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THE SECOND CIRCUIT REAFFIRMS THE EFFICACY OF RESTRICTIVE STOCK AGREEMENTS TO CONTROL ESTATE TAX VALUATION

Edmund W. Pavenstedt*

Introductory

OWNERS of close corporations have for many years entered into agreements with each other requiring a stockholder who wishes to dispose of his holdings first to offer them to his fellow stockholders or to the corporation and, in the case of death, granting to the survivors or the corporation an option to buy the shares from the decedent's estate. Such agreements either fix a price per share or contain a formula or a provision for appraisal under which such price is to be determined. About twenty years ago two leading cases both decided by the United States Court of Appeals for the Second Circuit, Wilson v. Bowers and Lomb v. Sugden, established the rule that the existence at date of death of a valid enforceable option, exercise of which would compel the executor to sell the shares at the stipulated price, fixes their value for federal estate tax purposes at the option price. This

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1 The term "close corporation" as used throughout this article means a corporation the stock of which is neither listed on a stock exchange nor traded in the over-the-counter market.

2 (2d Cir. 1932) 57 F. (2d) 682, affg. (D.C. N.Y. 1931) 51 F. (2d) 261.


4 The federal rule as derived from the estate tax cases was well summarized in Helen S. Delone, 6 T.C. 1188 at 1192-1193 (1946) (income tax; acq. 1946-2 Cum. Bul. 2), as follows:

"Where a stockholder has merely agreed to offer stock on certain terms if he should desire to sell, such an agreement does not restrict the value for tax purposes to the agreement price. ... Where, however, on the date as of which value is to be determined, there is a binding, irrevocable option, specifically enforceable, which leaves the shareholder no choice to refrain from selling at the stipulated price, the market value of stock so encumbered is the option price." (Italics as in original.)

This opinion was "Reviewed by the Court" and hence represents what may be described as the considered judgment of the Tax Court as a whole, rather than merely the view of the single Tax Court judge who wrote the opinion.

A more cautious commentator has stated the rule in similar terms but with the added conditions that (1) the price was fair at the time it was established, and (2) the decedent could not have disposed of the property at any time prior to his death. 1 Polisher, Estate
rule was held applicable even though the option was not exercised and despite the fact that the fair market value at date of death of shares not subject to such a restriction might exceed the agreement price.

During the last decade the government has succeeded in distinguishing these two Second Circuit decisions in an occasional estate tax case and they have quite generally been held inapplicable in cases involving the valuation of inter vivos gifts of stock subject to a restrictive price agreement where there was no enforceable option effective at the time of the gift. Consequently, it was felt in some quarters that the tendency of legal development was in the direction of

PLANNING AND ESTATE TAX SAVING 311 (1948). See, also, Molloy, "Restraints on Alienation and the Internal Revenue Code," 7 TAX L. REV. 439 at 453-454 (1952). One or two decisions if considered superficially might be deemed to cast doubt on the requirement that the restricted price must be fair at the time it was established. Thus the contrary might be inferred from the facts in Estate of Anna D. Childs, 2 T.C.M. 388 (1943), revd. on other grounds but aff'd. on this issue, (3d Cir. 1945) 147 F. (2d) 368, where a ten-year option at $10 per share was granted to a deserving stepson in 1935 and the 1939 date of death value was $100 per share. The $10 valuation was sustained solely on the ground of the existence of an enforceable option, without any discussion of the fairness of the option price in 1935. But there is nothing to indicate that $10 per share was not a fair price in that earlier year. Again, in Commissioner v. Bensel, (3d Cir 1938) 100 F. (2d) 639, the court said:

"It will thus be seen that instead of the ordinary creation of a trust by an individual by a unilateral indenture, we have here settlement of a business problem by the contract of two parties hostile to each other and dealing at arm's length, the object of which was a purchase of the father's stock at a price which was lower than full value." (emphasis supplied) But this seeming indication that a price may be fixed by hostile parties which is below fair value at the time of the agreement is shown to be erroneous by a reading of the opinion below which discloses that the option price reflected the price of approximately contemporary sales; and that an increase in value which might be expected to occur by the time of the optionor's death was merely "a circumstance which was within the reasonable contemplation of the parties at the time they entered into the agreement." Edith M. Bensel et al., Executors, 36 B.T.A. 246 at 249, 253 (1937). Support for the assertion that the price must be fair at the time it is established is found in Estate of Edwin R. Armstrong, 3 T.C.M. 77 (1944), affd. (7th Cir. 1945) 146 F. (2d) 457, and disregard of this requirement would seem hazardous. While the restrictive agreement, in order to be effective for federal estate tax purposes, must undoubtedly take effect upon execution [see Estate of James H. Matthews, 3 T.C. 525 (1944)], it need not entirely preclude a stockholder from disposing of his shares during life; it is sufficient if he is under obligation first to offer them at the restricted price to the other stockholders or to the corporation, as the case may be.

6 Claire Giannini Hoffman, 2 T.C. 1160 at 1178-1180 (1943), affd. on other issues, (9th Cir. 1945) 148 F. (2d) 285, cert. den. 326 U.S. 730, 66 S.Ct. 730, 66 S.Ct. 38 (1945) (no restriction on sale during decedent's life; gratuitous option); Estate of James H. Matthews, 3 T.C. 525 (1944) (no restriction on sale during decedent's life); Estate of Edwin R. Armstrong, 3 T.C.M. 77 (1944), affd. (7th Cir. 1945) 146 F. (2d) 457 (stock trustee during life, but decedent had power to terminate trust by discharging employee to whom he gave gratuitous option effective at settlor's death if employee survived).

6 Kline v. Commissioner, (3d Cir 1942) 130 F. (2d) 742, cert. den. 317 U.S. 697, 63 S.Ct. 440 (1943); Krauss v. United States, (5th Cir 1944) 140 F. (2d) 510; Commissioner v. McCann, (2d Cir 1944) 146 F. (2d) 385; James v. Commissioner, (2d Cir 1945) 148 F. (2d) 236; Spitzer v. Commissioner, (8th Cir. 1946) 153 F. (2d) 967;
permitting the government to collect taxes upon actual value despite restrictions imposed by private parties. Nevertheless, a direct frontal attack seeking outright reversal of Wilson and Lomb on the ground that these cases "are plainly outmoded and have no remaining vitality," such as the government recently made in May v. McGowan, was startling. Had this attempt succeeded, the adverse effect on many business arrangements would have been far-reaching. But the district judge held for the taxpayer and the Second Circuit affirmed in a per curiam opinion, specifically stating that it saw "no reason for questioning" the Wilson and Lomb decisions. The government's argument that these decisions left a loophole for tax evasion, was met by the statement that in the May case the district court had found no purpose to evade taxes. Furthermore, the Second Circuit expressed the opinion "that such a loophole, if important, should be closed by legislative action rather than by disregarding" its earlier decisions.

Since the government decided not to apply for certiorari, the Second Circuit decision in the May case should restore a degree of certainty to a field of discouraging confusion where prognostication had become difficult due to the "tax age" of the Wilson and Lomb decisions and the supposed limitation of their effectiveness by the gift tax and other cases. Such renewed certainty is most desirable.

Nee v. Katz, (8th Cir. 1947) 163 F. (2d) 256. Broadly speaking, the opinions in these gift tax cases held a restrictive agreement to be only one of the factors to be considered in the valuation of stock, even though the agreement may be of the type which obligates a stockholder's estate to sell at a restricted price. There would, however, seem to be a rather obvious distinction between a restrictive agreement operating in futuro and such an agreement which is presently operative. See Ness, "Federal Estate Tax Consequences of Agreements and Options to Purchase Stock on Death," 49 Col. L. Rev. 796 at 799 (1949); Montgomery's Federal Taxes—Estates, Trusts and Gifts (1950-51) 663-664.

7 Paul, Federal Estate and Gift Taxation §18.34, 785 (1946 Supp.).
9 In Estate of Albert L. Salt, 17 T.C. 92 at 99 (1951) the Tax Court quoted that part of the district court's opinion in the May case which rejected the government's contention that the Wilson and Lomb decisions should be overruled. However, the government did not make this argument in the Salt case either in its brief or, as confirmed to the writer upon inquiry of government counsel, upon oral argument. It is, however, interesting that the Bureau acquiesced in the Salt case which follows the Wilson-Lomb rule in the Internal Revenue Bulletin published on January 7, 1952 at which time the Department of Justice's contention that these decisions should be overruled was still pending before the Second Circuit, the May decision not being handed down until February 5, 1952.
10 Although the government's brief does not use such forthright words, their use on oral argument may reasonably be inferred from the Second Circuit's opinion.
11 Emphasis supplied.
12 Such decision presumably was, at least, in part, based on the district court's finding of fact that the agreement in the May case was entered into in good faith and without a tax avoidance purpose.
13 In re Cowles' Estate, 36 Wash. (2d) 710 at 715, 219 P. (2d) 964 at 966 (1950).
in view of the practical considerations which normally lead to execution of restrictive stock agreements and in view of the millions of dollars which have been invested to finance such agreements.

**Importance of Restrictive Stock Agreements**

A persuasive argument can be—and is frequently—made that the stockholders of a close corporation are courting trouble if they fail to adopt a restrictive agreement setting a value on the stock at which it may or must be disposed of in the event of death. An examination of the decisions involving valuation for federal estate tax purposes of stock in close corporations where the stockholders have not entered into any such agreement lends strong support to this contention.

