

JURISDICTION: OKLAHOMA TAX COMMISSION - DECISION
CITE: 98-07-23-008 / NOT PRECEDENTIAL
ID: P9500080
DATE: 07-23-98
DISPOSITION: SUSTAINED IN PART / DENIED IN PART
TAX TYPE: ESTATE
APPEAL: NO APPEAL TAKEN

FINDINGS OF FACT AND CONCLUSIONS OF LAW

A. The parties stipulate to the following:

1. The Decedent was born on February 4, 1916, and died on April 27, 1993 at the age of 77, as a resident of BIG County, Oklahoma.

2. In late February, 1992, ANONYMOUS FIRM completed a review of the estate planning of Decedent and his wife. The review included a projection of potential estate taxes and the amount of liquidity necessary to satisfy such estate tax liabilities. ANONYMOUS FIRM'S review was not uncommon in its role as advisor to clients with substantial assets.

3. On or about October 19, 1992, Decedent underwent a general medical exam/physical, as part of the process of initiating efforts to obtain additional life insurance. The physician's notes from this exam indicated that Decedent had been "in excellent health" and noted a past history of "[g]ood health, no major illnesses." Decedent passed the physical and was qualified to obtain life insurance. Decedent subsequently decided not to purchase the life insurance.

4. Approximately November 16, 1992, ANONYMOUS FIRM sent correspondence to a number of its clients, including Decedent, detailing potential federal legislative changes and the possible impact of such changes if enacted, as well as planning opportunities afforded under the existing law. This discussion included concern that legislation, which at the time was being actively discussed, could be enacted that would reduce the Federal lifetime gift/estate tax exemption equivalent from \$600,000 to \$200,000.

5. On December 31, 1992, Decedent transferred via gift 1,600 shares of THE COMPANY (herein, the "Company") stock to his stepson, which stock constituted approximately 18% of the issued and outstanding stock of the Company.

6. Decedent's stepson had worked for the Company since his college graduation, during which period he had worked in various phases of the business.

7. The Company has made an effective election to be taxed as an "S" corporation. A year-end transfer of stock of an "S" corporation, in contrast to a transfer during the taxable year, avoids the need for bifurcation of the tax year and also avoids certain complexity and increased costs of accounting for operations during the year.

8. ANONYMOUS FIRM issued an appraisal opinion which determined the fair market value of the gifted stock, discounted for marketability and minority interest, to be \$556 per share, for a total gift of \$889,600.

9. On or about February 3, 1993, Decedent visited his physician and complained of pain in his right leg that began two weeks earlier. The physician's notes from the visit state, "I have no idea what is going on."

10. Decedent again visited his physician on February 24, 1993. The physician's notes from the visit state, "Patient was here on 2-3. I was not sure what was going on with him and I am still not."

11. Decedent again visited his physician on March 1, 1993. The physician's notes from the visit state, Decedent "[h]ad physical in October. Things pretty good at that time . . . Really did not complain of anything else and labwork not too remarkable . . . I am not sure what is going on." Thus, as late as March 1, 1993 and a full two (2) months after Decedent's gift of the stock to his stepson, Decedent's physicians were not aware that Decedent was suffering from a life-threatening disease.

12. After subsequent testing, Decedent was ultimately diagnosed with pancreatic cancer, an extremely fast-moving affliction, about mid-March, 1993.

13. The Protestant filed Decedent's estate tax return on January 28, 1994. Such return reported a gross estate of \$10,607,527.00, consisting primarily of stock in the Company. Such stock was valued at the \$1,443 per share appraisal opinion value of ANONYMOUS FIRM.

14. On February 17, 1995, the Division issued an order assessing tax of \$158,039 plus interest for the period from January 27, 1994 to March 27, 1995 of \$27,657. The order increased the value of the estate by \$2,308,800 to account for the date of death value of the 1,600 shares of stock in the Company gifted by the Decedent to his stepson. The Division's assessment valued the gifted stock at the ANONYMOUS FIRM appraisal value of \$1,443 per share, giving no discount for the lack of marketability or minority interest in the Company represented by such gifted shares.

