



Agricultural Law Press

Publisher/Editor

Robert P. Achenbach, Jr.

Contributing Editor

Dr. Neil E. Harl, Esq.

* * * *

Issue Contents

Bankruptcy

Chapter 12

Legislation **114**

Plan **114**

Secured claims **115**

Contracts

Hedge-to-arrive contracts **115**

Federal Agricultural Programs

Crop insurance **115**

Farm programs **115**

Tuberculosis **115**

Federal Estate and Gift Tax

Charitable deduction **116**

Disclaimer **116**

Gifts **116**

Federal Income Taxation

Bad debt deduction **116**

C corporation

Shareholder basis **116**

Children **117**

Depreciation **117**

Disaster losses **118**

Discharge of indebtedness **118**

Education IRA **118**

Home office **118**

Income **118**

Installment sales **119**

Mileage expenses **119**

S corporations

Passive activity losses **119**

Sale of farm real property **119**

Sale of real property **119**

Social security benefits **119**

Theft loss **119**

Agricultural Law Digest

Volume 14, No 15

August 8, 2003

ISSN 1051-2780

Cash Renting After Death:

A Problem for Installment Payment of Federal Estate Tax?

— by Neil E. Harl*

Ordinarily, land that is cash rented after death which is subject to an election to pay federal estate tax in installments¹ is considered “distributed, sold, exchanged, or otherwise disposed of”² and the deferred tax is accelerated if the value of assets involved (plus all previous distributions, sales or disposition of assets after death) equals 50 percent or more of the date-of-death value of the interest in a closely-held business which qualified for installment payment.³ However, a recent private letter ruling⁴ has allowed cash renting of farmland after death without acceleration being triggered.

General rule on cash renting

The rule is well established that assets which are cash rented after death cease to be an “interest in a closely-held business” which is necessary in order to maintain continuing eligibility for installment payment of federal estate tax and to avoid acceleration.⁵ Indeed, a 1983 private letter ruling⁶ specifically so held. It has generally been thought that, to avoid acceleration, it was necessary for the lessor of the asset or assets to be bearing the risks of production and the risks of price change with evidence that there was some involvement in management, albeit short of material participation.⁷

The 2003 ruling

In *Ltr. Rul. 200321006*,⁸ the Internal Revenue Service ruled that a cash rent lease did not accelerate the deferred tax or count against the 50 percent that would lead to acceleration.⁹ In the facts of that ruling, a farmer who had been operating as a sole proprietorship and who had been actively involved in farming operations until the date of death, left a will leaving a majority of the decedent’s assets to a residuary trust with three primary beneficiaries.¹⁰ The beneficiaries were two sons and a third individual (unrelated) who had been raised by the decedent. The decedent’s will authorized the trust to lease portions of the land to the trust beneficiaries provided the beneficiaries were to operate the farm personally.¹¹ The will further provided that, in the event the trust beneficiaries (individually or in combination) were the sole owners of the farming entity, a lease to the entity was authorized.¹² Accordingly, the trust entered into cash rent leases with limited liability companies set up specifically by two of the beneficiaries.

Ordinarily, such post-death cash rent leases have been the occasion for acceleration of federal estate tax.¹³ However, in this instance the limited liability companies had single owners and, therefore, were considered disregarded entities.¹⁴ As a result, the rental

* Charles F. Curtiss Distinguished Professor in Agriculture and Professor of Economics, Iowa State University; member of the Iowa Bar.

arrangement was considered a lease directly to the respective heir and did not result in acceleration.¹⁵ The arrangement was viewed as not materially altering the business.¹⁶

The ruling cites to Rev. Rul. 66-62¹⁷ as authority. That ruling involved the change from a corporation to an unincorporated form with IRS holding that the transformation did not materially alter the business.¹⁸

Lease by residuary trust

The interesting question is why the ruling did not discuss in more detail the fact situation as involving a cash rent lease by the residuary trust. The rule is well established that a cash rent lease, even to a family member of the decedent, fails the test of being a business.¹⁹ Thus, a cash rent lease directly to a family member as heir would ordinarily be expected to trigger acceleration. The distinction is that a cash rent lease to the owner is not considered the same as a cash rent lease to a family member.²⁰

The important point is that it is the lessor that is expected to maintain the assets involved as a business.²¹ As the lessor, the residuary trust seemingly failed to meet that requirement.

