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LIENS FOR THE FAMILY-OWNED BUSINESS DEDUCTION
— by Neil E. Harl

As has been reported since the 1997 enactment of the family-owned business deduction and the substantial revisions in 1998, many of the provisions in the statute were drawn from special use valuation including the provision on liens to secure the payment of any recapture tax. Unfortunately, the problem with liens under the family-owned business deduction (FOBD) is substantially more involved than the lien on land for purposes of special use valuation.

A 2001 private letter ruling in the form of a memorandum to area IRS counsel has provided some guidance, albeit limited, on the issue of liens in the setting of the family-owned business deduction.

The FOBD reference

The family-owned business deduction statute specifies that the provisions relating to the special lien for additional estate tax are applicable to the family-owned business deduction. Under that provision, a special lien is imposed on all qualified farm or closely-held business real property for which an election has been made to utilize special use valuation. The lien arises at the time the election is filed and continues until the potential liability for recapture ceases, the qualified heir dies or the tax benefit is recaptured. The Treasury Department may authorize other security to be substituted for the real property in question to secure the payment of the tax that could become due if events occur triggering recapture. Moreover, the Treasury Department may subordinate the special lien to other obligations if sufficient collateral exists to protect adequately the Treasury’s interests.

The special lien is not valid against a purchaser, holder of a security interest, mechanic’s lien or judgment lien creditor unless properly filed. Even though properly filed, the lien does not take priority over—(1) real property taxes and special assessments for public improvements; (2) mechanic’s liens for repair or improvement of the property; (3) security interests for the construction or improvement of real property (to the extent of the real property involved in the improvement); (4) a contract to construct or improve real property (to the extent of the proceeds of the contract); or (5) the raising or the 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).

See the back page for details about the Agricultural Tax and Law Seminar in Nebraska, Oct. 2-5, 2001
Featuring discussion of EGTRRA 2001
by Dr. Neil E. Harl and Prof. Roger A. McEowen
The FOBD lien

The almost casual reference in the FOBD statute to the lien utilized for purposes of special use valuation raises a number of questions of a practical nature regarding the lien to secure the government’s interest in the assets involved in an electing qualified family-owned business. A lien on land under a special use valuation election involves establishment of a lien on real property in a fairly straightforward manner. Assuming that all property subject to the election is subject to estate should designate as security for the lien those assets under section 2057. The ruling goes on to explain that the estate may not designate as security for the lien only those assets needed to equal the amount of additional estate tax payable in the event of recapture. Rather, the lien should cover all assets subject to the election under section 2057. The ruling states that “an estate may not designate as security for the lien only those QFOBIs necessary to equal the amount of recapture tax; rather, the lien should cover all assets subject to the election under section 2057.” The ruling goes on to explain that the estate should designate as security for the lien those assets for which a deduction is claimed. Further, the lien amount should equal the maximum potential estate tax payable, assuming that all property subject to the election is subject to recapture.

In conclusion

The ruling discussed provides a glimpse of what is needed as guidance but much remains to come. The ruling states that proposed regulations should provide the needed guidance.