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HOLMAN V. COMMISSIONER: A DEATH KNELL FOR THE TAX VALUE OF TRANSFER RESTRICTIONS IN FAMILY LIMITED PARTNERSHIPS?

BRENT B. NICHOLSON

IN MEMORIAM

Professor Brent Nicholson passed away unexpectedly on December 4, 2010, at the age of 56. Professor Nicholson was a long-time faculty member at Bowling Green State University having served on the faculty since 1989. Professor Nicholson earned his Bachelor's of Science in Business Administration from Bowling Green State University in 1976 and his Juris Doctorate from the Ohio State University in 1979, and he was also a licensed Certified Public Accountant in the State of Ohio. Prior to joining BGSU, Professor Nicholson practiced accounting and law for ten years in Toledo, Ohio.

Over his career at BGSU, Professor Nicholson served the College of Business Administration in a variety of roles including Chair of the Department of Legal Studies, Inaugural Director of Entrepreneurship Academic Programs and Associate Dean. He taught a variety of courses in the College of Business Administration including classes in business law and entrepreneurship and taxation. He was revered as an effective and inspiring teacher, positively influencing the lives of thousands of students.

Professor Nicholson received numerous honors and awards throughout his academic career, including the Undergraduate Teaching Award in the College of Business in 2002, the Undergraduate Student Government Faculty Excellence Award in 1996 and 2002, and was twice nominated for the University Master Teacher Award;

Brent was a beloved and well-respected colleague, passionate educator, advisor, and true friend. He will truly be missed.

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INTRODUCTION

In 1990, Congress amended the Internal Revenue Code to add section 2703 in order to fortify the existing rules governing the use of the value set in a buy-sell agreement, or a similar set of restrictions, for transfer tax purposes.[1] Although the case law in this area was not silent on the issue prior to that time and, in fact, a Treasury Regulation had been in place on the issue since 1958[2] and a Revenue Ruling since 1959,[3] the perception persisted in Congress that such agreements were being used to artificially lower the estate and gift tax value of assets subject to such agreements or restrictions.[4] The concern was that taxpayers were using the agreements as tax avoidance schemes by creating deeply discounted values for the assets without a real business purpose and without loss of actual value or control by the owners.[5] Section 2703 required that a buy-sell agreement value be disregarded unless it served a bona fide business purpose, was not a testamentary scheme to pass the property to heirs for less than full value, and was comparable to other similar arrangements made in arm's length transactions.[6] Thus, section 2703 is of particular interest to owners of closely held businesses and estate planners and their clients.

This Article examines a recent United States court of appeals case concerning section 2703, *Holman v. Commissioner*,[7] and some earlier cases, including a few under the 1958 regulation, that are relevant to *Holman*. The purpose of this Article is to explain the current state of the law with respect to buy-sell type agreements and their influence on setting the transfer tax value. The Article begins with a discussion of the relevant Code and Regulations, focusing on section 2703 and its legislative history. The Article then follows with a look at some of the relevant case law and an in-depth look at *Holman* and ends with an analysis of the *Holman* decision.

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[1] *See* Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 2703, 104 Stat. 1388-498 (1990).

[2] *See* Treas. Reg. § 20.2031-2(h) (2010).

[3] *See* Rev. Rul. 59-60, 1959-1 C.B. 237.

[4] *See infra* note 21 and accompanying text.

[5] *Id.*

[6] *See* Omnibus Budget Reconciliation Act of 1990 § 2703 (describing the general rule and enumerating three exceptions). *See generally* Roger R. Fross, *Estate Tax Valuation Based on Book Value Buy-Sell Agreements*, 49 TAX LAW 319 (1996) (providing background on the law governing buy-sell agreement valuations).

[7] 601 F.3d 763 (8th Cir. 2010).

I. CODE, REGULATIONS, AND LEGISLATIVE HISTORY OF SECTION 2703

Section 2703 was added to the Internal Revenue Code in 1990 and is, in essence, a codification of Treasury Regulation 20.2031-2(h), rather than its replacement.[8] Its provisions apply to estate, gift, and generation skipping taxes[9] and it provides that valuations for purposes of those taxes are not to take into account any "rights" or "restrictions" relating to the property being valued.[10] These rights or restrictions may be contained in a variety of documents, including a partnership agreement, buy-sell agreement, or the articles or bylaws of an entity.[11] A covered right is a right to acquire the property at less than fair market value, and a covered

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[8] *Compare* Omnibus Budget Reconciliation Act of 1990 §11602 (indicating that § 2703 is an amendment to the current Code), *and* § 2703 (discussing the requirements for valuation and exceptions to those requirements), *with* Treas. Reg. § 20.2031(h) (2010) (discussing valuation of securities for gift tax purposes); *see also* Estate of True v. Comm'r, 390 F.3d 1210, 1231 (10th Cir. 2004) ("[W]hen Congress passed § 2703 … it essentially codified the rules laid out in § 20.2031-2(h)); Estate of Gloeckner v. Comm'r, 152 F.3d 208, 214 (2d Cir. 1998) ("Since the 1990 Act for all intents and purposes codifies this pre-existing regulatory language …."). As mentioned in the Introduction, the Internal Revenue Service had also weighed in on the topic with its guidance in Rev. Rul. 59-60, 1959-1 C.B. 237. Section 8 of that Revenue Ruling states:

> 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 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 at the death of the stockholders, such agreement may or may not, depending on 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 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.

Rev. Rul. 59-60, 1959-1 C.B. 237 (internal citations omitted).

[9] Treas. Reg. § 25.2703-1(a)(1) (2010).

[10] I.R.C. § 2703(a) (West 2003).

[11] Treas. Reg. § 25.2703-1(a)(3) (2010).

restriction is any restriction on the sale or use of the property.[12] Section 2703 is effective for agreements made or substantially modified after October 8, 1990.[13]

Subsection (b) contains the criteria for an exception to the sweeping language of section 2703(a). It provides that such rights or restrictions may be taken into account if three conjunctive requirements are met:[14] (1) it is a "bona fide business arrangement;"[15] (2) it is not a means to transfer the property to one's heirs for less than full and adequate consideration;[16] and (3) the rights or restrictions are comparable to similar arm's length transactions.[17] These three requirements are deemed met if non-family members of the transferor own, directly or indirectly, more than 50 percent of the value of the property subject to the right or restriction.[18]

It is important to note for purposes of this Article that neither the Code nor the Regulations provide a definition of the term "bona fide business arrangement."[19] For some guidance on the meaning of that important term, one must look to the legislative history of the provision and case law.

In the legislative history of section 2703, the Senate Finance Committee acknowledged the potential for using buy-sell agreements to create artificially low values for tax purposes, despite their usually legitimate use.[20] The intent of the legislation was to recognize buy-sell agreements that were entered into for legitimate business purposes and ignore those designed for tax avoidance.[21] The legislation sought, therefore, to disregard the buy-sell value unless it was of a kind that would have been entered into by unrelated parties in an arm's length transaction.[22]

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[12] *See id.* § 25.2703-1(a)(2)(i) to (ii).

[13] Omnibus Budget Reconciliation Act of 1990 § 11602(e)(1)(A)(ii), 104 Stat. 1388-419 (1990).

[14] Treas. Reg. § 25.2703-1(b)(2) (2010).

[15] I.R.C. § 2703(b)(1) (West 2003).

[16] *Id.* at § 2703(b)(2).

[17] *Id.* at § 2703(b)(1)-(3); Treas. Reg. § 25.2703-1(b)(1)(i) to (iii) (2010).

[18] *See* Treas. Reg. § 25.2703-1(b)(3) (2010).

[19] The term is not only used in the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 2703, 104 Stat. 1388-498 (1990), but also in Treas. Reg. § 20.2031-2(h) (2010) and Rev. Rul. 59-60, 1959-1 C.B. 237.

[20] 136 CONG. REC. 30,540 (1990) (explanatory material concerning Committee on Finance 1990 Reconciliation Submission pursuant to House Concurrent Resolution 310).

[21] *Id.* "The committee believes that buy-sell agreements … generally are entered into for legitimate business purposes that are not related to transfer tax consequences … the committee establishes rules that attempt to distinguish between agreements designed to avoid estate taxes and those with legitimate business agreements." *Id*. At 30,539.

[22] *See id.* at 30,541.

