



**Agricultural Law Press**

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# Agricultural Law Digest

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## Retained and Granted Life Estates

-by Neil E. Harl\*

Confusion sometimes reigns when mention is made of *granted* life estates and *retained* life estates. The two are quite different,<sup>1</sup> and are governed by different rules. *Retained* life estates usually involve original ownership of property with the decision made to grant another a limited interest for a designated time but with retention of the remaining interest. A *granted* interest is the interest given to another but of less than the entire interest. As an example, the father as owner of a section of farmland purchased the land in 1970 and farmed the land himself but granted to his only child in late 2017 a right to farm the land on his retirement beginning March 1, 2018 until the father's death (or, after his father's death, the granted life estate could become full ownership). That would be a granted life estate to the son. The father would have the remaining interest in the land until his death or until he sold the retained interest or gifted the retained interest to another.

### An interesting example

Three similar examples emerged a few years ago in three different states a couple of hundred miles apart. One of those involved a farmer who had purchased a tract of land in 1927 for \$80,000. He immediately set up the ownership with granted life estates to all of his children and grandchildren. The idea, as I was told, was to avoid probate. At his death, the holder of the most senior holder of a granted life estate would, he believed, merely have to present the documents at the courthouse and become the owner until that person's death. The father had a retained life estate for the duration of his life.

The father died in 1932, which marked the end of his retained life estate, and the first in line heir took over the farm. Incidentally, the farm in question was valued at his death at \$50,000, reflective of the weak land market in the late 1920's and much of the 1930s.

The heirs of the last holder of a granted life estates died in 2010. The immediate question was "what is the value of the farm?" The holder of the granted life estate wanted to sell the property. The additional questions came in quick succession. Was the value for income tax purposes fixed at the time of the death of the grandfather who had died in 1932? Certainly there was no effect from the deaths of the holders of the granted life estates from 1932 to 2010. Deaths of those with granted life estates merely drop their interests from sight, taxwise. None of those with granted life estates had an interest sufficient to obtain a new income tax basis at their deaths. If it had been the holder of the retained life estate who died in 2010, the fair market value of the property at that time would be subject to tax<sup>2</sup> and the property would have received a new income tax basis at that time. The last

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The last individual involved sufficiently to receive a new basis was the grandfather and that happened at his death in 1932. The arguments continued for some time.

### So is a retained life estate a good idea?

It is a good idea to consider carefully, at the time of decision making, every conceivable fact pattern that might emerge before inking any type of granted life estate or retained life estate documents.

The Treasury Regulations now provide guidance, also, on life estates to the donor's spouse,<sup>3</sup> son or daughter,<sup>4</sup> and charitable organizations.<sup>5</sup>

Careful planning is needed to avoid unexpected tax consequences at death, paying particular attention to retained life estates and, of course, the provisions in proposed granted life estates.

### END NOTES

<sup>1</sup> Harl, 1 *Farm Income Tax Manual* § 3.20[5][a][v] (2017). See 8 *Agricultural Law* § 62.02 (2017).

<sup>2</sup> I.R.C. § 2036(a)(1). See Treas. Reg. § 20.2036-1(c)(1)(i).

<sup>3</sup> See I.R.C. § 2036(a).

<sup>4</sup> See I.R.C. § 2036(a); Treas. Reg. § 20.2055-2(e)(2)(ii).

<sup>5</sup> Treas. Reg. 20.2055-2e(2).

## CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

### BANKRUPTCY

#### GENERAL

**MARSHALLING.** The debtors, husband and wife, owned and operated a farm. One bank held a first priority interest in the debtors' homestead and in the proceeds from the sale of the debtors' farm equipment. A second creditor held a second priority interest in only the equipment proceeds. The farm equipment was sold and the second creditor sought to invoke the doctrine of marshaling to require the bank to seek payment from the homestead first, thus allowing the second creditor a priority lien on the equipment proceeds. The bank argued that marshaling would violate Iowa homestead law by unnecessarily invading property that is otherwise exempt from the second creditor's collection efforts. The court stated that there were three elements necessary to support a claim for marshaling: (1) the existence of two creditors with a common debtor; (2) the existence of two funds belonging to the common debtor; (3) the legal right of one of the creditors to satisfy its claim from either of the two funds, and the legal right of the other creditor to satisfy its claim from only one of the funds. Both creditors agreed that all three elements were met in this case. The court noted, however, that the doctrine also requires the court to apply the doctrine equitably as to all parties. Thus, marshaling would not be appropriate if it inequitably affects the debtors' homestead rights. The second creditor claimed that, under Iowa Code § 561.16, the bank would be able to recover from the homestead because the homestead lien and equipment lien were created by separate loan contracts. Iowa Code § 561.16 provides in part: "The homestead may be sold to satisfy debts of each of the following classes: . . . 2. Those created by written contract by persons having the power to convey, expressly stipulating that it shall be liable, but then only for a deficiency remaining after exhausting all other property

pledged by the same contract for the payment of the debt." The court rejected this reasoning because, if the loans were considered separate contracts, then the third element supporting marshaling would no longer be met. Therefore, the court held that marshaling of the bank's liens would not be required. *In re Schantz, 2017 Bankr. LEXIS 2207 (Bankr. N.D. Iowa 2017)*.

#### CHAPTER 12

**DISMISSAL.** The debtor filed for Chapter 12 in June 2016 and a Chapter 12 plan was to be filed by September 12, 2016. On September 9, 2016, the debtor filed for an extension of time to file the plan because of problems with the debtor's farm irrigation and well. An extension to October 12, 2016 was granted, but the debtor filed for another extension on October 12, 2016 because of an illness in the debtor's family. The second extension was denied. However, the debtor filed a plan on October 17, 2016 which proposed to pay secured creditors interest-only payments on an annual basis in an aggregate amount of about \$50,000 per year for five years. The debtor disclosed that the plan assumed the receipt of disaster relief funds or agricultural loan proceeds that would enable the debtor to install new well pumping equipment necessary in order to restore the debtor's ability to irrigate the farm with well water. The Bankruptcy Court refused to consider the plan as untimely filed and ordered the dismissal of the case "for cause." Section 1221 provides that "the debtor shall file a plan not later than 90 days after the order for relief under this chapter, except that the court may extend such period if the need for an extension is attributable to circumstances for which the debtor should not justly be held accountable." The appellate court vacated and remanded the Bankruptcy Court decision because the Bankruptcy Court did not explain what standard it used to deny the extension. Thus, the appellate court ordered the case to be remanded to the Bankruptcy Court for explanation of the standard used. *In re Davis, 2017 Bankr. LEXIS 2169 (9th Cir. 2017)*.