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The Use of Restrictive Agreements in Estate Tax Valuation of Farmlands and Other Properties

By Don R. Castleman*

I. INTRODUCTION

There has been much discussion in recent years concerning the impact of inflation on estate and property tax valuation of farmlands. Because the quantity of land is limited, its value depends not only on its use but also on its potential use. A farm containing 600 acres, for example, may produce an income to its owner of $50,000 per year. Adjusting this figure for the value of the farmer's labor and attributing one-half of the income to the land and using a moderate capitalization rate of 8 percent, the land would have a "productive" value of $320,000. However, if the land is valued at its fair market value, i.e. the price for which the land could be sold in a market where residential, industrial, and commercial developers are bidding against the agricultural interests, the land might have a value of $600,000 to $2 million.

An example of such disparity in valuation occurred recently in Shelby County, Tennessee, when the county tax assessor reassessed all agricultural land in the county on the basis of the most recent sale prices of real estate. High density residential and commercial development had driven land prices as high as $20,000 per acre in some cases, and $2,500 to $3,000 per acre was considered a reasonable bargain. The result was that the property taxes on an acre of farm land might exceed the average income per acre from farming in some cases. Fortunately, legislation was hurriedly passed requiring valuation based on the use to which the property was devoted.

Although various proposals are pending before Congress, no such relief has yet been afforded in the area of federal estate taxes. The purpose of this article is to explore the use of restrictive agreements, purchase options, and rights of first refusal,
all commonly called "buy-sell" agreements, to limit the estate tax valuation of real estate. Since such agreements have generally been used only by closely held corporations, the significant case law and primary regulatory activity have involved closely held securities. But "buy-sell" agreements have also been used to value partnership interests, and there is precedent for their application to real estate apart from its inclusion in a corporation or partnership sale.\(^1\) Furthermore, it is logical that the underlying legal principles should apply regardless of the specific nature of the property involved.

Actually, the concept of using a buy-sell agreement, as discussed in this article, comes not as a separate approach to a problem, but rather as a logical extension of the prevailing methodology with regard to estate planning for persons possessing large capital inventories, particularly real estate. A farmer owning even modest acreage will quickly realize that liquidity will be a significant problem for his estate. Despite the authorization for paying federal estate taxes over a 10 year period under some circumstances,\(^2\) a prudent estate planner will invariably suggest that the farmer purchase substantial amounts of life insurance on his own life to provide the needed liquidity for the estate upon his death. To avoid inclusion of the life insurance proceeds in the estate and the resultant magnification of the estate tax problem,\(^3\) the competent planner will seek to have someone other than the executor or estate of the insured named as beneficiary and to have all incidents of ownership transferred to someone other than the insured. Frequently the named beneficiary and the owner of the policy will be the person to whom the farm is to pass upon death of the insured. The mechanics of planning are not regimented, but usually amount to an exchange between the executor and the survivor whereby the executor gets the insurance proceeds with which the tax is paid, and the survivor gets the farm. In the cases of insurance-funded corporate or partnership buy-sell agreements, the identical exchange, substitution of cash for estate assets, takes place. The important added feature in the


\(^2\) INT. REV. CODE OF 1954, § 6166 [hereinafter cited as I.R.C.].

\(^3\) Id. § 2042.
case of a properly drawn buy-sell agreement or purchase option is that the price to be paid for the asset can be fixed in the agreement and thereby influence the valuation for estate tax assessment.

This is not to say that the parties to the agreement can, by their own bargain, fix the value and bind the government to that determination for estate tax imposition, but the agreement is a factor to be considered in arriving at the value. Given full weight, the practical effect of the agreement will be to fix the value. The rationale of this theory rests on the basic rule of section 2031(a), which requires that the gross estate shall include "the value at the time of his death of all property . . . ." "Value" is defined by the treasury regulations as "fair market value . . . 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." If property is subject to a valid and enforceable option or agreement with a fixed price, a willing buyer would certainly not pay more than the optionee if the property was subject to an exercise by the optionee that would require the buyer to surrender the property at a lower price.