These decisions deal with 148 different stocks. The value at which the executor returned decedent's shares was sustained in only 20 instances. In the other 128 the courts increased the value for which the executor contended. Thus it can be argued that where stockholders failed to adopt a restrictive agreement, their estates have less than one chance in seven of winning a litigated controversy as to valuation.

A somewhat more refined analysis of the 128 instances in which the courts did not sustain the valuation urged by the representative of the estate discloses that in 59 of these the Commissioner's determination was accepted in full, usually because the executor's evidence was deemed insufficient to rebut the prima facie presumption of correctness which always attaches to this determination. In the remaining 69 valuations the courts fixed a figure somewhere between the two extremes proposed by the parties. A further breakdown of these

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15 A decedent's assets are valued for federal estate tax purposes as of the time of his death, except that the executor may elect to have the value of all the property included in the decedent's gross estate valued as of the date one year after death. In such event, property which is distributed, sold or exchanged within that year is valued as of the date of such transaction. I.R.C. §§811(a) to (g), (j). In order for a restrictive price to be effective as of the optional valuation date, it may be desirable to provide that the option to purchase decedent's shares shall be exercisable within a year and a day after his death.

16 Decisions examined are those listed in paragraph 1202 of the Commerce Clearing House Federal Estate and Gift Tax Reporter, supplemented by all relevant cases decided up to December 31, 1951.

17 The actual number of cases is only about one hundred, since numerous cases involve valuation of stock in more than one close corporation, or, occasionally, of more than one kind of stock in the same close corporation. The above discussion excludes cases involving the stock of close corporations where value was fixed with reference to sales occurring at a time sufficiently near death so as to affect the valuation of the decedent's shares.

18 Possibly some of the Commissioner's high valuations of close corporation stock result from the application of an old ruling, A.R.M. 34, 2 Cum. Bul. 31 (1920) which was designed particularly to furnish a formula under which there might be established the March
69 compromised valuations shows that six were so close to those contended for by the taxpayer that they may justifiably be classed as decisions in his favor;¹⁹ that in an additional 15 instances the value determined by the courts exceeded that fixed by the taxpayer by only from 6% to 20%;²⁰ and that in six further instances such excess ranged between 21% and 37½%.²¹

1, 1913 value of businesses put out of existence by the prohibition law. After giving consideration to the method of valuing brand names—and incidentally disclosing the deplorable fact that “in numerous instances it has been the practice of distillers and wholesale liquor dealers to put out under well-known and popular brands only so much goods as could be marketed without affecting the established market price therefor and to sell other goods of the same identical manufacture, age, and character under other brands, or under no brand at all, at figures very much below those which the well-known brands commanded”—the ruling proposes a general method of valuing a business. This is to compute the average earnings over a period of preferably not less than 5 years, to deduct therefrom a return of from 8% to 10% upon the average tangible assets for the period and to capitalize the remainder, i.e., the return upon the intangible assets at from 20% to 15%. The variation in the two sets of percentages was designed to differentiate between businesses involving varying degrees of risk. It is patent that a formula which has regard only to the last five years’ earnings may produce distorted results when applied to a “feast or famine” business or to one subject to an abnormal profits cycle. The World War II Excess Profits Tax Law specifically made allowances for such abnormalities. I.R.C. §722(b) (3). A determination of value depending solely on net earnings is unacceptable. Worcester County Trust Co. v. Commissioner, (1st Cir. 1943) 134 F. (2d) 578, revg. 46 B.T.A. 337 (1942). The formula set forth in A.R.M. 34 when applied to listed stocks may produce results absurdly in excess of actual market prices. Casey, “How to Keep a Close Corporation Alive and Not Ruin the Estate, When the Owner Dies,” 93 J. Accountancy 420-421 (April 1952); see, also, 1937 P-H Fed. Tax Serv. ¶23,164. Although A.R.M. 34 does not seem to have been relied upon or cited in any Treasury ruling since 1925 (S.R. 5545, IV-2 Cum. Bul. 242) and although the formula set forth therein is not included in the Treasury’s estate, gift or income tax regulations [Reg. 105, §81.10(c); Reg. 108, §86.19(c); Reg. 111, §29.113(a)(14)-1], a number of recent cases show that the Commissioner still seeks to employ this formula although usually without success. John Q. Shunk, 10 T.C. 293 at 302 (1948), revd. on another point, (6th Cir. 1949) 173 F. (2d) 747 at 750 (i.t.); Plaut v. Smith, 82 F. Supp. 42 at 48 (1949), affd. (2d Cir. 1951) 188 F. (2d) 543 (i.t.); Estate of A. Bluestein, 15 T.C. 770 at 786-788 (1950) (acq. 1951-1 Cum. Bul. 1; e.t.); M. M. Gordon et al., 9 T.C.M. 203 (1950) (i.t.); Shriver Co. v. Hofferbert, (D.C. Md. 1950) (e.p.t.) reported at 51-1 U.S.T.C. ¶66,001. For critical appraisals of A.R.M. 34, see 2 PAUL, FEDERAL ESTATE AND GIFT TAXATION §18.31 (1946 Supp.); 10A MERTENS LAW OF FEDERAL INCOME TAXATION §59.37 et seq. (1948).

¹⁹ Included in this category, for example, is Kathrine Schuhmacher, 8 T.C. 453 (1947), where the executors of two estates each returned certain stock at $22 per share, the Commissioner contended for valuations of $28 and $32, respectively, and the court determined $23 and $24, respectively. There is also included one of the valuations made in Estate of Justin Potter, Jr., 7 T.C.M. 240 (1948), even though the Tax Court fixed a value of more than double the amount contended for by the estate. The valuations made by the parties and by the court were: As per estate tax return, $3 per share; by the Commissioner, $75; by the Tax Court, $7.

²⁰ Included in this category are such cases as Estate of Lelia E. Coulter, 7 T.C. 1280 (1946), and Allen v. First National Bank of Atlanta, Exr., (5th Cir. 1948) 169 F. (2d) 221, where the respective per share values as contended by the executor, by the Commissioner, and as finally determined were $79.68-$150-$90 and $3,032-$8,900-$3,450.

²¹ The 37½% case in this category is Estate of Joseph E. Goar, 9 T.C.M. 854 (1950), where the executor contended for a value of $200 per share, the Commissioner for $447.31, and the Tax Court determined $275.
But even if such quasi-victories are taken into account, it seems apparent that in the absence of a restrictive agreement the executor's chances of sustaining a figure even reasonably close to his valuation of the stock of a close corporation are far from bright.\textsuperscript{22} That his prospects have worsened steadily may be inferred from the fact that out of the 20 known instances in which the court accepted the executor's valuation, 14 occurred in cases decided in 1935 or earlier,\textsuperscript{23} only four in cases decided during the period 1945 to 1948 and none since then.\textsuperscript{24}

The number of litigated federal estate tax proceedings involving valuation of the stock of a close corporation subject to some sort of price restriction is far smaller, totalling only 17 decisions.\textsuperscript{25} In these cases the government was successful, broadly speaking, where the restriction did not force the estate to sell and was limited to a requirement that the stock must be offered first at a restricted price to the surviving shareholders or to the corporation \textit{if the estate wished to sell}.\textsuperscript{26} But in more than half of these 17 decisions\textsuperscript{27} the courts held that the

\textsuperscript{22} Even where an executor who elected to use an optional valuation date (supra note 15) sold blocks of seven different unlisted stocks at public auction just prior to such date and returned them for estate tax purposes at the actual sales prices, he was only partially successful in having such values accepted. The aggregate sales proceeds which the executor reported were about $444,000. The Commissioner set a much higher value for each stock and determined a deficiency on the resulting increase of $1,721,000. The Tax Court accepted the valuation as per return with respect to three stocks but determined the value of the other four at prices which resulted in a total increase of about $246,000. While all of the stocks were bought by trustees of trusts established under the decedent's will, yet there was no doubt of the bona fides of the auction which was attended by more than 100 persons; on the principal lots of stock the bidding was active, ranging from 17 to 79 bids. Estate of Henry T. Sloane, 3 T.C.M. 555 (1944).

\textsuperscript{23} The first of these 14 cases, Estate of William H. Larkin, 1 B.T.A. 1045, was decided in 1925.

\textsuperscript{24} Furthermore, if the executor decides that he must litigate the valuation question there will be a delay prolonging administration of the estate. Although such delay is usually in the neighborhood of 4 years, there have been cases in which over 7 years and almost 11 years intervened between the date of death and the date on which the contested valuation was finally judicially determined. Kanawha Banking & Trust Co., 29 B.T.A. 376 (1933); Mary A. B. DuPont Laird, 38 B.T.A. 926 (1938).

\textsuperscript{25} Each of these cases happens to involve only a single stock.

\textsuperscript{26} Louise N. Schulz, 14 B.T.A. 419 (1928); City Bank Farmers Trust Company, Exr. (Estate of George H. Walker), 23 B.T.A. 663 (1931); Michigan Trust Company et al., Exrs. (Estate of Richard B. Messer), 27 B.T.A. 556 (1933); Frederick A. Koch, Jr., Exr., 28 B.T.A. 363 (1933); Estate of Ambrose Fry, 9 T.C. 503 (1947) (acq. 1948-2 Cum. Bul. 2). In Estate of James H. Matthews, 3 T.C. 525 (1944), the government won because the stock could have been sold during decedent's life without any restriction. This was also true with respect to the partnership interests involved in Claire Giannini Hoffman, supra note 5, and in Estate of George M. Trammell, 18 T.C. No. 77 (1952).

