"Use" Valuation Under The 1976 Tax Reform Act: Problems And Implications

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Abstract
With the rapid rise in farmland values during recent years, farmers and farm organizations have argued that land values have little relationship to agricultural productivity. The fact that farmers have been the dominant purchasers in the farm real estate market during this period of time would seem to discredit this argument to some degree, but public officials have been sympathetic to the farmers' arguments. Some state legislatures, particularly in areas of the country where urban expansion has placed upward pressures on land values, have adopted procedures to value farmland based on its agricultural productivity for purposes of assessing property tax.

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"USE" VALUATION UNDER THE 1976 TAX REFORM ACT: PROBLEMS AND IMPLICATIONS

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Michael D. Boehlje and Neil E. Harl

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"USE" VALUATION UNDER THE 1976 TAX REFORM ACT:
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Michael D. Boehlje** and Neil E. Harl***

I. Introduction

With the rapid rise in farmland values during recent years, farmers and farm organizations have argued that land values have little relationship to agricultural productivity. The fact that farmers have been the dominant purchasers in the farm real estate market during this period of time would seem to discredit this argument to some degree, but public officials have been sympathetic to the farmers' arguments. Some state legislatures, particularly in areas of the country where urban expansion has placed upward pressures on land values, have adopted procedures to value farmland based on its agricultural productivity for purposes of assessing property tax. In 1976, the use valuation concepts were encompassed in national tax legislation through the addition of Section 2032A to the Internal Revenue Code. This section enables "qualified real property" to be valued based on its "value in use" rather than "fair market value" as long as certain requirements are met. Such a valuation procedure has little precedence in estate tax law, and the implications of 2032A for farm families, investors in real estate and overall social policy as to land tenure are widesweeping.

The purpose of this paper is to review the major provisions of Section 2032A and the benefits of and problems (both procedural and data) that will be encountered in using the "use" valuation procedure. First, ____________________

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the problems of collecting data to obtain "use" value estimates along with the issues of material participation and eligibility requirements (pre and post death) will be discussed. Then, specific estimates of the benefits of "use" valuation for different size estates will be reviewed. Finally, the implications of the special use valuation privilege on real estate values, investment patterns, the land tenure system in rural America, and the interface of 2032A with other dimensions of estate tax law—specifically carryover basis and installment payment of tax—will be discussed.

II. The "Use" Value Legislation

"Use" Valuation Procedures

If qualified real property is used for farming purposes, its value can be determined in two ways: 1/ (1) the capitalization of cash rent minus property taxes by the appropriate Federal Land Bank interest rate and (2) through use of the following five factor formula:

1. Capitalization of income that the property can be expected to yield over a reasonable period under prudent management,

2. Capitalization of the fair rental value,

3. Assessed value if the state bases assessments on current use,

4. Comparable sales in the same geographical area but without significant influence from metropolitan or resort areas, and

5. Any other factor that would fairly value the real property. 2/

The first procedure for valuing land is based on the income capitalization theory for valuing a resource. Specifically,

1/ The procedures used to make the "use" valuation election are quite specific and are summarized in I.R.C. § 2032A(d) and in Form 706 and the instructions thereto.

2/ I.R.C. § 2032A(e)(8).
\[ V = \frac{a_1}{1+r} + \frac{a_2}{(1+r)^2} + \frac{a_3}{(1+r)^3} + \ldots + \frac{a_n}{(1+r)^n} \]  

(1)

where

\[ a = \text{expected annual income} \]
\[ r = \text{discount rate} \]
\[ V = \text{value of the resource} \]

As \( n \) approaches infinity, the formula becomes —

\[ V = \frac{a}{r} \]  

(2)

To use this procedure, Section 2032A requires that the "average annual gross cash rental for comparable land used for farming purposes and located in the locality of such farm" minus the average annual real estate taxes (state, if any, and local) for such comparable land, be divided by the "average annual effective interest rate for all new Federal Land Bank loans." All calculations are to use the last five full calendar years before death.\[^4\]

The discount rate. As is obvious from Equations (1) and (2), the discount rate plays a major role in resource valuation. Reducing the discount rate by half doubles the value of the resource, for example.

For special "use" valuation, the legislation specifies that the discount rate is to be the "average annual effective interest rate for all new Federal Land Bank loans." The term "effective" rate as used in the statute suggests a rate higher than the stated loan rate to account for loan closing costs and the "cost" of owning Federal Land Bank stock. It appears

\[^3\]I.R.C. § 2032A(e)(7)(A).
\[^4\]Ibid.
\[^5\]I.R.C. § 2032A(e)(7)(A)(ii).
that the rate is to be calculated for each Federal Land Bank District and made available through District Directors of Internal Revenue. Apparently, the calculated rates, to be available for each year starting with 1972, will include an allowance for the "cost" of owning Federal Land Bank stock but not for loan fees.

For informational purposes, and until calculated interest figures become available, the stated interest rates for the Omaha Federal Land Bank District appear in Appendix A. It should be noted that the Federal Land Bank of Omaha reports a rate one-half percent above the stated or announced rate for Truth-in-Lending purposes. See Appendix B.

Gross cash rents. The legislation specifies that the income capitalization approach to "use" valuation is to use "average annual gross cash rental for comparable land used for farming purposes and located in the locality of such farm..." That language seems to suggest actual cash rental figures on actual tracts of comparable land.

This is a crucial assumption and raises a number of questions—(1) Would "synthesized" cash rents based upon statistical estimation using available productivity information for the soil and the area involved be acceptable; (2) are "variable" cash rental figures (where the land owner agrees to accept a specified amount of crop per year but bears uncertainty as to the price to be used in calculating the rent) eligible; and (3) can the cash rent equivalent of a crop-share lease be used as a substitute for "gross cash rents", (4) how are improvements (particularly the building site) to be treated in the computations. Each of these questions is discussed briefly.

Synthetic cash rents might be obtained through a structural analysis of the factors that explain cash rents. Such factors would include productivity of the land, size of parcel, relationship between lessee and lessor, location of land, length of lease and value of improvements. Once the factors that explain cash rents have been quantified, a parcel could be characterized by these factors and a cash rent estimated. Although sufficient data are believed to be available to generate synthetic cash rent figures in some states within bounds of reasonable statistical error, it is not clear that rental figures obtained in this fashion would be acceptable under the statute. In some ways, the task would be simpler if such figures were acceptable for land valuation purposes.

As to the question of flexible cash rent leases, it would appear that data from such arrangements would not be acceptable. It is presumed that the statutory specification of cash rent meant cash rent as the term is commonly defined in agriculture and not a modification of the cash rent concept. Likewise, it has been assumed that a statutory bar would exist to using the cash rent equivalent of a crop share lease. This is unfortunate in light of the limited number of cash rented tracts in some areas and the greater incidence of crop share leases in most areas.

However, use of the cash rent equivalent of a crop share lease would raise several important questions. (1) It is not clear what price for the crop or crops would be used in the calculations. Use could be made of the price actually received for the crop for the year in question, but the crop may have been stored and not sold. Moreover, using actual sale price would tend to base land values on marketing decisions rather than land productivity. Use could be made of harvest time prices for crops, if a date or dates were specified, or an average annual market price could be
used. (2) It is not clear what yields should be used -- whether actual yields, average yields for the county or other area or long-term average yields should be used in the calculations. (3) It is not clear how costs should be handled in computing the cash rent equivalent. In particular, various procedures are used to handle harvesting, drying and storage costs as well as crop insurance costs. Also the treatment of depreciation and depletion of such items as capital improvements, tile lines and fences may present computational problems.

Finally, it is likely that cash rental rates over the long term will average significantly less than crop share returns. The difference represents, in approximate terms, compensation for the added risk and uncertainty borne by a land owner under a crop share arrangement as compared to a cash rent lease. Thus, a systematic and significant difference would be expected to exist between crop share return and cash rent with the result that the Internal Revenue Service would seek crop share data and the estate would search for cash rent information.

Improvements on real property, particularly the building site, present a unique problem in using the cash rent capitalization approach to "use" valuation. On rented farms where improvements are extensive and represent a substantial part of the value of the farm, the arrangement tends to be a livestock or cropshare lease. Rarely are heavily improved farms rented for cash. Thus, the problem may be posed of using cash rent data from farms with modest improvements to value farms of decedents with substantial improvements. The problem of comparability, to be discussed later, presents serious problems with improvements since it would be
difficult to find individual buildings, let alone a building site, that are comparable in size, construction, age, condition or location to that on the decedent's property. With increased specialization in farming and, rapid technological changes in grain storage and livestock production facilities and the technological obsolescence that results, the problems encountered in determining the use value of land with improvements will become more serious in the future. Guidance on how to determine the "use" value of a farm with improvements is needed. Two problems are posed — (1) is farm land to be valued separately, using comparable land that is cash rented, with improvements handled as a separate matter, or (2) is a farm to be valued as a unit with the comparability issue applicable to both the land and the improvements.

Relatively little published data on cash rents are available. The United States Department of Agriculture publishes an annual survey of "expected" cash rents for the coming crop season by state.\(^7\) The data are available by crop reporting district within each state. However, the data are only averages and would appear to be applicable only if the decedent had an "average" farm or could adjust rental rates successfully from the average figures. Moreover, the published rental rates are based on expected rates in the respondent's area and thus suffer from that additional infirmity. For informational purposes, the data for Iowa by crop reporting district for the years 1972 through 1977 are enclosed as Appendix C.

In the belief that actual cash rent figures on actual tracts of comparable land would be necessary to make the income capitalization approach to "use" valuation operational, a project has been commenced in Iowa on a pilot basis to identify, systematically, all cash rented tracts (whole farm or parts of farms) in the counties participating in the pilot effort. The project is described in Appendix D, "Suggested Guidelines for Cash Rent Data Collection for 'Use' Valuation of Farmland." A copy of the questionnaire to be used in the study is included as Appendix E.