Obviously, the predetermination of price under the agreement, and hence the property value for estate tax purposes, only benefits the estate if the option price is less than the value which would otherwise be assigned to the property. The significance of this ability to pre-establish value is that the parties to the agreement can determine the criteria upon which they will base their valuation, productive value rather than inflated relative values for example, and the parties can impede, if not eliminate, further inflation of the established value.

II. Predetermination Of Estate Valuation

An examination of the pertinent cases reveals the implica-

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4 Frederick A. Koch, Jr., 28 B.T.A. 363 (1933).
6 Ness, Federal Estate Tax Consequences of Agreements and Options to Purchase Stock upon Death, 49 COLUM. L. REV. 796 (1949).
7 I.R.C. § 2031(a).
tions of this theory, sometimes with startling results. In Wilson v. Bowers for example, the decedent, Arthur Wilson, died owning 3,000 shares of Earl & Wilson Co. common stock. The decedent had agreed by contract with his nephew Franklin and one Betts, who together with the decedent were the owners of all the outstanding company stock, that he would not sell or assign his shares without first offering them to his nephew, Franklin. The contract further provided that in the event of Wilson’s death, Franklin would have an option for a period of 4 months following the appointment of an executor to purchase the stock from Wilson’s estate at $6.66 2/3 per share, and in the event Franklin failed to exercise the option, a similar right was given to Betts. Reciprocal rights of first refusal and options to purchase granted by the other parties to Wilson furnished consideration for his promises.

Wilson died, leaving the stock to Franklin by will. The executor of his estate valued the shares of stock in the estate tax return at $20,000 or $6.66 2/3 per share, but the Commissioner of Internal Revenue increased the valuation to $23.55 per share. The court sustained the executor’s valuation based on the contract price, however, noting that the validity and enforceability of the contract was not disputed; that the shares could not have been sold during Wilson’s life, nor by his executor for more than the low price agreed upon in the contract, unless both Franklin and Betts agreed to forego their rights; and that the options would almost certainly have been exercised.

Even if each was penniless, money could readily have been borrowed on the stock when it was worth nearly four times the option price . . . . the possibility that the options would not be exercised seems too extravagant to require further refutation.10

The court concluded that even though Franklin did not exercise his option but rather took the shares as legatee under the will, this did not negate the effect of the existence of the option at the time of Wilson’s death: “Logically, subsequent events
should not be considered in determining value at the time of death.'

The United States Supreme Court has never passed on the effect of buy-sell agreements and options on valuation for estate tax purposes, but in *Helvering v. Salvage* the Court held that where an employee received, as compensation, stock subject to a repurchase option, the amount of income attributable to the employee could not exceed the option price of $100 per share even though the unencumbered value of the stock was $1,164.70. In affirming the decision of the Second Circuit, the Supreme Court said "Considering the option to repurchase at par, outstanding in 1922, there could be no proper finding of fair market value at that time in excess of $100 per share." Subsequently, the Second Circuit applied *Salvage* in *Lomb v. Sugden*. The stockholders of the Bausch & Lomb Optical Co. had given the other stockholders rights of first refusal on the sale of stock at a price to be computed by a formula set forth in the agreement. The right of first refusal also partially attached upon the death of a shareholder to the following extent: the deceased shareholder could leave any portion of his stock to his issue or another shareholder, but could not bequeath more than 10 percent of his holdings to any other party without first offering the stock to the surviving shareholders at the agreed price. Mrs. Carrie B. Lomb, a party to the agreement, died owning 1,500 shares of Bausch & Lomb stock valued by the option agreement at $69.445 per share. The Commissioner, however, determined a per share value of $100. Judge Augustus Hand observed:

