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When Does a Pre-death Sale Not Produce Income in Respect of Decedent?

-by Neil E. Harl

The concept of a new basis at death has been enormously advantageous to the agricultural sector and to the country generally in avoiding the “lock-in” effect that would occur if heirs were confronted with large income tax liability on the sale or other taxable disposition of inherited property. As is widely known, the loss of a new basis at death became reality after December 31, 2009, with a carryover basis implemented (although further Congressional action in 2010 is anticipated which would likely restore the rule of a new income tax basis at death). However, the concept of “income-in-respect of decedent” has denied a new basis to that category of property in the past and is almost certain to continue to do so in the future.

It is clear that a sale or taxable exchange, such as by installment sale, before death of the property owner produces income-in-respect-of-decedent and the new basis at death is sacrificed. A major issue is under what circumstances a pre-death sale can be interpreted to avoid IRD characterization and result in a new income tax basis at death.

The IRS requirements for avoiding IRD under a Pre-death Contract

In Rev. Rul. 78-32, the taxpayer had signed a binding executory contract to sell land with the closing set for March 15, 1976. The taxpayer died on February 5, 1976, after substantial fulfillment of the prerequisites to complete the sale and exchange the deed for payment at the closing. As the ruling notes, the remaining obligations to be performed after death and before the closing were ministerial, principally the transfer of title and possession of the property. The ruling acknowledged the approval of the “entitlement” test by the Fifth Circuit Court of Appeals. Under that test, income is considered income-in-respect-of-decedent if the decedent was entitled to the proceeds of a sale of property under an executory contract binding at the time of death. The ruling notes that, at the time of death, the taxpayer had substantially fulfilled all of the “substantive” prerequisites to completion of the sale and was unconditionally entitled to the proceeds at the time of death. Hence, the transaction produced income-in-respect-of-decedent with the entire difference between the predeath basis and the selling price taxable to the taxpayer. The property did not receive a new income tax basis from the death of the taxpayer as would otherwise have been the case.

That ruling was followed in a 1990 private letter ruling which again involved a real estate sales contract, but containing a provision making the contract cancellable by either party if the buyer did not obtain a mortgage commitment within 45 days and a clause that

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the contract could be extended in writing. The mortgage commitment was not obtained within the 45 day period but the parties closed on schedule with no extension of the contract. The letter ruling concludes that the transaction produced income-in-respect-of-decedent.

In a 2007 private letter ruling, a gas pipeline was discovered and caused a delay in closing as the resulting issues were resolved. The property was not deemed to produce income-in-respect-of-decedent. The seller needed to attend to substantive as well as ministerial matters as economically material contingencies emerged with discovery of the pipeline.

**The results of litigation**

The most influential case to date on the issue since the 1967 Fifth Circuit case was *Estate of Peterson v. Commissioner,* in which the Eighth Circuit Court of Appeals addressed the IRD issue in the context of the sale of feeder calves which had been sold under contract before the death of the decedent but were too light to meet the contract specifications at the time of death. The calves were returned to the estate and were fed and cared for by the decedent’s estate until the calves were heavy enough to meet the contract requirements. The Tax Court held and the Eighth Circuit affirmed that substantive acts remained to be performed and the calves were not, at the time of death income-in-respect-of-decedent. The appellate court agreed that, for a sale to produce IRD, four requirements must be met – (1) a legally-binding arrangement or contract; (2) the decedent must have performed the substantive non-ministerial acts required as pre-conditions of sale; (3) at the time of death, no economically material conditions existed which might have disrupted the sale; and (4) the decedent would eventually have received the sale proceeds if the decedent had lived. Those conditions were not all met in *Estate of Peterson v. Commissioner* because the calves were too light and the sale did not, therefore, produce income-in-respect-of-decedent.

In a 1992 Tax Court case, *Estate of Napolitano* the buyer would not accept the title to the property sold under contract (because of alleged housing violations) unless clouds on the title were cured or a purchase price adjustment was made (although the amounts in dispute in that regard were small). The property was held not to produce income-in-respect-of-decedent.

**In conclusion**

A careful review of the circumstances of the transaction is justified whenever death of the seller precedes the closing of the transaction. If substantive acts remain to be performed, as opposed to ministerial acts such as delivering the deed and giving possession, it should be possible to avoid IRD on the transaction.

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**ENDNOTES**


2. See note 1 supra.


5. See, e.g., *Estate of Peterson v. Comm’r,* 667 F.2d 675 (8th Cir. 1981), aff’d, 74 T.C. 630 (1980) (sale of calves that failed to meet weight requirement).


8. Id.


14. 667 F.2d 675 (8th Cir. 1981), aff’d, 74 T.C. 630 (1980).

15. I.R.C. § 691(a).

16. 667 F.2d 675 (8th Cir. 1981), aff’d, 74 T.C. 630 (1980).

17. T.C. Memo. 1992-316.

18. Id.