Mack Business Appraisals, LLC

Valuation Insights

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Estate of Valeria M. Miller, Deceased, Virgil G. Miller, Executor, Petitioner vs. Commissioner of Internal Revenue, Respondent, T. C. Memo 2009-119, May 27, 2009.

The following is an abbreviated version of our summary of the Estate of Valeria M. Miller , Deceased, Virgil G. Miller, Executor vs. Commissioner of Internal Revenue. To read a complete version of our summary of this court case, please visit our website at www.mackbusinessappraisals.com.

The Facts: Valeria M. Miller married her husband Mr. Miller in 1938 and they remained married until his death on February 2, 2000. Mr. and Mrs. Miller had four children; Virgil G., Gordon, Donald and Marcia. In October of 1991, Mr. Miller established the Virgil J. Miller Living Trust (the revocable trust). At the same time, the agreement that established the trust also established a life estate marital trust for Mrs. Miller ("QTIP trust"). When Mr. Miller passed away in 2000, his gross estate was valued at $7,667,939 and approximately 99.6% of his gross estate consisted of securities held by his revocable trust. As executor, Mr. Miller's son, Virgil G., elected to treat the QTIP trust property as qualified terminable interest property and Mr. Miller's estate claimed a marital deduction of $1,060,000 for assets funding the QTIP trust. The QTIP trust was made up of five accounts with Merrill Lynch and was funded on October 6, 2000.

At the age of 86, in November of 2001, Mrs. Miller established the V/V Miller Family Limited Partnership ("MFLP"). Virgil G. was General Partner and Mrs. Miller's Trust, Donald, Marcia and Gordon were the Limited Partners. Mrs. Miller was in good health at the time of formation. Although MFLP had not yet been funded, a valuation was performed as of December 31, 2001, showing the fair market value per unit of a limited partnership interest in MFLP for gift tax purposes based on statements provided by Virgil G. that detailed the assets that were going to be used to fund MFLP. This valuation indicated that MFLP had marketable securities of $4,336,380, a margin account payable of $499,573, and a net asset value of $3,836,807. The valuation also applied a 35% lack of marketability discount to the purported net asset value of MFLP and concluded that as of December 31, 2001, MFLP had a fair market value per unit of $2,264.73.

The Partnership agreement was not formally signed by the partners until February of 2002. Furthermore, when the unit certificates were initially issued, they were signed by Virgil G. signed and dated November 27, 2001. MFLP issued 1,000 units; with Mrs. Miller's trust receiving 920 limited partner units, Virgil G. receiving 10 general partner and 10 limited partner units, and Donald, Gordon and Marsha each receiving 20 limited partner units. This ownership remained constant until Mrs. Miller's death. Mrs. Miller ended up making the asset contributions to MFLP in April of 2002, and the total assets transferred constituted about 77% of her total net assets.

Virgil G., through his company VGM Enterprises, received a monthly fee to manage MFLP's securities. Virgil G. was the only employee of VGM Enterprises and spent approximately 40 hours per week managing the stock portfolio by utilizing his father's personally developed stock charting methodology, subscribing to trade publications and purchasing computer software to assist in securities and trading research.

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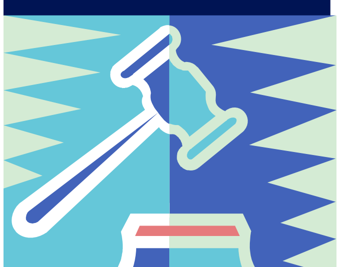
In April and May of 2003, Mrs. Miller suffered a series of health setbacks that initially began with a broken hip from a fall at her residence. On May 9, 2003, which was after her broken hip but before her head bruise was discovered on May 19th, she signed a letter requesting Fidelity to transfer all of her remaining assets except for the cash in her money market account over to MFLP. She died on May 28, 2003.

The estate timely filed Form 706 in February of 2004. The gross estate was shown as $2,637,024 with tax due of $994,299. The gross estate included 920 MFLP units valued at $2,589,118. The Form 706 did not include the value of the securities used to fund the QTIP trust in the value of the gross estate. Instead, Mrs. Miller's Form 706 indicted that she was the beneficiary of a trust for which a deduction was claimed by the estate of a predeceased spouse under section 2056(b)(7) and which was not reported on Mrs. Miller's Form 706.

The IRS timely filed a deficiency notice of $1,019,399 that, in part, increased the value of decedent's gross estate by the purported fair market value of the securities in the QTIP trust and by the amount of decedent's transfers to MFLP.

The Arguments: The issues for determination by the IRS were; (i) whether Mrs. Miller was required to include in her estate the securities used to fund the QTIP trust; (ii) whether cash and securities transferred by Mrs. Miller in April of 2002, and May of 2003 must be included in the value of the gross estate at their full value or whether they are entitled to a discount; and (iii) if they are entitled to a discount, is a 35% discount for lack of marketability appropriate?

The Findings: The Court reviewed each argument and made the following determinations. First, with respect to including the fair market value of the QTIP trust in the gross estate, the Court determined that the full fair market value must be included in the gross estate because the trust agreement provided that all income of the trust was to be distributed to Mrs. Miller at least annually and that income was not to accumulate in the trust, Mr. Miller's estate made a valid QTIP election, and his estate claimed a $1,060,000 marital deduction under section 2056(b)(7).