There has been an exception, at least in the pre-death qualification period, for trusts that were grantor trusts²² which was not the case in the 2003 letter ruling. Obviously, a residuary trust is not a grantor trust. It is noted that the residuary trust in question had three beneficiaries, only one of which was the lessee. Thus, it would appear that the trust was no longer meeting the "business" requirement in the period during which acceleration could occur.²³

In conclusion

Care is needed for all post-death leasing, entity transformations or other distributions, sales or dispositions. The latest ruling²⁴ should be used carefully as authority. It provides only limited authority for post-death cash rent leasing of assets subject to an election to pay federal estate tax in installments. The safe approach is to assure that the post-death owner of the assets,

including a trust, meets a "business" test during the entire period during which acceleration could occur.

FOOTNOTES

¹ I.R.C. § 6166. See generally 5 Harl, *Agricultural Law* § 42.05 (2003); Harl, *Agricultural Law Manual* § 5.05[1] (2003).

² See Treas. Reg. § 20.6166A-3(e)(2).

³ I.R.C. § 6166(g)(1)(A).

⁴ Ltr. Rul. 200321006, Feb. 12, 2003.

⁵ See I.R.C. § 6166(g)(1)(A).

⁶ Ltr. Rul. 8339023, June 24, 1983.

⁷ See 5 Harl, *supra* note 1, § 41.06[1].

⁸ February 12, 2003.

⁹ See I.R.C. § 6166(g)(1)(A).

¹⁰ Ltr. Rul. 200321006, Feb. 12, 2003.

¹¹ *Id.*

¹² *Id.*

¹³ See note 6 *supra* and accompanying text.

¹⁴ See Ltr. Rul. 9911033, Dec. 18, 1998.

¹⁵ Ltr. Rul. 200321006, Feb. 12, 2003.

¹⁶ *Id.*

¹⁷ 1966-1 C.B. 272.

¹⁸ *Id.*

¹⁹ See note 6 *supra*.

²⁰ Ltr. Rul. 200321006, Feb. 12, 2003.

²¹ See I.R.C. § 6166(g).

²² Ltr. Rul. 7747007, Aug. 19, 1977; Ltr. Rul. 8132027, May 1, 1981 (leasing under crop share lease); Ltr. Rul. 9422052, March 9, 1994. See Ltr. Rul. 200006034, Nov. 12, 1999 (assets in grantor trust eligible; decedent actively involved in business).

²³ I.R.C. § 6166(g)(1)(A).

²⁴ Ltr. Rul. 200321006, Feb. 12, 2003.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

LEGISLATION. The U.S. Senate has passed an extension to December 31, 2003, of Chapter 12 retroactive to July 1, 2003. The President is expected to sign the legislation.

PLAN. A third level mortgagee reached an agreement with the Chapter 12 debtor as to payment of the creditor's claim. The agreement was included in a plan presented for confirmation; however, the plan was not confirmed because of other difficulties.

An amended plan was presented and the creditor assumed that the original terms were included. Most of the terms were included but the date of the first payment was changed to just over one year later. The creditor did not attend the confirmation hearing and did not object to the amended plan until after the plan was confirmed. The court noted that the later payment date was not consistent with the other terms of the plan and the revision of the payment date would not prejudice the debtor because the plan had provided sufficient funds for the earlier payment date. Therefore, the court held that the failure of the creditor to object to the plan was excusable neglect and the plan would be amended to conform to the original agreement. *In re Hunt*, 293 B.R. 191 (Bankr. C.D. Ill. 2003).