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Robert P. Achenbach, Jr.

Contributing Editor

Dr. Neil E. Harl, Esq.

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Fixing Values at Death for Federal Estate Tax Purposes

-by Neil E. Harl*

With no readily determined fair market value from market determinations for ownership interests in most farm and ranch entities, it has been necessary to establish values for stock and other equity interests for federal estate tax, federal gift tax and federal income tax purposes as well as for purposes of fairness in making transfers.¹ Until 1990, it was an accepted practice to utilize stock transfer restriction provisions to fix values for transfers during life and at death.² That practice was supplemented by the enactment of legislation in 1990.³ The 1990 provision recognizes instances where values can be fixed at death⁴ and a recent case has applied those exceptions as well as the rules from the pre-1990 case law.⁵

The rules in effect before 1990

Under the case-law prevailing before 1990, a stock transfer restriction could fix the value of stock or other equity securities at death if certain conditions were met – (1) the price was fixed or determinable by formula; (2) the estate was under an obligation to sell under a buy-sell agreement or upon exercise of an option;⁶ (3) the obligation to sell was binding during life;⁷ and (3) the arrangement was entered into for bona fide business reasons and not as a substitute for a testamentary disposition.⁸

The 1990 provisions

The 1990 legislation⁹ supplemented, but did not replace, those guidelines with a general rule that such agreements, options or restrictions are not effective to set values at less than fair market value¹⁰ except for specified exceptions.¹¹ The 1990 enactment, while acknowledging that agreements, options or restrictions could not fix values at less than fair market value,¹² articulated three exceptions to the general rule.¹³ Under the exceptions, agreements, options or restrictions were not subject to the general rule if *all* of three requirements were met – (1) the agreement, option or restriction was a bona fide business arrangement;¹⁴ (2) the agreement, option or restriction was not a device to transfer the property to members of the decedent's family for less than full and adequate consideration in money or money's worth;¹⁵ and (3) the terms of the agreement, option or restriction were comparable to similar arrangements entered into by persons in an arms' length transaction.¹⁶

Because the 1990 provisions were meant to supplement but not replace prior case law,¹⁷ the pre-1990 rules requiring that an agreement, to be effective, must be binding during life

* Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.

and at death and must contain a fixed and determinable price continue to apply.¹⁸

Tax Court case decided in 2006

In a Tax Court case¹⁹ decided in 2006, an agreement restricting the sale of the decedent's stock in a bank fixed the fair market value in determining value for federal estate tax purposes. In 1994, the decedent's conservator and a bank negotiated an agreement for the sale of the decedent's stock in the bank, after death, for \$118 per share.²⁰ Litigation among the prospective heirs ensued and so the conservator in 1995 negotiated an agreement providing for the decedent and her heirs, except for one son, to receive \$118 per share of the bank stock and for the purchase by the son of the stock remaining in the decedent's estate for \$118 per share. In 1997, an agreement with the bank specified that the bank would pay \$217.50 plus four percent per year for each share to the son for the decedent's stock purchased by the son.²¹

I.R.S. argued that the 1995 agreement setting the value for the stock should be disregarded and the value should be used coming from the purchase of the stock within a month after the decedent's death.

The Tax Court held that the restrictive agreement controlled the value for federal estate tax purposes because the requirements for the pre-1990 case law and the statutory exceptions were satisfied – (1) the agreement reached among the prospective heirs fixed the value of all of the decedent's bank stock; (2) the agreement between the heirs and the conservator was enforceable with a court order approving the settlement and granting authority to the conservator to carry out the terms and conditions of the agreement; (3) the agreement furthered a business purpose by minimizing the risk to the decedent of holding a minority interest in a closely-held bank; (4) the agreement was found not to be a testamentary device inasmuch as the decedent received "significant" consideration under the agreement; The court addressed the difference between the \$118 per share value and the \$217.50 per share value and found that the \$118 per share value ". . . was fair at the time and in the particular circumstances,"²² and (5) the agreement was similar to comparable arms' length agreements.²³

The Tax Court reasoned that the statutory exceptions of I.R.C. § 2703(b) were satisfied so the general rule of I.R.C. § 2703(a) did not provide a basis for disregarding the earlier, pre-death, agreement which met all of the relevant case-law requirements.²⁴

Footnotes

¹ See generally 8 Harl, *Agricultural Law* § 58.05[1], [2] (2006); Harl, *Agricultural Law Manual* § 7.02[5][d] (2006).

² *Id.* See, e.g., Estate of Littick v. Comm'r, 31 T.C. 181 (1958), *acq.*, 1959-2 C.B. 5.

³ Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11602(a), 104 Stat. 1388-491 (1990).

⁴ I.R.C. § 2703(b).

⁵ Estate of Amlie v. Comm'r, T.C. Memo. 2006-76.

⁶ See, e.g., Estate of Littick v. Comm'r, 31 T.C. 181 (1958), *acq.*, 1959-2 C.B. 5.

⁷ See, e.g., Estate of Gannon v. Comm'r, 21 T.C. 1073 (1954).

⁸ Estate of Seltzer v. Comm'r, T.C. Memo. 1985-519 (buy-sell agreement was bona fide business arrangement where purpose of agreement was restriction of ownership of stock in corporation). See also Rev. Rul. 59-60, 1959-1 C.B. 237.

⁹ See note 3 *supra*.

¹⁰ I.R.C. § 2703(a).

¹¹ I.R.C. § 2703(b).

¹² I.R.C. § 2703(a).

¹³ I.R.C. § 2703(b).

¹⁴ I.R.C. § 2703(b)(1).

¹⁵ I.R.C. § 2703(b)(2). See Estate of Gloeckner v. Comm'r, T.C. Memo. 1996-148, *rev'd*, 152 F.3d 208 (2d Cir. 1998) (restrictive agreement controlled valuation; testamentary purpose not behind agreement); Rudolph v. United States, 93-1 U.S. Tax Cas. (CCH) ¶ 60,130 (S.D. Ind. 1993) (price set in buy-sell agreement prevailed where agreement represented bona fide business arrangement and was not testamentary device to avoid federal estate tax; annual review of purchase price was specified). Compare Estate of Blount v. Comm'r, 2005-2 U.S. Tax Cas. (CCH) ¶ 60,509 (11th Cir. 2005) (redemption price in modified buy-sell agreement did not control value of closely-held stock for federal estate tax purposes); Estate of True v. Comm'r, 2004-2 U.S. Tax Cas. (CCH) ¶ 60,495 (10th Cir. 2004) (formula price contained in buy-sell agreement not controlling in valuing business interests for estate and gift tax purposes; served as testamentary substitute); Estate of Lauder v. Comm'r, T.C. Memo. 1994-527 (formula price in restrictive shareholder agreement did not control value; principal purpose was to achieve testamentary objectives); Cameron W. Bommer Revocable Trust v. Comm'r, T.C. Memo. 1997-380 (estate failed to meet burden of proof that price per share set forth in buy-sell agreement reflected adequate and fair consideration in closely-held family corporation; not binding on decedent during life and substitute for testamentary distribution).

¹⁶ I.R.C. § 2703(b)(3).

¹⁷ See 136 Cong Rec. 30,488, 30,540-41 (1990).

¹⁸ See Estate of Amlie v. Comm'r, T.C. Memo. 2006-76.

¹⁹ Estate of Amlie v. Comm'r, T.C. Memo. 2006-76.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*