Review on Recent US Tax Court Cases
Focus on Nonoperating Assets

Dallas Estate Planning Council
February 5, 2026
Will Frazier, FASA

Today's Speaker

Will Frazier, FASA

Managing Director, Financial Advisory

Forensics, Litigation & Valuation Services

- 50+years of experience in valuation, investment banking, mergers and acquisitions, and litigation advisory services.
- For the last 25 years, Will's career focus has included valuing family-owned businesses and holding entities, such as family limited partnerships.
- He has performed valuations for estate and gift taxation, fairness/solvency opinions, bankruptcy and reorganization, disputes related to business transactions and shareholder disputes, family law matters, purchase and sale advisement, employee stock ownership plans, equity compensation, financial reporting, and other litigation, tax and corporate matters.

Estate of Giustina v. Comm’r. T.C.Memo. 2011-141

- Demonstrates value implications of weights used for income and asset-based approaches.
- Tax Court determined value of $27.45 million of 41% LP interest. 25% asset; 75% cash flow method
- **Under remand: 100% to income approach: $13.95 million**
- 49% discount to original value conclusion; 77.5% discount to asset value

Estate of Giustina – Valuation Principles

- **Operating businesses** should primarily be valued using the **income approach.**
- In some cases, **both income and asset approaches** may be appropriate.
- Confusion arises from the term "**underlying assets**":
  - Mentioned in *Estate of Jones and Cecil*
  - In *Jones*, timber (trees) are **operating assets**, not nonoperating

Court's Final Determination

- Tax Court originally assigned:
  - **25% weight** to asset-based valuation
  - **75% weight** to going concern
- Ninth Circuit found this [the asset sale scenario] **clearly erroneous:**
  - Hypothetical liquidation scenarios were **speculative**
  - Directed valuation based on **income approach** (DCF method)

Estate of Jones – Valuation of SJTC

weaver
Assurance · Tax · Advisory

- **Estate's Position:**
  - SJTC is an **operating company** that sells logs.
  - Should be valued as a **going concern,** with **primary consideration to earnings.**
  - Supported by *Rev. Rul. 59-60,* Section 5(a).
    - *In general, the appraiser will accord primary consideration to earnings when valuing stocks of companies which sell products…*
- **Respondent's Position:**
  - SJTC is a **natural resource holding company.**
  - Valuation should focus on the **value of its timberlands** (underlying assets).
  - Also cites *Rev. Rul. 59-60.*
- **Estate's Rebuttal:**
  - Rejects asset-based valuation.
  - Argues there is **no likelihood SJTC will sell its timberlands.**

Estate of Jones

- **Sale of Timberlands & Asset-Based Valuation**
- **Asset-based valuation assumes** access to timberland value via a hypothetical sale.
- **Likelihood of sale** affects how much weight is given to asset-based valuation:
  - **Less likely** SJTC is to sell timberlands → **less weight** assigned to asset-based approach.
- Supporting case:
  - *Estate of Giustina v. Commissioner,* 586 F. App'x 417 (9th Cir. 2014)
    - Court held **no weight** should be given to asset-based valuation
    - Asset sale assumption was **hypothetical** and **contrary to evidence**

Estate of Jones – Hybrid Valuation Approach

Tax Court:

- **SJTC exhibits characteristics of both:**
  - An **operating company** (selling logs)
  - An **investment/holding company** (owning timberlands)
- **Does not fit neatly into either category**
- A **blended valuation approach** is appropriate:
  - Consideration of both **earnings** and **underlying assets**
  - Each component should be **weighted appropriately**
- Further **fact-based analysis** is required to determine the correct weighting

Estate of Jones - Control & Liquidity Considerations

- In *Estate of Jones*, the interest being valued was **noncontrolling.**
- No plans to **sell land or liquidate** SJTC.
- Asset-based valuation assumes **access to asset value via sale**, which may not be realistic.
  - Estate of *Giustina v. Commissioner*, 586 F. App'x 417 (9th Cir. 2014)
    - Court rejected hypothetical liquidation scenarios
    - Remanded for valuation based on **going concern**

