BUY-SELL AGREEMENTS AND THE WEB OF FEDERAL ESTATE AND GIFT TAX EXPOSURE

ABSTRACT

Parties that unite to conduct business define their respective rights and obligations by entering into a buy-sell or restrictive agreement. Essential terms of a buy-sell agreement restrict alienability of shares, articulate conditions for permissive or mandatory redemption, and establish a unit value or formula to determine exit consideration. Moreover, a properly structured buy-sell agreement considers the income and estate tax interests of the parties. The closer the relationship between the parties, the greater the likelihood that the IRS will disregard the value ascribed by the exiting stockholder.

Many provisions in the Internal Revenue Code exact a clear-cut tax. The Code imposes, however, vague litmus tests to determine federal tax liability as a consequence of a transfer of business interests pursuant to a buy-sell agreement. From the dawn of the nineteenth century through the birth of the new millennium, the IRS and taxpayers continue to litigate over a series of subjective standards to contend with the valuation rules for transfers of business interests. This note identifies and analyzes federal tax considerations concerning the value ascribed to the transfer of closely held business interests.

Specifically, this note examines non-Code authority that is still relevant for many agreements in effect today. Following a brief review of the first arguably overbroad attempt by Congress to curb perceived estate freeze abuses, the focus of this note shifts to contemporary standards. The Code now provides a concise rule to govern values established under a buy-sell agreement. This note will also analyze the contemporary rule, its legislative history, and scant but available case law. Although succinct, the Code standard is highly subjective and fertile ground for controversy. Due to the subjective, yet untested, nature of the rule, this note identifies numerous areas through which one should proceed with caution. Finally, in January 2001, President Bush implored Congress to repeal the estate tax. This note also reviews the controversy and considerations surrounding the prospects for imminent legislative relief.

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I. INTRODUCTION

A. *Situations When Business Interests May Be Sold*

Two individuals, A and B, are the first to develop a proprietary wireless means for computer users to access either the Internet or other qualified computer users. This advance in technology will create a watershed of opportunity for the creators. They ante-up the necessary cash requirements, employ the necessary talents, establish their distribution channels, communicate their breakthrough to the appropriate consumers, and begin to sell.

From here, nothing but the coveted "American dream" lies ahead for A and B. After several years of newfound success and financial stardom, what tax issues could arise if A decides to retire at a young age? What if B suffers a permanent incapacity which, to a reasonable degree of medical certainty, will prevent him from ever being able to work another day in his life? Instead, what if B should die?

Admittedly, some of the facts may border on the fringe of cyberspace as we know it today. In principle, however, the outcomes do not. What tax issues need to be considered when two or more individuals operate a business, then later separate due to retirement, irreconcilable differences, extended incapacity, or death? In this hypothetical, if A retires, what can she do with her interest in the business? Can she sell it? If so, to whom? Does (or should) B have any say in A's interest in the business? What is A's interest worth? Who decides its value? What about the business? Does (or should) the business have any preemptive rights in A's interest?

B. *Form of Agreement to Sell Business Interests*

The answers to the preceding questions depend upon a number of factors. Is the business organized as a corporation, partnership, or a trust? Are A and B related as siblings, through marriage, lineal consanguinity, whether it be ascending, descending or collateral, or otherwise?[1] Did A and

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[1]Ascending consanguinity refers to relatives *up* the family bloodlines, i.e., parents, grandparents, etc. Descending consanguinity refers to direct descendants *down* the family bloodline. Collateral consanguinity refers to *cross* line collaterals: first line collaterals are brother-sister, niece-nephew, etc.; second line collaterals are first cousins, first cousins once removed, etc.; and so on beyond such degrees of relationship. For further analysis of these relations, see JESSE DUKEMINIER & STANLEY M. JOHNSON, WILLS, TRUSTS, AND ESTATES 85-87 (5th ed. 1995).

B enter into any agreements between each other or between each of them and their business?

When parties unite to form a business, they may define their respective rights by entering into a variety of agreements. An agreement may control the ultimate disposition of their respective interests.[2] An agreement may control the value ascribed or to be ascribed to their respective interests.[3] If the business is a corporation organized under Subchapter S or Subchapter C of the Internal Revenue Code (I.R.C.), and the parties intend for the corporation to purchase the stock of a withdrawing shareholder, the agreement is generally referred to as a stock redemption agreement.[4] If, on the other hand, the corporation is not a party to the agreement, but rather the shareholders agree to buy each others' interests, the agreement is generally referred to as a cross-purchase agreement.[5] Stock redemption agreements or cross-purchase agreements are often referred to as buy-sell or restrictive agreements.[6]

C. *Scope of the Issues*

Although A and B have a legal right to contract to dispose of their property interests as they so desire within the confines of appropriate governing law, their agreement, unbeknownst to the parties, may have adverse federal tax consequences.[7] A properly structured buy-sell or restrictive agreement should consider the income and estate tax interests of

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[2]*See* William P. Streng, *Estate Planning*, 800 Tax Mgmt. (BNA) at A-5 (Sept. 25, 2000) (analyzing, *inter alia*, succession issues for the closely-held business).

[3]*See, e.g.*, St. Louis County Bank v. United States, 674 F.2d 1207 (8th Cir. 1982) (establishing a formula to value shares to be sold). *But see* Treas. Reg. §§ 20.2031-1(b), 20.2031-2(h) (2001) (providing IRS regulations to value shares sold pursuant to contract); Rev. Rul. 59-60, 1959-1 C.B. 237 (providing IRS Revenue Ruling to value shares to be sold); 26 U.S.C. § 2703 (1994) (providing statutory rule to apply when shares sold pursuant to contract). *See generally* Diana S.C. Zydel & Norman J. Benford, *Valuation Principles and Recent Developments: Practical Guidance for the Estate Planner*, 34 REAL PROP. PROB. & TR. J. 207, 231 (1999) (providing overview of valuation approaches for closely-held businesses).

[4]*See generally* Richard L. Lavoie, *Valuation of Corporate Stock*, 831-2nd Tax. Mgmt. (BNA), at B-901 (1998) (providing IRS training materials that distinguish between various types of mandatory and optional redemption agreements); Christopher Stoneman & Willemien Dingemans Miller, *Estate Planning for Owners of Closely Held Business Interests*, 809 Tax Mgmt. (BNA), at A-1, A-4 (May 8, 2000) (explaining different types of buy-sell agreements and cautioning the drafter to ensure compliance with state law solvency rules).

[5]Stoneman & Miller, *supra* note 4, at A-1.

