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POST-DEATH CASH RENT LEASING: ONE MORE TIME

— by Neil E. Harl*

The law on cash rent leasing of farmland subject to special use valuation has been clear for nearly a decade.[1] Other than for the two-year grace period immediately following death[2] and the 1988 amendment allowing cash rent leases by a surviving spouse to a member of the surviving spouse's family,[3] cash rent leasing by a qualified heir in the post-death period causes recapture of special use valuation benefits.[4]

Gavin v. United States

Notwithstanding the crystal clear rule, the Eighth Circuit Court of Appeals decided a case on May 8, 1997, allowing cash rent leasing in a period after death that extended beyond the two-year grace period.[5] In that case, *Gavin v. United States*,[6] the decedent entered into a cash rent lease with his farming son, Gary, on January 4, 1990, to be effective for the crop year beginning March 1, 1990. The decedent died on January 17, 1990, leaving the land to his children and grandchildren. The farming son, the tenant, inherited a one-seventh interest in the land. The will also granted Gary the option to purchase the land from the estate and specified that if the option was exercised, the son would have one year to obtain financing for the purchase. A notice of intent to exercise the option was signed on December 12, 1990, for one tract with the purchase completed on October 1, 1991, less than two years after the decedent's death. For this parcel, the two-year grace period covered the period of cash rental with the major consequence that the recapture period was extended beyond 10 years by the period of cash renting.[7]

On February 4, 1992, more than two years after the decedent's death, the son signed a notice of intent to exercise the option to purchase the other tract. Gary, the farming son, continued to pay cash rent to the decedent's estate until February 29, 1992. On March 2, 1992, Gary made a down payment on that parcel.

The Eighth Circuit, quoting *Minter v. United States*[8] (which has been roundly criticized)[9] for the dubious proposition that a qualified heir who receives cash rental income "does not automatically lose the benefits of special use valuation,"[10] proceeded to state that the qualified heirs in *Gavin v. United States*[11] did not enter into a cash rent lease with just "another farmer."[12] Rather, the court opined, the rental was to the qualified heir whom the decedent "had groomed for many years to take over the family farm."[13] The court hedged its position slightly by saying, "although not dispositive, we conclude that the identity of the farmer is relevant to determining whether a decedent's heirs were mere landlords collecting a fixed rent."[14] The court, in a display of lack of understanding of the statute and the litigated cases, in support of that position cites a passage in *LeFever v. Commissioner*,[15] stating that "cash rental of the property to a nonfamily member is not a qualifying use."[16] That statement in *LeFever* was made in the context of the pre-death qualification requirements.[17] The statement in *LeFever* scarcely proves that cash rent leasing to a related tenant is permissible in the post-death period.

It has been clear since 1981 that cash rental of land in the pre-death period to a member of the decedent's family is permissible.[18] It has been equally clear that cash rental of land even to a member of the qualified heir's family in the post-death period causes recapture of special use valuation benefits[19] except for the two year grace period immediately following death[20] and, since 1988, cash rental by a surviving spouse to a member of the surviving spouse's family.[21]

Similarly, the Gavin court cited the case of *Brockman v. Commissioner*[22] for the proposition that "the case law and the legislative history of Section 2032A both made clear that the qualified use requirement is not satisfied if a decedent's financial stake or other involvement in land is merely that of a landlord who collects a fixed rent from an unrelated tenant."[23] That is a defensible statement for any court to make but it provides no support for approving cash rental to a related tenant in the post-death period. In citing to the 1976 Committee report on special use valuation,[24] the court mistakenly refers to a discussion of the pre-death qualification requirements[25] rather than the post-death qualified use test.[26] The Eighth Circuit made essentially the same error in *Minter v. United States*.[27] It is becoming clear that the Eighth Circuit Court of Appeals does not understand the differences between the pre-death and the post-death tests. The Court does cite, correctly, to

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Williamson v. Commissioner[28] for the proposition that cash rental to a relative will not suffice in the post-death period.[29] Indeed, that is the holding of every court that has considered the issue other than for *Gavin v. United States*.[30] The approval by the Eighth Circuit in *Minter v. United States*[31] of a cash rent lease to a family corporation where two of the qualified heirs were far from being fully at risk now appears to have been an appropriate prelude to the glaring misstep in *Gavin*.

The court in *Gavin* tried, feebly, to redeem itself with the assertion that the qualified heirs were "at risk" because the cash rent might not be paid.[32] In light of the fact that Iowa, the state of the decedent's domicile and the location of the farmland in question, has the most complete and far-reaching landlord's lien in the United States[33] makes that assertion less than compelling.

