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Tax Court Accepts Tax-affecting, Taxpayer Prevails in Jones

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INTRODUCTION

In the most notable U.S. Tax Court decision pertaining to the valuation of a closely held business in 2019, the Tax Court recently decided overwhelmingly in favor of the taxpayer, the Estate of Aaron U. Jones (the ''Estate'').[1] In the process, the Tax Court provided significant clarification to the court's position on the propriety of tax-affecting when valuing an operating business structured as a pass-through entity. The opinion was also notable for directly addressing whether a timberland owner and harvester ought to be valued based on its assets or its income, which provides insight into the valuation method that may be warranted for operating businesses with similar characteristics and/or in similar industries. It also proved to be another example of the inconsistent manner in which courts address the burden shifting rule of §7491[2] in estate and gift tax cases. Finally, though relegated to a footnote in the case, the government conceded the validity of a ''net-net gift'' agreement. With all of these issues, it gives practitioners a great deal to digest on valuation and planning issues.

THE GIFTS AT ISSUE

In 2009, Aaron U. Jones (Jones), continued what was over a decade long effort to create a business succession plan by forming family trusts and gifting equity interests in Seneca Sawmill Co. (SSC) and Seneca Jones Timber Co. (SJTC) to each of his daughters, individually, and to the trusts for their benefit. SSC was founded in 1954 and was a lumber manufacturer operating mills and selling its lumber nationwide. SSC was a 10% owner and the general partner of SJTC, which was formed in 1992 to be an entity to acquire, hold, and manage timberlands and real property for SSC's operations and supply of timber. For income tax purposes, both entities were pass-through

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[1] *Estate of Jones v. Commissioner*, T.C. Memo 2019-101.

[2] All section references herein are to the Internal Revenue Code of 1986, as amended (the ''Code''), and the regulations promulgated thereunder, unless otherwise stated.

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entities as SSC was treated as an S corporation and SJTC was a partnership. Jones reported these gifts on a timely filed gift tax return with values reported based on accompanying appraisals, prepared by a valuation firm, which had valued the interests at approximately $20,895,000, with voting interests in SSC valued at $325 per share, non-voting interests in SSC valued at $315 per share, and limited partnership units in SJTC valued at $350 per share.

The IRS issued a notice of deficiency in September of 2013, asserting a $44,986,416 deficiency in gift tax. Jones filed a petition pertaining to the notice of deficiency in November 2013. Jones later died in September of 2014, at which time the personal representatives of his estate replaced the decedent in the Tax Court proceeding. The Estate retained a different valuation expert to determine the value of the gifted interests. The Estate's valuation expert valued the SJTC interests at $21 million on a non-controlling, nonmarketable basis, with the value of each block of SJTC units transferred to each of his daughters determined to be $3,901,715 and a value per unit determined to be $380 (i.e., only slightly higher than the value determined by the initial valuation). The Estate's expert valued SJTC as a going concern and relied on the discounted cash flow (DCF) method within the income approach and the guideline public company (GPC) method within the market approach.

The IRS's valuation expert valued the SJTC interests at $140,398,000 on a non-controlling, nonmarketable basis, with the value of each block of SJTC units transferred to each of his daughters determined to be $25,973,611 and a value per unit of $2,511. The IRS's valuation expert valued SJTC as a going concern but relied on the net asset value method, an asset-based approach, as well as the market approach. The IRS also relied on a rebuttal valuation expert, who challenged elements of the Estate's expert's report.

A primary issue in *Jones* was whether SJTC should be valued using an income approach or an asset-based approach; however, the case also considered (i) the reliability of revised projections, taking into account industry-specific and broader economic circumstances; (ii) the propriety of tax-affecting the earnings of SJTC and SSC by factoring in the tax rates to which the businesses would be subject if they were C corporations in order to determine what a willing buyer and willing seller would conclude with respect to its value; (iii) intercompany loans between the two businesses; (iv) whether SSC's interest as a general partner in SJTC should be valued as a non-operating asset and a controlling interest, as asserted by the IRS; and (v) whether a 35% discount for lack of marketability was appropriate, or whether 30%, as asserted by the IRS, was the appropriate discount.

