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Barter-Equation Method Used to Value Block of Listed Stock (Seas Shipping Co., Inc., v. Commissioner, 371 F.2d 528, 2nd Cir. 1967)

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would allow the dealer to be sued in the Montana courts, even though the sale technically resulted "in accrual within this state of a tort action."⁵⁷

It is submitted that the instant case, being the single construction of the Montana long arm tort liability statute, is in accord with nationwide authority and sets a favorable precedent for Montana courts. Restricting jurisdiction to the physical boundaries of the state, while modern corporations distribute their products nationally, hampers an injured plaintiff in obtaining redress. Typically, the relevant evidence and witnesses will be located in the state in which the injury occurs. Requiring plaintiffs initially to assume the costs of maintaining a suit in a foreign jurisdiction may preclude them from enforcing small claims. The profitable right which corporations enjoy by interstate distribution of their products *should* give rise to a corresponding duty to defend suits involving those products wherever they are circulated in the ordinary course of business. Therefore, Montana courts should not limit themselves to jurisdiction over those foreign corporations evincing a specific intent to distribute products in Montana. Rather, the general intent to conduct business on the interstate level, from which introduction of products into Montana can be foreseen, should be the criterion. The instant case should be recognized as authority for extending jurisdiction on the basis of such a general intent.

BRENT REED CROMLEY

BARTER-EQUATION METHOD USED TO VALUE BLOCK OF LISTED STOCK.—In 1957 taxpayer shipping line sold ships to Moore-McCormack Lines, Inc. for \$17,000,000. The latter issued 300,000 shares of its stock to taxpayer as part payment of the purchase price.¹ The sales contract assigned a value of \$30 to the shares, although they were then selling on the New York Stock Exchange for about \$23.² Taxpayer reported a capital gain

⁵⁷This is a variation of the hypothetical advanced in *Erlanger Mills v. Cohoes Fibre Mills*, 239 F.2d 502, 507 (4th Cir. 1956), and commented upon in the instant case, *supra* note 31, at 83 n.11. Such an example demonstrates the need for the rule that each case must be decided upon its own set of facts. *Bullard, supra* note 31, at 82. There are numerous variables to consider, including the extent to which the defendant must be dealing in interstate sales, whether the plaintiff must be a resident of the forum state (not expressly required by the Montana statute quoted in text at note 29 *supra*. *But cf.*, Connecticut's statute, *supra* note 21), and whether the tort must have a relation to the type of commercial activity in which the defendant is engaged.

¹The remainder of the purchase price was to be paid in cash (\$3,200,000) and promissory notes or cash (\$4,800,000), at Moore-McCormack's option. The promissory notes actually given by Moore-McCormack were stipulated to have a fair market value equal to their face value.

²The highest price at which Moore-McCormack stock had ever been traded on the New York Stock Exchange was 25¼ during January and February of 1957. The price had been as low as 17 in December of 1957, and 10½ in 1960.

on the sale based on a per-share value of \$19.90. The Commissioner determined a deficiency and taxpayer appealed. The United States Tax Court upheld a \$30 valuation³ by totalling the individual ship values listed in the sales contract, subtracting the amount of cash and notes given to the seller, and equating the balance with the 300,000 shares. On appeal to the United States Court of Appeals for the Second Circuit, *held*, affirmed. The market value of stock may sometimes be determined by the value of the property for which it was exchanged in an arm's length transaction. *Seas Shipping Co., Inc. v. Commissioner*, 371 F.2d 528 (2nd Cir. 1967).

The fair market value of the Moore-McCormack shares had to be ascertained in order to compute taxpayer's capital gain. Stock market quotations were available as evidence of this value, so the question was whether the value could be determined by reference to the value of the property transferred by the taxpayer, rather than to the stock market quotations. "Fair market value" has been defined as the price at which property will 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 the facts.⁴ Generally, the price at which shares are traded on the open market is the best evidence of their value.⁵ Stock exchange quotations are usually reliable indices, but they are not necessarily conclusive.⁶ "If it is established that the value of any . . . share of stock determined on the basis of selling or bid and asked prices . . . does not reflect the fair market value thereof, then some reasonable modification of such basis or other relevant facts and elements of value are considered in determining the fair market value."⁷ Factors that may be considered are corporate assets, earnings, book value, character of the management, and any other matter which an informed seller and an informed buyer would take into account.⁸

³*Seas Shipping Co., Inc.*, 24 CCH Tax Ct. Mem. 1222 (1965).