The decision of the Supreme Court on January 13, 1936, in *Helvering v. Salvage*, 56 S.Ct. 375, 377, 80 L.Ed. [511], recognizes an option agreement as restricting the market value of stock in the hands of the owner to the option price. There Justice McReynolds said: "Considering the option to repurchase at par, outstanding in 1922, there could be no proper finding of fair market value at that time in excess of

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11 *Id.*
13 *Salvage v. Commissioner*, 76 F.2d 112 (2d Cir. 1935).
14 *Id.*  
15 297 U.S. at 109.
16 82 F.2d 166 (2d Cir. 1936).
$100 per share.” Because of the agreement, the decedent could not have secured a price greater than $69.455 at the time of her death. It is as of that time that the value of the stock must be determined. Then she could only give it or sell it to the other stockholders at the price fixed. Its value to the estate can be no greater than that with which the decedent parted. Edwards v. Slocum, 264 U.S. 61, 63, 44 S.Ct. 293, 68 L.Ed. 564.16

After Lomb v. Sugden, however, the issue became less clear. The Tax Court in Estate of Pearl Gibbons Reynolds17 modified the strength of the Second Circuit rule. It recognized Salvage as support for the rule of these cases that “first offer restrictions on the sale of securities are the sole index of the securities’ fair market value, at least where the restrictions are enforceable both at death and during the security holder’s lifetime,”18 but in limiting that rule declared:

However, early rulings by the Board of Tax Appeals (a predecessor to this court) and later rulings by various tribunals which have attempted to distinguish Wilson and Lomb make it clear that the existence of first offer provisions is usually no more than a relevant factor to be considered with all other factors in determining fair market value.19

In support of its modified rule, the court cited cases from the Third, Fifth and Eighth Circuits.

In the Third Circuit case, Kline v. Commissioner,20 the taxpayer owned stock subject to a restriction on transfer and an option exercisable only upon his death or termination of employment. If the taxpayer died or terminated his employment under “acceptable conditions” the option price was 75 percent of book value; if the employment was terminated by

16 Id. at 168. Application of income tax valuation cases to estate and gift tax valuation has been criticized in Note, 60 Harv. L. Rev. 123, 131 (1946), and such criticism is understandable. See Commissioner v. Wemyss, 324 U.S. 303 (1945), and United States v. Davis, 370 U.S. 65 (1962), in which the Court held that although a transaction may be considered a gift for gift tax assessment, it does not have to be considered a gift when assessing income tax. The principle of these cases, however, should not control the valuation problem at issue here.
18 Id. at 188, 189.
19 Id. at 189.
20 44 B.T.A. 1052, aff’d., 130 F.2d 742 (3d Cir. 1942).
the taxpayer under "unacceptable" conditions, the option price was 66 2/3 percent of book value; and if the company fired him for cause, the option price was 33 2/3 percent of book value. Taxpayer made a gift of stock and valued the shares for gift tax purposes at the lowest price he might be guaranteed under the agreement. The court noted the "small chance" that he would have his employment terminated in such a way as to subject him to the low value prescribed and said that "earning power of a stock is entitled to great consideration in determining value."\(^{21}\)

The Fifth Circuit, in *Krauss v. United States*,\(^ {22}\) did not reject *Lomb*, but distinguished it on its facts. In *Krauss*, like *Kline*, a gift tax case, the court noted that the restriction, contained in the charter of the issuing corporation, was only a right of first refusal incident to any intended sale of stock by the shareholders. The charter imposed no compulsion to sell, granted no absolute option to buy, and was therefore only a factor in arriving at the value of the stock for gift tax purposes, not its sole determinant. But the court agreed with the contention of the United States that the real holding in *Lomb* was that such a right of first refusal would fix the value for estate tax purposes.

This is precisely correct, and the Second Circuit itself has distinguished *Wilson* and *Lomb* with regard to gift tax application, in *Commissioner v. McCann*.\(^ {23}\) The stock in that case was subject to a bylaw provision requiring the employee to sell the stock at book value, requiring the company to purchase the stock in the event of termination of employment or death, and prohibiting transfer to a nonemployee.