The IRS relied on the outcome in the *Gross*[3] case and subsequent cases, where tax-affecting was rejected; however, the Tax Court notes that the IRS's experts themselves were silent on the overall propriety of tax-affecting. The Tax Court agreed with the conclusions of the Estate's expert on all points and notably rejected the IRS argument relating to the *Gross* line of cases, distinguishing the decisions in those cases as being based on the record before the court.

TAX COURT ACCEPTS TAX-AFFECTING AND THE "C-TO-S METHOD" WHEN VALUING A PASS-THROUGH ENTITY

Prior to the Tax Court's 1999 opinion in *Gross*, it was widely accepted that the earnings of a pass-through entity ought to be tax affected for valuation purposes. After all, while the entity does not pay tax, the earnings are taxed at the ownership level. The Subchapter S election does not eliminate the income tax burden associated with corporate earnings, but rather eliminates the tax on distributions (i.e., the dividend tax). The entity's earnings are passed through to the owners, who must include their pro-rata share of earnings as income on their personal income tax returns. Thus, most appraisers took the view that a pass-through entity (PTE) could be valued similarly to a C corporation (i.e., net of income tax on entity earnings).

If we imagine a discounted cash flow (DCF) approach to valuing an operating business, if the entity earnings are $100 annually, the first adjustment is to reduce the earnings by a tax rate. Before the 2017 Tax Cuts and Jobs Act, the combined federal and state tax rate may have approximated 40%. After the 2017 Tax Cuts and Jobs Act, which included a significant reduction in the federal tax rate on C corporation income, the federal and state tax rate may approximate 25%. Then, subject to other adjustments, the net amounts would be converted to present value. In addition, based on evidence submitted to the Tax Court in *Gross*, an internal IRS valuation guide for IRS appeals officers stated, ". . .S Corporations lend themselves readily to valuation approaches comparable to those used in valuing closely held corporations. You need only to adjust the earnings from the business to reflect estimated corporate income taxes that would have been payable had the Subchapter S election not been made."

The decision in *Gross* marked a turning point and, in hindsight, was the beginning of a 20-year debate

[3] *Gross v. Commissioner*, T.C. Memo 1999-254, *aff'd*, 272 F.3d 333 (6th Cir. 2001).

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for which the *Jones* decision has finally brought some much-needed clarity. The Tax Court reasoned in *Gross* that an appraiser must not ignore the tax savings in valuing the equity of the PTE. That is, when certain factors are present, tax advisors regularly recommend PTE structures to business owners as a means of reducing their overall income tax burden. In *Gross*, the Tax Court, however, did not accept tax-affecting the S corporation's earnings, stating that the taxpayer's expert, who explained the need for tax-affecting by listing eight tradeoffs or risk factors of the S election, ''. . . has not convinced us that such an adjustment is appropriate as a matter of economic theory or that an adjustment equal to a hypothetical corporate tax is an appropriate substitute for certain difficult to quantify disadvantages that he sees attaching to an S corporation election.'' Rather, the Tax Court found that the IRS expert's approach of applying a pre-shareholder tax discount rate (derived presumably from publicly traded C corporations through techniques such as the Capital Asset Pricing Model or Build-Up Method) to the actual net income of the entity, despite the net income being effectively pre-tax, was a valid approach due to its belief that there was a match between the level of earnings and the discount rate.

In *Kress*,[4] a federal gift tax case tried in federal district court earlier this year, the court held in favor of tax-affecting. It may have had no choice, as experts for the taxpayer and the IRS tax affected the earnings of Green Bay Packaging, Inc. when valuing the business using the income approach. While the Department of Justice handled this case for the U.S. Government, the expert used was Francis X. Burns, who is routinely used by the IRS in Tax Court. The *Kress* decision was a major development, portending how judiciaries might act going forward. Moreover, the court in *Kress* went even further, finding that a premium for the S corporation election was not appropriate. *Kress* provided the first taxpayer win on this issue in the federal judiciary since the *Gross* decision. *Kress*, along with various post-*Gross* state court decisions and the general consensus of the valuation community, provided the basis for taxpayers and their advisors to take positions based on tax-affecting. Yet, until *Jones*, there was still uncertainty as to how the Tax Court might rule.

