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CO-OWNERSHIP DISCOUNTS: A NEW DIRECTION?

— by Neil E. Harl*

A pair of U.S. Tax Court cases,\(^1\) decided exactly one week apart, have raised questions whether the Tax Court is moving toward the Internal Revenue Service position on co-ownership discounts\(^2\) or whether the court is adopting a more complex and sophisticated approach to co-ownership discounts.\(^3\) The questions may be answered on appeal (both cases are appealable to the Ninth Circuit Court of Appeal)\(^4\) or from additional cases decided by the Tax Court. The outcome is highly important to farm and ranch taxpayers.

History of co-ownership discounts

Before 1989 the Tax Court had been unenthusiastic with respect to co-ownership discounting and had disallowed such discounts in several cases\(^5\) although interests in real estate held as community property had been eligible for discount for nonmarketability of the decedent’s fractional interest.\(^6\) However, a 1989 case, *Estate of Youle v. Commissioner*,\(^7\) allowed a discount of 12 1/2 percent for tenancy in common ownership. That case was followed by *Estate of Wildman v. Commissioner*,\(^8\) which allowed a 40 percent discount for a 20 percent interest in farmland (for majority interest and restrictions on transferability); *Robinson v. United States*\(^9\) which allowed a discount for a tenancy in common interest in real property; *Mooneyham v. Commissioner*,\(^10\) permitting a 15 percent discount for a 50 percent undivided interest in real property for federal gift tax purposes; *Estate of Feuchter v. Commissioner*,\(^11\) where land value was discounted 15 percent to reflect a partnership’s undivided one-half interest; *Estate of Pillsbury v. Commissioner*,\(^12\) allowing a 15 percent discount for undivided 77 percent and 50 percent interests in real estate; *Estate of LaFruk v. Commissioner*,\(^13\) allowing a 20 percent discount for minority interest and a 10 percent discount for non-marketability for gifts of realty to children; *Estate of Casey v. Commissioner*,\(^14\) which permitted a 15 percent discount for a residence; and *Estate of Williams v. Commissioner*,\(^15\) where Florida timberland was discounted 20 percent for lack of marketability and 30 percent for lack of control and need to partition for a total discount of 44 percent. In *Estate of Cervin v. Commissioner*,\(^16\) a 20 percent discount was allowed for a 50 percent interest in a farm and homestead. Although the case was appealed on other issues, the co-ownership discount issue was not appealed by the government.

Thus, the discounting of co-ownership interests had become well established by late 1999.

The IRS position

Throughout the two decades when the co-ownership discount issue has been litigated, the Internal Revenue Service never waived from its position that any

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discount should be limited to the costs of partitioning the property. The Service position was that the issue of a discount was a question of fact.

The two recent cases

On December 29, 1999, the Tax Court decided Estate of Buscato v. Commissioner,18 which involved several apartment buildings in San Francisco, some of which were held by the decedent in co-ownership. The court allowed a 20 percent fractional interest discount as well as an 11 percent blockage discount (because of the number of properties in the same market, the state of the local economy at the time and the limited pool of investors). The Tax Court specifically rejected the IRS expert's approach based on the costs of partitioning the properties. The Court cited to Estate of Pillsbury v. Commissioner,19 Mooneyham v. Commissioner,20 and Estate of Williams v. Commissioner.21

A week later, on January 5, 2000, the Tax Court decided Estate of Busch v. Commissioner,22 which allowed a 10 percent discount for a co-ownership interest. The court stated that a 10 percent discount "would...be more than adequate to accommodate reasonable costs of partition."23 The estate had sought a 40 percent discount for co-ownership of the 90.74 acre tract of land on the outskirts of Pleasanton, California. The Court rejected the IRS argument that the owners were trying to sell the property and so no discount should be allowed. In Busch,24 the Court approved a value of $4,190,496 for the property. The land had been owned by the 98-year-old decedent and a trust for the 97-year-old surviving spouse of a deceased brother.

In conclusion

One possible interpretation of Busch25 is that the value of the tract (over $4 million) did not justify a larger discount for co-ownership. But even at that the decision represents an attentiveness to the cost of partitioning beyond that found in the earlier cases. Another possible interpretation is that the Tax Court is becoming impressed with the IRS position. As noted above, the full meaning of Busch26 will not be known until the case has been appealed or other cases have been decided or both.

FOOTNOTES

4 See n. 1 supra.
5 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 one-half interest in trust property not discounted as fractional share when trust property to be sold as entire fee simple interest).
8 T.C. Memo. 1989-667.
13 T.C. Memo. 1993-526.
14 T.C. Memo. 1998-59.
15 T.C. Memo. 1996-156.
16 T.C. Memo. 1994-550, rev’d on another issue, 111 F.3d 1252 (5th Cir. 1997).
18 T.C. Memo. 1999-424.
19 N. 12 supra.
20 N. 10 supra.
21 N. 15 supra.
22 T.C. Memo. 2000-3.
23 Id.
24 N. 22 supra.
25 N. 22 supra.
26 See n. 22 supra.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

PENDING LEGISLATION. The U.S. Senate has passed the Bankruptcy Reform Act of 2000. In part the legislation (1) permanently enacts Chapter 12, (2) changes the base year for determining the 50 percent or more of income from farm operations from the year prior to filing the petition to “at least 1 of the 3 calendar years” preceding the filing of the petition, and (3) requires confirmation of a Chapter 12 plan if the plan provides for payment of all of the debtor’s projected disposable income to allowed unsecured claims and the plan otherwise qualifies for confirmation. Sen. 625.

GENERAL-ALM § 13.03.

EXEMPTION.

PARTNERSHIP PROPERTY. The debtor operated a farm as a partnership with the debtor’s brother. The partnership dissolved upon the debtor’s filing for Chapter