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Neil E. Harl
Iowa State University, harl@iastate.edu

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DISCOUNTING PROPERTY VALUES AT DEATH

— by Neil E. Harl

The idea that property values can be discounted at death for a minority interest and for non-marketable is well established.1 Although discounting cannot be applied in addition to any reduction in value from special use valuation of land,2 discounting of corporate stock may produce a lower stock value than claiming special use valuation on the corporation-owned land.3

Discounting for co-ownership

More than a decade ago, it was well settled that interests in real estate held as community property were eligible for a discount for non-marketability of the decedent's fractional interest in the land.4 However, in several Tax Court cases, undivided interests in tenancy in common were ineligible for a discount.5 But a number of recent Tax Court decisions have allowed discounting. In one 1989 case,6 a 12-1/2 percent discount was allowed for a tenancy in common ownership interest. In another 1989 decision, the decedent's 20 percent interest in farmland was discounted a total of 40 percent for minority interest and for restrictions on transferability.7 A 1992 case allowed a discount of 15 percent for undivided interests (77 percent and 50 percent) in real estate.8 Another Tax Court case, also in 1989, allowed a discount on land value of 25 percent to reflect a partnership's undivided one-half interest with the resulting value multiplied by the decedent's percentage interest in the partnership.9 A U.S. District Court also allowed a discount for a tenancy in common interest in land.10

In a 1993 private letter ruling, IRS now insists that any discount should be limited to the cost of partitioning the property under state law.11

Discounting corporate stock

A discount for minority interest and for non-marketability has been allowed for many closely held corporations including farm and ranch corporations.12 Although the magnitude of the discount has varied widely, a discount in the range of 20 to 25 percent has been relatively common.13

Quite significantly, IRS has now abandoned its opposition to allowing a minority discount for federal gift tax purposes where family members in the aggregate own a majority interest.14

It is important to note that while a minority interest may give rise to a discount, a majority interest may carry a control premium.15

Continuing uncertainty

While discounting of both co-ownership interests and corporate stock has been allowed in numerous cases, uncertainty still exists over the size of the discount. The 1993 attempt by IRS to limit the discount for co-ownership interests to the costs of partitioning under state law could bring a modicum of certainty to that area, but additional cases and rulings are expected as taxpayers press for more generous discounting along the lines of what has been allowed in recent litigated cases.

FOOTNOTES

1 See generally 5 Harl, Agricultural Law § 43.02 (1993) (discounting for a co-ownership of property); 8 Harl, Agricultural Law § 58.05[2][c] (1993) (discounting of corporate stock values).
3 See ns. 12-15 infra.
5 Est. of Pudim v. Comm'r, T.C. Memo. 1982-606; Est. of Clapp v. Comm'r, T.C. Memo. 1983-721; Est. of McMullen v. Comm'r, T.C. Memo. 1988-500 (value of decedent's undivided one-half interest in trust property not discounted as fractional share where trust property to be sold as entire fee simple interest).
impairing the homestead exemption and as unsecured as to acres of farmland and the debtor sought to avoid the lien as homestead exemption for a 1.1 acre homestead. A creditor. B.R. 161 (Bankr. S.D. Ill. 1991) the will to probate. death of the decedent, with confirmation upon admission of law the title to the property passed under the will upon the that the bequests were estate property because under state law, the debtor was not entitled to the bequests following the bankruptcy petition and the debtor argued that the estate was not admitted to probate until after 180 days after the debtor filed bankruptcy, the debtor's aunt died leaving the debtor a bequest of real and personal property. The court held that although the lien was completely unsecured as to the farmland, the lien would be allowed to remain in effect until that although the lien was completely unsecured as to the farmland. The court held that although Ohio law restricting liquidation). See also Est. of Berg v. Comm'r, T.C. Memo. 1991-279, aff'd on these issues, 92-2 U.S.T.C. ¶ 60,117 (8th Cir. 1992) (estate entitled to 20 percent minority discount and 10 percent for lack of marketability for 26.9 percent ownership in closely held corporation). Rev. Rul. 93-12, I.R.B. 1993-7, revoking Rev. Rul. 81-253, 1981-2 C.B. 187 (no minority discount for gift tax purposes for value of one-third interest in closely held corporations transferred to each of three children). Est. of Salsbury v. Comm'r, T.C. Memo. 1975-333 (38.1 percent control premium for 51.8 percent of stock). But see Est. of Bright v. Comm'r, 658 F.2d 999 (5th Cir. 1981) (no control premium where decedent's undivided one-half community property interest in control block of stock was effectively severed into two minority interests at death; family attribution rules not applicable).

