

Blount, T.C.Memo. 2004-116

- 81 pages, only nine dealing with this issue
- citing *Huntsman*, 66 T.C. 861 (1976)
  - insurance proceeds included as nonoperating asset
- also reg. section 20.2031-2(f)
  - to extent not already taken into account
- and distinguishing *Cartwright*, 183 F.3d 1034 (9th Cir. 1999), aff'g in part T.C. Memo. 1996-286
  - stock purchase agreement not disregarded
  - "lion's share" of offsetting liabilities not for redemption of stock, but for earned fees

Blount, T.C.Memo. 2004-116, cont'd

- illustrating "fallacy" of estate's argument  
pp. 71-72
  - assume corp. w/ two shareholders, A and B,  
50 pct. each
  - sole asset 1.0 mil. cash
  - agreement to redeem each shareholder at death  
for 500k
  - if treated as liability,  
net value at B's death would be 500k,  
and B's share would be worth only 250k
  - but if B's estate redeemed at 500k,  
survivor A still holding stock worth 500k
  - hypothetical third party purchaser  
would pay 500k for half interest regardless

## brief aside re *Huntsman*

- decedent sole shareholder two corporations
- "key man" policy and two split-dollar policies
  - portion paid to estate in section 303 redemption
- notice of deficiency asserted
  - full inclusion of proceeds under section 2042
    - cf. Rev. Rul. 71-463, 1971-2 C.B. 333,  
revoked by Rev. Rul. 72-167, 1972-1 C.B. 307
    - TD 7312 (04/29/74), reg. section 20.2042-1(c)(6),  
cross ref. reg. section 20.2031-2(f)
- amended answer abandoned this position
- but second amended answer, after trial,  
nominally to conform to evidence, asserted  
2033 and 2042 inclusion of proceeds paid in redemption
- court treated as new matter, not tried by consent

not so brief aside re Cartwright

- decedent 71.43 pct controlling shareholder in law firm
- 1973 shareholders' agreement
  - amended in 1988 w/ reference only to decedent
- under existing agreement,
  - payout heavily weighted to fees on cases
  - brought to firm by exiting shareholder
- amendment to provide "enough" for surviving spouse without destroying firm
  - 5.0 mil. policy proceeds to be paid to estate
  - fixing price of decedent's stock,
    - "together with any claim to any cases or work in process"
- firm reported 4.1 mil. on 1099-MISC,
  - but estate did not report on 1041

## Cartwright, cont'd

- section 2703 not an issue in this case
- dispute is over allocation of 5.0 mil. proceeds as betw. stock and IRD
  
- court allocates w/ ref. to 1973 agreement, as 1988 amendment did not specify allocation
  - per IRS expert,
    - investment in stock 10k
    - 900k earned but unpaid profits
    - 15 pct control premium
  
  - excess must be "work in process," thus IRD
    - rejecting argument this is a corporate asset
  - prior sales by exiting partners
    - also suggest 1.1 mil. stock value

## Cartwright, cont'd

- appeals court largely affirmed
- remanded for consideration of
  - advanced client costs
  - work in process on contingent fee cases
- rejected estate's argument trial court should have included insurance proceeds in stock value, as this  
  
"would not necessarily affect what a willing buyer would pay for the firm's stock because it was offset by [the] obligation to pay out the entirety of the policy benefits to [decedent]'s estate"
- dissent argues decedent's only claim to "work in process" was as shareholder

Blount, 428 F.3d 1338 (11th Cir. 2005)

- reversing the Tax Court in part
- stock value should not have included insurance proceeds
- citing *Cartwright*

"the Ninth Circuit approved deducting the insurance proceeds from the value of the organization when they were offset by an obligation to pay those proceeds to the estate in a stock buyout"

- and *Huntsman*

to the effect that insurance proceeds are to be "taken into account" as a nonoperating asset, but not simply added to the value as otherwise determined

which brings us back to Connelly

- trial court rejects 11th Cir. reasoning in *Blount*

- citing

Adam S. Chodorow, *Valuing Corporations for Estate Tax Purposes: A Blount Reappraisal*, 3 *Hastings Business Law Journal* 1, 25 (2006)

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