Cecil v. Comm'r., T.C. Memo. 2023-24

Asset vs. Earnings-Based Valuation

- TBC is an **operating company**, not a holding company.
- **Earnings** are the best measure of fair market value—not underlying assets.
  - *Estate of Ford v. Commissioner*, T.C. Memo. 1993-580
- Mr. Morrison's **asset-based approach** rejected:
  - Inconsistent with **USPAP Standards Rule 9-3**
  - No realistic path to liquidation by minority shareholders

Cecil v. Comm'r., T.C. Memo. 2023-24

Valuation Approaches

	Adams		Hawkins		Morrisson	
Income Approach	DCF	*Wgt.*	Capitalized Net Cash Flow	*Wgt.*	DFBM (2)	*Wgt.*
Value	$12,900,084	*50%*	$10,865,400	*50%*	$12,931,000	
			Seam Adj. 24.65		Seam Adj. 17.6%	
			$13,638,300		$36,000,000 (3)	*90%*
Market Approach	GPC		GPC			
Value	$15,058,134	*25%*	$15,848,150	*50%*		
	Guideline Transactions (1)					
Value	$17,372,926	*25%*				
Asset Approach					NAVM	
					$92,000,000 (4)	*10%*
MMIV/sh	$1,456		$1,474		$4,160	

Cecil v. Comm'r., T.C. Memo. 2023-24

Fair Market Value

	Adams	Hawkins	Morrisson		
MMIV/sh	$1,456	$1,474	$4,160		
Discount for Lack of Marketability	30%	25%	19%-Class A 22% -Cl. B smll blck 27% Cl. B larae blck		
Fair Market Value					
	w/ Tax Affect'g				
Class A Common	$ 1,019	$ 1,131	$ 4,000	*$3,400.00*	(5)
Class B Common	$ 1,019	$ 1,108			
Small block			$ 3,276		
Large block			$ 3,066		

(1) Includes 20% LOC discount

(2) Defined Future Benefits Method. Seam adjusted DCF plus nonoperating assets (on noncontrolling but liquid basis).

(3) Added non-operating assets of $20.8 million (discounted for LOC).

(4) Includes 38.6% LOC discount.

(5) Correctly rounded

Cecil v. Commissioner – Valuation Approach

- Court upheld **Mr. Adams's use of the Discounted Cash Flow (DCF) method** for valuing TBC stock.
- **Respondent agreed** with DCF method but proposed adding more nonoperating assets:
  - Installment note from West Range transaction
  - Shareholder accounts receivable
  - Busbee Mountain
- Court **disagreed**: only **excess debt-free working capital** added value to TBC stock.

Shareholder Intent & Family Control

- **Liquidation of TBC deemed highly unlikely:**
  - Would require acquiring more shares, persuading others, or waiting for heirs
- **Credible testimony** from family members confirmed intent to retain ownership
- **2009 Shareholders' Agreement** and **1999 Voting Trust:**
  - Restricted stock transfers outside the family
  - Annual meetings used to:
    - Minimize internal disputes
    - Prevent rogue sales
    - Preserve TBC as a family asset

Final Valuation Considerations

- **Net Asset Value (NAV)** calculated **at $146,587,000**
- NAV assumes **marketable, liquid, controlling interest**
- Subject stock was **nonmarketable, illiquid, and noncontrolling**
- **IRS appraiser's valuation assigned zero weight** by the court

Pierce v. Commssioner T.C.Memo. 2025-29

- Operating Business
- Both Appraisers (taxpayer's and IRS')used DCF
- Valuing a Noncontrolling Interest
- Both Appraisers determined a 100% control value by DCF and by adding back Nonoperating Assets; then, applied discounts.
  - <u>No adjustments were made to expenses or capital structure</u>
  - This a non-controlling basis value
    - No discount for lack of control since value is already on a noncontrolling basis
    - In such case nonoperating assets should NOT be added back.
    - *See Giustina* and *Estate of Jones*

Pierce - Nonoperating Assets in Valuation

- Final component: **Add value of nonoperating assets** not captured elsewhere
- Supported by:
  - *Estate of Maggos*
  - *Estate of Kaufman*
  - *Estate of Renier*
  - All of the above are Controlling Interests
- Example:
  - Business has **$100 cash on hand** at valuation date
  - **Working capital need** is $50
  - **Excess cash** of $50 is classified as a **nonoperating asset**