CASES, REGULATIONS AND STATUTES by Robert P. Achenbach, Jr.

ANIMALS

HORSES-ALM § 1.01[1]. * The plaintiff was injured while riding a horse owned by the defendants on land owned by the defendants. The plaintiff was thrown from the horse when the horse suddenly bolted. The plaintiff alleged that the defendants failed to warn about the horse’s dangerous propensities. The court upheld a directed verdict for the defendant because the plaintiff failed to provide any evidence of the horse’s propensity to throw its rider. Mason v. Komlo, 621 N.E.2d 716 (Ohio Ct. App. 1993).

BANKRUPTCY GENERAL

ESTATE PROPERTY-ALM § 13.03[3]. * Within 180 days after the debtor filed bankruptcy, the debtor's aunt died leaving the debtor a bequest of real and personal property. The estate was not admitted to probate until after 180 days following the bankruptcy petition and the debtor argued that under state law, the debtor was not entitled to the bequests until after the will was admitted to probate. The court held that the bequests were estate property because under state law the title to the property passed under the will upon the death of the decedent, with confirmation upon admission of the will to probate. In re Chenoweth, 3 F.3d 1111 (7th Cir. 1993), aff’d, 143 B.R. 527 (S.D. Ill. 1992), aff’d, 132 B.R. 161 (Bankr. S.D. Ill. 1991).

EXEMPTIONS-ALM § 13.03[3]. * AVOIDABLE LIENS. The debtors claimed a homestead exemption for a 1.1 acre homestead. A creditor had obtained a judgment lien against the property and 106 acres of farmland and the debtor sought to avoid the lien as impairing the homestead exemption and as unsecured as to the farmland. The court held that although Ohio law allowed attachment of judgment liens against homesteads only upon sale or execution, the lien could be avoided as impairing the bankruptcy exemption, even where the homestead was not going to be sold. The court also held that although the lien was completely unsecured as to the farmland, the lien would be allowed to remain in effect until the land was sold in foreclosure, in case any equity arose from the sale. In re Mershman, 158 B.R. 698 (Bankr. N.D. Ohio 1993).

In 1988 through 1990, the debtors lived in a residence for which the debtors purchased building materials for improvements to the home. The debtors had not paid for the materials and the supplier filed a claim in the debtors' January 1993 bankruptcy case. In October 1990, the debtors changed residences and claimed a homestead exemption for the second residence in the bankruptcy case. The supplier obtained a judgment for the unpaid materials and filed a lien against the debtors' homestead. The debtors sought avoidance of the lien as impairing their homestead exemption. The court held that because the claim arose prior to the debtors' acquisition of the exempt homestead, the claim could not be avoided; however, because the claim was against the husband only, the claim could be avoided. In re Streeper, 158 B.R. 783 (Bankr. N.D. Iowa 1993).

HOMESTEAD. The court held that the debtors could claim a homestead exemption under Mo. Rev. Stat. § 513.475, for a residence purchased by the debtors under a contract for deed. In re Galvin, 158 B.R. 806 (Bankr. W.D. Mo. 1993).

The court held that the debtor could claim a homestead exemption for a mobile home under Fla. Stat. § 222.05. In re Meola, 158 B.R. 881 (Bankr. S.D. Fla. 1993).