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Elect Special Use Valuation to Obtain Portability Advantage?

-by Neil E. Harl*

The advent of portability for deaths after 2010, the recent run-up in farmland values, and the unusually low relative farmland values under one option of the special use valuation election have combined to provide encouragement to consider making the special use valuation election, even in estates where there was no present advantage in so doing. The objective is to increase the remaining, unused federal estate tax deceased spousal exclusion amount in the estate of the first of a couple to die which could be used at the death of the surviving spouse. The decision is, however, fraught with uncertainty and could prove disadvantageous in the estate of the surviving spouse.

An example of the contemplated advantage

A husband and wife own 800 acres of farmland, all held in tenancy in common, valued (at fair market value) at $10,000 per acre. The wife died in 2013 with a gross estate of $4,000,000 and estate settlement costs of $100,000 with her property all left to their children equally. The “deceased spousal unused exclusion amount” would be $5,250,000 (the basic exclusion amount for deaths in 2013) less the exclusion amount of $3,900,000 used to cover property included in her estate. That would mean the “deceased spousal unused exclusion amount” from her estate would be $1,350,000. The husband dies in 2024 with his 400 acres valued at that time at $20,000 per acre, with a gross estate of $8,000,000 (less $100,000 in estate settlement costs), and with an applicable exclusion amount assumed to be $6,400,000. His estate would have a taxable estate of $1,500,000 with an assumed federal estate tax liability of $600,000. However, if his spouse who died in 2013 was his “last deceased spouse,” the “deceased spousal unused exclusion amount” from her death in 2013 of $1,350,000 could be used by the husband’s estate to reduce the taxable estate to $150,000 for a federal estate tax liability of $60,000.

However, if the wife’s estate in 2013 had elected special use valuation, and reduced the farmland value to 40 percent of its fair market value, her estate would be valued at $1,600,000 (less estate settlement costs of $100,000) so that the deceased spousal unused

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exclusion amount would be $5,250,000 less $1,500,000 needed to cover her estate’s property, leaving $3,750,000. At the husband’s death in 2024, his own applicable exclusion amount of $6,400,000 plus $3,750,000 from his wife’s earlier death, would total $10,150,000. That would cover the 400 acres of farmland even if it had increased in value to $25,375 per acre.

What are the negatives in electing special use valuation in the wife’s estate?

First, electing special use valuation in the wife’s estate would result in special use value setting the income tax basis. Thus, the basis of her 400 acres would be $4,000 per acre (the special use value) rather than $10,000 per acre (its fair market value at the time of her death) for $6,000 per acre gain on sale after her death. Of course, if the land is not sold, the basis is relevant only for purposes of depreciation on fences, tile lines and buildings and other depreciable assets.

Second, the deceased spousal unused exclusion amount could be lost if the husband remarried in 2014 to a wealthy individual who died in 2021 leaving all of her property to her children but also destroying her husband’s deceased spousal unused exclusion amount of $3,750,000 (because she became the last deceased spouse).

Third, property values could fall and reduce substantially the projected federal estate tax at the survivor’s death.

What is the likely position of the Internal Revenue Service in all of this?

Unlike alternate valuation, which resides adjacent to special use valuation in the Internal Revenue Code, and requires that the election must demonstrate that the election is only available if it would decrease the gross estate and federal estate tax, there is nothing in the special use valuation statute or the regulations which impose a comparable requirement for filing a special use valuation election where no federal estate tax would be due. However, it is entirely possible that, given the recent enactment of portability, the Internal Revenue Service in a ruling or notice (or the Department of the Treasury (in regulations)) could take the position that an election under special use valuation cannot be made where no federal estate tax was due.

That position is strengthened by an overall review of why special use valuation was enacted (to reduce the federal estate tax owed on real property used in a farm or ranch business), by the fact that recapture provisions contemplate that the election would reduce federal estate tax due and part or all of the tax saved could be subject to recapture, and by the argument that special use valuation is a nullity if it does not deliver tax benefits to estates and heirs in a particular case and should not be used or relied upon otherwise.

It is not at all clear that IRS could prevail in litigation but clients should be made aware that defending an election to increase the portability amount could be costly.

ENDNOTES


3 See Duffy, Iowa Farmland Survey, Iowa State University, December 2012.

4 I.R.C. § 2032A(e)(7).


6 I.R.C. § 2032.

7 I.R.C. § 2032(c).

8 I.R.C. § 2032A.

9 I.R.C. § 2010(c)(4).

10 I.R.C. § 2032A(c).

ANIMALS

HORSES. The plaintiff was injured by a horse which had escaped from its owner at a county fair. The plaintiff was a volunteer at the fair, helping with the 4-H horse show, and had attempted to stop the horse, but the horse ran over the plaintiff. Although the plaintiff accepted workers’ compensation payments for the injury, the plaintiff sued the defendant university for negligence. The university argued that the acceptance of the workers’ compensation payments subjected the plaintiff to the exclusive remedy provisions of the workers’ compensation law. The court held that the plaintiff was a volunteer and not an employee of the university at the time of the accident; therefore, the plaintiff was not subject to the exclusive remedy provisions of the workers’ compensation law. The university also sought summary judgment under the Indiana Equine Activity Act, Ind. Code § 34-31-5-1. The plaintiff argued that the injuries did not result from an inherent risk of equine activities because the horse charged at and trampled the plaintiff. The court disagreed, holding that the