



FCG Valuation Case E-Flash

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CITATION:

THE RINGGOLD TELEPHONE COMPANY, Petitioner v. COMMISSIONER OF INTERNAL REVENUE, Respondent
T.C. Memo 2010-103 Docket Nos. 22783-07 Filed May 10, 2010.

OVERVIEW:

The Tax Court determined whether a post valuation date sale of a partnership interest should be included as evidence of fair market value. Additionally, the Tax Court decided the taxpayer's expert (who had a business valuation designation) was more credible and persuasive than the IRS' expert (who was not accredited in business valuation and had never appraised a company in the telecommunications industry).

SIGNIFICANT ISSUE NOT ADDRESSED IN THE RULING OR AT TRIAL:

In a telephone conversation with the taxpayer's expert, the authors confirmed that both experts tax affected the subject S corporation's income using C corporation income tax rates. According to the taxpayer's expert, the trial occurred during December 2008, well after the controversial Tax Court decisions asserting that tax affecting S corporation income is inappropriate, yet the issue was not discussed at trial. The absence of an IRS challenge on this issue should not be overlooked.

THE FACTS:

The Ringgold Telephone Company ("Taxpayer" or "Ringgold") provides telecommunication services. On January 1, 2000, Ringgold converted from a C corporation to an S corporation for federal tax purposes.

Ringgold, Bell South Mobility, Inc. ("BellSouth"), Trenton Telephone Co., and Bledsoe Telephone Co. each owned 25% partnership interests in Cellular Radio of Chattanooga ("CRC").

CRC's primary asset was a 29.54% limited partnership interest in Chattanooga MSA Limited Partnership ("CHAT"). Accordingly, Ringgold indirectly owned a noncontrolling interest in CHAT.

On November 27, 2000, Ringgold sold its 25% partnership interest in CRC to BellSouth for \$5,220,043.

BellSouth wholly owned Chattanooga CGSA, the sole general partner of CHAT and its controlling owner. Chattanooga CGSA's combined general and limited partner interest in CHAT was 55.31%.

A business valuation report was issued by Warinner, Gesinger & Associates, L.L.C., on February 15, 2000, which estimated the value of the CRC interest to be approximately \$2,600,000 ("February 2000 Report").

On Ringgold's 2000 Form 1120S, the February 2000 Report's value, \$2,600,000, was used to calculate the IRC § 1374 built-in gain attributable to the CRC interest as of January 1, 2000.

The IRS determined the January 1, 2000, fair market value of the CRC interest was \$5,243,602 (based on its November 27, 2000, sale to BellSouth) - instead of the February 2000 Report's \$2,600,000 - and asserted a tax deficiency and IRC § 6662(a) taxpayer penalty based on the difference.

DISCUSSION:

With regard to the value of the subject ownership interest, the court considered the following:

- The sale price of Ringgold's partnership interest in CRC was evidence of value.
- The Taxpayer, court, and IRS all agreed that the November 2000 sale occurred within a reasonable time of the valuation date (i.e., no significant events that would affect the share price occurred between January and November 2000) and was an arm's-length sale in the normal course of business.
- The sale price should be adjusted to reflect "special circumstances surrounding the buyer, the seller, or the transaction generally that could have skewed the sale price from a measure of true fair market value that would have been reached between a hypothetical buyer and seller absent those circumstances."
- The Taxpayer argued that a controlling interest holder would place a greater value on a minority interest compared to a hypothetical buyer who lacks control. Therefore, the purchase price reflects a control value. The IRS argued that because BellSouth already indirectly owned a controlling interest in CHAT, it would not have paid a control premium for the interest. The court recalled that the Taxpayer's own expert indicated BellSouth had no incentive from a control perspective to purchase the CRC interest. The court disagreed that a lack of control discount should be applied to the purchase price.
- In addition, the Taxpayer argued that BellSouth paid a premium for the CRC interest to discourage the other partners from exercising their rights of first refusal. As part of the argument, the Taxpayer's expert testified that if the sale was a strategic acquisition, BellSouth would pay a premium for the CRC interest. The court found the Taxpayer's expert to be a credible witness and found no evidence contradicting his testimony.

Based on the preceding, the court concluded that the sale price was probative, but not conclusive, evidence of the fair market value of the CRC interest on the valuation date.

The court also provided insightful information with regard to the two experts:

- The Taxpayer's witness, William E. King, CPA/ABV, is accredited in business valuation by the American Institute of Certified Public Accountants. Additionally, he has extensive experience in telecommunications valuations.
- The IRS' witness, Steven C. Hastings, CPA, is not accredited in business valuation and had never performed a business valuation for a telecommunications company prior to the subject appraisal.

The court found Mr. King to be a more persuasive expert relative to Mr. Hastings. In particular, his experience in valuing telecommunication companies allowed him to factor in industry specific conditions. Unlike Mr. Hastings, Mr. King also considered the distribution history of CHAT in his valuation analysis. The court recognized the importance of the distribution paying history to a minority shareholder who is unable to force the company to pay distributions.

CONCLUSION:

To determine the fair market value of the CRC interest, the court considered the sale price of the CRC interest, the King Report, and the Hastings Report, in addition to all other relevant factors.

The court found the taxpayer's expert credible and relied on his expert report rather than the IRS' expert report. However, Mr. King failed to consider the post-valuation date sale of the partnership interest to BellSouth in his analysis, a factor the court concluded should have been considered. To determine the value of the CRC interest, the court gave equal weighting to Mr. King's business valuation analysis, Mr. King's distribution yield analysis, and the BellSouth sale price.

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