'Lockstep' Transfers of Minority Interests Submerge—But Do Not Sink—Discounts

***Koblick v. Internal Revenue Service,* 2006 Tax Ct. Memo LEXIS 63 (April 3, 2006)**

The undersea world of minority discounts grows murkier with this recent memorandum decision from the U.S. Tax Court.

The taxpayer was a 45% shareholder in a company that owned a "submersible" lodge, which he effectively donated to a §501(c)(3) charity by transferring his interest simultaneously with those of the two other minority shareholders. The taxpayer claimed a $720,000 deduction for his interest, based in part on a valuation by a consulting engineer familiar with the vessel's original construction, which he attached to his filing.

In a subsequent audit, the IRS cut the deduction by half. The taxpayer challenged the deficiency, submitting a report by Thomas Ferguson, a marine surveyor (Manchester, NH), who estimated the entire vessel's replacement cost at $4.25 million, reduced by depreciation to $1.8 million.

Ferguson's replacement cost was supported by a letter from an oceanographic foundation, which claimed that the vessel was certified by the American Board of Shipping (ABS).

The submersible sealodge was not ABS-certified, however; and the report by the taxpayer's original consulting engineer had taken this into account, estimating replacement cost at $1.97 million. An IRS expert had arrived at an even lower replacement cost of $1.1 million, which he reduced by depreciation and inflation to a final value between $368,000 and $464,000.

Do minority discounts apply to an aggregate transfer?

At the hearing, the Tax Court found the engineer's replacement cost to be the "best starting point." It then depreciated the value according to Ferguson's analysis, arriving at a fair market value of $1.06 million for the submersible.

As for any discount, the IRS had proposed a 22% rate. But the taxpayer argued that because he had donated his 45% interest as part of a pre-arranged plan with the other shareholders to transfer 100% control, the court should allow an even lower minority interest.

The taxpayer won on this point: The Court cited the facts of *N. Trust Co. v. Commissioner*, 87 T.C. 349 (1986), in which four 25% shareholders had simultaneously transferred their interests to long-term trusts.

There, the taxpayers had sought a 90% discount (to reduce their taxable gift). Where the minority interests had "marched in lockstep" together, however, such that "their position

was no different than that of a single majority shareholder," the *N. Trust* court had allowed only a 25% discount.

Relying on this rationale, the *Koblick* court applied a 10% discount—which was still sufficient to uphold the IRS deficiency assessment. But the Tax Court didn't explain how it arrived at the 10% figure; nor did it explain how the "lockstep principle" justified *any* minority discount, given the simultaneous, collective transfer of a 100% controlling interest.

The taxpayer might have scuttled his investment—but the question of applying minority discounts to aggregate transfers is still at sea.