The Finance Committee's explanation also clarified several points. First, the legislation applied to referenced restrictions that may be contained in a variety of sources: a partnership agreement, articles of incorporation, bylaws, or a separate document.[23] Second, although the legislation mirrors some of the language of Treasury Regulation 20.2031-2(h), the Committee emphasized that the "business purpose" and "testamentary device" tests were separate and independent.[24] The third requirement of "comparable agreements" is a new test and, in essence, means that the party must show that the right or restriction was an arm's length agreement.[25] Relevant factors include: "the expected term of the agreement, the present value of the property, its expected value at the time of exercise, and the consideration offered …."[26] Isolated comparables are not sufficient and expert testimony is acceptable.[27] Where the business is unique and comparables are difficult to locate, similar businesses may be used.[28] Finally, the Committee noted that the legislation did not affect the present law requiring that the agreement be binding both during life and at death.[29]

II. PRIOR DECISIONS RELEVANT TO SECTION 2703 AND *HOLMAN*

Because of the relative paucity of cases under section 2703 and the similarity between the requirements of 2703(b) and Treasury Regulation 20.2031-2(h), an examination of a few of the relevant cases under the Regulation as well as under section 2703 will be helpful in shedding some light on the *Holman* decision.[30] A discussion of some of the more noteworthy cases follows.

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[23] *See id*. at 30,540.
[24] *See id*.
[25] *See id*. at 30,541.
[26] *Id*.
[27] *Id*.
[28] *Id*.
[29] *See id*.
[30] In fact, Treasury Regulation § 20.2031-2(h) specifically refers the reader to § 2703 for agreements made after October 8, 1990. "See section 2703 and the regulations … of this chapter for special rules involving options and agreements … entered into (or substantially modified after) October 8, 1990." Treas. Reg. § 20.2031-2(h) (2010).

A. Estate of Bischoff v. Commissioner[31]

In the 1930s Bruno Bischoff and his brother-in-law, Frank Brockhorst, formed two companies engaged in pork processing: Boar's Head Provisions Co. for processing, and Frank Brockhorst Co. for distribution.[32] The two acquired a smaller pork processor, Weinkauff, in the 1940s.[33] Ownership of the businesses was later expanded to include Bischoff and Brockhorst's children.[34] In 1960, the Bischoff and Brockhorst families transferred their ownership in Boar's Head, Weinkauff, and two real estate holding companies to an investment general partnership they collectively owned.[35] The general partnership was converted to a limited partnership, F.B. Associates, in 1961, with Bruno Bischoff and Frank Brockhorst serving as the general partners.[36] A 1963 amended limited partnership agreement contained stringent restrictions to prevent a partner from transferring their interest outside the partnership in order to maintain family control of the underlying businesses and provide continuity of management.[37] A similar arrangement for similar purposes was put in place for the limited partnership that owned Frank Brockhorst Co., the product distribution company.[38] Both limited partnership agreements contained a formula setting lifetime and at-death buyout prices, which became the subject of a dispute with the Internal Revenue Service (the Service).[39] The Service sought to disregard the agreement price formulas on the grounds that the restrictions served no bona fide business purpose and were testamentary devices.[40]

The Tax Court determined that the partnership restrictions did serve a legitimate business purpose and that the value of the interests for estate tax purposes was the agreement price.[41] Citing two Tax Court decisions and a

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[31] 69 T.C. 32 (1977).

[32] *Id*. at 34. Theodore Weiler was a third primary owner of the businesses. *Id.* The court does not disclose his relationship to the other two owners. *Id.*

[33] *Id.*

[34] *Id*.

[35] *Id*. at 35. The real estate holding companies owned the land and leased it to Boar's Head, Frank Brockhorst Co. and Weinkauff. *Id.*

[36] *Id.* The remaining family members were limited partners. *Id.*

[37] *Id.* at 35-36.

[38] *Id.* at 37.

[39] *Id.* at 36-37. In both limited partnerships the buyout price was the value of the partner's capital account with adjustments for income and withdrawals. *Id*.

[40] *Id.* at 39. The Service, of course, contended that the actual fair market value of the interests was considerably higher than the agreement price. *Id.*

[41] *Id*. at 39-40.

district court decision, the court determined that maintaining family ownership and control was commonly recognized as a legitimate business purpose.[42] The court stated, "[w]e are convinced that the members of F. B. Associates and Frank Brockhorst Co. entered into the respective partnership agreements in order to assure their continuing ability to carry on their pork processing business without outside interference …."[43]

Of greater interest, in light of the *Holman* decision, was the court's treatment of the Service's contention that the restrictions, particularly those in the F. B. Associates agreement, lacked a bona fide business purpose because F. B. Associates was "merely a holding company" and not an actively managed business.[44] The court rejected this contention as being "artificial and strained."[45] The court contended that to maintain family control of the operating companies owned by F. B. Associates it was necessary to restrict ownership in the limited partnership.[46] The fact that a partnership was inserted between the families and the operating companies was irrelevant given the legitimate business purpose: maintaining family control.[47] The business purpose, coupled with the binding nature of the restrictions during life and at death, made the agreement price the date of death value for the partnership interests.[48]

B. St. Louis County Bank v. United States[49]

Although this Eighth Circuit decision pre-dates the enactment of section 2703, it nonetheless bears on the decision in *Holman* because it came from the same circuit and concerns the meaning of a "bona fide business arrangement."[50] In this case, a decedent entered into a restrictive stock purchase agreement with the other owners of a closely held moving and storage company.[51] The other shareholders were the decedent's wife,

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[42] *Id*. (citing Estate of Reynolds v. Comm'r, 55 T.C. 172 (1970); Estate of Littick v. Comm'r, 31 T.C. 181 (1958), Balt. Nat'l Bank v. United States, 136 F. Supp. 642 (D. Md. 1955)).
[43] *Estate of Bischoff*, 69 T.C. at 40.
[44] *Id.* at 41.
[45] *Id.* at 40-41.
[46] *See id*. at 41.
[47] *See id.*
[48] *Id.*
[49] 674 F.2d 1207 (8th Cir. 1982).
[50] *Id.* at 1210.
[51] *See id.* at 1208.

children, and trusts created by the decedent for his grandchildren.[52] The relevant portion of the purchase agreement provided that the deceased owner of stock, or an owner wishing to transfer stock to a non-family member, had to first offer the stock to the company or other stockholders.[53] If that option was not exercised, the stock could then be sold outside the family.[54] When the agreement was formed, the company was in the moving and storage business,[55] but it subsequently sold those assets and thereafter rented real estate.[56] The decedent died in 1976 and the estate sought to use the purchase agreement formula price to set the date of death value, which was zero.[57] The Service objected that this amount was less than book value, which the Service asserted was the proper valuation.[58] The taxpayers paid the deficiency and filed suit. At the time of decedent's death, approximately 80 percent of the company's assets were in cash.[59]

The appellate court, deciding the case under Treasury Regulation 20.2031-2(h), found that the stock purchase agreement had a bona fide business purpose—maintaining family ownership and control.[60] The court disagreed with the district court's grant of summary judgment, however, due to the district court's determination that a finding of a bona fide business purpose *automatically* meant that the agreement was not a testamentary device.[61] The appellate court instead held that these tests

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[52] *See id.* Originally, Lee Sloan owned all the stock of the company except one share owned by his wife. *Id.* He then gifted shares equally to his daughter, son-in-law, and trusts for his three grandchildren. *Id.* The total shares owned by the children and trusts for the grandchildren represented about 40 percent of the outstanding stock. *Id.*

[53] *Id.*

[54] *Id.* at 1208-09. The purchase price was ten times the average annual earnings over the previous five years, adjusted for gains and losses, less the tax consequences of the gains or losses. *Id.*

[55] *Id.* at 209.

[56] *Id.*

[57] *See id*. When the company was in the moving and storage business, the per share price based on the agreement formula ranged from $597.00 to $1061.15. *Id.* That formula yielded a per share price of zero when the operating assets were sold and it went into rental real estate. *Id.*

[58] *Id*. (noting that at the time of Sloan's death the book value was $544.60 per share).

[59] *See id*. (noting that out of the total assets of $256,000, $201,000 consisted of cash).

[60] *See id.* at 1210 (citing Estate of Bischoff v. Comm'r, 69 T.C. 32 (1977); Estate of Reynolds v. Comm'r, 55 T.C. 172 (1970); Slocum v. United States, 256 F.Supp.753 (S.D.N.Y. 1966)).

[61] *See id.* at 1210 (internal citation omitted) ("Here, the District Court concluded that the existence of a valid business purpose necessarily excluded the possibility that the agreement was a tax-avoidance testamentary device …. We disagree.").

were independent—a view confirmed in the Regulations and legislative history of section 2703[62]—and that an agreement could have a bona fide business purpose and still be a prohibited tax avoiding testamentary device.[63] Perhaps most significant, however, was the court's finding that, under appropriate circumstances, maintaining family ownership and control of a passive business could be a bona fide business purpose.[64] Despite its similarities, this case differs from *Holman* because, at the time the agreement was made, the business was an active, operating one and the stock was closely held.