In *Jones*, the IRS lawyer argued against tax-affecting, stating that the S corporation is not subject to entity level tax, and leaned on the Tax Court's ruling in *Gross*. However, Judge Pugh observed that the IRS expert was ''noticeably silent'' on this matter. Judge Pugh went on to state that the IRS misconstrued its rationale in *Gross*, emphasizing that it concluded based on the record in that case that a zero-percent corporate tax rate best reflected the tax savings of the entity structure. The court in *Gross* had a choice between accepting a 0% tax rate and a 40% tax rate (with no subsequent premium applied), implying that it was effectively left to decide, based on the facts presented, against the plain use of a 40% tax rate as it ignored the savings associated with the Subchapter S election.

The *Jones* opinion also references the *Gallagher*[5] and *Giustina*[6] cases where the Tax Court also rejected tax-affecting. The *Jones* opinion emphasizes that the Tax Court in those cases rejected tax-affecting because the taxpayer's expert did not offer a reasonable method by which to quantify the reduction in the total tax burden borne by S corporation owners. In doing so, the Tax Court made it clear that the rejection of tax-affecting was the result of a lack of evidence put forward that the valuation expert was sufficiently accounting for the benefits of the pass-through structure. In the absence of such analysis, the Tax Court would likely continue to reject tax-affecting.

In *Jones*, the expert for the Estate used the discounted cash flow method, a form of the income approach, to value SJTC, an owner of timberland that was actively engaged in growing and harvesting activities for 16+ years and counting. The Estate's expert tax affected the earnings at a rate of 38% for federal and state income taxes. A guideline public company method was also used to derive a second indication of value. An analysis was then conducted to estimate dividend taxes avoided on account of the pass-through structure. The Estate's expert also considered an empirical study analyzing S corporation acquisitions. A 22% premium was ultimately derived and added to the weighted value from the income and market approaches.[7]

The Tax Court in *Jones* was given two choices: (1) the IRS position that a zero tax rate was applicable (i.e., no tax-affecting) and (2) the Estate's expert's opinion that the C-to-S Method should be used, applying a 38% tax rate to earnings to compute a C corporation equivalent value, followed by application of a

[4] *Kress v. United States*, 372 F. Supp.3d 731 (E.D. Wis. 2019). For a detailed analysis of *Kress*, please refer to James Dougherty & Todd Povlich, *The Latest Development in Business Valuation: Burdens of Proof, Tax Affecting S Corporations, and Chapter 14 in Kress,* 44 Estates, Gifts and Trusts J. 178 (July 11, 2019).

[5] *Estate of Gallagher v. Commissioner*, T.C. Memo 2011-148.

[6] *Estate of Giustina v. Commissioner*, 586 F. App'x 417, 418 (9th Cir. 2014) (holding that no weight should be given to an asset-based valuation because the assumption of an asset sale was a hypothetical scenario contrary to the evidence in the record), *rev'g and rem'g* T.C. Memo 2011-141.

[7] We refer to this two-step process as the ''C-to-S Method'' herein.

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22% adjustment factor (premium) to convert to an S corporation value. Judge Pugh stated clearly that based on the facts presented, the Estate's expert's argument was far more persuasive, and accepted the Estate's expert's numbers without adjustment.

The *Jones* and *Kress* opinions should immediately be considered as support for tax-affecting the earnings of an operating business structured as a PTE for income tax purposes. Furthermore, an analysis should be performed to determine the relative values of the C corporation and PTE structures. The *Jones* and *Kress* decisions validate the approach of first determining value on a C corporation equivalent basis, which typically involves tax-affecting the earnings. A secondary analysis to assess whether adjustments to value for differences in the structures is then warranted.

ASSET OR INCOME?

The other significant question addressed in *Jones* was whether to value non-controlling interests in the timberland owning partnership using an asset or income approach.