\textsuperscript{27} Wilson v. Bowers, (2d Cir. 1932) 57 F. (2d) 682; Rose Newman et al, Exrs., 31 B.T.A. 772 (1934); Lomb v. Sugden, (2d Cir. 1936) 82 F. (2d) 166; Commissioner v. Bensel, (3d Cir. 1938) 100 F. (2d) 639; Estate of John Q. Strange, C.C.H. Dec. 12,516-D (B.T.A. mem. 1942); Estate of Anna D. Childs, supra note 4; May v. McGowan, supra note 8; Estate of Albert L. Salt, 17 T.C. 92 (1951). In two cases the court on the
value of the stock for federal estate tax was limited to the price fixed by the agreement, even where the difference between the restricted price and the conceded fair market value at date of death was as great as $5.90 and $60 per share in one case and $250 and almost $6,000 in another.

When such a record disclosing such startling contrasts in valuation is called to the attention of stockholders in close corporations, the incentive to adopt a restrictive agreement which the courts may be expected to accept for death tax purposes is naturally great. Typically, such an agreement obligates either the surviving stockholders or the corporation, or gives them an enforceable option, to purchase a decedent stockholder's shares. In happier times of lower taxes the stockholders could contemplate the probability of amassing savings sufficient to enable the survivors to make at least a substantial part payment to the estate of a decedent stockholder for his shares, giving notes for the balance. Today even the chance of such savings is usually extremely remote. But there remains the possibility of designating the corporation itself in the restrictive agreement as the buyer of the decedent's shares. In the great majority of states a corporation may purchase its own shares if it has sufficient surplus. However, even though there may be a substantial surplus at the time when an

basis of its own review of the facts held the option price to represent fair market value. Third National Bank, Admr. v. United States, (D.C. Tenn. 1946) 64 F. Supp. 198; Estate of Henry A. Maddock, 16 T.C. 324 (1951). And where the value of decedent's stock or partnership interest is determined in a buy and sell agreement financed by life insurance, the insurance proceeds payable to his estate are to be set off against the value of the business interest determined pursuant to the agreement. Estate of John T. H. Mitchell, 37 B.T.A. 1 (1938) (acq. 1938-1 Cum. Bul. 20); Estate of Ray E. Tompkins, 13 T.C. 1054 (1949) (acq. 1950-1 Cum. Bul. 5); Estate of G. C. Ealy, 10 T.C.M. 431 (1951).

29 Estate of John Q. Strange, C.C.H. Dec. 12,516-D (B.T.A. mem. 1942). A similar result was reached in the Mississippi inheritance tax proceedings, although the state revenue officials more modestly sought to base the tax on book value of about $3,700 per share. Strange v. State Tax Commission, 192 Miss. 765, 7 S. (2d) 542 (1942).
30 Such earnings as the corporation is able to retain without falling afoul of §102 of the Internal Revenue Code (see infra note 32) will have been subjected to only one tax, i.e., the corporate levy. Upon distribution to the shareholders as dividends the government will take another tax bite. Thus, assuming that the rates applicable to the corporation and the shareholder are both 50%, there would be available out of each dollar of corporate earnings fifty cents to the corporation but only twenty-five cents to the stockholder. In other words, it takes two dollars of corporate earnings to furnish the stockholder with fifty cents which he can devote to a stock purchase, but only one dollar of such earnings to enable the corporation to buy the same amount of its stock. These same considerations apply to the payment of premiums on life insurance purchased with a view to buying the shares of the insured stockholder.
31 For a state by state summary, see The R & R Advanced Underwriting & Estate Planning Service 15-31 to 15-34; see also, The Diamond Life Bulletins, Business Insurance 498.
important stockholder dies, in the case of an operating business it will only rarely be in sufficiently liquid form. And even if a considerable part of it is represented by cash and marketable securities (perhaps an unlikely assumption considering the in terrorem effect of section 102), the normal close corporation’s working capital requirements and its relations with banks that extend vitally necessary credit will often preclude the application of any substantial part of its surplus to any important purchase of its stock.

At this point an alert life underwriter will often suggest key man insurance as a solution, either to render as certain as possible the existence of a surplus at the time of the key man’s death or to augment the then existing surplus by cash. In close corporations, which are

32 This section of the Internal Revenue Code imposes a surtax if a corporation is formed or availed of to prevent the imposition of income tax upon its shareholders through the medium of permitting earnings or profits to accumulate beyond the reasonable needs of the business.

33 Occasionally fears have been expressed as to possible adverse tax consequences which might result from the purchase of key man insurance by a corporation. One of these is applicable only to the one-man or quasi-one-man corporation and is based on the federal estate tax regulation which provides that a decedent will be deemed to have paid premiums on insurance on his own life indirectly “if payment is made by a corporation which is his alter ego.” Treas. Reg. 105, §81.27. However, this is not a real danger since the decisions hold that in the case of a buy and sell agreement financed by life insurance, the insurance proceeds payable to the estate of the insured are to be set off against the value of the stock determined pursuant to the agreement. Estate of John T. H. Mitchell; Estate of Ray E. Tompkins; Estate of G. C. Ealy; all supra note 27. Thus there will be no “double inclusion” of the restricted value of the stock plus the life insurance proceeds.

Another alleged danger is that premium payments may be taxed as dividends to the insured stockholder [Danzig, “Taxes—Insurance—and Stockholder-Survivor Agreements,” 28 Taxes 213 at 217-218 (1950); for a rebuttal, see Mannheimer, “Insurance to Fund Stock-Retirement and Buy-and-Sell Agreements,” 29 Taxes 393 (1951)], or to the surviving stockholders on the theory that the insurance on the decedent’s life which was used to buy in his stock was purchased by the corporation for the personal purposes of the survivors rather than for a corporate purpose. BOWE, INCOME TAX TREATMENT OF LIFE INSURANCE PROCEEDS 55 (1951). No cases have been found which support either of these theories. In fact in Commissioner v. Bonwit, (2d Cir. 1937) 87 F. (2d) 764, it was specifically held that where the corporation was the beneficiary of a policy on the life of a key man, premiums paid by it were not taxable income to the latter. Corporate premium payments have been held taxable income to the key man as dividends or additional compensation or without specific characterization, but only where the corporation was the beneficiary of the policies. Yuengling v. Commissioner, (3d Cir. 1934) 69 F. (2d) 971; Canaday v. Quitteau, (6th Cir. 1936) 86 F. (2d) 303; Commissioner v. Bonwit, supra; Paramount-Richards Theatres v. Commissioner, (5th Cir. 1946) 153 F. (2d) 602; George Matthew Adams, 18 B.T.A. 381 (1929); W. F. Parker, 38 B.T.A. 989 (1938). Finally, in one case where the key man’s estate was designated as the beneficiary, but the facts were confusing and susceptible of conflicting inferences, it was ultimately held that the premiums paid by the corporation were not taxable to him as dividends. Lewis v. O’Malley, (8th Cir. 1944) 140 F. (2d) 735, revg. (D.C. Neb. 1943) 49 F. Supp. 173.

34 In cases where the corporation’s management does not deem it in the best interests of the corporation to pay out premiums sufficient to finance the purchase of all of a key man’s stock, it may nevertheless be willing to purchase such smaller amount of insurance as will put it in funds to buy its own stock for an amount not in excess of the death taxes payable by the key man’s estate. Such a distribution will be receivable by the estate free
often incorporated partnerships, the stockholders typically are the managers or key men. The death of a key man (and this, of course, is equally true in the case of a key man who is not a stockholder) will normally have some adverse effect upon the corporation’s future,\(^{35}\)

of income tax, since (1) there will be no capital gains tax because the purchase price presumably will equal the estate’s stepped-up basis for the stock under section 113(a)(5) of the Internal Revenue Code, and (2) section 115(g)(3) of the Code provides that such a distribution shall under no circumstances be taxed as a dividend. Unfortunately, the availability of section 115(g)(3) has recently been curtailed by section 320 of the Revenue Act of 1951, which changed the original 1950 requirement that the value of the stock of the corporation must exceed 50% of the net estate (practically speaking, “net estate” as so used will usually be approximately half of the estate if the marital deduction is fully availed of) to 35% of the gross estate. In situations where the marital deduction is availed of this reduction in the percentage, which at first glance looks like a liberalization, has the reverse effect. This change was adopted in conference but neither the congressional hearings and debates nor the two Conference Committee reports carry any explanation [H. Rep. No. 1179, p. 76, and H. Rep. No. 1213, p. 17, both 82d Cong., 1st sess. (1951)]. The Senate Finance Committee had amended section 115(g)(3) by changing the percentage requirement from “more than 50% of the value of the net estate” to “more than 25%” of such value. And its Report [S. Rep. No. 781, 82d Cong., 1st sess., pp. 51-52 (1951)] explains that the amendment was designed to mitigate the hardship on those estates where the stock in a corporation forms a substantial part of the value of the net estate but falls short of meeting the 50% requirement. Hence it is not improbable that the “35% of the gross estate” amendment made by the Conference Committee was adopted under the mistaken assumption that it enlarged rather than restricted the scope of the remedy limited to “50% of the net estate.” If so, a return by further legislation to the original formula or, perhaps, even to 35% or 25% of the net estate would not seem to be beyond the bounds of reasonable expectation.