Determining what is "comparable". The requirement that cash rental data must be from "comparable land . . . in the locality"\(^8\) seems to limit the population of cash rent observations. If the term is defined literally to mean land with comparable productivity, interest is then focused on determining what land is comparable. However, if the term is defined to permit quantification of differences in productivity between the decedent's tract and the cash rented tract or tracts identified in the locality, it would be possible to adjust the cash rent observations for the differences in productivity.

In several mid-western states, indexes of land productivity have been developed to permit comparison of tracts. These index systems have been used extensively in land valuation for property tax purposes where relative

\(^8\)I.R.C. § 2032A(e)(7)(A)(i).
values are important. The Iowa system, for example, is known as the "Corn Suitability Rating" and encompasses various dimensions of productivity including soil type, slope, erosion, drainage, rainfall and other relevant factors. A productivity index is obtained for each 40 acre tract. This index system makes possible objective comparisons of land and provides a framework for making adjustments in cash rents based on differences in productivity. Because soil indexes are dependent upon a complete soil survey, not all areas are covered by an index system. In Iowa, for example, index data are available in more than two-thirds of the counties with all remaining counties except one making progress toward completing soil surveys.

It should be noted that adjustments in value and cash rents based on a soil productivity index are no different in concept than using "synthesized" cash rent data. Also, other dimensions of comparability such as improvements, location, and lease terms must be recognized in any attempt to value land using the rent capitalization approach. Comparability could also be determined by competent appraisal of the decedent's tract and the other tract or tracts for which cash rent information is available.

The "Five Factor Formula". If cash rent data are unavailable or the executor chooses to not use the rent capitalization approach to use valuation, he or she may elect to use the "Five-Factor Formula" for valuation noted earlier. Certainly this method is no more definitive in computational procedure or data base than the capitalization approach. Furthermore, it is unclear as to how these five factors are to be combined into a single

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9/ See Fenton, "Use of Soil Productivity Ratings in Evaluating Iowa Agricultural Land," 30 J. of Soil and Water Conservation 237 (1975). A copy of the article is enclosed as Appendix F.

10/ Part III of the questionnaire included as Appendix E is designed to make use of soil index information.
estimate of value. If a single factor can be chosen at the executors
discretion, one might expect information from crop-share rental arrangements
and/or property tax assessments based on use value to be utilized in the
valuation process. Certainly, the earlier issues raised with respect
to using crop-share rental data in a valuation proceed would still apply.
However, the legislation implies that no single factor of the "five-factor
formula" can be used as the sole base for valuation, but that all five
factors must be included and combined in an undisclosed fashion in the
valuation process.

Problems With Eligibility Requirements

As with most tax provisions affording relief to a limited group of
taxpayers, the requirements for "use" valuation of land are both numerous
and highly detailed. In some instances, problems of implementation are
anticipated unless clarification comes by regulation or statutory amendment.
To be eligible for "use" valuation several pre-death conditions must be
met, and several post-death requirements must be observed to avoid recapture
of the tax benefit.

Pre-death requirements. Pre-death requirements are of two types—
(1) Those assuring that farm (or other closely-held business) assets
comprise a substantial part of the estate and (2) Those designed to serve
as a "gate" to preclude mere investors from taking advantage of the tax
provision.

As to the first point, the adjusted value of the farm (or other closely-
held business) real and personal property must be at least 50 percent

\[11\] The statute uses the disjunctive, real or personal property, but it is
believed that the term can be viewed as in the conjunctive.
of the adjusted value of the gross estate, using fair market value figures, and must pass to a qualified heir or heirs.\textsuperscript{12} The term "adjusted value of the gross estate" means gross estate less allowable unpaid indebtedness attributable to the property.\textsuperscript{13} The intent seems to be to use a "net worth" figure, net of indebtedness attributable to the property.

It appears that 50 percent of the adjusted value of the gross estate must pass to a qualified heir(s) even if part of that amount is personal property. Because the recapture provisions refer only to dispositions or other disqualifying events relative to real property,\textsuperscript{14} it would seem that any personal property required to pass to a qualified heir to meet the 50 percent rule need not be held for the 15-year period after death to avoid recapture as is the case with the real property.

The term "qualified heir" is broadly defined to include any member of the decedent's family who acquired the property (or to whom the property passed) from the decedent.\textsuperscript{15} In turn, "member of the family" is defined to encompass an individual's ancestors and lineal descendants, a lineal descendant of a grandparent, the individual's spouse or the spouse of any such descendant.\textsuperscript{16} Legally adopted children are treated as a child of blood relationship.

In addition to the "50 percent" rule, at least 25 percent of the adjusted value of the decedent's gross estate must be qualified farm (or other closely-held business) real property that was acquired from or passed

\begin{itemize}
\item \textsuperscript{12} I.R.C. § 2032A(b)(1)(A).
\item \textsuperscript{13} I.R.C. § 2032A(b)(3)(A).
\item \textsuperscript{14} I.R.C. § 2032A(c)(1).
\item \textsuperscript{15} I.R.C. § 2032A(e)(1).
\item \textsuperscript{16} I.R.C. § 2032A(e)(2), H. R. 6715, § 3(d)(1) would amend I.R.C. § 2032A (b)(1) to make it clear that property must pass to a qualified heir in order to be "qualified real property".
\end{itemize}
from the decedent to a qualified heir.\(^{17/}\) Again, fair market value figures are used for determining compliance with the 25 percent rule.

It is clear, then, that a dual valuation system is required to take advantage of "use" valuation of real property. Fair market value is used for determining the conditions of eligibility and, as noted below, may be used in recapture calculations after death. And "use" valuation is utilized to calculate the federal estate tax gross estate, subject to the overall limitation that "use" valuation cannot be used to reduce the gross estate by more than $500,000.\(^{18/}\) Consequently, an appraisal of fair market value of the property will still be required in settling most estates.

Turning to the requirements purporting to restrict the privilege to those involved with a business, the "use" valuation rules specify that during five or more years in the eight year period ending with the decedent's death, the real property must have been owned by the decedent or a member of the decedent's family and held for a qualified use (farming or another closely held business use).\(^{19/}\) Moreover, during five or more years in the eight year period ending with the decedent's death, the decedent or a member of the decedent's family must have participated materially in the operation of the farm or other business.\(^{20/}\)

"Material participation" is a key concept in the legislation. Under the statute, material participation is to be "determined in a manner

\(^{17/}\) I.R.C. § 2032A(b)(1)(B);

\(^{18/}\) I.R.C. § 2032A(a)(2). If a marital deduction is claimed, the effective maximum benefit from "use" valuation is proportionately less than $500,000. For example, up to one-half of a $1,000,000 adjusted gross estate could be deducted without advantage being taken of "use" valuation. If the estate were reduced by $500,000 through application of use valuation, the adjusted gross estate would be $500,000 and the maximum marital deduction would be $250,000. Therefore, the real effect of "use" valuation is reduced to $250,000.

\(^{19/}\) I.R.C. § 2032A(b)(1)(C)(1).

\(^{20/}\) I.R.C. § 2032A(b)(C)(d).
similar" to the way it is defined for determining the tax on net earnings from self-employment.\footnote{21}{See I.R.C. §§ 1402(a)(1), 2032A(3)(6).} The general rule is that real estate rentals are not self-employment income. However, the presence of material participation converts rents to self-employment income. As specified in the regulations, "income derived by an owner . . . of land is included in determining net earnings from self-employment . . . if the income is derived under an arrangement between the owner . . . and another person which provides that such other person shall produce agricultural or horticultural commodities on such land, and that there shall be material participation by the owner . . . in the production or the management of the production of such agricultural or horticultural commodities; and . . . there is material participation by the owner . . . with respect to any such agricultural or horticultural commodity."\footnote{22}{20 C.F.R. § 404.1053(c)(1)(1976).}

"Use" valuation rules provide specifically that material participation can be attained by the decedent or a member of the decedent's family.\footnote{23}{I.R.C. § 2032A(b)(1)(C)(ii).} Thus, it would seem that the following arrangements would clearly assure material participation — (1) land rented to a third party by the decedent-to-be under a material participation lease, and (2) land rented by the decedent-to-be to a member of the family as the tenant under a material or non-material participation lease. It would also seem that the following should qualify, although the authority is less clear, — (1) land rented by the decedent-to-be to a partnership or corporation owned and controlled by the decedent-to-be under a material or non-material participation lease, (2) land
rented by the decedent-to-be under a material or non-material participation lease to a partnership or corporation owned and controlled by members of the family of the decedent-to-be, and (3) land owned by the decedent-to-be and rented under a material or non-material participation lease to a member of the family who in turn rents the land as a sublessor under a material participation lease to a third party tenant. Until clarified by regulations, rulings or judicial decision, the following are even less clear -- (1) land owned by a partnership or corporation if a majority (with a substantial minority component of ownership and control by non-eligible material participators) of ownership and management of the partnership or corporation are provided by the decedent-to-be; (3) land owned by a partnership or corporation and rented to a third party tenant under a material participation lease where a majority of ownership and management of the partnership or corporation are provided by the decedent-to-be and members of the family of the decedent-to-be.

It is reasonably clear, under current law, that material participation for social security purposes (and hence for "use" value purposes) cannot be attained by or through an agent. Before 1974, material participation for social security purposes could be gained through the efforts of an agent. However, a 1974 amendment to the tax code requires that material participation be achieved by the owner "determined without regard to any activities of an agent of such owner . . . in the production or the management or the production or such agricultural or horticultural commodities." Material participation by an agent is not imputed to

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24/ The general requirements for land owned by a partnership or corporation to be eligible for "use" valuation are discussed on pages


the landowner.

It is not clear what the outcome would be if land were rented directly to a third party tenant by the decedent-to-be under a material participation lease where material participation was provided by a member of the family of the landowner (as the decedent-to-be) as an agent. This poses a collision between the status of the member of the family as an agent and as an eligible material participator on the basis of being a family member. Material participation may be attained by a member of the family but not by an agent. It would seem that family member status, by virtue of specific sanction in the "use" value statute\textsuperscript{27} should prevail. However, this is not clear.

