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An Agricultural Law Research Article

**Recent Caselaw and Legislative Developments
Concerning Special Use Valuation of
Farm and Ranch Property**

by

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RECENT CASELAW AND LEGISLATIVE DEVELOPMENTS CONCERNING SPECIAL USE VALUATION OF FARM AND RANCH PROPERTY

*Roger A. McEowen**

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I. OVERVIEW

Real property utilized in farming or other closely-held businesses has been eligible to be valued in the estate for federal estate tax purposes at its special or

“use” value rather than fair market value for estates of decedents dying after 1976.¹ Unquestionably, substantial estate tax savings can be achieved by utilizing special use valuation. However, the statute is characterized by many technical requirements, and great care must be exercised in planning to utilize the election and in maintaining the election’s viability during the ten-year post-death recapture period.

This Article’s intent is not to detail all of the specific rules with respect to I.R.C. § 2032A. Instead, this Article is designed to provide guidance concerning recent caselaw and legislative developments involving I.R.C. § 2032A.

II. RECENT CASELAW AND LEGISLATIVE DEVELOPMENTS INVOLVING I.R.C. § 2032A

A. *Interest Rates*

Two valuation methods are available for qualified real property used for farming purposes.² Under the capitalization of rent approach, the special use value of elected land is determined in accordance with a numerator and a denominator.³ The numerator involves taking the “average annual gross cash rental for comparable land used for farming purposes and located in the locality of such farm” less the average annual real estate taxes (state, if any, and local) for such comparable land.⁴ The denominator is the “average annual effective interest rate for all new Federal Land Bank loans.”⁵ Federal Land Bank (FLB) interest rates are to be applied on a district, rather than a national, basis. The rates, as calculated, include an additional amount for ownership of FLB stock,⁶ and are specified annually by the Internal Revenue Service (Service) by FLB district.⁷

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1. See I.R.C. § 2032A(a)(1) (1994).

2. See I.R.C. §§ 2032A(e)(7)-(8) (1994).

3. See I.R.C. § 2032A(e)(7)(A) (1994).

4. See I.R.C. § 2032A(e)(7)(A)(i) (1994).

5. I.R.C. § 2032A(e)(7)(A)(ii) (1994). All calculations are to use the five most recent calendar years ending before the decedent’s death. See I.R.C. § 2032A(e)(7)(A) (1994).

6. See Treas. Reg. § 20.2032A-4(e)(2) (1988).

7. See Rev. Rul. 97-13, 1997-16 I.R.B. 4. This ruling sets forth the applicable farm credit bank interest rates for estates of decedents dying in 1997 as follows: Columbia, 8.88%; Omaha, 8.09%; Sacramento, 8.48%; St. Paul, 8.39%; Spokane, 8.27%; Springfield, 8.57%; Texas, 8.42%; and Wichita, 8.21%. See *id.* Rev. Rul. 97-13 also specifies which jurisdictions are contained in each district. The Columbia district consists of Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, Pennsylvania, South Carolina, Virginia, and West Virginia; the Omaha district consists of Iowa, Nebraska, South Dakota and Wyoming; the Sacramento district contains

The rent capitalization approach is not to be used if no comparable land for determining average annual gross cash rental exists or if the executor elects to value the real property using certain factors. The factors include the following: (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 (could use crop share); (3) assessed values 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.⁸ Note that this is the only procedure available for non-farmland except for fair market value.⁹

B. *Filing of Recapture Agreement*

1. *Nature of the Problem*

If the executor timely elects special use valuation and the election substantially complies with the requirements of the regulations, minor defects in the election or the agreement can be cured, thereby saving the election.¹⁰ If the notice of election, as filed, does not contain all of the required information, or the recapture agreement as filed does not contain all required information, or does not include the signatures of one or more persons required to enter into the agreement, the executor has a reasonable period of time (not exceeding ninety days) after being notified of the problem to provide such information or agreements.¹¹

The types of information omitted from the notice of election that may be supplied after the initial election include the following: (1) omitted Social Security numbers and addresses of qualified heirs; (2) copies of written appraisals of the

Arizona, California, Hawaii, Nevada and Utah; the St. Paul district contains Arkansas, Illinois, Indiana, Kentucky, Michigan, Minnesota, Missouri, North Dakota, Ohio, Tennessee and Wisconsin; the Spokane district contains Alaska, Idaho, Montana, Oregon and Washington; the Springfield district contains Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island and Vermont; the Texas district contains Alabama, Louisiana, Mississippi and Texas; the Wichita district contains Colorado, Kansas, New Mexico and Oklahoma. *See id.*

8. *See id.*

9. *See* I.R.C. § 2032A(e)(8) (1994). This valuation method is commonly referred to as the five factor approach.

