UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

Estate of H.A. True, Jr. v. Commissioner of Internal Revenue

390 F.3d 1210 (10th Cir. 2004) · No. Nos. 02-9010, 02-9011, 02-9012 · Decided December 2, 2004

SUMMARY

The Tenth Circuit affirmed the Tax Court's determination of estate and gift tax deficiencies arising from transfers of interests in closely held family businesses. The court held that formula prices in the family buy-sell agreements did not control valuation because the agreements functioned as testamentary substitutes rather than reflecting transfers for full and adequate consideration. The court also upheld substantial-understatement penalties.

CASE DETAILS

COURT	United States Court of Appeals for the Tenth Circuit
WRITING FOR THE COURT	Seymour; Porfilio; Murphy
JURISDICTION	Federal
DECIDED	December 2, 2004
DOCKET	Nos. 02-9010, 02-9011, 02-9012
DISPOSITION	affirmed
PROCEDURAL POSTURE	Appeal from the United States Tax Court's determination of estate and gift tax deficiencies and penalties
STANDARD OF REVIEW	Legal questions are reviewed de novo; factual findings are reviewed for clear error; valuation and penalty reasonable-cause determinations are reviewed for clear error.
PRECEDENTIAL VALUE	Published
PARTIES	Estate of H.A. True, Jr., H.A. True III Personal Representative; Jean D. True v. Commissioner of Internal Revenue

TOPICS

estate tax · gift tax · tax court procedure · tax deficiency · tax penalties · contracts · estate planning · partnership law · corporate law

PRACTICE AREAS

Tax Law · Estate Planning and Probate · Corporate Law · Contracts

QUESTIONS PRESENTED

1. Whether the Tax Court erred in concluding that the formula prices in the True buy-sell agreements did not control the value of the transferred interests for estate tax purposes.
2. Whether the Tax Court erred in not considering the non-price restrictive terms of the buy-sell agreements when valuing the interests for estate and gift tax purposes.
3. Whether the Tax Court erred in imposing accuracy-related penalties for substantial underpayment.

HOLDINGS

1. The Tax Court did not err; a buy-sell agreement's price term controls for estate tax purposes only if the agreement was entered into for bona fide business reasons and is not a testamentary substitute intended to pass interests for less than full and adequate consideration. The evidence supported the Tax Court's conclusion that the True agreements were testamentary substitutes and not supported by adequate consideration.
2. Brodrick v. Gore is overruled to the extent it holds that buy-sell agreement price terms are wholly controlling for estate tax purposes when the agreement binds all parties equally at life and death. Modern law under Treas. Reg. § 20.2031-2(h) and I.R.C. § 2703 requires a full examination of bona fide business purpose and whether the agreement is a testamentary substitute.
3. The price terms do not control for gift tax purposes; the transfers were not made in the ordinary course of business, and the agreements fail the price term control test, which applies in pari materia to estate and gift taxes.
4. The Tax Court did not err; once the agreements are determined to be testamentary substitutes, their non-price restrictive terms are tainted and may be disregarded for valuation, but the family's commitment to maintain control may be reflected through marketability discounts.
5. The Tax Court did not clearly err; taxpayers failed to demonstrate reasonable cause and good faith under I.R.C. § 6664(c) because they did not reasonably rely on appraisals or professional advice, and their reliance on prior gift-tax cases was not sufficient.

KEY QUOTATIONS

> *"the stated price in a buy-sell agreement will control for estate tax purposes where (1) the price is determinable from the agreement, (2) the terms of the agreement are binding throughout life and death, (3) the agreement is legally binding and enforceable, and (4) the agreement was entered into for bona fide business reasons and is not a testamentary substitute intended to pass on the decedent's interests for less than full and adequate consideration."* (1219)

> *"Where shareholders are members of the same family and the circumstances indicate that testamentary considerations influenced the decision to enter into a restrictive stock agreement, an assumption that the price stated in the agreement is a fair one is unwarranted."* (1224)

> *"it would be anomalous if particular portions of the shareholder agreement are now deemed relevant to the question of the fair market value of the decedent's stock."* (1230)

FACTUAL BACKGROUND

Dave True built family businesses in oil, gas, ranching, and transportation, each governed by buy-sell agreements that priced transfers at tax book value. After Dave's death in 1994 and Jean's retirement, their interests were transferred under the agreements. The IRS asserted estate and gift tax deficiencies, claiming the formula prices understated fair market value. The Tax Court found the agreements were testamentary substitutes, valued the transferred interests substantially higher, and imposed accuracy-related penalties.

PROCEDURAL HISTORY

The IRS issued notices of deficiency for estate and gift taxes arising from transfers of interests in family businesses governed by buy-sell agreements. Taxpayers filed petitions in the Tax Court. After a week-long trial, the Tax Court determined deficiencies and penalties, and taxpayers appealed to the Tenth Circuit.

DISPOSITION

affirmed

CASES CITED

- United States v. Cartwright, 411 U.S. 546 (1973)
- Heyen v. United States, 945 F.2d 359 (10th Cir. 1991)
- Estate of Gloeckner v. C.I.R., 152 F.3d 208 (2d Cir. 1998)
- St. Louis County Bank v. United States, 674 F.2d 1207 (8th Cir. 1982)
- Dorn v. United States, 828 F.2d 177 (3d Cir. 1987)
- Slocum v. United States, 256 F. Supp. 753 (S.D.N.Y. 1966)
- Cameron W. Bommer Revocable Trust v. C.I.R., T.C.M. (RIA) 97-380 (1997)
- Estate of Lauder v. C.I.R., T.C.M. (RIA) 92-736 (1992)
- Estate of Lauder v. C.I.R., T.C.M. (RIA) 94-527 (1994)
- Estate of Godley v. C.I.R., 80 T.C.M. (CCH) 158 (2000)
- Estate of Bischoff v. C.I.R., 69 T.C. 32 (1977)
- Brodrick v. Gore, 224 F.2d 892 (10th Cir. 1955)
- True v. United States, 547 F. Supp. 201 (D. Wyo. 1982)
- True v. United States, No. C79-131K (D. Wyo. Oct. 1, 1980)
- True v. United States, 190 F.3d 1165 (10th Cir. 1999)
- Dodge v. Cotter Corp., 203 F.3d 1190 (10th Cir. 2000)
- Montana v. United States, 440 U.S. 147 (1979)
- C.I.R. v. Sunnen, 333 U.S. 591 (1948)
- C.I.R. v. Wemyss, 324 U.S. 303 (1945)

- United States v. Boyle, 469 U.S. 241 (1985)
- Spitzer v. C.I.R., 153 F.2d 967 (8th Cir. 1946)
- Harwood v. C.I.R., 82 T.C. 239 (1984)
- Krauss v. United States, 140 F.2d 510 (5th Cir. 1944)
- C.I.R. v. McCann, 146 F.2d 385 (2d Cir. 1944)
- Estate of Littick v. C.I.R., 31 T.C. 181 (1958)
- Fiorito v. C.I.R., 33 T.C. 440 (1959)
- Wolf v. C.I.R., 4 F.3d 709 (9th Cir. 1993)