For those seeking to establish material participation under a lease, the tests developed for social security purposes may provide helpful guidelines. Four tests have been developed, any one of which constitutes material participation\textsuperscript{28}:

- No. 1 (any three) --- (a) provide half or more of the direct costs of producing a crop, (b) furnish half or more of the equipment and livestock used, (c) advise and consult with the tenant periodically, and (d) inspect production activities periodically;
- No. 2 — regularly and frequently make decisions which may be expected significantly to affect or contribute to the success of the enterprise;
- No. 3 — perform physical work in the production or management of the production of commodities raised (100 hours spread over five or more weeks per year); or
- No. 4 — do those things which, in total, show that the landlord is materially and significantly involved in production.

\textsuperscript{27} See I.R.C. § 2032A(b)(1)(C)(ii).

\textsuperscript{28} See 20 C.F.R. §§ 404.1053(c)(3); Social Security Handbook §§ 1224-1322.
If material participation is to be achieved under a crop share or livestock share lease based upon participation in decision making, it is suggested that the lease be drafted with care to show clearly the expected role for the landowner in the decision-making process. Specifically, it is suggested that the lease be drafted to require involvement by the landowner in decisions relating to -- (1) cropping patterns and the rotation, if any, to be followed each year, (2) levels of fertilization and formulae of fertilizer to be applied (NPK), (3) participation or non-participation in government price/income support programs, (4) plans for chemical weed and insect control including type of chemical, rate of application and type of application (broadcast or band), (5) soil and water conservation practices to be followed, (6) scheduling of repairs to buildings, fences and tile lines, (7) decisions on use of storage facilities as between landlord and tenant, (8) changes in basic tillage practices (e.g. shift to minimum tillage), (9) varieties of seed to be purchased, (10) marketing strategy for the landlord's share of the crop and coordination of delivery by the tenant, and (11) for livestock share leases, decisions relative to type of livestock production to be undertaken, level of production planned, nutrition and animal health plans and marketing strategies. It is also suggested that the landowner maintain a daily, diary type record of activities related to participation in the production of income under the lease.

In many situations, planning to meet the pre-death requirements for "use" valuation may be directly competitive with eligibility for social security benefits.29/ If a member of the family serves as the material

29/ Material participation is likely to have implications for social security tax as well as benefit eligibility. Material participation produces earned income which is subject to self-employment tax unless earnings exceed the current covered amount ($17,700 for 1978). Earned income above the allowable level in retirement ($4,000 for those 65 or over, $3240 for those under 65) reduces social security benefits. Except for the year of retirement, reductions in benefits are calculated on an annual basis starting in 1978. Social Security Amendments of 1977, P.L. 95-216.
participator, social security benefits would not be reduced for the landowner as the decedent-to-be. Additional social security tax would be levied against the materially participating family member unless his (her) earnings already exceed the current covered amount. If the landowner as the decedent-to-be is the only feasible material participator, choice must be made between qualifying for "use" valuation of land or maintaining social security benefit eligibility. It should be noted that the social security benefits pass to the decedent-to-be and are relatively certain in amount; the tax reduction from "use" valuation would inure to the benefit of the surviving heirs and the size of the benefit may be difficult to assess. Thus, unless the objective is to maximize overall family wealth, the decision may be to maintain social security benefit eligibility.

It should be remembered that earned income reduces social security benefits only through age 72 (age 70 after 1981). Above those levels, an incentive exists to redraft non-material participation leases to involve material participation. If non-material participation is chosen during the age span from 62 to 72 and then the lease is redrafted to reflect material participation, it would be necessary for the decedent-to-be to survive for at least five more years thereafter because of the requirement that material participation must have occurred for five of the last eight years before death.30/

30/ I.R.C. § 2032A(b)(1)(C).
Although the rules on participation involving a partnership or corporation are not clear, it would seem that the problem of simultaneous eligibility for social security benefits and for "use" valuation of land might be eased with an entity such as a corporation. With direct operation of the farm by the corporation or rental of the farm by the corporation to a farm tenant (who is not a family member) under a material participation lease, the options for assuring material participation at the corporate level may be greater than assuring material participation directly by the decedent-to-be or member of the family before death, and by the qualified heir or member of the qualified heir's family after death. Specifically, if all members of the board of directors and all officers and employees of the corporation are members of the family, sufficient involvement in management to assure material participation may be possible with the decedent-to-be limited to labor and management consistent with maximum social security benefits.

**Post-death requirements.** To assure that the benefits of "use" valuation would inure to those with a long-term commitment to the farm business, the tax benefits are recaptured under specified circumstances during the 15 years after the death of the landowner.

If the real property is disposed of within 15 years after the death of the decedent to non-family members or ceases to be used for farming or other closely-held business purposes, the tax benefits are recaptured.\(^{31/}\) Note that leasing the property under a material participation lease is a qualified use of the property. Full recapture occurs within the first

\(^{31/}\)I.R.C. § 2032A(c).
10 years with a phaseout between 10 and 15 years.\textsuperscript{32} Partial dispositions lead to partial recapture.\textsuperscript{33} Recapture does not occur, however, on death of the qualified heir as to that heir's portion of the total amount of property involved.\textsuperscript{34} In fact, death of the qualified heir terminates the possibility of recapture as to that individual's qualified property. Thus, there is an incentive to transfer the property to the qualified heir who has the highest probability of death because his or her death within the 15 year recapture period will terminate the recapture possibility.

Recapture apparently occurs upon transfer of the real property even though the transfer is income tax free as a tax-free exchange,\textsuperscript{35} involuntary conversion\textsuperscript{36} or sale and reinvestment of a principal residence.\textsuperscript{37} However, if the property is disposed of by means of an involuntary conversion or condemnation proceeding and the proceeds are channeled into the remaining qualifying property, the recapture rules apparently do not apply.

It was not intended for recapture to occur upon the tax-free transfer\textsuperscript{38} of qualified real property to a partnership or corporation if — (1) the qualified heir retains the same equitable interest in the property as before the transfer, (2) the partnership or corporation would be considered

\begin{itemize}
  \item \textsuperscript{32}I.R.C. § 2032A(c)(3).
  \item \textsuperscript{33}I.R.C. § 2032A(c)(2)(D).
  \item \textsuperscript{34}I.R.C. § 2032A(c)(1).
  \item \textsuperscript{35}I.R.C. § 1031.
  \item \textsuperscript{36}I.R.C. § 1033.
  \item \textsuperscript{37}I.R.C. § 1034.
  \item \textsuperscript{38}See I.R.C. §§ 351, 721.
\end{itemize}
a closely-held business, and the partnership or corporation consents to personal liability for recapture of tax if it disposes of the real property or ceases to use the property for qualified purposes during the period in which recapture could occur.

Cessation of qualified use triggering recapture can also occur if material participation is not continued after death. Absence of material participation for three or more years during any eight year period ending after the decedent's death results in recapture. Note that this recapture rule does not assure eight years after death to amass five years of material participation. Rather, conditions for recapture could be met during the first year after death or any year thereafter. This rule suggests that attention should be given to the selection of executors or administrators. Unless a member of the family is the farm tenant or otherwise in a position to be a material participator, the estate representative may be the only eligible material participator. In those situations, a member of the family should be the executor or administrator if "use" valuation eligibility is important unless absence of material participation during the period of estate settlement would not result in disqualification.

The requirement for post-death material participation means that immediate attention should be given after death to review of material participation status. It may be necessary to revise the lease and shift to material participation in order to avoid disqualification or recapture of the tax benefit.

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39/ See I.R.C. §§ 2032A(g), 6166: at least 20 percent of the partnership interest or corporate stock included in the deceased's estate or the firm have 15 fewer partners or shareholders, as the case may be.


41/ I.R.C. § 2032A(c)(7)(B).
Because of the way the post-death material participation requirement is phrased, the unwary -- and even some who are wary -- may suffer loss of eligibility for "use" valuation. For that reason, it is suggested that legislative or regulatory attention be given either -- (1) to eliminating the material participation requirement for a period after death equaling normal estate settlement, or (2) to amending the statute such that five years of material participation in the first eight years after death would meet the requirement.

It is important to note that material participation is to be by the qualified heir or any member of the qualified heir's family, for the period during which the property was held by the qualified heir. This contrasts with the requirement that material participation be by the decedent or any member of the decedent's family during the time the property was held by the decedent.

The recapture of tax benefits upon disposal outside the family or upon cessation of use for farming or other closely-held business uses is the lesser of -- (1) the "adjusted tax difference" (the excess of the federal estate tax liability that would have been incurred had "use" valuation not been used over the actual federal estate tax liability based on "use" valuation), or (2) the gain on sale over "use" value or the excess of fair market value of the property over the "use" value if disposal is

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other than by sale or exchange at arm's length.\footnote{45} If more than one qualified heir receives qualified real property, the recaptured tax liability is allocated among the property interests in proportion to their respective reductions in value. Qualified heirs are made personally liable for the recaptured tax.\footnote{46} That outcome is not changed even though the qualified heir or heirs may not have received the full tax benefits from "use" valuation and may have paid fair market value for the property in an intrafamily settlement.

It is important to note that recapture requires at most the repayment of tax that would have been due had "use" valuation not been used. Recapture does not require the payment of interest on the recaptured tax. The benefit from "use" valuation thus could be substantial even if recapture were to occur. For example, postponement of payment of $100,000 of tax for 10 years is "worth" $115,894 if the deferred tax could be invested with an eight percent net return. This economic advantage from the "time value of money" is offset at least in part by the lower income tax basis for the property inasmuch as "use" value becomes the value used at death for the "fresh start" adjustment under the carryover basis rules.\footnote{47}

\footnote{45}{\textit{I.R.C.} \S\ 2032A(c)(2)(A)(ii).}
\footnote{46}{\textit{I.R.C.} \S\ 2032A(c)(6).}
\footnote{47}{\textit{I.R.C.} \S\ 1023.}
Special rules for land held by an entity. The regulations are to set forth the application of the "use" valuation rules for property interests held in a partnership, corporation or trust. The legislative intent seems clear that land owned by entities is to be ineligible for "use" valuation. The major question seems to be the eligibility requirements imposed upon land owned other than by individuals.

