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Neil E. Harl
Iowa State University, harl@iastate.edu

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REVALUING PRIOR GIFTS AT DEATH

— by Neil E. Harl

One result of the 1976 effort unifying the federal estate and gift tax was that "adjusted taxable gifts" after 1976 are taken into account in determining cumulative transfers at death.1 This is the mechanism by which use of any part or all of the unified estate and gift tax credit during life is taken into account at death.

A major question that has been repeatedly litigated in recent years is whether IRS after death can revalue lifetime gifts falling within the category of adjusted taxable gifts.2 The predominant view emerging from the cases is that IRS may indeed revalue such gifts even though the period of time for challenging gift tax liability has expired.3

Adjusted taxable gifts

It is important to note that the term "adjusted taxable gifts" does not include all gifts made during life. The term includes gifts made after 1976 and not covered by the federal gift tax annual exclusion,4 the federal gift tax marital deduction5 or the federal gift tax charitable deduction.6 Thus, relatively few farm and ranch taxpayers have made adjusted taxable gifts. In most instances, gifts are covered by one of the three deductions. However, for those making major gifts to donees other than the taxpayer's spouse or a qualifying charity, the question of whether the gift can be revalued after death may be highly important.

Revaluation for federal gift tax purposes

Under the Internal Revenue Code, a redetermination of prior gifts is barred for purposes of taxing current gifts if, with regard to the prior gift — (1) the statute of limitations has run and (2) a federal gift tax was paid or assessed.7 In that situation, the prior gift's value is that used as a basis for payment or assessment of federal gift tax.8 IRS has explained that the purpose of the statute in question was to prevent the valuation of a past transfer from being placed in doubt after IRS had previously been satisfied as to the correctness of the valuation of the gift.9 It should be noted that valuations on a no-tax return do not enjoy the same protection.10

Since use of the unified credit is mandatory,11 failure to use the available unified credit to cover gifts prevents the three year statute of limitation from running as to the assessment of federal gift tax.12 Inasmuch as few farm and ranch taxpayers make gifts sufficient in value to use the unified credit during life, the statute has relatively little practical effect.

Revaluation for federal estate tax purposes

The question is whether the statute, I.R.C. § 2504(c), which by its terms applies to the federal gift tax, applies also for federal estate tax purposes. The federal estate tax levied at death depends upon the value of cumulative lifetime transfers as well as the value of property passing at death.13 The federal estate tax is the tax on the taxable estate plus "adjusted taxable gifts."14 Thus, there is no tax imposed at death on adjusted taxable gifts but adjusted taxable gifts use up the unified credit and move the estate into higher tax brackets.

In a 1984 ruling,15 the Internal Revenue Service held that lifetime taxable gifts could be redetermined and revalued as of the date of the gift even though the limitations period had expired. The first case to discuss the issue, Boatmen's First National Bank v. United States,16 held that I.R.C. § 2504(c) was applicable to federal estate tax computations and that IRS could not revalue lifetime gifts where gift tax had been paid and the statute of limitations had run. In a 1990 Tax Court case, Estate of Smith,17 a divided court upheld the IRS position. Two subsequent Tax Court cases18 and a U.S. District Court decision19 also agreed with the IRS position. One of the Tax Court cases has now been affirmed by the Fourth Circuit Court of Appeals.20

The latest case, Evanson v. United States,21 entered a summary judgment on the issue in favor of the taxpayer, thus aligning that court with Boatmen's First National Bank v. United States,22 and stated —

"... The issue produces either opposite results or spirited dissents when presented to different courts. I quite frankly do not know which is the more rational holding, but feel that the IRS has more resources for purposes of appeal."

Conclusion

Although the courts are divided, the balance seems to be shifting toward the IRS view that I.R.C. § 2504(c) does not apply to the federal estate tax. The lesson is clear: the valuation of any taxable gifts should be carefully prepared and dutifully preserved to combat a later assertion that the property was undervalued.
FOOTNOTES
2 See ns. 13–22 infra and accompanying text.
3 Id.
4 See I.R.C. § 2503(b).
5 See I.R.C. § 2523.
7 I.R.C. § 2504(c).
8 Id.
9 Rev. Rul. 84-11, 1984-1 C.B. 201.
10 Id.
12 Ltr. Rul. 8132001, April 24, 1981.