The court makes much of the fact that the lease with the son for the parcel of land in question provided for an option of $10,000 fixed cash rent or a 50 percent share of the crops.[34] In point of fact, however, the tenant paid cash rent for the land. It is scarcely relevant what the tenant might have paid in rental.

In conclusion

The decision in *Gavin*[35] confirms the age-old adage that "tough cases make bad law." It is clear from the record that the tenant was a bona fide farmer and came within 45 days of fully complying with the statute to avoid recapture of special use valuation benefits. However, it does not build confidence in the tax system or the judicial system to torture both the law and the facts to reach a desired result.

FOOTNOTES

1 See generally 5 Harl, *Agricultural Law* § 43.03[2][g][i][H] (1997); Harl, *Agricultural Law Manual* § 5.03[2][f][i][c] (1997).
2 I.R.C. § 2032A(c)(7)(A).
3 I.R.C. § 2032A(b)(5)(A).
4 See I.R.C. § 2032A(c)(6)(A).
5 Gavin v. United States, 97-1 U.S.Tax Cas. ¶ 60,273 (8th Cir. 1997).
6 *Id*.
7 I.R.C. § 2032A(c)(7)(A)(ii).
8 19 F.3d 426 (8th Cir. 1994).
9 See Harl, Cash Rental of Land After Death to Family Corporation: No Special Use Valuation Recapture, 5 *Agric. L. Dig.* 73 (1994).
10 97-1 U.S.Tax Cas. ¶ 60,273 (8th Cir. 1997).
11 *Id*.
12 *Id*.
13 *Id*.
14 *Id*.
15 100 F.3d 778, 782 (10th Cir. 1996).
16 97-1 U.S.Tax Cas. ¶ 60,273 (8th Cir. 1997).
17 LeFever v. Comm'r, 100 F.3d 778, 783 (10th Cir. 1996).
18 Treas. Reg. § 20.2032A-3(b)(1). See, e.g., Ltr. Rul. 8149006, Aug. 26, 1981 (cash rent lease to son met qualified use test).
19 See, e.g., Williamson v. Comm'r, 974 F.2d 1525 (9th Cir. 1992) (cash rent lease to nephew); Lavonna Pauline 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).
20 I.R.C. § 2032A(c)(7)(A).
21 I.R.C. § 2032A(b)(5)(A).
22 903 F.2d 518, 521 (7th Cir. 1990).
23 97-1 U.S.Tax Cas. ¶ 60,273 (8th Cir. 1997).
24 H.R. Rep. No. 94-1380 at 23 (1976).
25 I.R.C. § 2032A(b)(1).
26 I.R.C. § 2032A(c)(1)(B).
27 19 F.3d 426 (8th Cir. 1994).
28 974 F.2d 1525 (9th Cir. 1992).
29 97-1 U.S.Tax Cas. ¶ 60,237 (8th Cir. 1997).
30 Williamson v. Comm'r, 974 F.2d 1525 (9th Cir. 1992) (cash rental to nephew caused recapture); Stovall v Comm'r, 101 T.C. 140 (1993) (cash rent lease to brother caused recapture); Shaw v. Comm'r, T.C. Memo. 1993-139 (cash rent lease to brother caused recapture).
31 19 F.3d 426 (8th Cir. 1994).
32 97-1 U.S.Tax Cas. ¶ 60,237 (8th Cir. 1997).
33 Iowa Code § 570.1 (1997). See 13 Harl, *Agricultural Law* § 121.05[2][a] (1997).
34 97-1 U.S.Tax Cas. ¶ 60,273 (8th Cir. 1997).
35 *Id*.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

BANKRUPTCY

GENERAL-*ALM* § 13.03.*

EXEMPTIONS

TOOLS OF THE TRADE. The debtors were cattle breeders and raisers and owned two bulls used in the operation. One bull was subject to a security interest and the debtors sought to avoid the lien as impairing the exemption for the bull as a tool of the trade. The court acknowledged case precedent on both sides of the issue and held that an animal could not be eligible for the tool of the trade exemption because the exemption statute, Section 522(F)(1)(B)(i), provided for an exemption for animals used for personal, family or household use. The debtors also sought to avoid a lien on hay and grain which was to be used to feed the cattle. The court held that the exemption for feed was limited to the amount necessary for animals for the personal, family or household use and was not available for business assets. ***In re* Smith, 206 B.R. 186 (Bankr. N.D. Iowa 1996)**.

FEDERAL TAXATION-*ALM* § 13.03[7].*

DISCHARGE. The debtor first filed a Chapter 13 case in 1988 which was eventually dismissed in 1991. Three