In holding that the Tax Court erred in refusing to consider evidence other than the option price, the court said: "The fact that the price at the shareholder's retirement or death was fixed for both parties, did not prevent the shareholder from collecting any dividends declared before that time . . . ."\(^ {24}\) The court thus agreed with the Third Circuit that retention

\(^{21}\) Id. at 745.

\(^{22}\) 140 F.2d 510 (5th Cir. 1944).

\(^{23}\) 146 F.2d 385 (2d Cir. 1944).

\(^{24}\) Id. at 386.
value as well as sale value must be considered in gift tax cases, and adopted the reasoning of Kline and Krauss:

Nobody could know when the donor would retire or die; meanwhile, he would be entitled to such dividends as were declared; and when he did retire or die, the book value of the shares would not be likely to bear much relation to what it was at the time of the gift.\(^{25}\)

Retention value, however, does not have to be considered in estate tax cases, as the court demonstrated by distinguishing Wilson and Lomb, since in those cases the power to retain has terminated and retention value has thereby been eliminated. This distinction was expressed directly in Spitzer v. Commissioner,\(^{26}\) a case dealing with the problem of gift tax valuation of stock subject to a restrictive shareholder’s agreement. The Court distinguished Wilson, Lomb, and Salvage:

Plainly, all these cases are distinguishable from the facts in the present case. In the income tax case the value of the shares and the critical time for the determination of value were fixed by the option contract. In each of the estate tax cases the critical event, the death of the holder of the shares, which subjected the stock to purchase for a price stated in the option, had occurred. In the circumstances of these cases it was plain that a purchaser could not be found for the shares at a greater price than that for which he would be compelled to sell immediately upon acquisition. In the present case petitioner at the time of the gift was 51 years of age, with a life expectancy of twenty years. When the gift was made no one could predict when petitioner might die, or retire without the consent of the other executive stockholders. The critical event necessary to occur in order to bring into play the provisions of the contract fixing the price of the stock given by petitioner to his wife had not occurred; and, by its terms, the contract might have been terminated long before the occurrence of the critical event.\(^{27}\)

In the First Circuit, an estate valuation case appearing to be contrary to the Second Circuit rule, is distinguishable on its facts. In Worcester County Trust Co. v. Commissioner,\(^{28}\) James

\(^{25}\) Id.
\(^{26}\) 153 F.2d 967 (8th Cir. 1946).
\(^{27}\) Id. at 970.
\(^{28}\) 134 F.2d 578 (1st Cir. 1943).
Smith died owning 12,760 shares of stock in Southwell Wool Lombing Company the articles of incorporation of which required any shareholder or the executor or administrator of any deceased shareholder, before transferring any shares for value or by gift or otherwise, to offer the shares to the company for book value for 30 days. Furthermore, the articles provided that the restriction would not apply to a testamentary or intestate distribution to legatees or next of kin. Declining to follow the Second Circuit’s Wilson and Lomb cases, the court held that the restriction did not fix the value for estate tax purposes but was merely a factor.

Although the First Circuit did not refer to Wilson and Lomb directly, those cases are clearly distinguishable on their facts, since, in Worcester County, the restriction applied only to lifetime sales, and not to testamentary disposition. Thus, Wilson and Lomb may still be persuasive in the First Circuit, after Collins v. Commissioner, which followed Worcester County. Although refusing to follow Wilson, and Lomb, and Salvage, the Collins court kept them alive in the First Circuit by distinguishing them expressly: “We do not disagree with the results of the aforementioned three cases, but merely hold that the Series G bonds owned by decedent are of a nature different from that of the stock and option rights involved in those cases.”

