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Discounts for Co-Ownership of Real Estate

-by Neil E. Harl

Today, discounts for co-ownership of interests in real estate are available generally and that has been the case since the late 1980s. Earlier cases involving undivided interests in tenancy in common were not eligible for a discount. The Youle case with a 12 ½ percent discount, the first case to allow a discount, was soon followed by discounts of up to 20 percent and, more recently, much larger discounts. For example, the case of Estate of Williams v. Commissioner. The discount allowed in that Tax Court decision for a gift of undivided interests in Florida timberland for 20 percent for lack of marketability and 30 percent for lack of control and need to partition was allowed for a total discount of 44 percent).

A Lesson Learned From Contrasting Cases

A pair of Tax Court cases in 1999 and 2000 provides a lesson on managing the discounting process. The case of Estate of Brocato v. Commissioner, involved a 20 percent fractional share discount allowed for rental properties in San Francisco. Two weeks later, in a case involving farmland which had been virtually enveloped by economic development, Estate of Busch v. Commissioner, the Tax Court approved a 10 percent discount. The court made it clear that the widespread discussion about probable sale of the property caused the court to take the position that 10 percent was more than adequate in light of the discussion about a probable sale by the heirs, apparently on a widespread basis. The lesson learned – even if later sale is in prospect, keep it quiet.

Discounts from routing property through marital and non-marital shares

In a 1996 Court of Appeals case, Bonner v. United States, a discount was allowed for undivided interests at death routed through marital and non-marital shares even though the post-death ownership might be reunited in the same beneficiaries. However, that case proved to be controversial. While the Bonner decision followed Estate of Bright v. United States, and that case was followed by the Ninth Circuit Court of Appeals case of Propstra v. United States. The Seventh Circuit Court of Appeals, in Citizens Bank & Trust Co. v. Commissioner, criticized those cases. The Citizen’s Bank case involved voting and non-voting stock placed in separate trusts.

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Discounts for art collections

For several years, discounts for art collections were modest. An estate’s fractional interest in an art collection could typically be discounted for the costs of partition and sale but not for the fractional interest itself. In a later decision, a five percent discount was allowed. 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.

The Tax Court, in Estate of Elkins v. Commissioner, 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. However, on appeal the Fifth Circuit Court of Appeal allowed a 44.75 percent discount for an undivided interest in the works of art involved in that litigation. 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 taxpayer’s argument that there is no “recognized” market for fractional interests in art and the art in question had been voluntarily subjected to restraints (and alienation) as well as restraints on possession.

The key issue is whether Elkins v. Commissioner will chart the discount course for art collections going forward.

Litigation costs

The Fifth Circuit Court of Appeals awarded litigation costs in Estate of Baird on grounds the IRS position of limiting co-ownership discounts to costs of partitioning property was not justified.

ENDNOTES

1 See Estate of Youle v. Comm’r, T.C. Memo. 1989-138 (discount of 12 ½ percent allowed for tenancy in common ownership).
2 Estate of Pudim v. Comm’r, T.C. Memo. 1982-606; Estate of Clapp v. Comm’r, T.C. Memo. 1983-721; 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).
3 T.C. Memo. 1998-59.
4 T.C. Memo. 1999-424.
5 The Internal Revenue Service had argued, unsuccessfully, the limit should be the cost of partitioning.
6 T.C. Memo. 2000-3.
7 84 F.3d 196 (5th Cir. 1996).
8 658 F.2d 999 (5th Cir. 1981).
9 680 F.2d 1248 (9th Cir. 1982).
10 839 F.2d 1249 (7th Cir. 1988).
12 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).
13 T.C. Memo. 1994-211.
14 140 T.C. 86 (2013).
15 2014-2 U.S. Tax Cas. (CCH) ¶ 60,683 (5th Cir. 2014).
16 416 F.3d 442 (5th Cir. 2005).

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

BANKRUPTCY

CHAPTER 12

DISMISSAL. The debtor filed a proposed Chapter 12 plan in September 2014 and the plan provided that the debtor would seek to avoid two secured debts. The debtor was unsuccessful in avoiding either of the secured debts and sought further time to appeal; however, the debtor did not pursue the appeal and did not file any amended plan. The court court noted several other delaying tactics, including the debtor’s firing of counsel and the debtor’s failure to appear at a disposition and a hearing. The court noted that the estate had lost value during the delays and the debtor did not have income to pay the interest on the secured debts; thus, the court dismissed the case under Section 1208(c) for unreasonable delay by the debtor that was prejudicial to the creditors, failure to file a plan timely, failure to confirm a plan, and continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation. On appeal, the appellate court affirmed. In re Haffey, 2017 Bankr. LEXIS 4063 (Bankr. 9th Cir. 2017), aff’g, 2015 Bankr. LEXIS 1850 (Bankr. E.D. Ky. 2015).

FEDERAL FARM PROGRAMS

BEEF. The AMS has issued a notice that it is revising the United States Standards for Grades of Carcass Beef (beef standards) to allow dentition (the condition of teeth) and documentation of actual age as additional methods of classifying maturity of carcasses presented to USDA for official quality grading. 82 Fed. Reg. 57569 (Dec. 6, 2017).