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Featured Article

REVIEW OF THE DAVIS CASE PART ONE OF THREE

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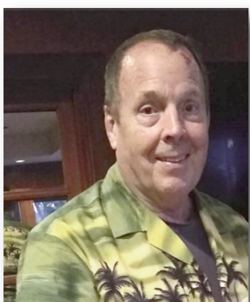

This newsletter, provided by Klaris, Thomson & Shroeder, Inc. ("KTS"), will discuss the Davis Case (Part one of Three)

We have chosen to break the presentation into three parts. The first part included herein is an overview of the case in which we give some comments on the actual court proceedings. In our next issue we will discuss blockage discounts as argued in the Davis Case. The minority discount was stipulated by the appraisers at 15% under heavy pressure from the judge. Therefore, we do not discuss it herein.

In our 3rd Issue on this topic, KTS will cover the marketability discount and how we quantified the built-in capital gains portion of the marketability discount.

Our discussion of the Davis Case may be slightly different than what you have read or heard about in the past 25 years since the court issued its opinion (June 1998), however, we were there and we do not need to guess or try to infer what the judge said in her court room, or what went into the printed case.

We hope after our discussion (written in three parts) you may have a more balanced appreciation and understanding of the Davis Case.

OVERVIEW OF THE CASE

The case involved the valuation of two 25 share blocks of voting stock, each representing a 25.77 percent voting interest. The function of the appraisal was for gift tax.

The Company was Artemus D. Davis Investment and Cattle Co., also known as ADDI&C or ADD. The Company was an investment holding company and a "C" corporation which meant that its shareholders were subject to double taxation, once at the corporate level and again at the shareholder level.

The primary asset of the Company was approximately 1.0 million

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shares of a publicly traded stock known as Winn Dixie. The 1.0 million shares represented approximately 1.3 percent of the outstanding shares of Winn Dixie and 85 percent of the value of ADDI&C.

A key valuation issue in this case was the impact, if any, of potential built-in capital gains tax relative to the Winn Dixie stock in the hands of an ADDI&C shareholder and should there be any consideration given to this impact.

So far, the courts had been very consistent, as of 1998, on this issue giving no consideration (if there was no present intention to liquidate the assets). If any consideration was to be given, what should it be? Should it be a dollar-for-dollar consideration, as the taxpayer's first expert argued, or as another factor influencing the marketability discount as the taxpayer's second expert and KTS argued?

Additional valuation issues included a blockage discount relative to the Winn Dixie shares and the minority and marketability discounts relative to a 25.77 percent voting interest. We should point out that after the gifts were made, there were 3 shareholders, none of which had control, one with a 48.46 percent interest and two with 25.77 percent interests.

As many of you are well aware, the tax court does not generally like valuation issues in the courtroom and the Judge in the Davis case specifically did not want valuation issues in her court. "These valuation issues should be settled among the experts", she said before the case started.

"A key valuation issue in this case was the impact, if any, of potential built-in capital gains tax relative to the Winn Dixie stock in the hands of an ADDI&C shareholder and should there be any consideration given to this impact."

Judge Chiechi was extremely irritated that we did not settle the valuation issues as of the day before the trial and told all three experts if we showed up the next morning in her court room, we would regret it. "Hell has no fury like a pissed off tax court Judge", she stated.

The next day came and we did not settle the valuation issues. We did, however, stipulate to the minority interest discount that the prior evening, after over four hours of discussion among the five experts, myself for the IRS and four experts for the taxpayer. The four experts appeared to be the two who wrote the appraisal reports and the two who signed the reports for the taxpayer.

The taxpayer's attorney opened with "Your honor, what we have is a house with an elephant in the living room…". After one more opening sentence, he was told to sit down and "I've heard enough from you…".

Next it was the IRS attorney's turn and her opening comment was that Washington had instructed her to argue that there is to be no consideration for built-in capital gains, even though their own expert (KTS) gave consideration. And in the future, IRS valuation experts would be so instructed. You would have thought a bombshell dropped on the

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courtroom. "Mrs. Sherlock I've told you if Washington wants to make certain arguments, they better get their ass down to my courtroom." Then she was promptly told to sit down.