15. The Protestant timely protested the assessment by letter dated March 8, 1995.

B. Additional Findings:

1. The date of death value of the stock transferred to Decedent's stepson represents 21.76% of Decedent's gross estate.

2. Decedent did not have a pattern of past gift giving prior to the gift of stock to his stepson.

3. Decedent's Will provides that all of the property in Decedent's estate is bequeathed to Decedent's wife, as Trustee of the Revocable Inter Vivos Trust of DECEDENT.

4. The Revocable Trust provides that upon DECEDENT'S death, if his wife survives him, the trust estate shall be divided into Trust A and Trust B. During her lifetime, all of the net income of Trust A and Trust B shall be paid to Decedent's wife. Upon her death, the principal of Trust A is to be transferred in accordance with the Will of Decedent's wife, while Trust B assets are to be distributed to Decedent's stepson.

5. Decedent's tax advisor, MR. TAX ADVISOR, of ANONYMOUS FIRM, testified that during 1992, Decedent contemplated a gift of stock to his stepson to reward him for his loyalty and contribution to the success of the Company. According to MR. TAX ADVISOR, Decedent was satisfied that his stepson had exhibited the requisite level of maturity, commitment and responsibility which warranted participation in the ownership of the Company.

6. Decedent's adjusted basis in the stock at the time of the gift was approximately \$310,400.00.

7. At the time of the gift, Decedent and his wife possessed cash and/or liquid assets in excess of the amount of the gifted shares.

8. Decedent also had a stepdaughter who was not active in the Company. Although Decedent was on good terms with his stepdaughter, no gifts were made by Decedent to his stepdaughter.

9. Decedent was also motivated to make the gift of stock to his stepson by his concern that the \$600,000.00 exemption equivalent was going to be reduced to \$200,000.00.

10. The gifted stock had a highly appreciated value.

11. Upon making the gift, the economic benefits of ownership in the Company were immediately conferred to Decedent's stepson.

ISSUES AND CONTENTIONS

Two issues are presented for decision. The first issue is whether Protestant properly excluded the value of the stock transferred to Decedent's stepson from Decedent's gross estate. The second issue is whether the date of death value of the transferred stock should be discounted to reflect the minority interest and lack of marketability applicable to such stock.

Protestant contends that the gift of stock was not made in contemplation of death. In support of this contention, Protestant argues that the gift was motivated by Decedent's desire to reward his stepson for his loyalty and service to the Company and to implement prudent estate tax planning. Protestant also contends that the value of the stock should be adjusted to properly reflect the minority interest and lack of marketability discounts accorded to transfers of minority interests in closely-held companies.

The Division contends that the Order Assessing Tax should be sustained. In support of this contention, the Division argues that the transfer of stock was made without consideration, that the transfer was made within three (3) years of Decedent's date of death and that the transfer constituted a material part of Decedents' estate. The Division further argues that notwithstanding whether the gift was partly motivated by the desire to reward the recipient, the value of the stock is includable in the gross estate since the gift was also motivated by estate tax consequences.

APPLICABLE LAW

Gifts of real or personal property made by a decedent in contemplation of death shall be included in the value of the gross estate of the decedent. 68 O.S. 1991, § 807(A)(2). A presumption that the gift of property was made in contemplation of death arises where the transfer is made within three (3) years of the death of decedent, without an equivalent in monetary consideration, and the transfer consists of a material part of decedent's estate. *Id.*

Section 807(A)(2) represents "a legislative scheme to prevent inheritance tax evasion by imposing certain criteria on inter vivos transfers." ***Wilson v. Oklahoma Tax Commission***, 594 P.2d 1210, 1212 (Okla. 1979). The Legislative scheme has been in place since the enactment of the Inheritance and Transfer Act of 1939.¹

¹ Laws 1939, p. 400, § 1. The Inheritance and Transfer Act was repealed in 1965 and recodified as the Estate Tax Laws, 68 O.S. Supp. 1985, § 801 et seq. Laws 1965, c.250. §§ 1-3.

