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Issue Contents

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History of Annually Determined Prices for Ownership Interests

-by Neil E. Harl*

For active farms and ranches, one of the most difficult issues in estate and business planning is how to go about setting values for multiple ownership situations if both on-farm heirs and off-farm heirs are involved. Our experience has been that the task can be eased if –(1) the organizational documents (articles of incorporation, bylaws and shareholder agreements for corporations and the same as to partnerships and other organizational structures) have been agreed to by the owners as to how and when the valuation is to occur; (2) the valuation process has been carried out annually without exception; and (3) the results have been agreed to by the designated group, usually those holding an equity interest.

This article focuses principally on whether the results of an annual valuation can be expected to prevail if challenged in valuation of assets at the death of an owner.

Pre-1990 rules

Under case law decided before the 1990 "freeze" rules were enacted, a stock transfer restriction could fix values at death, for example, if – (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;[1] (3) the obligation to sell was binding during life;[2] and (4) the arrangement was entered into for bona fide business reasons and not as a substitute for a testamentary disposition;[3]

Act of 1990

The Omnibus Budget Reconciliation Act of 1990[4] supplemented the pre-1990 case law in two respects. The 1990 Act provided a general rule that property is to be valued without regard to any option, agreement, restriction "or other right" which set price at less than fair market value of the property.[5] The 1990 Act also specified that the general rule would not apply if the option, arrangement, restriction "or other right" met each of these requirements – (1) it is a bona fide business arrangement, (2) it is not a device to transfer value to family members for less than full consideration, and (3) the terms are comparable to "similar" arrangements entered into in an arm's length transaction.[6]

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The Committee Reports indicated that the 1990 Act was meant to supplement, but not to replace, prior case law.[7] Thus, the pre-1990 rules requiring that an agreement be binding during life and at death and contain a fixed and determinable price continued to apply.

Estate of Amlie v. Commissioner

In a 2006 case, *Amlie v. Commissioner*,[8] involving the valuation of stock of an Iowa bank, the exceptions in I.R.C. § 2703(b) were satisfied so I.R.C. §2703(a) did not provide a basis for disregarding the pre-death agreement.

In conclusion

So, what was feared would be a barrier to relying upon the pre-1990 rules turned out not to be a barrier after all. Pre-death planning is, of course, vital if there is reliance on the *Amlie* decision and the language in the 1990 Act.

A further footnote

A careful, well-documented record of valuations determined each year by the designated group doing the valuation of farmland, machinery, stored grain, livestock inventory and other assets including business vehicles, is also vital.

END NOTES

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

[2] See, e.g., Estate of Gannon v. Comm'r, 21 T.C. 1073 (1954); Estate of Blount v. Comm'r, T.C. Memo. 2004-116, *aff'd, rev'd and rem'd in part*, 428 F.3d 1338 (11th Cir. 2005).

[3] E.g., Estate of Gloeckner v. Comm'r, T.C. Memo. 1996-148, *rev'd*, 152 F.3d 208 (2d Cir. 1998).

[4] Pub. L. No. 101-508, § 11602(a), 104 Stat. 1388 (1990).

[5] I.R.C. § 2703(a).

[6] I.R.C. § 2703(b). See Ltr. Rul. 200852029, Sept. 19, 2008 (interest in real estate joint venture not subject to I.R.C. § 2703 special valuation inasmuch as more than 50 percent was owned by persons who were not family members and interests were subject to restrictions in buy-sell agreement).

[7] 136 Cong. Rec. 30,488, 30,540-41 (1990).

[8] T.C. Memo. 2006-76. For discussion of this case, see Harl, "Fixing Values at Death for Federal Estate Tax Purposes," 17 *Agric. L. Dig*. 73 (2006).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ADVERSE POSSESSION

FENCE. The plaintiffs owned land north of the defendant's property and the two properties were separated by a fence in existence for more than 50 years. In preparation for granting an easement for a pipeline, the defendant had a survey performed which showed that the fence was located north of the true boundary between the properties. The pipeline company destroyed the old fence and constructed a new fence on the true boundary. The plaintiffs sued for possession and a permanent injunction to remove the fence and damages for the cost of a new fence at the old location. The trial court ruled in favor of the plaintiffs, holding that the plaintiffs had proved continuous possession of the disputed land by reason of the fence as a boundary. On appeal the defendants challenged the sufficiency of the evidence of actual possession of the disputed strip of land. Under La. Civ. Code art. 3424, to acquire possession, one must intend to possess as owner and must take corporeal possession of the thing. La. Civ. Code art. 3425 provides that corporeal possession is the exercise of physical acts of use, detention or enjoyment over a thing. One who possesses a part of an immovable by virtue of a title is deemed to have constructive possession within the limits of recorded title. Under La. Civ. Code art. 3426, in the absence of title, one has possession only of the area that the person actually possesses. Actual possession must be either inch by inch possession or possession within enclosures. An enclosure is any natural or artificial boundary. La. Civ. Code art. 3426, comment (d). For the purposes of acquisitive prescription (adverse possession), actual possession is determined according to the nature of the property. See La. Civ. Code art. 3487, revision comment (c). In this case, the fence ran through a wooded wetland area which prevented consistent activity up to the fence line. Thus, the court found that the plaintiffs were not required to show that they planted crops, mowed or cut timber on a regular basis up to the fence line. The court further found that plaintiffs exercised corporeal possession of the disputed strip of land based on activities including maintaining the fence line, cutting hay and hunting. The appellate court affirmed the trial court that the original fence line was the legal boundary between the properties by acquisitive prescription. **Madden v. L.L. Golson, Inc., 2017 La. App. LEXIS 1203 (La. Ct. App. 2017)**.

ANIMALS

HORSES. The plaintiff was injured while riding a horse the plaintiff was considering purchasing from the defendants. The plaintiff had told the defendants that the plaintiff had some experience in riding horses but just before attempting to ride the horse, the plaintiff asked the defendant whether the horse was safe for the plaintiff. The defendant assured the plaintiff that the horse was safe. However, the plaintiff did not have much experience with gaited horses, as was the horse involved, and quickly lost control of the horse and was thrown. The defendants had posted warning signs about the dangers of farm animal activities and