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"STACKING" DEDUCTIONS FOR SPECIAL USE VALUATION AND MINORITY DISCOUNT

— by Neil E. Harl*

Farm and ranch businesses for many years have been eligible for discounts for minority interest and for non-marketability.[1] Since 1976, farmland used in a business has been eligible for special use valuation at death for federal estate tax purposes.[2] The question has been whether the two types of discounts could both be claimed with respect to the same property.

Nature of the discounts

A discount for minority interest and for non-marketability, often between 20 and 30 percent, has been allowed for stock interests in many closely held corporations including farm and ranch corporations.[3] Undivided interests held as community property[4] or in co-ownership such as tenancy in common[5] have also been subject to a substantial discount, often in the range of 15 to 20 percent.[6]

The discount for special use valuation has been limited to a maximum reduction (of the gross estate) of $750,000.[7] The actual reduction in value depends upon the outcome of the cash rent capitalization formula[8] or the five-factor formula for valuation.[9] A 30 to 60 percent discount has been possible in recent years with even greater discounts in the 1970s.[10]

Can both sets of discounts be used?

Until 1989, no formal determination had been made as to whether a discount could be obtained for a minority interest and for non-marketability in addition to the reduction in value based on special use valuation. It had been generally believed that such "stacking" of discounts was not permissible and in that year the Tax Court decided a case confirming that outcome.[11] In that case, *Estate of Maddox*,[12] the Tax Court held that for stock valued at a discount by virtue of special use valuation, a minority discount was not also available.[13]

In the 1994 case of *Estate of Hoover*,[14] the Tax Court again confirmed that position in denying an attempted 30 percent minority discount for a 26 percent interest in a limited partnership engaged in cattle ranching followed by special use valuation of the land.[15] However, that decision has been reversed on appeal with the Tenth Circuit Court of Appeals holding that both sets of discounts may be available if the special use valuation limit of $750,000 has been reached.[16] In *Hoover*, the estate had first subtracted the $750,000 maximum reduction of gross estate and then applied the minority interest discount.

The court in *Hoover* noted that the earlier *Maddox* case[17] had not involved the $750,000 limit on special use valuation. The appellate court distinguished *Hoover* from *Maddox* and held that "a proper determination of fair market value necessarily must consider the decedent's minority interest and discount for it."[18] Thus, the discount for minority interest and non-marketability should first be applied to determine fair market value and the special use valuation reduction in gross estate (up to $750,000) could be claimed.

With that reasoning, an estate electing special use valuation could first reduce fair market value by the amount of the discount for minority interest and for non-marketability and then take the lesser of special use value or the value produced by the discount for minority interest and non-marketability. In the event special use value was more than $750,000 below the "fair market value" set by the discount for minority interest and non-marketability, the special use value reduction would be limited to the $750,000 figure. In that situation, the estate would receive the benefit of both discounts. Otherwise, if the $750,000 minimum reduction of the gross estate was not at issue, the estate could claim the lesser of the special use value or the value after claiming the discount for minority interest and non-marketability.

Another factor to consider

In analyzing the availability of the two separate sets of discounts, it is important to note that special use value applies only to land and not to value represented by machinery, equipment or livestock. The discount for minority interest and non-marketability applies to ownership interests regardless of the nature of the underlying property. Therefore, the portion of value attributable to non-real estate should arguably be eligible for a minority interest and non-marketability discount even though the land is valued under special use valuation.

To date, neither IRS nor the courts have recognized that distinction.

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FOOTNOTES

[1] See generally 8 Harl, *Agricultural Law* § 58.05[2][c] (1995); Harl, *Agricultural Law Manual* § 7.02[5][d] (1995).

[2] See generally 5 Harl, *Agricultural Law* § 43.03[2] (1995); Harl, *Agricultural Law Manual* § 5.03[2] (1995).

[3] See Est. of Ford v. Comm'r, T.C. Memo. 1993-580, *aff'd*, 53 F.3d 924 (8th Cir. 1995) (20 percent discount for minority interest and 10 percent for non-marketability; net asset value methodology used); Luton v. Comm'r, T.C. Memo. 1994-539 (10, 15 and 20 - percent discounts allowed for different corporations for non-marketability; 20 percent discount allowed for one-third minority interest in one corporation in addition to 15 percent lack of marketability discount); Est. of Frank v. Comm'r, T.C. Memo. 1995-132 (discounts allowed for minority ownership and lack of marketability in closely-held family corporation). See also Est. of Berg v. Comm'r, T.C. Memo. 1991-279, *aff'd on these issues*, 976 F.2d 1163 (8th Cir. 1992) (estate entitled to 20 percent minority discount and 10 percent for lack of marketability for 26.9 percent interest in closely-held real estate holding company).