\(^{35}\)The loss suffered by a corporation due to the death of a key man, who is a stockholder, will be reflected in the valuation of decedent’s stock for federal and state death tax purposes if the amount of such loss can be established by satisfactory evidence. Such a loss is not easy to prove. The only really useful case which indicates the nature of the required proof, is Estate of Charles S. Ingalls, Newell et al., Exrs. [25 B.T.A. 773 (1932)]. There the decedent who owned 85% of the stock was apparently the indispensable man in a corporation engaged in the Indiana limestone business. This corporation had insured his life for $300,000 and the amount of these insurance proceeds was includible in the date-of-death value of the stock under the rule established in 1926 in Annie S. Kennedy, 4 B.T.A. 330, and Estate of W. A. Blair, 4 B.T.A. 959. The executors in the federal estate tax return valued the preferred at $75 and the common at $154.10 per share. This valuation had been concurred in by two Indiana inheritance tax appraisers. The Commissioner of Internal Revenue raised these figures to $100 and $250, respectively. The difference in the value of the corporation’s net assets resulting from these divergent valuations of its stock was primarily due to the fact that the Commissioner included the life insurance proceeds without any offset for the loss sustained by the corporation through the death of decedent, whereas under the theory of the executors and the state tax appraisers these two items just about cancelled each other out.

At the original hearing, Sterling Newell et al., Executors, 25 B.T.A. 773 (1932), the witnesses for the taxpayer were (1) the company’s secretary and auditor who testified generally as to decedent’s value to the business up to the very time of his death in 1928; (2) the representative of a Cleveland firm of investment bankers which in 1924 had underwritten $300,000 of the company’s bonds only on condition of the company, which he called “a 99.9% one-man concern,” insuring Ingalls’ life for a like amount; (3) one of the Indiana State appraisers who explained the valuation reached by his colleague and himself; and (4) an attorney, one of the executors, who testified as to Ingalls’ unique value to the business and the unfavorable state of the industry at the time of his death. The evidence of the last three witnesses is set forth in detail in the above cited report of the
perhaps only of a temporary, and perhaps of a permanently crippling nature. Hence the corporation has an insurable interest in its key men. This was recognized by the Supreme Court of the United States as long

Board of Tax Appeals. The record of this hearing shows (pp. 84-85) that at the conclusion thereof the member stated that he was "perfectly willing to decide the case for the petitioner on the evidence before him."

Nevertheless, his decision, while sustaining a value of only $75 for the preferred, in effect was a victory for the government since he valued the common at $242.44. On appeal the 7th Circuit reversed, Newell v. Commissioner, 66 F. (2d) 102 (1933), and remanded the case with directions to take further evidence "to ascertain the amount of the company's loss through the death of the deceased" and "what effect the modification in the earning capacity of the corporation would have upon the fair market value of the common stock."

Thereafter the Board in a brief memorandum opinion stated that upon additional evidence presented by the executors it found the loss sustained by the company upon the death of Ingalls was $300,000 which was fully covered by insurance and determined a value for the common of $154.11 per share. 1934 P-H Fed. Tax Serv., ¶1742.

An examination of the record on rehearing discloses that additional evidence was offered by two witnesses, both of whom expressed the opinion that the Company's loss was at least $500,000 which was double the net gain it realized by receipt of the insurance proceeds, since the policy had a cash surrender value of about $50,000 at date of death. One of these witnesses, an employee of the company, did not add much to the prior testimony beyond his estimate of the value of the company's plant. The second, an attorney, convincingly established his qualifications for valuing stock and men in executive positions, described in detail Ingalls' "almost superhuman efforts" to overcome the company's troubles during the decade preceding his death, told of his own efforts to help Ingalls obtain credit which, after an earlier rebuff in 1920, met with success in 1924 only on condition of the insurance on Ingalls' life, recalled a valuation he had made in 1926 when Ingalls had a chance to sell his stock and finally gave cogent reasons for the absence at the date of Ingalls' death of any market for the company's property or stock.

Despite this additional evidence, the conclusion seems inescapable that the life insurance required by the investment banking firm as a condition for the bond money was the crucial factor responsible for the Board's final decision. And that factor was brought out at the original hearing. Another interesting facet is that the government introduced evidence that the company earned more in each of the two years following Ingalls' death than ever before. The board member, however, accepted the executors' explanation that these profits were due to three contracts which had been negotiated by Ingalls. Both hearings were conducted by the same Member, whose decisions were not reviewed by the full Board.

Another case in which the value of stock was reduced because decedent was a key man, but which did not involve any life insurance, is The Fourth National Bank (Estate of Howard E. Case) v. United States, (D.C. Kan. 1934) 15 A.F.T.R. 1011. See also, The Fourth National Bank (Estate of Sara Blair Case) v. Motter, (D.C. Kan. 1934) 15 A.F.T.R. 1015 (involving valuation of the same stock owned by the key man's wife); Estate of Charles E. Kimball, 5 T.C.M. 982 (1946). For cases where decedent was not himself the key man, but where the court stated that the latter's death, age or health must be considered when valuing decedent's stock, see Worcester County Trust Co. v. Commissioner, supra note 18; Mary Walker Edwards, 4 T.C.M. 69 (1945) (gift tax). In Estate of P. M. Vandenhoeck, 4 T.C. 125, 137 (1944), however, "the ability of the corporation's president" was mentioned by the Tax Court as an argument for "a much greater value than book value." In Estate of Leonard B. McKitterick, 42 B.T.A. 130 at 138 (1940), the government produced evidence successfully rebutting testimony of the alleged loss caused the Philip Morris Company by reason of the death of decedent who was its president. Finally, Estate of S. A. Scherer, C.C.H. Dec. 11,371-A (B.T.A. mem. 1940), holds that a mere claim of loss by reason of the death of the owner and manager cannot prevail in the absence of proof that a loss has in fact been sustained.
ago as 1924 when Chief Justice Taft, after discussing a deceased key man's value to his corporate employer, said: 86

"Life insurance in such a case as the one before us is valid and is not a wagering contract. There was certainly an insurable interest on the part of the Company in the life of Biddle . . . . Life insurance in such a case is like that of fire and marine insurance, a contract of indemnity . . . . It is a substitution of money value for something permanently lost either in a house, a ship, or a life."

A recent United States court of appeals decision carried this business purpose aspect of key man insurance a step further by holding that money borrowed by a corporation to pay premiums on such insurance taken out to finance the purchase of the key man's stock on his death is an indebtedness "incurred for business reasons" 37 where the acquisition of such stock may be necessary to the continuation of harmonious management which might be jeopardized if the shares fell into unfriendly hands. 88

As strikingly emphasized in this opinion by the Third Circuit, the usefulness of the restrictive stock purchase or stock option agreement to provide for continuation of the business by the same management is another important reason for adopting such an agreement. If it provides that the surviving stockholders or the corporation must buy the decedent's shares and obligates his estate to sell them, this effectively precludes the entry of any new and perhaps uncongenial co-owners. Furthermore, such an outright buy-and-sell agreement is, generally speaking, a guarantee 39 that the executor will have sufficient

87 Treas. Reg. 112 §35.719-1, under the World War II Excess Profits Tax Law, provides: "In order for any indebtedness to be included in borrowed capital it must be bona fide. It must be one incurred for business reasons and not merely to increase the excess profits credit." Under the current excess profits tax law this requirement has been written into the statute which specifies that the indebtedness must be "incurred in good faith for the purposes of the business." I.R.C. §439(b)(1).
88 Emeloid Co., Inc. v. Commissioner, (3d Cir. 1951) 189 F. (2d) 230, revg. 14 T.C. 1295 (1950). The decision would seem to lend strong support to the contention that a corporate expenditure for key man insurance is made for a legitimate corporate business purpose and that hence premiums so expended, although not deductible under section 24(a) (4) I.R.C. for income and excess profits tax purposes, should be deducted in determining whether there has been an accumulation of the type penalized by section 102 (supra note 32). Nor should the cash surrender value of such insurance be taken into account when making such a determination.
89 The qualification, of course, is that the corporation must have a surplus at the time when it becomes obligated under the buy-and-sell agreement. If it has some surplus, but the amount is less than the amount of the purchase it is obligated to make, its board of directors could not authorize it to issue notes to supplement such part payment as it can legally make. Such notes could, of course, be legally given by the surviving stock-
funds to pay death taxes and administration expenses which, in many cases where substantially all of the decedent's estate is represented by his interest in his business, i.e., by the stock of his close corporation, cannot be obtained from any other source. If the restrictive stock agreement merely gives the surviving stockholders or the corporation an enforceable option to buy the stock from the estate at the stipulated price, then there will be no such guarantee to the executor but at least an opportunity to prevent the shares from passing under the will to a widow, who, now that her husband's substantial salary has ceased, may be expected to harass the directors to declare larger dividends than they think wise; or to a son, who may have been the apple of his father's eye, but whom the father's erstwhile associates view with somewhat less enthusiasm as a potential "partner" or, to give just one more out of an infinite number of possible illustrations, to indifferent heirs who might be induced to sell their shares to a competitor.

It is impossible to state whether the desire for continued harmonious management or the fear of an excessive and possibly litigation-breeding Treasury valuation is primarily responsible for the execution of restrictive stock purchase and stock option agreements. But whichever of these considerations may be dominant\(^{40}\) — and in many cases doubtless both motives are present — the fact is that such agreements are popular and that in many instances they are financed by life insurance.

The increase in the sale of business insurance in recent years is said to have been tremendous.\(^{41}\) Of course, not all of it is taken out to finance stock purchase agreements. Some of it may be destined to be used merely for indemnification purposes. Some of it may be bought with the thought of such protection if the key man dies prematurely before there has been sufficient time adequately to train his successor, but with the further purpose that if the key man lives to his retirement holders if they were the purchasers under the agreement. This is a point to keep in mind in drafting a stock purchase or stock option agreement when deciding who the purchasing or optionee party is to be.