[6]*Id.*

[7]*See infra* note 15.

the parties to the agreement.[8] Such an agreement should be tailored to the form of the business.[9] Moreover, when the parties to the agreement are related, and a primary interest is to minimize the estate tax burden, it is critical that the buy-sell or restrictive agreement be drafted properly. For purposes of this note, all parties are assumed to be either United States citizens or residents at the time of their death.[10]

D. *Objectives*

This note focuses on the specious nature of non-Code authority to value interests transferred pursuant to a buy-sell agreement. Although the guiding authority is long on text, it is short in direction. This note will review the first, short-lived congressional estate freeze provision enacted in response to the tenuous nature of non-Code authority. An analysis of contemporary standards will conclude the note. The Code now provides one concise rule to disregard the value of property transferred pursuant to a buy-sell agreement. An exception to the general rule arises, however, when three subjective conditions exist. This note analyzes the statutes, regulations, and scant case law for the general rule and each element of the exception. Next, this note reviews recent controversy and consideration surrounding the prospects for imminent legislative relief. Finally, this note closes with a cogent recap of the issues when a buy-sell agreement establishes value for interests transferred.

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[8]*See generally* Robert A. McLeod, *Estate Taxes and the Closely Held Business: The Beginning of the End?*, 22 WM. MITCHELL L. REV. 1349, 1369-72 (1996) (distinguishing between estate tax consequences and income tax consequences from the disposition of an interest in a closely-held business).

[9]*See generally* Mark R. Siegel, *The Internal Revenue Code's Assault on Buy-Sell Agreements*, 54 LA. L. REV. 149 (1993) (analyzing the tax consequences of sales and redemptions under buy-sell agreements).

[10]From the outset, it is important to distinguish U.S. citizens or residents from those who are not U.S. citizens or residents. U.S. citizens or residents are subject to federal estate taxes under Subchapter A (Estates of Citizens or Residents), of Chapter 11 (Estate Tax), of Subtitle B (Estate and Gift Taxes), of Title 26 (Internal Revenue Code) of the United States Code (collectively, the Code). *See* Treas. Reg. § 20.0-1(b) (2001) (defining the scope of the regulations between citizens or residents and nonresidents not citizens). Whereas estates of nonresidents who are also not U.S. citizens are subject to federal estate taxes under Subchapter B (Estates of Nonresidents Not Citizens) of the Code. The rules, regulations, and governing case law for estates of nonresidents who are not citizens are beyond the scope of this note. *See id.* (defining the scope of the regulations between citizens or residents and nonresidents not citizens).

II. GOVERNING LAW

A. *The Value of Business Interests Generally*

Generally, a decedent's gross estate includes the value of "all property, real or personal, tangible or intangible, wherever situated."[11] Treasury Regulation section 20.2031-1(b) defines and qualifies value as follows:

> [t]he value of every item of property includible in a decedent's gross estate . . . is its fair market value at the time of the decedent's death . . . . [F]air market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts . . . . All relevant facts and elements of value as of the applicable valuation date shall be considered in every case.[12]

When the assets of the decedent's gross estate include marketable securities, value is the fair market value on the applicable valuation date.[13] Generally, published sources are readily available to obtain the fair market value of marketable securities on the applicable valuation date. This is not the case, however, for closely-held business interests.[14]

B. Scrutiny of the Bounty

Shareholders that transfer closely-held business interests are in a position to manipulate the value of their interests transferred pursuant to a buy-sell or restrictive agreement. For example, if Treasury Regulation

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[11]26 U.S.C. § 2031(a) (1994). *See also* 26 U.S.C. § 2033 (1995) (increasing the gross estate to "include the value of all property to the extent of the interest therein of the decedent at the time of his death").

[12]Treas. Reg. § 20.2031-1(b) (2001). In establishing the value of an interest in a closely-held business, one must consider an appraisal of the business, its earnings capacity, and other relevant factors. *See* Treas. Reg. § 20.2031-3 (2001).

[13]*See* Treas. Reg. § 20.2031-2(a). *Cf.* Treas. Reg. § 20.2031-8(2)(b) (valuing a decedent's interest in mutual funds at the public redemption price). *Compare* 26 U.S.C. § 2033 (valuing property as of the date of the decedent's death), *with* 26 U.S.C. § 2032 (permitting the executor to elect an alternate valuation date under appropriate circumstances).

[14]*See generally* Edwin T. Hood et al., *Valuation of Closely Held Business Interests*, 65 UMKC L. REV. 399 (1997) (providing a comprehensive analysis of the rules and issues associated with valuing a closely-held business).

section 20.2031-1(b) is applied literally to a buy-sell or restrictive agreement, parties could attempt to minimize the effect of section 2031 by placing an arbitrarily low value on the securities.[15] That value would then be used as the basis to compute the estate tax.[16] Alternatively, the IRS could summarily deny the value placed on securities sold or purchased under a buy-sell or restrictive agreement.[17] To prevent either situation, the Treasury issued a regulation specifically addressing options or contracts to purchase securities.[18] In part, the regulation provides that:

> [l]ittle weight will be accorded a price contained in an option or contract under which the decedent is free to dispose of the underlying securities at any price he chooses during his lifetime. . . . Even if the decedent is not free to dispose of the underlying securities at other than the option or contract price, such price will be disregarded in determining the value . . . unless it is determined under the circumstances of the particular case that the agreement represents a bona fide business arrangement and not a device to pass the decedent's shares to the natural objects of his bounty for less than an adequate and full consideration in money or money's worth.[19]

Further, the Treasury stated that "[t]he effect, if any, that is given to the option or contract price in determining the value of securities for estate tax purposes depends upon the circumstances of the particular case."[20]

Because generally accepted valuation methods did not exist for closely-held business interests, the message that Treasury Regulation section 20.2031-2(h) sends is that property interests to be valued based on a contract are subject to greater scrutiny.

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[15]This assumes that the parties to the agreement have an ulterior motive to set a low value for the stock to be sold or redeemed. This could be the case, for example, between a parent (about to exit the business or upon parent's death), and a child who stands to assume the interest (either from a purchase from parent or through a stock redemption). In this example, the agreement would mandate that a decedent shareholder's estate must sell its shares to the surviving shareholders at a fixed price. If the share price was deliberately set low, then the asset value included in the decedent shareholder's gross estate would likewise be low. *See, e.g.*, St. Louis County Bank v. United States, 674 F.2d 1207 (8th Cir. 1982).

[16]*See* 26 U.S.C. § 2031(a). *See also id.* § 2033.

[17]*See, e.g.*, *St. Louis County Bank*, 674 F.2d at 1209 (providing an example of IRS valuation of a decedent's stock based on book value).

[18]Treas. Reg. § 20.2031-2(h) (2001).

[19]*Id.*

[20]*Id.*

C. *The Value of Closely-Held Business Interests (of Any Type)*

To provide guidance in determining a reasonable method to value an interest in a closely-held business, the Treasury issued the landmark, comprehensive Revenue Ruling 59-60.[21] The ruling opens with the comment that "[n]o general formula may be given that is applicable to the many different valuation situations arising in the valuation of such stock."[22] Thereafter, *inter alia*, the ruling set forth a list of factors that a qualified appraiser should consider to determine the value of a closely-held business.[23]

Because the regulations did not provide clear guidance on how to determine value by means of a buy-sell agreement, Revenue Ruling 59-60 provided a sharper focus as follows:

> Section 8. Restrictive Agreements
>
> Frequently, in the valuation of closely held stock for estate and gift tax purposes, it will be found that the stock is subject to an agreement restricting its sale or transfer. Where shares of stock were acquired by a decedent subject to an option reserved by the issuing corporation to repurchase at a certain price, the option price is usually accepted as the fair market value for estate tax purposes. However, in such case

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[21]Rev. Rul. 59-60, 1959-1 C.B. 237.

