



# WHEN RESULTS COUNT

## TAX VALUATION E-FLASH

### Special Edition

#### CORPORATE OFFICES

##### California (Los Angeles)

James S. Rigby ABV, ASA  
[jrigby@fvginational.com](mailto:jrigby@fvginational.com)

Erich Z. Sylvester JD., ASA  
[esylvester@fvginational.com](mailto:esylvester@fvginational.com)  
213.362.9991

##### Florida (Tampa)

Michael J. Mard ABV, ASA  
[mmard@fvginational.com](mailto:mmard@fvginational.com)

Steven Hyden ASA  
[shyden@fvginational.com](mailto:shyden@fvginational.com)  
813.985.2232

#### REGIONAL OFFICES

##### California (Oakland)

John J. Mayerhofer FACHE, FHFMA  
[jmayerhofer@fvginational.com](mailto:jmayerhofer@fvginational.com)  
510.531.2943

##### California (Silicon Valley)

Robert T. Lanz  
[rlanz@fvginational.com](mailto:rlanz@fvginational.com)  
408.777.2914

##### Illinois (Chicago)

Michael J. Mattson  
[mmattson@fvginational.com](mailto:mmattson@fvginational.com)  
773.769.3045

##### Iowa (Des Moines)

Terry J. Allen ABV, ASA  
[tallen@fvginational.com](mailto:tallen@fvginational.com)  
515.953.4498

##### Massachusetts (Framingham)

Stephen J. Bravo ABV, AM, CBA  
[sbravo@fvginational.com](mailto:sbravo@fvginational.com)  
508.872.4002

##### Missouri (Kansas City)

Terry J. Allen ABV, ASA  
[tallen@fvginational.com](mailto:tallen@fvginational.com)  
816.373.3340

##### Montana (Great Falls)

John R. Gilbert ABV, ASA, CVA  
[jgilbert@fvginational.com](mailto:jgilbert@fvginational.com)  
406.453.1800

##### New York (Rochester)

Rosanne T. Schwartz ABV, ASA, CVA  
[rschwartz@fvginational.com](mailto:rschwartz@fvginational.com)  
716.271.6540

**Eberl's Claim Service, Inc. v. Commissioner, No. 99-9033, 2001 U.S. App. Lexis 8162, United States Court of Appeals for the Tenth Circuit, May 4, 2001**

The Tenth Circuit affirmed a Tax Court opinion that held a corporation may deduct only a portion of the amounts paid to its shareholder/president as reasonable compensation.

Kirk Eberl was president, director, and sole shareholder of Eberl's Claim Service Inc. (ECS), which was an independent claims adjuster for insurance companies. For 1992 and 1993, ECS deducted \$4.3 million and \$2 million, respectively, as Eberl's compensation. ECS had never declared a dividend. The IRS contended that reasonable compensation was \$500,000 and \$400,000 for 1992 and 1993 respectively and the amounts paid in excess of this were disguised dividends.

The Tax Court opined that because of Mr. Eberl's qualifications high compensation was justifiable. However, the court pointed out that:

- 1) ECS paid Eberl most of its income,
- 2) Eberl's compensation agreement was not at arm's length, and
- 3) Other ECS employees didn't share in the profits.

The court concluded that \$2.3 million of the 1992 and \$1 million of the 1993 compensation was reasonable.

Circuit Judge Carlos F. Lucero reviewed the Tax Court's holding that some of the compensation was reasonable and applied the multi-factor test of *Pepsi-Cola Bottling Co. v. Commissioner*, 528 176 (10th Cir. 1976) to determine the reasonableness of compensation under section 162(a)(1). Because the salary arrangement was between Eberl as a shareholder and Eberl as an employee, the court found the compensation arrangement inherently suspect and thus possible to view as unreasonable on that ground alone. After considering the *Pepsi-Cola* factors, Judge Lucero agreed with the Tax Court's analysis, finding that

Continued on page 2



# WHEN RESULTS COUNT

## TAX VALUATION E-FLASH

### Special Edition

#### SERVICES OFFERED:

Corporate Transaction Services

Tax Related Services

International Valuations

Employee Stock Ownership Plans

Litigation Services

Intellectual Property Services

Accounting / SEC Review

the salary was unreasonably large, and then relied on the IRS's expert testimony to fix a reasonable amount.

The Judge also considered an argument raised by the taxpayer on appeal, that the court should use an "independent investor" test instead of a reasonableness test to determine a reasonable compensation. Although noting that it is much simpler than the multi-factor approach, the court concluded that absent en banc rehearing it was bound to use the multi-factor test.

[Click Here for Full Text of Cases](#)



Edited by John R. Gilbert ABV, ASA, CVA  
The Financial Valuation Group  
Mountain States Managing Director  
(c) Copyright 2001

*We are founding members of The Financial Consulting Group whose members provide Business Valuation, Expert Testimony and Litigation Consulting services nationally and internationally.*

*For more information on court cases involving valuation issues, or for a complimentary subscription to our newsletters, please visit:*

[www.fairmarketvalue.com](http://www.fairmarketvalue.com)

*We encourage you to forward this E-flash to other interested parties.*