C. Estate of Gloeckner v. Commissioner[65]

Estate of Gloeckner v. Commissioner is another case rendered under Treasury Regulation 20.2031-2(h) that is nevertheless relevant to the decisions under section 2703. This case notably did not involve family members. The deceased, Frederick Gloeckner, was party to a redemptive agreement with respect to his stock in Fred Gloeckner & Co.[66] Gloeckner was the majority owner and it was his wish that Joseph Simone own and manage the business upon his death.[67] The purchase agreement provided that, at his death, the company was to redeem as much of Gloeckner's stock as was necessary to pay his estate tax in the event it had to purchase all his stock, which was still not sufficient to pay the tax.[68] It also

[62] *See* Treas. Reg. § 25.2703-1(b)(2) (2010) ("Each of the three requirements described … must be independently satisfied …."); 136 CONG. REC. 30,540 (1990) ("[T]he bill clarifies that the business arrangement and device requirements are independent tests.").

[63] *St. Louis Cnty. Bank*, 674 F.2d at 1210.

[64] *Id.*

[65] 152 F.3d 208 (2d Cir. 1998).

[66] *See id*. at 210. Gloeckner was a party to an original agreement with a minority shareholder, Gustav Poesch, dating back to 1960. *See id.* The parties decided to revise the agreement in 1987; however, Poesch, for unknown reasons, never signed the new agreement. *See id.* at 211. He sold his stock to the company in 1988 so he was not involved in the issues related to this litigation. *See id.*

[67] *Id.* at 210. Simone was not related to Gloeckner and had worked at the company for a number of years, eventually becoming an officer. *See id.* Gloeckner made two loans to Simone totaling $175,000, one of which was interest free, the other of which carried interest. *See id.* Both were secured by Simone's home. *Id.* Otherwise, their relationship was professional, rather than social. *See id.*

[68] *See id.* at 211. Gloeckner left only collateral heirs at his death. *See id.* at 210. This testamentary arrangement was thought to allow his heirs to inherit free of the estate tax, and in cash instead of stock in a closely held business, in which they presumably had little interest. *See id.* Simone inherited $40,000 cash plus all the common stock of Fred

contained restrictions on lifetime transfers and gave the company first rights to purchase Gloeckner's stock during life or at death.[69] Simone owned only a small number of shares that had been gifted him by Gloeckner and he signed a similar agreement.[70] Outside appraisers were used to fix the redemption price based on fair market value.[71]

There was no dispute that the price was fixed or determinable from the agreement, that the estate was obligated to sell at that price, and that inter vivos transfers were also required at the agreement price.[72] Rather, the issue in the case was whether the fourth requirement of Treasury Regulation 20.2031-2(h) was met: did the agreement represent a bona fide business arrangement and not a testamentary device to transfer shares to the natural objects of the decedent's bounty for less than adequate and full consideration?[73] The court quickly found the agreement constituted a bona fide business arrangement because it was designed to "maintain current managerial control."[74] Because Simone was not a family member and had a professional relationship with the deceased, the court found Simone *not* to be a "natural object of the decedent's bounty."[75] Thus, because there was a bona fide business arrangement and no evidence of a testamentary device, the value fixed by the agreement was the value of the closely held stock for estate tax purposes.

Gloeckner & Co. not redeemed. *See id.* at 211. The preferred stock went to a foundation. *See id.* As mentioned in the text, the arrangement failed in the sense that, even though all the stock was purchased, the estate still had to come up with about $1 million. *See id*.

[69] *See id.* at 211.

[70] *See id*.

[71] *See id.* KPMG Benchmark fixed the value of Mr. Gloeckner's shares at $440 per share. *Id.* Simone's shares were valued at $290 per share, presumably because of their minority status. *Id.* When Gustav Poesch, also a minority shareholder, was bought out in 1988 he was paid $290 per share. *Id*.

[72] *See id.* at 213.

[73] *See id.* at 210.

[74] *Id*. at 214 (citing St. Louis Cnty. Bank v. United States, 674 F.2d 1207, 1210 (1982) (managerial control by the family); Estate of Carpenter v. Comm'r, 64 T.C.M. (CCH) 1274,1280 (1992) (managerial control by an unrelated business partner)).

[75] *Id*. at 214. The court criticized the Tax Court for "jumping ahead" of matters by determining that there was a "testamentary purpose" to the arrangement and then proceeding to investigate whether there was adequate and full consideration. *Id.* The court cautioned that, to give full effect to the regulatory language, it was necessary to first determine if the intended beneficiary of the agreement was a "natural object of decedent's bounty." *Id.* If they are not, the inquiry ended, as was the case here. *See id*.

D. Estate of True v. Commissioner[76]

This Tenth Circuit decision, like *Gloeckner*, involved Treasury Regulation 20.2031-2(h) and, in particular, the fourth prong of the regulatory test: whether the agreement was a bona fide business agreement and not a testamentary device to pass shares at less than full and adequate consideration.[77] Also, like *Gloeckner,* the Tax Court found a bona fide business purpose existed for the agreements involved in the case: to ensure family ownership and control of the enterprise.[78] Under these facts, that purpose aided in the goal of reinvesting profits to facilitate oil reserve exploration and also facilitated enforcement of a policy of active participation of family members in the work of the business because, under the terms of the agreement, inactive members were required to relinquish their interests.[79] There is, however, an important distinction between *Gloeckner* and *True*: *True* involved family members and *Gloeckner* did not. Therefore, the Service did not contest the finding of a bona fide business purpose on appeal.[80]

While acknowledging a lack of extensive precedent on the issue,[81] the appellate court found that the agreements in *True* did further a testamentary purpose and were not for full and adequate consideration.[82] As to the testamentary purpose issue, the court indicated that several factors must be considered in that evaluation: the age and health of the individual at the time he or she made the agreement; the enforcement or lack of enforcement of the agreement in previous instances; the exclusion of certain assets in the value calculation, for example, goodwill; whether the price term was set arbitrarily or in consultation with professionals; the

[76] 390 F.3d 1210 (10th Cir. 2004).

[77] *See id*. at 1218-19.

[78] *See id.* at 1219.

[79] *See id.*

[80] *See id.*; *see also supra* notes 65-75 and accompanying text (discussing the specifics of the *Gloeckner* case).

[81] *True*, 390 F.3d at 1220. The court said, "[W]e note there is not a wealth of cases outlining the full process by which a court should examine whether a buy-sell agreement satisfies the fourth prong of the price term control test." *Id*. The court determined that the "price term control test" was the test whereby the price term of a buy-sell agreement would control for estate tax valuations if, (1) the price was fixed and determinable from the agreement, (2) it was binding during life and at death, (3) it was legally binding and enforceable, and (4) it served a bona fide business purpose and was not a testamentary device to pass the decedent's interests for less than adequate and full consideration. *Id.* at 1218. In *True*, the first three prongs were not in issue. *See id*. at 1218-20.

[82] *See id.* at 1222.

degree of negotiation between the parties; the allowance in the agreement for adjustment of the price; and whether all parties were bound by the agreement.[83] The court also noted that agreements among family members should be given a closer examination as they, of course, are more likely to implicate a testamentary purpose and carry, in all likelihood, a greater potential for mischief.[84] The court further stated that under prior case decisions this assessment, in essence, was an "arm's length transaction" test.[85]

The court found a testamentary purpose for a number of reasons: (1) a lack of professional involvement in setting the strike price;[86] (2) the exclusion from the price of the value of intangible assets;[87] (3) the lack of a mechanism within the agreement for revising the price;[88] (4) the lack of negotiation among the parties to the agreement;[89] and, most importantly to the appeals court, (5) the complete disinheritance of an inactive family member who was bought out, including disinheritance from assets not covered by the restrictive agreement.[90]

The court upheld the Tax Court's determination that the transfers were for adequate and full consideration.[91] Under the Tax Court's analysis,

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[83] *Id.* at 1220.

[84] *Compare id*. (citing Cameron W. Bommer Revocable Trust v. Comm'r, 74 T.C.M. (CCH) 346 (1997) (holding that for a buy-sell to control the date of death value it must be binding both during life and at death); Estate of Lauder v. Comm'r, 64 T.C.M. (CCH) 1643 (1992)), *with Gloeckner, supra* notes 65-75 and accompanying text (comparing a similar case not involving family members).

[85] *See True*, 390 F.3d at 1220 (citing to Dorn v. United States, 828 F.2d 177, 181 (3d Cir. 1987); Bensel v. Comm'r, 36 B.T.A. 246, 252-53, *aff'd*, 100 F.2d 639 (3d Cir. 1938); Estate of Littick v. Comm'r, 31 T.C. 181, 186 (1958); Estate of Godley, 79 T.C.M. (CCH) 158, 164 (2000)). The taxpayers tried to argue that the legislative history of section 2703 indicated that the requirement of an arm's length transaction was a new requirement of section 2703(b)(3). *See id.* at 1220-21 n.9. The court countered that, while it was a new component of the statutory standard, it was a long established and still viable part of the existing case law. *See id*.

[86] *See True*, 390 F.3d at 1222 (the strike price is the required purchase/sale price).