⁴See, e.g., *Willow Terrace Development Co. v. Commissioner*, 345 F.2d 933 (3rd Cir. 1965); *Goldstein v. Commissioner*, 298 F.2d 562 (9th Cir. 1962); *In re Williams' Estate*, 256 F.2d 217 (9th Cir. 1958). Treas. Reg. § 1.170-1(c) (1958), as amended, T.D. 6605 (1962); Treas. Reg. § 20.2031-1(b) (1958).

⁵10 MERTENS, FEDERAL INCOME TAXATION § 59.13; 4 RABKIN & JOHNSON, FEDERAL INCOME, GIFT AND ESTATE TAXATION § 52.11(1). Compare Treas. Reg. § 20.2031-2 (1958), which provides in part that the "mean between the highest and lowest quoted selling prices on the valuation date shall be considered the fair market value per share. . . ."

⁶10 MERTENS, *op. cit. supra* note 5, at § 59.14.

⁷Treas. Reg. § 20.2031-2(e) (1958). Mertens notes that while "the most frequently employed method of valuing stock is by reference to sales of other blocks of the same or similar stock, where such sales are not available or their validity as measures of value are questionable, a number of other factors have been taken into consideration." 10 MERTENS, *op. cit. supra* note 5, at § 59.12.

⁸*Arc Realty Co. v. Commissioner*, 295 F.2d 98, 103 (8th Cir. 1961). Mertens lists these and other factors which the courts have looked to: The company's earnings or loss record, the character of its management, the dividend policy, the financial condition and balance sheet of the corporation issuing the stock, the rate the corporation pays to borrow money, the result of its efforts to sell or borrow on its stock, and offers for the stock. 10 MERTENS, *op. cit. supra* note 5, at § 59.12. The Internal Revenue Service has also listed factors which might be considered. Rev. Rul. 54-77, 1954-1 CUM. BULL. 187.

The fair market value of stock cannot always be established with exactness or accuracy.⁹ However, fair market value need not be readily ascertainable for computation of capital gain, but only ascertainable,¹⁰ and only in rare cases will property be deemed to have no fair market value.¹¹

In the instant case quotations from the New York Stock Exchange were available as evidence of the value of the Moore-McCormack shares. Taxpayer argued the depressing effect which the sale of an unusually large block of stock could have on market prices would reduce the per-share value to a figure below the stock market quotations, that is, to \$19.90 per share. Taxpayer was attempting to apply the concept known as the "blockage" rule.

Early Treasury Department regulations stated unqualifiedly that the size of the holdings was not relevant in determining stock value.¹² However, in 1937 the courts began to take the view that blockage could be a factor,¹³ and the Treasury Department finally accepted this view under the Internal Revenue Code of 1954.¹⁴

The "blockage" rule is not automatically applied whenever the quantity of stock is great.¹⁵ There is no presumption that a large block of stock is less valuable per se.¹⁶ For example, a block may carry with it control of a corporation and thus have a greater value than market price based on day-to-day trading in small units.¹⁷ The effect of the "blockage" rule is thus a matter of evidence, not doctrinaire assumption.¹⁸

The courts are reluctant to depart from the orthodox use of quoted market prices unless persuasive evidence is produced that the market cannot absorb the block at current market prices.¹⁹ It has been suggested that the astute lawyer should present the following facts to persuade a court that consideration of "blockage" is warranted: (1) The number of shares of the subject company outstanding, (2) the number of shares listed, (3) daily and weekly trading in terms of the number of shares for a reasonable time prior to and after the valuation date, (4) price movements, (5) the trading value as related to the amount listed and

⁹*Arc. Realty Co. v. Commissioner*, *supra* note 8, at 103.

¹⁰*Marsack's Estate v. Commissioner*, 288 F.2d 533, 535 (7th Cir. 1961).

¹¹Rev. Rul. 58-402, 1958-2 CUM. BULL. 15; *Marsack's Estate v. Commissioner*, *supra* note 10. Of course, if the property received has no fair market value, then there is no taxable gain by the recipient. *Burnet v. Logan*, 283 U.S. 404 (1931).

¹²Treas. Reg. 79 (1932); Treas. Reg. 80 (1937).

