DOUBLE DISCOUNTS,
FACT OR FICTION

by
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Issue: Within the Fortress Group, a question has arisen concerning the possibility of taking a "double discount" on certain types of assets that have been contributed to a family limited partnership. Is this possible?

Background: Consider, for example, a situation where Appraiser A has been retained to value the common stock of a closely-held company, XYZ Corporation. Part of the accepted practice of completing such a valuation is to determine an appropriate discount for lack of marketability. Such discounts can run the gamut from 15% to 75%, with the average being 35%. This discount reflects the inability of the shareholder to immediately sell shares on the open market. A company that is publicly-traded is obviously more marketable than one that is closely-held and has no ready market available for disposing of shares.

A second discount considered by the appraiser arises out of a lack of control, sometimes referred to as a minority interest. Controlling shares of a company - usually 51% or more - are worth more than minority shares. All the prerogatives of control, such as the ability to merge, acquire, enter into contracts, sell assets, set policy, etc., go with the controlling shares. The minority shareholder has virtually no managerial rights or privileges. A minority discount is not always appropriate, and can only be considered when minority shares (less than the amount required for control) are being valued.

Let's assume that Appraiser A determined that the enterprise value (value of 100% of the shares on a control basis) of the company was $1,500,000, and that the total discounts of 35% were appropriate. The fair market value of the company, therefore, was determined to be $975,000 ($1,500,000 x 65%). At this point, the stock of the corporation is contributed to a Fortress limited partnership and Appraiser B is asked to value a minority interest in the partnership for gift tax purposes. Can yet another discount be taken?

Conclusion: The answer is **YES**, but this is not a double discount. One cannot take a double discount for estate and gift tax purposes, but one can take the appropriate discounts on differing assets. The critical issue is that Appraiser B is not valuing the stock of the corporation; that value was provided by Appraiser A. As a matter of fact, Appraiser B is not valuing any of the underlying assets on the partnership. In the Fortress documents, no partner has a right to any of the underlying assets. It has long been a basic tenant of business valuations that an investor has no right to the underlying assets of the business, but rather a proportionate share of the business that owns the assets.

In the Fortress valuation, the appraiser is valuing a minority partnership interest. The underlying assets or their liquidity is not the relevant issue. The relevant issue is the value of the minority partnership interest given the considerable barriers to marketability and control designed into the partnership agreement by Fortress.

Can a double discount be taken? No! But, two appropriately structured discounts can be taken on different assets. In this example, Appraiser B might conclude that a minority partnership interest should be discounted, say 40%. Partnership assets were valued at $975,000; therefore, the value of the partnership will be $585,000 ($975,000 x 60%). Through this technically correct process, the value has been decreased from $1,500,000 to $585,000 for estate and gift tax purposes - a decrease of 61% from the original enterprise value. Be careful! The stakes are too high to cut corners. The savings in estate and gift taxes can be substantial; therefore, each valuation must be prepared in exact accordance with case law, revenue rulings and the promulgations of the Uniform Standards of Professional Appraisal Practice.