



FCG Valuation Case E-Flash

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CITATION:

Pierre v. Commissioner, 133 T.C. No. 2, August 24, 2009

The Tax Court was asked to determine whether transfers of interests in a single-member LLC should be valued as direct transfers valued as an undiscounted, proportionate share of the LLC's assets or as transfers of interests in the LLC, thus being subject to valuation discounts.

THE FACTS

Suzanne J. Pierre formed the single-member Pierre Family, LLC ("Pierre LLC"), a New York limited liability company, on July 31, 2000. Both parties agreed Pierre LLC was validly formed under New York state law, which recognizes the entity as being separate and apart from its members.

Pierre LLC was treated as a disregarded entity under the check-the-box regulations for federal income tax purposes.

On September 15, 2000, Ms. Pierre transferred cash and marketable securities to the entity. To use her available generation-skipping transfer tax exemption, 9.5-percent interests were transferred to two trusts 12 days after the LLC was capitalized. Ms. Pierre then sold 40.5 percent interests to each trust in exchange for promissory notes.

The IRS

Because Pierre LLC is a single-member LLC and a disregarded entity under the check-the-box regulations, the IRS argued the gifts should be treated as direct, undiscounted transfers of cash and securities rather than discounted transfers of LLC member interests. As a result, lack of control and marketability discounts were not appropriate.

The Taxpayer

The taxpayer argued that state law - rather than federal tax law - determines the nature of a taxpayer's transferred ownership. More explicitly, because New York state law recognizes the entity as being separate and apart from its owner, the subject LLC ownership interests were subject to discounts for lack of control and lack of marketability.

Court Analysis

The court’s majority ruled the check-the-box regulations do not apply to transferred property ownership interest for federal gift tax purposes, but rather govern how the entity will be taxed for federal income tax purposes.

The court’s minority argued that Pierre LLC and Ms. Pierre constitute only one actor for federal tax purposes, which includes federal gift tax purposes as well. As a result, the gift of an interest in Pierre LLC should be treated as a direct gift of cash and securities. More explicitly, the court’s minority indicated the taxpayer should bear the burden - as well as the benefits - of the check-the-box regulations.

CONCLUSION

Neither the regulations nor previous court rulings cited by the IRS or the court’s minority provided the court’s majority with evidence that the existence of the entity (validly formed under state law) should be ignored for federal gift tax purposes. If the check-the-box regulations apply, federal law - rather than state law - would define property rights and interests transferred for federal gift tax purposes. Accordingly, the court allowed the valuation discounts.

Brueggeman and Johnson Yeanoplos, PC specializes in business valuation and litigation support services. Because of our education and background as CPAs we have a broad understanding of the financial, accounting, and tax issues surrounding valuation and commercial damage issues.

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