¹³See *Jenkins v. Smith*, 21 F. Supp. 251 (D. Conn. 1937).

¹⁴Rev. Rul. 59-60, 1959-1 CUM. BULL. 237; Treas. Reg. 20.2031-2(e) (1958).

¹⁵10 MERTENS, *op. cit. supra* note 5, at § 59.15.

¹⁶*Maytag v. Commissioner*, 187 F.2d 962 (10th Cir. 1951); *Richardson v. Helvering*, 80 F.2d 548 (D.C.Cir. 1935).

¹⁷*Kier v. Commissioner*, 28 B.T.A. 633 (1933); *Helvering v. Safe Deposit & Trust Co. of Baltimore*, 95 F.2d 806 (4th Cir. 1938), *affirming* 35 B.T.A. 259 (1937). It may also be possible that a skilled broker could obtain market prices for the block to be valued.

¹⁸*Helvering v. Safe Deposit & Trust Co. of Baltimore*, *supra* note 17.

¹⁹4 RABKIN & JOHNSON, *op. cit. supra* note 5, at § 52.11(2).

the number of shares being valued, and (6) the distribution of outstanding shares, *i. e.*, is the entire outstanding stock likely to be traded, or are large blocks held by interests close to the company and are they unlikely to be traded.²⁰

The Tax Court in the instant case did not feel sales of 100-share lots were indicative of the value of taxpayer's 300,000 share block, and it held that "blockage" was not a relevant consideration if the taxpayer had neither the need nor intention²¹ to liquidate his shares.²² On the contrary, the court felt that since the block constituted the largest individual holdings of Moore-McCormack stock, the per-share value was greater than the mean stock average. The Tax Court also felt the value was enhanced by a shareholders' agreement and a memorandum of understanding²³ which gave the taxpayer certain collateral benefits.

Once it decided the stock quotations were not determinative of the shares' value, the Tax Court resorted to the barter-equation method.²⁴ There was no precedent authorizing use of this method when the property to be valued was traded on an active market.²⁵ The only authority for the Tax Court's decision were cases dealing with property for which there was little or no market, notably *United States v. Davis*.²⁶ That case concerned the purchase by a taxpayer of his wife's inchoate marital rights by transferring stock to her for a release. The Court of Claims had decided it could not compute capital gains because it was impossible to ascertain the fair market value of the rights. The United States Supreme Court reversed, holding that the transfer of appreciated property was a taxable event. It was then faced with the dilemma of valuing the

²⁰Badger, *Blockage as a Valuation Problem*, 20 INST. ON FED. TAXATION 587 (1962).

²¹Provision 12 of the sales contract stated that the seller (taxpayer) "represents, warrants and covenants that it is acquiring the shares of Common Stock of BUYER solely for investment and not with a view to the resale or further distribution thereof." Taxpayer still held the shares.

²²The Tax Court's holding as to "blockage" has been termed "questionable." 4 RABKIN & JOHNSON, *op. cit. supra* note 5, at § 52.11(2). The Tax Court's approach indicates an incorrect belief that fair market value is a subjective quality which varies with the particular owner of the property. Instant case at 530, n.3. When valuing stock at its valuation date the courts are necessarily measuring a hypothetical transaction as far as the taxpayer is concerned. Even if he does not intend to sell the stock it would not seem this should have an effect on what would have been realized from a hypothetical sale. Nevertheless, in the instant case, Taxpayer's own expert witness, an investment banker, testified on cross-examination that blockage would not be a factor if there was no intention to sell the stock.

²³The shareholders' agreement was made with certain principal stockholders of Moore-McCormack. It was agreed that the parties would vote their stock to elect directors, two of whom were to be nominated by taxpayer, and the remaining seven by a majority of the parties to the agreement. The agreement was to continue for five years or until taxpayer ceased to beneficially own at least 100,000 shares of stock. The memorandum of understanding provided *inter alia* that Moore-McCormack would employ certain key men of taxpayer's line, although it was not required that the employment continue for a specific time. Also, Moore-McCormack was to continue using the name of taxpayer's line on the ships purchased for a five year period.

²⁴The barter-equation method equates two sides of a barter. One side is chosen and the other is then said to equal it in value.

²⁵Instant case at 532.

