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1 UNITED STATES COURT OF APPEALS

2 FOR THE SECOND CIRCUIT

3 ___________________

4 August 2002 Term

5 Argued: April 28, 2003 Decided: August 26, 2003

6 Docket No. 01-4189

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8 Estate of Paul C. Gribauskas, Deceased, Roy L. Gribauskas,

9 Co-Executor, Carol Beauparlant, Co-Executor

10 Petitioners - Appellants.

11 v.

12 Commissioner of Internal Revenue,

13 Respondent - Appellee.

14 ________________________

15 BEFORE: VAN GRAAFEILAND, MINER, and POOLER, Circuit Judges.

16 _________________________

17 Decedent's estate appeals from a decision by the Tax Court

18 (Nims, J.) holding that remaining installments of Lotto winnings

19 must be valued, for estate tax purposes, pursuant to Internal

20 Revenue Code §7520. Reversed and remanded.

21 ________________________

22 Mark R. Kravitz, Esq., Wiggin & Dana, New Haven, CT, for the

23 Petitioners - Appellants.

24 Jonathon S. Cohen, Esq., Department of Justice, Tax Division,
25 Washington DC, for Resondent - Appellee.
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1 Van Graafeiland, *Senior Circuit Judge.*

2 This appeal concerns the valuation, for estate tax purposes,
3 of a decedent's Connecticut Lotto prize. The Tax Court (Nims,
4 J.) held that the prize must be valued pursuant to the actuarial
5 tables prescribed under Internal Revenue Code § 7520. For the
6 reasons that follow, we reverse and remand.

7 The decedent, Paul Gribauskas, and his wife won a
8 $15,807,306.60 Connecticut Lotto prize in late 1992, to be paid
9 out in twenty annual installments of $790,365.34. Following
10 disbursement of the first installment, Gribauskas and his wife
11 divorced. Thereafter, each was entitled to receive $395,182.67
12 annually. Gribauskas died intestate on June 4, 1994, with 18
13 installments remaining to be paid.

14 Decedent's estate filed an Estate Tax Return Form 706 on
15 September 11, 1995. The value of the remaining prize
16 installments was discounted on the return to account for
17 restrictions imposed on Lotto winnings by the State of
18 Connecticut. Pursuant to those restrictions, all prizes in
19 excess of $1 million were payable in twenty equal annual payments
20 which could not be accelerated under any circumstances. More
21 significantly, winners were forbidden from assigning or
22 transferring their right to future installments to third parties.
23 As one would expect, these prohibitions severely restricted the
24 ability of winners to exchange contractually their rights to

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future payments for an up-front lump sum. Nevertheless, as the parties in this case have stipulated, a market for such unassignable winnings did exist, albeit as a significant discount, at the time that the estate filed its return. Decedent's estate, after factoring in this risk-based market discount, valued the Lotto prize at $2,603,661.02 on its return.

The Commissioner thereafter determined that the prize, properly characterized, constituted an annuity, and therefore should have been valued pursuant to the actuarial tables set forth under I.R.C. § 7520. Consulting these tables, the Commissioner determined that the present value of the award was, in fact, $3,528,058.22. The estate correspondingly was assessed a $403,167.00 tax deficiency.

On February 18, 1998, the estate filed a petition in the Tax Court seeking redetermination of the deficiency. In support of its petition, the estate argued that the § 7520 tables should not govern valuation in this case because they yielded an "unrealistic and unreasonable" result in that they did not accurately account for loss of value due to marketability restrictions.[1] Notably, the parties stipulated that a market for the Lotto winnings did exist at the time the return was filed,

[1] The estate preliminarily argued that the installment payments could not properly be characterized as an annuity, and, for that reason alone, could not be valued under the § 7520 tables. The Tax Court held that the prize constituted an annuity, and the estate does not challenge that ruling on appeal.

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1 that the prize's market value was diminished considerably due to
2 transfer restrictions, and that, if departure from the § 7520
3 tables was warranted, the estate's valuation of the prize was
4 correct. JA 44-47, 58.
5 The Tax Court held, as a matter of law, that marketability
6 restrictions, per se, did not justify departure from tabular
7 valuation. *See Estate of Gribauskas v. Comm'r*, 116 T.C. 142, 165
8 (2001). In particular, the court concluded that prior case law
9 did not support deviating from the actuarial tables on the basis
10 of marketability restrictions alone, and that deviation in this
11 case would undermine the policy favoring standardized actuarial
12 valuation of annuities. *Id.* at 160-64. We believe that the
13 desire for standardization is not so demanding.
14 An estate tax is imposed on the value of the taxable estate
15 (defined as the value of the gross estate minus applicable
16 deductions) of every deceased United States citizen or resident.
17 26 U.S.C. §§ 2001 and 2051. The value of the gross estate, in
18 turn, includes the fair market value of all the decedent's
19 property. *See* 26 U.S.C. § 2031; 26 C.F.R § 20.2031-1 (b). "The
20 fair market value is the price at which the property would change
21 hands between a willing buyer and a willing seller, neither being
22 under any compulsion to buy or to sell and both having reasonable
23 knowledge of relevant facts. . . . All relevant facts and
24 elements of value as of the applicable valuation date shall be