One of the two entities involved in the case was SJTC, an Oregon limited partnership. SJTC was formed by its general partner, SSC, an Oregon Subchapter S corporation. SSC owned a sawmill and was a significant lumber producer. It needed a reliable and significant supply of timber to operate. Seeing risks that government-owned forestry would be unavailable for timber cutting, its owners began purchasing timberland and ultimately formed SJTC in 1992 to own this timberland.

In the case, the IRS expert argued that SJTC is an asset holding company and that its partnership interests ought to be valued based on the appraised value of its underlying timberland. The Estate's expert saw the situation quite differently, arguing that partnership interests in SJTC ought to be valued based on its income because SJTC's activities are inextricably linked to those of its general partner and affiliate, SSC, an operating business. SJTC's primary activity is growing and harvesting timber to sell to SSC, a 55-year-old lumber producer with no expectation of ceasing activities. A non-controlling partner of SJTC would fully expect that SSC and SJTC would continue to operate as-is, and that any economic return from SJTC would be a function of earnings, not asset value.

Judge Pugh agreed with the Estate's expert, citing a number of reasons. SSC's continued operation as a sawmill depended on having a reliable supply of logs from SJTC. It is highly unlikely that SSC would direct SJTC to sell land. Judge Pugh said it was entirely appropriate to consider the economic relationship between the two entities. Therefore, the court found that a discounted cash flow method was far more appropriate than a net asset value method.

Notwithstanding certain other key factors, this determination alone by the Tax Court ultimately led to acceptance of a significantly lower value as the earnings-based value put forth by the Estate's expert was much lower than the asset-based value put forth by the IRS's expert.

The *Jones* decision, as well as outcomes in other tax cases including *Giustina*, provide a basis upon which taxpayers could make similar arguments in analogous situations. There are many industries and investment partnerships where the question arises as to the appropriateness of an income-based or asset-based valuation approach. For example, this is a common issue when handling valuations of entities engaged in the following business activities: agriculture; farming; real estate; timberland; and marine transportation. In many cases, the decision about which approach is relevant will have a significant impact on the ultimate gift or estate tax value.

BURDEN OF PROOF

The decision's analysis of a procedural issue—who had the burden of proof in this case—proved to be an interesting aspect of the case. The question of who carries the burden of proof arises when disputes relating to questions of fact end in evidentiary ties. A conclusion of fair market value is a question of fact,[8] causing the burden of proof question to arise often in gift and estate tax valuation cases. Courts have approached this question using two distinct approaches.

The taxpayer ordinarily bears the burden of proving that the Commissioner's determinations are wrong; the IRS's determination is presumed to be correct under longstanding case law.[9] However, §7491 provides that where a taxpayer has introduced credible evidence pertaining to any factual issue relevant to the determination of the taxpayer's liability, the burden of proof with respect to such issue will shift to the Commissioner. Credible evidence is defined as that evidence, the quality of which, after critical analysis, ''the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted (without regard to the judicial presumption of IRS correctness). A taxpayer has not produced credible evidence for these purposes if the taxpayer merely makes implausible factual assertions, frivolous claims, or tax protestor-type argu-

[8] *Estate of Dailey v. Commissioner*, T.C. Memo 2001-263; *Leibowitz v. Commissioner*, T.C. Memo 1997-243.

[9] *Arthur v. Unkart*, 96 U.S. 118, 122 (1878); *Arthur v. Rindskopf*, 105 U.S. 418 (1882).

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ments. . . .''[10] There are four limitations to this burden shifting rule as in addition to providing the credible evidence to the IRS: (1) the taxpayer must fulfill its duty to substantiate any item reported; (2) the taxpayer must maintain all records and cooperated with the requests from the IRS; (3) certain net worth thresholds were not exceeded;[11] and (4) there is not another provision of the Code that overrides the application of the general rule. The shifting of proof is significant only in the event of an evidentiary tie; if both the taxpayer and the Commissioner have produced credible evidence, then the party with the weight of the evidence will prevail.

