Family Attribution & the IRS

by
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ISSUE: For years it has been the contention of the IRS that all stock or other business interest held by family members should be aggregated for purposes of a Fair Market Valuation for estate or gift tax purposes. The result of this aggregation, or family attribution of ownership, is to cause all blocks of stock (or other ownership interest, such as partnership interests), regardless of their minority position, to be valued on a control basis. The IRS assumed that all family members would vote as a block on all occasions and on all matters. This position was succinctly stated in Revenue Ruling 81-253, which in effect required the attribution of all family ownership, regardless of the size of the block owned.

The result of the position taken by the IRS is to greatly increase the Fair Market Value of small minority blocks of interests by arbitrarily applying a control premium. The practical affect was to cause a 20% to 50% increase in taxable value. The IRS held tightly to this position even though the courts consistently disagreed. [Estate of Lee v. Commissioner (1978); Estate of Bright v. United States (1981); Estate of Andrews v. Commissioner (1982)]

IRS SEES THE LIGHT: After two decades of insisting on the attribution of all family ownership in a business entity, and after losing virtually every tax court case relating to this arbitrary application of attribution, the IRS reversed its position in a newly released revenue ruling. **Revenue Ruling 93-12** concurs with the position held by the courts and valuation professionals for years, that it is inappropriate to aggregate all family interest in a closely-held business enterprise when determining the Fair Market Value of a specific ownership block. Each situation must be studied on its own merits and examined on the basis of the specific facts.

WHAT NOW: The introduction of Revenue Ruling 93-12 is certainly good news; however, caution is still required. Our discussions with revenue agents will take a different track. Instead of arguing over the issue aggregation, we will be discussing two very technical issues.

First of all, Revenue Ruling 93-12 did not address the size of the minority discount. The IRS will be carefully scrutinizing the size of the discount and the reasoning behind the discount. Carefully structured arguments, clearly stated in the valuation document, will be necessary. The arbitrary selection of a minority discount will no longer be sufficient, even if it's based on some sort of published average.

Secondly, a minority discount may not be appropriate from a technical valuation point of view. In order to apply a minority discount, the valuation must have been prepared on the basis of a control methodology. It is appropriate to take a minority discount from a controlling interest valuation. It is not appropriate, however, to take a further minority discount from a valuation prepared on the basis of publicly-traded minority interests. In other words, some valuations are already on a minority basis, thus no further discount for minority interest is appropriate.

For these reasons, its will be even more important to provide a valuation document based on solid methodologies and analytical evidence. All discounts must be supported and the valuation methodology must be appropriate for the discounts applied.