Statutorily, for land held by a partnership to be eligible the decedent's interest in the partnership must comprise 20 percent or more of the total capital interest in the partnership or the partnership must have 15 or fewer partners. Similarly, for a corporation to be an owner of land eligible for "use" valuation the decedent's interest in the corporation must comprise 20 percent or more of the value of the voting stock or the corporation must have 15 or fewer shareholders. A trust or estate is not subject to comparable limitations, but a person must hold a present interest in a trust to be eligible and property owned by a trust or estate is considered proportionately owned by its beneficiaries. Likewise, property owned by a partnership or corporation is deemed to be proportionately owned by the partners and shareholders, respectively. This suggests that the decedent's fractional ownership of the entity would govern in terms of the fraction of the entity's real property deemed owned by the decedent.

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48/ I.R.C. § 2032A(g). No mention is made of land owned by an estate although the section providing the definition of "closely-held business" does include estates. I.R.C. § 6166(b)(2)(C).

49/ I.R.C. §§ 2032A(g), 6166(b)(1)(B).

50/ I.R.C. §§ 2032A(g), 6166(b)(1)(C).


52/ Ibid.
For real property owned by entities, the material participation requirements seem to warrant special attention. Because it does not appear that material participation can be achieved by agent, it would seem that material participation for real property held in a trust or by a partnership or corporation must be achieved by the decedent-to-be or a member of the family. The issue again becomes one of whether material participation by those who have a majority interest in the entity will be adequate. For a partnership, until clarifying regulations are issued, it would seem wise to plan for all partners to be eligible material participators, if possible. Likewise, in a corporation it would seem prudent for all members of the board of directors and all officers to be eligible material participators until definitive guidance is received from the Department of Treasury.

For a trust, until clarified by regulations, an eligible material participator should be at least a co-trustee (unless material participation is achieved otherwise) with the trust agreement specifying that farm management decisions are to be made by the eligible material participator.

Federal tax lien

A special lien is imposed on all qualified farm or closely-held business real property for which an election has been made to utilize "use" valuation. The lien continues until — (1) the potential liability for recapture ceases (15 years), (2) the qualified heir dies, or (3) the tax benefit is

\[53/\text{See I.R.C. § 1402(a)(1).}\]

\[54/\text{I.R.C. § 6324B.}\]
recaptured. The lien must be filed with the Clerk of the United States District Court of the district where the property is located or another state-designated office in order to preserve its priority against a purchaser, holder of a security interest, mechanic's lien or judgment lien creditor.

Even though properly filed, the special lien does not take priority over designated "super priority" claims. That includes real property taxes and special assessments for public improvements, mechanic's liens for repair or improvement of the property, security interests for the construction or improvement of real property (to the extent of the real property involved in the improvement), a contract to construct or improve real property (to the extent of the proceeds of the contract), or "the raising or harvesting of a farm crop or the raising of livestock or other animals" (to the extent of the crops or livestock involved and the property affected by the general lien for unpaid federal taxes). Obligations for other purposes, such as borrowing to acquire interests of other heirs or to pay state death taxes and estate settlement costs would be subject to the lien. Also subject to the lien would be typical refinancing arrangements where the real property is used to secure new funds advanced to

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55/ I.R.C. § 6324B(b).

56/ I.R.C. §§ 6324B(c), 6324A(d)(1), 6323(f).


repay outstanding obligations. Thus, conflicts between the special lien and subsequent debt obligations may be especially acute if the lender requires a first lien for credit extension. However, the special tax lien may be subordinated with the approval of the Department of the Treasury if sufficient collateral exists to secure adequately the interest of the Department of the Treasury as well as those of the lender.\textsuperscript{62} And the Department of the Treasury may authorize other security to be substituted for the real property in question to secure payment of the tax.\textsuperscript{63} Additional guidance in this area would be helpful to taxpayers, lenders and field personnel of the Internal Revenue Service.

**III. Benefits of "Use" Valuation**

The benefits to individual farm estates of the "use" valuation procedure will result from the reduced estate tax liability because of a lower taxable estate as well as the reduced liquidation costs that will be incurred to pay the estate taxes. To assist farmers in evaluating the benefits of "use" valuation, the major provisions of Section 2032A have been incorporated in the ISU Computer Assisted Estate Planning model.\textsuperscript{64} The procedure used to estimate the "use" value of farm real estate is based on the capitalized value of cash rents minus property taxes.

Because of the difficulty encountered in obtaining cash rent data from individual users (some who have had no experience in the cash rental market), cash rents are estimated based on the current market value of real

\textsuperscript{62}\textsuperscript{I.R.C. § 6325.}
\textsuperscript{63}\textsuperscript{I.R.C. § 6324B(d).}
\textsuperscript{64}\textsuperscript{Boehlje, Michael and Neil E. Harl, "Computer Assisted Estate Analysis", Law-Econ 163, Department of Economics, Iowa State University, July 1977.}
estate as provided by the user. This estimation procedure utilizes the equations of Table 1 which were obtained by regressing USDA cash rent data for the different districts of Iowa as a function of land values from the Iowa Land Value Survey. The data base for these estimates includes the years 1956 to 1976. A separate equation was estimated for each of the nine crop reporting districts in Iowa, and the statistical properties of all nine equations indicate that land value and land value squared are significant explanatory variables in the regression equation at the .05 probability level, and all of the equations have an $R^2$ of .99 or better, indicating that these two variables explain in excess of 99% of the variation in cash rents. One would not expect these specific equations to be sufficiently accurate to be utilized in determining cash rents for specific pieces of property when filing an estate tax return, but they do appear to be adequate for planning purposes. Note the similarity in the equations for all nine crop reporting districts in Iowa, and also note that in all cases cash rents are estimated to be an increasing function of land values, but that cash rents increase at a decreasing rate as land value increases.

These equations are used in the Computer Assisted Estate Analysis model to estimate the "use" value for qualified real estate in the following manner. The user or client is asked to provide information on the "fair market value" of the real estate on a per acre basis. Using this current market value in the appropriate equation for the user's crop

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reporting district, a cash rent value for the current year is determined. Then, an estimate of the value of the real estate in the previous year is determined by multiplying the current market value times the appropriate rate of change in land values for that area as estimated by the Iowa Land Value Survey. This estimate of land value is again entered into the cash rent regression equation and a cash rent is estimated for the previous year. The estimation procedure continues for five years into the past with the land value being decreased each year based on the rate of change suggested by the Iowa Land Value Survey, and the cash rent each year being obtained through the use of the regression equation. Once the five year cash rent series has been estimated, the average can be calculated.

A similar procedure was to be used in determining the 5 year average property taxes, but because of limited data availability, a more simple statewide rather than district estimation procedure was utilized. The capitalization rate was obtained from the Omaha Farm Credit Banks by averaging effective interest rates on new Federal Land Bank loans for the most recent five years.

The estimated "use" value of farm land based on the above computation procedure is compared to the "fair market value" in Table 2. The estimation equation for Central Iowa (District 3) was used to obtain the "use" value estimates. The estimation procedure suggests a use value for this district that is approximately 30 to 45 percent of fair market value. Also note that the reductions in value due to "use" valuation procedures in general are larger for the higher valued land compared to land with lower values. These results imply that larger benefits of "use" valuation will accrue in
those regions of Iowa with high land values compared to those areas with low land values.

The specific benefits of use valuation of real property for estates of different sizes and composition are summarized in Table 3. The calculations assume a farm operation with land valued at $1450 per acre and a will that transfers all property to the spouse at the husband’s death and then to the children at the wife’s subsequent death. Note that with a net worth of approximately $250,000, "use" valuation has little benefit because the marital deduction and credits are sufficient to eliminate most of the tax liability even if the property is valued at "fair market value". In these cases, the executor may choose to value the property at "fair market" rather than "use" value to increase the basis and thus increase the depreciation deductions and reduce the potential capital gains tax at a subsequent sale.

With a $500,000 net worth comprised of approximately 50 percent real property, the use valuation privilege saves taxes and reduces the liquidation costs at the deaths of both husband and wife. A total tax savings of $41,872 can be attributed to the use valuation election at both deaths. This tax savings along with the reduction in liquidation costs results in the transfer of $47,896 of additional property from the parent to the heirs, a savings of almost 10 percent of the net worth of the estate. If the estate was comprised of 90 percent real property, the tax savings at both deaths amounts to $64,556, and total property transferred to the heirs is increased by $78,119 through the election of special use valuation. Thus, the heirs receive almost 14 percent more of the parents’ estate if use valuation is elected.
The numerical results of Table 3 illustrate that use valuation also has sizable benefits for the $750,000 and $1,000,000 size estates. With the $750,000 estate comprised of 90 percent real property, the heirs receive $124,618 more wealth through the use valuation election. With a $1,000,000 estate comprised of 90 percent real property, the benefits of use valuation total $161,798, and the heirs receive almost 15 percent more of the parents' estate when the real property is valued using special use valuation procedures rather than fair market value.