The Tax Court in *Jones* noted that the Estate asserted that it had provided complete and conclusive documentation and credible testimony of a correct valuation of the interests in SJTC sufficient to shift the burden of proof under §7491. However, this statutory provision was not applied to shift the burden because the Tax Court held that the decision was made ''on the basis of a preponderance of the evidence in the record.'' In other words—there was no tie so burden shifting under §7491 is unnecessary. This is one of the approaches taken by courts in valuation cases.[12]

The other approach taken by courts is to rule that §7491 does apply because the statutory requirements were met,[13] but that the procedural victory has no impact as the case is ultimately decided on the preponderance of the evidence offered by one side or the other. Interestingly, in the *Kress* decision that has gained notoriety for its favorable decision regarding tax-affecting pass-through entities, the district court in that case followed this approach in regards to the taxpayer's attempt to shift the burden under §7491.

The inconsistent approach to how §7491 is applied is highlighted in *Jones* given the Tax Court did state that the burden had shifted to the government for its increased deficiency. After the Estate's expert submitted slightly higher values than what was initially reported on the gift tax return, the IRS expert subsequently increased his valuation of the SJTC interest. The Tax Court held that the burden of proof had shifted and that the IRS would bear the burden of proof with respect to the amount of the asserted deficiency attributable to the increased valuation of the SJTC interest. The Tax Court was absolutely correct to find that the government had the burden of proof as it is clear in the Tax Court rules that while the taxpayer generally has the burden of proof, if the government increases the deficiency, then it has the burden.[14] The Tax Court cites to the rule under §7491, but then notes that the resolution of the issue in this case is on the basis of a preponderance of the evidence in the record, rather than depending on which party bears the burden of proof.[15] Given the case was decided by a preponderance of the evidence, the Tax Court could have left the burden of proof issue alone altogether instead of commenting on one aspect and remaining silent on the §7491 issue.

NET-NET GIFT

Although top billing in *Jones* was given to the tax-affecting analysis and the appropriate valuation method for an operating business—there is a footnote on a different valuation issue that should not go unnoted. Although the IRS challenged the impact of the ''net-net gift'' in its notice of deficiency—it conceded at trial that ''the arrangement is permissible.''[16] The gifts made by Jones to his daughters were structured as ''net-net gifts,'' by which each of his daughters as-

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[10] Staff of J. Comm. On Taxation, 105th Cong., *Description of Senate Finance Committee Chairman's Mark Relating to Reform and Restructuring of the Internal Revenue Service* (JCX-17-98) (J. Comm. Print 1998). For a more detailed discussion of the burden-shifting rule, see *The Latest Development in Business Valuation: Burdens of Proof, Tax Affecting S Corporations, and Chapter 14 in* Kress, 44 Estates, Gifts and Trusts J. 178 (July 11, 2019).

[11] The net worth threshold is typically inapplicable in the gift and estate tax context. Under §7491(a)(2)(C), the net worth threshold applies to partnerships, corporations, or trusts, but not to individuals or estates.

[12] *See Estate of Bongard v. Commissioner*, 124 T.C. 95, 111 (2005) (finding that ''the outcome of this case is determined on the preponderance of the evidence and is unaffected by section 7491.''); *Huber v. Commissioner*, T.C. Memo 2006-96 (determining the case based on the preponderance of the evidence); *Estate of Mitchell v. Commissioner*, T.C. Memo 2011-94 (holding that burden did not shift because that resolving the case did not depend on which party had the burden of proof); *Estate of Giustina v. Commissioner*, T.C. Memo 2011-141 (conclusions made based on a preponderance of the evidence rendered the allocation of the burden of proof immaterial); *Estate of Kelly v. Commissioner*, T.C. Memo 2012-73 (decision based on the preponderance of the evidence so the burden of proof was immaterial to the case); *Estate of Bates v. Commissioner*, T.C. Memo 2012-314 (decision based on the preponderance of the evidence so the burden of proof was immaterial to the case).

[13] *See Kress v. United States*, 372 F. Supp.3d 731 (E.D. Wis. 2019); *In re Wyly*, 552 B.R at 381 (burden is placed on the government in gift tax cases); *Kohler v. Commissioner*, T.C. Memo 2006-152 (holding burden shifted to government, but decision was reached based on the fact that taxpayer's valuation experts provided more credible and persuasive evidence); *Estate of Litchfield v. Commissioner*, T.C. Memo 2009-21 (burden shifted to government, but decision was reached based on the fact that taxpayer's valuation experts relied on more accurate data and conclusions based on that data were appropriate); *Estate of Cheng Van v. Commissioner*, T.C. Memo 2011-22 (burden shifted to IRS, but the IRS satisfied the burden of persuasion).