[4] Propstra v. U.S., 680 F.2d 1248) (9th Cir. 1982).

[5] See, e.g., Est. of Youle v. Comm'r, T.C. Memo. 1989-138 (discount of 12-1/2 percent allowed for tenancy in common ownership); Est. of Cervin v. Comm'r, T.C. Memo. 1994-550, *appeal docketed*, 5th Cir. August 31, 1995) (20 percent discount allowed for 50 percent interest in farm and homestead). But see Ltr. Rul. 9336002, May 28, 1993 (discount should be limited to cost of partitioning property).

[6] See, e.g., Est. of Pittsbury v. Comm'r, T.C. Memo. 1992-425 (15 percent discount allowed for undivided 77 percent and 50 percent interests in real estate).

[7] I.R.C. § 2032A(a)(2).

[8] I.R.C. § 2032A(e)(7). See 5 Harl, *supra* n. 2, § 43.03[2][b].

[9] I.R.C. § 2032A(e)(8). See 5 Harl, *supra* n. 2, § 43.03[2][c].

[10] See Hartley, "Final Regs. Under 2032A: Who, What and How to Qualify for Special Use Valuation," 53 *J. Tax.* 306, 308 (1980) (range from 29 percent to 76 percent by IRS District).

[11] Est. of Maddox v. Comm'r, 93 T.C. 228 (1989).

[12] *Id.*

[13] See Ltr. Rul. 9119008, Jan. 31, 1991.

[14] 102 T.C. 777 (1994).

[15] *Id.*

[16] Hoover v. Comm'r, 68 F.3d 1044 (10th Cir. 1995).

[17] *Supra* n. 11.

[18] *Supra* n. 16.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

AUTOMATIC STAY. The debtors farmed land leased from a related person on a 60/40 crop share basis. The land owner had a mortgage against the farm under a note co-signed by the debtors and the debtors had made all the payments on the note. The debtors' Chapter 12 plan provided for payment of the note in full. The lender initiated a foreclosure action against the land owner without first seeking relief from the automatic stay. The court held that, although it would have been prudent for the lender to first seek relief from the automatic stay, the foreclosure suit did not violate the stay because the suit was against a nondebtor and would not affect the debtors' rights under the lease. ***In re* Smith, 189 B.R. 11 (Bankr. C.D. Ill. 1995)**.

CLAIMS. A secured creditor had obtained a pre-petition judgment of foreclosure against the debtor but the foreclosure sale was stayed by the debtor's bankruptcy petition. The Bankruptcy Court set a bar date for creditors' claims and the order required all disputed claims to be filed by the bar date and made all creditors responsible for verifying the accuracy of claims filed by the debtor. The creditor obtained relief from the automatic stay and proceeded with the foreclosure sale. Once the sale was completed and the deficiency amount determined, the creditor finally filed a claim, more than one month after the claims bar date. The creditor sought approval for the late filing under Bankr. Rules 9006(b)(1) for excusable neglect or 3003(c)(3) for good cause. The Bankruptcy Court held that the late filing was allowed under Rule 3003 because the delay in filing was caused by the creditor's waiting for the foreclosure sale to be completed in order to determine the amount of the claim. The District Court reversed, holding that Rule 3003 could not be used to allow the late filing, under *Pioneer Inv. Services v. Brunswick, 507 U.S. 380 (1993)*. In addition, the District Court held that the creditor did not comply with the Rule 9006 excusable neglect standard because the creditor intentionally delayed the claim filing until after the foreclosure sale. **Agribank v. Green, 188 B.R. 982 (C.D. Ill. 1995)**.

ENVIRONMENTAL CLEANUP COSTS. The debtor had operated a trucking business at a facility leased from a creditor. The lease provided that the debtor was responsible for any costs of cleaning up environmental damage caused by the debtor during the lease. After the debtor filed for bankruptcy, the lease was rejected by the debtor and the landlord had the property inspected for environmental damage. The state (New Jersey) environmental quality agency required a number of cleanup actions and the landlord sought recovery of those costs as administrative expenses. The court held that the cleanup costs were not entitled to administrative priority because the costs were incurred post-petition and the environmental hazards were not an imminent hazard to public health and safety. ***In re* McCrory Corp., 188 B.R. 763 (Bankr. S.D. N.Y. 1995)**.

EXEMPTIONS

IRA. The debtor claimed a federal exemption for the debtor's interest in an IRA. The trustee objected to the exemption on the basis that the debtor was not entitled to