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# NOTES

## INVERSE BLOCKAGE—VALUATION OF CONTROL BLOCKS OF LISTED SECURITIES FOR FEDERAL ESTATE TAX PURPOSES

### INTRODUCTION

Occasionally the gross estate of a decedent contains a large block of listed<sup>1</sup> corporate securities. Consequently, the estate's administrator has the task of computing the federal estate tax applicable to the block. The appropriate method for valuing such large blocks of stock repeatedly has been the subject of litigation<sup>2</sup> following enactment of the Federal Estate Tax in 1916.<sup>3</sup> Since 1954, valuation problems for federal estate tax purposes<sup>4</sup> have been governed by section 2031(a) of the Internal Revenue Code. The section's language provides:

The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or *intangible*, wherever situated.<sup>5</sup>

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1. Listed securities as used in this note refers to corporate stock which is traded on either a stock exchange or on the over-the-counter market.

2. See, *e.g.*, *Helvering v. Safe Deposit & Trust Co.*, 95 F.2d 55 (4th Cir. 1938); *Schnorbach v. Kavanagh*, 120 F. Supp. 828 (W.D. Mich. 1951); *Estate of Bernon S. Prentice*, 25 P-H Tax Ct. Mem. 11 (1956).

3. Revenue Act of 1916, ch. 463, § 202, 39 Stat. 777.

4. The United States Supreme Court stated: "The gift tax was supplementary to the estate tax. The two are in *pari materia* and must be considered together." *Estate of Sanford v. Commissioner*, 308 U.S. 39, 44 (1939). Reference may, therefore, be made to various gift tax valuation cases throughout this note. Although the note may be equally relevant to some gift tax valuation problems, no attempt is made to include them. This note is addressed solely to the valuation of listed corporate securities under the federal estate tax provisions of § 2031(a) of the 1954 Internal Revenue Code.

5. INT. REV. CODE OF 1954, § 2031(a). (Emphasis added.) This section is substantially unchanged from the 1916 Act. See note 3 *supra*.

Value has been held to mean "fair market value" by both the regulations, *Treas. Reg.* § 20.2031-2(e) (1958), and the courts. See, *e.g.*, *Cecil H. Gamble*, 33 B.T.A. 94, 99 (1935), *aff'd*, 101 F.2d 565 (6th Cir.), *cert. denied*, 306 U.S. 664 (1939). The term "fair market value" has come to have a definite meaning. ANGELL, *CURRENT PROBLEMS IN FEDERAL TAXATION* 3 (3rd rev. ed. 1957). The present regulations provide that:

The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts.

*Treas. Reg.* § 20.2031-2(b) (1958). Although there is varying judicial language which defines "fair market value" more colorfully, it does little to clarify the term. See *Phillips v. United States*, 12 F.2d 598, 601 (W.D. Pa. 1926), where the court stated:

This [fair market value] may be defined to be the value of the property in

The section's language is applicable to valuing blocks of securities included within a decedent's gross estate.

Valuation is concerned with determining the fair market value. Traditionally, courts use two phrases for describing appropriate methods for valuing blocks of securities: (1) Market value; and (2) blockage. The method to be used—as will subsequently be shown—depends upon the particular factual context.

A third method for valuing blocks of stock is indicated by language in regulation 20.2031-2(e) which provides:

*Where selling prices or bid and asked prices do not reflect fair market value. . . . [I]f the block of stock to be valued represents a controlling interest, either actual or effective, in a going business, the price at which other lots change hands may have little relation to its true value.<sup>6</sup>*

This note designates this "third method"<sup>7</sup> as "inverse blockage" because the effect of the valuation is inverse to the typical blockage situation.

In the typical blockage situation, X dies leaving 100,000 shares of United Oblets common stock. The stock is traded on a national exchange and approximately 200,000 shares are sold each year. The market cannot absorb decedent's 100,000 share block without depressing the market price. Therefore, because the number of shares to be valued is large in relation to the number of shares traded, the block's value will be reduced for federal estate tax purposes to the depressed market price.

Unlike the typical blockage situation described above, inverse blockage involves a control element. Assume X dies leaving fifty plus per cent of United Iblets stock. Because this block represents control of the

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money as between one who wishes to purchase and one who wishes to sell; a price at which a seller willing to sell at a fair price, and a buyer willing to buy at a fair price, both having reasonable knowledge of the facts.

In *Ithaca Trust Co. v. United States*, 279 U.S. 151, 155 (1929), Justice Holmes said: "But the value of property at a given time depends upon the relative intensity of the social desire for it at the time, expressed in the money that it would bring in the market." A valuation figure predicated on "speculation" and not sound business judgment and logic is not a "fair market value." *ANGELL, op. cit. supra* at 4. The courts have rejected "speculative value" in a variety of valuation cases. *Helvering v. Tex-Penn Oil Co.*, 300 U.S. 481, 499 (1937); *United States v. Safety Car Heating & Lighting Co.*, 297 U.S. 88, 98 (1936); *Burnet v. Logan*, 283 U.S. 404, 413 (1931); *Humes v. United States*, 276 U.S. 487, 494 (1928). Compare *In re Hill's Estate*, 193 F.2d 734 (2d Cir. 1952), where the court stated that even though a right under valuation was "speculative," it was "better a fair guess than the one answer sure to be wrong."

6. Treas. Reg. § 20.2031-2(e) (1958).

7. See Treas. Reg. §§ 20.2031-2(b)—20.2031-2(e) (1958). In reality, probably only one method of valuation exists with an unlimited number of factors to be considered. For simplicity this one method may be subdivided into three branches—market value, blockage, and inverse blockage. All will be explained later.

corporation it can be sold at a higher price than a large non-control block or individual shares. The control block's value may therefore be greater than the market price for federal estate tax purposes.

The above situation comes within regulation 20.2031-2(e). Following issuance of the regulation in 1958, no decisions involving the inverse blockage valuation method have been reported.

This note discusses situations in which the inverse blockage method for valuing blocks of securities is applicable, and attempts to analyze various problems which confront the practitioner when computing the federal estate tax on large blocks passing through a decedent's estate. Prior to an analysis of inverse blockage, and to put inverse blockage in proper context, a brief review of the market value and the blockage methods of valuation is necessary.

### *Market Value*

Under the market value method of valuation, the stock is valued at the stock exchange<sup>8</sup> sales price at or near the valuation date.<sup>9</sup> In the absence of sales, the median of the "bid" and "asked" prices at or near the valuation date are used.<sup>10</sup> The total number of shares held are multiplied by the determined unit price to arrive at the value of the block. The market value method is used where X dies leaving 100 shares of stock in United Oblets. United Oblets stock is traded on a national exchange, and approximately 10,000 shares are sold every day. The stock is valued at the market price.