The Tax Commission has the burden of establishing that (1) the transfer occurred; (2) the transfer was a material part of decedent's estate; (3) the transfer was not made for an equivalent in monetary consideration; and (4) the transfer was made within three years of death. Oklahoma Tax Commission Order No. 94-06-21-003.² Where the Commission establishes the above elements, the statutory presumption arises and the burden of proof shifts to the Estate to show that the transfers were not gifts made in contemplation of death. *Id.*

"Material" as used in the context of Section 807(A)(2) means "having real importance or great consequences", Webster's New Collegiate Dictionary 702 (1979); and "important, more or less necessary, having influence or effect", Black's Law Dictionary 880 (5th ed. 1979). See, 25 O.S. 1991, § 1. Whether a transfer of property is a "material part" of an estate is determined under the following factors; the proportion the gifted property bears to the total estate, the size of the gift, the nature of the gift and the nature of the remainder of the estate. *In re Miller's Estate*, 404 Pa. 156, 170 A.2d 857 (1961); 42 Am.Jur.2d. *Inheritance, Etc., Taxes* § 95.

The differentiating factor between an inter vivos gift and one made in contemplation of death is the transferor's motive. *U.S. v. Wells*, 283 U.S. 102, 51 S.Ct. 446, 75 L.Ed. 867 (1931). A transfer "in contemplation of death" is a disposition of property prompted by the thought of death (although it need not be solely so prompted). 26 C.F.R. § 20.2035-1(c)(1954). A transfer is prompted by the thought of death if (1) made with the purpose of avoiding death taxes, (2) made as a substitute for a testamentary disposition of the property, or (3) made for any other motive associated with death. *Id.* Contemplation of death is the statutory criteria, not necessarily contemplation of imminent death, *Fatter v. Usry*, 269 F.Supp. 582, 584 (E.D. La. 1967); or expectation of death, *Berman v. U.S.*, 487 F.2d 70, 72 (5th Cir. 1973).

Factors to be considered in determining whether the estate has overcome the presumption that the gift is made in contemplation of death are:

- (a) the age of the decedent at the time the transfers were made;
- (b) the decedent's health, as he knew it, at or before the time of the transfers;
- (c) the interval between the transfers and the decedent's death;
- (d) the amount of the property transferred in proportion to the amount of property retained;
- (e) the nature and disposition of the decedent;
- (f) the existence of a general testamentary scheme of which the transfers were a part;
- (g) whether the donees to the decedent were the natural objects of his bounty;
- (h) the existence of a long established gift-making policy on the part of decedent;
- (i)

² The Order of the Tax Commission which adopted the Findings, Conclusions and Recommendations of the Administrative Law Judge decreed that the statements of law contained therein were of precedential effect.

the existence of a desire on the part of the decedent to escape the burden of managing property by transferring the property to others; (j) the existence of a desire on the part of the decedent to experience vicariously the enjoyment of the donees of the property transferred; and (k) the existence of the desire by the decedent of avoiding estate taxes by means of making inter vivos transfers of property. *Cunningham v. U.S.*, 553 F.2d 394, 396 (5th Cir. 1977).

For estate tax purposes, property shall be appraised at fair cash market value. 68 O.S. 1991, § 816(A). "Fair cash market value" is defined as "the value and price at which the property transferred would change hands between a willing buyer and a willing seller, both free of any compulsion to buy or sell." *Id.* In valuing property which has no readily ascertainable value, the Commission has adopted certain rules and regulations. See, 68 O.S. 1991, § 203. Of particular importance to this matter is Rule 8.010.08 of the Oklahoma Tax Commission Permanent Rules.³ Rule 8.010.08 provides in pertinent part that "[N]on-publicly traded items shall be valued in accordance with IRS Revenue Ruling 59-60."

Revenue Ruling 59-60 in general is an outline and review of the approach, methods and factors to be considered in valuing shares of capital stock of closely held corporations for federal estate and gift tax purposes. Revenue Ruling 59-60 does not specifically address the discountability of such stock.

