



Agricultural Law Press
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Agricultural Law Digest

Volume 23, No. 15

July 27, 2012

ISSN 1051-2780

Revised Rules for Post-Death Maneuvering of Value

-by Neil E. Harl*

On November 18, 2011, the Department of the Treasury issued proposed regulations¹ withdrawing the proposed regulations issued April 25, 2008² which were designed to combat post-death maneuvering of value in utilizing the alternate valuation date approach to federal estate tax valuation.³ The issue had arisen because of the strategy employed in *Kohler, Jr. v. Commissioner*⁴ by which a corporate reorganization after death was used to reduce the value of the estate from \$144.5 million to \$47 million.

The Tax Court had refused to follow *Flanders v. United States*⁵ which had blocked such strategies in the past. The *Flanders* case⁶ involved a decrease in value of farmland resulting from the trustee's post-death execution of an agreement under the Williamson Act which required that the land use remain in agriculture for at least 10-years. In exchange, the landowners were to receive a reduction in property taxes.⁷ The strategy, had it been successful, would have reduced the fair market value of \$220,000 to \$30,000 for an 86 percent reduction in value.⁸ The District Court in *Flanders* held that the decrease in value was not includible in calculations of the land on the alternate valuation date and the full fair market value was accepted as the alternate valuation figure.⁹

The 2008 proposed regulations

The 2008 regulations were issued in proposed form ostensibly to reconcile those different interpretations of the provision authorizing the alternate valuation method of valuing property at death if several requirements are met.¹⁰ The 2008 proposed regulations, which were made effective on or after April 25, 2008, would have made it clear that estates were allowed to use the alternate valuation method “. . . to the extent that the change in value during the alternate valuation period is the result of market conditions.”¹¹ The term “market conditions” was defined as “events outside of the control of the decedent (or the decedent's executor or trustee) or other person whose property is being valued that affect the fair market value of the property being valued.”¹² The proposed regulations went on to state that changes in value attributable to mere lapse of time “or other post-death events other than market conditions” *would be ignored* in determining the value of the decedent's gross estate under the alternate valuation method.¹³

The term “post-death events” included a reorganization of an entity in which the estate held an interest, a distribution of cash or other property to the estate from such an entity or one or more distributions by the estate of a fractional interest in such an entity.¹⁴ One of the

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examples in the proposed regulations detailed a post-death corporate reorganization that mirrored *Kohler, Jr. v. Commissioner*.¹⁵ One example was included in the 2008 proposed regulations which made the point that a mere reduction in property values during the alternate valuation period (up to six months after death) continued to be acceptable under the alternate valuation rules.¹⁶

The 2011 proposed regulations

Under the 2011 proposed regulations, if property in an estate is subject to a distribution, sale, exchange or disposition during the alternate valuation period, the estate must value the property on the transaction date with the value included in the gross estate being the fair market value of the property on the date of *and immediately prior* to the transaction.¹⁷ Two exceptions are identified to that general rule –

1. If, during the alternate valuation period, an interest in an entity includible in the gross estate is exchanged for a different interest in the same entity, or in an acquiring or resulting entity, and if the fair market value of the interest on the date of the exchange equals the fair market value of the property for which it was exchanged, the transaction is not treated as an “exchange.”¹⁸ For this purpose, fair market values are considered to be equal if the difference does not exceed five percent as of the transaction date.

2. If, during the alternate valuation period, an estate receives a distribution from a business entity, bank account or retirement trust, and an interest in that entity is includible in the decedent’s gross estate, the estate may use the six-month date for valuing the property held in the estate if the fair market value of the interest in the entity includible in the gross estate immediately before the distribution equals the sum of the fair market value of the distributed property on the date of distribution and the fair market value of the interest in the entity includible in the gross estate immediately after the distribution.¹⁹ If that requirement is not satisfied, the estate must use the fair market value as of the distribution date and immediately prior to the distribution of the entire interest in the entity includible in the gross estate.

The Proposed Regulations may be justified on the merits of what the Department of the Treasury wants to accomplish but it is clear that it has been at the expense of clarity and simplicity.

ENDNOTES

¹ 76 Fed. Reg. 71491-71498, Nov. 18, 2011.

² NPRM REG-112196-07, April 25, 2008, 73 Fed. Reg. 22300, which would have amended Treas. Reg. § 20.2032-1, Prop. Treas. Reg. § 20.2032-1(f), under I.R.C. § 2032(a).

³ I.R.C. § 2032. See generally 5 Harl, *Agricultural Law* § 43.03[1] (2012); Harl, *Agricultural Law Manual* § 5.03[1] (2012). See also Harl, “IRS Proposes Change to Combat Post-Death Maneuvering of Value,” 19 *Agric. L. Dig.* 65 (2008).

⁴ T.C. Memo. 2006-152, *non-acq.*, I.R.B. 2008-9, AOD 2008-01.

⁵ 346 F. Supp. 95 (N.D. Calif. 1972).

⁶ *Id.*

⁷ See California Land Conservation Act of 1965, Calif. Gov’t Code § 51,200 (popularly known as the “Williamson Act”).

⁸ *Flanders v. United States*, 346 F. Supp. 95 (N.D. Calif. 1972) (the court opinion referred to an 88 percent reduction in value but the figures appear to support only an 86 percent reduction in value).

⁹ *Id.*

¹⁰ I.R.C. § 2032.

¹¹ Prop. Treas. Reg. § 20.2032-1(f)(1).

¹² *Id.*

¹³ *Id.*

¹⁴ Prop. Treas. Reg. § 20.2032-1(f)(3).

¹⁵ T.C. Memo. 2006-152, *non-acq.*, I.R.B. 2008-9, AOD 2008-01.

¹⁶ Prop. Treas. Reg. § 20.2032-1(f)(3)(ii), Example 2.

¹⁷ Prop. Treas. Reg. § 20.2032-1(c)(1)(i).

¹⁸ Prop. Treas. Reg. § 20.2032-1(c)(1)(ii).

¹⁹ Prop. Treas. Reg. § 20.2032-1(c)(1)(iii)(A).



FARM ESTATE AND BUSINESS PLANNING

by Neil E. Harl

The Agricultural Law Press is honored to publish the completely revised and updated 16th Edition of Dr. Neil E. Harl’s excellent guide for farmers and ranchers who want to make the most of the state and federal income and estate tax laws to assure the least expensive and most efficient transfer of their estates to their children and heirs.

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