The market value method gained judicial acceptance prior to the passage of the 1916 Federal Estate Tax Act. The Illinois Supreme Court,<sup>11</sup> in dealing with a stock valuation problem for state inheritance tax purposes,<sup>12</sup> considered the often speculative nature of the stock ex-

8. Stock exchange, as used in this note, refers to any place where stock is traded whether it be on a regular exchange or on the over-the-counter market.

9. If there is a market for stocks . . . on a stock exchange, in an over-the-counter market, or otherwise, the mean between the highest and lowest quoted selling prices on the valuation date is the fair market value per share. . . . If there were no sales on the valuation date, but there were sales on dates within a reasonable period both before and after the valuation date, the fair market value is determined by taking a weighted average. . . .

Treas. Reg. § 20.2031-2(b) (1958).

10. If 20.2031-2(b) is not applicable:

[T]he fair market value may be determined by taking the mean between the bona fide bid and asked prices on the valuation date, or if none, by taking a weighted average [of the bid and asked prices before and after the valuation date]. . . .

Treas. Reg. § 20.2031-2(c) (1958). *Accord*, Treas. Reg. § 20.2031-2(d) (1958).

11. *Walker v. People*, 192 Ill. 106, 61 N.E. 489 (1901).

12. An inheritance tax "is a tax imposed upon the privilege of receiving property from a decedent at death" whereas an estate tax "is a tax imposed upon the privilege of transmitting property at death." LOWNDES & KRAMER, *ESTATE AND GIFT TAXES* 2 (2d

change. The court held that, even in light of the inherent nature of the exchange, over a period of time the market value would furnish the best indicia of value for all purposes.<sup>13</sup> The court stated:

The competition of sellers and buyers, most of them careful and vigilant to take account of everything affecting value of stock in which they deal, and each mindful of his own interests, and seeking for some personal gain and advantage, will almost universally, if time sufficient be taken, furnish the true measure of the actual value of the stock.<sup>14</sup>

The market value method, having the "administrative advantage of certainty"<sup>15</sup> has been accepted by both the courts<sup>16</sup> and the regulations.<sup>17</sup>

### Blockage

Blockage has the effect of reducing the stock's value below that of the market price. It is primarily used where relatively few shares of stock are traded in the existing market in comparison with the size of the block of stock to be valued. This situation destroys or seriously affects the weight given the market price as competent evidence of value.<sup>18</sup> Blockage is based on the economic theory of supply and demand: "Where the former [supply of stock] far exceeds the latter [demand for the stock on the market], it [the block of stock to be valued] has a depressing effect upon value."<sup>19</sup>

In reviewing blockage in a stock valuation case for federal estate tax purposes, the Fourth Circuit Court of Appeals<sup>20</sup> stated: "It [The Board of Tax Appeals] could not ignore the pregnant fact, having found it to exist, that a large block of stock cannot be marketed and turned into

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ed. 1962). Although a difference exists between the two taxes the court's reasoning would apply equally to federal estate taxes.

13. Walker v. People, *supra* note 11, at 112, 61 N.E. at 491.

14. *Ibid.*

15. Joseph Soss, 9 P-H Tax Ct. Mem. 861 (1940); see Estate of Daniel Guggenheim, 39 B.T.A. 251 (1939).

16. See, e.g., Maytag v. Commissioner, 187 F.2d 962, 965 (10th Cir. 1951); Mott v. Commissioner, 139 F.2d 317 (6th Cir. 1943); Bull v. Smith, 119 F.2d 490 (2d Cir. 1941); Estate of Leonard B. McKitterick, 42 B.T.A. 130 (1940); John J. Newberry, 39 B.T.A. 1123 (1939).

17. Treas. Reg. §§ 20.2031-2(b)—20.2031-2(d) (1958).

18. See Laird v. Commissioner, 85 F.2d 598 (3rd Cir. 1936); Safe Deposit & Trust Co., 35 B.T.A. 259, 263 (1937), *aff'd*, 95 F.2d 806 (4th Cir. 1938); William S. Gordon, 33 B.T.A. 460 (1935); T. B. Hoffer, 24 B.T.A. 22 (1931); James Couzens, 11 B.T.A. 1040, 1161 (1928).

19. Commissioner v. Shattuck, 97 F.2d 790, 792 (7th Cir. 1938).

20. Helvering v. Safe Deposit & Trust Co., 95 F.2d 806 (4th Cir. 1938).

money as readily as a few shares."<sup>21</sup> Although the blockage method of valuation was criticized on several occasions,<sup>22</sup> it became established as a valuation method in the early forties.<sup>23</sup> Finally in 1958 it was officially recognized by the Internal Revenue Service in the following provision:

If the executor can show that the block of stock to be valued is so large in relation to the actual sales on the existing market that it could not be liquidated in a reasonable time without depressing the market, the price at which the block could be sold as such outside the usual market, as through an underwriter, may be a more accurate indication of value than market quotations.<sup>24</sup>

### INVERSE BLOCKAGE

Inverse blockage is the opposite of blockage. Both blockage and inverse blockage have their foundation in the number of shares present in a block of stock. The relationship of the three methods may be viewed as follows. A few shares are valued at the market price. As the number of shares increases in comparison to the number of shares traded, the value is reduced below the market price under blockage. A further increase in the number of shares to the point where the *block* represents control would then increase the stock's value above the market price under inverse blockage.

#### *Size as a Relevant Valuation Factor*

Administrative rulings and practices on the subject of size as a relevant factor to be used in valuing blocks of securities have varied throughout the years. In 1919 the regulations expressly forbade the consideration of the size of the holding as a factor in valuing the block of securities.<sup>25</sup> Subsequent regulations omitted any mention of the subject until again in 1934 the Internal Revenue Service expressly forbade the use of the size of the stock holding as a factor.<sup>26</sup> This provision remained in effect until the late thirties when it came under close judicial scrutiny

21. *Id.* at 812; see *Helvering v. Kimberly*, 97 F.2d 433 (4th Cir. 1938); *accord*, *Commissioner v. Shattuck*, 97 F.2d 790, 792 (7th Cir. 1938); *cf.* Cecil H. Gamble, 33 B.T.A. 94, 100 (1935), *aff'd*, 101 F.2d 565 (6th Cir.), *cert. denied*, 306 U.S. 664 (1939).

22. *Havemeyer v. United States*, 59 F. Supp. 537, 552 (Ct. Cl.), *cert. denied*, 326 U.S. 759 (1945) (dissenting opinion); *Henry F. Dupont*, 2 T.C. 246, 262 (1943) (dissenting opinion); *Bingham's Adm'r v. Commonwealth*, 196 Ky. 318, 244 S.W. 781, 789-90 (Ct. App. 1922).