10. The election is to be made on the federal estate tax return. *See* I.R.C. § 2032A(d)(1) (1994).

11. *See* I.R.C. § 2032A(d)(3) (West Supp. 1998). Under I.R.C. § 2032A(d)(3), an estate representative has up to 90 days after notification of a deficiency to provide the following: (1) information missing from the special use valuation election, (2) the signatures of individuals who are required to enter into the agreement of personal liability for recapture tax, and (3) information missing from the agreement of personal liability. *See id.*

property to be specially valued, but only if the appraisal was actually obtained before the estate tax return was filed; and (3) a full legal description of the property, but only if the original notice of election filed with the estate tax return described the property with reasonable clarity.¹² However, the Service has maintained that some omissions cannot be cured under the "substantial compliance" rule.¹³

In 1991, legislation was proposed (but not passed) to allow subsequent submission of information without regard to the compliance regulations if the election was made and the recapture agreement was submitted.¹⁴

The relief of I.R.C. § 2032A(d)(3) does not apply if a recapture agreement is not filed with the estate tax return on which the election is made.¹⁵ Both the Seventh Circuit Court of Appeals and the Tax Court have refused to allow estates to perfect defective elections when a recapture agreement was not filed with the return.¹⁶ In *Prussner v. United States*,¹⁷ the court rejected the estate's argument that a cover letter submitted with the return was a defective recapture agreement that permitted the estate to perfect its election.¹⁸ In *Estate of Merwin v. Commissioner*,¹⁹ the court rejected the argument that a recapture agreement was superfluous under then applicable state (California) law.²⁰ Although state law applies to the recapture agreement to determine if it is valid, the court did not find

12. See Rev. Rul. 85-84, 1985-1 C.B. 326.

13. See, e.g., Tech. Adv. Mem. 85-32-010 (May 2, 1985) (finding that the failure of qualified heirs to sign the agreement is incurable); Tech. Adv. Mem. 85-28-003 (Mar. 22, 1985) (finding that the substitution of the signature of the minor child's trustee for the signature of the natural parent was insufficient to satisfy statutory requirements); Priv. Ltr. Rul. 92-21-022 (Feb. 20, 1992) (finding that the failure to comply with the requirements of treasury regulation 20.2032A-8(a), including the notice of election and the agreement to special use valuation described in § 2032A(d)(2) of the Code, at the time of filing the federal estate tax return is incurable). The courts have also supported the Service's position that some omissions are fatal. See, e.g., *Estate of Grimes v. Commissioner*, 937 F.2d 316 (7th Cir. 1991) (finding that failure to attach a notice of election or a signed recapture agreement along with the estate tax return was incurable); *Estate of Strickland v. Commissioner*, 92 T.C. 16 (1989) (finding that failure to identify comparable properties and failure to base special use valuation on actual cash rents on comparable property resulted in a failure to sufficiently comply with the regulations); *Estate of Sequeira v. Commissioner*, 70 T.C.M. (CCH) 761 (1995) (finding that failure to comply with the regulations under section 2032A relating to the election of special use valuation resulted in valuation of the subject properties at the fair market values on the date of the decedent's death).

14. See H.R. 2735, 102d Cong. § 4706 (1991).

15. See I.R.C. § 2032A(d)(3) (West Supp. 1998).

16. See *Prussner v. United States*, 896 F.2d 218, 223 (7th Cir. 1990); *Estate of Merwin v. Commissioner*, 95 T.C. 168, 173 (1990).

17. *Prussner v. United States*, 896 F.2d 218 (7th Cir. 1990).

18. See *id.* at 222.

19. *Estate of Merwin v. Commissioner*, 95 T.C. 168 (1990).