The results of these computer analyses suggest a number of conclusions. First, the benefits of use valuation in terms of tax savings are substantial, for estates in excess of $250,000. The benefit increases as estate size increases because with increasingly larger estates a larger proportion of the maximum allowable reduction of $500,000 can be utilized. Furthermore, even for those estates that can utilize the entire $500,000 maximum allowable reduction due to use valuation, increased benefits from use valuation will still accrue as the estate size increases because of the progressive nature of the marginal tax rates. Obviously, estates with a larger proportion of real property will be able to obtain larger benefits from use valuation, thus encouraging those who can qualify to purchase real estate rather than personal property because of the potential tax benefits. And finally, the benefits of use valuation accrue not only from the tax savings, but because of the reduced liquidation costs that will be incurred to pay the taxes. The results summarized here suggest that use valuation can increase substantially the amount of property transferred to the heirs, and with the sizable benefits that can be obtained by using this procedure, significant cost and effort can be incurred to qualify for and obtain the "use" value privilege.
Table 1. Equations for Estimating Cash Rent for Farmland in Iowa

<table>
<thead>
<tr>
<th>District</th>
<th>Intercept</th>
<th>Land Value</th>
<th>Land Value Squared</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northwest (1)</td>
<td>-12.0127</td>
<td>+.10410</td>
<td>-.00003206</td>
</tr>
<tr>
<td>North Central (2)</td>
<td>-10.8024</td>
<td>+.11005</td>
<td>-.00003360</td>
</tr>
<tr>
<td>Northeast (3)</td>
<td>-6.3663</td>
<td>+.10336</td>
<td>-.00002210</td>
</tr>
<tr>
<td>West Central (4)</td>
<td>-15.4241</td>
<td>+.12936</td>
<td>-.00004781</td>
</tr>
<tr>
<td>Central (5)</td>
<td>-14.7608</td>
<td>+.11605</td>
<td>-.00003458</td>
</tr>
<tr>
<td>East Central (6)</td>
<td>-10.9015</td>
<td>+.10692</td>
<td>-.00002631</td>
</tr>
<tr>
<td>Southeast (7)</td>
<td>-10.5788</td>
<td>+.13415</td>
<td>-.000051894</td>
</tr>
<tr>
<td>South Central (8)</td>
<td>-9.7130</td>
<td>+.15524</td>
<td>-.00010231</td>
</tr>
<tr>
<td>Southeast (9)</td>
<td>-11.2306</td>
<td>+.11779</td>
<td>-.000040875</td>
</tr>
</tbody>
</table>

Table 2. Examples of Use Value Estimates for Central Iowa

<table>
<thead>
<tr>
<th>Fair Market Value</th>
<th>&quot;Use&quot; Value</th>
<th>&quot;Use&quot; as a Percent of Market Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2200</td>
<td>$675</td>
<td>30.7</td>
</tr>
<tr>
<td>2000</td>
<td>661</td>
<td>33.1</td>
</tr>
<tr>
<td>1800</td>
<td>639</td>
<td>35.5</td>
</tr>
<tr>
<td>1600</td>
<td>608</td>
<td>38.0</td>
</tr>
<tr>
<td>1400</td>
<td>563</td>
<td>40.2</td>
</tr>
<tr>
<td>1200</td>
<td>504</td>
<td>42.0</td>
</tr>
<tr>
<td>1000</td>
<td>429</td>
<td>42.9</td>
</tr>
<tr>
<td>800</td>
<td>340</td>
<td>42.5</td>
</tr>
<tr>
<td>600</td>
<td>235</td>
<td>39.2</td>
</tr>
</tbody>
</table>
### Table 3. Implications of Use Valuation for Various Estate Size

#### I. Net Worth of Decedent - $250,000

<table>
<thead>
<tr>
<th>Husband's Death</th>
<th>50% Real Property</th>
<th>90% Real Property</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Use Value</td>
<td>Market Value</td>
</tr>
<tr>
<td>Adjusted Gross Estate</td>
<td>$141,335</td>
<td>$215,971</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Wife's Death</th>
<th>50% Real Property</th>
<th>90% Real Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Gross Estate</td>
<td>150,751</td>
<td>225,412</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td>0</td>
<td>1,600</td>
</tr>
</tbody>
</table>

Value of Property Received by Heirs: 223,919  /  223,713
Percent of Parents' Estate Received by Heirs: 90.13 / 90.35

#### II. Net Worth of Decedent - $500,000

<table>
<thead>
<tr>
<th>Husband's Death</th>
<th>50% Real Property</th>
<th>90% Real Property</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Use Value</td>
<td>Market Value</td>
</tr>
<tr>
<td>Adjusted Gross Estate</td>
<td>$285,060</td>
<td>$434,331</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td>0</td>
<td>14,837</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Wife's Death</th>
<th>50% Real Property</th>
<th>90% Real Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Gross Estate</td>
<td>297,464</td>
<td>432,974</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td>23,289</td>
<td>50,324</td>
</tr>
</tbody>
</table>

Value of Property Received by Heirs: 420,536  /  443,864
Percent of Parents' Estate Received by Heirs: 84.92 / 89.62
### III. Net Worth of Decedent - $750,000

<table>
<thead>
<tr>
<th>Husband's Death</th>
<th>50% Real Property</th>
<th>90% Real Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Gross Estate</td>
<td>Use Value</td>
<td>Market Value</td>
</tr>
<tr>
<td>$428,784</td>
<td>$652,711</td>
<td>$272,365</td>
</tr>
<tr>
<td>13,150</td>
<td>58,317</td>
<td>0</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wife's Death</td>
<td>Adjusted Gross Estate</td>
<td>Use Value</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td>Market Value</td>
<td>612,746</td>
</tr>
<tr>
<td>51,364</td>
<td>63,856</td>
<td>16,574</td>
</tr>
<tr>
<td>Value of Property Received by Heirs</td>
<td>595,083</td>
<td>531,171</td>
</tr>
<tr>
<td>Percent of Parents' Estate Received by Heirs</td>
<td>80.34</td>
<td>72.08</td>
</tr>
</tbody>
</table>

### IV. Net Worth of Decedent - $1,000,000

<table>
<thead>
<tr>
<th>Husband's Death</th>
<th>50% Real Property</th>
<th>90% Real Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Gross Estate</td>
<td>Use Value</td>
<td>Market Value</td>
</tr>
<tr>
<td>$572,074</td>
<td>$871,071</td>
<td>$394,133</td>
</tr>
<tr>
<td>45,788</td>
<td>91,945</td>
<td>2,687</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wife's Death</td>
<td>Adjusted Gross Estate</td>
<td>Use Value</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td>Market Value</td>
<td>801,685</td>
</tr>
<tr>
<td>54,890</td>
<td>93,498</td>
<td>49,155</td>
</tr>
<tr>
<td>Value of Property Received by Heirs</td>
<td>777,518</td>
<td>679,881</td>
</tr>
<tr>
<td>Percent of Parents' Estate Received by Heirs</td>
<td>78.80</td>
<td>69.32</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Husband's Death</th>
<th>50% Real Property</th>
<th>90% Real Property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted Gross Estate</td>
<td>Use Value</td>
<td>Market Value</td>
</tr>
<tr>
<td>$390,138</td>
<td>$794,376</td>
<td></td>
</tr>
<tr>
<td>49,155</td>
<td>93,583</td>
<td></td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wife's Death</td>
<td>Adjusted Gross Estate</td>
<td>Use Value</td>
</tr>
<tr>
<td>Federal Estate Tax</td>
<td>Market Value</td>
<td>658,028</td>
</tr>
<tr>
<td>83.49</td>
<td>68.71</td>
<td></td>
</tr>
</tbody>
</table>
IV. Implications of "Use" Valuation

The benefits of "use" valuation of real estate for individual farmers have been reviewed in the earlier section. The emphasis of this discussion will be on effects that "use" valuation will have on land values, investment patterns, land tenure arrangements, credit transactions and transfer alternatives.

One would expect that "use" value will typically be less than fair market value in almost all circumstances. This will occur for at least two reasons—(1) the investment behavior of farmers suggests that historically they have been willing to accept a lower rate of return on land (and thus a lower discount rate for purposes of valuing and bidding for land) than the discount rate currently being used in the "use" valuation formula. Historically, rates of return on land have averaged in the range of 4-5 percent per year compared to the typical range on interest rates for new Federal Land Bank loans of 7 1/2-9 percent per year,\(^{66/}\) (2) cash rental figures as required by the "use" valuation procedure are expected to be lower than the rental rate received by land owners who are willing to incur some of the risk of production and price changes as reflected in crop-share rental arrangements. Consequently, since land owners are frequently expecting a higher income from their investment than the cash rental rate, and they may be willing to accept a lower rate of return than the discount rate, one would expect "use" valuation estimates to be consistently lower than fair market value. For deaths in 1977, "use" valuations of 35-40 percent of fair market value were relatively common using the cash rent capitalization approach. Calculations for deaths in 1978

have reflected a slightly higher set of "use" valuation figures from cash rent capitalization inasmuch as 1972 cash rents were replaced with 1977 figures which were generally higher. Even at that, "use" value figures of 40-50 percent of fair market value or comparable sale value are not uncommon.

Although the specific impacts of such deviations between "use" value and fair market value are not known, one can speculate on the impact this deviation might have on investment behavior. The benefits of "use" valuation demonstrated for different size estates in Table 3 can illustrate the potential impacts for various investors in qualified real property. These benefits have been summarized on a per acre basis in Table 4. Since the benefits of use valuation will accrue in the future at death, their current value can only be evaluated by discounting the benefits at an appropriate rate to reflect the time value of money.

Because of the pre-death requirement that qualified property must be used for farming or other closely held business purposes for five of the eight years preceding death, one could presumably not obtain the benefits of a current purchase for at least a minimum of five years. If a purchase of qualified real property is made with expectations of death in five years, the present value of the use valuation benefits total $172 per acre for the $500,000 estate. With the $750,000 and $1,000,000 estates, the present value of the benefits for a death in five years total $182 and $178 per acre respectively. As the expected life increases, and thus more years elapse between the purchase of the property and the date of death, the present value of the "use" valuation benefit declines. The benefit totals
$50-60 per acre if death is expected to occur 20 years following the purchase. These figures indicate the per acre price premium that could be paid for real property that would qualify for "use" valuation. For a farmer with a life expectation of five years, the price premium of Table 4 amounts to approximately 12% of the fair market value of the land used in the analysis. Thus, it could be expected that with increasing age, farmers would be encouraged to move toward a greater investment in land and less investment in non-land assets. Those with a longer life expectancy would pay a smaller premium for the benefits of "use" valuation as indicated in Table 4. Thus, the "use" valuation legislation could enable older farmers to outbid younger farmers for a particular parcel of land based strictly on the value of the tax benefits each would receive. In general, the bid price for farm real estate would be expected to rise in the amount of the net present value of such tax benefits. This can only result in an increased divergence between the value of the land and its cash income generating capacity.