[87] *See id*. at 1222-23.

[88] *See id.* at 1223.

[89] *See id*. at 1224.

[90] *See id.* (citing Estate of Godley v. Comm'r, 80 T.C.M. 158 (2000)). The Tenth Circuit did concede that several factors militated against a finding of a testamentary purpose. *Id.* at 1221 n.10. Those factors were the good health of the decedent at the time the agreements were made, the previous enforcement of the agreements in the past, and the binding nature of the agreements. *Id.* The court concluded, however, that the factors noted above outweighed these considerations. *Id*.

[91] *See id.* at 1234. In this portion of the opinion, after a lengthy review, the court overruled its precedent in *Broderick v. Gore*, 224 F.2d 892 (10th Cir. 1955), to the extent

which the court of appeals adopted, the court required consideration that "would be agreed upon by persons with adverse interests dealing at arm's length. Under this standard, the formula price must bear a reasonable relationship to the unrestricted fair market value of the stock in question."[92] While the fair market value may appropriately consider discounts for such factors as a lack of marketability or lack of liquidity, it should not take into account discounts based on restrictions that have been found to have a testamentary intent.[93] In *True*, the agreement price was the tax book value, while the fair market value, even after discounting for lack of marketability, was considerably higher, undermining the taxpayer's argument that the agreement price represented adequate consideration.[94] The court reviewed the Tax Court's determinations for clear error and found none.[95]

E. Smith v. United States[96]

This case is significant because it affirms that the law in effect prior to the enactment of section 2703 continues to be in effect and the enactment of section 2703 did not alter the requirements of pre-existing law.

The subject matter of the case included certain gifts of interests in a family limited partnership made by Sidney E. Smith to his two children.[97] The partnership owned all the stock of an operating company.[98] Smith made gifts to his children of limited partnership interests that totaled approximately 20 percent each of the limited partnerships.[99] The Service

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it held that the price terms of a buy-sell were binding for estate tax purposes if the terms were binding on the parties during life and at death. *See id*. at 1232.

[92] *Id*. at 1234 (internal citation omitted).

[93] *See id*. at 1234-35.

[94] *See id.* at 1235. For one set of interests the difference between the two was $80.40 per share (fair market value) versus $38.69 per share (tax book value), and for another set of interests the difference was $353,100 (fair market value) versus $54,653 (tax book value). *See id.*

[95] *See id.* at 1234 ("[W]e must now determine if the Tax Court clearly erred in holding taxpayers failed to satisfy their burden of showing the agreements represented adequate consideration. After reviewing the record, we conclude the answer to this question is no.").

[96] No. 02-264, 2005 U.S. Dist. LEXIS 24711 (W.D. Pa. July 22, 2005). The Magistrate's opinion in the case was affirmed by the district court in *Smith v. United States*, No. 02-264, 2005 U.S. Dist. LEXIS 20383, at *3 (W.D. Pa. Aug. 19, 2005).

[97] *Smith,* 2005 U.S. Dist. LEXIS 24711, at *2-3.

[98] *Id*. The operating company was named Erie Navigation Company and had previously been owned entirely by Mr. Smith. *Id*.

[99] *See id.* at *17.

disputed the value assigned those interests.[100] The taxpayers sought to reflect in their valuation the effect of a partnership restriction on the sale of an interest.[101] The Service argued that, due to the application of section 2703(a), such restriction should be ignored.[102] The taxpayers countered that the restriction should be honored as the agreement fell within the exception outlined in section 2703(b).[103]

The federal magistrate hearing the case originally granted a partial summary judgment in favor of the taxpayers on the issue of whether the restriction was a bona fide business arrangement,[104] but the magistrate denied summary judgment because of disputes over material facts on the issues of whether the agreement was a testamentary device and whether it was comparable to similar arrangements (the second and third prongs of the section 2703(b) test).[105] After additional discovery, both parties re-filed motions for summary judgment on these last two issues.

The magistrate, on the new cross-motions for summary judgment, concluded that she did not need to address the last two requirements of the exception.[106] Citing to the Tax Court opinion in *Blount v. Commissioner*,[107] she reasoned that the law prior to the enactment of section 2703 was not altered by that provision, and that under that pre-existing law, an agreement or restriction "must be binding on the parties both during life and after death" to be binding for valuation purposes.[108] Here, Mr. Smith, prior to his death, owned two-thirds of the general partnership interests and more than half of the limited partnership

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[100] *See id.* at *3-4.

[101] *See id.* at *5-6.

[102] *See id.* at *3-6. The restriction in question provided that on the purchase of a partnership interest the partnership, or a purchasing partner, was to pay the price over a term of up to fifteen years, determined by the purchaser, with interest in equal annual installments. *See id*. The Smiths had valued the gifts at $1,025,392, the Service at $1,828,598. *Id*. at *3.

[103] *See id.* at *6-7.

[104] The district court's affirmation of the magistrate's report is at *Smith*, No. 02-264, 2005 U.S. Dist. LEXIS 20383, at *3 (W.D. Pa. Aug. 19, 2005).

[105] *See id.*

[106] Apparently, neither party had raised this issue. *See id.* at *11-12.

[107] 87 T.C.M. (CCH) 1303, 1310 (2004) ("[A]s the legislative history makes clear, section 2703 was intended to supplement, not supplant, the existing legal requirements: 'The bill does not otherwise alter the requirements for giving weight to a buy-sell agreement. For example, it leaves intact present law rules requiring that an agreement have lifetime restrictions in order to be binding on death.'"). *Blount*, in turn, referenced the legislative history of section 2703 at 136 CONG. REC. S15,683 (Oct. 18, 1990). A discussion of the appellate court decision in *Blount* follows in the next Part of the Article.

[108] *Smith*, 2005 U.S. Dist. LEXIS 24711, at *12-13.

interests, giving him control of the entity.[109] He thus had the ability to unilaterally change the terms of the restrictions during his lifetime. The magistrate stated, "it has been held that the unilateral authority of the transferor to alter the terms of a restrictive agreement during his lifetime renders the agreement non-binding."[110] On that basis, the restrictions were not to be taken into account in valuing the gifts.

F. Estate of Blount v. Commissioner[111]

George Blount, James Jennings, and the Blount Construction Company entered into a stock purchase agreement in 1981 that required Blount or Jennings to consent to the other's transfer of stock and also provided that the company would purchase the deceased's stock at death.[112] The price was to be agreed upon by the parties or, if no agreement, the stock's book value controlled.[113] Insurance was purchased to fund the buyout.[114] Valuations of the company stock were made annually for an Employee Stock Ownership Program.[115] Jennings died in 1996, and his shares were purchased from his estate based on book value.[116] Later in the year, Blount and the company revised the stock purchase agreement to require a flat purchase price of $4 million for all of Blount's shares at his death.[117] Experts for the taxpayer and the Service disagreed about the total valuation of the company, of which Blount

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[109] *Id*. at *18-19 ("Mr. Smith … was able to unilaterally make all General Partner decisions under the Smith FLP agreement …. Mr. Smith owned more than one half of the limited partnership interests … thus enabling Mr. Smith to unilaterally give the 'Consent of the Limited Partners' ….").

[110] *Id*. at *16.

[111] 428 F.3d 1338 (11th Cir. 2005). The case is quite similar to *Smith v. United States*. *See supra* notes 96-110 and accompanying text.

[112] *See Blount*, 428 F.3d at 1340. Blount Construction performed construction work for public and private entities. *Id.* Blount and Jennings were the only shareholders. *Id.*

[113] *Id.*

[114] *See id.* This was done so that the company could still operate while honoring the stock redemptions. *Id.* Three million dollars of insurance was purchased on each shareholder. *See id*.

[115] *See id.* As of January 1995, the total value of the company was about $7.9 million. *Id.* The ESOP purchased stock from Blount, Jennings, or from new issues by the company. *See id.*

[116] *See id*. At his death Jennings owned 46 percent of the company and his estate received just under $3 million for his shares. *Id*.

[117] *Id.* The apparent impetus for the revision was Blount's diagnosis of cancer with a short time to live. He died less than a year after the agreement was revised. *See id.* at 1341.

owned 83 percent at the time of his death.[118] The pertinent issue was not the various methods of valuation; it was whether the price set in the stock purchase agreement was binding. The Tax Court and the court of appeals both held that it was not.[119] The Tax Court found that the agreement was not binding during both life and at death and that it was not comparable to similar arrangements.[120]

In the appellate court's discussion of the case, it first determined that section 2703 was applicable due to the substantial modification made to the 1981 agreement in 1996.[121] It then determined that the 1981 agreement was not binding during life because, after Jennings's death, the only parties to the agreement were Blount and the company.[122] Blount controlled the company through his 83 percent stock ownership and his role as the only director and president.[123] He could thus easily modify the agreement at any time and did modify it in 1996.[124] To further buttress its decision, the Tax Court found that the agreement was not comparable to other similar agreements, and the appellate court did not find that conclusion erroneous.[125] The existence of a bona fide business purpose and whether the agreement was a device to transfer assets to the natural objects of the decedent's bounty for less than full and adequate consideration were not at issue in the case.[126] The only solace for the taxpayer in the case was the court's overturning of the Tax Court's inclusion of insurance proceeds in making its valuation.[127]

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[118] *See id.* at 1341. The estate received the $4 million for his shares. *Id.*

[119] *See id.* at 1346.

