



The Method of Comparables and Tax Court Valuations of Private Firms: An Empirical Investigation

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Abstract:

This paper introduces a series of valuation models that mimic important features of regulatory prescriptions and legal precedent for the method of comparables as applied in estate and gift tax cases. We evaluate the models using out-of-sample estimation to determine which ones have the most desirable statistical properties for prediction. We then compare the predictions from these models to the valuations put forth by taxpayers, the IRS, and judges in estate and gift tax cases. This analysis reveals that taxpayers and the IRS propose values consistent with their underlying incentives, but significantly different from most bias-adjusted forecast models. The judges choose values consistent with the average value of the two experts and with bias-adjusted forecast models. Thus, the tax litigation system appears to ultimately produce an estimate of value that is consistent with an objective application of the method of comparables to the available data.