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## TRANSFERRING DEVELOPMENT RIGHTS: SPECIAL USE VALUATION RECAPTURE EVENT?

— by Neil E. Harl\*

A New Jersey federal district court decision, *Estate of Gibbs v. United States*,<sup>1</sup> as the first litigated decision on the effect of the transfer of development rights on special use valuation recapture,<sup>2</sup> has focused attention on what types of transfers of interests in land lead to recapture.

The statute specifies that—

“If within 10 years after the decedent’s death and before the death of the qualified heir...the qualified heir disposes of any interest in qualified real property (other than by a disposition to a member of his family) there is hereby imposed an additional estate tax.”<sup>3</sup>

Thus, the issue is what constitutes “any interest in qualified real property.”<sup>4</sup>

### Facts in Estate of Gibbs

In the facts of *Estate of Gibbs v. United States*,<sup>5</sup> the estate elected special use valuation on farmland which reduced the value of the land for federal estate tax purposes from \$988,000 to \$349,770. Later, the qualified heirs sold a “conservation servitude” to the State of New Jersey for \$1,433,493.72 with a deed of easement which imposed restrictions on the property. The deed granted the conservation servitude by way of an “agricultural deed restriction for farmland preservation purposes” to the county under the New Jersey Right-to-Farm Act.<sup>6</sup> The servitude specified that the land was to be maintained as a farm in perpetuity.

The qualified heirs argued that the acquisition of the conservation servitude was only a contractual restriction on future use of the farmland and not a disqualifying disposition of an “interest” in the land subject to the special use valuation election. The Internal Revenue Service took the position that the granting of the conservation servitude triggered recapture because an interest in the real property was conveyed.

The court, in ruling for the estate, observed that New Jersey law construed land use restrictions as “equitable servitudes,” not property interests. Thus, the interest conveyed was only a contract right and not the disposition of an interest in the real estate.<sup>7</sup>

### Other Authorities

In a 1987 private letter ruling,<sup>8</sup> IRS held that a “deed of easement” to a foundation

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for a stated consideration of \$490,000 which preserved the land in agricultural use was a disposition which resulted in the imposition of a recapture tax. The Service noted that the consideration received for the granting of the easement constituted proceeds from the sale of an interest in real property.

In *Rev. Rul. 88-78*,<sup>9</sup> the question was whether the grant of a lease in subsurface oil and gas interests, the extraction of oil or the disposition of royalty rights with respect to farmland valued under the special use valuation rules caused recapture of the benefits. The Service noted that the interest of a lessee in oil and gas in place was an interest in real property for federal income tax purposes<sup>10</sup> and a royalty interest is a fee interest in mineral rights and real property.<sup>11</sup> Thus, based on income tax authorities, the Service asserted that the disposition of oil rights is the disposition of an interest in real property.<sup>12</sup> However, because a committee report stated that “elements of value which are not related to the farm or business use (such as mineral rights) are not to be eligible for special use valuation,”<sup>13</sup> the disposition of rights to oil was not a disposition that would cause recapture of special use valuation benefits. The ruling proceeded to state that “well-drilling activity and the subsequent extraction process” normally would interrupt farm operations and would constitute a “cessation of use” for purposes of recapture.<sup>14</sup>

A 1990 private letter ruling<sup>15</sup> involving a subsurface pipeline easement held that the granting of the easement did not trigger the recapture tax in that the easement “neither interrupts nor affects the use” of the land subject to the special use valuation election.

Thus, the position of the IRS in *Rev. Rul. 88-78*<sup>16</sup> and the 1990 private letter ruling<sup>17</sup> seems to be that even if a conveyance is of an interest in the real property, no recapture results so long as the surface use is not interrupted.

#### Returning to *Estate of Gibbs*

In applying *Rev. Rul. 88-78*<sup>18</sup> and the 1990 private letter ruling to *Gibbs*,<sup>19</sup> it would appear that even if the easement or servitude involved an interest in real property, which the court said it did not, recapture should not result so long as there is no interruption of the surface use. Certainly, an

easement assuring that the surface use would be limited to agricultural use in perpetuity leaves little room for argument that the easement is of a nature to assure continuation of the surface use. The court in *Gibbs* made an oblique reference to this argument in stating that “...the Court’s decision should not be construed as carving out an exception for the particular land use restrictions imposed here, just by virtue of the fact that they have the effect of giving the United States ‘more than it originally bargained for—farmland in perpetuity rather than being limited to a ten-year period.’”<sup>20</sup> The court instead reached its conclusion on a more narrow ground—that the qualified heirs did not dispose of an interest in land.

Arguably, even if such an easement had involved transfer of an interest in land, recapture should not have occurred so long as the surface use was not interrupted.<sup>21</sup>

#### FOOTNOTES

- <sup>1</sup> 98-1 U.S. Tax Cas. (CCH) ¶ 60,307 (D. N.J. 1997). The case is designated as not for publication.
- <sup>2</sup> I.R.C. § 2032A(c). See generally, 5 Harl, *Agricultural Law* § 43.03[2][g] (1997); Harl, *Agricultural Law Manual* § 5.03[2][f] (1997).
- <sup>3</sup> I.R.C. § 2032A(c)(1) (emphasis added).
- <sup>4</sup> *Id.*
- <sup>5</sup> 98-1 U.S. Tax Cas. (CCH) ¶ 60,307 (D. N.J. 1997).
- <sup>6</sup> N.J. Stat. Ann. § 4:1C-1 *et seq.*
- <sup>7</sup> See I.R.C. § 2032A(c)(1).
- <sup>8</sup> Ltr. Rul. 8731001, March 19, 1987.
- <sup>9</sup> 1988-2 C.B. 330.
- <sup>10</sup> See *Rev. Rul. 68-226*, 1968-1 C.B. 362.
- <sup>11</sup> *Rev. Rul. 73-428*, 1973-2 C.B. 303.
- <sup>12</sup> *Rev. Rul. 88-78*, 1988-2 C.B. 330.
- <sup>13</sup> H.R. Rep’t No. 1380, 94th Cong., 2d Sess. 24 (1976).
- <sup>14</sup> *Rev. Rul. 88-78*, 1988-2 C.B. 330.
- <sup>15</sup> Ltr. Rul. 9035007, May 25, 1990.
- <sup>16</sup> 1988-2 C.B. 330.
- <sup>17</sup> Ltr. Rul. 9035007, May 25, 1990.
- <sup>18</sup> 1988-2 C.B. 330.
- <sup>19</sup> 98-1 U.S. Tax Cas. (CCH) ¶ 60,307 (D. N.J. 1997).
- <sup>20</sup> *Id.*
- <sup>21</sup> See *Rev. Rul. 88-78*, 1988-2 C.B. 330; Ltr. Rul. 9035007, May 25, 1990.

## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

### BANKRUPTCY

#### GENERAL-ALM § 13.03.\*

**AUTOMATIC STAY.** The debtor had purchased a pickup with an installment loan from a creditor. When the debtor defaulted on the loan, the creditor obtained a judgment. One day after the debtor filed for bankruptcy,

the creditor obtained a repossession title to the pickup but did not obtain possession. The creditor refused to relinquish the title when informed about the bankruptcy filing and the court held that retention of the repossession title violated the automatic stay. *In re Carrigg*, 216 B.R. 303 (Bankr. 1st Cir. 1998).

**PREFERENTIAL TRANSFERS.** In September 1995 a creditor filed an action on a debt against the debtor. In February 1996, the creditor obtained a judgment for the