Case References Supporting DCF Method

- **Estate of True, Estate of Maggos, Estate of Jackson,** and **Estate of Hendrickson** support the use of DCF
- Notes:
  - *Estate of True and Estate of Jackson* do **not** discuss nonoperating assets—only the DCF method
  - *Estate of Maggos:* Petitioner held 56.7% interest in Pepsi-Cola Alton Bottling, Inc.
  - *Estate of Hendrickson:* Decedent owned 49.97% of a small Indiana bank; **interest deemed controlling by the Court**

Estate of True v. Comm'r. T.C. Memo. 2001-167

- For estate tax purposes, the property being valued is the **interest owned by the decedent** at death (IRC §2031).
- Valuation focuses on the **degree of control** in the decedent's interest, **not** the control passed to heirs.
  - *Estate of Chenoweth v. Commissioner,* 88 T.C. 1577 (1987)
- The **hypothetical willing buyer–willing seller test** is objective:
  - Identity and prior holdings of the transferee are **not considered**
  - *Estate of Watts v. Commissioner*, 823 F.2d 483 (11th Cir. 1987)
  - *Estate of Bright v. United States*, 658 F.2d 999 (5th Cir. 1981)

Estate of True – Discount Considerations

weaver
Assurance · Tax · Advisory

- **Restricted stock studies** are more relevant than **pre-IPO studies**:
  - True Oil interests are subject to **state law transfer restrictions**
  - True Oil is **not comparable** to a company nearing IPO
- **Marketability discount** adjusted:
  - Proposed 40% discount reduced to **30%**
  - Adjustment due to **improper reliance** on True Oil’s buy-sell agreement by taxpayer’s appraiser

Estate of Gallo v, Comm'r. T.C.Memo. 1985-363

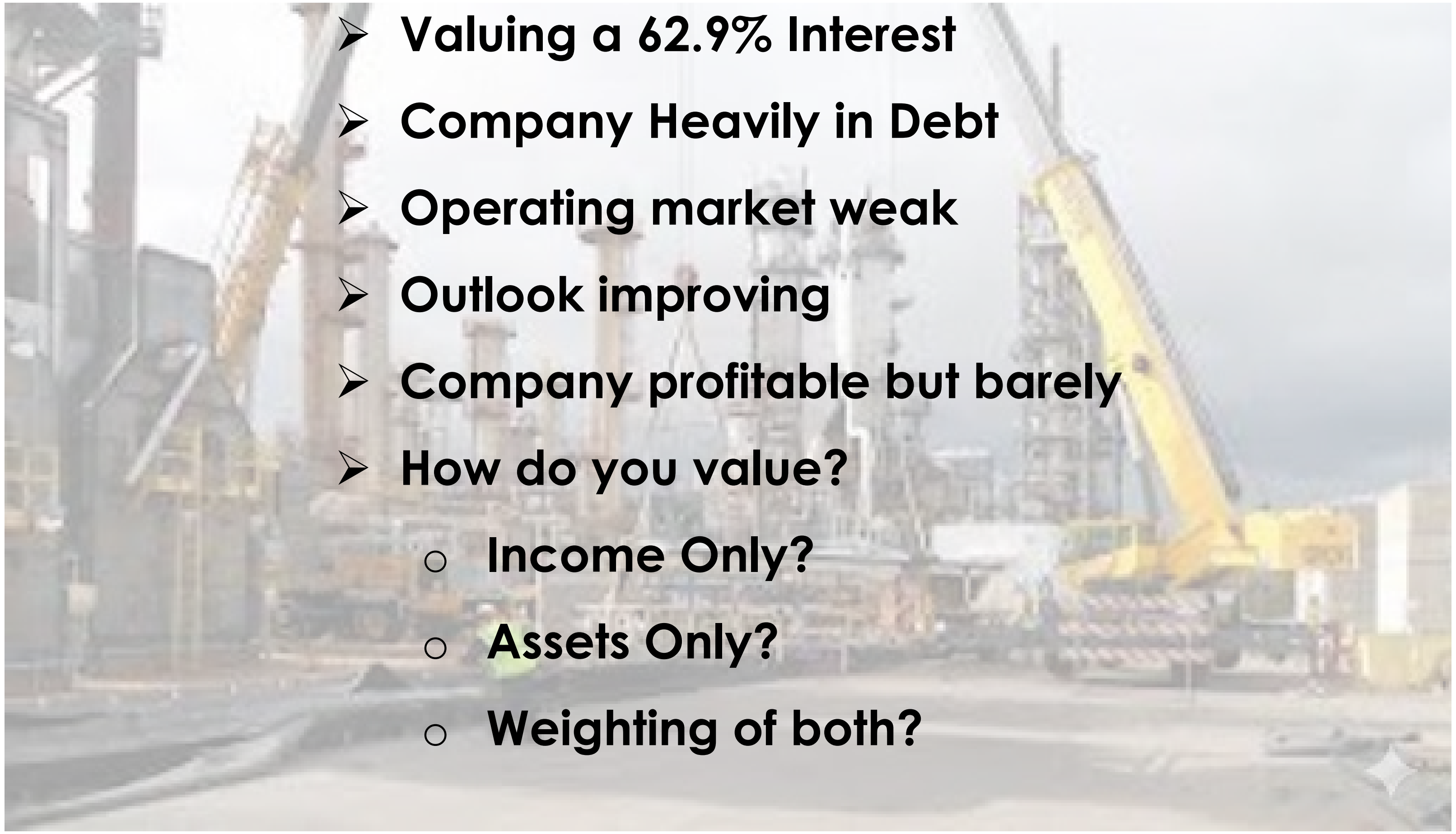
- **Respondent's primary argument:**
  - Lehman Brothers **focused too heavily on earnings** in its valuation of Gallo.
- **No dispute** that earnings are **more important than assets** for valuing Gallo.
- **Criticism:** Lehman Brothers **ignored asset value entirely.**
  - Cited: *Estate of Andrews v. Commissioner,* 79 T.C. 938, 945 (1982)

