

# Internal Revenue Service Accepts Minority Interest Discounts

by Thomas E. Pastore

One of the most litigious issues between the Internal Revenue Service (“IRS”) and tax payers is the application of minority interest discounts to partial ownership interests in closely-held businesses and family assets. In the past, the IRS has tried to argue that minority interest discounts do not apply to partial ownership interests held by family members. As an example, the IRS would take the position that a 20% interest in a \$10 million company would have a fair market value of \$2 million. The taxpayer would contend that a *minority discount*, for example 30%, should be applied to determine a fair market value of \$1.4 million.

The IRS has changed its position on minority interest discounts over time. On January 26, 1993, the IRS issued Revenue Ruling 93-12 which states that a minority discount will not be disallowed solely because a transferred interest, when aggregated with interest held by

family members, would be part of a controlling interest. This ruling has important implications for owners of closely-held businesses as well as for high net worth individuals and families.

Prior to the issuance of Revenue Ruling 93-12, the IRS attempted to enforce Revenue Ruling 81-253. Revenue Ruling 81-253 held that, ordinarily, no minority shareholder discount would be allowed with respect to transfers of shares of stock between family members if, based upon a composite of the family members’ interests at the time of transfer, control of the corporation existed in the family unit. In essence, the IRS attributed the control held by the family as a whole to each family member’s partial interest.

In spite of Revenue Ruling 81-253, key court cases upheld the application of minority interest discounts to family ownership interests. In the *Estate of Bright v. United States*, 658 F. 2d 999 (5th Cir. 1981), the court held that because community-owned shares were subject to partition, the decedent’s own interest was equivalent to 27.5% of the outstanding shares and, therefore, should be valued as a minority interest. In *Propstra v. United States*, 680 F. 2d 1248 (9th Cir. 1982), the district court maintained that the estate was entitled to a discount on the undivided one-half interest in several pieces of real estate owned by the deceased and his wife as a community property. The *Estate of Andrews v. Commissioner*, 79 T.C. 938 (1982) and *Estate of Lee v. Commissioner*, 69 T.C. 860 (1978), nonacq., 1980-2 C.B. 2. are two cases in which the courts held that corporation shares owned by other family members cannot be attributed to an individual family member for determining whether shares should be valued as a controlling interest of the corporation.

As a result of these cases and the issuance of Revenue Ruling 93-12, Revenue Ruling 81-253 has been revoked. If a proper appraisal is performed, time consuming and costly litigation with the IRS can be avoided when attributing a minority interest discount to a family member’s interest. Minority interest discounts should not be taken for granted. Estate and gift taxes can be as high as **55%** of the value of wealth transferred during life and at death. To preserve assets with the family, private business owners and high net worth individuals should retain a fully qualified appraiser as part of the strategic wealth planning process.

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