

11th Circuit disregards changeable buy-sell agreement, but insurance proceeds used for buyout not included in value

Estate of Blount v. Commissioner, 428 F.3d 1338, 2005 U.S. App. LEXIS 23502 (11th Cir. October 31, 2005). *Judge Birch*.

Key words:

Estate tax, Fair market value (FMV), Stock repurchase agreement, ESOP

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As reported in the August 2004 issue of *BVUpdate*, the issue in this estate tax case was the value of George Blount's (decedent's) interest in a closely held company on the date of his death. The U.S. Tax Court disregarded an ESOP repurchase liability and a buy-sell agreement, but included the full value of company-owned life insurance, and valued the company at \$9.9 million.

Facts

Blount owned 83.2 percent or 43,080 shares of **Blount Construction Company (BCC)**. In 1981, prior to the formation of the BCC ESOP, he and the only other shareholder, entered into a shareholders' buy-sell agreement with BCC. The agreement restricted the transfer of stock during the lifetime of the shareholder and at death, and set the per-share purchase price as BCC's book value at fiscal yearend immediately preceding the deceased shareholder's death.

Then, in 1996, Blount as the only remaining shareholder entered into a new buy-sell agreement with BCC. The new agreement was operative only upon his death and set a fixed, lump-sum purchase price of \$4 million. He signed the agreement in his individual capacity and on behalf of BCC as its president. Additionally, there was a life insurance policy owned by the company that provided about \$3.1 million to pay off the mandated buy-out of the shares.

Tax Court decision

The Tax Court found that the 1996 buy-sell agreement was a modified version of the 1981 agreement, and ignored the agreement's set value because Blount had the unilateral ability to modify it, thus failing to satisfy the requirement that it be binding during life. The court also disregarded the agreement under IRC Section 2703, which requires that to be included in a valuation, a buy-sell agreement's terms must be "comparable to similar arrangements entered into by persons in an arm's length transaction." Here, the court concluded that the parties were "related" and had not engaged in arm's-length bargaining. The Tax Court included the full amount of the insurance proceeds as nonoperating assets,

and also concluded that because the buy-sell agreement had been disregarded, the issue of whether BCC's obligation under that agreement to redeem decedent's stock should offset the proceeds was not before the court.

Holding and rationale

The Eleventh Circuit affirmed the Tax Court's decision that the buy-sell agreement could not set the value of BCC for estate tax purposes, but reversed on the inclusion of the insurance proceeds as nonoperating assets.

The appellate court determined that the exception to the rule that the value of the taxable estate generally is the fair market value of the decedent's property at the date of death, codified by the Omnibus Budget Reconciliation Act of 1990, Pub. L. 101-508, 104 Stat. 1388 (OBRA), was inapplicable because the stock-purchase agreement in this case was unilaterally changeable during Blount's lifetime, and thus violated the exception's requirement that the buy-sell agreement must be binding during the life of the decedent.

The court came to the same conclusion under the different theory that the agreement did not satisfy the exception's requirement that the buy-sell agreement must be comparable to similar arrangements entered into at arm's length, because it found that the Tax Court had not erred in its determination that the agreement had not been made at arm's length.

As to the insurance proceeds, the appellate court ruled that the Tax Court had erred because those proceeds had already been taken into account in the determination of net worth. The court noted that even when a buy-sell agreement is inoperative for purposes of establishing the value of the company for tax purposes, the agreement remains an enforceable liability against the valued company, if state law fixes such an obligation—which it had in this case. Here, the insurance proceeds were offset dollar-for-dollar by BCC's obligation to satisfy its contract with the decedent's estate. The court thus concluded that such nonoperating "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.