²⁶370 U.S. 65 (1962), *reversing in part*, 152 Ct.Cl. 805, 287 F.2d 168 (1961).

released inchoate rights.²⁷ The Supreme Court stated that in the absence of a readily ascertainable value, it is acceptable to hold the value of two properties exchanged in an arm's length transaction are either equal in fact, or presumed to be equal.²⁸ The Court concluded that since the parties had dealt at arm's length while negotiating the settlement, the value of her rights was equal to the fair market value of the shares transferred to her by her husband.²⁹

With this support the Tax Court in the instant case held that since the value of the Moore-McCormack stock was not readily ascertainable, and because the parties had dealt at arm's length, the value of the property transferred was evidence of the value of the stock received in exchange.³⁰

There was persuasive evidence of the fair market value of the ships. They had been appraised under the auspices of the Federal Maritime Board as part of its standard procedure in approving such sales. These appraisals were based on domestic market prices and were slightly higher than those listed in the sales contract.³¹ This indicated the fair market value of the ships was at least equal to their listed values in the contract.³²

The Tax Court also relied on the \$30 figure which the contract assigned to the shares. While a contract value is not necessarily determinative of property's fair market value,³³ it can be very persuasive evidence

²⁷There were conflicting decisions concerning the valuation of such rights. The Third Circuit Court in *Commissioner v. Mesta*, 123 F.2d 986 (3d Cir. 1941), *cert. denied*, 316 U.S. 695 (1942), and the Second Circuit in *Commissioner v. Halliwell*, 131 F.2d 642 (2d Cir. 1942), *cert. denied*, 319 U.S. 741 (1943) had both held such transfers were taxable events and had then measured capital gain by the difference between the taxpayer's basis and the value of the appreciated property he had transferred to his wife. However, in *Commissioner v. Marshman*, 279 F.2d 27 (6th Cir. 1960), *cert. denied*, 364 U.S. 918 (1960), these decisions were not adopted, the Sixth Circuit holding that although there was a taxable event, the impossibility of evaluating the rights received precluded the finding of taxable gain.

²⁸The Supreme Court's authority was *Philadelphia Park Amusement Co. v. United States*, 130 Ct.Cl. 166, 126 F.Supp. 184 (1954), where it was necessary to value a 10-year franchise extension. *Accord*: *United States v. General Shoe Corporation*, 282 F.2d 9 (6th Cir. 1960), (valuation of the benefits received from contributing real estate to an employees' retirement trust); *International Freighting Corp. v. Commissioner*, 135 F.2d 310 (2d Cir. 1943), (valuation of benefits received by the contribution of stock to a stock bonus plan under which stock was awarded each year to taxpayer's outstanding employees).

²⁹The Supreme Court recognized that it was arguable that the presumption was weakened by the tensions, emotions and practical necessities surrounding divorce negotiations, but it believed that once it was recognized that there had been a taxable event, it was more consistent with the general purpose and scheme of the taxing statutes to approximate the gain rather than ignore it altogether.

³⁰*Seas Shipping Co., Inc.*, *supra* note 3, at 1228.

³¹Other sales of similar ships had grossed comparable prices.

³²These contract values governed their escrow arrangement, the possibility of a *force majeure*, and the removal of certain ships from the transaction at Moore-McCormack's option.

³³*Carl L. Danielson*, 44 T.C. 549 (1965), where it was held that the covenants not to compete were not realistically bargained for.

of true value when established by persons with adverse interests.³⁴ The evidence sustained such a finding.³⁵

The Second Circuit Court approved the Tax Court's holding,³⁶ but warned that the barter-equation method should be used "sparingly and with considerable caution."³⁷ Apparently³⁸ the Circuit Court would only allow its use when: (1) The transaction is an arm's length transaction, (2) the fair market value of the property transferred by the seller can be persuasively established, and (3) the fair market value of the property received cannot be "readily" ascertained.³⁹

The instant case marks the first time the barter-equation method has been employed to value property traded on an open market. Section 1001 (b) of the Internal Revenue Code of 1954 states that capital gain is to be measured by the fair market value of the property received.⁴⁰ The Sixth Circuit Court in the *Marshman* decision⁴¹ felt this could not be accomplished by valuing the property transferred by the taxpayer in exchange for the property received. However, it is quite possible that in some instances the value of the property transferred will furnish the best evidence of the value of the property received, and section 1001 (b) would not preclude use of the barter-equation method in such cases.⁴²

As the Circuit Court noted in the instant case, there are inherent dangers in evaluating one side of a barter by determining what the other side is worth.⁴³ The two sides are not necessarily equal and there is usually no logical reason for starting with one side rather than the other.⁴⁴ There may not be persuasive evidence of the value of the property on either side of the barter. Also, a complex evaluation problem could arise where, as in the instant case, the consideration moving from the seller became part of the buyer's assets, and by the transaction, the seller became part owner of those assets.

