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Do Sales Close to the Date of Death Establish Value for Federal Estate Tax (and Basis) Purposes?

-by Neil E. Harl

As discussed in a recent issue of the *Digest*, the law is clear as to when property is to be valued for federal estate tax and federal income tax basis purposes. That guidance does not resolve the question of how to value the assets as of those dates prescribed as the time for determining value for federal estate tax and income tax basis purposes.

When property is to be valued

Federal statutory law is clear as to when property is to be valued for federal estate tax and income tax basis purposes. The value of the gross estate for federal estate tax purposes is determined as of the date of death or as of the alternate valuation date, which is six months after death unless the property is disposed of before six months have elapsed. For alternate valuation date purposes, valuation can be made as of “. . . the date of distribution, sale, exchange or other disposition” of the property during the six month period after death or, if not distributed, sold, exchanged or otherwise disposed of, as of six months after death. The valuation established under those rules relates back to the date of death for purposes of valuation and for purposes of post-death income tax basis. Thus, it is clear that all values, for purposes of determining the value of the gross estate, and for purposes of income tax basis determination, are made as of the date of death and changes in valuation after death (or before death) are immaterial except for the alternate valuation date provisions.

It should be noted that valuations under the special use valuation rules affect the income tax basis and the valuation of the gross estate inasmuch as special use valuation produces a valuation figure for “qualified real property.” For land subject to a qualified conservation easement, the amount allowed for the easement is excluded from the gross estate.

How is the property valued?

What is less clear is how the property is to be valued for assets that are not traded on a stock exchange or not otherwise subject to a market valuation. That is, of course, the usual situation for farm and ranchland, machinery and equipment and most other assets held at death for farm and ranch decedents including ownership interests in entities owning assets at the death of an owner. Of course, market values are likely to be available for grains and oilseeds, feed in inventory and, in some instances, for hay and other forage. Market value estimates may be available, also, for items of machinery and equipment.

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But in the absence of date-of-death fair market value determinations, what about sales after death (or even before death)? Several recent cases have provided useful guidance on the acceptability of valuations derived from such sales.

It is generally accepted that for this purpose, fair market value is the price that a hypothetical willing buyer would pay a hypothetical willing seller, both persons having reasonable knowledge of all relevant facts and neither person under a compulsion to buy or to sell.12

In a 2001 case decided by the Ninth Circuit Court of Appeals,13 the per share price paid for closely-held corporation stock (which was not publicly traded) in a sale shortly after the decedent’s death was dispositive as to stock value. The sales were accepted as evidence of the value of the estate’s minority interest in the corporation because the sales – (1) occurred within two months after the end of the alternate valuation date which was elected by the estate; (2) the sale involved willing and knowledgeable buyers and sellers; and (3) the sales were neither forced nor distressed.14 The appellate court reversed the Tax Court which had held that the sales were not at arm’s length and were “… not sufficiently similar to the estate’s much larger . . . interest to make their sales price representative of the value of the estate’s stock.”15

In a 2005 Tax Court case,16 the fair market value of a decedent’s interest in the stock of a closely-held bank was determined using the actual sales price of the stock in a transaction that occurred after the decedent’s death. Two transactions involving the stock had occurred in the 15-month period prior to death but the Tax Court held that those stock prices were not indicative of the stock’s fair market value because – (1) the sellers of those shares were believed not to be knowledgeable, with the shares involved selling for substantially less than the appraised value; and (2) the shares sold at that time (17) were not comparable in number to the decedent’s 116 shares which were sold in the transaction after death. The third sale, occurring nearly 14 months after death, was considered by the court to be the best measure of the fair market value of the decedent’s stock interest in the bank because the sale was an arm’s length transaction, consummated by unrelated parties and involved the actual stock interest held by the decedent at death.17 The only adjustment allowed was a three-percent adjustment for inflation to account for the passage of time. The court noted that the record did not establish the presence of any other material change in circumstances between the date of the post-death sale and the applicable valuation date.18

Endnotes


2 I.R.C. §§ 2031(a), 2032(a), 2032A.

3 See Harl, note 1 supra.

4 I.R.C. § 2031(a).

5 I.R.C. § 2032(a).

6 Id.


8 I.R.C. § 2032A.

9 I.R.C. § 2032A(a)(1).

10 I.R.C. § 2031(c).

11 I.R.C. § 2031(c)(1).


13 Morrissey v. Commissioner, 243 F.3d 1145 (9th Cir. 2001), rev’g and rem’g, Estate of Kaufman v. Comm’r, T.C. Memo. 1999-119.

14 Id.


17 Id. See Estate of Fitts v. Comm’r, 237 F.2d 729 (8th Cir. 1956), aff’g, T.C. Memo. 1955-269.

18 Id.

CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr

CONTRACTS

ACCEPTANCE OF GOODS. The debtor entered into a finance lease contract under which the debtor agreed to lease four crop sprinkler systems which were purchased from a third party. The debtor received one system and had it installed but the second and third systems were delivered but not installed. A fourth system was not delivered. None of the sprinkler systems conformed to the systems identified under the contract. However, the debtor did not unconditionally reject any of the delivered systems but indicated that an attempt to use the systems was intended. The debtor did unconditionally reject the second and third systems four months after delivery. The court held that the debtor was liable for the lease payments on the three sprinkler system delivered because the debtor failed to make a timely unconditional rejection of the systems. In re Rafter Seven Ranches LP v. C.H. Brown Co., 2008 U.S. App. LEXIS 23558 (10th Cir. 2008), aff’d, 362 B.R.