[120] *See* Estate of Blount v. Comm'r, 87 T.C.M. (CCH) 1303, 1312, 1316 (2004).

[121] *See Blount*, 428 F.3d at 1343. Under the 1981 agreement, the total book value of Blount Construction Company would have been $8.5 million. *Id.* Under the 1996 amendment, the total book value of the company was $4.8 million. *Id.* This difference, along with a revision that prevented the company from paying the purchase price in installments, and the elimination of a price adjustment feature caused the court to conclude that the modifications were substantial. *See id.*

[122] *See id.* at 1344.

[123] *Id.*

[124] *See id.* ("Blount essentially had the unilateral ability to modify the 1981 agreement during his life, and, in fact, he did modify it during his life.").

[125] *See id.* The only expert for the taxpayer on this issue considered only price in his evaluation of comparables and ignored $1.9 million in liquid assets, resulting in a valuation that was $2 million less than other experts. *See id.*

[126] *See id.* at 1342, 1344. Referring to the Tax Court's analysis, the Eleventh Circuit stated, that "the first two prongs of the test were not at issue." *Id.* at 1344.

[127] *See id.* at 1346 ("We conclude that such non-operating 'assets' should not be included in the fair market valuation of a company where, as here, there is an enforceable contractual obligation that offsets such assets.").

G. Estate of Amlie v. Commissioner[128]

This Tax Court Memorandum decision was the focus of some dispute between the majority and the dissent in *Holman* and was decided based on both pre-2703 law and section 2703.[129] Because it is one of the few cases under section 2703 prior to *Holman* and because of the disagreement between the majority and dissent in *Holman* over its precedential value, it warrants a more expansive discussion. Although the decision dealt with several issues, this Article concerns itself with only those aspects of the decision involving the effect of agreement restrictions on the estate valuation.

Decedent Pearl Amlie left her estate to her children and grandchildren.[130] One child, Rod, was bequeathed certain bank stock in which Mrs. Amlie had a minority interest (ultimately called First American Bank Group, Ltd. or FABG),[131] and he, his wife, and their children were given rights of first refusal on shares of the bank stock not passing by bequest to Rod.[132] Approximately three years before Mrs. Amlie's death, her conservator (appointed several years before her death because of her advanced age and her own concerns about her ability to manage her finances) entered into a so-called 1995 Family Settlement Agreement (FSA) with Mrs. Amlie's children and grandchildren.[133] This agreement secured for Mrs. Amlie's heirs, other than Rod, a fixed price for the FABG stock of $118 per share.[134] Rod thought that value too low and thus the FSA provided that the bequest to him of the bank stock would be transferred to him "in kind" and the stock so transferred would be

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[128] 91 T.C.M. (CCH) 1017 (2006).

[129] Holman v. Comm'r, 601 F.3d 763, 778 (8th Cir. 2010) (Beam, J., dissenting); *see Amlie*, 91 T.C.M. (CCH) at 1024-25, 1028.

[130] *See Amlie*, 91 T.C.M. (CCH) at 1018-19.

[131] *See id.*

[132] *See id.* at 1019. The bequest was originally to Rod directly, but Mrs. Amlie's will was amended to name a trust for Rod and his family, The Rod Amlie Trust. *Id.* Rod's trust was bequeathed the amount of FABG shares equal to one half the value of certain farmland that was given in equal shares to a sister and children of a deceased brother. *Id.* Rod's trust then had a right to purchase any remaining shares of FABG stock owned at death by his mother. *Id.*

[133] *See id.* at 1019, 1021. The agreement was between Mrs. Amlie's daughter, the two children of a deceased son, Rod Amlie, his wife, their children, and the trustees of the Rod Amlie Trust. *See id.* at 1021, n.15. The conservator was not a signatory. *See id.* at 1024-25.

[134] *Id.* at 1021.

valued at that price.[135] Further, his trust had the right to purchase the remainder of Mrs. Amlie's FABG stock at the $118 price after the decedent's death,[136] and the estate could also require the trust to purchase the stock (mutual put/call options).[137] Because the conservator was acting in a representative and fiduciary capacity with respect to Mrs. Amlie, the agreement was submitted to, and received approval from, a state district court.[138] Two years after entering the FSA, Rod negotiated an agreement with FABG for FABG to purchase the stock he acquired through bequest and post-death purchase at $217.50 per share, plus 4 percent per year appreciation.[139]

At Mrs. Amlie's death in 1998, her estate recorded the value of the bank stock for tax purposes at the $118 per share price fixed in the agreement.[140] The Service rejected that value and, instead, sought to value the stock at the higher price negotiated by Rod with FABG for his FABG stock, $217.50 per share.[141] That was, in fact, the value at which the stock was actually sold by Rod to FABG one month after her death.[142] The Service sought to disregard the FSA value under Treasury Regulation 20.2031-2(h) and section 2703.[143] The reason for disregarding the FSA, argued the Service, was that the agreement did not contain a fixed value required by Treasury Regulation 20.2031-2(h) because the amount of stock to be purchased by Rod (or his trust) was not knowable until after decedent's death.[144] The court rejected this argument because the price was fixed for whatever shares were part of the bequest (all of Mrs.

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[135] *See id.* at 1021. The agreement also prohibited the conservator from disposing of the FABG stock without the consent of Rod, his wife, their children, and his trust. *Id.*

[136] *See id.*

[137] *See id.* at 1021.

[138] *See id.* at 1022.

[139] *Id.* These were referred to as the 1997 Agreements. *Id.* These agreements secured for the Rod Amlie Family Trust a total price of $1,489,724.93 for all the FABG stock. *Id.* The value of all the FABG stock at the $118 price was $993,756.96, the value reflected on the estate tax return. *Id.* The Service contended that the higher value was the proper one and assessed a deficiency based on the difference of $495,967.97. *See id.* at 1022-23.

[140] *See id.* at 1021-22.

[141] *See id.* at 1022-23. The Service also sought to impose penalties for fraud and negligence under I.R.C. section 6662. *See id.* at 1023.

[142] *See id.* at 1022.

[143] *See id.* at 1024.

[144] *See id.* The amount of FABG stock Rod was bequeathed was to equal one-half the value of the farmland given to his sister and the children of his deceased brother, respectively. *See id.* That value would not be determined until death. *See id.* The amount of stock to be purchased was the total shares owned at death minus the shares bequeathed. *See id.*

Amlie's FABG stock) and whatever shares were to be sold to Rod thereafter.[145] The court was satisfied that the price was fixed and determinable at death, and the agreement was binding both during life and at death.[146]

The court then turned its attention to section 2703. As to the first requirement of subsection (b), the court found a valid business purpose for the FSA agreement.[147] The court stated, "[i]n our view, an agreement that represents a fiduciary's efforts to hedge the risk of the ward's holdings may serve a business purpose within the meaning of section 2703(b)(1). In addition, planning for future liquidity needs of decedent's estate … constitutes a business purpose under section 2703(b)(1)."[148] To the Service's argument that no business purpose could be present because the object of the agreement was an investment asset (closely held bank holding company stock), not an actively managed business, the court said, "[w]e rejected such an argument in *Estate of Bischoff v. Commissioner* and find it equally unpersuasive here."[149]

The Service also argued that the agreement represented a testamentary device because the decedent received no value for the 1995 agreement (the decedent owned no more and no less stock than she did prior to the agreement), and the price was less than what Rod was able to obtain in 1997—almost twice the value of the $118 agreement price.[150] The court rejected both arguments.[151] As to the first, the court said that there was consideration in the form of securing a set price on an otherwise variably valued asset (and a minority interest at that) along with a reduction in litigation risk, and that the other heirs also agreed to the price.[152] As to the second argument, the court stated, "[t]he conservator, in an effort to fulfill

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[145] *See id.* The 1995 FSA established a ceiling and floor on what the decedent would receive for her FABG stock and transferred the risk of price fluctuations to Rod's trust. *Id.* It ended up benefiting him to the extent of about $500,000 (less capital gains taxes). *See id.* at 1022.

[146] *See id.* at 1025 (Referring to this as meeting "the pre-section-2703 requirements.").

[147] *See id*. at 1026.

[148] *Id.*

[149] *See id.* at 1026 (internal citation omitted); *see* discussion of *Estate of Bischoff supra* at notes 31-48 and accompanying text.

