Office of Chief Counsel
Internal Revenue Service
Memorandum

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subject:

Gift Tax Examination

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Donor =
Corporation A =
Corporation B =
Trust =
Shares =
Date 1 =
Date 2 =

ISSUE

Whether, under the circumstances described below, the hypothetical willing buyer and seller of shares in a publicly-traded company would consider a pending merger when valuing stock for gift tax purposes.

CONCLUSION

Yes. Under the fair market value standard, the hypothetical willing buyer and seller of a publicly-traded company would consider a pending merger when valuing stock for gift tax purposes.

FACTS

Donor is a co-founder and Chairman of the Board of Corporation A, a publicly-traded corporation. On Date 1, Donor transferred Shares to Trust, a newly-formed grantor retained annuity trust with a term, with a remainder to his children. later on Date 2, after the market closed, Corporation A announced a merger with Corporation B. The merger was the culmination of negotiations with multiple parties, and then, before the Date 1 transfer, exclusive negotiations with Corporation B.

On the day of trading after the merger was announced, the value of the Corporation A stock increased substantially, though less than the agreed merger price. The merger was consummated more than after Date 1.

The Internal Revenue Service has reviewed the underlying transaction documents from the year preceding the merger. Such documents include the Corporation A and Corporation B exclusivity agreement, correspondence between Corporation A and Corporation B, and Board meeting minutes. The record as compiled to date supports the position that, as of Date 1, the hypothetical willing buyer of the stock could have reasonably foreseen the merger and anticipated that the price of Corporation A stock would trade at a premium

LAW

Section 2512(a) of the Code provides that if a gift is made in property, the value thereof at the date of the gift shall be considered the amount of the gift.

Section 25.2512-1 of the Gift Tax Regulations provides, in part, that if a gift is made in property, its value at the date of the gift shall be considered the amount of the gift. The value of the property is the price at which such property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and both having reasonable knowledge of relevant facts.

Section 25.2512-2(a) generally provides that the value of stocks and bonds is the fair market value per share or bond on the date of the gift.

Section 25.2512-2(b)(1) provides, in relevant part, that if there is a market for stocks or bonds, on a stock exchange, in an over-the-counter market or otherwise, the mean between the highest and lowest quoted selling prices on the date of the gift is the fair market value per share or bond.

Section 25.2512-2(e) provides, in relevant part, that in cases in which it is established that the value per bond or share of any security determined on the basis of the selling or bid and asked prices as provided under § 25.2512-2(b) does not represent the fair market value thereof, then some reasonable modification of the value determined on that basis or other relevant facts and elements of value shall be considered in determining fair market value.

The value of property for Federal transfer tax purposes is a factual inquiry wherein the trier of fact must weigh all relevant evidence and draw appropriate inferences to arrive at the property's fair market value. Bank One Corp. v. Commissioner, 120 T.C. 174 (2003), rev'd on other grounds, 458 F3d 564 (7th Cir. 2006) (citing Commissioner v. Scottish Am. Inv. Co., 323 U.S. 119 (1944)). For this purpose, fair market value is the price that a hypothetical willing buyer would pay a hypothetical willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts. Treas. Reg. § 25.2512-1; Rev. Rul. 59-60, 1959-1 C.B. 237. The valuation of property is a question of fact. See Redstone v. Commissioner, T.C. Memo. 2015-237.

The willing buyer and willing seller are hypothetical persons, rather than specific individuals or entities, and their characteristics are not necessarily the same as those of the donor and the donee. See Estate of McCord v. Commissioner, 120 T.C. 358 (2003), rev'd on other grounds, 461 F3d 614 (5th Cir. 2006); Estate of Newhouse v. Commissioner, 94 T.C. 193 (1990). The hypothetical willing buyer and willing seller are presumed to be dedicated to achieving the maximum economic advantage. Newhouse, 94 T.C. at 218.

The principle that the hypothetical willing buyer and seller are presumed to have "reasonable knowledge of relevant facts" affecting the value of property at issue applies even if the relevant facts at issue were unknown to the actual owner of the property. Estate of Kollsman v. Commissioner, T.C. Memo. 2017-40, appeal docketed, No. 18-70565 (9th Cir. Feb. 27, 2018). Moreover, both parties are presumed to have made a reasonable investigation of the relevant facts. Id. Thus, in addition to facts that are publicly available, reasonable knowledge includes those facts that a reasonable buyer or seller would uncover during the course of negotiations over the purchase price of the property. Id. Moreover, a hypothetical willing buyer is presumed to be "reasonably informed" and "prudent" and to have asked the hypothetical willing seller for information that is not publicly available. Estate of Kollsman, supra.

