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Gift, Estate, & Income Tax Valuation Insights Newsletter

Fixing Price or Fixing Risk?

Sections 2031, 2703, Huffman, and the Case for Independent Valuation

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Executive Summary

Buy-sell agreements are foundational planning tools for closely held businesses. When thoughtfully structured, they provide continuity, liquidity, and governance stability.If not drafted carefully, they can undermine estate planning objectives and create significant transfer tax exposure. For advisors of closely held business owners, the recurring question is not whether to use a buy-sell agreement, but whether the pricing mechanism embedded in the agreement will be respected for estate and gift tax purposes.

Before the 1990 enactment of Chapter 14, which includes **§2703**, courts evaluated buy-sell agreements under §2031 using a set of judicially developed principles. In general, those principles required that the estate be obligated to offer the security for sale at the decedent's death, that a fixed and determinable price be established for the security, that lifetime transfers of the security at prices exceeding that amount be precluded, and that the arrangement not operate as a device to transfer property for less than full and adequate consideration. While §2703 now governs the analysis, these foundational concepts continue to inform how courts evaluate whether buy-sell pricing should control reported values for gift and estate tax purposes.

The United States Tax Court decision in ***Huffman v. Commissioner, T.C. Memo. 2024-12***, provides a current illustration: the IRS and the courts will not automatically accept buy-sell pricing for transfer tax purposes. Formula pricing provisions such as book value, fixed multiples, or stale fixed prices remain particularly vulnerable to being disregarded. The case also reinforces a practical conclusion for planners: a valuation process agreement requiring a qualified, independent appraisal at the relevant transfer date is essential, particularly for family-owned businesses.

Section 2703: The Statutory Framework

Section 2703(a) directs that, for estate and gift tax purposes, property must be valued without regard to:

1. Any option, agreement, or other right to acquire property at less than fair market value; or
2. Any restriction on the right to sell or use property.

Buy-sell agreements are therefore ignored unless they satisfy the safe harbor in §2703(b). To qualify, the agreement must:

1. Be a bona fide business arrangement;
2. Not be a device to transfer property to family members for less than full and adequate consideration; and
3. Have terms comparable to similar arrangements entered into at arm's length.

These requirements are cumulative. Failure to satisfy any one of them results in the pricing restriction being disregarded.

Importantly, §2703(b) provides that these three requirements are generally presumed satisfied if more than 50 percent (by value) of the subject property is owned, directly or indirectly, by individuals who are not members of the transferor's family. In those situations, the analysis effectively reverts to the traditional §2031 framework. In contrast, for family-controlled businesses, taxpayers must satisfy both the longstanding §2031 principles and the heightened §2703 requirements. This distinction materially increases the level of scrutiny applied to intrafamily agreements.

The Huffman Case: A Cautionary Example

In *Huffman*, the Tax Court examined right-to-purchase (RTP) agreements within a family-owned aerospace parts manufacturer, Dukes, Inc. The Huffman family owned its shares via two vehicles: Dukes Research and Manufacturing, Inc. (DRM), which held 304,124 shares, and the Huffman Family Trust, which held 118,635 shares. Chet Huffman entered into RTP agreements with both entities for nominal consideration, establishing fixed maximum aggregate purchase prices of $3.6 million and $1.4 million, respectively, for a total of $5.0 million (an effective price of $11.83 per share).

The taxpayers argued that these agreements fixed the value of the shares. The IRS disagreed, determining that the shares were worth substantially more, reaching a combined value of $38.2 million: $27.5 million for DRM's shares, and $10.7 million for the Trust's shares. Based on these values, the effective price was approximately $90.36 per share and the combined gift tax exposure was approximately $33.2 million.

The Tax Court analyzed the agreements under §2703 and concluded that the pricing provisions failed the comparability requirement. As a result, the agreements were disregarded for transfer tax valuation purposes.

Several aspects of the opinion are particularly relevant:

1. The intrafamily nature of the agreements triggered heightened scrutiny.
2. The fixed pricing was established years earlier and was not tied to contemporaneous fair market value.
3. The agreements afforded Chet Huffman significant flexibility, including unilateral exercise rights.
4. The taxpayers failed to establish meaningful comparability to arm's-length arrangements.

The Tax Court also rejected reliance on the purported Lloyd-Barneson agreement, a prior agreement that gave Lloyd Huffman (Chet's father) the option to purchase another shareholder's interests in the business, as a comparable. The agreement itself was not introduced into evidence, and the Tax Court noted that it had only vague and incomplete references to its terms. Critically, the Tax Court further observed that even if the agreement had been submitted, it would not have been comparable. The Lloyd-Barneson arrangement reportedly provided an option exercisable at death, whereas Chet Huffman's agreement allowed him to acquire shares at any time for any reason. That difference in timing flexibility materially alters the economic characteristics of the arrangement and undermines comparability under §2703(b)(3).