23. *Helvering v. Maytag*, 125 F.2d 55, 63 (8th Cir.), *cert. denied*, 316 U.S. 689 (1942).

24. Treas. Reg. § 20.2031-2(e) (1958).

25. Treas. Reg. § 37 (1919).

26. Treas. Reg. § 80 (1934).

and was eventually rejected as being contrary to actual stock exchange practices.<sup>27</sup> In 1939 the prohibition was removed;<sup>28</sup> for the next nineteen years, the regulations made no mention of size as a relevant valuation factor. The 1939 regulation did provide, as did the previous 1934 regulation, that "All relevant facts and elements of value . . . should be considered,"<sup>29</sup> in determining the stock's "fair market value."

Even though no mention of size was made in the regulations, the size factor was not ignored by the judiciary. In 1942 the Eighth Circuit Court of Appeals<sup>30</sup> in a stock valuation case stated:

As well as any controverted questions of administrative law may be settled without declaration by the Supreme Court, it is established that the size of a block of listed stock *may be a factor* to be considered in its valuation for gift or estate tax purposes.<sup>31</sup>

In spite of this judicial pronouncement, the Internal Revenue Service continued to argue that the size of a block of stock should have no relevancy in estimating its market value.<sup>32</sup> Ultimately, size became recognized officially as a valid valuation factor in the 1958 regulations.<sup>33</sup>

### *Effect of Inverse Blockage*

Having recognized size as a factor in valuation cases, the Internal Revenue Service sought to use it as a two-edged sword. The Board of Tax Appeals, in *Frank J. Kier*,<sup>34</sup> had laid the groundwork. *Kier* involved the valuation for federal estate tax purposes of approximately three per cent of the outstanding common stock of the Standard Sanitary Manufacturing Company. Few shares were sold in the market in comparison to the estate's holdings. Blockage was sought as the proper valuation method by the petitioner. In rejecting size as a relevant factor, Judge Goodrich stated:

This theory [blockage] cuts both ways. It frequently happens that the ownership of a large block of stock controls the

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27. See, e.g., *Commissioner v. Shattuck*, 97 F.2d 790 (7th Cir. 1938); *Helvering v. Kimberly*, 97 F.2d 433 (4th Cir. 1938); *Helvering v. Safe Deposit & Trust Co.*, 95 F.2d 806 (4th Cir. 1938).

28. T.D. 4902, 1939-1 Cum. Bull. 325.

29. *Ibid.*

30. *Helvering v. Maytag*, 125 F.2d 55 (8th Cir.), *cert. denied*, 316 U.S. 689 (1942).

31. *Id.* at 63. (Emphasis added.)

32. *Commissioner v. Stewart's Estate*, 153 F.2d 17, 18 (3rd Cir. 1946); *Groff v. Munford*, 150 F.2d 825, 828 (2d Cir. 1945); *Helvering v. Maytag*, 125 F.2d 55, 60 (8th Cir.), *cert. denied*, 316 U.S. 689 (1942).

33. See Treas. Reg. § 20.2031-2(e) (1958).

34. 28 B.T.A. 633 (1933).

management and policies of the corporation and that fact effects a great enhancement of value of the total holdings over that of smaller units.<sup>35</sup>

Just as a large block of stock is worth less than the market price due to economic phenomena, a control block of stock is worth more than the market price due to the advantages of control. The effect of inverse blockage, therefore, is to raise the value of a control block of securities above the market price.

### *Reason for Lack of Authority*

The lack of case law dealing with inverse blockage situations prior to 1958 is probably due to several factors. One reason is that taxpayers obviously are interested in paying the smallest estate tax possible. Thus, whenever the chance arises for valuing large blocks of corporate securities, they naturally claimed a discount under blockage.

On the other hand, the Internal Revenue Service prior to 1958 was so preoccupied with disclaiming the size of a block of securities as a relevant valuation factor<sup>36</sup> and seeking to use the market value method,<sup>37</sup> that adoption of an inverse blockage principle would have been contrary to their general disclaimer. Considering the taxpayer's position, however, along with the Internal Revenue Service's stand, it is apparent that prior to 1958 *no one* was in a position to argue that a block of stock should be valued at a premium when the block represented a "controlling interest."

Although the lack of case authority since the introduction of the 1958 regulation cannot be explained, as can the absence before the 1958 regulation, at the present time at least one case involving inverse blockage is pending before the Tax Court.<sup>38</sup>

## VALUATION UNDER INVERSE BLOCKAGE

### *Discussion Model*

The validity of the regulation providing for inverse blockage is being assumed.<sup>39</sup> Several factors, however, may cast doubt on this assump-

35. *Id.* at 634; see *Groff v. Munford*, 150 F.2d 825 (2d Cir. 1945); *Helvering v. Safe Deposit & Trust Co.*, 95 F.2d 806 (4th Cir. 1938).

36. See note 32 *supra*.

37. *Ibid.*

38. *Estate of Robert Hosken Damon*, Docket Nos. 2820-64 and 2851-64.

39. As a general rule regulations prepared by an executive department and passed under statutory authority are valid. *Helvering v. Safe Deposit & Trust Co.*, 95 F.2d 806, 810 (4th Cir. 1938). Of course the power to make regulations is only the power to carry into effect the will of Congress as expressed in the statute. *Manhattan Co. v. Commissioner*, 297 U.S. 129, 134 (1936). Any regulation that "operates to create a rule out of harmony with the statute, is a mere nullity." *Ibid.* Regulations must be both consistent with the statute and reasonable to be valid. *Ibid.*



tion. These factors are raised in the following hypothetical.<sup>40</sup>

Assume Thomas I. Control, a well-known corporate executive dies leaving in his estate 1,020,000 shares (or fifty-one per cent) of the outstanding common stock of United Oblets, the remaining shares being widely distributed. Approximately ten per cent of United Oblets stock is traded on a national exchange each year. The executors of Control's estate decide to have the stock valued one year after the date of death for federal estate tax purposes.<sup>41</sup> On the valuation date, 1,000 shares of United Oblets stock sells on the market at a price of \$10.00 per share.

Further, suppose the entire block of 1,020,000 shares is left to Mr. Control's son, Working Control. Six years prior to his father's death, Working Control had been elected President and Chairman of the Board of United Oblets. Working Control believes that a thirty per cent block of United Oblets stock coupled with his present position (as represented by his presidency and chairmanship) and the fact that both he and his father, who was the founder of the corporation, have excellent records while managing the business, is enough to maintain control of the corporation.