[14] Tax Ct. R. 142(a)(1). *See also Anselmo v. Commissioner*, 80 T.C. 872, 886 (1983), *aff'd*, 757 F.2d 1208 (11th Cir. 1985); *Learner v. Commissioner*, T.C. Memo 1983-122.

[15] *Jones* at p. 24.

[16] *Jones*, n. 2.

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sumed liability not only for the gift liability attributable to the gift (as is the case with a ''net gift''), but also the estate taxes attributable to the inclusion in the gross estate of any gift taxes paid on gifts made within three years of the date of death pursuant to §2035(b) (the ''net-net gift'').

The concept behind the net-net gift planning technique is that the donee's agreement to be the party responsible for the tax liability is consideration to the donor and therefore reduces the value of the gift pursuant to the principles of §2512(b). The value of the consideration to pay the estate tax liability attributable to the gifts is not the full amount of the tax, but only present value of the liability which also factors in the likelihood of the liability being incurred (i.e., mortality risk of the donor). By agreeing to pay the estate tax liability for gift taxes paid under §2035(b), the donees are effectively betting on the mortality of the donor. If the donor dies within three years of the gift, the donees will be responsible for a tax liability in excess of the valuation reduction allowed for gift tax purposes. If the donor survives the period—then there was effectively a reduction in value of a risk that never materialized.[17]

The net-gift technique has long been accepted by the IRS.[18] The net-net gift technique, on the other hand has only faced scrutiny more recently. In 2003, the government successfully persuaded the Tax Court to reject this planning technique's impact on valuation in the *McCord* case.[19] This decision was successfully appealed to the Fifth Circuit, which ruled in favor of the taxpayer; however, the IRS did not acquiesce to the decision and the appellate decision left many issues regarding the technique unresolved.[20] Mr. Jones utilized this technique in his planning after the Tax Court's rejection of the technique. As the Fifth Circuit decision would not have been binding in this circumstance given that he and the fiduciaries of his estate live in Oregon, it is not clear whether the arrangement would have withstood scrutiny at the time given the uncertainty remaining after the Tax Court's rejection of the technique and the taxpayer victory in the Fifth Circuit's decision. Further, the impact of the Fifth Circuit opinion was limited because the computational method to determine the discount was not in dispute. The government simply argued that the potential liability was too speculative and did not present evidence to contest the taxpayer's computational method.

It was not until after his death that the planning technique was validated by the Tax Court in *Steinberg v. Commissioner*.[21] However, this planning technique has not yet been blessed by the IRS in the way that the net gift has been, and there is only one favorable Tax Court opinion on the matter.[22] The *Jones* opinion, therefore, is notable in that the IRS conceded that the net-net gift arrangement was permissible and that the estate is not liable for accuracy-related penalties. The government's concession in the case could potentially be suggestive for future cases. Importantly, while the validity of the arrangement was conceded, the valuation impact is not clear at this time.[23] Given that the valuation of the gift is a critical component to this planning technique and accurate tax reporting, the concession in *Jones* is welcome but the extent of its implications is not yet entirely known.[24]

TAKEAWAYS

The Tax Court in *Jones* made it clear that entity structure must be considered when deriving the fair market value of a business interest for gift and estate tax purposes. Moreover, the Tax Court was clear that, subject to the facts presented, it will allow tax-affecting in the first instance so long as the benefits of the pass-through structure are considered in the second instance. In doing so, the Tax Court has blessed the so-called ''C-to-S Method'' of valuation, which means that pass-through entities are first valued on a C corporation equivalent basis (in large part because

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[17] For a more detailed discussion of the planning technique *see,* Michael S. Arlein and William H. Frazier, *The Net, Net Gift,* Trusts & Estates (Aug. 2008); James I. Dougherty and Marissa Dungey, ''Unwrapping the Net, Net Gift Interpreting and applying the Tax Court's *Steinberg* Decision,'' Trusts & Estates (Feb. 2014).