Generally, a valuation of property for Federal transfer tax purposes is made as of the valuation date without regard to events happening after that date. Ithaca Trust Co. v. United States, 279 U.S. 151 (1929). Subsequent events may be considered, however, if they are relevant to the question of value. Estate of Noble v. Commissioner, T.C. Memo. 2005-2, n.3. Federal law favors the admission of probative evidence, and the test of relevancy under the Federal Rules of Evidence is designed to achieve that end. Id. Thus, a post-valuation date event may be considered if the event was reasonably foreseeable as of the valuation date. Trust Services of America, Inc. v. U.S., 885 F.2d 561, 569 (9th Cir. 1989); Bank One Corp., 120 T.C. 174, 306. Furthermore, a post-valuation date event, even if unforeseeable as of the valuation date, also may be probative of the earlier valuation to the extent that it is relevant to establishing the amount that a hypothetical willing buyer would have paid a hypothetical willing seller for the subject property as of the valuation date. See Estate of Gilford v. Commissioner, 88 T.C. 38, 52-55 (1987).

In Silverman v. Commissioner, T.C. Memo. 1974-285, aff'd, 538 F.2d 927 (2d Cir. 1976), cert. denied, 431 U.S. 938 (1977), the petitioners gifted shares of preferred stock while in the process of reorganizing with the intent to go public. The Tax Court rejected the expert testimony presented by the petitioners because the expert failed to take into account the circumstances of the future public sale.

In Ferguson v. Commissioner, 174 F.3d 997 (9th Cir. 1999), aff'g 108 T.C. 244 (1997), the appellate court considered the issue of whether the Tax Court correctly held that taxpayers were liable for gain in appreciated stock under the anticipatory assignment of income doctrine. In Ferguson, taxpayers owned 18 percent of AHC and served as officers and on the board of directors. In late 1987 and early 1988, the AHC board of directors contacted and eventually authorized Goldman, Sachs & Co. to find a purchaser of AHC and to assist in the negotiations. By July 1988, Goldman, Sachs had found four prospective purchasers. Shortly thereafter, AHC entered into a merger agreement with DCI Holdings, Inc. With the taxpayers abstaining from the vote, the AHC board unanimously approved the merger agreement. On August 3, 1988, the tender offer was started. On August 15, taxpayers with the help of their broker executed a donation-in-kind record with respect to their intention to donate stock to a charity and two foundations. On September 9, 1988, the charity and the foundations tendered their stock. On September 12, 1988, the final shares were tendered and on October 14, 1988, the merger was completed. The court concluded that the transfers to charity and the foundations occurred after the shares in AHC had ripened from an interest in a viable corporation into a fixed right to receive cash and the merger was "practically certain" to go through. In particular, the court noted that "[t]he Tax Court really only needed to ascertain that as of [the valuation] date, the surrounding circumstances were sufficient to indicate that the tender offer and the merger were practically certain to proceed by the time of their actual deadlines - several days in the future." Ferguson, 174 F.3d at 1004. Consequently, the assignment of income doctrine applied and the taxpayers realized gain when the shares were disposed of by charity and the foundations.

The current case shares many factual similarities with Ferguson, including the targeted search by the Board of Directors of Corporation A to find merger candidates, the exclusive negotiations with Corporation B immediately before the final agreement, the generous terms of the merger, and an agreement that was "practically certain" to go through. While the Ferguson opinion deals exclusively with the assignment of income doctrine, it also relies upon the proposition that the facts and circumstances surrounding a transaction are relevant to the determination that a merger is likely to go through. See Bank One and Kollsman, supra. The current case presents an analogous issue, that is, whether the fair market value of the stock should take into consideration the likelihood of the merger as of the Date 1 transfer of Shares to Trust. The Ferguson and Silverman opinions, as considered by the Tax Court and the Second and Ninth Circuit Courts of Appeal, support the conclusion that the value of stock in Corporation A must take into consideration the pending merger. Accordingly, a value determined on the basis of the selling price as provided under § 25.2512-2(b) does not represent the fair market value of Shares as of the valuation date; pursuant to § 25.2512-2(e), other relevant facts and elements of value must be considered in determining fair market value. Under the fair market value standard as articulated in § 25.2512-1, the hypothetical willing buyer and willing seller, as of Date 1, would be reasonably informed during the course of negotiations over the purchase and sale of Shares and would have knowledge of all relevant facts, including the pending merger. Indeed, to ignore the facts and circumstances of the pending merger would undermine the basic tenets of fair market value and yield a baseless valuation.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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Please call (202) 317-4628 if you have any further questions.