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1 considered in every case." 26 C.F.R. § 20.2031-1 (b).
2 Generally, the value of an annuity, or of any interest for a term
3 of years, is derived from application of standardized valuation
4 tables. *See* 26 U.S.C. § 7520(a). However, departure from the
5 valuation tables is appropriate when adherence to them "would
6 produce an obviously erroneous result", *Berzon v. Comm'r*, 534
7 F.2d 528, 532 (2d Cir. 1976), or would "produce a substantially
8 unrealistic and unreasonable result." *O'Reilly v. Comm'r*, 973
9 F.2d 1403, 1408 (8th Cir. 1992). A party challenging application
10 of the tables "bears the 'considerable burden of proving that the
11 tables produce such an unrealistic and unreasonable result that
12 they should not be used.'" *Shackleford v. U.S.*, 262 F.3d 1028,
13 1032 (9th Cir. 2001) (quoting *O'Reilly*, 973 F.2d at 1408).
14 *Shackleford, supra,* serves as a useful guidepost for
15 deciding the case at hand. In that case, the Ninth Circuit Court
16 of Appeals ruled on an issue virtually identical to that which we
17 now face. The court held that, because the standardized
18 valuation tables did not reasonably approximate the fair market
19 value of a California lottery prize that was subject to anti-
20 assignment restrictions, departure from the tables was
21 appropriate where the taxpayer provided a more realistic and
22 reasonable valuation method. *Id.* at 1033. In arriving at its
23 holding, the court correctly observed that the "right to transfer
24 is 'one of the most essential sticks in the bundle of rights that

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1 are commonly characterized as property'", and that an asset
2 subject to marketability restrictions is, as a rule, worth less
3 than an identical item that is not so burdened. *Id.* at 1032
4 (citations omitted).

5 As stated previously, the parties in the case before us have
6 stipulated that the transferability restrictions on the prize had
7 an adverse impact on its market value. Moreover, the
8 Commissioner agrees that the estate's valuation of the winnings,
9 a figure over $900,000 below that prescribed by the § 7520
10 standardized valuation tables, accurately reflects the market
11 discount attributable to those restrictions. Under these
12 circumstances, application of the tables would clearly "produce a
13 substantially unrealistic and unreasonable result", *O'Reilly*, 973
14 F.2d at 1408. We hold, therefore, that valuing the winnings
15 pursuant to the tables was erroneous.

16 The Tax Court held that adherence to the tables was proper
17 because no prior case, other than the opinion of the *Shackleford*
18 district court[2] (which it dismissed as "anomalous"), has held
19 that marketability restrictions alone can justify departure. See
20 *Gribauskas*, 116 T.C. at 163. In its brief before this Court, the
21 Commissioner argues for a similarly narrow interpretation of the
22 precedent. The Commissioner contends that despite the broad

[2]The Ninth Circuit affirmed the district court opinion in Shackleford after the Tax Court issued its opinion in the case at hand.

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1 language in departure cases such as *O'Reilly*, departures from the
2 tables are appropriate only when the proponent of departure can
3 show a substantial inconsistency between the actual facts and the
4 assumptions underlying the tables, e.g., when the rate of return
5 is actually lower than the assumed rate of return in the tables,
6 or when the death of the measuring life is imminent due to
7 terminal illness. *See Berzon*, 534 F.2d at 532 (departure
8 appropriate when one could predict with assurance that the income
9 from an investment would be zero, and that therefore, use of the
10 actuarial tables with a presumed yield of 3.5% led to "an
11 obviously erroneous result"); *O'Reilly*, 973 F.2d at 1406
12 (departure appropriate when very low dividends historically paid,
13 and therefore, the actuarial tables, assuming a much higher
14 yield, "produce[d] a wildly unrealistic measurement"); *see also*
15 *Froh v. Commissioner*, 100 T.C. 1, 5 (1993) (use of tables would
16 be "unrealistic and unreasonable" in valuing an income stream,
17 when the projected income stream is expected to be exhausted
18 prior to the expiration of the income term being valued); *Estate*
19 *of Jennings v. Commissioner*, 10 T.C. 323, 327 (1948) (departure
20 from mortality tables appropriate when reasonable life expectancy
21 of decedent's husband (the measuring life) was not longer than a
22 year from decedent's death).
23 The Commissioner is correct in characterizing the case law
24 up to this point— excluding, of course, *Shackleford*— as

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1 authorizing departures only when the actual facts are
2 inconsistent with the assumptions underlying the tables. The
3 Commissioner suggests that departures should be limited to the
4 fact patterns of the prior cases. Although it is possible to
5 make a distinction between cases involving inconsistencies
6 between the tables' assumptions and the ultimate facts and cases
7 identifying only an error in the ultimate result of the tables'
8 valuation, such a distinction is unadvisable. The reasoning
9 behind the departures in the earlier cases is completely
10 applicable to errors in the ultimate valuation, like those in the
11 case at hand. The governing principle is that a departure is
12 allowed if the tables produces a substantially unrealistic and
13 unreasonable result.
14 Furthermore, the need for efficiency and consistency does
15 not justify the application of the standardized tables in the
16 instant case. The law sufficiently accounts for such policy
17 concerns by placing the burden on the party challenging the
18 application of the tables to prove that the tables yield a
19 substantially unreasonable or unrealistic result. *See*
20 *Shackleford*, 262 F.3d at 1032. This high burden has been met by
21 the decedent's estate in the instant case by virtue of the
22 stipulations in the record.
23 We reverse and remand to the Tax Court for further
24 proceedings consistent with this opinion.