The above would be the expected result to the extent the individual's investment in land would not produce the maximum reduction of federal gross estate of $500,000. Those with sufficient investment in land to assure without a doubt the maximum reduction in gross estate would be expected to maintain an investment position in land sufficient to assure the maximum tax saving but "use" value in itself would not encourage greater investment in land. On balance, the encouragement for many to increase investment in land to assure the maximum reduction in tax would be expected to generate upward pressure on land prices, although the net effect might well be modest because many older farmers already have a substantial investment position in land.
Table 4. Value of Benefits from "Use" Valuation Per Acre of Land

<table>
<thead>
<tr>
<th>Net Worth</th>
<th>Benefits Per Acre</th>
<th>Present Value of Benefits (8%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Present Value of Benefits</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Assuming Death in:</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 years</td>
</tr>
<tr>
<td>$500,000</td>
<td>$252</td>
<td>$172</td>
</tr>
<tr>
<td>$750,000</td>
<td>$267</td>
<td>$182</td>
</tr>
<tr>
<td>$1,000,000</td>
<td>$261</td>
<td>$178</td>
</tr>
</tbody>
</table>

The size of the benefits accruing from "use" valuation would be expected to attract additional interest in land as an investment. For investors who do not own farm land or other land eligible for "use" valuation, the impact of the "use" valuation option on investment behavior could be much greater than for farmers. Thus, a nonfarmer with no investment in land but with a $2,000,000 estate could shift $1,000,000 to land, reduce his or her gross estate by $500,000, and obtain an assumed federal estate tax benefit of $225,000 (45 percent tax bracket). A farmer with a $2,000,000 estate, half or more of which was in land, would derive the same dollar benefit but the effect on investment patterns would be less.

As noted, the size of estate of the investor influences the absolute size of the "use" valuation benefits with those possessing larger estates receiving a greater net benefit from a $500,000 reduction in the gross estate from "use" valuation. Thus, the maximum tax savings from "use" valuation of land would range from zero (for those with estates not subject to federal estate tax) to $350,000 for someone in the 70 percent federal estate tax bracket. In addition to these tax savings, any reduction in liquidation costs would also be attributable to the "use" valuation privilege.
It is clear, then, that the major impact on investment patterns would be felt as investors able to meet the pre-death and post-death requirements for "use" valuation of land endeavor to gain a position in land ownership sufficient to assure a reduction in the gross estate of $500,000.

The net value of the tax benefit rises with size of estate because of the graduated tax rate but once the $500,000 reduction in gross estate is reached, further benefits come from having a larger estate and that is a function not just of ownership of land but of ownership of all assets. Thus, if the gate restricting the "use" valuation privilege is opened further to enable "non-farm" investors to obtain the tax benefits noted above, one would expect increased movement of equity capital from the non-farm into the farm sector. The implications of such movements with respect to the separation of ownership and control of farm assets should be evaluated. It would be expected that additional capital would flow into farmland, driving up the price, until investors were once again indifferent between investing in farmland with the benefits of "use" valuation and investing in other assets valued at death at fair market value. Thus, the effect would be a one-time increase in land value with subsequent purchasers paying a higher price for land.

If the "gate" does hold, the result would be a substantial economic advantage for those able to meet the pre-death and post-death requirements with the result that such individuals (presumably farmers and those actively involved in management under a lease) would be able to bid land away from those ineligible to utilize "use" valuation (presumably non-farm investors).
Certainly, free flows of capital between various sectors of the economy are essential to optimal resource allocation. But, increased incentives for investment attributable primarily to tax legislation, particularly when that investment may do little to add to the productivity of the sector as is frequently the case with purchases of farm real estate, must be evaluated with care.  

The current situation concerning material participation and the conflicts therein with respect to simultaneously obtaining social security benefits and maintaining qualification for "use" valuation will certainly have implications for leasing arrangements. In essence, this conflict has the attributes of self-destruction, for to maintain material participation, many leasing arrangements may be changed from cash rent to crop share rental agreements. This would reduce the number of potential observations from which to obtain data for the capitalized rent approach to "use" valuation since under current law only cash rent data can be used. In addition, changes in leasing from cash to crop-share agreements would be expected to increase the risk that will be borne by retirement age farmers. The implications for the services offered by farm management firms are apparent unless legislative changes occur. Certainly, one of the key issues that must be faced squarely is the cost versus the benefit of

67/ Purchase by non-farm investors of farm land from other non-farm investors or non-farm heirs of deceased farmers assures an out-flow of capital from agriculture comparable to the inflow from the new investment if land values are left unchanged. Only in the event land is purchased from farmers and the resulting funds are available for financing agricultural production would investment in agriculture by non-farm investors have a direct effect on availability of production credit. Moreover, if the presence of additional outside capital results in a bidding up of farm land prices, the land base has "absorbed" additional capital but without any necessary direct effect on capital availability for production. See Harl, "Influencing the Structure of Agriculture," paper delivered in Distinguished Visitor Lecture Series, University of Arizona, February 27, 1978, p. 8.
changing the material participation rules to allow participation by agent. Such a change would enable those not actively involved in the farm business such as retired widows to utilize the services of a farm management agency to operate the farm without the risk of disqualification for "use" valuation. However, the potential cost that may be incurred in terms of encouraging "non-farm" investors to purchase farm real estate, particularly in light of the benefit estimates presented earlier, cannot be viewed lightly.

It is fundamental to any discussion and analysis of the "use" valuation of land to reach an agreement on the purposes of the legislation and the objectives of the U.S. Congress in enacting such a departure from traditional fair market value. Although different interpretations exist, it is believed that the basic purpose to be served by the legislation was to reduce the federal estate tax burden for estates holding an interest in farms and other small businesses, and not necessarily to reduce the federal estate tax burden for those investing in farmland. This is an important point and should be kept firmly in mind in evaluating proposed amendments to the statute.

The tax lien that attaches to real property if "use" valuation is elected has implications concerning credit utilization and credit flows in agriculture. Some lenders have expressed reservations as to advancing funds if the security already has a "use" valuation tax lien attached. If such a lien is attached to real property, it may reduce the possibility of using that property as the collateral for refinancing as commonly occurs.
during farm expansion and in periods of financial stress. Consequently, if such liens become a common occurrence, those farmers may find it more difficult to use their real estate as a source of security for credit transactions.

An important implication of the recapture rules that may result in conflicts between "on-farm" and "off-farm" heirs should also be noted. As has been indicated earlier, if the real property ceases to be used for a qualified purpose or is sold outside the family, recapture of any tax benefits may occur. A conflict between the heirs can clearly occur in the following scenario which is not atypical in the agricultural sector. Assume the on-farm heir, because of disability or other investment opportunities including the opportunity to purchase a more productive parcel of real estate, decides to sell the qualified property and pay his portion of the recapture tax. The non-farm qualified heirs would be forced by this decision to become material participants, or to pay their share of the recapture tax. One might expect such a conflict between the interests of the on-farm and off-farm family heir could result in substantial family discord during the fifteen year period when recapture can occur.

Implications for gift giving and sale of the property prior to death should also be noted. Presumably, the proceeds of a sale including the installment sale of land would not qualify for "use" valuation. Consequently,

68/ For example, 15% of the funds loaned in the Omaha Federal Land Bank district in 1977 were advanced to pay short-term debts and 28% were used to refinance mortgages; Federal Land Bank of Omaha, 1977 Annual Report, January 1978, p. 3.
the sale of real property prior to death may in fact increase the estate tax liability even though such a sale may satisfy other estate planning objectives. Furthermore, the sale or gift of sufficient property to reduce the proportion of qualified property below the 50 and 25 percent pre-death requirements discussed earlier would also preclude the election of use valuation. So, care must be exercised in planning for the gift or sale of property during lifetime if it is desired to maintain eligibility for the "use" valuation privilege. And note that maintaining eligibility for this privilege may in fact present conflicts with other estate planning objectives, specifically in cases where a gradual transition of an "on-going" firm from one generation to the next is desired.

A final point should be noted concerning the interface between the "use" valuation provisions and the regulations concerning "carryover basis" and installment reporting of federal estate tax. In brief, the "carryover basis" rules eliminate the stepped-up basis that was obtained by the recipient of property at the decedent's death prior to 1977, and replace it with a basis that is carried over from the decedent. Thus, at the time of a subsequent sale, tax will be due on the amount of gain as calculated by the market value of the property at the time of the sale minus the basis of the property adjusted for the gain deemed to have accrued prior to January 1, 1977, and the other adjustments to basis that may be made under the carryover basis rules. If "use" valuation is used to value real property, this value is also used in the calculation of the "fresh start" adjustment to "carryover basis". The result of

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69/ I.R.C. § 1023.
70/ I.R.C. § 6166.
72/ I.R.C. § 1023.
"use" valuation would be a reduction in the adjusted basis and an increase in the gain taxable at a subsequent sale. The combination of use valuation and the carryover basis rules could result in the accumulation of substantial gain in real property. If real estate continues to increase in value, a further gain and thus tax liability will accrue so that recipients of property transferred at death may be increasingly reluctant to sell because of the large tax burden. This "locked-in" effect may result in reduced offerings of real estate on the market and more rental arrangements. With reduced offerings, values for property on the market may be bid up even further, and certainly different types of credit demands would arise with the emphasis on financing rental arrangements rather than real estate purchases.

