Estate of Bischoff v. Commissioner, 69 T. C. 32 (1977)

The value of partnership interests for estate tax purposes can be limited by enforceable buy-sell agreements if they serve a bona fide business purpose.

Summary

Bruno and Bertha Bischoff created trusts for their grandchildren and owned interests in several partnerships. The case addressed whether the estate tax valuation of their partnership interests should be limited by the buy-sell provisions in the partnership agreements, whether trust corpora should be included in their estates under the reciprocal trust doctrine, and the appropriate valuation of their interests in a real estate partnership. The court upheld the buy-sell agreements, applied the reciprocal trust doctrine to include the trust corpora in the estates, and applied a minority discount to the valuation of the real estate partnership interests.

Facts

Bruno and Bertha Bischoff, who died in 1967 and 1969 respectively, owned interests in F. B. Associates and Frank Brunckhorst Co. , partnerships involved in pork processing. They also created trusts for their grandchildren, with each other as trustees. The partnership agreements included restrictive buy-sell provisions intended to maintain family ownership and control. Upon their deaths, the partnership interests were valued and redeemed according to these provisions. The Commissioner challenged the valuation and inclusion of trust assets in the estates.

Procedural History

The executors of Bruno and Bertha Bischoff's estates filed federal estate tax returns, valuing the partnership interests according to the buy-sell agreements and excluding the trust corpora from the estates. The Commissioner issued deficiency notices, asserting higher valuations for the partnership interests and inclusion of the trust corpora. The case was heard by the United States Tax Court.

Issue(s)

1. Whether the estate tax valuation of decedents' interests in F. B. Associates and Frank Brunckhorst Co. is limited by the partnership buy-sell provisions?
2. Whether the trust corpora created by Bruno and Bertha for their grandchildren are includable in their gross estates under sections 2036(a)(2) or 2038(a)(1)?
3. What is the fair market value for estate tax purposes of decedents' partnership interests in B. B. W. Co. ?

Holding

1. Yes, because the buy-sell provisions had a bona fide business purpose of maintaining family ownership and control, and were not merely a substitute for a

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testamentary disposition.
2. Yes, because the trusts were interrelated and the powers held by each decedent over the other's trust were sufficient to apply the reciprocal trust doctrine, making the trust corpora includable in their estates.
3. The fair market value should include a 15% minority discount, reflecting the limited control and marketability of the interests in B. B. W. Co.

Court's Reasoning

The court upheld the buy-sell agreements because they served legitimate business purposes, such as maintaining family control and ensuring managerial continuity. The court rejected the Commissioner's argument that such agreements were only valid for active businesses, finding that maintaining control over a holding company was a valid purpose. The reciprocal trust doctrine was applied because the trusts were interrelated, and each decedent held powers over the other's trust that would have been includable if retained in their own trust. The court also found that a minority discount was appropriate for the B. B. W. Co. interests due to the limited control and marketability of such interests, citing New York partnership law and prior case law.

Practical Implications

This decision reinforces the validity of buy-sell agreements in estate planning, provided they serve a legitimate business purpose. It underscores the importance of drafting such agreements carefully to withstand IRS scrutiny. The application of the reciprocal trust doctrine in this case serves as a reminder to estate planners of the potential pitfalls of using crossed trusts, especially between spouses. The valuation of partnership interests with a minority discount also guides practitioners in valuing similar interests, particularly in real estate partnerships. Subsequent cases have continued to apply these principles, with courts scrutinizing the business purpose of buy-sell agreements and the interrelationship of trusts in estate planning.

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