Upon receipt of his inheritance, Working Control carries out his plan to reduce his stock holding to thirty per cent. He makes arrangements, prior to the valuation date, to sell 420,000 shares or twenty-one per cent of the outstanding stock in a secondary distribution offer. The sale is completed after the valuation date at \$10.00 per share. Due to the brokerage commissions Working Control must pay, he receives a profit of \$9.25 per share from the sale.<sup>42</sup>

In the above hypothetical, the issue is whether the entire block of stock in the estate should be taxed at a premium on the basis that the block represented a "controlling interest"? Many subsidiary questions

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40. Valuation problems under federal estate tax regulations are numerous. Because some problems appear more often than others, the more prevalent ones will be discussed. In no way is the following discussion intended to be inclusive.

41. Initially, only one valuation date was open to the estate:

"The estate so far as may be is settled as of the date of the testator's death. . . . The tax is on the act of the testator. . . . Therefore the value of the thing to be taxed must be estimated as of the time when the act is done." *Ithaca Trust Co. v. United States*, 279 U.S. 151, 155 (1929) (Holmes, J.). The Internal Revenue Code was subsequently amended to provide for an alternate valuation date. Revenue Act of 1935, ch. 829, § 202(a), 49 Stat. 1022. If the estate elects this alternate method the stock will be valued at its sale price or within one year of decedent's death whichever occurs first. Treas. Reg. § 20.2932-1(a)(1) and § 20.2032-1(a)(2) (1958). Barring a transfer of the stock within one year of decedent's death, the valuation question merely becomes one of which date is selected. Treas. Reg. § 20.2032-1(b) (1958).

42. The difference between the sale price (\$10.00 per share) and the price the seller receives (\$9.25) is generally referred to as the seller's cost. Said cost is paid to the selling group responsible for the secondary distribution. See *NEW YORK STOCK EXCHANGE, MARKET METHODS FOR YOUR BLOCK OF STOCK* 17.

are involved, including: (1) Does it matter that the negotiations were being made prior to the valuation date and that it was foreseeable that Working Control would receive less than the market value for the twenty-one per cent block? (2) Would it have mattered if International Iblets, another corporation, would have been willing to purchase the entire block at \$12.00 per share? (3) What difference would it have made if Working Control was forced to sell part of the stock to pay the estate taxes? (4) Should Working Control's intent be given any weight where negotiations for the secondary distribution were not started until after the valuation date? These questions present a few of the factors that must be considered in analyzing inverse blockage valuation. These questions are discussed subsequently in this note.

### *Types of Control Applicable to Inverse Blockage*

Regulation 20.2031-2(e) provides that a block of stock may be worth more than its aggregate per share market price if the block represents control, either actual or effective, in a going business<sup>43</sup>—the phrase “blocks of stock” should be emphasized because control may exist in other forms.<sup>44</sup> The block of stock in the above model should represent the controlling interest by itself. Obviously fifty-plus per cent of the voting stock constitutes actual control in most cases.<sup>45</sup> Because effective control can exist with less than fifty per cent, the crucial inquiry becomes what does “effective” control mean in the regulation?

In considering an estate tax question, the Tax Court<sup>46</sup> in reviewing

43. Treas. Reg. § 20.2031-2(e) (1958).

44. In a case involving the Public Utility Holding Company Act of 1935, the Sixth Circuit Court of Appeals discussed the problem of corporate control and stated:

Corporate wealth has become so widely distributed that control over it has tended to become more and more remote from ownership. Ownership of corporate shares without appreciable corporate control and control of corporate wealth without appreciable ownership has become a natural phenomenon of our economic system. Seven major types of corporate control were extant when the present Act was passed and others may develop from the urge of individuals to avoid public regulation. . . .

The types of control referred to are: (1) through complete ownership of capital stock, (2) a majority ownership, (3) through a legal device without majority ownership, such as pyramiding through holding companies or a large issue of nonvoting stock with a comparatively small issue of stock with voting rights, or voting trusts, (4) minority control, which exists when comparatively few shares of corporate stock are in the hands of one group and the remainder widely scattered, (5) management control, which exists where all the stock is so widely distributed that no stockholder takes sufficient interest in the affairs of the corporation to influence or control it, (6) proxy control through committees, (7) through interlocking corporate officers or directors.

Detroit Edison Co. v. SEC, 119 F.2d 730, 739, cert. denied, 314 U.S. 618 (1941).

45. See Joseph Soss, 9 P-H Tax Ct. Mem. 861, 867 (1940).

46. Estate of Bernon S. Prentice, 25 P-H Tax Ct. Mem. 11 (1956).

a valuation of nineteen per cent of the outstanding stock in a corporation said:

It is recognized that a concentrated block of stock though less than a majority may give effective control of corporate management and policies where the balance of the stock ownership is widely scattered. . . . However, the evidence here does not establish that control existed.<sup>47</sup>

What per cent less than fifty constitutes control cannot, of course, be categorically determined, but is determinable upon many considerations. Arguably, the block of stock must represent a significant factor by itself in the control of the corporation before inverse blockage may be considered.

#### *The Premium Factor in a Control Block*

Since the purpose of inverse blockage is to increase the value of a control block of securities, a premium must exist in the control block. Not only should the control block be worth more than the price the stock is being sold for in the market, but it should also be shown that this premium could be retained by the estate. It seems unreasonable to tax an estate for something it does not own or may not legally retain.

##### a. Sale of Corporate Control at a Premium

It has been contended that corporate control may not be sold at a premium.<sup>48</sup> This contention probably was first articulated by Berle and Means in 1932.<sup>49</sup> Under their "corporate asset" theory, any premium received for the sale of a control block of stock is paid for "power," not for stock.<sup>50</sup> Thus the premium would properly belong to the corporation rather than to the selling stockholder.<sup>51</sup>

The question whether corporate control may be sold at a premium which the seller can retain has arisen in several recent New York deci-

47. *Id.* at 17.

48. BERLE & MEANS, *THE MODERN CORPORATION AND PRIVATE PROPERTY* 243 (1935). Many other articles have been written on the sale of corporate control. See Bayne, *A Legitimate Transfer of Control: The Weyenberg Shoe-Florsheim Case Study*, 18 STAN. L. REV. 438 (1966); Bayne, *Corporate Control as a Strict Trustee*, 53 GEO. L.J. 543 (1965); Bayne, *A Philosophy of Corporate Control*, 112 U. PA. L. REV. 22 (1963); Berle, *The Price of Power: Sale of Corporate Control*, 50 CORNELL L.Q. 628 (1965); Berle, "Control" in *Corporate Law*, 58 COLUM. L. REV. 1212 (1958); Hill, *The Sale of Controlling Shares*, 70 HARV. L. REV. 986 (1957); Jennings, *Trading in Corporate Control*, 44 CALIF. L. REV. 1 (1956).

