31 T.C. 181 (1958)

A bona fide buy-sell agreement that restricts both lifetime and testamentary transfers of stock, and is not a testamentary substitute, can establish the stock's value for estate tax purposes, even if the agreed price is less than the fair market value.

Summary

Three brothers, owning nearly equal shares of a family corporation, entered into a buy-sell agreement stipulating that upon the death of any brother, the corporation would purchase their shares at a fixed price of $200,000. When one brother, Orville, died, his estate valued his shares at $200,000 per the agreement. The Commissioner of Internal Revenue argued the shares should be valued at their fair market value of $257,910.57, contending the agreement was a testamentary device to avoid estate tax. The Tax Court held that the buy-sell agreement was a bona fide business arrangement, not a testamentary substitute, and thus the agreed-upon price controlled the estate tax valuation.

Facts

Orville, Arthur, and Clay Littick were brothers and principal shareholders of the Zanesville Publishing Company. To ensure family control and business continuity, they executed a buy-sell agreement in 1952. The agreement stipulated that upon the death of any brother, the corporation would purchase their shares for $200,000. At the time of the agreement, Orville was terminally ill with cancer, a fact known to all parties. Orville died in 1953, and his estate adhered to the agreement, valuing his 670 shares at $200,000 for estate tax purposes. The fair market value of the stock, absent the agreement, was stipulated to be $257,910.57.

Procedural History

The Estate of Orville Littick filed an estate tax return valuing the stock at $200,000. The Commissioner of Internal Revenue assessed a deficiency, arguing the stock should be valued at its fair market value of $257,910.57. The Estate petitioned the Tax Court to contest the Commissioner's determination.

Issue(s)

1. Whether the restrictive buy-sell agreement, executed while one shareholder was terminally ill, was a bona fide business arrangement or a testamentary device to depress estate tax value?

2. Whether the price fixed in a valid buy-sell agreement is controlling for estate tax valuation purposes, even if it is less than the fair market value of the stock?

Holding

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1. Yes, the buy-sell agreement was a bona fide business arrangement because it served a legitimate business purpose (maintaining family control and business continuity) and was binding on all parties during life and at death.

2. Yes, the price fixed in the valid buy-sell agreement is controlling for estate tax valuation because the stock was restricted by the agreement, and the agreement was not a testamentary substitute.

Court's Reasoning

The Tax Court reasoned that restrictive agreements are effective for estate tax purposes when they restrict transfers during life and at death. The Commissioner argued that the agreement was a testamentary plan due to Orville's impending death and the potentially below-market price. However, the court found no evidence suggesting the $200,000 valuation was not fairly negotiated or intended for tax avoidance. The court emphasized that the agreement was intended to maintain control of the business within the family, a legitimate business purpose. Quoting precedent, the court stated the principle that when owners set up an arm's-length agreement to dispose of a part owner's interest to other owners at a fixed price, "that price controls for estate tax purposes, regardless of the market value of the interest to be disposed of." The court distinguished testamentary substitutes from bona fide business arrangements, finding the Littick agreement to be the latter. The court noted that while Orville was ill, it was not certain he would predecease his brothers, and the agreement was binding on all parties regardless of who died first. The court relied heavily on *Brodrick v. Gore*, which similarly upheld a buy-sell agreement price against the Commissioner's fair market value argument.

Practical Implications

Estate of Littick reinforces the principle that buy-sell agreements, when properly structured and serving a legitimate business purpose, can effectively fix the value of closely held stock for estate tax purposes. This case is crucial for estate planners advising family businesses and closely held corporations. To ensure a buy-sell agreement is respected by the IRS for valuation purposes, it must:

- Be a binding agreement during life and at death.
- Serve a bona fide business purpose, such as maintaining family control or business continuity.
- Be the result of an arm's-length transaction.
- Be reasonable in its terms at the time of execution, even if the fixed price later deviates from fair market value.

This case demonstrates that even if a shareholder is in poor health when the agreement is made, the agreement can still be valid if it meets these criteria and is not solely designed to avoid estate taxes. Subsequent cases have cited *Littick* to support the validity of buy-sell agreements in estate tax valuation, emphasizing the

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importance of business purpose and lifetime restrictions.

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