Secondly, the Court reviewed the 2002 and 2003 transfers separately. After review of all relevant facts, the Court determined that Mrs. Miller's transfers in April of 2002 satisfied the bona fide sale exception and were entitled to the claimed discount in valuing Mrs. Miller's gross estate. The Court then determined that Mrs. Miller's transfers made in May of 2003 did not have legitimate and substantial nontax business reasons for the transfers. The Court determined that there was no driving force behind the transfers except the declining health of Mrs. Miller and Virgil G.'s wish to reduce the value of Mrs. Miller's gross estate. The Court's final determination was such that the estate was to be increased by the amounts used to fund the QTIP trust, the estate was entitled to the claimed discount for the securities transferred to MFLP in April of 2002, but the estate was not entitled to the claimed discount for the securities transferred to MFLP in May of 2003.

Parting Thoughts: An interesting "split decision" by the Court. I was surprised that there wasn't more discussion or concern shown by the Court regarding the sloppy chronology of the MFLP formation, gifts, and capital contributions between November 2001 and April 2002.

I was also surprised that (1) there was no discussion of why the appraiser only applied a lack of marketability discount; (2) there was no discussion of why a minority interest discount was not applied to the limited partner units; and (3) the IRS did not dispute the application of a 35% marketability discount.

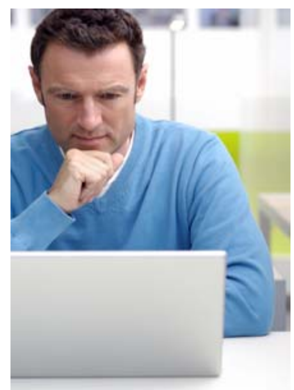
SBA Lending Activity Increases

A recent survey by Terry & Associates, Inc. in June of 2009 indicated that more banks are lending again and the SBA is reporting significant improvements in the number and dollar volume of loan approvals. In February of 2009, only 12.4% of survey respondents reported higher SBA loan volume when asked to describe their current SBA loan activity while in June of 2009 nearly 50% of all survey respondents reported higher SBA loan volume.

The new SBA goodwill requirements are causing severe slowdowns in processing and funding times for borrowers. It will be interesting to see how or if the SBA resolves the goodwill restrictions in the new SOP 50 10 5(a) which is expected in September.

Do ESOP Companies Perform Better than Non-ESOP Companies?

A recent survey by the National Center for Employee Ownership (NCEO) indicated that out of 310 responding ESOP owned companies, 34% had per year share price increases of 0% to 10%, 31% had a share price increase per year of 10% to 19%, 23% of companies had a share price increase per year of more than 20% and only 12% of companies responding reported a decrease in share prices. During this same period, 75% of publicly traded companies had negative returns., and if you remove 2008 from the equation and only look at the period from 2003 to the stock market peak, stocks rose about 10% per year. Although this sample is not a random sample (as it represents companies willing to answer the survey), the results are still very interesting.



<u>Cubs Corner:</u> At the time of writing this, I am at my peak of disgust with this season. The Cubs have dropped 6 of their last 9 games and are now 5 games out of the wildcard and 6 games behind the Cardinals. Gregg has blown 3 games over the past 2 weeks on walk-off homeruns, and the vast majority of their key players are either injured or continue to underperform. As I look back, the offseason moves have virtually all been a complete disaster. We traded DeRosa (the biggest mistake) who could regularly play right field, second base or third base and signed Milton Bradley at over twice the cost of DeRosa and whose stats now don't even hold water to DeRosa's stats this year. We've tried to fill the hole at second base with Fontenot, Miles, Freel and now Baker. We didn't resign Blanco (our dependable backup catcher) and Soto, after his rookie of the year performance last year, has barely hit his weight and has been injured quite often. The clubs decision to get more left handed bats to balance the lineup has resulted in the team going from first in the league in runs scored last year to 10th in runs scored this year. The only saving grace that still gives them a sliver of hope this year is that they have a weak schedule that has 23 of their last 39 games at Wrigley Field, which should give them an advantage and better opportunity to gain ground on either the Cardinals or the wildcard. Only time will tell if they can salvage the season over these last six weeks of the regular season.

Visit our website located at
www.mackbusinessappraisals.com

Mack Business
Appraisals, LLC

26956 N. 90th Lane
Peoria, Arizona 85383
Toll Free: 888-789-2401
Phone: 623-340-6770
Fax: 623-476-5405
E-mail: john@mackbusinessappraisals.com

About Mack Business Appraisals, LLC

Mack Business Appraisals, LLC provides expert business valuation services to businesses across the United States for various purposes including, but not limited to: gift and/or estate tax, merger and acquisition, ESOP's, buy-sell agreements, S-corporation election, SBA funding, stock option granting and management planning purposes. Mack Business Appraisals, LLC also has extensive experience in valuing family limited partnerships (FLP's) and limited liability companies (LLC's) for gift and estate tax purposes. We have built a strong reputation of providing superior service, technical expertise, and a commitment to excellence. Unlike many multi-disciplinary valuation firms, we focus our expertise on one area - business valuation.

John G. Mack, ASA, CBA, is the managing member of Mack Business Appraisals, LLC. Mr. Mack is a 1993 graduate of the University of Iowa with a Bachelor's degree in Finance from the College of Business Administration. Mr. Mack is an accredited member of the American Society of Appraisers (ASA), Business Valuation Discipline, and has also attained the Certified Business Appraiser (CBA) designation as offered by the Institute of Business Appraisers. Inc.

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