The provisions with respect to installment reporting of federal estate tax may also influence the transfer of real estate by the decedent-to-be before death. To qualify for the 15-year installment payment privilege, a closely-held business must exceed 65 percent of the adjusted gross estate. Thus, a decedent-to-be would not plan to sell or gift business real or personal property to others if he plans to qualify for installment payment of tax and such a sale or gift would reduce the business property to 65 percent or less of the adjusted gross estate. In fact, the combination of the installment payment of tax and "use" valuation rules is expected to discourage transfers of real property by the decedent-to-be, and the "carry-over" basis rules will likely discourage transfers by the heirs. The result could be that those families who now own rural

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real property will encounter encouragement not to transfer that property outside the family and a rather exclusive class of rural land holders would develop over the years. The political and social implications of such a permanent group of land owners with the tax system discouraging entry are beyond the scope of this discussion, but such a land tenure system may not be in the best interests of the "family farm".
## APPENDIX A

### COMPUTATION OF AVERAGE INTEREST RATES

The Federal Land Bank of Omaha

<table>
<thead>
<tr>
<th>Number of Months</th>
<th>Interest Rate</th>
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<tr>
<td><strong>5-Year Period Ended 12-31-77:</strong></td>
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<tr>
<td>1-1-73 - 9-30-73</td>
<td>9 7.50%</td>
</tr>
<tr>
<td>10-1-73 - 6-30-74</td>
<td>9 8.00%</td>
</tr>
<tr>
<td>7-1-74 - 10-31-74</td>
<td>4 8.50%</td>
</tr>
<tr>
<td>11-1-74 - 8-31-75</td>
<td>10 9.00%</td>
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<td>9-1-75 - 10-31-77</td>
<td>26 8.75%</td>
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<tr>
<td>11-1-77 - 12-31-77</td>
<td>2 8.25%</td>
</tr>
<tr>
<td><strong>Average Interest Rate for 5-Year Period Ended 12-31-77 - To Be Used When Death Occurs in 1978</strong></td>
<td><strong>8.46%</strong></td>
</tr>
</tbody>
</table>

| **5-Year Period Ended 12-31-76:** |
| 1-1-72 - 3-31-72 | 3 8.00%        |
| 4-1-72 - 9-30-73 | 18 7.50%       |
| 10-1-73 - 6-30-74| 9 8.00%        |
| 7-1-74 - 10-31-74| 4 8.50%        |
| 11-1-74 - 8-31-75| 10 9.00%       |
| 9-1-75 - 12-31-76| 16 8.75%       |
| **Average Interest Rate for 5-Year Period Ended 12-31-76 - To Be Used When Death Occurs in 1977** | **8.25%** |
To: All Presidents and Branch Office Managers  

Subject: Average Interest Rate for Use in 1978

In January, 1977, we advised you that the 1976 Tax Reform Act permitted an executor of an estate to elect one of two methods of valuing real estate used in farming or in a closely-held business, in order to compute the estate tax. One method involved the Federal Land Bank’s interest rates for the past 5 years.

The average interest rate on loans made by the Federal Land Bank of Omaha for the 5-year period from January 1, 1973, to December 31, 1977, was 8.46 percent. This rate would apply where death occurs in 1978. The average interest rate for the 5-year period from January 1, 1972, to December 31, 1976, was 8.25. This rate would apply where death occurred in 1977.

The Internal Revenue Code provides that the interest rate shall be the "effective rate" and our annual percentage rate when computed in accordance with actuarial principals for Truth-in-Lending is 1/2 percent greater than the contract, or billing, rates reflected above. Also, there are 12 Federal Land Bank Districts and the rates of the Federal Land Bank of Omaha are not necessarily identical with the rates of other Districts.

The Federal Land Bank of Omaha makes no representation concerning the interpretation of the tax law. This letter is provided for informational purposes, only. If you are so requested, you may provide a copy of this letter to any persons making inquiry.

Sincerely,

James E. Ludeman  
Vice President

Attachment
Table 1. Estimated Farm Land Rental Rates - Iowa 1/
Whole Farm - Dollars Per Acre

<table>
<thead>
<tr>
<th></th>
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<td>State Average</td>
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<td>$69</td>
<td>$60</td>
<td>$53</td>
<td>$39</td>
<td>$35</td>
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Table 2. Estimated Farm Land Rental Rates - Iowa
Crop Land - Dollars Per Acre

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<td>$53</td>
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<td>87</td>
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<td>$70</td>
<td>$58</td>
<td>$44</td>
<td>$35</td>
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</tbody>
</table>

1/ Prepared by E. G. Stoneberg, Extension Economist from data received from the Economic Research Service, USDA, Washington D.C.
APPENDIX D

Suggested Guidelines for Cash Rent Data Collection for "Use Valuation of Farmland"

Section 2032A of the Internal Revenue Code, which was added by the Tax Reform Act of 1976, creates two new methods for valuing land. One, for which only farmland is eligible, includes capitalization of gross cash rent on comparable land in the locality (minus property taxes) at the average annual effective Federal Land Bank interest rate. All calculations are to use the last five full calendar years before death. The other new method for valuing land, open to farmland and other land used in a closely-held business, is a five factor formula. The rent capitalization approach is expected to be used to a much greater degree for farmland than the five factor formula.

One of the major problems with the rent capitalization approach is in identifying actual tracts of land that are cash rented and that are comparable to the decedent's tract or tracts as required by the statute. For the rent capitalization approach to become operational, it appears that it will be necessary to identify tracts of comparable land that have been leased under cash rental arrangements for the last five years prior to the decedent's death. A suggested procedure for identifying such tracts of land, acquiring cash rental information, creating an appropriate custodial arrangement for the data, and assuring data retrieval from the file are discussed below.

The usefulness of a system for adducing cash rental information is enhanced if the procedures used are uniform throughout the state. Therefore, it is suggested that the procedures followed be as uniform as possible throughout the state.
I. The Questionnaire

Using the questionnaire

A three part questionnaire identified as "Uniform Questionnaire: Cash Rents" has been developed for use in collecting cash rental information. A limited number of copies have been made available from the Department of Economics, Iowa State University. The questionnaire may be reproduced locally as needed.

Part I - The first part of the questionnaire contains basic identifying information. An identifying number should be assigned to the tract covered by the questionnaire by the local custodian of the file. This identifying number is viewed as an aid in filing and retrieving information locally. It is suggested that the number contain the county number and the number of the questionnaire assigned in order as the questionnaires are received by the custodian of the local file. For example, the first questionnaire submitted for Hamilton County would be assigned the number 40-1. The county name also appears and can be entered before local reproduction if desired.

The rest of the first page of Part I is completed by the local interviewer. Interviewers are urged to complete Part I even if there is less than 5 years' rental experience for the tract. Even cash rental for 1978 only would be helpful if the tract continues to be cash rented in the future. Obviously, cash rental for 1972 only is of little value. However, even there, it is possible that such data could conceivably be useful if the regulations permit the establishment of cash rental rates by piecing together information from tracts cash rented for less than the full five year period. The questionnaire requests cash rent infor-
mation from 1972 forward under the assumption that information for the
5 years 1972 through 1976 will be useful for several years in conjunc-
tion with the filing of federal estate tax returns for deaths in 1977
and in conjunction with the audits of such returns.

The code number for the part of the farm that is cash rented should
be completed by the interviewer if and to the extent possible.

- The county number is a two digit number assigned by the counties
  by alphabetic listing. E.g. Boone County is 08, Polk County is 77.

- Each individual or firm participating in the data collection ef-
  fort should be assigned a two digit number by the custodian of the file.
  That number should be entered above "Interviewer".

- The tract number is one or more two digit numbers describing the
  tract in question within a section. A diagram listing code numbers by
  40 acre tract appears on the back of Part I of the questionnaire and is
  set out below also —

<table>
<thead>
<tr>
<th>Tract Code Within a Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>44</td>
</tr>
<tr>
<td>43</td>
</tr>
<tr>
<td>34</td>
</tr>
<tr>
<td>33</td>
</tr>
</tbody>
</table>

To describe the NW 1/4 of the section, the tract number would be shown as
41-44, the E 1/2 of the NE 1/4 would be shown as 11-12. The full section
would appear as 11-44.
The section number is a two digit number. E.g. section 6 would be listed as "06", section 36 would appear as "36".

- The township part of the code is a three digit number, giving the township north of the base line.

- The range is a two digit number giving the range from the 5th Principal Meridian.

The person interviewed should be asked to complete and sign the "Statement by Person Interviewed" at the bottom of Part I.

**Part II** - It is recognized that some individuals are sensitive to the sharing of cash rental information. Thus, in some instances, the person interviewed may be willing to complete Part I but not be willing to complete Part II. If the person interviewed is willing to provide specific information on rental, Part II should be completed.

The top half of Part II is to be completed only if the entire farm is cash rented. If the residence is separately rented, that information may be entered on lines 1(b) and 1(c). The next four lines request information to be used in statistical estimation at Iowa State University.

The lower half of Part II is used if less than the entire farm is cash rented.

For both portions of Part II, the form asks for acres involved, the cash rental in dollars or dollars-per acre, and the property tax in dollars.

Again, the person interviewed should complete and sign the statement at the bottom of the page.
Part III - This part provides an opportunity for memorializing the Corn Suitability Rating for the tract or tracts involved. Space is provided for three tracts on each sheet; additional sheets may be used and marked appropriately. The interviewer is not expected to complete Part III. Information entered on Part III may be helpful in determining what is "comparable land" and is essential for Iowa State University research purposes. For 1978, Iowa State University data needs will likely be limited to designated pilot counties.

The reverse side gives an example of Corn Suitability Rating calculation and contains a worksheet for figuring the Rating for aggregated tracts for which CSR information is available. The Corn Suitability Rating may be helpful in determining what is "comparable land". In counties in which CSR information is available (about two-thirds of the counties in Iowa), the data are in the hands of the County Assessor. A listing of those counties appears as Exhibits A and B.