\(^{40}\) A Treasury attorney has expressed the opinion that "the prime reasons" which cause stockholders of close corporations to enter into restrictive stock purchase agreements "frequently have little, if anything, to do with taxes." Raum, "Stock Purchase Agreements Among Stockholders of Close Corporations" in New York University Eighth Annual Institute on Federal Taxation 702 (1950).

\(^{41}\) Statistics to support this frequently made assertion are not generally available, presumably due to the difficulty in many cases faced by the home office of a life insurance company of determining whether a policy was taken out for business insurance reasons. However, the Mutual Benefit Life Insurance Co. reports that business insurance written by it in 1951 totalled about $48,000,000 which was an increase of over 40% over 1950 and represented 18.6% of the company's total new insurance sales in 1951. Gains as high as 500% over 1950 business insurance volume were reported by 45 of the company's 72 agencies. Newark Evening News (Wall Street edition) Feb. 26, 1952, p. 55.
age, then the cash surrender value of the policy can be applied to the payment of his pension. While there are no precise statistics concerning the amount of business insurance which is sold to corporations, nevertheless there are at least one or two studies which furnish some indication. A recent survey of business practices by the National Industrial Conference Board covering 229 manufacturing companies shows that approximately one company in five carries insurance on the lives of some of its executives to offset loss of their services to the company, such coverage ranging from $10,000 to $1,000,000 per insured individual. A study of the business life insurance market by the University of Illinois business school, covering two large cities and five smaller towns in a number of middle western states, shows that about 56% of the businesses studied were organized in corporate form and that half of these carry either key man or "business continuation" insurance. Finally, the Institute of Life Insurance has published an estimate that during 1950 there was purchased "over $1,000,000,000 of new insurance naming a corporation, partner or business associate as beneficiary, and a sizeable additional volume was set up with a trustee, a relative or, in some cases, the estate named as beneficiary." Even if business life insurance represents only 10% of the 18 billion dollar annual total of ordinary life insurance being sold today—and this is believed to be a conservative estimate—it is

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42 The same considerations which control the effectiveness of restrictive stock agreements seem equally applicable to an agreement to purchase a decedent's interest in a partnership at some stipulated price. See Claire Giannini Hoffman, supra note 5; Matthews, "Estate Tax Consequences of Agreements for the Sale of a Partnership Interest Effective at the Partner's Death—An Appraisal of the Status of the Law," 26 Tex. L. Rev. 729 (1948).

43 The Conference Board Business Record 230-232 (June 1950). 26 companies furnished data as to the amount of key man insurance carried which indicates an average of $350,000 per corporation.

44 University of Illinois Bulletin, Vol. 47, No. 37 (January 1950), Mehr and Wales, "Business Life Insurance and Its Economic Applications," prepared by Bureau of Economic and Business Research, College of Commerce and Business Administration, University of Illinois. The study was limited to (a) businesses with annual sales volume in excess of $50,000 and more than five employees and (b) locally owned retail, wholesale and manufacturing enterprises.

45 The following table reflects the amounts of the principal different kinds of life insurance written in the United States during the past 5 years (000,000 omitted):

<table>
<thead>
<tr>
<th></th>
<th>1947</th>
<th>1948</th>
<th>1949</th>
</tr>
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<tbody>
<tr>
<td>Ordinary</td>
<td>$15,499</td>
<td>$15,355</td>
<td>$15,275</td>
</tr>
<tr>
<td>Industrial</td>
<td>4,575</td>
<td>4,600</td>
<td>4,930</td>
</tr>
<tr>
<td>Group Life</td>
<td>3,001</td>
<td>3,350</td>
<td>3,525</td>
</tr>
</tbody>
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1950 (revised) 1951 (estimated)

<table>
<thead>
<tr>
<th></th>
<th>1950</th>
<th>1951 (estimated)</th>
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<tbody>
<tr>
<td>Ordinary</td>
<td>$18,070</td>
<td>$18,838</td>
</tr>
<tr>
<td>Industrial</td>
<td>5,402</td>
<td>5,510</td>
</tr>
<tr>
<td>Group Life</td>
<td>7,203</td>
<td>4,800</td>
</tr>
</tbody>
</table>

See Life Insurance Fact Book 15 (1951) (published by Institute of Life Insur-
apparent that the dollar volume invested therein is so substantial as to make any new decision concerning the effect of a restrictive agreement rendered by an important court, such as the Second Circuit's opinion in the *May* case, an event which will have far-reaching financial consequences. In view of the practical importance of this decision, a brief review of the rules developed in prior cases, an analysis of the facts, contentions and decision in the *May* case and an attempt to forecast its effect may be of some use to both bar and business.

**The Rules Developed in Prior Cases**

Originally in 1928 and 1931 the Board of Tax Appeals in the *Schulz* and *City Bank Farmers Trust Company* cases refused to give effect to restrictive agreements, going so far as to state:

"Although the parties can restrict the sale price of the stock as between themselves they can not, by such a contract, restrict the right of the Government to collect taxes upon the actual value of the stock."

This alarmingly broad language, however, it soon appeared, was
to be limited to so-called First Offer restrictions which merely obligate the stockholder and his estate to offer the stock first, at the restricted price, to the other stockholders or to the corporation, as the case may be, in the event the stockholder or the estate should wish to sell. In the Michigan Trust Company case decided in 1933 the Board of Tax Appeals sustained the government because the executors were under no obligation to sell—that is, it was just another First Offer restriction—but carefully distinguished the Second Circuit's decision of the preceding year in Wilson v. Bowers where the taxpayer was successful because the surviving stockholders had an enforceable option and could compel the executors to sell the stock. This indicated that the Board was prepared to follow the Second Circuit's holding as indeed it has done consistently ever since.

Wilson v. Bowers is the first of the leading circuit courts of appeals decisions in this field. There three stockholders, Arthur Wilson, his nephew Franklin Wilson and one Betts, formed a corporation. They also made a contract in which each agreed that if he during his life wished to sell he must first offer to the others at $6.66-2/3 per share and that his executor must sell the stock at this price to the surviving stockholders if one of them chose to buy. Specifically, as applied to the estate of Arthur, who died first, the agreement gave an option to the nephew to buy the stock at the restricted price within four months after the qualification of executors, and if he failed to exercise this right, Betts was to have a similar option for a second period of four months. As a matter of fact, Arthur bequeathed his shares to his nephew and consequently the option was never exercised. At date of death the uncontested fair market value of the stock was $23.55 per share.

51 In one curious decision, Waldemar R. Helmholz, Exr., 28 B.T.A. 165 (1933), the Board sustained the executor's valuation even in a mere first offer situation. There, the charter and by-laws obligated a stockholder and his estate, if either wanted to sell, first to offer to the directors at par. The Board sustained such $100 valuation as against $320 claimed by the Commissioner. It distinguished the Schulz case, 14 B.T.A. 419 (1928), because in the Helmholz case, although there was no evidence of an offer by the executor, the directors had tendered the money to him.


53 (2d Cir. 1932) 57 F. (2d) 682, affg. 51 F. (2d) 261.

Edith M. Bensel et al., Exrs., 36 B.T.A. 246 (1937); Estate of John Q. Strange, C.C.H. Dec. 12,516-D (B.T.A. mem. 1942); Estate of Anna D. Childs, 2 T.C.M. 388 (1943); Estate of Albert L. Salt, 17 T.C. 92 (1951).
A large part of the government's argument was devoted to an issue which today is only of academic interest since the statutory language on which it depended has disappeared.55 The balance of its brief sought to distinguish a New York decision, Matter of Fieux,56 which had held a substantially similar agreement controlling with respect to valuation for New York State inheritance tax purposes, but the attempted distinction was again based on technical rather than practical grounds. In the Fieux case the option was actually exercised. It was not exercised in the Wilson case. In the latter the government argued that, taking under the will, the nephew relinquished his option thus "leaving the interest which passed by will the full value of the shares."57 Judge Swan brushed this argument aside in one sentence saying: "Logically, subsequent events should not be considered in determining value at the time of death."

Incidentally, it may be noted that the other two members of the court which handed down the Wilson decision were Circuit Judges Augustus N. Hand and Learned Hand. Four years later in Lomb v. Sugden58 a somewhat more liberal restrictive agreement came before the same distinguished trio. Mrs. Lomb, the decedent, owned 21\% of the stock of Bausch & Lomb Optical Company, a close corporation. In an agreement designed to keep the shares "within the family" all of the common stockholders agreed that during life a stockholder wishing to sell must make a first offer to the others based on a price determined under a formula (which took into account capitalized earnings limited, however, by a ceiling of 100% of book value) and if a stockholder died without issue the surviving stockholders were to have an option to buy on the same terms.59 The restrictive agreement did not affect inter vivos gifts to other stockholders or bequests to the same; in fact,

55 See Revenue Act of 1918, §402(a) as construed in Crooks v. Harrelson, 282 U.S. 55, 51 S.Ct. 49 (1930) and compare with Revenue Act of 1926, §302(a). Under the earlier statute property was includible "To the extent of the interest therein of the decedent at the time of his death which after his death is subject to the payment of the charges against his estate and the expenses of its administration and is subject to distribution as part of his estate." The 1926 act eliminated the italicized clause.

57 57 F. (2d) 682 at 684 (1932).
58 (2d Cir. 1936) 82 F. (2d) 166.
59 The statement of facts does not mention any restriction on a stockholder who died with issue surviving. It may have been taken for granted that such a one would not bequeath his stock outside the family.
a decedent dying without issue was privileged to leave up to 10% of his shares to an outsider. Mrs. Lomb bequeathed her shares to her husband who was also a stockholder. At the time of her death the formula price was $69.445 per share as against a fair market value of $100 determined by the Commissioner.