49. BERLE & MEANS, *op. cit.* *supra* note 48.

50. *Id.* at 244.

51. *Ibid.*

sions.<sup>52</sup> In *Essex Universal Corp. v. Yates*,<sup>53</sup> the president and chairman of Republic Pictures Corporation, a Mr. Yates, owned 28.3 per cent of the voting stock. Essex Universal Corporation entered into a contract with Yates to purchase his interest in Republic at "roughly two dollars above the market price on the Exchange."<sup>54</sup> The stock at the time the contract was entered into was selling at the exchange price of approximately six dollars per share. With the sale of the block, a transfer of control was to be effected by seriatim resignation<sup>55</sup> of eight of the fourteen directors of Republic.<sup>56</sup> Following Yates' repudiation of the contract, the proposed buyer, Essex Universal, sued to recover damages for an alleged breach. Summary judgment was entered for Yates. Subsequently, the judgment was reversed and remanded. On the appeal, the basic question was whether the provision for seriatim resignation was illegal and unenforceable in light of the premium.<sup>57</sup> The Second Circuit Court of Appeals held that it was not per se illegal.<sup>58</sup> Professor Bayne<sup>59</sup> in discussing *Essex* prepared a summary syllogism outlining the central argument of the "opinion."<sup>60</sup>

The bare sale of office is illegal.

But the sale is bare only if (in violation of two postulates of "corporate democracy")<sup>61</sup>

- (1) The sale is not supported by the consent of the appropriators, and
- (2) The consent of the appropriated is not gained by the

52. *Essex Universal Corp. v. Yates*, 305 F.2d 572 (2d Cir. 1962); *Matter of Carter v. Muscat*, 21 App. Div. 2d 543, 261 N.Y.S.2d 378 (1st Dep't 1964); *In re Caplan Petitioner*, 20 App. Div. 2d 301, 246 N.Y.S.2d 913 (1st Dep't 1964), *aff'd mem.*, 14 N.Y.2d 679, 198 N.E.2d 908, 249 N.Y.S.2d 877 (1964).

53. 305 F.2d 572 (2d Cir. 1962).

54. *Id.* at 573.

55. Seriatim resignation is described in paragraph 6 of the sales contract involved in *Essex*. It provides:

Upon and as a condition to the closing of this transaction if requested by Buyer at least ten (10) days prior to the date of the closing:

(a) Seller will deliver to Buyer the resignation of the majority of the directors of Republic.

(b) Seller will cause a special meeting of the board of directors of Republic to be held, legally convened pursuant to law and the by-laws of Republic and simultaneously with the acceptance of the directors' resignations set forth in paragraph 6(a) immediately preceding will cause nominees of Buyer to be elected directors of Republic in place of the resigned directors.

*Id.* at 573-74.

56. *Id.* at 574.

57. *Id.* at 573.

58. *Ibid.*

59. Bayne, *The Sale-of-Control Quandary*, 51 CORNELL L.Q. 49 (1965).

60. In fact there are four opinions—that of the court and three concurrences by the Chief Justice Lumbard and Judges Clark and Friendly.

61. See Bayne, *A Philosophy of Corporate Control*, 112 U. PA. L. REV. 22 (1963).

vote of sufficient stock—but only a majority consent is sufficient.

*But* a majority is present:

- (1) Clearly with 50+ per cent stock, and
- (2) Equivalently with 28.3 per cent.

Therefore, the sale is legal.<sup>62</sup>

All of the judges concurred in the decision with only minor variations. Chief Judge Lumbard qualified the *per se* illegality principle of the sale of corporate control by noting:

It is established beyond question in New York law that it is illegal to sell corporate office or management control by itself (that is, accompanied by no stock or *insufficient stock* to carry voting control).<sup>63</sup>

The judge went on to define the phrase “voting control” as that which “would incontestably belong to the owner of the majority of the voting stock. . . .”<sup>64</sup> The court’s requirement for majority control of the voting stock is perhaps the sole requisite for legitimate transfer of control. Judge Clark’s concurrence refers to this majority control requirement by stating: “New York law may render unlawful an agreement for the naked transfer of corporate office.”<sup>65</sup> Chief Judge Lumbard, on the other hand, referred to the illegality of the “bare sale of office.”<sup>66</sup> Judge Friendly in his concurring opinion goes further than his brethren when he states:

Hence I am inclined to think that if I were sitting on the New York Court of Appeals, I would hold a provision like Paragraph 6 [Seriatim resignation of the majority of Republic’s directors] violative of public policy save when it was entirely plain that a new election would be a mere formality—i.e., when the seller owned more than 50% of the stock.<sup>67</sup>

The 28.3 per cent block was found by the court to have “equivalent power”<sup>68</sup> to that of a majority block. The court equated “practical certainty”<sup>69</sup> of electing the new directors by the holders of 28.3 per cent of

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62. Bayne, *supra* note 59, at 51.

63. Essex Universal Corp. v. Yates, 305 F.2d 572, 575 (2d Cir. 1962). (Emphasis added.)

64. *Ibid.*

65. *Id.* at 580.

66. *Id.* at 577.

67. *Id.* at 581.

68. *Id.* at 575.

69. *Id.* at 579.

the voting stock with "majority certainty"<sup>70</sup> that they said should be present in such a control transfer. In the end, the court never really held that control of the corporation could be transferred by the conveyance of the 28.3 per cent block of common stock.

Because 28.3 per cent of the voting stock of a publicly owned corporation is usually tantamount to majority control, I would place the burden of proof on this issue on Yates as the party attacking the legality of the transaction. Thus, unless on remand Yates chooses to raise the question whether the block of stock in question carried the equivalent of majority control, it is my view that the trial court should proceed to consider the other issues raised by the pleadings.<sup>71</sup>

As to the question of whether a premium may be received, Chief Judge Lumbard pointed to the general rule that under New York law a controlling shareholder may normally derive "a premium from the sale of a controlling block of stock."<sup>72</sup> There being "no impropriety *per se*" in the fact that the seller received more per share than the prevailing market price of the stock.<sup>73</sup> The judge recognized, however, that in some cases the controlling shareholder who transferred immediate control may be compelled to account to the corporation for that part of the consideration that exceeded the block's fair market value.<sup>74</sup> The judge was referring to the familiar looting cases of *Gerdes*,<sup>75</sup> *Insuranshares*,<sup>76</sup> and *Perlman*<sup>77</sup> where, he stated, the illegality lay with the sellers who "appropriated to their personal benefit a corporate asset" which belonged to all the shareholders.<sup>78</sup> Essentially Chief Judge Lumbard's point is that "there are premiums and there are premiums."

