

Action on Decision

SUBJECT: Herbert V. Kohler, Jr. et al. v. Commissioner; T.C. Memo. 2006-152; 92 T.C.M (CCH) 48; T.C. Dkt. Nos. 4621-03, 4622-03, 4646-03, 4649-03

Issue:

Whether I.R.C. § 2032 allows a discount for transfer restrictions and a purchase option (“restrictions”) imposed on closely-held corporate stock pursuant to a post-death tax-free reorganization in determining the fair market value of the decedent’s stock on the alternate valuation date.

Discussion:

At decedent’s death on March 4, 1988, decedent owned common stock in the Kohler Company (“Kohler”). The stock was not subject to restrictions. On May 11, 1998, Kohler underwent a tax-free reorganization under § 368(a). Pursuant to the reorganization, decedent’s estate opted to exchange its stock for stock that was subject to restrictions. The estate then elected to use the six month alternate valuation date under § 2032(a)(2). In determining the value of the Kohler stock on that date, the estate discounted the fair market value of the stock to account for the post-death restrictions. The Commissioner determined that no discount for post-death restrictions was permitted and the estate then filed a petition in the U. S. Tax Court.

The Commissioner argued in the Tax Court, among other things, that the court should ignore the post-death restrictions in valuing the stock. In making that argument, the Commissioner relied on the legislative history of the predecessor to § 2032, which indicates that Congress intended to provide relief for post-death decreases in the value of estate property resulting from market forces when valuing estate property on the alternate valuation date. See, S. Rep. No. 1240, at 9 (1935) and 79 Cong. Rec. 14632 (1935) (statement of Mr. Samuel B. Hill). See, also, Maass v. Higgins, 312 U.S. 443, 446 (1941) (purpose of predecessor to § 2032 was to “mitigate the hardship consequent upon shrinkage in the value of estates during the year following death”). Thus, post-death restrictions that reduce the value of estate property should not support a discount. See, Flanders v. United States, 347 F. Supp. 95 (N.D. Cal. 1972) (estate may not claim a discount for a land conservation easement placed on estate property after the decedent’s death). The Tax Court disagreed and held for the taxpayer.

In rejecting the Commissioner’s argument, the court focused on whether the reorganization was a “disposition” for purposes of § 2032(a)(1) and § 20.2032-1(c)(1). The court appeared to reason that because § 20.2032-1(c)(1) provides that a tax-free reorganization under § 368(a) does not constitute a disposition (which would otherwise require valuation on the date of disposition under § 2032(a)(1)), the court had to value the property in the condition it existed as of the date six months after the decedent’s death pursuant to § 2032(a)(2). By that point in time, the character of the property had

changed because the estate had exchanged the stock it held on the date of death for different stock that was subject to restrictions.

We think the court erred in focusing on whether a disposition had occurred rather than on whether it should take into account a change in the character of the property that had occurred during the alternate valuation period. Section 20.2032-1(c)(1) addresses what constitutes a disposition for purposes of determining *when* to value property (either on the date of disposition or the date six months after the decedent's death), not the character of the property to be valued. In similar circumstances, the district court in Flanders held that, "Congress intended that the character of the property be established for valuation purposes at the date of death. The option to select the alternative valuation date is merely to allow an estate to pay a lesser tax if unfavorable market conditions (as distinguished from voluntary acts changing the character of the property) result in a lessening of its fair market value." Flanders, 347 F. Supp. at 98. *C.f.* Estate of Holl v. Commissioner, 967 F.2d 1437 (10th Cir. 1992) (Oil and gas extracted after death must be valued in its condition as of the date of death, *i.e.*, as minerals in place, citing Flanders for the proposition that the value of the asset must recognize its condition as of the date of death or its "pre-change value").

Consistent with the valuation approach in Flanders, the character of the property to be valued in Kohler, was established for valuation purposes as of the date of death. Consequently, the court should have ignored changes in the character of the stock due to the post-death restrictions in determining the value of the stock on the alternate valuation date. Accordingly, we nonacquiesce in the decision of the court in Kohler.

Recommendation: Nonacquiescence

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