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## Misleading Rulings Holding No Recapture on Possible Cash Rent Lease After Special Use Valuation Election

-by Neil E. Harl\*

For those who elect special use valuation for farmland at death for federal estate tax purposes,<sup>1</sup> one of the major concerns is the possibility of recapture in the after-death period.<sup>2</sup> Four almost identical letter rulings, issued in 2011, have provided further guidance on the relevant authority governing post-death recapture.<sup>3</sup> Unfortunately, the rulings cite approvingly to two Court of Appeals decisions,<sup>4</sup> both of which have been roundly criticized as improperly approving post-death cash rent leasing at the time of those cases.<sup>5</sup> To complicate matters further, an amendment in 1997, retroactive to December 31, 1976, expanded the opportunity to receive cash rentals on special use valued land after death.<sup>6</sup> That aspect is not mentioned in the 2011 rulings.<sup>7</sup>

### The facts of the four 2011 letter rulings

The complicated facts involved a decedent who left farmland to four children some of whom disclaimed interests in the farmland in favor of trusts. The trusts planned to transfer property interests to four limited liability companies which in turn were to lease the land to a partnership owned by family members. As the ruling states,

“Pursuant to the terms of each proposed lease, each LLC will lease its undivided interest in Farm to Partnership for agricultural purposes, specifically to be used for farming purposes. Partnership will agree to pay each LLC a sum certain per annum or a certain percentage share of the crops grown per annum. The decision to pay either a fixed cash rent or to pay rent based on a percentage of crops grown on Farm shall be made solely by partnership.”

IRS first ruled that the transfer of the undivided interests in the farmland by the trusts to the LLCs would not be treated as a disposition of the trust beneficiaries’ interests in the farmland, inasmuch as the transfers were to family members who were eligible to be treated as qualified heirs. All of the grandchildren and spouses involved in the transfers were family members and the owners of interests in the LLCs (through the trusts) as transferees were represented as executing an agreement to be liable for any additional estate tax on recapture.

The second ruling was that the payment by the partnership annually as rent on the land could be either a sum certain (a cash rent amount) or a certain percentage of crops grown (a share rent amount of each crop) with that decision resting solely with the partnership.

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The justification given for that conclusion was the holding in *Gavin v. United States*,<sup>8</sup> which involved a choice by the son leasing the farmland from the other children of the decedent to pay either a cash rent of \$10,000 or a 50 percent share of the crops. The problem with that case was that, at the time, with two exceptions *cash rents were not permitted in the recapture period by one qualified heir to another qualified heir*. It was clear at the time (1990 to 1992) that cash rental of land, even to a member of the qualified heir's family in the post-death period caused recapture of special use valuation benefits<sup>9</sup> except for the two-year grace period immediately following death<sup>10</sup> and, since 1988, cash rental by a surviving spouse to a member of the surviving spouse's family.<sup>11</sup>

The 1997 amendment,<sup>12</sup> added a provision that cash rent leasing was permissible in the post-death period by a lineal descendant of the decedent to a member of the family of the lineal descendant,<sup>12</sup> which would have embraced the fact pattern in the four letter rulings, but that statutory amendment *was not even mentioned in the rulings*.<sup>13</sup> Instead, the authors of the ruling cited to a case that was thoroughly discredited and ignored the statutory amendment that would have provided clear authority for the holding in the four rulings.

The impression left by the rulings is that any cash renting is permissible in the post-death period with qualified heirs and the reality is that, except for the special rule for surviving spouses,<sup>14</sup> only lineal descendants of the decedent renting to members of the lineal descendant's family can properly cash rent land without recapture consequences. The term "qualified heir"<sup>15</sup> is much broader than "a lineal descendant of the decedent renting to a member of the lineal descendant's family."<sup>16</sup>

#### In conclusion

It would be unwise to rely on the language in the four rulings. Decisions on cash renting in the post-death period are governed by the statute<sup>17</sup> and not by *Gavin v. United States*<sup>18</sup> which was incorrectly decided and its authority has not improved since 1997.

#### ENDNOTES

<sup>1</sup> I.R.C. § 2032A. See generally 5 Harl, *Agricultural Law* § 43.03[2] (2011); Harl, *Agricultural Law Manual* § 5.03[2] (2011). See also Harl, "Post-Death Cash Rent Leasing: One More Time," 8 *Agric. L. Dig.* 89 (1997).

<sup>2</sup> I.R.C. § 2032A(c).

<sup>3</sup> Ltr. Rul. 201129016, April 6, 2011; Ltr. Rul. 201129018, April 6, 2011; Ltr. Rul. 201129019, April 6, 2011; Ltr. Rul. 201129020, April 6, 2011.

<sup>4</sup> *Gavin v. United States*, 113 F.3d 802 (8th Cir. 1997); *Minter v. United States*, 19 F.3d 426 (8th Cir. 1994).

<sup>5</sup> See Harl, "Post-Death Cash Rent Leasing: One More Time," 8 *Agric. L. Dig.* (1997).

<sup>6</sup> Tax Reform Act of 1997, Pub. L. No. 105-34, § 504, 111 Stat. 788 (1997), amending I.R.C. § 2032A(c)(7)(E).

<sup>7</sup> See note 3 *supra*.

<sup>8</sup> 113 F.3d 802 (8th Cir. 1997).

<sup>9</sup> See, e.g., *Williamson v. Comm'r*, 974 F.2d 1525 (9th Cir. 1992) (cash rent lease to nephew); *Shaw v. Comm'r*, T.C. Memo. 1991-372 (cash rent lease to son); *Fisher v. Comm'r*, T.C. Memo. 1993-139 (cash rent lease to brother).

<sup>10</sup> I.R.C. § 2032A(c)(7)(A).

<sup>11</sup> I.R.C. § 2032A(c)(7)(E).

<sup>12</sup> See note 6 *supra*.

<sup>13</sup> I.R.C. § 2032A(c)(7)(E).

<sup>14</sup> See note 3 *supra*.

<sup>15</sup> See I.R.C. § 2032A(c)(7)(E).

<sup>16</sup> I.R.C. § 2032A(e)(1).

<sup>17</sup> See I.R.C. § 2032A(c)(7)(E).

<sup>18</sup> I.R.C. § 2032A(c)(7)(E).

<sup>19</sup> 113 F.3d 802 (8th Cir. 1997).

## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

### BANKRUPTCY

No items.

### FEDERAL FARM PROGRAMS

**CROP INSURANCE.** The FCIC has issued proposed regulations amending the Common Crop Insurance Regulations, Onion Crop Insurance Provisions which provide policy changes, clarify existing policy provisions to better meet the needs of insured