In relation to the premium, *Essex* suggests that wherever corporate control is transferred, accompanied by the sale of some stock, "a rebuttable presumption arises that any premium over the market value is illicit."<sup>79</sup> When a premium is found to exist in a control block of stock,

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70. Refers to fifty plus per cent of the voting stock outstanding in *Essex Universal Corp.*

71. *Essex Universal Corp.*, *supra* note 63, at 579.

72. *Id.* at 576.

73. *Ibid.*

74. *Ibid.*

75. *Gerdes v. Reynolds*, 28 N.Y.S.2d 622 (Sup. Ct. N.Y. County 1941).

76. *Insuranshares Corp. v. Northern Fiscal Corp.*, 35 F. Supp. 22 (E.D. Pa. 1940).

77. *Perlman v. Feldman*, 219 F.2d 173 (2d Cir. 1955), *reversing* 129 F. Supp. 162 (D. Conn. 1952), *cert. denied*, 349 U.S. 952 (1955).

78. *Essex Universal Corp.*, *supra* note 63, at 576.

79. *Bayne*, *supra* note 59 at 72.

Traditionally directors owed a fiduciary duty to the corporation only, and as a corollary, a controlling stockholder was not a fiduciary and owed no duty to outside

that part of the premium attributable to the sale of corporate control should not be included under the *Essex* decision, unless it can be shown that the premium is not illegal. This view is substantiated by the fact that money received for the transfer of corporate office is illegal and must be returned to either the corporation or *pro rata* to the remaining stockholders.<sup>80</sup> If the stockholder could not legitimately retain the premium, he should not be taxed upon it.<sup>81</sup> This may transfer the burden of proof from the petitioner where it normally lies to the Internal Revenue Service.

#### b. Premium of a Control Block of Stock Due to Investment Value

A premium in a control block of stock may be attributed to its investment value as well as to its control value. The investment value may be determined by considering the amounts which must be paid in order to acquire the same block of stock through a general offer to all of the

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shareholders as individuals when he sold his stock. See *Gallagher v. Pacific Am. Co.*, 97 F.2d 193, 194 (9th Cir. 1938) (dictum); *Roosevelt v. Hablin*, 199 Mass. 127, 85 N.E. 98, 101 (1908) (dictum); *Levy v. Feinberg*, 29 N.Y.S.2d 550 (Sup. Ct. 1941), *rev'd sub nom.*, *Levy v. American Beverage Corp.*, 265 App. Div. 208, 38 N.Y.S.2d 517 (1st Dep't 1942); *Stanton v. Schenck*, 140 Misc. 621, 251 N.Y. Supp. 221 (Sup. Ct. 1931). This idea gradually eroded. See, e.g., *Blazer v. Black*, 196 F.2d 139 (10th Cir. 1952); *Speed v. Transamerican Corp.*, 99 F. Supp. 808 (D. Del. 1951); *Hobart v. Hobart Estate Co.*, 26 Cal.2d 412, 159 P.2d 958 (1945); *Agatucci v. Corradi*, 327 Ill. App. 153, 63 N.E.2d 630 (1945); *Buckley v. Buckley*, 230 Mich. 504, 202 N.W. 955 (1925). See generally *Loss, SECURITIES REGULATIONS 327-44* (1951). Still the controlling shareholder was not a fiduciary in regard to his stock. See 3 *FLETCHER CYC. CORP.* § 900 (perm. ed. 1947). And he was able to sell to whomever he wished at any time and at any price. See, e.g., *Tyron v. Smith*, 191 Ore. 172, 229 P.2d 251 (1951); *Commonwealth Title Ins. & Trust Co. v. Seltzer*, 227 Pa. 410, 76 Atl. 77, 79-80 (1910) (dictum). He was limited though as to the sale or abuse of his controlling position. *Levy v. Feinberg, supra*. At best, it can only be said that this area of law is in a process of change at the present time.

80. It has been stated that any amount of money received for the transfer of corporate office is illegal and must be returned to either the corporation or *pro rata* to the remaining stockholders. See, e.g., *Essex Universal Corp. v. Yates*, 305 F.2d 572 (2d Cir. 1962); *Guernsey v. Cook*, 120 Mass. 501 (1876); *Reed v. Catlett*, 228 Mo. App. 109, 68 S.W.2d 734 (1934); *McClure v. Law*, 161 N.Y. 78, 55 N.E. 388 (1899); *Andrews, The Stockholder's Right to Equal Opportunity in the Sale of Shares*, 78 HARV. L. REV. 505 (1965); *Berle, "Control" in Corporate Law*, 58 COLUM. L. REV. 1212 (1958); *Hill, supra* note 48, at 998.

81. As early as 1927 the United States Supreme Court held that illegal income received from bootlegging during Prohibition is taxable. *United States v. Sullivan*, 274 U.S. 259 (1927). In 1961 the Supreme Court extended this doctrine to cover receipts from embezzlement as being taxable income. *James v. United States*, 366 U.S. 313 (1961).

It is arguable that if the estate receives an illegal premium from the sale of their control block during the period prior to the alternate valuation date, the estate should be taxed upon the total sales price. See note 41 *supra*. Often, though, the illegality question arises in a different manner. The block is valued at a price that is presumed to be its fair market value. No sale has occurred. The estate should not be taxed on an illegal premium that has not and probably will not be received. To do so would presume that the estate intended to act in an illegal manner in the future.

shareholders.<sup>82</sup> If the block's value is worth more as reflective of a controlling interest (and this value may legally be retained by the seller) in the absence of other factors, this additional or premium value would be taxable to the estate.

The investment value may probably be proven in a manner similar to that used in blockage cases. For example, expert witnesses may be called to testify to the value of a block of stock representing a controlling interest in a corporation.<sup>83</sup> Factors which have been considered in blockage cases and which should be considered<sup>84</sup> in inverse blockage situations include: (1) Quoted market price on the valuation date;<sup>85</sup> (2) the volume of sales;<sup>86</sup> (3) the trend of the securities market;<sup>87</sup> (4) a five-year earnings record;<sup>88</sup> (5) the nature of the company's business;<sup>89</sup> (6) the number of regular and special dividends paid;<sup>90</sup> (7) business prospects for the future;<sup>91</sup> (8) attitudes of the stockholders;<sup>92</sup> (9) the general financial

82. From the available information that exists, it appears that the private sale of control shares at a premium is no longer the customary practice. It is of interest to note that of 573 members of the New York Society of Security Analysts polled in June of 1947, seven out of eight believed "it is the duty of management to transmit to stockholders any offer to purchase a substantial number of shares at more than the current market price. . . ." GRAHAM & DODD, *SECURITY ANALYSIS* 736, App. n. 51 (3rd ed. 1951). As Professor Jennings notes in one of his articles, "[A] partner in one of the nation's leading investment banking firms, who requests anonymity, has told the writer: 'We won't handle such deals. It isn't right. All must sell at the same price and must receive the same information.'" Jennings, *supra* note 48, at 18 n.68. Today it appears that the general offer is the accepted method of transferring corporate control.