The Seventh Circuit appears to follow the Second Circuit position, although it declined to do so in Armstrong’s Estate v. Commissioner because the argument had not been raised in the Tax Court. In disposing of the argument, however, the Court telegraphed a future adoption of the Second Circuit rule: “Had petitioner advanced the theory before the Tax Court, that the value of the stock was reduced by this restriction on its transfer by Goldsmith and his heirs and assigns, the Tax Court might well have considered it.”

Given a chance to reaffirm its earlier position, the Second Circuit did so in May v. McGowan in 1952, even though the

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216 F.2d 519 (1st Cir. 1954).
Id. at 521.
146 F.2d 457 (7th Cir. 1944).
In the Tax Court, the pivotal issue was includibility, not valuation.
146 F.2d at 460.
194 F.2d 396 (2d Cir. 1952).
result was to value property at zero for estate tax assessment. In doing so, it gave effect to an agreement between a father and son, equal partners in business, and each owning 500 of the 1,000 outstanding shares of stock, that during their joint lives neither would dispose of shares without extending a right of first refusal to the other partner for $100 per share. The agreement also provided, however, because the son had personally guaranteed loans to the corporation of $164,409.86, that the option price for each share purchased by the son would be reduced by 1/500 of the indebtedness upon the date of the exercise of the option. The agreement was also operative by the same terms upon the death of either partner.

At the time of father's death, the indebtedness of the corporation, personally guaranteed by the son, amounted to $90,707.50. Thus, the formula set the son's option price at $100 - (90,707.50 ÷ 500) = 0, and the executor included the 500 shares owned by the father in the estate at a value of zero. There was apparently no attempt by the Commissioner to disregard the agreement totally and value the stock at fair market value by the conventional asset/earnings/comparative sales method. Rather, he accepted the $100 per share value stated in the buy-sell agreement, but disallowed any diminution as a result of the corporate indebtedness.

The court again cited Salvage and Lomb as authority for its position: "It seems clear that with the option outstanding no one would purchase the stock of the decedent at its value unrestricted by the option when it was subject to call by Harry A. May at zero.”

Some earlier decisions had considered the transfer by the decedent (the granting of the option or right of first refusal) as taking effect in possession or enjoyment upon his death and therefore includible in his estate as a transfer in contemplation of death. It was argued in those cases that to the extent of the "bargain," i.e. the difference between normal fair market value at time of death and the stated contract price to be paid to decedent's estate for the property, the decedent had made a

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32 Id. at 397.
33 Worcester County Trust Co. v. Commissioner, 134 F.2d 578 (1st Cir. 1943); Commissioner v. Bensel, 100 F.2d 639 (3d Cir. 1938), aff'd 36 B.T.A. 246 (1937).
34 Int. Rev. Code of 1939, § 811(c) (now I.R.C. § 2035, 2036, 2037).
transfer that did not become effective until his death.

The Tenth Circuit, in its major contribution to the subject, disposed of the "includible transfer" theory in *Broderick v. Gore.* There the deceased had owned an interest in a partnership, and the partnership agreement provided that, in the event of withdrawal of a partner, the other partners would have an option to purchase the withdrawing partner's interest at book value, and in the event of the death of a partner, then the estate of the deceased partner would be obligated to sell, and the surviving partners would be obligated to purchase, the deceased partner's interest for book value. The father, Harry Gore, died leaving his interest to his copartners by will. The copartners, his sons, were also residuary beneficiaries and co-executors. Rather than take the father's interest under the will, the sons filed a petition in the probate court to compel themselves, as executors, to perform as required by the partnership agreement and to sell the interest to themselves as individuals. After a hearing in which the estate was represented by a court appointed special administrator, the probate court found that the agreement was specifically enforceable, that the book value of the decedent's interest was $345,897.53, and ordered the sale. The estate tax return for Gore's estate reported the partnership interest at book value in reliance on the finding of the probate court, but the Commissioner valued the interest at $516,457.84 and assessed additional estate tax. The Tenth Circuit, however, citing *Wilson, Lomb and Salvage,* held that the restriction contained in the partnership agreement was determinative of the value for estate tax purposes.