[22]*Id.*

[23]The ruling provides:

It is advisable to emphasize that in the valuation of the stock of closely held corporations . . . all available financial data, as well as all relevant factors affecting the fair market value, should be considered. The following factors, although not all-inclusive are fundamental and require careful analysis in each case:

(a) The nature of the business and the history of the enterprise from its inception.

(b) The economic outlook in general and the condition and outlook of the specific industry in particular.

(c) The book value of the stock and the financial condition of the business.

(d) The earning capacity of the company.

(e) The dividend-paying capacity.

(f) Whether or not the enterprise has goodwill or other intangible value.

(g) Sales of the stock and the size of the block of stock to be valued.

(h) The market price of stocks of corporations engaged in the same or a similar line of business having their stocks actively traded in a free and open market, either on an exchange or over-the-counter.

Id. § 4.01.

> the option price is not determinative of fair market value for gift tax purposes. Where the option, or buy and sell agreement, is the result of voluntary action by the stockholders and is binding during the life as well as the death of the stockholders, such agreement may or may not, depending upon the circumstances of each case, fix the value for estate tax purposes. However, such agreement is a factor to be considered, with other relevant factors, in determining fair market value. Where the stockholder is free to dispose of his shares during life and the option is to become effective only upon his death, the fair market value is not limited to the option price. It is always necessary to consider the relationship of the parties, the relative number of shares held by the decedent, and other material facts, to determine whether the agreement represents a bonafide [sic] business arrangement or is a device to pass the decedent's shares to the natural objects of his bounty for less than an adequate and full consideration in money or money's worth.[24]

Because Revenue Ruling 59-60 focuses on the corporate enterprise, the IRS expanded the scope of the ruling to encompass "business interests of any type,"[25] "including partnerships, proprietorships, etc."[26]

Presently, there are two rules that are both independent and interdependent—Treasury Regulation section 20.2031-2(h) and Revenue Ruling 59-60. The former focuses on the effect of a contract price in determining the value of securities. Independently, the regulation analyzes the circumstances to establish the value.[27] Revenue Ruling 59-60, however, provides a template to value closely-held business interests. Independently, the ruling outlines the process to determine value. Collectively, Treasury Regulation section 20.2031-2(h) and Revenue Ruling 59-60 create a basis

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[24] *Id.* § 8 (citations omitted).

[25] Rev. Rul. 65-192, 1965-2 C.B. 259. Revenue Ruling 65-192 states, *inter alia*, that:

> The general approach, methods and factors outlined in Revenue Ruling 59-60 . . . for use in valuing closely-held corporate stocks for estate and gift tax purposes are equally applicable to valuations thereof for income and other tax purposes and also in determinations of the fair market values of business interests of any type and of intangible assets for all tax purposes.

Id.

[26] *Id.* § 4.01.

[27] *See* Treas. Reg. § 20.2031-2(h).

for taxpayers to establish and measure bona fide transfers of closely-held business interests.

D. *Don't Meet Me In St. Louie*

As successor executor to the estate of Lee J. Sloan, St. Louis County Bank brought a landmark suit that led to an eventual change in the law.[28] The effect of the court's analysis in this case remains in the language of the statute.[29]

Mr. Sloan and his wife were the sole owners of a moving and storage company.[30] In 1956, they gifted nearly half of their interest in the business to their descendants.[31] Nearly eight years after the gifts, all of the shareholders entered into an agreement to restrict the transfer of the stock outside the family.[32] Under the agreement, the company and the shareholders had a right of first refusal to purchase the shares whenever a shareholder either died or wished to transfer his or her interest outside the family.[33] The option to purchase the shares was at a price determined by a formula stated in the agreement.[34] The formula to value the stock was reasonable at the time the agreement was entered into.[35]

In 1972, the company sold "virtually all of its operating assets" and thereafter engaged in a new line of business.[36] The change in operations resulted in a change in the company's profitability and, consequently, a "significant adverse impact on the 'value' of the [company] stock."[37] As a result of the change in the company's operations, the value of the stock included in Mr. Sloan's estate, as determined by the formula set forth in the agreement, was $0 at the time of his death.[38] The IRS ignored the share value determined by the agreement; it used the book value per share of the company and assessed a deficiency against the estate.[39]

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[28]St. Louis County Bank v. United States, 674 F.2d 1207 (8th Cir. 1982).

[29]*See infra* Part V.A.

[30]*St. Louis County Bank*, 674 F.2d at 1208.

[31]*Id.*

[32]*Id.*

[33]*Id.*

[34]*St. Louis County Bank*, 674 F.2d at 1208.

[35]*Id.* at 1210.

[36]*Id.* at 1209.

[37]*Id.*

[38]*St. Louis County Bank*, 674 F.2d at 1209.

[39]*Id.*

The court held that the fact that the agreement had a bona fide business purpose[40] did *not* preclude the "possibility that the agreement was a tax-avoidance testamentary device."[41] In other words, despite the bona fide business purpose, the effect of the agreement was to bypass any estate tax liability.[42] The court's rationale was that the decedent was in poor health when the agreement was entered into, the agreement was not used at the death of another shareholder, and the property had a zero value prescribed by the formula in the agreement.[43]

III. WEATHERING ESTATE FREEZE CONDITIONS

A. *The Tsunami*

I.R.C. section 2036(c) was the first "anti-freeze" provision and final forerunner to today's law taxing the value of closely-held business interests.[44] Congress intended this new provision to curb perceived estate freeze abuses.[45] This section sought to assess an immediate gift tax when a shareholder-donor retained a fixed income equity interest and transferred the growth equity interest in the business. Although the aim of section 2036(c) was to tax the transfer in value between ownership interests, its language was broad enough to affect most estate plan techniques.[46] By 1990, I.R.C. section 2036(c) was retroactively repealed because of substantial public protest.[47]

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[40]*Id.* at 1210 (explaining that the "maintenance of family ownership and control of the business" constituted "a bona fide business purpose").

[41]*Id.*

[42]*St. Louis County Bank*, 674 F. 2d at 1211. *See generally* RICHARD B. STEPHENS ET AL., FEDERAL ESTATE & GIFT TAXATION ¶ 19.04[1][a] (7th ed. 1996) (discussing valuation agreements among family members to avoid taxes versus bona fide business arrangements).

[43]*St. Louis County Bank*, 674 F.2d at 1210-11.