83. *E.g.*, Henry F. DuPont, 2 T.C. 246, 256 (1943).

84. Both blockage and inverse blockage are to be used where "the selling prices or bid and asked prices do not reflect fair market value." Treas. Reg. § 20.2031-2(e) (1958). Since value is a question of fact, see note 5 *supra*, the same facts relevant for blockage would appear to be equally relevant for inverse blockage.

85. *Helvering v. Safe Deposit & Trust Co.*, 95 F.2d 806, 808 (4th Cir. 1938); *John J. Newberry*, 39 B.T.A. 1123, 1133 (1939); *Cecil H. Gamble*, 33 B.T.A. 94 (1935), *aff'd*, 101 F.2d 565 (6th Cir.), *cert. denied*, 306 U.S. 664 (1939).

86. *Schnorbach v. Kavanagh*, 102 F. Supp. 828, 832 (W.D. Mich. 1951); *Have-meyer v. United States*, 59 F. Supp. 537, 548 (Ct. Cl. 1945), *cert. denied*, 326 U.S. 759 (1945); *Frank J. Kier*, 28 B.T.A. 633 (1933).

87. *Mott v. Commissioner*, 139 F.2d 317, 318 (6th Cir. 1943); *Helvering v. Safe Deposit & Trust Co.*, 95 F.2d 806, 808 (4th Cir. 1938); *Lamar Fleming, Jr.*, 20 P-H Tax Ct. Mem. 660 (1951).

88. *Schnorbach v. Kavanagh*, 102 F. Supp. 828, 834 (W.D. Mich. 1951); *Moore-McCormack Lines Inc.*, 44 T.C. 745, 760 (1965); *Cecil H. Gamble*, 33 B.T.A. 94 (1935), *aff'd*, 101 F.2d 565 (6th Cir.), *cert. denied*, 306 U.S. 664 (1939).

89. *John J. Newberry*, 39 B.T.A. 1123, 1133 (1939); *Lamar Fleming, Jr.*, 20 P-H Tax Ct. Mem. 660 (1951).

90. *Schnorbach v. Kavanagh*, 102 F. Supp. 828, 834 (W.D. Mich. 1951); *Cecil H. Gamble*, 33 B.T.A. 94 (1935), *aff'd*, 101 F.2d 565 (6th Cir.), *cert. denied*, 306 U.S. 664 (1939); *Frank J. Kier*, 28 B.T.A. 633, 635 (1933).

91. *Helvering v. Safe Deposit & Trust Co.*, 95 F.2d 806, 808 (4th Cir. 1938); *Lamar Fleming, Jr.*, 20 P-H Tax Ct. Mem. 660 (1951); *Frank J. Kier*, 28 B.T.A. 633, 635 (1933) (dictum).

92. *Frank J. Kier*, 28 B.T.A. 633, 635 (1933) (dictum).



condition of the corporation;<sup>93</sup> (10) the relative position of the company with similar companies in the same business;<sup>94</sup> (11) the number of shares held;<sup>95</sup> (12) the presence of an attempt to gain corporate control.<sup>96</sup>

*Foreseeable Events May be Considered*

The federal district court in *V. A. Gould v. R. C. Granquist*<sup>97</sup> considered the admissibility of evidence for federal estate tax valuation purposes. In determining the value of fifty-one shares of stock on the valuation date, December 16, 1955, the court charged the jury as follows:

As the Court has previously instructed you, you will be called upon to decide upon a fair market value of the stock as of December 16, 1955. In determining this value, *you may consider only such evidence as would have been available to a buyer and seller as of this date.* You may not consider anything that happened subsequent to December 16, 1955, unless that event was reasonably foreseeable as of that date.<sup>98</sup>

There is, however, authority for the proposition that subsequent events may corroborate a judgment based upon what is foreseeable on the valuation date.<sup>99</sup>

a. Existence of a Willing Buyer

Assuming the proposition that only foreseeable events at the time of valuation may be considered, the question remains whether the likelihood of a buyer for the entire block is foreseeable? Under blockage valuation a ready market exists at the exchange where small lots of the listed security are traded day to day. Normal procedures for selling blocks of stock exist and are frequently utilized. A large block of stock may be sold by several methods: (1) A specialist block purchase;<sup>100</sup> (2) an exchange distribution;<sup>101</sup> (3) a special offering;<sup>102</sup> or (4) a secondary distribution.<sup>103</sup> On the other hand, it does not necessarily follow that a

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93. *Schnorbach v. Kavanagh*, 102 F. Supp. 828, 834 (W.D. Mich. 1951); *Lamar Fleming, Jr.*, 20 P-H Tax Ct. Mem. 660 (1951).

94. *John J. Newberry*, 39 B.T.A. 1123, 1133 (1939); *Frank J. Kier*, 28 B.T.A. 633, 635 (1933).

95. *Estate of Telling v. Commissioner*, 13 P-H Tax Ct. Mem. 719, 722 (1944).

96. *Estate of Marjorie G. Brush*, 22 CCH Tax Ct. Mem. 900, 910 (1963).

97. 59-1 U.S. Tax Cas. 72,330 (D. Ore. 1959).

98. *Id.* at 72,334. (Emphasis added.)

99. *Jenkins v. Smith*, 21 F. Supp. 251, 254 (D. Conn. 1937); *Simmons Co.*, 8 B.T.A. 631 (1927), *aff'd*, 33 F.2d 75 (1st Cir.), *cert. denied*, 280 U.S. 588 (1929).

100. See generally NEW YORK STOCK EXCHANGE, *MARKETING METHODS FOR YOUR BLOCK OF STOCK* 7.

101. See generally *id.* at 11.

102. See generally *id.* at 14.

103. See generally *id.* at 17.

buyer for the block of shares that represents "controlling interest" exists. If no such "control" buyer exists, it arguably would be unreasonable to value the control block at a premium—a premium that essentially is non-existent and unrealizable until such a buyer comes into existence. Because a large block of stock "cannot be marketed and turned into money as readily as a few shares,"<sup>104</sup> in the absence of a purchaser, the controlling interest should be valued under the blockage provision.

