



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

ACTION ON DECISION

SUBJECT: Estate of Mitchell v. Commissioner, 250 F.3d 696 (9th Cir. 2001), aff'g in part, rev'g in part, and remanding T.C. Memo. 1997-461; on remand, T.C. Memo. 2002-98.

Issue:

Whether the Court of Appeals erred in shifting the burden of proving the valuation of stock to the Commissioner on the basis that the Commissioner's determination of the value of the stock was arbitrary and excessive.

Facts:

During an audit of the decedent's estate, the Commissioner retained an expert who initially valued stock owned by the estate, representing 49.04% of the outstanding stock of a closely held corporation, at \$81 million. At the Commissioner's request to treat the stock as if it were a controlling interest, the expert increased the value of the stock to \$105 million, the value that was used to determine a deficiency in estate tax. In a case that predates the effective date of IRC § 7491, the estate petitioned the Tax Court.

The estate filed a motion to shift the burden of persuasion to the Commissioner on the basis that the deficiency determination was arbitrary because the stock should have been valued as a minority interest. The Tax Court denied this motion. At trial, the Commissioner's expert witness valued the stock at \$81 million; the estate's expert witnesses valued the stock at between \$20,634,000 and \$29,000,000. The Tax Court found that the value of the stock was \$41,532,600. On appeal, among other things, the Ninth Circuit held that the Tax Court erred in denying the motion to shift the burden of persuasion, relying on United States v. Stonehill, 702 F.2d 1288 (9th Cir. 1983) (an unreported income case) and Cohen v. Commissioner, 266 F.2d 5 (9th Cir. 1959) (an unreported income case).

Discussion:

In general, a notice of deficiency is entitled to a presumption of correctness, and a taxpayer has the burden of proving the adjustments in a notice of deficiency incorrect. T.C. Rule 142; United States v. Janis, 428

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U.S. 433, 441-442 (1976); Welch v. Helvering, 290 U.S. 111 (1933). Ordinarily, courts will not “look behind” a notice of deficiency to examine the basis for the adjustments that have been made, the propriety of the Commissioner’s motives, or the administrative policy or procedure used in determining a deficiency. Zuhone v. Commissioner, 883 F.2d 1317, 1325 (7th Cir. 1989); Jackson v. Commissioner, 73 T.C. 394, 400 (1979). In unreported income cases, the Commissioner may not rely on the presumption of correctness unless the Commissioner presents some foundation or predicate evidence connecting a taxpayer to an income generating activity. Janis, 428 U.S. at 441-42; Anastasato v. Commissioner, 794 F.2d 884, 886-87 (3d Cir. 1986); Jackson, 73 T.C. at 400-01.

In this case, the appellate court erred in “looking behind” the notice of deficiency because this case did not involve unreported income. Accordingly, the exception to the general rule regarding the presumption of correctness did not apply. This case involved a stock valuation dispute. As a result, the notice of deficiency should have been presumed correct, leaving the taxpayer with the ultimate burden of persuasion. Silverman v. Commissioner, 538 F.2d 927, 930-31 (2d Cir. 1976) (stock valuation); Estate of Lauder v. Commissioner, T.C. Memo. 1994-527 (stock valuation). The Stonehill and Cohen unreported income cases relied on by the appellate court are not applicable.

Recommendation:

Nonacquiescence.

Reviewers:

CGW
TJK

_____/s/
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Special Counsel

Approved:

Donald L. Korb
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