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Recapture Under Special Use Valuation on Sale of Non-Elected Property?

-by Neil E. Harl

Even with the increase in the applicable credit amount to $5 million per decedent in 2011,1 (up from $3.5 million in 2009),2 and the newly enacted “portability” rules that permit a decedent to utilize the remaining applicable credit amount (or applicable exclusion amount) of the last deceased spouse (dying after 2010) at least for 2011 and 2012,3 the rapid run-up in farmland values in many areas the past few months has caused some farm and ranch estates to keep an eye on special use valuation.4 That provision enables estates with eligible real property to reduce the gross estate for deaths in 2011 by as much as $1,020,000 for the special use valuation of “qualified real property.”5

One question, which is often raised well after death, is whether real property passing through the estate but not included in the special use valuation election or the agreement of personal liability for recapture tax is subject to recapture on sale or other disposition.6

The situation with the family-owned business deduction

That question came up a few years ago for the family-owned business deduction7 which was modeled to a substantial degree after special use valuation.8 Although no regulations were issued (the provision was repealed for decedents dying after December 31, 20039 except for recapture),10 no rulings were issued on this feature of the provision and no cases have been litigated on this precise aspect of the provision, it was concluded that if a qualified heir disposes of a portion of a qualified family-owned business interest (whether or not the real property in question was subject to an election to claim the family-owned business deduction), other than to a member of the qualified heir’s family or through a qualified conservation contribution, recapture occurs.11 The focus, however, of the family-owned business deduction was on the business,12 not on specific real estate assets, as with special use valuation.13

Recapture consequences under special use valuation

As with the family-owned business deduction, regulations on this issue have not been issued for recapture under special use valuation.14 The statute, however, states that “…if the qualified heir disposes of any interest in qualified real property…or ceases to use for the qualified use the qualified real property…there is imposed an additional tax.”15 The term “qualified real property” is referred to in another statutory subsection16 in that

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8 Charles F. Curtiss Distinguished Professor in Agriculture and Emeritus Professor of Economics, Iowa State University; member of the Iowa Bar.
qualified real property must be “... designated in the agreement referred to in subsection (d)(2).” Therefore, the first step in evaluating the risks from post-election sales or other dispositions of property is to check the election and the agreement of personal liability filed with the election\(^7\) to see if the real property the owner wants to sell — (1) was subject to the election and (2) was listed in the agreement of personal liability. If the answer to both questions is no, a sale or other disposition of the property included in the estate but not included in the election or agreement of personal liability should not cause recapture.

The regulations that have been issued\(^8\) support this position in that the regulation states that “an election under section 2032A need not include all real property included in the estate which is eligible for special use valuation, but sufficient property to satisfy the threshold requirements of section 2032A must be specially valued under the election.” Two Technical Advice Memoranda are in agreement. The first TAM\(^9\) states that an election can be made for less than all of the decedent’s property (one of three tracts). The other TAM\(^10\) states that “... section 2032A does not indicate that all qualified property included in the decedent’s estate must be specially valued before any such property is so valued. ...” The TAM goes on to state that sufficient property to satisfy the thresholds must be specially valued and it is possible to elect special use valuation for less than all of the qualified real property.”\(^21\) Moreover, the regulations state that the agreement of personal liability must express consent to collection of any additional estate tax imposed under section 2032A(c) from the qualified real property.”\(^22\)

In conclusion

Therefore, based on the authority to date, it would seem that a sale or other disposition of real property not subject to a special use valuation election and not listed in the agreement of personal liability should not trigger recapture of federal estate tax.

ENDNOTES

4 I.R.C. § 2032A.
6 I.R.C. §§ 2032A(a), 2032A(b)(1)(D).
7 I.R.C. § 2057.
9 I.R.C. § 2057(j). However, that section was subject to the sunset provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16.
12 I.R.C. § 2057(f)(1).
13 I.R.C. § 2032A(c)(1)(A), (B).
14 Three sets of regulations have been issued – Treas. Reg. § 20.2032A-3 (material participation); Treas. Reg. § 20.2032A-4 (method of valuing farm real property); and Treas. Reg. § 2032A-8 (election and agreement).
15 I.R.C. § 2032A(c) (Emphasis added).
16 I.R.C. § 2032A(b)(1)(D).
17 The agreement of personal liability is referred to in I.R.C. § 2032A(d)(2) as follows – “The agreement referred to in this paragraph is a written agreement signed by each person in being who has an interest ... in any property designated in such agreement consenting to the application of subsection (c) [pertaining to recapture] with respect to such property.”
19 TAM 8040016, June 30, 1980.
20 8045017, July 30, 1980.
21 TAM 8045017, July 30, 1980.