Estate of Gallo – Asset Value Consideration

- **Lehman Brothers did not ignore asset value:**
  - Concluded Gallo's **asset value was insufficient** to support a valuation above the price-earnings method.
- **Lehman did not appraise Gallo's assets,** but neither did Desmond (except for land).
- Unlike *Estate of Andrews*:
  - This case **does not involve a situation** where **net asset value per share exceeded** the earnings-based valuation.
- **Conclusion:** Earnings-based valuation was appropriate given the facts and asset profile.

Estate of Beatrice Dunn v. Comm'r. TCM. 2000-12

Estate of Beatrice Dunn v. Comm'r. TCM. 2000-12

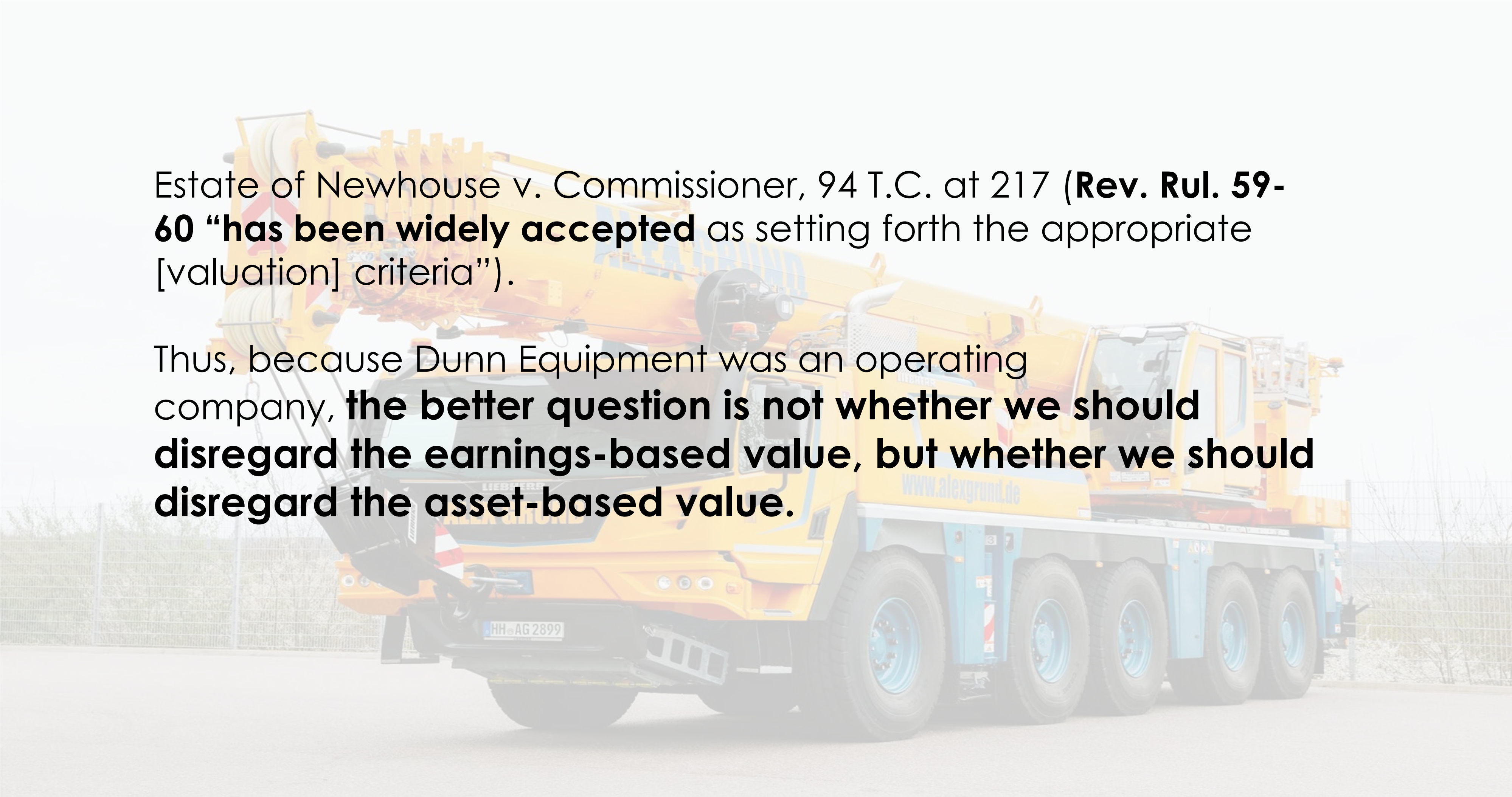


- Valuing a 62.9% Interest
- Company Heavily in Debt
- Operating market weak
- Outlook improving
- Company profitable but barely
- How do you value?
  - Income Only?
  - Assets Only?
  - Weighting of both?

Estate of Beatrice Dunn v. Comm'r. TCM. 2000-12

We find that the value of Dunn Equipment is best represented by a combination of an earnings-based value using capitalization of net cash-flow and an asset-based value using fair market value of assets, with an appropriate discount for lack of marketability and lack of super-majority control.