20. See *id.* at 174.

support for the claim that California law made a decedent's qualified heirs liable for the recapture tax without a formal, binding recapture agreement.²¹

2. Recent Developments

The Fifth and Eleventh Circuit Courts of Appeal have now joined the Seventh Circuit Court of Appeals and the Tax Court in determining that when an estate fails to file a recapture agreement with the estate tax return, the substantial compliance provision of I.R.C. § 2032A(d)(3) is not satisfied and the election can not be perfected.²²

In *Estate of Hudgins v. Commissioner*,²³ the decedent's estate timely filed Form 706 and checked the box indicating a desire to elect special use valuation.²⁴ The estate completed and submitted a Schedule N, together with the required attachments.²⁵ A "Notice of Election" was also attached to the estate tax return, but it contained only nine of the fourteen items required by the Form 706 instructions and the underlying regulations.²⁶ The Notice of Election contained signature lines for all five of the decedent's grandsons, but only three had signed the Notice by the time it was filed.²⁷ A memorandum was attached to the estate tax return indicating that the signatures of the two grandsons would be obtained on a different document and transmitted to the Service.²⁸

The estate was audited and the Service denied the special use valuation election because of the incomplete Notice of Election and the failure to attach an executed recapture agreement.²⁹ Within ninety days after receiving the notice of denial, the estate submitted all previously missing information, documentation and signatures.³⁰ The Service again denied the estate's election contending that the estate's initial election was not in "substantial compliance" with the regulations.³¹ As such, the estate could not perfect its election. The Service issued a deficiency notice to the estate in the amount of \$149,622.³²

21. *See id.*

22. *See Estate of Hudgins v. Commissioner*, 57 F.3d 1393, 1398-99 (5th Cir. 1995); *Estate of Lucas v. United States*, 97 F.3d 1401, 1407 (11th Cir. 1996), *cert. denied*, 117 S. Ct. 1468 (1997).

23. *Estate of Hudgins v. Commissioner*, 57 F.3d 1393 (5th Cir. 1995).

24. *See id.* at 1394.

25. *See id.* at 1395.

26. *See id.* at 1395; *see, e.g.*, Treas. Reg. § 20.2032A-8(a)(3) (1986).

27. *See Estate of Hudgins v. Commissioner*, 57 F.3d at 1395.

28. *See id.*

29. *See id.*

30. *See id.*

31. *See id.*

32. *See id.*

The Tax Court held that the estate was entitled to special use valuation because the estate's initial election substantially complied with the election requirements.³³ As such, the estate could perfect its election within the statutory period following notice of the defective election.

The Fifth Circuit, in reversing the Tax Court, held that the estate was not in substantial compliance with the regulations.³⁴ The court noted that the estate tax return was not accompanied by a recapture agreement and that the Notice of Election that accompanied the estate tax return was substantially defective for not containing information supporting the special use values listed in the return.³⁵ The court held that a special use valuation election can *never* be in substantial compliance with the requirements of I.R.C. § 2032A if the estate tax return is not accompanied by a recapture agreement signed by the holders of all interests in the qualified assets that binds them under state law to be liable for tax deficiencies in the event of disqualifying use or disposition of the property during the recapture period.³⁶ The court also noted that Congress intended to allow estates to perfect I.R.C. § 2032A elections only as to technical defects contained in the recapture agreement or Notice of Election.³⁷

In *Estate of Lucas v. United States*,³⁸ the court ruled that the estate's special use valuation election was not in substantial compliance with the I.R.C. § 2032A filing requirements because a recapture agreement did not accompany the estate tax return.³⁹ On the estate tax return, the estate did not check either the "yes" or "no" box with respect to whether a special use valuation election was being made. The estate nevertheless attached Schedule N, attempting to elect special use valuation. The estate also attached affidavits of the decedent's two sons that purported to serve as the estate's notice of election. The Service held the election defective for failure to attach a recapture agreement.⁴⁰ The estate furnished the agreement within ninety days, but the Service denied the election asserting that the initial submission did not substantially comply with the regulations.⁴¹

33. See *id.* at 1394.

34. See *id.* at 1406.

35. See *id.* at 1398-99. For example, the Notice of Election did not contain written appraisals of the fair market values of the properties; the name, address, taxpayer identification number and relationship to the decedent of each person succeeding to an interest in the subject properties; value of the property interest being received by each such successor based on both fair market value and qualified use; and affidavits setting forth the activities constituting material participation, identity of the participants and the qualified use of the properties. See *id.* at 1399.

