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CITATION:
Estate of Josephine T. Thompson et al. v. Commissioner; Nos. 06-0815, 06-1132, 2nd Circuit, August 23, 2007

SUMMARY:
Citing the incompetence of the valuation experts, the 2nd Circuit remanded for the Tax Court to determine if reliance on appraisers was reasonable and in good faith for purposes of an accuracy related penalty.

DETAILS:
In Estate of Thompson, T.C. Memo 2004-174, July 26, 2004 (FCG E-Flash 6-7), the Tax Court made its own determination of fair market value, but did not impose an accuracy related penalty. Decedent died in 1998 owing a 20.57% interest in Thompson Publishing Co., Inc. (TPC), a New York corporation and publisher of the Thomas Register. The estate claimed a fair market value of $1,750,000 for the subject interest, while the IRS claimed the value should be $35,273,000.

The taxpayer expert was an Alaska attorney who had little formal training and experience in business valuation. He was assisted by a CPA who likewise had little training or experience. The estate admitted that they hired the Alaska attorney because he represented to them that he would be able to secure a better valuation result for them in Alaska than they would be able to obtain in the New York IRS office.

The Tax Court found both the taxpayer's and IRS' valuations to be "deficient and unpersuasive." The Court cited the lack of experience and training of the Alaska lawyer and accountant and their lack of membership in any professional appraisal organizations. The Court was also troubled that the Alaska attorney was appointed to act as administrator for the estate to handle the anticipated audit. The reports and testimony of the taxpayer experts were termed “marginally credible” by the Court, which also noted they were “barely qualified” to value the company.

The Estate appealed on a burden of proof issue and the IRS appealed based on the failure to impose the accuracy related penalty. It was undisputed that the Tax Court made an error in its valuation calculation by including the income from non-operating assets in its capitalization calculation and also adding the non-operating assets as a separate component of value.

The 2nd Circuit remanded the case for the Tax Court to correct its calculation error (accepting all other aspects of the calculation) and to determine whether the Estate’s reliance on its two “appraisers” was reasonable and in good faith for the purpose of avoiding the underpayment penalty. The 2nd Circuit noted that reliance on an expert’s opinion may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.

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