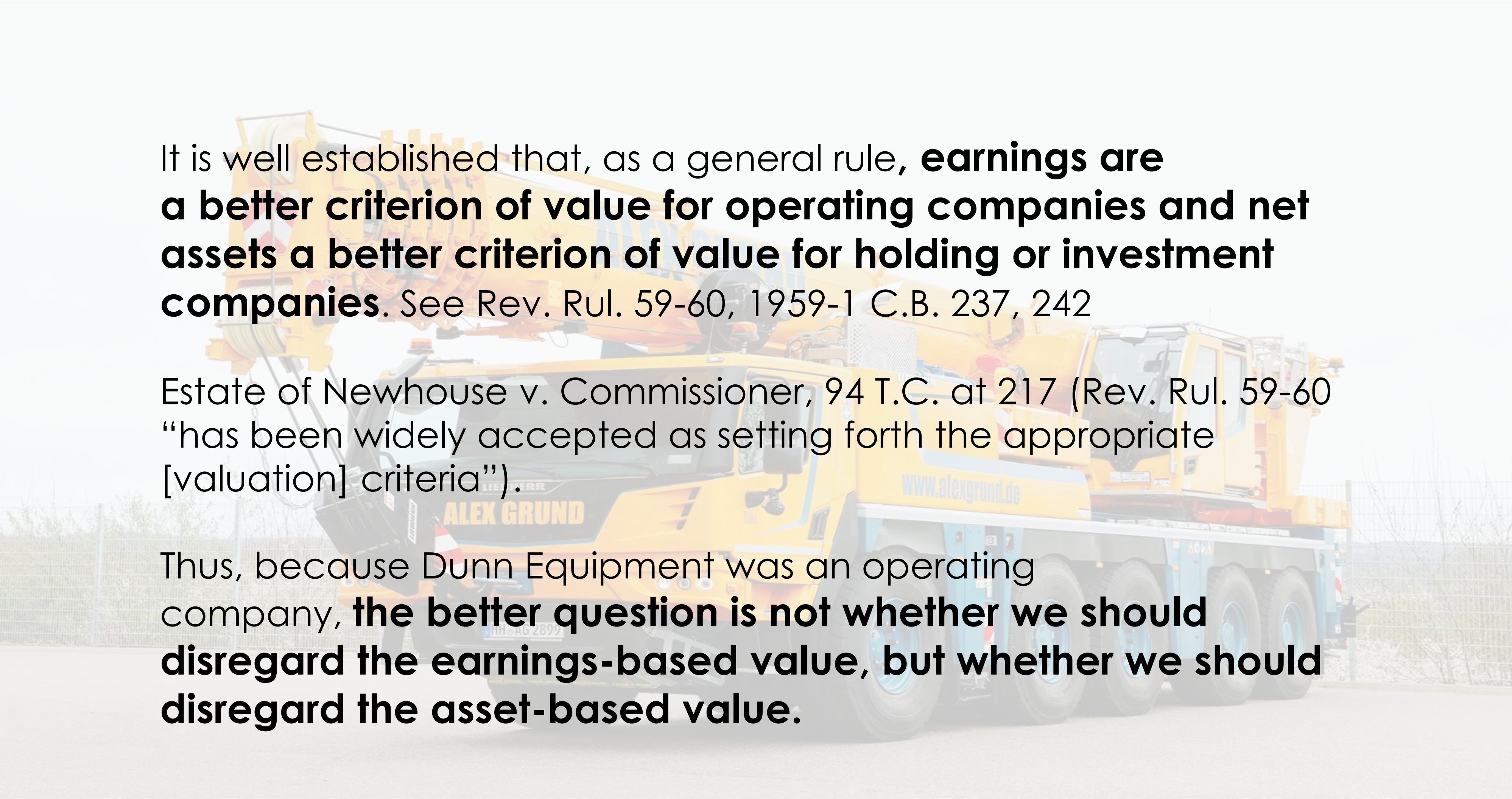
It is well established that, as a general rule, **earnings are a better criterion of value for operating companies and net assets a better criterion of value for holding or investment companies**. See Rev. Rul. 59-60, 1959-1 C.B. 237, 242



Estate of Newhouse v. Commissioner, 94 T.C. at 217 (**Rev. Rul. 59-60 "has been widely accepted** as setting forth the appropriate [valuation] criteria").

Thus, because Dunn Equipment was an operating company, **the better question is not whether we should disregard the earnings-based value, but whether we should disregard the asset-based value.**

Estate of Beatrice Dunn v. Comm'r. TCM. 2000-12



It is well established that, as a general rule, **earnings are a better criterion of value for operating companies and net assets a better criterion of value for holding or investment companies**. See Rev. Rul. 59-60, 1959-1 C.B. 237, 242

Estate of Newhouse v. Commissioner, 94 T.C. at 217 (Rev. Rul. 59-60 "has been widely accepted as setting forth the appropriate [valuation] criteria").

Thus, because Dunn Equipment was an operating company, **the better question is not whether we should disregard the earnings-based value, but whether we should disregard the asset-based value.**

Estate of Dunn v. Commissioner, 301 F.3d 339 (5th Cir. 2002),

Despite having concluded that "the hypothetical investor would give earnings value substantial weight" and acknowledging "that, as a general rule, earnings are a better criterion of value for operating companies [which Dunn Equipment is]

and

net assets a better criterion of value for holding or investment companies [which Dunn Equipment is not],"

the Tax Court **confected** the weighting factor of its valuation method by assigning a weight **of 35% to earnings-based value** and **65% to asset-based value**

Estate of Dunn v. Commissioner, 301 F.3d 339 (5th Cir. 2002)

- **Fifth Circuit held:**
  - **Weight Income Approach by 85%**
  - **Weight Asset Approach by 15%**
    - **But only after deducting Built-in Capital Gains taxes dollar for dollar**

We hold as a matter of law that the built-in gains tax liability of this particular business's assets must be considered as a dollar-for-dollar reduction when calculating the asset-based value of the Corporation, just as, conversely, built-in gains tax liability would have no place in the calculation of the Corporation's earnings-based value.