Stock of closely held corporations must be discounted for lack of marketability. *Mertens*, § 59:54. 42 Am. Jur. 2d *Inheritance, Estate, and Gift Taxes* § 263 (1969). See, *Snyder v. Comm.*, 93 TC 529 (1989). An additional discount is allowed for stock which conveys a minority interest in a closely held corporation because the buyer will not be able to control the corporation and, therefore, cannot assure the timing of dividend payments or liquidation of the corporation. *Mertens*, supra. See, *Ward v. Comm.*, 87 TC 78 (1986).

CONCLUSIONS OF LAW

1. Jurisdiction over the parties and subject matter of this proceeding is vested in the Tax Commission. 68 O.S. 1991, § 207.

2. Gifts of real or personal property made in contemplation of death are included in the value of the gross estate of a decedent for estate tax purposes. 68 O.S. 1991, § 807(A)(2). See, *Wilson v. Oklahoma Tax Commission*, 594 P.2d 1210, 1212 (Okla. 1979).

³ Currently codified as Rule 710:35-5-22 of the Oklahoma Administrative Code.

3. Gifts of a material part of a decedent's estate made within three (3) years of death are presumed to be made in contemplation of death. 68 O.S. 1991, § 807(A)(2).

4. Here, the evidence shows that a transfer of stock occurred, that the transfer constituted a gift to the recipient, that the transfer was made within three (3) years of decedent's death and that the property transferred was a material part of decedent's estate. Therefore, the burden of proof shifts to Protestant to show that the gift was not made in contemplation of death. See, Oklahoma Tax Commission Order No. 94-06-21-003.

5. The differentiating factor between gifts inter vivos and gifts in contemplation of death is the transferor's motive. *U.S. v. Wells*, 283 U.S. 102, 51 S.Ct. 446, 75 L.Ed. 867 (1931). Transfers prompted by the thought of death, even if they are also prompted by other motives, are includable in the gross estate of the decedent. 26 C.F.R. § 20.2035-1(c)(1984). See, *Fatter v. Usry*, 269 F.Supp. 582, 584 (1967). A transfer is prompted by the thought of death if (1) made with the purpose of avoiding death taxes, (2) made as a substitute for a testamentary disposition of property, or (3) made for any other motive associated with death. *Id.* Contemplation of death is the statutory criteria, not necessarily contemplation of imminent death, *Fatter*, supra; or expectation of death, *Beaman v. U.S.*, 487 F.2d 582, 584 (5th Cir. 1973).

6. Here, the evidence indicates that the transfer was made in contemplation of death. Notwithstanding whether the transfer was partly motivated by "life-oriented" reasons (the desire to reward the recipient for loyalty and service to the Company), the transfer was also motivated by the potential change in the federal exemption equivalent. See, 26 C.F.R. § 20.2035-1(c)(1)(1984). Accordingly, Protestant improperly excluded the value of the transferred stock from Decedent's gross estate.

7. The date of death value of the transferred stock must be adjusted to reflect the minority interest and lack of marketability discounts accorded to the transfer of minority interests in closely held corporations. The stock, discounted for marketability and minority interest, was valued at \$556.00 per share at the time of the gift. The gift was made approximately four (4) months prior to Decedent's death. The Division did not challenge this valuation. Accordingly, the date of death value of the transferred stock shall be adjusted to reflect a value of \$556.00 per share, or a total value of \$889,600, for purposes of inclusion in Decedent's gross estate.

8. Protestant's protest to the Order Assessing Tax should be sustained in part and denied in part.

DISPOSITION

Based on the above and foregoing, it is DETERMINED that the protest of THE Estate of DECEDENT be sustained in part and denied in part. It is further DETERMINED that the amount in controversy be adjusted in accordance herewith and that the resultant amount be fixed as the deficiency due and owing.

OKLAHOMA TAX COMMISSION

CAVEAT: This decision was **NOT** deemed precedential by the Commission. This means that the legal conclusions are not generally applicable or are limited in time and/or effect. Non-precedential decisions are not considered binding upon the Commission. Thus, similar issues may be determined on a case-by-case basis.