Then, the taxpayer's first valuation expert took the stand. It appeared to me that this expert (who was very qualified) after 3 lefts, 2 rights and a full uppercut (from the Judge) was trying to hold himself up by the ropes. I was glad I didn't have to go first.

The next taxpayer expert (an elderly gentleman with white hair and a cane, Dr. something or other) walked to the stand, somewhat concerned, but having all his notes neatly tabbed for reference appeared confident. The first salvo was fired just after he was sworn in, "Did the court ask you to bring those notes to the stand?", "No your honor", "Get rid of them!" It was downhill from there.

The Judge had both guns out and was firing left and right. This expert got a brief and timely break when the court had to break for another case for 15 minutes. When the expert returned for redirect, he was now able to recall the answers to some key cross-examination questions such as how much of his 50 percent marketability discount was for built-in capital gains? And, what he had written in one of his books about a certain formula used by the other expert for the taxpayer?

The expert got off the stand dazed and came towards me, asking me if I understood what he was trying to say. He was obviously bleeding profusely. At last, it was my turn on the hot seat. I knew the taxpayer's attorneys had to pound me hard on cross examination or they would lose for sure. After the first 30 minutes of rapid fire and the cross examination from an excellent trial attorney, I received my first warning, "Mr. Thomson, you are being evasive." I knew I would not get a second warning before the Judge turned her guns on me. I had to go to yes/no answers, which caused me some pain on a couple of minor issues relative to the marketability discount.

Either the Judge was being nice to me, or she knew a major reason the experts could not settle the valuation issues was beyond my control as the taxpayer's experts handled the built-in capital gains issue 180 degrees apart. One expert took the discount up front dollar-for-dollar and the second expert considered it in his marketability discount.

This caused the Judge to pound both taxpayer's experts on who was right and who was wrong and state that she had a mind to throw out both of their reports.

In order to understand the tone of the court room, let me give you three quotes I can remember on the experts from the judge:

First – "Mr. Pratt are you just plugging numbers to get where you want to be?"

Second – "Mr. Howard, you are either extremely non-responsive to my question, or you can't understand my question, I'll repeat it one more time."

Third – "Mr. Thomson, you are being evasive, answer the question."

In our next issue we will cover the blockage discount in which KTS, based on the facts and circumstances of this case, concluded that no blockage discount was appropriate and the court agreed. ○

In Living Memory of Marie Schroeder

On April 1st, Gary Schroeder, Managing Director of the St. Louis office of KTS, and other members of their team gathered for a tree planting ceremony to honor the memory of Marie Schroeder. In recognition of the positive influence she had on all who worked alongside her, a tree was planted by Margo Sutter, founder and executive director, and other volunteers of Shedrow Horse Rescue and Therapy on their grounds. Marie's love of horses spurred her generous donations to the rescue, care and rehabilitation provided by Shedrow to their many horses, giving freely when she learned that 11 horses needed to be saved from a kill pen within 4 hours as well as continued contributions. This living memorial will serve as a lasting tribute to a life that enriched her workplace and her community. In addition, a plaque was made in her name and placed on the wall of honor at Shedrow reading "Marie Schroeder, Forever in our Hearts and Pastures, Equus-Shedrow Farm".

The ceremony provided an opportunity for reflection as attendees shared thoughtful memories about Marie's contributions, character, and the many ways she supported others and her community.

While we continue to mourn her passing, we also express gratitude for the privilege of having known and worked with Marie. This memorial tree represents a collective appreciation and ensures that her legacy remains a visible and meaningful part of a shared space.

KLARIS, THOMSON & SCHROEDER, INC. is a national full service valuation and consulting company specializing in business valuations, intangible asset valuations, financial consulting, expert testimony and litigation support. In addition, we also perform real estate valuations, machinery and equipment valuations, and international transfer pricing analyses.

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