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Neil E. Harl
Iowa State University

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The Intricacies of Income-In-Respect-of Decedent

by Neil E. Harl

Property held until death ordinarily is entitled to a new income tax basis, determined as of the date of death of the owner.¹ However, property defined as “income-in-respect-of-decedent” at the death of the property owner is not eligible to receive a new income tax basis as of the death of the owner of the property.² With the run-up in property values in recent years, the result can be a sharp difference in future income tax liability, depending upon the classification of the property at death. Without much doubt, the federal income tax provisions (as well as state income tax rules in most states), in short, strongly encourage retention of highly appreciated property until death. Likewise, the rules separating income-in-respect-of-decedent property from other assets have great significance in planning for the disposition of assets at death.

This issue has been affected by the changing practices in selling grain, livestock and other farm products with the practices not fully reflected in drawing the lines between property that is classified as subject to income-in-respect-of-decedent rules and those not so classified.

Share rents: a troublesome area

Share rents held by a non-materially participating decedent at death or share rents which the decedent had a right to receive at the time of death for economic activities occurring before death are generally income-in-respect-of-decedent taxable on sale by the estate or other successor.³ However, a landlord’s share of rental items is not treated as income-in-respect-of-decedent if the decedent was a “materially participating” landlord. If this issue is raised, as a matter of pre-death or post-death planning, it should be noted that material participation by a landlord creates possible liability for self-employment taxes, even after the landlord is retired and receiving self-employment benefits.

Farm operators and materially participating landlords do not usually encounter income-in-respect-of-decedent problems.

Property sold at the time of death

Gain from the sale of property may produce income-in-respect-of-decedent where the sale is completed by the personal representative and there are no substantive acts yet to be performed.⁴ In order for a sale to have ripened to the point where a decedent has the right to the proceeds on the date of death, two conditions must be met – (1) there must be a legally binding contract and (2) the decedent must have performed the substantive (as opposed to the ministerial) acts required as preconditions of sale.

¹ Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.
In one case, the buyer would not accept title unless clouds on title were cured or a purchase price adjustment was made; the item was not income-in-respect-of-decedent. In another, a gas pipeline was discovered and caused a delay in closing as the resulting issues were resolved.

In one of the few cases involving farm property (feeder calves), a sales contract entered into before death required that the calves be heavier in weight than proved to be the case; however, the estate proceeded to return the calves to the feedlots and the calves, weeks later, met the contract specifications. The significant economic contributions by the estate in increasing the weights of the animals were sufficient for the animals to meet the contract terms.

Sale of grain

There have been relatively few litigated cases involving grain sales. The general belief has been that grain sales after death produce income-in-respect-of-decedent. However, in recent years some grain sales have taken on a different character where the grain is deposited at the grain elevator or other buyer’s facilities with the understanding that the seller could initiate the sale later as the price settles at an acceptable level (if it does). The grain, residing in the buyer’s storage facilities, may still be owned by the seller at the time of seller’s death or the buyer may have assumed possession of the grain but the seller still has not been paid. In that case, the seller has the dominant stake in the grain with the grain still unsold.

Installment sales

Installment contracts or notes may also create income-in-respect-of-decedent.

In conclusion

With the shifts occurring in grain sales, it is likely that questions will be raised as to which sales will receive a new income tax basis; the pressure to qualify for a new basis at death will mount inasmuch as the grain usually has a zero value for cash method taxpayers.

END NOTES

1 I.R.C. §1014(a)(1). The three exceptions are listed in I.R.C. §1014(a)(2), (a)(3), (a)(4).
2 I.R.C. §691(a)(1).
5 Estate of Napolitano v. Comm’r, T.C. Memo. 1992-316.
7 Estate of Peteron v. Comm’r, 74 T.C. 630(1980), aff’d, 667 F.2d 675 (8th Cir. 1981).
8 Of course, state regulators have a stake in all of this as well.
9 See Holt v. United States, 97-2 U.S. Tax Cas. (CCH) ¶ 50,929 Fed. Cir. 1997) (installment notes received by married taxpayers on sale of community property were income-in-respect-of-decedent and not entitled to new basis at death).

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

BANKRUPTCY

CHAPTER 12

DISMISSAL. The debtor was a trust which the trust principal characterized as a business trust; however, the court declined to rule on whether the debtor qualified for Chapter 12 because other issues resulted in the same outcome as if the debtor was ineligible for Chapter 12. The trustee filed a motion to dismiss the Chapter 12 case for several other reasons: (1) the plan was untimely filed, (2) the debtor failed to answer questions from the trustee at the meeting of creditors, and (3) the court had already granted the debtor’s landlord relief from the automatic stay to terminate the debtor’s lease which was the most asset held by the debtor. Section 1208 provides that the court may dismiss a chapter 12 case for “cause”: “(c) On request of a party in interest, and after notice and a hearing, the court may dismiss a case under this chapter for cause, including —(1) unreasonable delay, or gross mismanagement, by the debtor that is prejudicial to creditors; . . . (3) failure to file a plan timely under section 1221 of this title; . . . and (9) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation . . . .” Section 1221 provides “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 court found that the debtor’s principal had suffered a head injury but noted that no request for an extension of time to file the plan was made. Thus, the court held that the debtor’s failure to timely file a plan or request an extension was grounds for dismissing the case. The debtor filed a plan in opposition to the trustee’s motion but the court held that the plan was completely insufficient to be considered a reviewable plan. Thus, the failure to file a meaningful plan was another reason to dismiss the case. The court found that the debtor’s principal’s refusal to answer questions from the trustee at the creditors’ meeting was not based on any right of the debtor and constituted unreasonable delay; thus, the court held that the case should be dismissed for unreasonable delay. Finally, the court found