[18] Rev. Rul. 75-72.

[19] *McCord v. Commissioner*, 120 T.C. 358, 399-404 (2003).

[20] *Succession of McCord v. Commissioner*, 461 F.3d 614, 629 (5th Cir. 2006).

[21] *Steinberg v. Commissioner*, 145 T.C. 184 (2015) (''*Steinberg II*''); *Steinberg v. Commissioner,* 141 T.C. 258 (2013) (''*Steinberg I*'').

[22] Other cases have presented issues related to the concepts involved with the net-net gift. For example, where the donee being might be responsible for the estate taxes attributable to §2035(b) inclusion due to state estate tax apportionment provisions as opposed to an explicit agreement between donor and donee. *See Estate of Sommers v. Commissioner*, 149 T.C. 209 (2017). Such cases, however, do not provide reliable authority or the level of detail necessary to implement net-net gifts. *See also Armstrong v. United States*, 277 F.3d 490 (4th Cir. 2002); *Murray v. U.S*, 687 F.2d 386 (Ct. Cl.1982).

[23] The footnote points out that the concession is subject to Tax Ct. R. 155 computations, meaning it is possible that the parties will take different approaches to the valuation as the IRS may raise additional arguments since the ones raised in *Steinberg II*.

[24] For a clear and concise explanation of the computation method used by the appraiser in *Steinberg*, *see* Steve Akers, *Estate Planning Current Developments and Hot Topics,* pages 184-186 (Dec. 2015). *See also* Michael S. Arlein and William H. Frazier, *The Net, Net Gift,* Trusts & Estates (Aug. 2008), as modified by a letter to the editor and response, Trusts & Estates (Nov. 2008).

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virtually all guideline public companies are C corporations). Then, the appraiser must consider the benefits of the pass-through structure and application of a C-to-S adjustment factor.

Going forward, the debate is likely to move towards quantification of the adjustment factor, whether the adjustment is always warranted, and whether the adjustment factor ought to vary based on facts and circumstances. There are many situations where an adjustment factor may not be applicable. There are certainly many situations where adjustment factors well less than 22% (which was applied in *Jones*) will be appropriate. For instance, in cases where companies limit distributions to amounts satisfactory to cover pass-through tax liabilities, it may be logical that lower or zero premiums apply. Moreover, with the significant reduction in the federal corporate income tax rate to 21.0% per the 2017 Tax Cuts and Jobs Act, the economic differential between C corporation and pass-through entity structures may have declined or been eliminated. It is unclear how the IRS or the Tax Court will respond to lower premiums or zero premiums in cases where appraisers have demonstrated sound rationale. We are also likely to have to wait many years for a case to be tried where the valuation date is after the passage of the 2017 Tax Cuts and Jobs Act.

Further guidance on this issue is expected soon; the Tax Court has the opportunity to rule on tax-affecting for valuing S Corporation stock in *Estate of William A.V. Cecil, Sr. v. Commissioner* and *Estate of Mary R. Cecil v. Commissioner*,[25] which have been consolidated for trial, briefing, and decision. The case was tried in 2016 and is still pending decision. We understand that the valuation experts for both the taxpayer and the IRS in *Cecil* tax-affected the entity's earnings when determining value using the income approach; accordingly, the *Cecil* case may not only provide additional support for tax-affecting as a matter of law but provide the circumstances for consideration of the adjustment factor. In any event, it is clear from the *Jones* opinion that the Tax Court has distinguished the *Gross* line of cases as being decided on the facts and not as a rejection of tax-affecting per se.

Lastly, as a takeaway and reminder of best practices, the Tax Court noted the depth of experience of the taxpayer's valuation expert and the thorough and detailed approach to the determination of value, and in particular noted that the IRS expert omitted some considerations and made speculative conclusions at trial regarding the effect of omitted considerations. The taxpayer wins in both *Jones* and *Kress* highlight the need for experienced valuation experts and robust conclusions of value.

[25] Docket No. 14639-14; Docket No. 14640-14.

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