[44]Omnibus Budget Reconciliation Act of 1987, Pub. L. No. 100-203, § 10402(a), 101 Stat. 1330-431 (1997), *reprinted in* 1987 U.S.C.C.A.N. (101 Stat. 1330) 431.

[45]"If a person holds a substantial interest in an enterprise, and in effect transfers a disproportionate share of the potential appreciation in the enterprise, then the transferred property shall be included in his gross estate." H. R. REP. NO. 100-391 (II), at 1044 (1987), *reprinted in* 1987 U.S.C.C.A.N. 2313-660.

[46]*See, e.g.*, Richard L. Dees, *Section 2036(c): The Monster That Ate Estate Planning and Installment Sales, Buy-Sells, Options, Employment Contracts and Leases*, TAXES, Dec. 1988, at 876. *See also* Louis A. Mezzullo, *Valuation Rules Under Chapter 14: The Impact on Gift and Estate Taxation*, 1995 A.B.A. SEC. REAL PROP., PROB., AND TR. L. 6.

[47]"Outcries that this mechanism, while meshing with existing Code provisions, nevertheless was vague, overly broad, unworkable, potentially unfair, and not an appropriate mechanism to deal with [estate] freezes . . . ." STEPHENS ET AL., *supra* note 42, ¶ 19.01[1], at 19-5. *See also* Michael I. Frankel, *Estate Freezes: What's Left Under IRC Section 2701*, *in*

B. *The Quiet Storm*

In its journey to adopt contemporary estate freeze provisions, the Senate proposed: (1) to repeal I.R.C. section 2036(c) and (2) to adopt the valuation rules of Chapter 14.[48] Chapter 14 is an amalgam of special valuation rules to fairly tax perceived estate freeze transactions.[49] Whereas I.R.C. section 2036(c) sought to include the appreciated value of interests transferred in the decedent's gross estate, Chapter 14 results in current gift tax on "transfers."[50] This may lead to less overall tax collected, but it would be received in advance.

With respect to buy-sell agreements under Chapter 14, the legislative history provides, in pertinent part:

> [T]he value of property is determined without regard to any option, agreement, right or restriction, unless (1) the option, agreement, right or restriction is a bona fide business arrangement, (2) the option, agreement, right or restriction is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration, and (3) the terms of the option, agreement, right or restriction are comparable to those obtained in similar arrangements entered into by persons in an arm's length transaction.[51]

The third prong was especially important because it seemed to limit the scope for comparison to "similar arrangements." The problem with this is that unless others are entering into "similar arrangements," an otherwise acceptable agreement could be invalidated (for valuation purposes). To

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VALUATION TECHNIQUES IN ESTATE PLANNING 23, 25 (PLI Estate Planning & Admin., Handbook Series No. 0-240, 1995). Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11601, 104 Stat. 1388-1, 1388-490 (1990), *reprinted in* 1991-2 C.B. 524.

[48]*See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11601, 104 Stat. 1388-1, 1388-490 (1990), *reprinted in* 1991-2 C.B. 603-04.

[49]*See generally* Mezzullo, *supra* note 46, at 8 (explaining that Congress intended for Chapter 14 to allow non-abusive business owners to engage in estate planning (citing Senate Finance Committee Report, Oct. 18, 1990)). I.R.C. § 2701 valuation rules for certain transfers of interests in corporations and partnerships; I.R.C. § 2702 provides valuation rules for certain transfers of interests in trusts; I.R.C. § 2703 provides valuation rules for buy-sell agreements; and, I.R.C. § 2704 deals with certain lapsing rights and restrictions. I.R.C. §§ 2701-2704 (West 2001).

[50]STEPHENS ET AL., *supra* note 42, ¶ 19.01[3], at 19-7.

[51]*See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11601, 104 Stat. 1388-1, 1388-490 (1990), *reprinted in* 1991-2 C.B. 604.

address the valuation issue for buy-sell agreements, the Conference agreement provided the following critical explanatory comment to the third prong of the Senate Amendment:

> The conferees do not intend the provision governing buy-sell agreements to disregard such an agreement merely because its terms differ from those used by another similarly situated company. The conferees recognize that general business practice may recognize more than one valuation methodology, even within the same industry. In such situations, one of several generally accepted methodologies may satisfy the standard contained in the agreement.[52]

Two other noteworthy matters are included in the legislative history. First, with respect to the effective date for the new provisions to be applied to buy-sell agreements, Congress provided that the amendment "generally applies to transfers made and agreements entered into (or substantially modified) after October 8, 1990."[53] Because of the prospective nature of the effective date, prior case law may remain binding precedent, and prior regulations may govern the law to be applied. Thus, Treasury Regulation section 20.2031-2(h) was modified to reference I.R.C. section 2703 and its related regulations for such agreements entered into or substantially modified after October 8, 1990.[54] The regulations to I.R.C. section 2703 provide some guidance in determining whether an agreement has been "substantially modified."[55] The Code provides examples to illustrate the substantial modification regulations.[56] Caution is urged against the

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[52]*Id.* at 1991-2 C.B. 606.

[53]*Id.* at 1991-2 C.B. 604.

[54]*See* T.D. 8395, 1992-1 C.B. 321.

[55]In particular, the regulation provides that:

> [a]ny discretionary modification of a right or restriction, whether or not authorized by the terms of the agreement, that results in other than a de minimis change to the quality, value, or timing of the rights of any party with respect to the property that is subject to the right or restriction is a substantial modification.

Treas. Reg. § 25.2703-1(c)(1) (2001). The failure to make a mandatory modification required by the agreement is presumed to be a substantial modification. *Id. Cf.* A mandatory modification required by the right or restriction is not a substantial modification. Treas. Reg. § 25.2703-1(c)(2)(i).

[56]If a child enters into a lease with his/her parent and puts limits on the parent's use of the property which are different than similar arrangements between non-related parties, then the restriction on the use of the property would be disregarded when determining the value of the property to be included in the parent's gross estate. *See* Treas. Reg. § 25.2703-1(d), ex. 1.

practitioner who must determine whether a change to a pre-I.R.C. section 2703 agreement results in a "substantial modification."

The second noteworthy comment in the legislative history to I.R.C. section 2703 is that it required a Treasury study.[57] By no later than December 31, 1992, the Secretary of the Treasury was to study and report the results of buy-sell agreements and discretionary rights "that have the potential for distorting transfer tax value."[58] As of the conclusion of this note, this author has been unable to find any such report issued as required in the conference agreement.

IV. CONTEMPORARY STANDARDS AND ISSUES

A. *The Basic Rule*

The law that governs buy-sell agreements entered into (or substantially modified) after October 8, 1990 is located at I.R.C. section 2703.[59] The text of I.R.C. section 2703 is simple and concise; however, the issues that arise are substantial. The consequences that might flow from the failure to comply with I.R.C. section 2703 could lead to a financial catastrophe. Accordingly, it is important to review closely the statutory language of I.R.C. section 2703:

> Section. 2703. Certain Rights and Restrictions Disregarded
>
> (a) General Rule.
> For purposes of this subtitle, the value of any property shall be determined without regard to —
>
> (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or
> (2) any restriction on the right to sell or use such property.

