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Subject: Fw: The FMV Valuation Alert - Estate of Elkins [C]

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Regarding the B artist estate I mentioned few months ago the trustees tell me they got extension to pay the taxes and are selling pieces slowly, cost about 3% which is attractive, I may do a loan after all and use the put structure we discussed.

From: "FMV" [REDACTED]

Sent: 09/18/2014 07:58 PM GMT

To: Paul Morris

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Fifth Circuit Overturns Tax Court Decision in *Elkins*

(Estate of Elkins)^[1]

By Lance S. Hall, ASA^{*}

In March of 2013, the Tax Court in *Estate of Elkins* determined that undivided interests in 64 works of art in the Estate, where the other owners were family members, should be subject to a 10-percent discount. The Court arrived at this conclusion after noting that one of the four undivided interest holders had testified that the family loved the art and wanted to keep it in the family. Accordingly, the Court surmised that the other family members would want to buy the Decedent's undivided interests at full pro rata, and undiscounted, value of each of the 64 works of art. The fact that "fair market value" dictates a "hypothetical willing buyer" did not trouble the Court. The Court merely decided that the "hypothetical willing buyer" would buy the art and immediately turn around and sell the art to the remaining family members. Moreover, a 10-percent discount would provide the "hypothetical willing buyer" with sufficient profit motivation to enter into the transaction, knowing that the family would stand ready to purchase the undivided interest at an undiscounted value.

The decision was in sharp contrast to the 44.75-percent discount used by the Estate in its Form 706 filing and the 50-percent to 95-percent discounts that the Estate's trial experts had determined. On the other hand, the IRS proffered no experts and argued that, since no discount is required for charitable gifts of undivided interests in art, no discounts for undivided interests should be allowed for estate tax purposes. The Tax Court flatly rejected the IRS's contention that no discounts are applicable. The Fifth Circuit agreed.

The undivided interests in the 64 pieces of art were also subject to a co-tenant agreement, whereby the owners waived their rights to force a partition (by sale or otherwise) and agreed that any sale of the art would require unanimous approval. The Tax Court, however, stated that the agreement was to be ignored under Section 2703(a).^[2]

In a very straightforward and matter-of-fact opinion by the Fifth Circuit, the entirety of the discount determination by the Tax Court in *Elkins* was overturned and the discounts accepted.

The following are some of the comments of the Fifth Circuit.

- "First, the Tax Court neither expressed nor implied credibility concerns with any witness, lay or expert, so there are no credibility calls to which we owe a special deference."
- "Second, the willing buyer/willing seller test of fair market value is ubiquitous We therefore owe no enhanced deference to the Tax Court's application of that test."
- The Tax Court issued its opinion based upon "the *preponderance* of the evidence. ... But, when, as here, the *only* evidence on an issue is that presented by but one party – and by the one that did not have the burden of proof, at that – there is no 'preponderance': it takes two to tango."
- "... given the total absence of substantive evidence from the Commissioner on the issue of quantum, the Tax Court should have accepted and applied the uncontradicted quantum of the partial-ownership discounts that the Estate proved with much more than substantial evidence."
- "...in the absence of any evidentiary basis whatsoever, there is no viable factual or legal support for the court's own nominal 10 percent discount."
- "The Estate, as taxpayer, presented *all* of the discount evidence, and a surfeit at that, further eschewing the propriety of a nominal discount."
- "Counsel claimed that the court faulted [the taxpayer's experts] for not concluding that, in and of itself, [the family's] psychic attachment [to the art] would guarantee the hypothetical willing buyer a virtually undiscounted purchase price for the Decedent's fractional interests, regardless of those heirs' strong legal and financial positions as putative hostile co-owners with such a hypothetical buyer."
- "We have again reviewed the entire transcript of the testimony of the Estate's experts and their written reports, and we are satisfied beyond cavil that they considered and correctly weighed all factors and characteristics of the Elkins heirs when determining how much a hypothetical willing buyer would pay for Decedent's fractional interests and thus become a co-owner with them."
- "We repeat for emphasis that the Estate's uncontradicted, unimpeached, and eminently credible evidence in support of its proffered fractional-ownership discounts is not just a 'preponderance' of such evidence; it is the *only* such evidence."
- "Nowhere is there any evidentiary support for the Tax Court's unsubstantiated declaration that 'a 10% discount would enable a hypothetical buyer to assure himself or herself of a reasonable profit on a resale of those interests to the Elkins children.'"
- "Besides the error in logic of presuming that the hypothetical willing buyer *must* turn right around and sell his fractional purchases to those heirs, we cannot escape the conclusion that, under the facts of this case and the way the parties tried it, such a determination constitutes reversible error under any standard of review."
- "... the Elkins heirs are neither *hypothetical* willing buyers nor *hypothetical* willing sellers, any more than the Estate is deemed to be the hypothetical willing seller."
- "A potential willing buyer would undoubtedly insist that his potential willing seller *further discount* the sales price to account for the virtual impossibility of making an immediate 'flip' of the art. Such a fully informed willing buyer would be well aware that, by virtue of becoming a co-owner with the sophisticated, determined, and financially independent Elkins heirs, he could not possibly make such a quick resale -- absent a deep discount, that is."

- "... the situation is only exacerbated by the effect of the various restrictions on partition, alienation, and possession that survived the death of the Decedent."
- "The record on appeal is sufficient for us to render a final judgment and dispose of the sole issue in this case without prolonging it by remand at the cost of more time and money to the parties."
- "[We] hold that the correct quantum of the fractional-ownership discounts applicable to the Decedent's pro rata share of the stipulated FMVs of the various works of art are those determined by the Estate's experts..."

As you can read in the above quotes from the Fifth Circuit, this was a complete rejection of the Tax Court's valuation discount decision in *Elkins*. As a sop to the Judge in *Elkins*, the Fifth Circuit stated, "We are never comfortable in disagreeing with, much less reversing, a jurist of the experience, reputation, and respect enjoyed by the Tax Court judge whose work product we are called on to review today. Yet, our review of the court's extensive explication of this case and its ultimate conclusion that the proper discount is 10 percent, leaves us with the 'definite and firm conviction that a mistake has been made.'"

¹ No. 13-60472 (September 15, 2014) overturning *Estate of Elkins* 140 T.C. No. 5 (March 11, 2013)

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³ The Fifth Circuit, while never addressing this issue directly, clearly considered the co-tenant agreement in its overturning of the Tax Court's conclusions. This author has previously faulted the Tax Court's decision in *Elkins* because the Tax Court failed to consider the exceptions to Section 2703(a) found in Section 2703(b). The co-tenant agreement appeared to qualify under each of the three exceptions in Section 2703(b).

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