CASES, REGULATIONS AND STATUTES
by Robert P. Achenbach, Jr.

BANKRUPTCY
GENERAL—ALM § 13.03.*

EXEMPTIONS
AVOIDABLE LIENS. The debtors sought to avoid a nonpurchase-money security interest in a handgun claimed as an exempt household good. The court held that the pistol was a household good and the lien was avoidable as impairing the exemption. The court adopted the definition of “household good” established in In re McGreeny, 955 F.2d 957 (4th Cir. 1992) as goods typically found around the home and used to facilitate the day-to-day living within the home. Thus, because a pistol is used in the home for protection, a pistol was a household good. Matter of Raines, 161 B.R. 548 (Bankr. N.D. Ga. 1993).

HOMESTEAD. The debtor sought to avoid a nonpurchase-money security interest in the debtor’s mobile home as impairing the debtor’s homestead exemption. The creditor argued that the mobile home was personal property not eligible for the homestead exemption. The court held that the Virginia homestead exemption was broad enough to include mobile homes; therefore, the exemption would be allowed and the nonpurchase-money security interest avoided for impairing the exemption. In re Goad, 161 B.R. 161 (Bankr. W.D. Va. 1993).

TAX REFUND. The debtors claimed a federal income tax refund as exempt under the exemption for wages under Fla. Stat. § 222.11. The court held that the refund was not eligible for the exemption because the funds were not held in a bank account to which the debtors had access and the taxes were not considered wages earned by the debtors. In re Lancaster, 161 B.R. 308 (Bankr. S.D. Fla. 1993).

FEDERAL TAXATION—ALM § 13.03[7].*

AVOIDABLE LIENS. The IRS had filed a claim for $207,000 in taxes, penalties and interest owed by the debtors. The debtors had no assets other than $15,000 in exempt property and sought to avoid the IRS pre-petition tax lien to the extent the lien was unsecured. The debtors argued that Dewsnup v. Timm, 113 S.Ct. 773 (1992) barred such avoidance only as to consensual liens; therefore, the nonconsensual tax lien was avoidable to the extent it was unsecured. The court held that Section 522(c)(2)(ii)(B) specifically excludes tax liens from avoidance as to exempt property and that Dewsnup applied to nonconsensual liens, also. In re Doviak, 161 B.R. 379 (Bankr. E.D. Tex. 1993).

DISCHARGE. The debtor filed suit against the IRS for post-discharge levies against the debtor. The IRS argued that the claims for taxes supporting the levies were nondischargeable because the debtor failed to file a return for the tax years involved. As proof of the debtor’s failure to file, the IRS presented two substitute returns. The court held that a valid substitute return was prima facie evidence of the debtor’s failure to file the return, placing the burden on the debtor to show that a return was filed or that the substitute return was inaccurate. The court also held that only substitute returns which are subscribed by the Secretary of the Treasury are valid for this purpose; therefore, because one of the substitute returns was not subscribed by the Secretary, an issue of fact remained as to whether the debtor had filed a return for that tax year. In re Bank, 161 B.R. 406 (Bankr. N.D. Ohio 1993).

SOVEREIGN IMMUNITY. The debtor had received a discharge in a Chapter 13 case after paying all claims for federal income taxes, and the case was closed. However, the IRS filed liens, made levies and coerced the debtor into making post-discharge payments on the discharged taxes. The debtor brought suit to reopen the case and to recover the excess assessments and resulting costs for the suit. The IRS claimed the defense of no waiver of sovereign immunity because the debtor’s suit was not a claim of the bankruptcy estate. The court held that Section 106(a) provided a waiver of sovereign immunity only as to claims which were property of the estate at the commencement of the case or arising before the case is closed, Sections 541, 1306;