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[57] *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11601, 104 Stat. 1388-1, 1388-490 (1990), *reprinted in* 1991-2 C.B. 604.

[58] *Id.*

[59] 26 U.S.C. § 2703 (1994). *See also supra* notes 53-56 and accompanying text (explaining the basis for and significance of October 8, 1990).

> (b) Exceptions.
> Subsection (a) shall not apply to any option, agreement, right, or restriction which meets each of the following requirements:
>
> (1) It is a bona fide business arrangement.
>
> (2) It is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth.
>
> (3) Its terms are comparable to similar arrangements entered into by persons in an arms' length transaction.[60]

B. *The Analysis*

An option, agreement, or other right to purchase or use any interest in business at less than its fair market value will be disregarded.[61] Instead, the property value is determined without regard to the option, agreement or other right.[62] In addition, any device to restrict the right to sell or use such property will be disregarded when determining the value of any property interest.[63] Collectively, the rules stated in this paragraph apply when determining the value of property and are referred to herein as "Rights and Restrictions."[64] What constitutes "property" may be subject to challenge.

1. Round One: Value What Property?

In *Estate of Church v. United States*,[65] perhaps the first case under I.R.C. section 2703, the IRS sought to apply an expansive definition of the

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[60]26 U.S.C. § 2703 (1994).

[61]*Id.* § 2703(a)(1).

[62]*Id.*

[63]*Id.* § 2703(a)(2).

[64]*See e.g.*, 26 U.S.C. § 2703 entitled, "Certain rights and restrictions disregarded."

[65]85 A.F.T.R.2d 2000-804, 2000-805 to -806 (W.D. Tex. Jan. 18, 2000). This case was brought by the IRS to deny the valuation discount applied to decedent's partnership interest as of her date of death. *See* I.R.C. § 7701(a)(2) (2001) (defining partnership interests). *See generally supra* notes 11-13 (articulating what property should be included in the gross estate of the decedent and when such property should be valued).

term "property." In *Church*, a partnership was formed two days before Mrs. Church, a cancer survivor, died unexpectedly.[66]

The IRS contended that the property to be included in the decedent's estate were the assets she contributed to the partnership, not her partnership interest.[67] Neither the IRS nor the court found a statutory basis for the IRS's claim.[68] The court noted that I.R.C. section 2703 does not define the term "property."[69] Further, the court held that "[t]he estate tax is imposed on that which a decedent transfers at death without regard to the nature of the property interest before or after death."[70] The government failed to persuade the court to ignore the partnership interest and tax the assets contributed to the partnership by Mrs. Church.[71] Also, in finding for the petitioner, the court did not accept the government's argument to disregard the partnership agreement to value the partnership interest.[72] Consequently, property is defined as used in its legal context.

2. Scope and Limits of the Basic Rules

The Rights and Restrictions rules apply for gift, estate, and generation-skipping transfer tax purposes.[73] These provisions pertain to agreements entered into after October 8, 1990.[74] Moreover, these rules to disregard the effect of the restrictions are broad in scope. Namely, the vehicles through which parties execute a buy-sell agreement may be part of or separate from: a partnership agreement,[75] articles of incorporation,[76]

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[66]*Estate of Church*, 85 A.F.T.R.2d at 2000-805 to -806.

[67]*Id.* at 2000-810.

[68]*Id.*

[69]*Id.* at 2000-810 to -811.

[70]Estate of Bright v. United States, 658 F.2d 999, 1001 (5th Cir. 1981) (en banc); *Estate of Church*, 85 A.F.T.R.2d at 2000-810 (citing I.R.C. § 2033).

[71]*Estate of Church*, 85 A.F.T.R.2d at 2000-810 to -811.

[72]*Id.* at 2000-811.

[73]*See* Treas. Reg. § 25.2703-1(a)(1). *See also supra* note 8.

[74]Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, 104 Stat. 1388-1, 1388-498, *reprinted in* 1991-2 C.B. 529. *See also supra* notes 53-56 and accompanying text (explaining the basis for, and significance of, October 8, 1990); Treas. Reg. § 25.2703-2 (providing the effective dates for Treas. Reg. § 25.2703-1).

[75]Treas. Reg. § 25.2703-1(a)(3). *See also* Informal Senate Report, S. 3209, 101st Cong., 2d Sess. (1990), 136 CONG. REC. S15777 (Oct. 18, 1990).

[76]Treas. Reg. § 25.2703-1(a)(3).

corporate bylaws,[77] a shareholders' agreement,[78] or "*any other agreement*."[79] Notwithstanding the broad scope of the rules to disregard the effect of the restrictions, a court will not disregard essential term provisions of an agreement.[80]

Three conditions taken together will quash the rules to disregard the effect of the restrictions determined by an agreement: (1) when the agreement exists for "bona fide" business purposes;[81] (2) when the agreement is not part of a strategy to transfer an interest in business to a family member "for less than full and adequate consideration in money or money's worth";[82] and (3) when the terms of the agreement are "*comparable to similar arrangements*" entered into in an arm's-length transaction.[83] Since all three conditions must be met,[84] "the mere showing that a right or restriction is a bona fide business arrangement is not sufficient to establish that the right or restriction is not a device to transfer property for less than full and adequate consideration."[85]

Each of these three situations is presumed to exist if more than fifty percent of the property value subject to agreement is owned by individuals who are not members of the transferor's family.[86] In addition, the agreement must contain the same right or restriction between the individual

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[77] *Id.*

[78] *Id.*

[79] *Id.* (emphasis added). *But see* Treas. Reg. § 25.2503-1(4) (exempting perpetual restrictions on the use of real property that qualified for a charitable deduction under enumerated provisions of the Code).

[80] In *Estate of Church*, the IRS sought to have the court disregard the term restriction and restrictions on sale in a partnership agreement. *Estate of Church*, 85 A.F.T.R.2d at 2000-804, 2000-811. As in the court's legislative analysis of the term "property" (*see supra* notes 65-70), there was nothing in the record to support the government's claim to disregard the terms of the agreement. *Id.* The court held:

> By its very nature, a partnership is a voluntary association of those who wish to engage in business together, and upon whom the law imposes fiduciary duties. Term restrictions, or those on the sale or assignment of a partnership interest that preclude partnership status for a buyer, are part and parcel of the property interest created by state law. These are not the agreements or restrictions Congress intended to reach in passing I.R.C. section 2703.

Estate of Church, 85 A.F.T.R.2d at 811.

[81] Treas. Reg. § 25.2703-1(b)(1)(i).

[82] *Id.* § 25.2703-1(b)(1)(ii).

[83] *Id.* § 25.2703-1(b)(1)(iii) (emphasis added).

[84] "Each of the three requirements described in [Treas. Reg. § 25.2703-1(b)(1)] must be independently satisfied for a right or restriction to meet this exception." *Id.* § 25.2703-1(b)(2).