The federal district court held against the taxpayer, principally because it thought—apparently erroneously—that the agreement did not legally restrict a lifetime sale to an outsider. On appeal the circuit court held the agreement valid. The government in its brief sought to distinguish the Wilson case on the ground that here no right to purchase ever vested in the other stockholders, since that could only happen if Mrs. Lomb while alive had decided to sell or in her will failed to bequeath at least 90% of her stock to other stockholders. The court, however, stated that it could see no essential difference between the two cases. The government also made an argument based on tax evasion phrased as follows:

"To restrict the Commissioner of Internal Revenue in his administration of the Federal Estate Tax Laws to a fictitious and theoretical valuation of property which never became a legally enforceable selling price thereof, would open the door to tax avoidance."

Since the court held the contract valid and enforceable, it disregarded this contention. It looked at the whole transaction from another angle, namely, what was the amount that Mrs. Lomb could have obtained for her stock at the time of her death? The answer, obviously, was $69.445. The opinion went on to state that the value of the stock to the estate can be no greater than that with which decedent parted. Whatever may be thought of the correctness of this last statement, it is further apparent that the court was very much influenced by a Supreme Court decision involving a restrictive stock agreement handed down only a few months earlier. In Helvering v. Salvage the Supreme Court held that the cost basis of stock acquired in a prior year was not its fair market value but the far lower option price at which

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61 Id. at 15-16.
62 For example, would this hold true if there were no restrictions on the sale of stock in the hands of the executor? See Worcester County Trust Co. v. Commissioner, (1st Cir. 1943) 134 F. (2d) 578.
the issuing corporation had the right to repurchase the stock during that year under a contract in which the owner of the shares also agreed not to compete with the company. The Salvage case, it may be noted, was an income tax case. The Supreme Court of the United States has never considered the effect of a restrictive stock agreement on value in an estate tax case.64

The Treasury made one further attempt to obtain a favorable decision from a circuit court of appeals when it took the Bensel case to the Third Circuit in 1938.65 There a father placed stock of a family corporation in trust, retaining income and voting rights for life, and gave his son an option to purchase the stock at the father’s death with payments spread over a 20-year period if the son so desired. The option price was $5.902 per share as against a stipulated fair market value at date of death of $60. Since more than 50,000 shares were involved, the Commissioner's increase in value was not far short of three million dollars.

The government claimed that this transaction was merely an inter vivos transfer for an inadequate consideration and that the value of the transferred property in excess of the amount fixed by the option price was also includible in the father’s gross estate. The facts, however, showed that the father and the son had been bitterly hostile for years and that the sole reason for the arrangement was the father’s desire to retain the services of his son since he recognized that the son was the most able man in the company. Additional facts, including extended haggling and several revisions of the option price, convincingly demonstrated that the agreement represented the settlement of a business problem by two unfriendly parties dealing at arm’s length. Under these circumstances both the Board of Tax Appeals and the circuit court of appeals held that the option price was controlling.

It may be inferred from some of the language in this opinion that a similar option given to a friendly employee, who has made no threats of quitting, or to a natural object of a taxpayer’s bounty, who in fact

64 I Polisher, Estate Planning and Estate Tax Saving (1948), at 314, suggests that in the absence of an authoritative decision by the Supreme Court on this question, discretion might be the better part of valor and clients should be cautioned that where a close relationship exists between the parties to such a contract, one should not be too sanguine about the federal estate tax fate of such agreements.

65 Supra note 4.
enjoyed the taxpayer's affection, should be disregarded for estate tax valuation purposes, if only because it was gratuitous, i.e., given without consideration. And, indeed, the Tax Court has so held in the *Armstrong* and *Hoffman* cases, respectively.\(^{66}\)

One more circuit court of appeals decision should be considered in sketching the background against which *May v. McGowan* was decided. This is the often misinterpreted case of *Worcester County Trust Co. v. Commissioner*.\(^{67}\) It held that a restrictive stock agreement was not controlling but must be given some effect as one among the other evidentiary factors when determining the date of death value of the stock subject to the restriction. So stated, it would seem that this decision was a modification—and one distinctly disadvantageous to taxpayers—of the rule laid down in *Wilson* and *Lomb*. The *Worcester County* case was referred to in this sense in the government's brief on appeal in the *May* case as follows:\(^{68}\)

"The Lomb and Wilson cases have been criticized. See II Paul, Federal Estate and Gift Taxation, Sec. 18.34 and 1946 Supp., Sec. 18.34. In *Worcester County Tr. Co. v. Commissioner*, supra, the court adopted a rule that option restrictions necessarily may have a depressing effect on the value of stock but are no more than one of the relevant factors to be taken into account in valuation."

The facts of *Worcester County Trust*, however, show that this interpretation cannot be justified. That case involved a *mere first offer restriction during life and no restriction at all on testamentary or intestate transfers*. The Board of Tax Appeals in line with its prior decisions in mere First Offer cases\(^ {69}\) sustained the Commissioner. The First Circuit, nevertheless, reversed on the ground that any legatee or distributee would take stock which in his hands would again be subject to the first-offer-during-life restriction, a factor which must be considered in determining fair market value for estate tax purposes. Therefore, what this decision really holds is that even in a case where the executor is *under no obligation* to sell, nevertheless a mere first offer agreement effective during life may serve to reduce value for estate tax purposes. This decision went far beyond the rule laid down in *Wilson* and

\(^{66}\) Supra notes 4 and 5, respectively.

\(^{67}\) (1st Cir. 1943) 134 F. (2d) 578, revg. 46 B.T.A. 337 (1942).

\(^{68}\) Pp. 13-14.

\(^{69}\) These are included in the decisions cited supra note 26.
Lomb and it is difficult to understand how it can reasonably be used to cast doubt on the "remaining vitality" of those cases.

**May v. McGowan**

The facts which prompted the execution of the restrictive stock agreement in the *May* case are unusual. Originally the decedent conducted his coal business as a sole proprietor. Between 1926 and 1929 he borrowed from a bank putting up securities as collateral. This loan had no connection with the coal business. The time when the indebtedness was incurred suggests its purpose. In 1927 decedent's son became an employee and two years later an equal partner in the business. The debt to the bank then amounting to $182,000 became a liability of the partnership, but as between the partners it was recognized that the father alone was liable. In 1926 the partners organized a corporation to which they transferred all of the partnership assets, the corporation assuming all of the partnership's liabilities, including the indebtedness to the bank. Five hundred shares of stock were issued to each of the two partners. The bank, as a condition to its acceptance of the liability of the corporation for the debt, demanded that the two stockholders individually guarantee the debt up to its then amount of about $161,500. Father and son delivered to the bank an agreement which recited these circumstances and included the required guarantee. The agreement further recited that each of the two stockholders desired to avoid division of corporate control between himself and a person not then a stockholder. To this end father and son agreed that neither would sell his stock during his lifetime without first offering it to the other and that the survivor would have an irrevocable option to buy the stock of the one who died first. The offering price and the option price were fixed at $100 per share, with the exception that the amount payable per share by the son was to be reduced by 1/500th of the bank indebtedness remaining unpaid at the time. According to the agreement this concession in price was made because the son otherwise would have been unwilling to underwrite what had always been regarded as the father's debt. In other words, as long as the loan exceeded $50,000, the father could not sell the shares without first offering them to the son for nothing and upon the father's death the son would have an option to buy the shares at zero value.

This, in fact, was the situation when the father died in 1945. His executors returned the shares at zero value for federal estate tax purposes; the Commissioner determined a deficiency based on a value of $100 per share; and the executors eventually brought a suit for refund.

The district court found as a fact that the 1936 agreement was entered into in good faith and without a tax avoidance purpose. It addressed its first inquiry to the test laid down in *Wilson* and *Lomb*, i.e., whether at date of death the stock was subject to an enforceable option to buy at a specific price and, in this connection, refused to hold with the government's contention that these decisions of the court of appeals of its own circuit "are plainly outmoded and have no remaining vitality."\(^{71}\)

The district court also rejected the argument that in any event *Wilson* and *Lomb* were distinguishable because both dealt with decedents who died prior to the enactment of the Joint Resolution of March 3, 1931.\(^{72}\) This contention was based on the view that the restrictive agreement amounted to a testamentary disposition (transfer with possession retained for life) without full and adequate consideration, the present statutory test,\(^{73}\) whereas prior to 1931 it was alleged that where the transferor had retained only a life interest there was no need for the court to consider the adequacy of the consideration for transfers by restrictive agreement beyond the question whether there was sufficient legal consideration to make the agreements binding. The district court, calling attention to the purpose of the Joint Resolution\(^{74}\)

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\(^{71}\) Id. at 328.

\(^{72}\) 46 Stat. L. 1516, c. 454 (1931).

\(^{73}\) I.R.C., §811(c)(1)(B). Under the earlier statute, §302(c) of the Revenue Act of 1926, the value of property was included in a decedent's estate "to the extent of any interest therein of which the decedent has at any time made a transfer, by trust or otherwise, in contemplation of or intended to take effect in possession or enjoyment at or after his death, except in case of a bona fide sale for an adequate and full consideration in money or money's worth." The 1931 amendment made by Joint Resolution specifically included as a transfer to take effect at death one under which the transferor "retained for his life . . . the possession or enjoyment of, or the income from, the property . . . ."