[150] *Amlie*, 91 T.C.M. (CCH) at 1026-27.

[151] *See id.*

[152] *See id.* at 1026. In fact, at that juncture Rod's interests and those of the other heirs were adverse. *See id.* at 1027. The lower the price, the greater the number of shares that would pass to Rod by bequest. *Id.* at 1026-27. The higher the price, the fewer shares passing by bequest. *See id.* Because the other heirs were opting for a fixed price, it was in their interest that it be at a higher value. *See id.*

fiduciary obligations, and the other prospective heirs, in furtherance of their own interests, accepted a price they believed (on the basis of professional advice) was fair at the time and in the particular circumstances."[153]

The court also analyzed the requirement of comparable terms, again finding for the estate.[154] To support its contention that the terms of the FSA were comparable to similar arrangements, the estate used the expert testimony of an attorney, experienced in the purchase and sale of closely held businesses, who contended that the 1995 FSA contained essentially the same terms as an earlier agreement between the conservator and the bank.[155] The Service, pointing to Treasury Regulation 25.2703-1(b)(4), said isolated comparables were not sufficient.[156] The court dismissed this assertion, holding that "[w]hile the regulations caution against using 'isolated comparables,' we believe that in context the regulations delineate more of a safe harbor than an absolute requirement that multiple comparables be shown."[157] The court was satisfied that this was an arm's length transaction, similar to what other parties would enter.[158]

Having thus found that the exception of 2703(b) was satisfied and that the "pre-section 2703" requirements were met, the court determined that

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[153] *Id.* at 1027. This was certainly a case of the Service using twenty-twenty hindsight. It was two years after the 1995 FSA before Rod was able to obtain the higher price. *See id.* at 1026. The conservator and the other heirs valued the certainty of knowing the price of the stock without further contest with FABG, whereas Rod was willing to stand by his conviction that the $118 price was too low. *See id.* at 1021. He seemingly was correct, but it is a stretch to argue that the conservator's (and other heirs') decision to accept the security of a known price constituted a testamentary device on the part of the deceased. As the court said, "the other prospective heirs and Rod simply disagreed regarding the potential risks and rewards of further negotiation or litigation with FABG …." *Id.* at 1027.

[154] *See id.* at 1027.

[155] *See id.* The earlier agreement, referred to as the 1994 Agreement, was a putative agreement between Mrs. Amlie's conservator and FABG for the purchase and sale of her shares after her death at the $118 per share price. *See id.* at 1020. This was the agreement Rod had objected to and which resulted in the 1995 FSA. *See id.* at 1021. Interestingly, although the conservator entered expert testimony that the $118 price was fair, the 1994 Agreement was rejected by the district court as not being in Mrs. Amlie's best interests. *Id.* at 1020-21.

[156] *Id.* at 1027. "Evidence of general business practice is not met by showing isolated comparables." Treas. Reg. § 25.2703-1(b)(4)(ii) (1992).

[157] *Amlie*, 91 T.C.M. (CCH) at 1027.

[158] *See id.* "[O]n the facts of this case, we are persuaded that the 1995 FSA price terms were arm's length." *Id.*

the price term in the agreement was binding for estate tax valuation purposes.[159]

III. THE *HOLMAN*[160] DECISION

The Eighth Circuit announced the *Holman* decision on April 7, 2010.[161] Although the court split on the decision, *Holman* represents a complete victory for the Service on both the section 2703 issues and the amount of allowable valuation discounts.

The taxpayer petitioners, Tom and Kim Holman, transferred publicly traded stock in Dell, Inc. to a newly created family limited partnership as part of their estate plan.[162] The Holmans then gifted limited partnership interests to their minor children who transferred, through a custodian, previously owned shares to the partnership in exchange for additional limited partnership interests.[163] The Holmans filed gift tax returns for the affected years (1999, 2000, and 2001) and claimed combined marketability and minority discounts of approximately 49 percent, based in part on restrictions contained in the partnership agreement.[164] The Service challenged the transactions as gifts of the underlying stock and not of the limited partnership interests, and further claimed the restrictions in the partnership agreement should not be considered under section 2703(a);[165] therefore, the appropriate combined discount should be 28 percent (later lowered at trial to approximately 17-27 percent).[166]

While the partnership agreement provided for numerous purposes for the entity, the petitioners themselves argued before the Tax Court that the essential purposes of the partnership were to provide asset protection (from dissipation by the children, creditors, or future spouses of the

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159 *Id.* at 1028.

160 601 F.3d 763 (8th Cir. 2010).

161 *See id.*

162 *See id.* at 765. The professed estate planning goals were to transfer wealth, preserve family wealth, avoid the dissipation of wealth by the children, and educate the children about investments and the responsibility of wealth. *See id.* at 767. Notably, tax reduction and tax avoidance were not explicitly mentioned. *See id*. The amount of Dell stock held in the partnership represented about .28 percent of the total shares outstanding. *Id.* at 767.

163 *Id.* at 765-66.

164 *See id*. at 766-67. The substantial discount was intended to also reflect a lack of marketability and the fact that they were minority interests. *See id.* at 767. The discounts were based on outside appraisals. *See id.*

165 *See id.* at 765-67.

166 *See id*.

children) and wealth education for the children.[167] Additionally, the petitioners contended that, though they intended to diversify the investment portfolio of the partnership in the future, they did not have an overall investment strategy or plan for the partnership beyond the holding of passive investments.[168]

The partnership agreement also contained several restrictions on the transfer of partnership interests, which formed the basis for the amount of the discounts taken on the tax returns. Section 9.1 of the agreement prohibited a limited partner from withdrawing, assigning, or encumbering a partnership interest except in accordance with agreement.[169] Section 9.2 provided for certain permissible transfers within or for the benefit of the family.[170] Most significantly, section 9.3 allowed the partnership to: (a) purchase, under specified terms, an interest transferred in violation of the agreement; (b) assign this purchase right to a current partner; (c) accept the transferee as a limited partner; or (d) refuse to accept the transferee as a limited partner or purchase the interest, in which event the transferee merely possesses the transferor's right to distributions but has no other rights as a limited partner.[171]

The Tax Court found that the Holmans's gifts to their children were of limited partnership interests, not of the underlying Dell stock.[172] The court did so largely based on the potential fluctuation of the stock value and the consequent economic risk during the period between the formation of the limited partnership and contribution of shares and the later date of transfer

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[167] *See id*. at 767.

[168] *Id.* ("Neither donor [Tom or Kim Holman] claimed an intent to maintain Dell stock as the sole asset of the partnership nor described any particular investment strategy … other than a future intent to diversify the portfolio's holdings. Neither donor claimed an intent to hold anything other than passive investments in the partnership nor described any business activity related to the partnership.").

[169] *Id.* at 766.

[170] *Id.*

[171] *Id.*

[172] Holman v. Comm'r, 130 T.C. 170, 185, 191 (2008). This analysis consumed a considerable portion of the court's opinion in the case. For a detailed discussion of the Tax Court opinion, see Alden Koste, Note, *The IRS Fished Its Wish: The Ability of Section 2703 to Minimize Valuation Discounts Afforded to Family Limited Partnership Interests in* Holman v. Commissioner, 59 CATH. U. L. REV. 289, 290 (2009) ("[T]his Note delves into the *Holman* case and considers how the IRS successfully employed section 2703(a)."), and Andrew T. Sullivan, Casenote, *Transferring Wealth: Holman v. Commissioner of Internal Revenue Retains Hope for the Family Limited Partnership Despite Continuous Attacks by the IRS*, 55 LOY. L. REV. 207 (2009) ("This Note focuses on the *Holman* court's discussion of acceptable methods to utilize an FLP to provide tax savings for gift transfers through application of valuation discounts.").

of partnership interests.[173] The Service did not contest this finding on appeal.[174]

The Tax Court then analyzed the section 2703 issues, finding the partnership agreement restrictions should not be considered in valuing the partnership interests because the 2703(b) exception did not apply.[175] Specifically, the court held that the agreement did not represent a bona fide business arrangement and that the transactions were a testamentary substitute, thus violating 2703(b)(1) and (2).[176] In light of those determinations and the conjunctive nature of 2703(b), the Tax Court did not address the applicability of 2703(b)(3).[177] The court need not have addressed the testamentary device issue under (b)(2), however, because its decision held there was no bona fide business arrangement; thus, the former issue was irrelevant. The Eighth Circuit, upholding the Tax Court on the business arrangement prong of 2703(b) appropriately did not address whether the arrangement was a testamentary substitute.[178] The remainder of the Tax Court decision dealt with the conflicting evidence of the valuation discount experts; the court ultimately concluded those of the Commissioner were more appropriate.[179]

At the appellate level, the taxpayers argued that the partnership restrictions should be considered in the valuation determination, and further that those valuations were considerably lower than those the Service proposed due to greater discounting.[180] A majority of the appellate panel disagreed, however, and sided with the Service.[181]

The circuit court majority found that the Holmans did not create a bona fide business arrangement because the partnership was not in fact

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[173] *Holman*, 130 T.C. at 190-91. The court distinguished *Shepherd v. Comm'r*, 115 T.C. 376 (2000) and *Senda v. Comm'r*, T.C. Memo 2004-160, *aff'd*. 433 F.3d 1044 (8th Cir. 2006) by stating, "[p]etitioners did not first transfer LP units to [the custodian and trustee for the children] and then transfer Dell shares to the partnership, nor did they simultaneously transfer Dell shares to the partnership and LP units to [the custodian/trustee]." *Holman*, 130 T.C. at 186-87. The partnership was formed and stock transferred on November 3, 1999, though the units were not transferred until November 8, 1999. *Id.*

[174] *See Holman*, 601 F.3d at 765.