Ultimately, even if the agreements reflected legitimate business objectives, the failure to satisfy the comparability requirement proved dispositive.

Why Formula Pricing Is Vulnerable Under Section 2703

Many buy-sell agreements rely on formula pricing, such as book value, adjusted book value, or multiples of EBITDA or revenue. While administratively convenient, these approaches are difficult to defend under the combined §2031 and §2703 framework. Static formulas are inherently misaligned with dynamic businesses. Book value ignores goodwill, while fixed multiples often fail to reflect changes in risk, growth, or capital structure. What may appear reasonable at inception can quickly diverge from fair market value.

More importantly, formula pricing typically fails the comparability requirement. Courts require evidence that the pricing mechanism mirrors what unrelated parties would negotiate in similar circumstances. In practice, taxpayers rarely have access to sufficiently detailed, transaction-level data to support that conclusion. General assertions about industry practice are not sufficient.

For family-controlled businesses, this issue is amplified. Because these entities generally do not meet the more-than-50-percent nonfamily ownership threshold, they must satisfy the full scope of §2703, including the comparability requirement. That requirement, in turn, is exceptionally difficult to meet without grounding the pricing mechanism in a defensible determination of fair market value.

The Superior Alternative: A Valuation Process Agreement

Rather than relying on fixed or formula-based pricing, practitioners should consider valuation process agreements that require determination of fair market value by a qualified, independent appraiser at the time of transfer. Such agreements align directly with the governing legal framework. They reflect how unrelated parties transact, support the bona fide business arrangement requirement, and mitigate concerns that the agreement functions as a device to transfer wealth at a discount.

From a practical standpoint, an appraisal concurrent with the transfer provides a defensible foundation for buy-sell pricing. While valuation conclusions may still be challenged, the analysis shifts from the validity of the pricing mechanism to the reasonableness of the valuation methodology.

For family-owned businesses in particular, this approach is not simply preferable, in practice, it is often necessary. The statutory emphasis on comparability, combined with the absence of a meaningful safe harbor, makes it difficult to justify any pricing mechanism that is not directly tied to fair market value.

Conclusion

Buy-sell agreements remain indispensable tools in closely held business planning. However, pricing mechanisms that deviate from real-time fair market value face significant risk under §2703. The Tax Court's analysis in *Huffman* underscores that courts will disregard contractual pricing when comparability and arm's-length standards are not satisfied. The case also highlights a broader structural reality: for family-controlled businesses, the comparability requirement is difficult to satisfy without a credible, contemporaneous appraisal.

For advisors, the implication is clear. Replace static formulas with a defensible valuation process. Engage qualified appraisers. Design agreements that reflect how sophisticated, unrelated parties transact. In this context, the objective is not to fix price, it is to fix risk.

Upcoming Conferences

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- Timothy K. Bronza, CPA, ASA
- Thomas C. Insalaco, CFA, ASA
- Barbara Walters Price

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Texas Bar Association Advanced Estate Planning Strategies 2026

April 23-24, 2026 | Boulder, CO

- J. David Smith, CFA, ASA
- Andrew B. Frew, ASA, ABV
- Barbara Walters Price

SPEAKING ENGAGEMENT

ABA Section of Real Property, Trust and Estate Law (RPTE) National CLE Conference

May 1, 2026 | Chicago, IL

- Travis W. Harms, CFA, CPA, ABV (panelist)

"Fair (Market) Warning: This is Not a Final Determination— Practical Advice from Tax Litigators"

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- Allocation of Value, Determination of Professional Goodwill
- Charitable Contributions – Reg. §1.170A – 13(c)(2)
- Compensation in Kind – Reg. §1.61-2(d)(1)
- Compensation Planning – IRC §§83(b) and 409(A)
- Corporate Reorganizations
- C Corporation to S Conversion – IRC §1374
- Divestitures
- Expatriation Tax Reporting – IRC §877A
- Income Tax Controversies – Valuation Consulting
- Net Operating Loss (NOL) Carryforwards – IRC §382
- Not-For-Profit – IRC §501(c)(3)
- Qualified Stock Purchases – IRC §§351, 352, and 338
- Valuation of Closely Held Securities Held by a Stock Bonus, Pension or Profit-Sharing Plan of an Employer – IRC §401(a)(28)(C)
- Worthless Securities – IRC §165

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