a 10% blockage discount based on premise that the block was so large that it could not have been disposed of all at once without depressing the market value and therefore alternatively would need to be sold in a private placement. Unfortunately, neither of the estate's experts were able to support their position adequately enough and the prevailing decision was to disallow. In support of the court position it is noted that the number of shares held were just over 1 million with an average trading volume of 300,000 in the market and the stock was on an upward trend.
- The minority discount, although accepted in concept by all parties as is apparent in the table, was taken by the IRS as the splitting the baby approach and confirmed by the tax court.
- The DLOM represents the breakthrough opinion in the case. In the final analysis the tax court accepted the concept that there is a built in capital gain component that requires consideration. The determination of what percentage that amount should represent was in question.
- The concept that the taxpayer could have avoided tax by converting from a C-corporation to an S-corporation was rejected due to the 10 year holding period requirement.

The implications of this case relate to clients whom are holding assets or planning to move assets into some form of holding company. The issues that need to be considered when reviewing these situations are as follows:

- The organizational form of the
- The nature of the assets
- The type of investor
- The size of the investment