

**In this issue:**

- Shareholder Actions
- Estate Planning & Valuation
- Matrimonial Arena

## Shareholder Actions

### *Fair Value Not Always the Standard in Shareholder Actions*

In New Jersey we often look to fair value as the Standard of Value in Corporate Shareholder Actions. In simplest terms, fair value is fair market value without the application of minority or marketability discounts. The intent is that minority shareholders are not penalized for taking advantage of the Appraisal Statute and to protect oppressed, minority shareholders from being treated unfairly through application of discounts against their pro-rata stock value. The oft quoted cases, **Balsamides v. Protameen Chemical** and **Wheaton v. Smith** reminds us that, "the guiding principal, ..., is that the marketability discount cannot be used unfairly by the controlling or oppressing shareholders to benefit themselves to the detriment of the minority or oppressed shareholders." We note that discounts are provided for in the Balsamides matter in order to be fair to the oppressed shareholder.

A recent case in Colorado, **Kim v. The Grover C. Coors Trust** again reminds us that it is a common misconception to presume that statutory fair value is the appropriate standard of value in every shareholder dispute. A minority shareholder alleged a breach of fiduciary duty by directors for approving a sale of preferred stock to raise badly-needed capital. Rather than viewing the matter as a dissenters' rights action the Court focused on the questions of whether the transaction was fair. As a result, the fair value standard under the state's Model Business Corporation Act was not invoked and the fair market value standard was applied, including consideration of appropriate discounts.

This case serves as an excellent reminder that standard of value is the first and most important topic of discussion between analyst and attorney at the onset of an engagement. For a more detailed discussion of **Kim v. The Grover C. Coors Trust**, visit our website at [www.koenigassociatesllc.com](http://www.koenigassociatesllc.com)

## Estate Planning & Valuation

*Robert Dallas,  
Petitioner v.*

*Commissioner of  
Internal Revenue  
Respondent  
United State  
Tax Court,*

*T.C. Memo 2006-212  
September 26, 2006*

This case, by now well known to many Estate practitioners, addresses a number of issues. We'll take a look at two of them; (1) whether or not to **tax-affect S corporation earnings** and (2) the appropriateness of adjusting for **reasonable compensation**.

### **Whether to Tax-Affect S Corporation Earnings**

The Tax Court has once again decided against tax-affecting the income stream of a subject entity that has chosen to be taxed as a Subchapter S corporation under the Internal Revenue Code. Despite the position of the IRS and its prior success on this issue, many valuation analysts believe that tax affecting Subchapter S earnings is correct. Petitioner's expert testimony to support a tax affect of S corporation earnings included (1) he has always tax-affected S corporation income; (2) an informal pole at a recent conference showed 90 to 95 percent of responding appraisers tax-affect S corporation income; (3) the American Society of Appraisers (ASA) Board rejects any application for certification if the candidate submits test answers or reports for review that do not tax-affect S corporation income; (4) his experience is that all bankers, investment bankers, and business brokers use tax-affecting in estimating the value of S corporation stock; and (5) his firm uses tax-affecting in valuing S corporation stock held by employee stock ownership plans (ESOP) that it submits to the Department of Labor. The Tax Court ultimately

gave little weight to the above rationale and indicated, "there is insufficient evidence to establish that a hypothetical buyer and seller would tax-affect [Sub S] earnings and...tax-affecting is not appropriate." If valuation analysts are to convince the Tax Court that tax effecting is appropriate for an S corporation income stream better financial models and evidence will need to be presented.

### **Reasonable Compensation**

A common adjustment to subject entity earnings for valuation purposes is the compensation paid to closely held business owners. In the majority of circumstances, owner/shareholders of closely held corporations compensate themselves in excess of what they might otherwise earn should they seek employment elsewhere. The closely held owner is, in effect, taking profits in the form of salary. Respondent, IRS, contended that the subject's earnings should be increased on the assumption that Dallas family officers are *unreasonably* compensated. The Tax Court took a similar position on this issue regarding testimony and support presented by the experts, stating, "the record does not contain the quality of factual analysis customarily used by courts in deciding whether compensation is reasonable." It again appears that the analyst did not provide the Tax Court with the necessary support on which to consider a reasonable compensation adjustment.

Dallas v. Commissioner also had to decide on (1) the appropriate level of discount for lack of marketability; (2) valuation of self-canceling notes, and; (3) the proper treatment of a Share Adjustment Clause. For a more detailed discussion of Dallas v. Commissioner, visit our website at [www.koenigassociatesllc.com](http://www.koenigassociatesllc.com).

## **Matrimonial Arena**

### **IRS Expands Taxpayers' Options for Direct Deposit of Refunds**

Although tax filing season is now behind us, it is good to be aware of the new IRS option for income tax refund claims. Taxpayers who use the direct deposit option on their tax return for their refund claim are now allowed to divide their refunds in up to three financial accounts. This is done through Form 8888, "Direct Deposit of Refund to More Than One Account". Clearly, this provides an opportunity for divorcing parties to make sure each gets their agreed upon share of the income tax refund should one be claimed on the return. Of course, in order to accomplish this, the parties must both sign and file a joint income tax return.

### **Waiver of Husband's Equity in Home to Ex-Wife Not Alimony as It Wasn't a Cash Payment**

*Rocke Richard LaBozetta v. Commissioner, TCS 2006-122*

In the property settlement agreement, Karen LaBozetta agreed to buy out Rocke LaBozetta's share of equity in the marital home, a sum approximating \$73,000. The agreement also provided that Rocke owed Karen \$23,400 (with the parties waiving an actual payment of that amount) to further reduce the amount of equity owed to him. Rocke deducted the \$23,400 as alimony to Karen. Because it was not a cash payment, as required by Section 71 (b) of the Internal Revenue Code, the waiver was a transfer incident to divorce, not alimony. Furthermore, the divorce agreement specifically waived alimony for both parties. The Tax court held that Rocke could not deduct the \$23,400 as alimony.

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