³⁴*Ullman v. Commissioner*, 264 F.2d 305 (2d Cir. 1959), *affirming* 29 T.C. 129 (1957).

³⁵*Seas Shipping Co., Inc.*, *supra* note 3, at 1228.

³⁶In order for the 2nd Circuit Court to have disturbed the Tax Court's conclusion in the instant case, it must be shown that the Tax Court's decision was clearly erroneous. *Maytag v. Commissioner*, *supra* note 16, at 964.

³⁷Instant case at 532.

³⁸The Circuit Court said the barter-equation method should be used only under "certain limited conditions." Instant case at 529. The Court did not specify what those conditions might be. However, at page 532 of the instant case the Circuit Court noted that conditions existed which made it feasible to use the barter-equation method, and mentioned that persuasive evidence of an arm's length transaction and of the value of the ships (the property transferred) was available. The Tax Court applied the method because there was no "readily" ascertainable value for the shares, and this was not overruled by the Circuit Court.

³⁹The Tax Court felt there was no "readily" ascertainable value for the Moore-McCormack shares because the Stock Exchange quotations did not reflect many aspects of the transaction. See *supra* note 23.

⁴⁰INT. REV. CODE OF 1954, § 1001(b).

⁴¹See *supra* note 27.

⁴²See *supra* notes 26 and 28.

⁴³Instant case at 529-30.

⁴⁴Thus, in the instant case the Tax Court could have started with the stock exchange quotations and equated the ships with those figures to determine what the ships were worth.

Normally, if value is not "readily" ascertainable from market quotations or the like, modifications can be made⁴⁵ and other factors considered.⁴⁶ The Tax Court's language in the instant case could be interpreted as allowing use of the barter-equation method whenever value is not "readily" ascertainable.⁴⁷ However, heretofore the method had only been applied where the circumstances prohibited use of any other means. For example, the *Davis* case first used the word "readily" from which the above implication could arise.⁴⁸ It was actually impossible to value the marital rights in that case by means other than barter-equation.⁴⁹ Thus, the *Davis* case and the prior cases⁵⁰ indicate that only when a valuation problem is extremely difficult, if not impossible, should a court resort to the barter-equation approach.

The instant case does not deviate from the above norm, despite the fact that active trading offered some evidence of the stock's value. Stock market quotations are not always conclusive,⁵¹ and when, as in the instant case, they cannot provide the court with an accurate fair market value, there is nothing which would preclude use of the barter-equation method. It should be remembered, however, that the method does have inherent infirmities.⁵² Therefore, before it is employed a court should be faced with a very difficult, if not impossible, valuation problem, and persuasive evidence of the value of the property transferred and the presence of an arm's length transaction should be available. Under this rule the barter-equation method would be applied only when there was a real possibility that (1) it could supply a valid fair market value which the standard procedure could not provide, or (2) a taxable gain might otherwise be ignored because the fair market value of property received was impossible to determine. This means the barter-equation method would be used infrequently, and only when necessary, and as the Circuit Court pointed out, it should be used "sparingly and with considerable caution."⁵³

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⁴⁵See *supra* note 7.

⁴⁶See *supra* note 8.

⁴⁷Of course, this would be true only if the other two conditions were present: (1) An arm's length transaction (which will usually be present) and (2) persuasive evidence of the value of the property transferred (which might not always be present).

⁴⁸When it spoke of the absence of a "readily" ascertainable value the Tax Court cited *Davis* as authority.

⁴⁹The Supreme Court relied upon *Philadelphia Park Amusement Co.*, *supra* note 28, as authority for the holding in *Davis*. In that case the barter-equation method was applied because a franchise extension was incapable of valuation with "reasonable accuracy" or "reasonable certainty."

⁵⁰See *supra* notes 26 and 28.

⁵¹See *supra* note 6.

⁵²See *supra* note 43.

⁵³See *supra* note 17.