[175] *Holman*, 130 T.C. at 191, 199.

[176] *Id.*

[177] *Id.* at 199 (noting that as the agreement failed the requirements of both 2703(b)(1) and (2), the court saw no reason to address 2703(b)(3)).

[178] *Holman*, 601 F.3d at 772-73 n.5.

[179] *Holman*, 130 T.C. at 199, 216. This portion of the opinion will not be addressed in this Article.

[180] *See Holman*, 601 F.3d at 768.

[181] *See id.* at 775.

conducting any business.[182] The court held that the Holmans had merely altered their investments from highly liquid (publicly traded stock) to a more illiquid limited partnership "container."[183] In reaching this conclusion, the court made an important preliminary decision: the holding of the Tax Court regarding whether this constituted a bona fide business arrangement was a finding of fact subject to review for clear error only.[184] The dissent took the majority to task on this point, but this preliminary holding certainly made the job of the appellate court much easier.

The taxpayers argued the court was, in essence, imposing a requirement that the partnership be an operating business; the court insisted otherwise.[185] While conceding some potential relevance, the court also distinguished the *Black, Murphy,* and *Schutt* estate tax cases decided under section 2036(a).[186] Those cases also involved entities holding passive investments. In this regard, quoting *Erickson v. Commissioner*, the court said, "[t]here is no significant nontax purpose … where a family limited partnership is just a vehicle for changing the form of the

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[182] *Id.* at 770 ("[I]n the present case, there was and is no 'business,' active or otherwise.").

[183] *See id*. at 770-72 ("Here, as in *Erickson*, the family partnership is a 'mere asset container.'").

[184] *See id*. at 769 (citing Estate of True v. Comm'r, 390 F.3d 1210, 1218-19 (10th Cir. 2004); St. Louis Cnty. Bank v. United States, 674 F.2d 1207, 1210-11 (8th Cir. 1982)). The court later states that "context matters such that it is appropriate to defer to the reasoned judgment and fact-finding ability of the Tax Court" and referred to the determination of a bona fide business arrangement as a "factually intense inquiry." *Id*. at 772.

[185] *See id.* at 769. The court said that neither it nor, as the taxpayers asserted, the Tax Court sought to create an "operating business nexus" requirement to have a bona fide business arrangement. *Id.* (internal citations omitted).

[186] *See id.* at 771 (citing Estate of Black v. Comm'r, 133 T.C. 15 (2009); Estate of Murphy v. United States, No. 07-CV-1013, 2009 WL 3366099 (W.D. Ark. Oct. 2, 2009); Estate of Schutt v. Comm'r, 89 T.C.M. (CCH) 1353 (2005)). I.R.C. section 2036(a) generally includes in a gross estate of a decedent property which the decedent transferred, but retained a lifetime right to possession, enjoyment, or income from the transferred property. *See id.* at 771. An exception exists if the property was transferred in a bona fide sale for adequate and full consideration. *See id.* Case law has deemed that provision to contain a legitimate business purpose requirement. *See id.* The *Black, Murphy*, and *Schutt* cases involved situations in which the retained assets were investment securities and the restrictions were intended to preserve the investment strategy of the transferor. *See id.* While the courts in those cases found a legitimate business purpose for the existence of the partnership, the Tax Court in *Schutt*, as quoted in *Holman*, ruled "the mere holding of an untraded portfolio of marketable securities weighs negatively in the assessment of potential nontax benefits." *Id.* at 771-72.

investment in the assets, a mere asset container."[187] The court based its conclusion of "no bona fide business arrangement" on the following facts: (1) the only asset of the partnership was the Dell stock, and (2) no concrete investment strategy or plan for the partnership existed other than the passive holding of marketable securities.[188] The court ruled the prevention of asset dissipation by the children and their financial education through the partnership were, likewise, not business purposes.[189]

The court of appeals also distinguished *Amlie*, a decision relied on heavily by the dissent.[190] Although the underlying asset in *Amlie* was an investment asset (stock), the court found several distinguishing features. In *Amlie*, the stock was a minority interest in a closely held business, while in *Holman* the stock was of a publicly traded company.[191] Further, in *Amlie* a conservator with fiduciary duties represented the decedent prior to her death.[192] That conservator expressed concerns about the productivity of an asset that represented a minority interest in a closely held business not paying a dividend.[193] This situation was obviously not present in *Holman*.

The taxpayers also argued that only the intentions of the parties, not the nature of the assets in the partnership, were relevant;[194] again, the court disagreed.[195] Context, the court said, mattered.[196] The context that mattered was that the partnership contained, and likely would only contain, publicly traded securities, was a device to protect assets, and, in all likelihood, would provide tax advantages during life and at death.[197] There was, of course, nothing wrong with those functions, it just was not something this court saw as a business.[198] Having so decided, the court did not find it necessary to examine either of the other prongs of 2703(b) and

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[187] *See id.* at 772.

[188] *See id.* at 767, 772.

[189] *See id*. at 772. The appellate court summarized the motivations of the Holmans as "estate planning, tax reduction, wealth transference, protection against dissipation by the children, and education for the children." *Id.*

[190] *See id.* at 770-71; 777-78 (Beam, J., dissenting) (citing Estate of Amlie v. Comm'r, 91 T.C.M. (CCH) 1017 (2006)).

[191] *See id.* at 770.

[192] *Id*.

[193] *See id*.

[194] *See id.* at 769.

[195] *See id.* Although the assets in the partnership were not relevant, the taxpayers argued intent and the language of the restrictions were the only relevant factors. *See id.* This appears rather self-serving.

[196] *Id*. at 770.

[197] *See id.*

[198] *See id.* at 772.

proceeded to analyze the appropriate amount of discounts to be applied.[199] On that issue, it also deferred to the judgment of the Tax Court.[200]

IV. DISSENT

Judge Clarence Arlen Beam wrote a cogent dissent, finding that all three prongs of the 2703(b) exception were satisfied and, thus, the restrictions in the partnership agreement should be considered in the transfer valuations.[201]

As mentioned earlier, Judge Beam also differed with his colleagues on the standard of review.[202] He conceded that the ultimate question of whether there was a bona fide business arrangement was a factual one.[203] He saw the issues in this case—however, as identifying the correct legal criteria for that determination, as well as a question of statutory interpretation—questions of law subject to de novo review by the appellate court.[204] It is, of course, interesting but highly speculative to contemplate how Judge Beam would have ruled if he had accepted the majority view on this issue.

As a matter of legislative intent, Judge Beam, citing a Joint Tax Committee staff report, found that maintaining family control was a legitimate business purpose, even if the assets under control were investments.[205] Further, he asserted that a Senate Finance Committee report deemed family control of a limited partnership in a holding company a legitimate business purpose.[206] The Holman partnership restrictions were thus consistent with that intent.[207]

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[199] *See id.* at 768-69, 773.

[200] *See id*. at 775-76.

[201] *See id*. at 776 (Beam, J., dissenting).

[202] *See id.* at 776-77.

[203] *See id.* at 776.

[204] *Id*. at 776-77 ("[T]he fundamental question before us is whether the Tax Court employed the correct criteria, framework, or test to make this factual determination …. [W]e review the Tax Court's statutory interpretations de novo.").

