Huber v. Commissioner, T.C. Memo 2006-96, May 9, 2006.

The Facts:

Michael W. Huber, Caroline P. Huber, Tabitha A. Huber, Hans A. Huber and Laurel D. Huber ("Taxpayers") made gifts of various amounts of stock in J.M. Huber Corp. ("Company") between 1997 and 2000. The IRS questioned the proper amount of gift tax that Taxpayers should pay on these gifts reported on their Forms 709 from 1997 to 2000.

The Company was founded in 1883 and is a diversified, large privately-held business with sales in excess of $500 million annually. During the period 1997-2000, the Company had approximately 250 shareholders, the majority of which whom were Huber family members, the Huber Foundation (a nonprofit charitable organization), and various independent nonprofit organizations (including universities). Ernst & Young was engaged annually to appraise the Company's shares. The annual appraisals were used for all transactions during this time period, including intra-family sales, gifts to nonprofit organizations and corporate redemptions. The price determined by the annual appraisals and used in the stock transactions included a discount of 50% for lack of marketability.

The IRS agreed with the freely-traded value of Huber shares determined by Ernst & Young, but challenged the appropriateness of the discount for lack of marketability and whether the shareholder transactions were at arm's length. The IRS appraisal expert concluded that the discount for lack of marketability should be 30% for 1997, 25% for 1998, 45% for 1999 and 30% for 2000.

The Arguments:

One argument used by the IRS was that the Tax Court consistently closely scrutinizes transactions between related parties, such as family members, and often concludes that they are not arm's length transactions.

Furthermore, they stated that there was a lack of negotiations between buyers and sellers, suggesting that there was a lack of intent to realize the best price for the shares.

The IRS also stated that the bona fide business purpose of maintaining family control should be set aside if it serves as a device to pass an interest for less than full and adequate consideration.

Finally, the IRS also challenged the arm's length nature of the sales by stating that the Company did not offer its shares for sale to the public and thus failed to obtain the optimum price.

The Findings:

The Court found that there were over 90 transactions that took place between 1994 and 2000 by Company shareholders involving an amalgam of relationships including between immediate relatives, between distant relatives and between shareholders and independent nonprofit organizations. Each of these transactions always relied upon the Ernst & Young appraised value. The Court found that the variety of relationships among the shareholders in the Company as a positive indicator of the existence of arm's-length sales. The appraised value had been used for many instances such as charitable donations where a higher value would have been preferable.

The Court also found that negotiation is not a necessary element of an arm's length transaction and stated that the weight of case law is actually to the contrary.

The Court rejected the notion that an interest was being transferred for less than full and adequate consideration by stating that almost 250 shareholders would not harmoniously accept an artificially low valuation of the Company's stock just so a few people who may or may not be related to them can pay less gift and/or estate tax.

Finally, the Court rejected the notion that the Company must take itself public in order to sell its shares at a fair price stating the courts have long recognized the rights of shareholders in closely held companies to remain private. The Court stated that the IRS's assumption that offering Company stock to the public would have garnered a higher price was purely hypothetical.

Ultimately, a complete prevailing for the Taxpayer!