\(^{74}\) The amendment made thereby (supra note 73) was intended to overcome the effect of the decision in *May v. Heiner*, 281 U.S. 238, 50 S.Ct. 286 (1930), as reflected in three per curiam decisions handed down by the Supreme Court on March 2, 1931. These held that a transfer in trust with a retained life estate was not a transfer intended to take effect in possession or enjoyment at death. See the writer's "Congress Deactivates Another Bombshell: The Mitigation of Church and Spiegel," 5 Tax L. Rev. 309 at 334, note 155 (1950).
called this "captious reasoning" and held that the statutory words which bring into a decedent's estate interests in property transferred during life with possession or enjoyment of the property retained until death do not comprehend as a transfer of *an interest in property* an agreement giving a right to purchase the property.\(^{76}\)

On appeal the government argued:

(1) Conceding, for the sake of argument only, the validity of the option agreement, it was error to regard that agreement as controlling and not as only one of many factors to be considered in ascertaining fair market value;

(2) Alternatively, that the debt referred to in the agreement had been satisfied even prior to 1936, thereby making the sliding price scale in the option agreement wholly inoperative as a factor in determining fair market value; and

(3) Again alternatively, that the effect of the agreement was a testamentary disposition of property without an adequate and full consideration in money or money's worth within the meaning of the Internal Revenue Code.

The court, in a per curiam opinion, disregarded the second contention entirely and touched on only one point made in the other alternative argument.\(^{76}\)

\(^{76}\) The government also argued that the debt referred to in the agreement was fully discharged long before the date thereof. This contention apparently was based on the fact that the debt dropped to about $45,000 for a period of five days in November 1930, after which it immediately rose to over $198,000. The district court observed that if this were so it could only mean that partnership funds arising out of the business had been used to discharge the father's personal obligation. It held that the validity of the option as an option at a specific price enforceable at the father's death did not depend on whether the debt could be said to have been technically discharged some years prior to the agreement, but on whether the agreement was supported by a valid consideration. Such consideration, the court held, was furnished by the mutual covenants. The same argument as to the prior discharge of the debt was renewed in the government's Brief on Appeal (pp. 14-18) but was disregarded in the opinion of the Second Circuit, unless an indirect refutation thereof may be inferred from that court's summary of the facts.

\(^{76}\) This point was the government's contention (Brief on Appeal, p. 8) that the consideration given by the son could be considered adequate and full only if, inter alia, the indebtedness to the bank was not one to which the son was already subject. The argument ran that the son's partnership interest must have already been subject to the indebtedness from the time when the partnership was formed. The Second Circuit disposed of this argument on the ground that the son's obligation as a member of the partnership to pay the claims of the bank was different from the personal obligation which he assumed in 1936 when the corporation was formed, since the bank could not resort to his personal assets for payment of its loan until it had exhausted its remedy against the partnership assets. Hence the son substituted a new and different obligation which in itself under New York law was an adequate and new consideration for his undertaking.
The government's first and principal contention was that, if the court did not consider the case distinguishable from *Wilson* and *Lomb*, the rule of those cases should be "reconsidered" or "re-examined" in the light of the more recent gift tax decisions involving valuation of stock subject to a restrictive agreement and of the *Worcester County Trust Company* decision. In effect, as was pointed out in the taxpayers' brief, the government asked the court to disavow the decisions in the *Wilson* and *Lomb* cases.

Counsel for the executors convincingly distinguished the gift tax cases on the ground that none of them involved an enforceable option to buy at the critical date and further demonstrated by quotations from two of these opinions that this distinction was specifically recognized therein. This information is supplied here because the court in the

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77 The government's argument that the facts of May afford grounds for distinction (Brief, pp. 10-12) is based on differences which seem unimportant. It is effectively disposed of in the taxpayers' brief (pp. 8-9). The surmise may be hazarded that this part of the argument was not meant to be taken seriously. In any event, the court in its opinion wholly disregarded it.

78 Brief on Appeal, pp. 7, 12, 14.

79 Supra note 6.

80 Supra note 18.

81 P. 9. The government's brief rather annoyingly consistently refers to the son as the "taxpayer" but the taxpayers in the case were, of course, the executors of the father's estate.

82 The taxpayers' brief at p. 6 quotes the following excerpt from *Krauss v. United States*, 140 F. (2d) 510 at 511:

"Here, as they did below, appellants insist that *Lomb v. Sugden*, 2 Cir., 82 F. 2d 166, and the cases it cites, are controlling. The United States denies this. It concedes that there are general expressions in that case which would support appellants' view that the provision relied on here, that if a stockholder decides to sell, he must first give a sixty-day privilege to the other stockholders to buy at the price fixed, had the effect claimed for it to limit the value to that price. It points out though this was not the real holding of that case, that its holding was that the value of stock to the estate of a deceased stockholder under a contract provision conferring an absolute option or right on the other stockholders for a time fixed to buy at a price named, fixed the value to the estate at that price. Helvering v. *Salvage*, 297 U.S. 106, 56 S.Ct. 375, 80 L. Ed. 511, cited in support, is to the same effect." (Italics as in brief).

The taxpayers' brief continues by quoting the following excerpt from *Commissioner v. McCann*, 146 F. (2d) 385:

"When there is an open market in which property can be bought and sold, it may be very difficult, if not impossible, to avoid the conclusion that the market price is the 'value' for all purposes. That price is the sum which will secure the property, if anyone wishes to buy it, or will replace it, if anyone has parted with it; that price is the sum which represents the current estimate of the present value of its future earnings and of its final liquidation. An option immediately exercisable—a 'call'—will, however, ordinarily be regarded as a limit upon market value, or any other value however ascertained or ascertainable, because the person having the option, if well advised, will exercise it as soon as the value rises above the option price. If there are reasons why he will not then do so, he must prove them who wishes to discard the option price as the measure. For this reason we held in *Wilson v. Bowers*, 57 F. 2d 682, and *Lomb v. Sugden*, 82 F. 2d 166, that an option price was the proper measure when the shareholder died, for in each case the option could be exercised at death." (Italics as in brief).
May opinion did not discuss the government’s argument in any detail but merely stated:

“It seems clear that with the option outstanding no one would purchase the stock of the decedent at its value unrestricted by the option when it was subject to call by Harry A. May at zero. This was the rationale of our decisions in Wilson v. Bowers, 2d Cir., 57 F. 2d 682, and Lomb v. Sugden, 2d Cir., 82 F. 2d 166. In Lomb v. Sugden, supra [at p. 168], we said that this view was supported by the Supreme Court’s decision in Helvering v. Salvage, 297 U.S. 106 . . . , to the effect that an outstanding option to purchase restricts the market value of stock in the hands of the owner to the option price. We see no reason for questioning the foregoing decisions.”

The court went on to say:

“If they leave a loophole for tax evasion in some cases, here the district court found that there was no purpose to evade taxes. Such a loophole, if important, should be closed by legislative action rather than by disregarding the cases we have cited.\(^{83}\)

While this statement should, no doubt, be styled dictum, it may fairly be interpreted to mean that if a case should reach the Second Circuit involving an option enforceable at date of death and a factual situation which strongly tended to show at least a concomitant tax evasion purpose, that court would nevertheless adhere to the still vital rule embodied in its earlier decisions and reaffirmed in the May case.

A note of caution, however, may be injected at this point. One or more of the remaining ten United States courts of appeals or the Court of Claims might take a different view as to the judicial function in closing loopholes, particularly if it were confronted with some case in which (as was not the case in May) there was a purpose to evade tax.

To round out the picture it may be of interest to consider a recent state court decision in which just such a situation was deemed to exist.

Possible Abuse of Restrictive Stock Agreements

That courts will disregard restrictive agreements which they consider devices to evade death taxes is illustrated by several federal cases\(^{84}\) and rather strikingly by the recent decision of the Supreme

\(^{83}\) 194 F. (2d) 396 at 397 (1952).

\(^{84}\) Supra note 5.
Court of the State of Washington in In re Cowles' Estate. The opinion contains an interesting review of the federal and state rules and discusses the two conflicting solutions of the problem of whether or not the option price should establish the value of the optioned stock for inheritance or estate tax purposes.

The facts of the Washington case are that the owner and publisher of the Spokane Spokesman Review and of the Spokane Chronicle granted an option to his son to buy about 25% of the stock of each of these corporations as well as all of the stock of a related company. The consideration was stated to be $10,000 in hand paid and the son's promise to remain actively engaged in an executive or administrative capacity in the business of the three corporations. The price under the option for the three blocks of stock was about half a million dollars. The contract, which was dated October 5, 1943, provided that if the son worked for ten years he could exercise the option during the last quarter of 1953, or earlier if the father should sooner die. Non-exercise of the option during the year following the father's death, however, was not to affect the son's right to exercise it during the last quarter of 1953.

