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CITATION:
Huber v. Commissioner, T.C. Memo. 2006-96, May 9, 2006

SUMMARY:
The Tax Court determined that sales of shares between family members in a closely held corporation were arm's-length transactions and supported the prices used for gift tax returns.

DETAILS:
Taxpayers Michael W. and Caroline P. Huber, Tabitha A. Huber, and Hans A. and Laurel D. Huber made various gifts of stock in J.M. Huber Corp. (Huber) between 1997 and 2000. Huber is a family owned corporation with sales in excess of $500 million and approximately 250 shareholders. The shares of Huber are held by members of the Huber family, the Huber Foundation (a nonprofit charitable organization), and various independent nonprofit organizations, including universities. The prices used in the stock transactions were based on appraised values, including a consistently applied 50% discount for lack of marketability. The annual appraisals were used for all transactions, including intra-family sales, gifts to nonprofit organizations and corporate redemptions.

Taxpayers relied on this appraised value in making gifts, but the IRS challenged this value and whether the shareholder transactions were at arm's-length. The IRS appraisal expert concluded that the discount for lack of marketability should be 30% for 1997, 25% for 1998, 45% for 1999, and 30% for 2000. The Court did not deal with the IRS attack on the taxpayer appraisal, but focused instead on the arm's-length argument as the threshold issue.

One prong of the IRS attack on the arm's-length nature of the sales was that Huber did not offer shares for sale to the public and thus failed to obtain the optimum price. The Court rejected the notion that Huber must take itself public in order to sell its shares at a fair price, noting that, *"Courts have long recognized the rights of shareholders in closely held companies to remain private…Further, respondent's assumption that offering a stock to the public would have garnered a higher price is purely hypothetical."*

The IRS also argued that the bona fide business purpose of maintaining family control should be set aside if it serves as a device to "pass an interest to the natural objects of one's bounty or to convey that interest for less than full and adequate consideration." The Court dismissed this argument noting that the appraised value had been used for many instances such as charitable donations where a higher value would have been preferable. The Court said, *"We reject respondent's suggestion that almost 250 shareholders would harmoniously accept an artificially low valuation of the Huber stock so that a few people who may or may not be related to them can pay less estate tax…We therefore conclude that the existence of close family relationships between parties of some of the 90 sales transactions in the record is neutralized by the fact that many of the transactions took place between parties that were hardly related or unrelated and who had fiduciary obligations to obtain the best price."*

Another prong of the IRS attack was the lack of negotiations between buyers and sellers, suggesting that there was a lack of intent to realize the best price for the shares. The Court also rejected this, saying, *"Respondent fails to cite any caselaw that holds that negotiation is a necessary element of an arm's-length transaction. In fact, the weight of authority is to the contrary."*

The taxpayers completely prevailed in this case.

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