[85] Treas. Reg. § 25.2703-1(b)(2).

[86] Treas. Reg. § 25.2703-1(b)(3) (2001).

and the transferor.[87] The non-family agreement is not considered in the analysis that follows.

V. SANCTUARY

A. *Bona Fide Business Arrangement*

Property value will be determined without regard to an agreement or restriction on the property unless, *inter alia*, there is a "bona fide business arrangement."[88] The phrase "bona fide business arrangement" is not defined in either the Code or the regulations.[89] However, ample case law exists to define what constitutes a "bona fide business arrangement."[90]

Business arrangements are bona fide if used, *inter alia*, to retain key employees,[91] to provide management incentives,[92] or to provide shareholder/key-employees with continued employment.[93] In the context of a family limited partnership arrangement, case law supports the position that, under appropriate circumstances, this test may be met. For example, in *Estate of Church*, the court found that the primary business purpose of the limited partnership was to preserve the family ranch enterprise "and remove it from the control of one or more fractional, undivided-interest owners who could use the property at will, interfere with operations, and ultimately force a partition or sale of the ranch."[94] Under these circumstances, the court held that the "[p]artnership had bona fide business purposes and was not a sham as that term is used [for estate tax purposes]."[95]

In each of nearly three consecutive private letter rulings, the IRS did not find a bona fide purpose for the creation of a family limited partnership.[96] In each memorandum, parties entered into family limited

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[87] *Id.*

[88] 26 U.S.C. § 2703(b)(1) (2001).

[89] *See* Treas. Reg. § 25.2703-1(b).

[90] *See e.g.*, St. Louis County Bank v. United States, 674 F.2d 1207 (8th Cir. 1982).

[91] Bensel v. Commissioner, 36 B.T.A. 246, 253 (1937).

[92] Cobb v. Commissioner, T.C.M. (Prentice-Hall, Inc., 1985) ¶ 85,208 (1985).

[93] *Id.*

[94] Estate of Church v. United States, 85 A.F.T.R.2d 2000-804, 2000-807 (W.D. Tex. Jan. 18, 2000).

[95] *Id.* at 2000-808.

[96] Priv. Ltr. Rul. 97-25-002 (Mar. 3, 1997); Priv. Ltr. Rul. 97-23-009 (Feb. 24, 1997); Priv. Ltr. Rul. 97-19-006 (Jan 14, 1997).

partnership agreements proximate in time to the decedent's death.[97] The IRS ruled that the family limited partnerships served as testamentary devices to minimize estate tax liability.[98] On the other hand, a bona fide business arrangement does exist where a taxpayer created a family limited partnership to conduct an active trade or business.[99] If the prime purpose of a family limited partnership is to liquidate and distribute its assets after a decedent's death, however, it may not pass muster under I.R.C. section 2703(b)(1). This conclusion is logical because the mere temporary existence of the entity should not justify a tax benefit.

Practitioners should exercise careful and objective analysis of the *non*-tax reasons to create a family limited partnership. Furthermore, tax counsel should exercise caution to ensure that the partner's contributions and respective capital interests do not result in gift tax liability.[100]

B. *Tax Device*

The IRS will disregard an option to acquire property at less than fair market value, or a restriction on the right to use property, unless "[i]t is not a device to transfer such property to members of the decedent's family for less than full and adequate consideration in money or money's worth."[101] On its face, the language in the statute appears straightforward. In fact, it is ambiguous and fertile ground for future dispute. Two independent prongs are required to satisfy the I.R.C. section 2703(b)(2) exception; viz., not an intrafamily device, and transfer for adequate consideration.

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[97]*E.g.*, Priv. Ltr. Rul. 97-19-006 (Jan. 14, 1997) (forming family limited partnership two days before decedent's death, while decedent was terminally ill).

[98]"The formation of the partnership and the subsequent transfer of the partnership interests on the Decedent's death are treated as a single testamentary transaction. Therefore, the partnership is disregarded for estate tax valuation purposes." Priv. Ltr. Rul. 97-25-002 (Mar. 3, 1997). When viewed in the aggregate, it is clear that despite the formation of the partnership "nothing of substance was intended to change as a result of the transfers" and, indeed, the transaction did nothing to affect decedent's or the son's interest in the underlying assets "except to reduce federal transfer taxes." Priv. Ltr. Rul. 97-23-009 (Feb. 24, 1997).

[99]*Estate of Church*, 85 A.F.T.R.2d at 2000-807 to -808. *See also* St. Louis County Bank v. United States, 674 F.2d 1207 (8th Cir. 1982).

[100]*See e.g.*, *Estate of Church*, 85 A.F.T.R.2d 2000-804 (W.D. Tex. Jan. 18, 2000) (distinguishing between capital contributions and proportional ownership from gifts of money or money's worth, in turn used as capital contribution).

[101]26 U.S.C. § 2703(b)(2).

1. Intrafamily Device

While the flush language of the statute proscribes transfers to "members of the decedent's family," on a broader scale, the regulations prohibit property transfers to "natural objects of the decedent's bounty."[102] The regulations subsume members of a decedent's family to include "any . . . individual who is a natural object of the [decedent's] bounty."[103] Thus, greater opportunity exists for an IRS challenge to any intrafamily transfers. This analysis may be consistent with the court's holding in *St. Louis County Bank*,[104] but at least one court held that there is a limit to the destiny of this lineal train.

In *Estate of Gloeckner v. Commissioner*,[105] the IRS invoked I.R.C. section 2703 to disregard share value determined under a stock redemption agreement (the agreement). Among other things, the agreement provided the company with a right of first refusal to restrict *inter vivos* sales to third parties.[106] Upon death, the agreement obligated the company to redeem as many shares from the estate as necessary to pay for the decedent's estate taxes.[107] Any shares not redeemed were bequeathed to the remaining shareholder.[108]

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[102]*Compare* 26 U.S.C. § 2703(b)(2) *with* Treas. Reg. § 25.2703-1(b)(1)(ii). It is noteworthy that while Congress intended for the provisions of Chapter 14 to apply to estate, gift, and generation skipping transfer taxes, the statutory language used in 26 U.S.C. § 2703(b)(2) applies only to "members of the decedent's family." Use of the term "decedent" implies that gifts would be excluded, whereas, the language in Treas. Reg. § 25.2703-1(b)(1)(ii) would encompass gifts. Query whether a case *against* the IRS would survive through the courts if a taxpayer argues to apply the plain language of the statute.

[103]Treas. Reg. § 25.2703-1(b)(3).

[104]*See* St. Louis County Bank v. United States, 674 F.2d 1207 (8th Cir. 1982). St. Louis County Bank was a pre-October 8, 1990 buy-sell agreement which was tested under Treas. Reg. § 20.2031-2(h), *not* I.R.C. § 2703(b)(2).

[105]71 T.C.M. (CCH) 148 (1996), *rev'd*, 152 F.3d 208 (2d Cir. 1998).