Finally, the Tax Court in *Claire Giannini Hoffman* considered whether an agreement controlling transfer upon death, but not inter vivos disposition, can escape revaluation by the Commission on the same terms as those indicated in the foregoing discussion. In *Hoffman* the taxpayer had extended to his brother an option exercisable upon the taxpayer's death to pur-

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38 224 F.2d 892 (10th Cir. 1955).
39 2 T.C. 1160 (1943); aff'd on other issues, 148 F.2d 285 (9th Cir. 1945).
40 The First Circuit, in Worcester County Trust Co. v. Commissioner, 134 F.2d 578 (1st Cir. 1943), had held that the converse, a mere lifetime restriction, does not escape revaluation because the agreement becomes inoperative and allows greater value upon the death of the owner.
chase his interest in a partnership at a price far below its fair market value. The Tax Court held the agreement to be a gratuitous promise, unsupported by adequate consideration, and made solely to benefit a favored individual, the natural object of the promisor's bounty. It further held that no lifetime restriction limited the value of the interest or restricted its transferability, and refused to allow the agreement to establish valuation.

The current treasury regulations adopt the Hoffman rule, refusing to give conclusive effect to options exercisable upon death alone, or those not "bona-fide business arrangement[s]" but designed merely to avoid estate tax. A careful reading of the regulation, however, suggests that it does not prevent the transfer by option to a business associate who is also a relative of the transferee. It simply makes family status a factor in determining whether the transfer is supported by adequate consideration.

III. Conclusion

The accumulated case law and current regulations suggest that the following rules will govern transfers by buy-sell agreements:

1. In order for a restrictive agreement to be considered in determining valuation of the restricted assets in an estate,

   Another person may hold an option or a contract to purchase securities owned by a decedent at the time of his death. The effect, if any, that is given to the option or contract price in determining the value of the securities for estate tax purposes depends upon the circumstances of the particular case. Little 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. Such is the effect, for example, of an agreement on the part of a shareholder to purchase whatever shares of stock the decedent may own at the time of his death. 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 of the securities 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.

   Note that every major case, especially May v. McGowan, 194 F.2d 396 (2d Cir. 1952), has involved an intra-family agreement. Thus, such agreements can constitute "bona-fide agreement[s]" under the regulation."
the agreement must meet the following conditions:

(a) It must limit the ability of the owner to transfer the assets during his lifetime for any price in excess of the price stated in the agreement. This requirement would appear to be met by the use of a mere right of first refusal.43

(b) It must represent a bona fide business agreement and not merely a device to pass the property to the natural objects of the owner's bounty.44 The identity of the parties to the agreement will bear on the issue of bona fides but would not appear to preclude intra-family arrangements so long as there is a bona fide business purpose such as the preservation of family ownership or to induce future generations to remain with the family business.45

(c) It must be supported by adequate and full consideration. Normally, mutual covenants will provide adequate consideration where the parties are all owners of an equity interest in the assets. Where one of the parties does not presently have an equity interest, something more is necessary.46 The significant factor is that the adequacy of consideration is tested by the value of the underlying assets on the date the agreement is made or the option is granted, rather than the value at the date of death. Consequently, if the price stated in the agreement is a fair price at the time of the agreement, based upon the current value of the assets, value at the time of death will not matter.47

2. Assuming the requirements of the regulation are met, so the agreement price is considered, the critical decision then is whether the stated price is to be determinative or merely a factor in arriving at value for estate tax purposes. The writer submits that Wilson and Lomb remain viable and that for purposes of estate tax valuation, the option price is determinative.

