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Cash Renting Land: Eligibility for 15-Year Installment Payment, the Family-Owned Business Deduction and Special Use Valuation

-by Neil E. Harl*

For several years, the rules governing the cash rental of land to a family-owned entity for purposes of 15-year installment payment of federal estate tax,¹ the family-owned business deduction² and special use valuation³ have been developed and refined with distinctive differences among the three provisions for which guidance is often sought. A private letter ruling, released in May of 2005, has addressed the availability of the three provisions in the context of a unique fact situation⁴ and, in the process, has introduced some confusion into the fairly clear guidance in existence.

Facts of the letter ruling

The ruling in question, dated January 14, 2005, involved an automobile dealer, the decedent, who had formed two corporations to carry on retail automobile dealerships.⁵ The decedent continued to be involved in the day-to-day operations of both corporations until the time of his death.⁶ All of the stock in the two corporations had been transferred to a trust of which the decedent was the sole beneficiary for his life.⁷

In addition, the decedent continued to own two tracts of real property on which the dealerships were conducted.⁸ Apparently, the tracts of real property were rented to the respective corporations under cash rent leases.

Eligibility for installment payment of federal estate tax

The ruling first addresses the eligibility of the assets for 15-year installment payment of federal estate tax.⁹ The ruling finds that the decedent was carrying on two trades or businesses through the corporations and because 100 percent of the stock was owned by the decedent's trust, the interests are deemed to be interests in a single closely-held business.¹⁰ Interestingly, the ruling cites *Rev. Rul. 75-366*¹¹ as authority for treating the corporations as trades or businesses. That 1975 Revenue Ruling involved a crop-share lease farming operation wherein the ruling concludes that the decedent was carrying on a trade or business because the decedent was significantly involved in the farming operation under the lease through participation in management.

The 2005 ruling then turns to the two tracts of real property which were apparently cash rented to the corporations and concludes that the decedent was carrying on a sole proprietorship.¹² Because the tracts of land were "necessary and essential to carry out the day-to-day operations" of the dealership corporations, the two land tracts were treated as part of the single trade or business with the corporations and the land tracts comprising that single trade or business.¹³

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Family-owned business deduction

The ruling concludes that the land tracts were “integral to the business operations” of the dealership corporations and were “qualified family-owned business interests” and thus were eligible for the family-owned business deduction.¹⁴ The ruling goes on to discuss the “qualified use” test¹⁵ under special use valuation and the fact that there is a similar requirement under the family-owned business deduction. The ruling, in a highly confusing passage, then reverts to the rules under I.R.C. § 6166, and states –

Directly owned real property that is leased by a decedent to a separate closely held business is considered to be qualified real property, but only if the separate business qualifies as a closely held business under § 6166(b)(1) with respect to the decedent on the date of his or her death and for sufficient other time (combined with period during which the property was operated as a proprietorship) to equal at least 5 years of the 8 years preceding death. For example, real property owned by the decedent and leased to a farming corporation or partnership owned and operated entirely by the decedent and fewer than 15 members of the decedent’s family is eligible for special use valuation.

First, that passage states that the § 6166 tests include a requirement that the tests must be met for five or more of the last eight years before death.¹⁶ The problem is that there is no such requirement. The Section 6166 tests are point-of-death tests. The second and final sentence of the above passage states that real property “leased to a farming corporation or partnership owned and operated entirely by the decedent and fewer than 15 members of the decedent’s family is eligible for special use valuation.”¹⁷ The law is well settled that real property cash rented to a member of the decedent’s family as tenant or an entity wholly owned by members of the family as tenant, at the time of death and for five or more of the last eight years before death, is eligible for special use valuation. There is no requirement that limits tenant entities to fewer than 15 members of the decedent’s family. The passage in the ruling is highly misleading and incorrect.

Special use valuation

The ruling¹⁸ states, without much further elaboration, that the tracts of land in question would be eligible for special use valuation under I.R.C. § 2032A. Although the ruling does not so state, the only special use valuation provision that would be available to an automobile dealership would be the five-factor formula.¹⁹

It is important to note that the rental of the land was apparently at a fixed rental, but the saving element was that the land was being used in a closely-held business.²⁰

Conclusion

The one conclusion that can be drawn from the ruling²¹ is that assets leased at a fixed cash rental may be eligible for 15-year installment payment of federal estate tax if the assets were used as an integral part of a trade or business in which the decedent was involved. That could be useful authority in farm and ranch

operations structured with the land rented to the production entity.

FOOTNOTES

¹ I.R.C. § 6166. See generally 5 Harl, *Agricultural Law* § 42.05 (2005); Harl, *Agricultural Law Manual* § 5.05[1] (2005).

² I.R.C. § 2057. See generally 5 Harl, *Agricultural Law* § 44.03 (2005); Harl, *Agricultural Law Manual* § 5.04[7] (2005).

³ I.R.C. § 2032A. See generally 5 Harl, *Agricultural Law* § 43.03[2] (2005); Harl, *Agricultural Law Manual* § 5.03[2] (2005).

⁴ See Ltr. Rul. 200518011, Jan. 14, 2005.

⁵ Ltr. Rul. 200518011, Jan. 14, 2005.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ I.R.C. § 6166.

¹⁰ Ltr. Rul. 200518011, Jan. 14, 2005.

¹¹ 1975-2 C.B. 472.

¹² Ltr. Rul. 200518011, Jan. 14, 2005.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ I.R.C. § 2032A(b)(2).

¹⁶ Ltr. Rul. 200518011, Jan. 14, 2005.

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ I.R.C. § 2032A(e)(8).

²⁰ See *Heffley v. Comm’r*, 884 F.2d 279 (7th Cir. 1989) (farmland was not eligible for special use valuation because rented for fixed rental and was not used in closely-held business).

²¹ Ltr. Rul. 200518011, Jan. 14, 2005.

AALA ANNUAL AGRICULTURAL LAW SYMPOSIUM

The American Agricultural Law Association is holding its annual Agricultural Law Symposium on October 7 & 8, 2005 at the Country Club Plaza Marriott in Kansas City, MO. New this year is 165 minutes of farm and ranch taxation presentations on Friday, October 7. The presentations will be made by Neil E. Harl, Roger A. McEowen and Phil Harris. A special “Friday only” registration is offered to allow tax professionals to attend the Friday tax presentations without having to attend both days. More information can be found on the AALA web site <http://www.aglaw-assn.org> or by contacting Robert Achenbach, AALA Executive Director at RobertA@aglaw-assn.org or by phone at 541-485-1090.