[106]*Id.* at 2550.

[107]*Id.* Decedent was never married and had no children. *Estate of Gloeckner*, 152 F.3d at 210. When decedent died in 1990 at the age of 88, he had a grandniece and a grandnephew, to whom he wanted to leave the bulk of his estate, but not the shares of his business, and all bequests unencumbered by estate taxes. *Id.* Although not mentioned in either courts' analysis, presumably, the estate redeemed the decedent's shares under I.R.C. section 303. Under I.R.C. section 303, where a shareholder's death is the cause of the redemption, the decedent's estate realizes no capital gain on the difference between the shareholder's basis and the redemption proceeds. The logic for this rule is that the estate is required to step-up the basis in the shares on the decedent's death. *See* I.R.C. § 1014 (2001).

[108]*Estate of Gloeckner*, 152 F.3d at 211.

The remaining shareholder at the time of the decedent's death was a business associate.[109] The business associate was not related to the decedent by blood or marriage, nor did the IRS present any evidence that there was anything more than a close friendship between the decedent and the remaining shareholder.[110] The estate argued that the share value in the agreement should not be disregarded because it was a "binding agreement entered into for a valid business purpose."[111]

Initially, the tax court held that I.R.C. section 2703 did not apply.[112] Next, the court stated that "[f]or the price set forth in the agreement to control, the agreement also must *not* constitute a testamentary device."[113] After an analysis of the facts, the tax court then determined that the effect of the agreement was to reduce the decedent's estate tax.[114] As a result, the court held that there was a sufficient basis for an inference that the agreement was entered into for a testamentary purpose.[115] The court proceeded to determine whether the share price in the agreement reflected full and adequate consideration, and ultimately increased the value claimed by the estate.[116]

On appeal, the Second Circuit Court of Appeals not only reversed the tax court's decision, but it also shifted the focus of its analysis.[117] The court of appeals focused primarily on the relationship between the decedent and the remaining shareholder. Analyzing the history of the regulations,

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[109] *Estate of Gloeckner*, 71 T.C.M. (CCH) 148, at 2549-50.

[110] *Id.* at 2549.

[111] *Id.* at 2551.

[112] *Id.* Although the agreement was modified after October 8, 1990, the alternate valuation date used by the estate *preceded* the effective date of I.R.C. § 2703. *Estate of Gloeckner*, 71 T.C.M. at 2552.

[113] *Estate of Gloeckner*, 71 T.C.M. (CCH) at 2553 (citing Estate of Lauder v. Commissioner, 64 T.C.M. (CCH) 1643 (1992)).

[114] "[D]ecedent had an interest in *not* having the shares valued at an amount greater than necessary to satisfy [the] liabilities [of the his estate]." *Id.* at 2553.

[115] *Id.*

[116] *Id.* at 2554-55.

[117] In particular, the court stated:

> Concluding instead that the agreement [at issue] may serve some kind of very general testamentary purpose without focusing on to whom the shares of stock are conveyed, and then jumping ahead to ask whether full and adequate consideration was received — as the tax court did here — misses the relevance of the phrase "natural object of decedent's bounty."

Estate of Gloeckner, 152 F.3d at 214. The court also went on to quote: "'[A] basic tenet of statutory construction, equally applicable to regulatory construction, [is] that a statute should be construed so that effect is given to all provisions, so that no part will be inoperative or superfluous.'" *Id.* (quoting Silverman v. Eastrich Multiple Inv. Fund, L.P., 51 F.3d 28, 31 (3d Cir. 1995)).

the court noted that "'[t]he class of persons who may be the objects of an individual's bounty is not necessarily limited to persons related by blood or marriage.'"[118] After *de novo* review of the decision below, the court of appeals held that the circumstances in the record "lend no support to the tax court's implicit conclusion that [the decedent] sought to convey his shares to a natural object of his bounty."[119] After the court decided that the agreement was improperly classified as a testamentary device,[120] it declined the need to determine whether it reflected full and adequate consideration.[121]

2. Full and Adequate Consideration

Although the legislative history provides no support for the requirement of full and adequate consideration, both the rule and the regulations use the same language.[122] All that is needed to litigate this provision is a difference of opinion on the adequacy of the interest valued.[123] Notwithstanding the lack of guidance under I.R.C. section 2703(b)(2), the estate tax transfer provisions uniformly except from tax bona fide sales for full and adequate consideration.[124] Under these

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[118] *Estate of Gloeckner*, 152 F.3d at 215 (quoting Special Valuation Rules, 57 Fed. Reg. 4250, 4253 (1992)).

[119] *Id.* at 216. "[I]n contrast to the situation in *St. Louis County Bank*, where a zero value on the shares meant no estate tax would be assessed, the agreement did not place [the decedent's] kin in a position to avoid all estate taxes." *Id.*

[120] "[A]s that term is used in Treas. Reg. § 20.2031-2(h) . . . ." *Estate of Gloeckner*, 152 F.3d at 216.

[121] *Id.* at 216-17. The court then compared:

> Estate of Seltzer, T.C.M. [(Prentice-Hall, Inc.) ¶ 85,518 (1985)] (ending its analysis after having found the agreement was not a testamentary substitute, even though other considerations suggested that the fixed price was too low); Estate of Carpenter, 64 T.C.M. (CCH) [1274,] 1279-80 [(1992)] (same); *cf.* Estate of Lauder, 64 T.C.M. (CCH) [1643,] 1659 [(1992)] (continuing its analysis to discern whether the price paid reflected an adequate and full consideration in money or money's worth only after having found a fair inference that the restrictive agreements at issue were designed to serve a testamentary purpose).

Estate of Gloeckner, 152 F.3d at 217.

[122] *Compare* 26 U.S.C. § 2703(b)(2) *with* Treas. Reg. § 25.2703-1(b)(1)(ii).

[123] *But see supra* note 121 and accompanying text (declining to reach the issue of full and adequate consideration until after there is sufficient evidence to indicate that there exists a testamentary device).

[124] *See* I.R.C. §§ 2035(d), 2036(a), 2037(a), 2038(a), & 2040(a) (2001). *See also* I.R.C. § 2043 (analyzing transfers for insufficient consideration received or exchanged under any of the estate tax transfer provisions and to powers of appointment).

provisions, the inquiry focuses on the correlation between the monetary value of the interest transferred and the consideration received.

While the courts have yet to test this provision under I.R.C. section 2703, its companion predecessor has been tested.[125] In *Estate of Lauder*, the court noted that "a formula price may reflect adequate and full consideration notwithstanding [the fact] that the price falls below market value."[126] On further analysis in a subsequent decision, the court stated that an arbitrary manner to establish a formula, particularly one that tends to "depress the value of the stock[,]" would render the formula price invalid.[127] In finding for the IRS, the court held that net book value per share selling price to members of the decedent's family stated in the redemption agreement did not represent full and adequate consideration.[128]

C. *Similar Arrangements Inquiry*

Because most arrangements that control the transfer of interests are private, the similar arrangements requirement may be the most difficult for a taxpayer to sustain. To begin with, one must conclude that a "fair bargain" has taken place.[129] Additional considerations include: the expected term of the agreement; current fair market value; anticipated changes in value; and the adequacy of consideration.[130] Presently, the similar arrangements test has no case law history.[131] It may help a taxpayer to show industry practice, but "[e]vidence of general business practice is

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[125]*See* Treas. Reg. § 20.2031-2(h).