In applying the principles of the foregoing discussion to assets other than securities, the regulations provide a clear

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43 May v. McGowan, 194 F.2d 396 (2d Cir. 1952); Lomb v. Sugden, 82 F.2d 166 (2d Cir. 1936); Wilson v. Bowers, 37 F.2d 682 (2d Cir. 1932); Littick, 31 T.C. 181 (1958); Weil, 22 T.C. 1267 (1954).
44 Fiorito, 33 T.C. 440 (1959).
45 Commissioner v. Bensel, 100 F.2d 639 (3d Cir. 1938), aff'd, 36 B.T.A. 246 (1937).
46 Id. The court held that the parties to the agreement, although father and son, were hostile to each other and thus dealt at arm's length.
answer. Although the cases discussed herein have involved real estate only as an asset represented by corporate securities or a partnership interest, the same principles should apply.

Many farmers are engaging in their farming business with sons and other "natural objects of their bounty" in associations that are either loosely defined as partnerships, although title to the property is held in one name only, or that have actually accomplished true partnership or corporate status under the law. Since the prerequisite business purpose probably exists, great benefit can be derived for these persons by the use of buy-sell agreements. Although not every situation will allow the use of this arrangement to halt further inflation of farm values for estate tax purposes, such agreements remain a very valuable and logical tool in estate planning.

ADDENDUM

Subsequent to the writing of this article, Congress passed the 1976 Tax Reform Act, which revised Internal Revenue Code, Section 2032A. This new section goes a long way toward solving the problem of inflated valuation of farm lands and closely held business for estate tax purposes, but some limitations remain. Although the limitations are not so onerous as to render the new provision ineffective, they may, in many cases, raise problems which could be avoided. The significant disadvantage of the new provision over the use of buy-sell agreements, is that although the new act provides for a conservative valuation method, it is a valuation at death. A buy-sell agreement enables the taxpayer to use the conservative method at an earlier time and thus eliminate further inflation of that value.

49 Estate of Francis J. Moors, No. 99866 (B.T.A., Oct. 22, 1940); P-H B.T.A. Dec. No. 40,520. In this case the decedent died owning a one-third interest in a summer home at Cohasset, Mass., which he had acquired in 1915 by purchase from a trust established under his mother's will. The purchase by the decedent and his two brothers had been pursuant to an agreement among the five beneficiaries of the trust allowing the purchase for $60,000 subject to repurchase of any of the three interests upon death of a brother for a fraction of the $60,000 equal to the fraction owned by the deceased brother. When Francis J. Moors died in 1937, the executors purchased his one-third interest for $20,000, and included the property in his estate at that value. The Commissioner revalued the property at $31,966, but the Board of Tax Appeals, finding that the maximum price which the estate could receive for the property was $20,000, held that the valuation could not exceed that figure.
The second significant development under the new law results from the amended basis rules of Section 1014. One of the critical considerations in buy-sell agreements has been the fact that the estate would have a stepped-up basis equal to the value determined under the agreement, and therefore, when the sale pursuant to the agreement took place, the estate would have no recognized gain. Under the new act, the estate does not get a stepped-up basis, but rather carries over the basis of the decedent, adjusted to the fair market value on December 31, 1976. Since this "fresh start" basis rule does not rely on the actual value on December 31, 1976, but instead prorates any increase in value over original basis, it would seem to be impossible to assure that the price established in the agreement would equal "value" on December 31, 1976. Thus, the estate tax savings occasioned by a reduced valuation pursuant to a buy-sell agreement, must be offset by the tax on gain that the estate will realize in the event of the sale pursuant to the agreement. Although prior cases have not considered whether an actual sale took place, it is predictable that such a sale or some other recognition of gain might be required in the future in order to render the valuation contained in the buy-sell agreement as determinative. This means that the estate planner must take into account the possibility of such a tax on gain in determining whether a buy-sell agreement will produce an ultimate estate tax savings. One additional factor related to the foregoing problem is that the taker of the property will have a benefit in that the basis in his hands will be determined under Section 1012 rather than under Section 1014 as amended. Therefore, the possibility of a subsequent sale by the taker of the property must also be taken into account in evaluating the desirability of the use of the buy-sell agreement.