Revenue Ruling 59-60

- Section .02 (c)
  - Consideration also should be given to any assets **not essential to the operation of the business, such as investments in securities, real estate, etc.** In general, such nonoperating assets will command a lower rate of return than do the operating assets, although in exceptional cases the reverse may be true.

Revenue Ruling 59-60

- SEC. 7. AVERAGE OF FACTORS.

- Because valuations cannot be made on the basis of a prescribed formula, **there is no means whereby the various applicable factors in a particular case can be assigned mathematical weights…**no useful purpose is served by taking an average of several factors (for example, book value, capitalized earnings and capitalized dividends)…**Such a process excludes active consideration of other pertinent factors**, and the end result cannot be supported by a realistic application of the significant facts in the case except by mere chance.

- BVS- III Asset-Based Approach
  - **Valuations of particular ownership interests in an enterprise may or may not require the use of the asset-based approach.**
  - The asset-based approach should not be the sole appraisal approach used in assignments relating to operating companies appraised as going concerns unless this approach is customarily used by sellers and buyers. In such cases, the appraiser must support the selection of this approach.

AICPA – Valuation Services

- **Statement on Standards for Valuation Services No. 1**
  - When valuing a controlling ownership interest under the income approach, the value of any *non-operating assets*, non-operating liabilities, or *excess or deficient operating assets* should be excluded from the computation of the value based on the operating assets and **should be** added to or deleted from the value of the operating entity. **When valuing a non-controlling ownership interest under the income approach, the value of any non-operating assets, non-operating liabilities, or excess or deficient operating assets may or may not be used to adjust the value of the operating entity depending on the valuation analyst's assessment of the influence exercisable by the non-controlling interest.** In the asset-based or cost approach, it may not be necessary to separately consider non-operating assets, non-operating liabilities, or excess or deficient operating assets.

Valuing a Business –Pratt et al (6th Edition)

- **Nonoperating Assets (Pg. 298)**
  - "…it often makes a significant difference whether one is valuing a **noncontrolling interest or a controlling interest**. It is also important to know, if possible, **the likelihood of the sale of the assets**. The market attributes very little weight to non-income producing, nonoperating assets unless they are likely to be sold *[and the proceeds distributed to the equityholders]."*

    \- words in italics mine

Business Valuation and Federal Taxes – Pratt and Laro (2nd. Ed.)

weaver
Assurance · Tax · Advisory

- **Separating Nonoperating Items from Operating Items (Pg. 134)**
  - Some argue for not reclassifying nonoperating items when valuing minority interests. The minority stockholder does not have the power to liquidate the assets; therefore, **reclassifying nonoperating items and adding back their value would usually result in overvaluation for a minority shareholder.**
  - An alternative for minority interest valuations would be to find the fair market value of non operating assets, net of a minority interest discount, and add it to the value of the operating company.

Valuation Methodology: Discounted Cash Flow (DCF)

- The **income approach**, specifically the **discounted cash flow (DCF) method**, is the appropriate method to value [a company].
- DCF determines business value by summing:
  - Present value of projected cash flows over a discrete period
  - Present value of the terminal value
  - Value of nonoperating assets
- Key components required for DCF valuation:
  - **Projected future cash flows** for a discrete period
  - **Discount rate** to determine present value of future distributions
  - **Terminal value** of the company
  - **Nonoperating assets [when valuing a company].**

Estate of Gallo – Asset Value Skepticism

- **Desmond's report** was the only source of asset value evidence for Gallo.
- Court expressed **skepticism** about Desmond's asset valuations.
- Even Desmond gave **little weight** to his adjusted book value:
- At trial: *"Those assets are worth what they'll earn. If they're not producing wine, those assets aren't worth anything at all."*
- **Key principle:**
  - Asset value may be considered, but **no weight needs to be assigned** if doing so would be **unreasonable.**

weaver

Assurance • Tax • Advisory

Will Frazier, FASA

Managing Director, Financial Advisory

Valuation Advisory Services

will.frazier@weaver.com

832-320-7930