**8816. How can the fact that a business owner holds a minority or majority interest in an entity impact the use of a buy-sell agreement?**

The extent to which an owner will maintain control over an enterprise certainly impacts the value of an interest being sold. Therefore, it is necessary to consider whether the departing owner is going to be paid for their interest based upon the percentage interest owned in the enterprise, or for the fair market value of the interest being sold.

In this context, control premiums and minority discounts are especially important in the small business where the business is owned by a small group of individuals who may also be significantly involved in the day-to-day operations of the business. Control and minority issues may be important in establishing the value of business interests that are subject to a buy-sell agreement and are certainly an issue which must be considered.

Normally, an interest in a business is valued in proportion to the entire value of the business. However, application of a premium that reflects one owner’s (or a group of owners’) ability to control business affairs, including the ability to withdraw business assets, has been recognized in many cases.[[1]](#footnote-1) Therefore, if a paticular owner has voting control, a control premium is appropriate. But what if it takes two owners to establish voting contol? In these cases, premium pricing has been found appropriate where one owner functions as the “swing vote” within the business, in recognition of the substantial influence that the owner has over the business’ affairs.[[2]](#footnote-2)

It is also important to note that a swing vote premium, is not always appropriate since it involves a fact-intensive analysis. For example, the Ninth Circuit did not allow a premium for swing vote status in the case of *Simplot v. Commissioner,* reversing the Tax Court’s determination of value that was based largely on scenarios constructed by the court to prove the value of the particular owner’s influence and control. The Ninth Circuit found that it was an error for the Tax Court to base value on fictional potential purchasers, rather than concrete facts.[[3]](#footnote-3)

A valuation discount has often been applied in the context of minority ownership interests in order to reflect the *lack* of control that these owners may influence over business affairs.[[4]](#footnote-4) In certain cases, a minority discount is combined with a discount for lack of marketability that is generally found in the small business context.[[5]](#footnote-5) (It should be noted that the discount for lack of marketability is often available even for majority interests in a closely-held business.)[[6]](#footnote-6)

Minority discounts will generally be disallowed, however, in the context of larger companies, where securities are marketable and there are multiple business owners.[[7]](#footnote-7)

**Planning Point:** It becomes a client decision as to whether or not the valuation approach should account for any premiums or discounts associated with a minority or controlling interest in the business. For example, the agreement can be drafted to determine a value for the overall business, with this value to be multiplied by the percentage interest in the business being sold. This approach does not reflect any premium or discount. In the alternative, the valuation can be calculated to reflect the value of a specific percentage interest of the business (i.e. the fair market value of a 30 percent interest in the business). This approach will take into account discounts or premiums.

1. . On control premiums generally, see *Estate of Bright v. United States*, 658 F.2d 999 (1981); *Estate of Desmond v. Comm.,* TC Memo 1999-76 (majority stock interest in an S corporation was subject to a control premium); *Rakow v Comm.*, TC Memo. 1999-177 (controlling interest in corporation was subject to a control premium). [↑](#footnote-ref-1)
2. . *Estate of Winkler v*. *Comm.*, TC Memo. 1989-231 and Let. Rul. 9436005. [↑](#footnote-ref-2)
3. . *Estate of Simplot v. Comm.*, 249 F3d 1191 (2001), rev'g 112 TC 130 (1999). [↑](#footnote-ref-3)
4. . See, e.g., *Knott v. Comm.*, TC Memo 1987-597; *Estate of Berg v. Comm.*, TC Memo 1991-279; *Moore v. Comm.*, TC Memo 1991-546 (minority interest in a general partnership). But see also *Ahmanson Found. v. United States*, 674 F.2d 761 (1981); *Estate of Curry v. United States*, 706 F.2d 1424 (1983); *Citizens Bank & Trust Co. v. Comm.*, 839 F.2d 1249 (1988) (no discount for nonvoting interest if the same decedent hold majority of voting interest). [↑](#footnote-ref-4)
5. . *Estate of Hecksher v. Comm.*, 63 TC 485 (1975); *Estate of Titus* v. *Comm.*, TC Memo 1989-466; *Moore v. Comm.*, TC Memo 1991-546 (minority discount); *Mandelbaum v. Comm.*, TC Memo 1995-255 (lack of marketability discount) and *McCormick Estate v. Comm.*, TC Memo 1995-371 (minority discount and lack of marketability discount); *Gross v. Comm.*, TC Memo 1999-254 (minority interest in S corporation was given a combined minority and lack of marketability discount). [↑](#footnote-ref-5)
6. . *Estate of Bennett v. Comm.*, TC Memo 1993-34; *Estate of Andrews v. Comm.*, 79 TC 938 (1982). [↑](#footnote-ref-6)
7. . Snyder v. Commissioner, 93 TC 529 (1989), Estate of Dougherty v. Commissioner, TC Memo. 1990-274, Citizens Bank & Trust Co. v. Commissionerr, 839 F.2d 1249 (1988). [↑](#footnote-ref-7)