On its face this looks like a reasonable arrangement providing for what is perhaps a bargain purchase to reward ten years of hard work for the companies. At the option prices the Spokane Review and the Chronicle were each valued at about one million dollars. Indeed, the father's lawyer testified that the option agreement had not been drawn

85 36 Wash. (2d) 710, 219 P. (2d) 964 (1950).
86 Id. at 715. No attempt has been made to make a thorough study of state cases dealing with the topic of this article and those cited below do not purport to represent a complete list. The "two conflicting solutions" referred to by the Washington court are the federal rule of the Wilson and Lomb cases and the so-called Pennsylvania rule. The latter is that no agreement by a property owner fixing value can control the state's appraisers or in any way create a limitation binding on the state; it will merely be considered with the other evidence. In re McLure's Estate, 347 Pa. 481, 32 A. (2d) 885 (1943); In re DeJone's Estate, 347 Pa. 486, 32 A. (2d) 888 (1943). Accord: Commissioner of Corporations, etc. v. Worcester County Trust Co., 305 Mass. 460, 26 N.E. (2d) 305 (1940) (involving same "first offer" restriction as the federal estate tax case, Worcester County Trust Co. v. Commissioner, supra, note 18); Grell v. Kelly, 134 N.J. Eq. 134 N.J. Eq. 593, 36 A. (2d) 321 (1940); Schroeder v. Zink, 4 N.J. 1, 71 A. (2d) 283 N.W. 452 (1939); Op. Atty. Gen. North Carolina, 604 (new) C.C.H. Inheritance, Estate and Gift Tax Service, ¶8563 (1940). Contra: Matter of Vivanti, 138 App. Div. 281, 122 N.Y.S. 954 (1910); Matter of Fieux, 241 N.Y. 277, 149 N.E. 857 (1925); Matter of Miller, 191 Misc. 784, 79 N.Y.S. (2d) 372 (1948) (no restriction during life); Strange v. State Tax Commission, 192 Miss. 765, 7 S. (2d) 542 (1942).
up with any thought of tax avoidance, but to guarantee the continuation by the son, who already owned or controlled about 40% of the two newspaper corporations, of certain definite management policies. The attorney further testified that the father in fairness to the other heirs did not wish to will the stock to his son and therefore hit upon the option plan which gave the son sufficient time to accumulate funds to exercise his option. All of this has a plausible ring.

Certain additional facts, however, seemed to the court to place the transaction in a somewhat different light. To begin with, at the time of the execution of the contract, the father was 78 years old. He died about two years later and left the bulk of his estate, including the three blocks of stock subject to the option, in trusts for his surviving grandchildren. The son was named as one of the trustees and the will provided he should have the right to vote all the shares of the stock of the three companies. The son, although he at all times remained in an executive capacity with the three companies, did not exercise the option during the year following his father's death. Possibly he will also abstain from doing so when he gets his second opportunity in 1953, both to avoid higher income tax brackets during his life and the additional estate tax payable on his death. If he lets the present arrangement stand, the stock will pass from the first to the fourth generation with the third generation enjoying the income of the trust and the active member of the second generation having full voting control during his life, at the price of only one death levy. Such an arrangement, which, of course, is in no way dependent upon the stock option agreement, may have prompted the court to scrutinize particularly closely the manner in which the amount of this single levy should be fixed.

The executors, who included the son, hoped to limit it to the tax on $519,750, the option price. Two of the three appraisers agreed with them, but the third, who under Washington law is, in effect, the appointee of the state tax commission, refused to accept the option price as determinative and stated that in order to make findings as to the full value of the stock, he required the books and records of the corporation which had not been made available to him. The executors thereupon went to court for an order directing the recalc-

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87 This assumes that the trust continues for the lives of the grandchildren and that their issue are named as remaindermen.
trant appraiser to show cause why he should not approve the inventory filed by his colleagues. The state filed a cross-petition asking that the executors be directed to produce the corporate books. The state was successful, the lower court specifically finding that the option contract was not binding upon the appraisers. The executors then appealed to the state supreme court.

That court, which affirmed, recognized that survivorship stock option contracts are in many cases entered into for motives entirely unrelated to tax savings. It remarked that although there had been much litigation, “the courts have not found a conclusive solution and the whole matter is in a state of discouraging confusion.” It contrasted the federal rule, which gives effect to the price fixed by an enforceable option, to the Pennsylvania rule which holds such an option agreement to be only one of the evidentiary factors. But it concluded that even if accepted as a general principle, the federal rule was inapplicable in the instant case because the parties to this intra-family contract were not dealing at arm’s length. Significantly the court said:

“... If we were to hold that the option price were binding in a case such as this, it would be possible for an owner of stock, wishing to bequeath it to the natural object of his bounty, to achieve the same result by giving the latter an option to purchase the stock upon his death for a purely nominal sum. In this manner, he could, in effect, determine the amount of inheritance tax to be paid.”

The effect of this decision was not to fix a price higher than the option price. The court did not fix any price, but merely rejected the executors’ contention that the option price was necessarily controlling and directed them to make available to the tenacious state appraiser the corporate books so that the full value of the stock, with proper weight given to the restrictive agreement, might be determined.

It is possible to distinguish this case from some of those which apply what the court called the federal rule on the ground that it involved a state inheritance tax, levied on what is received by heirs, legatees and

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69 36 Wash. (2d) 710 at 717, 219 P. (2d) 964 at 967 (1950).
60 This would include decisions in states which now have death tax laws derived from the federal estate tax such as Strange v. State Tax Commission, 192 Miss. 765, and Matter of Miller, 191 Misc. 784, 79 N.Y.S. (2d) 372. It may be noted, however, that New York adopted the “federal rule” before the national courts did and at a time when it still had an inheritance tax, as distinguished from an estate tax. See Matter of Fieux, 241 N.Y. 277, 149 N.E. 857 (1925).
distributees, whereas the federal estate tax is an excise levied on the transfer of property from the dead to the living. Indeed, the Washington court noted this distinction. It is believed, however, that it would be hazardous to rely thereon, since the Tax Court or some other federal court not within the Second Circuit, might well hold that a restrictive stock option given to the natural object of the optionor’s bounty palpably and solely for tax minimization reasons cannot be availed of to defeat collection of the proper measure of federal estate tax.

Conclusion

Restrictive stock purchase and stock option agreements in many instances serve a useful purpose by obviating costly and time-consuming litigation with respect to valuation of stock of close corporations and by enabling the surviving shareholders in such corporations to keep out discordant “partners.” In cases where the agreement is bona fide and represents an arm’s length bargain it should be sustained by the courts in federal estate tax cases. Both courts which considered May v. McGowan were convinced that agreement there had no tax evasion purpose. In view of that fact, the reaffirmance of the rule of Wilson and Lomb, which was deemed moribund by sufficient tax experts both within and outside the government so as to cause concern to the profession, should be welcome.

The contrary view is that a restrictive agreement of the option type running in favor of the natural object of the decedent’s bounty affords an obvious loophole for tax evasion which should be plugged. An option at a restricted price given to a third party might also be considered a tax evasion device in instances where it is not exercised and the stock passes to the natural object of the optionor’s bounty under his will. This raises the question of whether the Second Circuit’s reference to closing such a loophole by legislation is one to which the Treasury ought to react.

Tax evasion, however, is not a purpose in many situations where the optionee is the natural object of another’s bounty. See, e.g., May v. McGowan! The same is true of countless cases where a third party optionee abstains from exercising his right and the stock passes to the natural object of the decedent’s bounty.

91 Some states, notably New Jersey and Pennsylvania, have not accepted this view for state death tax purposes. Supra note 86.
An illustration of the latter situation which readily comes to mind and which represents quite usual circumstances is where several brothers own a family business they have built up which is organized in corporate form. They are worried as to the possibility of who may have the stock of the "partner" who dies. Each, let us assume, has a son and hopes his offspring will take his place in the business when he dies if the boy likes the business and if the surviving brothers think well of the boy's abilities. While still young enough to acquire insurance at reasonable rates, the brothers cause the corporation to take out key man insurance on the life of each and enter into an agreement which obligates each stockholder to make a first offer to the corporation if he wishes to sell and gives the corporation an option to buy the shares of a deceased stockholder within a reasonable period after his death. Now it is true that if one of the sons goes into the business and proves competent and congenial, the surviving stockholders probably will not cause the corporation to exercise its option when the boy's father dies if the latter has bequeathed the shares to his son, i.e., to the natural object of his bounty. In such a case the valuation for estate tax purposes will be controlled by the option price, which may be lower than the Commissioner's notion of the fair market value of the shares. But this does not represent a fraud on the revenue. It must be remembered that when the option agreement was executed, the brothers, under the perfectly realistic facts here assumed, could not know either how their minor children might turn out or how the survivors would regard them or a still reasonably young and attractive widow, if she were the legatee. Hence, even though the stock might pass to the natural object of the shareholder's bounty, he can have no assurance that it will, and therefore he—and his fellow stockholders as well—will see to it that the price to be determined under the formula contained in the agreement will be a fair one which will give an adequate quid pro quo to his heirs in the event of exercise of the option.

These somewhat obvious considerations have been spelled out to illustrate the difficulty involved in any attempt to draft legislation directed at scotching the undervaluation, by means of an option never intended to be exercised, of bequests to the natural objects of the testator's bounty. We have here one of the many situations where an attempt to close a loophole would in all probability do far more harm to business than the additional revenue would justify.

It is, therefore, to be hoped that the Treasury will not seek some legislative remedy which almost surely will be bound to do more harm
to small business than the checking of tax evasion would justify, but will rely on the good sense of the courts to continue to disregard for tax purposes option arrangements which lack bona fides or any real consideration. On the other hand, taxpayers and their advisers should not seize upon the government's setback in *May v. McGowan* to abuse what has become a popular and desirable business arrangement designed to perpetuate many small businesses. The Second Circuit said: "Such a loophole, *if important*, should be closed by legislative action."  

This language may be interpreted to indicate that the court is skeptical as to the importance of the loophole. The writer's own experience leads him to believe that the overwhelming majority of agreements of the type here under discussion are adopted for purposes other than tax evasion. But it is urged that taxpayers and their advisers, whether of the legal, accounting or insurance profession, rigidly abstain from adopting or recommending pure tax evasion schemes. A contrary policy if pursued by sufficient short-sighted persons might some day furnish the Treasury with enough ammunition to claim that the loophole had become important and that Congress should follow the Second Circuit's indication in *May v. McGowan*.

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92 See cases cited supra note 5.
93 Emphasis supplied.