[126]*Estate of Lauder*, 64 T.C.M. (CCH) at 1660 (citation omitted).

[127]Estate of Lauder v. Commissioner, 68 T.C.M. (CCH) 985, 998-99 (1994).

[128]*Id.* at 998.

[129]Similar arrangements, in general —

> A right or restriction is treated as comparable to similar arrangements entered into by persons in an arm's length transaction if the right or restriction is one that could have been obtained in a fair bargain among unrelated parties in the same business dealing with each other at arm's length. A right or restriction is considered a fair bargain among unrelated parties in the same business if it conforms with the general practice of unrelated parties under negotiated agreements in the same business.

Treas. Reg. § 25.2703-1(b)(4)(i). *Cf.* Treas. Reg. § 25.2703-1(d), ex. 1 (disregarding a lease agreement between decedent and child when less than full and adequate consideration is implied by the finding that "the terms of the lease were not comparable to leases of similar property entered into among unrelated parties").

[130]Treas. Reg. § 25.2703-1(b)(4)(i). *See also supra* notes 122-128 (providing an analysis of full and adequate consideration).

[131]*But see supra* notes 96-98 and accompanying text (finding that family limited partnerships were not valued comparable to similar arrangements). *See generally supra* note 129 (citing an example of similar analysis inquiry in the regulations).

not met by showing isolated comparables."[132] If comparables are difficult to find because circumstances are unique to a taxpayer, it may be necessary to engage an expert to support the arrangement.

VI. PROSPECTS FOR LEGISLATIVE RELIEF

In his first attempt to reshape the federal government in the new millennium, President George W. Bush appealed to Congress to revise the tax policy.[133] Indeed, the President's budget plan to govern our country seeks major tax relief.[134] In particular, with respect to taxing the transfer of interests at death, President Bush asked for a wholesale repeal of the "death tax."[135] The President predicates his desire to eliminate the estate and gift tax on the inequity of the Code and the need to foster economic growth.[136] Specifically, the present system taxes accretions to wealth and subsequent transfers thereof.[137] The President's blueprint for a new beginning by eliminating the estate and gift tax aims to "help family businesses and give seniors renewed incentive to save for their children."[138]

As of the writing of this note, the law does not reflect any part of President Bush's proposal to repeal the "death tax."[139] A sizable volume of controversy, however, abounds.[140] Although the law and regulations in

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[132]Treas. Reg. § 25.2703-1(b)(4)(ii).

[133]*See* The White House Office of the Press Secretary, *Address of the President to the Joint Session of Congress*, at 7 (Feb. 27, 2001), *available at* http://www.whitehouse.gov/news/releases/ 2001/02/20010228.html (last visited Mar. 31, 2002).

[134]*See generally id.* (discussing rate reductions to all income tax brackets, elimination of the top tax bracket, and repeal of the death tax).

[135]*Id.*

[136]*See* A BLUEPRINT FOR NEW BEGINNINGS: A RESPONSIBLE BUDGET FOR AMERICA'S PRIORITIES (Feb. 28, 2001), at 35 *available at* http://www.whitehouse.gov/news/usbudget/blueprint/blueprint.pdf (last visited Mar. 31, 2001).

[137]*See generally* The White House Office of the Press Secretary, *supra* note 133 (explaining the cause for the inequity with the present system of taxation).

[138]*See* A BLUEPRINT FOR NEW BEGINNINGS, *supra* note 136, at 35.

[139]*But see* H.R. 3, 107th Cong. (2001) (presenting President's bill, referred to as the "Economic Growth and Tax Relief Act of 2001" to amend certain provisions of the Code).

[140]*See, e.g.*, 147 CONG. REC. H761, at H772 (daily ed. Mar. 8, 2001) (presenting the comment of Mr. Kennedy from Rhode Island, that the President's tax bill is "bad for America");147 CONG. REC. H761, at H790 (presenting the comment of Mr. Crowley from New York, that the President's tax bill is a "misguided plan to provide tax cuts to a select few"); 147 CONG. REC. H761, at H781 (presenting the comment of Mr. Castle from Delaware, that the President's tax bill provides "meaningful relief to all income levels"); 147 CONG. REC. H761, at H789 (presenting the comment of Mr. Stupak, that Congress needs to know the President's entire budget before it can determine "how much it can afford to spend on a tax cut"). *See also* Tom Herman, *A Change in Death & Taxes? Debating the Options for an Estate-Tax Overhaul*, WALL

effect at the outset of 2001 are likely to change, Congress is not likely to eliminate estate and gift taxes in their entirety.[141] Notwithstanding either an immediate partial reduction in estate and gift tax liability, or a reduction in such exposure over time, the valuation rules under Chapter 14 of the I.R.C.[142] will, in all probability, continue to govern transfers of business interests. Accordingly, absent any change to existing governance, the rules and regulations previously set forth herein dictate the standards to establish value for interests transferred pursuant to a buy-sell agreement.

VII. CONCLUSION

A buy-sell agreement could serve a critical role for a closely-held business owner. The agreement could address many tax and non-tax factors. When an agreement is used, in part, to establish value for a business interest, two sets of rules and regulations govern whether and when the agreement may be disregarded. For agreements entered into or substantially modified after October 8, 1990, I.R.C. section 2703 and its progeny apply. For agreements entered into prior to I.R.C. section 2703, various Treasury regulations and their progeny apply.[143] Each set of rules is not necessarily mutually exclusive of the other.

For the value or formula used in a buy-sell agreement to apply for estate tax purposes on a transferor's death, it is imperative that qualifying conditions be in place. This is a highly subjective area of the law; therefore, it is essential that the practitioner be aware of the rules and apply them properly. Otherwise, the intended outcome of the words that echoed in halls of Congress over seventy-five years ago may ring true:

> I do not see why we should tax the man who has labored hard day-by-day and who accumulates small savings, sometimes a nickel, or sometimes a dollar at a time, on which he hopes to live in his declining years, and then not tax a gift of $40,000 or $50,000. I can not imagine.[144]

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ST. J., Feb. 26, 2001, at C1, C13 (presenting four options for estate tax reform).

[141]"[T]otal [estate tax] repeal isn't likely to happen soon." *See* Herman, *supra* note 140, at C1.

[142]*See supra* notes 48-50 and accompanying text.

[143]*See generally* Part II (providing applicable standards to determine whether value may be disregarded when established in a buy-sell agreement).

[144]65 CONG. REC. 3120 (1924) (statement of Rep. Green).