



Fifth Circuit Court Reverses Tax Court Ruling on Fractional Interest Valuation Discounts

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On September 15, the U.S. Court of Appeals for the Fifth Circuit reversed a 2013 Tax Court decision that had allowed only a nominal, 10% fractional interest discount for artwork included in a decedent's estate.

James A. Elkins, Jr. died on February 21, 2006. At the time of his death, Mr. Elkins owned undivided fractional interests in 64 valuable works of art. The other owners of the art were Mr. Elkins' three children. On Mr. Elkins federal estate tax return, the executors of Mr. Elkins' Estate (the "Estate") applied a 44.75% combined fractional interest discount (for lack of control and marketability) for each piece of art, as determined by Deloitte LLP. The IRS challenged the Estate's valuation, claiming that no discount was appropriate.

In *Estate of Elkins v. Commissioner*, 140 T.C. 86 (2013), the Tax Court heard the arguments of the Estate and the IRS. The Estate presented reports and testimony of three well-qualified experts to justify discounting the fractional interests in the artwork for estate tax purposes. At trial, the Estate's experts opined on the appropriate discount for each piece of art, which ranged approximately from 50% to 80%. As support for its argument that there should be no valuation discount for fractional interests in artwork, the IRS presented only testimony of experts to the effect that no market exists for undivided interests in art. (The IRS's argument rested on regulations providing that fair market value is determined with reference to the market in which property is most commonly sold to the public, which, in the case of artwork, is the retail market where all fractional interest owners agree to sell simultaneously without a discount.) The Tax Court rejected the IRS's argument that fractional interests in artwork could not merit a valuation discount for estate tax purposes. The Tax Court also rejected, however, the Estate's experts' valuation discount determinations, finding that the discount percentages were too large in light of the probability that a purchaser of the interests could "flip" the interests to the other fractional interest owners of the artwork at an undiscounted price. Thus, the Tax Court allowed, under the particular circumstances, a nominal fractional interest discount of only 10% for each piece of art.

On appeal, the Fifth Circuit Court affirmed the Tax Court's ruling that valuation discounts were appropriate and reversed the Tax Court's ruling that only a nominal discount was appropriate. The Fifth Circuit Court ruled that, "given the total absence of substantive evidence from the Commissioner on the issue of quantum, the Tax Court should have accepted and applied the uncontradicted quantum of the partial-ownership discounts that the Estate proved with much more than substantial evidence." The

Fifth Circuit Court specifically found that the Estate's experts had considered the possibility of "flipping" the artwork to the other fractional interest owners when determining the appropriate valuation discounts. The Fifth Circuit Court further found that, absent any evidence offered by the IRS relating to discount percentages, the Tax Court should not have endeavored to determine a different discount percentage. In effect, the Fifth Circuit Court held that, because the Estate's experts were well qualified, had considered all relevant facts, and were not contradicted by IRS experts with respect to the amount of the appropriate discounts, the Tax Court was obliged to adopt the discount determinations of the Estate's experts.

The Fifth Circuit Court's opinion confirms the possibility of obtaining substantial valuation discounts for fractional interests in artwork for gift and estate tax purposes. On a broader level, however, the Court's opinion underscores the importance of retaining well-qualified and thorough experts to determine and support valuation discounts in gift and estate tax planning matters.

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