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Another Slant to Co-Ownership Discounts

-by Neil E. Harl*

A decision by the Fifth Circuit Court of Appeals in 2014, Elkins v. Commissioner, involving co-ownership of art collections has added another chapter to the saga of co-ownership discounts. Although other courts have allowed discounts for the costs of partition and sale, the courts generally have been reluctant to allow more than a token discount for a fractional interest itself in art works. The Elkins case allowed a 44.75 percent discount for undivided interests in works of art and a 10 percent discount for restrictions on transferability. An earlier Ninth Circuit case approved a token five percent discount.

The history of co-ownership discounts

Co-ownership discounts are now widely accepted and have been for some time. However, it was only about 25 years ago that the courts were declining to approve discounts for co-ownership. But the case of Youle v. Commissioner, approved a 12 ½ percent discount for co-ownership which was fairly quickly boosted to 20 percent by the courts. The discount has remained around 20 percent although some litigated allowances have been as low as 10 percent and as high as 60 percent for co-ownership of timberland held in trust.

The courts have, however, been unwilling to approve discounts for co-ownership in joint tenancy. Community property has been eligible for discounting for co-ownership for several years.

Throughout, the position of the Internal Revenue Service has been that discounting for co-ownership should be limited to the costs of partitioning the property. However, the Fifth Circuit Court of Appeals in Estate of Baird v. Commissioner in 2005 approved an award of litigation costs on the grounds that the Internal Revenue Service position of limiting discounts in co-ownership to the costs of partitioning the property was not justified.

What about discounts for co-ownership of art works?

A Ninth Circuit Court of Appeals case in 2009 approved a five percent discount for the costs of partition and sale involving an art collection but did not allow a discount for a fractional interest itself. In another case, Estate of Scull v. Commissioner, the decedent owned a 65 percent undivided interest in a “pop” and “minimalist” art collection which was granted nominal discounts from the stipulated fair market value.

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The Tax Court, in Estate of Elkins v. Commissioner,28 approved a 10 percent discount for a lengthy list of art works owned in co-ownership by the decedent, ostensibly because the decedent’s children would likely purchase any fractional interest sold.29 However, on appeal the Fifth Circuit Court of Appeal allowed a 44.75 percent discount for undivided interests in the works of art involved in that litigation.30 IRS had argued in that case that no discount should be allowed from the pro rata fair market value of the decedent’s interest. However, the appellate court was impressed by the taxpayers’ argument that there is no “recognized” market for fractional interests in art and the art in question had been voluntarily subjected to restraints on partition (and alienation) as well as restraints on possession.

Will Elkins v. Commissioner chart the discount course for art collections going forward?

At this stage, that is difficult to say. The Fifth Circuit Court of Appeals has earned the distinction of being the most “taxpayer friendly” court of appeals in the country. But it will require additional cases before it can be said that the Elkins view will prevail widely.

ENDNOTES

1 2014-2 U.S. Tax Cas. (CCH) ¶ 60,683 (5th Cir. 2014).
3 Stone v. United States, 2007-1 U.S. Tax Cas. (CCH) ¶ 60,540 (N.D. Calif. 2007). See also Stone v. United States, 2007-2 U.S. Tax Cas. (CCH) ¶ 60,545 (N.D. Calif. 2007), aff’d, 2009-1 U.S. Tax Cas. (CCH) ¶ 60,572 (9th Cir. 2009) (five percent discount allowed).
4 See note 1 supra.
5 Id.
6 See note 3 supra.
7 Estate 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). See Estate of Clapp v. Comm’r, T.C. Memo. 1983-721; Estate of Pudim v. Comm’r, T.C. Memo. 1982-606.
8 T.C. Memo. 1989-138 (12 ½ percent discount allowed for 50 percent interest in tenancy in common ownership of real property).
9 See, e.g., Estate of Cervin v. Comm’r, T.C. Memo. 1994-550, rev’d on another issue, 111 F.3d 1252 (5th Cir. 1997).
10 E.g., Estate of Brocato v. Comm’r, T.C. Memo. 1999-424.
11 Estate of Busch v. Comm’r, T.C. Memo. 2000-3 (10 percent discount allowed for agricultural property which the court stated was “more than adequate” to cover reasonable costs of partition action; estate had claimed 40 percent – heirs had made it known property would be sold for development).
12 Estate of Baird v. Comm’r, T.C. Memo. 2001-258.
14 Propstra v. United States, 680 F.2d 1248 (9th Cir. 1982).
15 Ltr. Rul. 9336002, May 28, 1993; Ltr. Rul. 9943003, June 7, 1999 (discount for co-ownership of realty should be limited to costs of partitioning; discount is matter of fact).
16 416 F.3d 442 (5th Cir. 2005).
17 Id.
18 See Stone v. United States, 2007-2 U.S. Tax Cas. (CCH) ¶ 60,572 (9th Cir. 2009) (unreported decision), aff’g, 2007-2 U.S. Tax Cas. (CCH) ¶ 60,545 (N.D. Calif. 2007). An earlier District Court opinion in the same case appears at 2007-1 U.S. Tax Cas. (CCH) ¶ 60,540 (N.D. Calif. 2007).
19 T.C. Memo. 1994-211.
21 Id.
22 2014-2 U.S. Tax Cas. (CCH) ¶ 60,683 (5th Cir. 2014).

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

ANIMALS

HORSES. The defendant and plaintiff were friends and the plaintiff visited the defendant’s farm to ride horses with the plaintiff’s granddaughter. As the plaintiff rode away from the farm, the saddle became loose and slid off of the horse, causing the plaintiff to fall off and become injured. The plaintiff filed a suit in negligence, alleging that the defendant was negligent in failing to tighten the saddle cinch and to provide a cinch hobble before the plaintiff rode away from the farm. The defendant filed for summary judgment on the basis that the Georgia Injuries from Equine or Llama Activities Act, Ga. Code § 4-12-1 et seq., gave the defendant civil immunity from negligence suits. The trial court granted the summary judgment. On appeal, the plaintiff argued that two exceptions in the statute applied to allow the suit. The plaintiff pointed to Ga. Code § 4-12-3(b)(1)(A) which allows liability where an “equine activity sponsor, equine professional, … or person … provided the equipment or tack, and knew or should have known that the equipment or tack was faulty, and such equipment or tack was faulty to the extent that it did cause the injury.” The plaintiff argued that the failure to properly tighten the saddle cinch and provide...