[205] *See id.* at 777 (citing STAFF OF JOINT COMMITTEE ON TAXATION, 101st CONG., 2d Sess., REPORT ON FEDERAL TRANSFER TAX CONSEQUENCES OF ESTATE FREEZES 14 (Comm. Print 1990)). In this regard Judge Beam criticized the majority for an unduly narrow reading of *Bischoff*. *See id.* He read Congress's citation of *Estate of Bischoff* as endorsing the notion of maintaining family control as a legitimate business purpose regardless of what constituted the underlying business. *See id.* The majority saw no underlying business in this case. *See id.*

[206] *See id.* (citing 136 CONG. REC. S15,680 (1990) (explanatory material concerning Committee on Finance 1990 Reconciliation Submission pursuant to House Concurrent

The dissent also quarreled with the majority's differentiation of *Amlie*. Judge Beam argued that the same portion of the Finance Committee Report cited in support of the arrangement in *Amlie* supported the arrangement in *Holman*.[208] Because the lack of an actively managed business was not fatal in *Amlie,* Judge Beam contended it should not be fatal in the Holmans's case.[209] The only notable difference in the two cases, the dissent argued, was that in *Amlie* the purpose of the restrictions was to provide for future liquidity needs; whereas, in *Holman* it was to protect against ownership by unrelated parties.[210] As the Finance Committee Report cited both as common uses of a buy-sell agreement, *Amlie* was a proper precedent.[211] However, something that is a "common purpose" for a buy-sell agreement does not automatically make it a bona fide business arrangement. As the majority mentioned, the *Amlie* situation arguably required a value fixing apparatus due to the illiquid nature of the assets involved there (closely held stock), a fact not present in *Holman*.[212] As the majority also stated, context matters.[213]

The dissent also noted that it was a legitimate business purpose to allow the partners discretion over the question of who may become a partner.[214] That function was part of the partnership restrictions as well.[215]

Finally, with respect to the business purpose issue, Judge Beam found that the legislative intent of section 2703 was to prohibit primarily tax motivated restrictions from creating artificially low asset valuations.[216] In

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Resolution 310); STAFF OF JOINT COMMITTEE ON TAXATION, 101st CONG., 2d Sess., REPORT ON FEDERAL TRANSFER TAX CONSEQUENCES OF ESTATE FREEZES 14 n.44 (Comm. Print 1990)).

[207] *Id.* at 777.

[208] *See id.* at 778 ("[B]uy-sell agreements are commonly used to control the transfer of ownership in a closely held business, to avoid expensive appraisals in determining purchase price, to prevent the transfer to an unrelated party, to provide a market for the equity interest, and *to allow owners to plan for new liquidity needs in advance.*") (emphasis in original).

[209] *Id.* ("[I]f the absence of an 'actively managed business interest' was irrelevant in *Amlie*, it is unclear why an actively managed business interest is required in the present case ….").

[210] *See id.*

[211] *See id.*

[212] *See id.* at 770 (majority opinion).

[213] *Id.*

[214] *See id.* at 779 (Beam, J., dissenting) (without such restrictions, the dissent pointed out, the Holmans as general partners could end up owing fiduciary duties to persons they never contemplated).

[215] *See id.* (referencing section 9.3 of the partnership agreement so provided).

[216] *See id.*

the present case, Judge Beam read the majority opinion to say that the Holmans's primary motivation for the partnership restrictions was to prevent asset dissipation.[217] Because the majority's declared primary purpose was not tax driven, the restrictions were bona fide business arrangements under 2703(b)(1).[218]

Having so found, the dissent continued its analysis under the last two prongs of 2703(b). The device test of (b)(2) was satisfied because the "clear" language of the subsection made its application only relevant in transfers at death, despite the Treasury Regulation making for a broader application: applying it to the "natural objects of the transferor's bounty" rather than "members of the deceased's family."[219] Because the Regulation was in conflict with the language of the Code, it was invalid.[220] The comparable terms test of (b)(3) was also met because the restrictions found in the Holman agreement were typical of such agreements between parties in an arm's length transaction.[221] As all three of the 2703(b) tests were met, according to the dissent, the transfer restrictions must be taken into account in the partnership interest valuation.[222]

V. ANALYSIS

The majority in *Holman* got it right. Had the dissent's point of view prevailed, there would be little left of Congress's intent to curtail the use of buy-sell agreements or similar kinds of restrictions as a mere tax avoidance scheme. The arrangement was certainly not designed for a business purpose. The Holmans took an inherently liquid, easily valued

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[217] *Id.* at 780. The appellate court, however, found the motivations to be "estate planning, tax reduction, wealth transference, protection against dissipation by the children, and education for the children." *See supra* note 189.

[218] *See Holman*, 601 F.3d at 780 (Beam, J., dissenting). Judge Beam summarized the Holmans's business purposes as maintaining family control over participation in the partnership, maintaining control over the right to income, protection against creditors, and control over who may become a partner. *See id*.

[219] *Id.* at 781 ("It is clear that the phrase 'members of the decedent's family' unambiguously limits § 2703(b)(2)'s application to transfers at death."). Similar wording to the phrase, "natural objects of the transferor's bounty" found in Treas. Reg. 25. 2703-1(b)(1)(ii), can be found in Treas. Reg. 20. 2031-2(h) and Rev. Rul. 59-60, 1959-1 C.B. 237, 244 ("natural objects of his bounty"). Judge Beam's point, of course, is not the language per se, but its use pursuant to the language of section 2703(b).

[220] *Holman*, 601 F.3d at 781 (Beam, J., dissenting).

[221] *See id.* at 781-82. The fact that the restrictions were typical of those found in similar agreements was all that was necessary to satisfy the test according to the Tax Court and Judge Beam. *See id.*

[222] *See id.* at 782.

asset and turned it into one that was illiquid and difficult to value. Why? In all likelihood, to reduce the transfer tax cost. They sought the benefits of retaining control of the Dell, Inc. stock, protection of the stock against the claims of creditors or spouses of children, prevention of dissipation of the stock by the children, and perhaps some wealth education of the children; yet, they still retained the ability to have the stock valued for transfer tax purposes at half its true value. Contrary to Judge Beam's attempts to portray it otherwise, the Holmans's actions seem to be exactly those that Congress sought to eliminate with its enactment of section 2703. As indicated in *Erickson*, the Holmans merely changed the form of the "asset container."[223] As stated in *Schutt*, "the mere holding of an untraded portfolio of marketable securities weighs negatively in the assessment of potential nontax benefits."[224]

Judge Beam was somewhat misleading in his citation to the legislative history of section 2703 contained in the Senate Finance Committee Report. He cites the Report's reference to *Bischoff* for the proposition that perpetuation of family ownership is a legitimate business purpose even when the form of business is a limited partnership interest.[225] While the Committee Report does refer to *Bischoff* on that point, it does so simply as part of its exposition of what "a number of courts have held."[226] Further, it should also be remembered that, while *Bischoff* involved two limited partnerships, one owned an active, operating business, the other owned stock in closely held operating companies, not an investment portfolio of publically traded stock.[227] The court in *Bischoff* may have rejected the contention, *in that case*, that no bona fide business purpose could exist with respect to a holding company, but it still found a business purpose in partnership restrictions to maintain family control of several closely held operating businesses.[228] That is a distinctly different situation than that in *Holman*.

The *Amlie* "precedent" was not much of a precedent. The surface similarity is in the partnership's holding of an investment asset. The differences, however, are stark and significant. The stock in *Amlie* was stock in a *closely held* business, the value of which was speculative.[229] It

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[223] Erickson v. Comm'r, 93 T.C.M. (CCH) 1175, 1181 (2007).

[224] Estate of Schutt v. Comm'r, 89 T.C.M. (CCH) 1353, 1367 (2005).

[225] *See Holman*, 601 F.3d at 777 (Beam, J., dissenting).

[226] 136 CONG. REC. 30,538 (1990) (explanatory material concerning Committee of Finance 1990 Reconciliation Submission pursuant to House Concurrent Resolution 310).

[227] *See* Estate of Bischoff v. Comm'r, 69 T.C. 32, 33-34 (1977).

[228] *See supra* notes 31-48 and accompanying text.

[229] *See supra* notes 128-59 and accompanying text.

was a *minority interest* in that closely held business, an inherently tenuous position.[230] The instigator of the agreement in *Amlie* was a *fiduciary* that was discharging its fiduciary duties to protect the ward and decedent from the vagaries of the position of a minority interest holder in a closely held business.[231] Finally, the participants in the *Amlie* agreement, in addition to the conservator, were several family members, one of whom was at decided odds with the others. None of those factors were present in *Holman*.[232] Thus, rather than precedent and legislative history supporting the Holmans, the facts of *Holman* prove more consistent with the majority opinion.

CONCLUSION

The *Holman* decision could be seen as a serious blow to taxpayers, family limited partnerships, and the value of buy-sell agreements or like restrictions. It is not such a decision, or, even if it is, it should not be lamented. The Holmans "pushed the envelope" with their arrangement, and they were appropriately called to account for it. While there are certainly circumstances where a buy-sell agreement or similar restriction with respect to investment assets should be honored for transfer tax valuation purposes or discounted to reflect those restrictions, it is stretching the boundaries of tax fairness too far to do so where the only asset in the family "container" is passively held, publicly traded stock.

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[230] *See* Amlie v. Comm'r, 91 T.C.M. (CCH) 1017, 1021 (2006).
[231] *See id.*
[232] *See supra* notes 160-200 and accompanying text.