Assuming that a prospective purchaser of the control block may exist, the question becomes who has the burden of showing the existence or non-existence of this prospective buyer. If the Internal Revenue Service sends a deficiency notice to the estate, the courts place the burden of proving respondent's determination erroneous and of proving the correct value of the stock on the petitioner.<sup>105</sup> But should the burden remain with the petitioner's estate to show that no one is interested in purchasing his control block? The burden of proving a negative may be impossible. The question remains judicially unanswered.

#### b. Intent or Need of the Estate to Liquidate

The intent of the petitioner was recently considered in a valuation case. The Tax Court<sup>106</sup> in determining the value of a block of stock for capital gains purposes has stated that "There is no doubt that the 300,000 shares here involved would depress market prices if liquidated; only 166,000 shares of Mooremac were traded on the stock exchange in all of 1957."<sup>107</sup> The court commented further:

In light of the fact that petitioner had neither *intention nor need* to liquidate the 300,000 share block, we hold that the size of the block in the instant case is evidence not that "blockage" is applicable, but, rather, that the per share value is greater than the mean stock exchange price.<sup>108</sup>

In this case the 300,000 share block controlled two seats on the board of directors for at least five years under a voting trust agreement.<sup>109</sup> Additional rights such as the right to operate the Robin Line—a portion of the corporation—and the right to employ certain key individuals in re-

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104. *Helvering v. Safe Deposit & Trust Co.*, 95 F.2d 806, 812 (4th Cir. 1938).

105. The general rule in valuation cases is that the burden of proof lies upon the petitioner. *E.g.*, *Estate of Warren H. Poley*, 16 P-H Tax Ct. Mem. 254, 257 (1947), *aff'd*, 166 F.2d 434 (3rd Cir. 1948); *Frank J. Kier*, 28 B.T.A. 633, 634 (1933).

106. *Seas Shipping Co.*, P-H Tax Ct. Mem. ¶ 65,240 (1965).

107. *Id.* at 1342.

108. *Ibid.* (Emphasis added.)

109. *Moore-McCormack Lines Inc.*, 44 T.C. 745, 760 (1965).

sponsible positions also were granted to the holder of the block.<sup>110</sup> The effect of these rights was to invest with the holder partial control of the corporation. The Tax Court held in a companion case:

These rights [two seats on the board, operation of the Robin Line, and employment of key personnel] had some value above and beyond the value of the stock alone, as reflected in stock exchange prices, absent such collateral rights, and hence, the mean stock exchange price is not determinative of the overall value of 300,000 shares coupled with the bundle of collateral rights involved in this case.<sup>111</sup>

If one's intent to liquidate is a factor to be considered for raising the value of a block of stock, it arguably could also be a factor to be considered for reducing the block's value.<sup>112</sup>

One of the purposes of the federal estate tax is to diffuse wealth.<sup>113</sup> Often decedent's estate is forced to liquidate much of the estate's property to pay the federal estate tax. Assuming that the executors will sell part of the estate's assets to outsiders to pay the tax, it is apparent that these assets are worth less to the beneficiaries except their realization value. If the executors in the Working Control example above intend to sell a twenty per cent non-control block of stock to pay the federal estate tax, should not their intent be given weight, especially where the sale is completed after the valuation date?<sup>114</sup> Why should the estate be forced to value that segment of their control block at a premium—a premium that will never exist?<sup>115</sup> If after the sale the remaining block no longer constitutes an inverse blockage situation, it is arguable that one of the other methods of valuation should be used.

### c. Distribution of Estate

Using the Thomas I. Control example discussed above, suppose Working Control dies leaving his thirty per cent control block of stock. Thomas successfully controlled United Oblets for thirty years. Should

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110. Seas, the holder, also had the right to operate the Robin Line, a portion of the corporation, and to employ certain key men in positions carrying responsibility and compensation of a high degree. *Ibid.*

111. *Ibid.*

112. The question remains open.

113. FEDERAL AND STATE DEATH TAXES: REPORTS TO THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION PURSUANT TO SECTION 1203(b)(6), REVENUE ACT OF 1926, vol. II, pt. 2, 97 (Washington, 1933).

114. When the stock is sold before the valuation date, no problem exists. The stock sold is valued at the sale price. See note 41 *supra*. The remaining part of the block would probably be valued in the normal way.

115. The question remains judicially unanswered.

it matter for valuation purposes whether Working Control leaves his block to be divided equally among three, five, or ten parties? If each party was to receive only three per cent of the stock, could they sell it at a premium? Here again one may argue that intent should be considered—not the intent of the legatee but rather the intent of the testator.

The problem of division of a block has been considered in the context of gift tax cases. In *Thomas A. Standish*<sup>116</sup> four separate gifts, each consisting of 4,000 shares of stock in a particular corporation, were given away at the same time. For gift tax valuation purposes the donor sought to have the four gifts valued as one block consisting of 16,000 shares. The Tax Court rejected this one block idea, and instead, valued each gift of 4,000 shares separately without considering the effect the other blocks would have on the market.<sup>117</sup>

Although an estate tax is imposed upon the privilege of transmitting property at death,<sup>118</sup> the property nevertheless must be taxed only as to its value. Arguably if the stock had been specifically divided and left to various people or trusts, the estate would not retain a premium for control because the control is dissipated. The size and number of the legacies should be a relevant factor in arriving at a final valuation in inverse blockage situations.

### CONCLUSION

The primary effect of inverse blockage is to value control blocks of corporate securities at a premium above the market price. The law in relation to the sale of corporate control presently is in a state of change. Considerations such as what constitutes control, the intent of the testator or legatee, the division of the control block upon death, the presence of a willing buyer and the division of the premium into its investment and control values are a few of the problems to be dealt with and decided by the courts. Inverse blockage, in short, presents many judicially unanswered valuation problems.

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116. 8 T.C. 1204 (1947).

117. *Id.* at 1209; *accord*, *Helvering v. Hutchings*, 312 U.S. 393 (1941); *Phillip v. Tomlinson*, 62-2 U.S. Tax Cas. 86,443 (S.D. Fla. 1962); *Lawrence C. Phipps*, 43 B.T.A. 1010 (1941), *aff'd*, 127 F.2d 214 (10th Cir.), *cert. denied*, 317 U.S. 645 (1942); *but see* *Lamar Fleming, Jr.*, 20 P-H Tax Ct. Mem. 660 (1951).

118. *LOWNDES & KRAMER, ESTATE AND GIFT TAXES* 2 (2d ed. 1962).