Collecting Cash Rent Information

It is suggested that each county participating in the pilot project in 1978 to collect cash rent information develop a plan for completion of questionnaires. The following may be helpful ways to approach the collection problem --

1. Ask each individual or firm preparing farm income tax returns to request permission of the taxpayer for completion of the questionnaire (or at least Part I thereof) if the tax preparer notes farm cash rent paid or received.
2. A request could be made of farm lenders to assist in the data collection effort with supplies of the questionnaire made available to those interested in participating.

Completed questionnaires should be transmitted periodically to the custodian of the local file. While in the custody of the interviewer, the completed questionnaires should be treated as confidential information to assure confidence in the system by persons interviewed.

Establishing and Maintaining the Local File

In recognition of the sensitivity of cash rental information, and in an effort to assure confidence in the total cash rental collection system, it is necessary in each county to establish a custodian for the local file. It is suggested that interested individuals in each county (or group of counties if approached in a multi-county basis) reach an agreement on an appropriate custodian for the local file. The custodian of the file should be selected to assure —

1. Accessibility to the file by all eligible parties as defined in next section.

2. An appropriate degree of custodial care to guard against unauthorized release of the information.

3. That the file will be maintained on an up-to-date basis to facilitate use.

Local groups are urged to consider establishment of a nonprofit corporation (Chapter 504A of the Iowa Code) as a custodian with seats on the governing board occupied by representatives of user groups. Such corporations could be chartered for the sole purpose of serving as
local custodian for the cash rental file for the county or area involved.

**Access to the File**

The pilot project to acquire cash rental information is based on the assumption that access to the local cash rental file would be assured, on a need-to-know basis, during the period of estate administration and until completion and acceptance of the final audit of the federal estate tax return or completion of litigation relating thereto, whichever is later.

1. The fiduciary or an agent of such fiduciary for an estate or trust estate that includes farmland within or near the geographic area covered by the file in question.

2. The attorney or attorneys for the estate or trust estate representative.

3. The distributee of farmland from a decedent who died owning farmland within or near the geographic area covered by the file in question or a person who bears liability for payment of federal estate tax in the estate of such a decedent.

4. Representatives of the Internal Revenue Service.

5. The Department of Agronomy and the Department of Economics at Iowa State University for research purposes (no data shall be published that permit the identification of information about specific tracts of land).

6. In the event of enactment of legislation authorizing "use" valuation of land for Iowa inheritance tax purposes, representatives of the Iowa Department of Revenue.
Transmitting Information to Iowa State University

For 1978, custodians of files in counties designated as pilot project counties are asked either to — (1) relinquish questionnaires to permit photocopying by Iowa State University project personnel, or (2) provide a carbon or photocopy of completed parts of questionnaires to Iowa State University for research purposes. All such materials should be sent to Neil E. Harl, 478 East Hall, Iowa State University, Ames, Iowa 50011.

For years after 1978, it is anticipated that special forms will be printed that make two copies, the original to be retained in the local file and the copy forwarded to Iowa State University.

II. Interest Rates

The Internal Revenue Service has not indicated its position on the procedure to be followed in making the Federal Land Bank interest rate calculation. Those working in this area should watch for a ruling or announcement on this matter.

The Federal Land Bank of Omaha has calculated the stated interest rate at 8.25% for deaths in 1977 and 8.46% for deaths in 1978 as shown on Exhibit C. The estimate of that office is that the effective rate would be about 0.5% higher than the stated rate based upon their calculations for Truth-in-Lending purposes.

III. Other Sources of Cash Rent Information

The Crop and Livestock Reporting Service of the United States Department of Agriculture, the result of an annual survey, publishes each

The data suffer from two infirmities. First, they are averages for the crop reporting district. Although data may be obtained by county, the figures are not statistically reliable because of the relatively small number of survey responses for each county. Thus, the data could be used directly only if the farm in question was an "average" farm for the crop reporting district. The second problem is that the data are based upon the cash rent the respondents believe will be paid for the coming crop year. The figures are not based upon actual cash rent observations. For these reasons, it seems likely that the USDA figures will have limited usefulness for "use" valuation. The data may be helpful for purposes of general comparison with observations of actual cash rental paid.
**Uniform Questionnaire**

**Cash Rents**

**Part I**

1. **Person interviewed**
   - Address

2. **Role of person interviewed:** landlord
   - Address
   - Tenant
   - Other (specify)

3. **Interviewer**

4. **Date of interview**

5. **Landlord**
   - Address
   - Tel. no.

6. **Tenant**
   - Address
   - Tel. no.

7. **Code number for part of farm cash rented**
   - (County) (Interviewer) (Tract) (Section) (Township) (Range)
   - (Enter in Part II, Item 1 or Part II, Item 2)
   - Acreage

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<th>Year</th>
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<th>Landlord</th>
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<th>Landlord</th>
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<tbody>
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<td>All but residence</td>
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</tbody>
</table>

**Statement of Person Interviewed**

I hereby agree to insertion of the above information in a file maintained in county for such questionnaires and to disclosure of said information by the custodian of the file to those individuals demonstrating a need to know such information for federal estate tax purposes or for state succession, inheritance or estate tax purposes if property subject to such tax is valued at other than fair market value.

Person Interviewed: ____________________________
Date: ____________________________
## Tract Code Within a Section

<table>
<thead>
<tr>
<th>44</th>
<th>41</th>
<th>14</th>
<th>11</th>
</tr>
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<tbody>
<tr>
<td>43</td>
<td>42</td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td>34</td>
<td>31</td>
<td>24</td>
<td>21</td>
</tr>
<tr>
<td>33</td>
<td>32</td>
<td>23</td>
<td>22</td>
</tr>
<tr>
<td>Year</td>
<td>Acres</td>
<td>Rent</td>
<td>Tax</td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
<td>------</td>
<td>-----</td>
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<tr>
<td>1978</td>
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<td>1973</td>
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</tr>
<tr>
<td>1972</td>
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</tr>
</tbody>
</table>

1. Cross cash rent-
2. Total farm-
3. Separate rental charged for residence or farmstead
4. Was residence or farmstead occupied by the farm tenant (FT) or another leasee (L)
5. Length of lease-
6. Effective date of lease-
7. Length of time tenant has been renting this land from present landlord:
   - this is first year
   - 1-3 years
   - 4-10 years
   - more than 10 years
8. Relationship of landlord and tenant:
   - Parent/child
   - brother/brother (or sister)
   - uncle/nephew (or niece)
   - spouses
   - no relation
   - controlled corporation
   - controlled partnership
   - other (specify)

NOTE: Use additional sheets if needed to show different rental arrangements during the time in question. Footnotes on reverse side.

Statement of Person Interviewed
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Person Interviewed
Date
1/ Gross cash rent is defined as the rent on land for a specified period at an agreed upon amount per acre or per farm with the landlord bearing no uncertainty of yield or price variation.

2/ If the rent charged varies for row crop, pasture and hay land, use item 2 below rather than this item.

3/ Length of lease means length of original lease in force for that year. Leases that are renewed, with renegotiation or otherwise, are considered new leases for this purpose.

4/ This is the date the lease first became effective. A one-year lease, even if automatically renewed, is a one-year lease for this purpose with an effective date, usually, of March 1.

5/ If available.

6/ A child/step parent relationship is to be treated as a lease between unrelated parties.

7/ If the leasehold relationship, whether because of a fiduciary duty, presence of a farm manager or otherwise, has produced a rental that approximates reasonably a fair rental value, this arrangement is to be treated as a lease between unrelated parties.
<table>
<thead>
<tr>
<th>Code number of tract</th>
<th>(County)</th>
<th>(Interviewer)</th>
<th>(Tract)</th>
<th>(Section)</th>
<th>(Township)</th>
<th>(Range)</th>
<th>Assessor's Tract No.</th>
</tr>
</thead>
</table>

1. **Corn suitability rating (CSR)**
   Weighted average for tract described above
   Does the above CSR weighted average for tract include adjustments for drainage ways, till outcrops, etc.? Yes 2/ No
   Assessed value for improvements (if any) ____________________________
   Assessed value for land (not including improvements) ____________________________

2. **Assessed value for land (not including improvements) ____________________________

3. **Assessed value for land (not including improvements) ____________________________

---

**Note:** Use additional sheets if needed to show different rental arrangements during the time in question.

1/ See reverse side for explanation of computational procedure.

2/ If adjustments have been made in the CSR rating, as indicated, please provide information on nature of the adjustments made. A machine copy of the assessor's card would be acceptable if the adjustments are reflected thereon.
### Example for Weighting Corn Suitability Rating

<table>
<thead>
<tr>
<th>Tract</th>
<th>Acres/tract</th>
<th>CSR Rating</th>
<th>Weighted Scores</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>40</td>
<td>x 90.0</td>
<td>3,600</td>
</tr>
<tr>
<td>2</td>
<td>20</td>
<td>x 88.0</td>
<td>1,760</td>
</tr>
<tr>
<td>3</td>
<td>20</td>
<td>x 91.2</td>
<td>1,824</td>
</tr>
<tr>
<td>4</td>
<td>40</td>
<td>x 82.0</td>
<td>3,280</td>
</tr>
<tr>
<td></td>
<td>120</td>
<td></td>
<td>10,464</td>
</tr>
</tbody>
</table>

\[
\frac{10,464}{120} = 87.2
\]

### Worksheet for Weighting Corn Suitability Rating

<table>
<thead>
<tr>
<th>Tract</th>
<th>Acres/tract</th>
<th>CSR Rating</th>
<th>Weighted Scores</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td></td>
<td>x</td>
<td></td>
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<tr>
<td>7</td>
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<td>x</td>
<td></td>
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<tr>
<td>8</td>
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<td>x</td>
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<tr>
<td>9</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td></td>
<td>x</td>
<td></td>
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<tr>
<td>11</td>
<td></td>
<td>x</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td></td>
<td>x</td>
<td></td>
</tr>
</tbody>
</table>

Weighted CSR = \( \frac{\text{ weighted sum of scores } }{\text{ total acres} } \) = 

---

1/ For many tracts, adjustments may be needed for drainage ways, till outcrops, and other features affecting productivity of the tract.