Volume 28 | Number 10 Article 1

5-12-2017

Fixing Corporate Values at Death by Agreement

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Agricultural Law Press
Publisher/Editor
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Issue Contents

Agricultural Law Digest

Volume 28, No. 10 May 12, 2017 ISSN 1051-2780

Fixing Corporate Values at Death by Agreement

-by Neil E. Harl*

Establishing values for corporate stock (or other types of entities as well) at death for farm and ranch entities has always been a difficult task. Unlike stock held at death in a corporation listed on a stock exchange, where values are readily established in the various stock exchanges, with day-to-day trading in securities, ownership interests in small, closely held corporations must rely heavily on the values of corporate assets for which there are market-driven values determined every trading day (such as for grains, cattle held for slaughter and other commodities traded regularly) and appraisals for real estate.

This problem has existed for many years with various solutions approved from time to time. Legislation passed in 1990[1] addressed the issue and supplemented earlier pre-1990 case law.

The pre-1990 rules

Under case law decided before the 1990 rules were enacted, a stock transfer restriction could fix value at death for federal estate tax purposes 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;[2] (3) the obligation to sell was binding during life;[3] and (4) the arrangement was entered into for *bona fide* business reasons and not as a substitute for a testamentary disposition.

The Omnibus Budget Reconciliation Act of 1990

The Omnibus Budget Reconciliation Act of 1990 supplemented the pre-1990 case law in two respects – (1) 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.[4] (2) the 1990 Act specified that the general rule would not apply if the option, arrangement, restriction "or other right" met *each* of these requirements—(a) it is a *bona fide* business arrangement, (b) it is not a device to transfer value to family members for less than full consideration, and (c) the terms are comparable to "similar" arrangements entered into in an arm's length transaction.[5]

In a key passage, the Committee Reports indicate that the 1990 Act was meant to supplement, but not to replace, prior case law.[6] Thus, the pre-1990 rules requiring that an agreement be binding during life and at death and contain a fixed and determinable price

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Agricultural Law Digest is published by the Agricultural Law Press, 127 Young Rd., Kelso, WA 98626 (ph 360-200-5666), bimonthly except June and December. Annual subscription $90 by e-mail. http://www.agrilawpress.com Printed on recycled paper.

continued to apply. A Tax Court case decided in 2006, *Estate of Amlie v. Commissioner*,[7] involving the valuation of bank stock in an Iowa bank, held that the pre-death valuation agreement was upheld; 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. A 2011 Tax Court case, *Hendrix v. Commissioner*,[8] allowed the stock in a closely-held S corporation to be valued using a formula clause, at least for purposes of charitable gifts and gifts to family members. Those two cases, although only Tax Court decisions, have provided a platform for a carefully worded agreement to set the price for corporate securities. For farm and ranch operations, those two cases are helpful authority behind establishing values of corporate stock at death.

END NOTES

[1] The Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11602(a), 104 Stat. 1388-353 (1990).

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

[3] See, e.g., Estate of Blount v. Comm'r, T.C. Memo. 2004-116, *aff'd, rev'd and rem'd in part,* 2005-2 U.S.Tax Cas. (CCH) ¶ 60,509 (11th Cir. 2005)(redemption price in 1981 buy-sell agreement (which had been modified later) did not control value of stock for federal estate tax purposes, did not apply during life and requirements of I.R.C. §2703(b)(3) not satisfied); Estate of Gannon v. Comm'r, 21 T.C. 1073 (1954). Compare Estate of Lenheim v. Comm'r, T.C. Memo. 1990-403 (restrictive stock transfer agreement ignored or waived on numerous occasions so accorded little weight).

[4] I.R.C. § 2703(a).

[5] 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 agreements).

[6] 136 Cong. Rec. 30,488, 30,540-541 (1990).

[7] T.C. Memo. 2006-76.

[8] T.C. Memo. 2011-133.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

ADVERSE POSSESSION

RIGHT-OF-WAY. The disputed strip of land was part of a right-of-way for a public road which ran between the neighboring properties of the parties. Both properties were originally part of a single farm. The defendant purchased a one acre residential parcel from the original owners, and a survey performed as part of that purchase established the eastern boundary of the parcel at the western edge of the right-of-way. The disputed strip was located between the western edge of the right-of-way and the center of the right-of-way. The defendant claimed ownership of the strip, arguing that, if the right-of-way was abandoned, it would be divided at the center of the right-of-way with half reverting to the adjoining landowners. The court rejected this argument because the deed for the one acre parcel clearly established the boundary of that parcel at the edge of the right-of-way. The defendant also argued that ownership of the disputed strip was acquired through adverse possession because of the defendant's use of the strip as part of the defendant's front yard. The court reviewed the evidence of the defendant's use of the strip and held that the trial court's denial of title by adverse possession was not clearly erroneous. The court noted that the defendant's use of the strip was sporadic and, during the early years of ownership, based on acquiescence of the neighbors. **Davis v. Maxwell, 2017 Vt. unpub. LEXIS 63 (Vt. 2017)**.

BANKRUPTCY

GENERAL

EXEMPTIONS

HOMESTEAD. The debtors, husband and wife, purchased a 315 acre farm in 2003 and grew one crop on the land before leasing the land in 2004 to a partnership owned 50 percent by the debtors and 50 percent by the husband's brother. The debtors built a residence on a 4.22 acre portion of the farm in 2010 and claimed a homestead exemption for the residential parcel and 170.44 additional acres of the leased farm. The Texas Constitution, Tex. Const. art. XVI, § 51, allows a homestead exemption for up to 200 rural acres for a married couple. A creditor objected to the exemption for the 170.44 acres, arguing that the debtors had abandoned the homestead character of the land by permanently leasing the land to the partnership. The court noted that case precedent established that two factors are needed to qualify rural land as a homestead: (1) overt acts by the debtors to establish the land as a farm and (2) lack of any termination of the use of the land as a homestead by the debtors. The court found that the debtors had established the entire 315 acres as a homestead by farming the land during the first year of ownership and making farm improvements to the buildings and land. The court also found that the debtors had not abandoned their use of the land as a homestead because the lease to the partnership was a year-to-year lease without any intention to