36. See *id.* at 1396-97.

37. See *id.* at 1400-01.

38. *Estate of Lucas v. United States*, 97 F.3d 1401 (11th Cir. 1996).

39. See *id.* at 1404.

40. See *id.* at 1403.

41. See *id.* at 1404.

Even though the court held that the estate did make a special use valuation election because it expressed the clear intent to make the election, the court concluded that the estate failed to provide substantially all of the information required.⁴² The court ruled that the phrase "information with respect to such election" contained in § 1421 of the Tax Reform Act of 1986 included the recapture agreement.⁴³ In 1997, the Supreme Court declined to review the Eleventh Circuit's opinion.⁴⁴

The Taxpayer Relief Act of 1997⁴⁵ broadens the opportunity to correct omissions in special use value elections by specifying that if an election is made in a timely manner and the notice of election does not contain all required information or one or more signatures are not included on the agreement filed, the executor of the estate may submit the information within ninety days after a request from the Service.⁴⁶

C. Extension of Time to Make the Election

The Service has discretion to grant an extension of time for an estate to make a special use election if the estate requests an extension within a reasonable time, and granting the extension would not jeopardize the government's interests.⁴⁷ Reasonable action must be taken to deal promptly with the missed deadline.⁴⁸

In Private Letter Ruling 96-12-010,⁴⁹ the decedent died owning property for which a special use valuation election could have been made. The estate did not, however, make an election under I.R.C. § 2032A on the federal estate tax return to specially value the real property in the decedent's gross estate.⁵⁰ The Service ruled that the estate was entitled to an extension of time for making an I.R.C. § 2032A election, but noted that the estate bore the burden of proving to the

42. See *id.* at 1413.

43. See *id.* (citing Tax Reform Act of 1986, Pub. L. No. 99-514, § 1421(a), 100 Stat. 2085, 2716 (1986)).

44. Estate of Lucas v. United States, 97 F.3d 1401 (11th Cir. 1996), *cert. denied*, 117 S. Ct. 1468 (1997).

45. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 1997 U.S.C.C.A.N. (111 Stat.) 788.

46. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1313(a), 1997 U.S.C.C.A.N. (111 Stat.) 788, 1045 (amending I.R.C. § 2032A(d)(3) (1994)). The amendment is effective for deaths after August 5, 1997. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 1313(b), 1997 U.S.C.C.A.N. (111 Stat.) 788, 1045.

47. See Treas. Reg. § 301.9100-1 (1997).

48. See Tech. Adv. Mem. 92-04-005 (Oct. 16, 1991).

49. Priv. Ltr. Rul. 96-12-010 (Dec. 18, 1995).

50. See *id.*

Service's satisfaction that all of the I.R.C. § 2032A requirements had been satisfied.⁵¹

D. Disposition of Elected Land

1. Nature of the Problem

If elected land is disposed of by the qualified heir within the recapture period after the decedent's death to anyone who is not a member of the qualified heir's family, the tax benefits are recaptured.⁵² Partial dispositions of elected land lead to partial recapture of tax benefits.⁵³

If an interest in qualified real property is exchanged solely for an interest in qualified exchange property and the exchange qualifies for nonrecognition treatment under I.R.C. § 1031, no recapture tax is imposed on the exchange.⁵⁴ This is not a disqualifying disposition. If other property is received in the exchange, a partial recapture tax is imposed.⁵⁵ "Qualified exchange property" means real property that is to be used for the same qualified use (as a farm or in a closely-held business) under which the real property exchanged originally qualified.⁵⁶

The amount of any recapture tax imposed with respect to the qualified exchange property can be determined as follows: (1) any interest in the qualified exchange property shall be treated in the same manner as if it were a portion of the interest in the qualified real property exchanged;⁵⁷ (2) any recapture tax imposed on the exchange is treated as tax imposed on a partial disposition (for purposes of computing the amount of any recapture tax on a later disposition or cessation of qualified use of the qualified exchange property);⁵⁸ and (3) material participation with respect to the qualified real property exchanged is treated as material participation with respect to the qualified exchange property.⁵⁹

51. See *id.*

52. See I.R.C. § 2032A(c)(1) (1994).

53. See I.R.C. § 2032A(c)(2)(D) (1994).

54. See I.R.C. § 2032A(i)(1)(A) (1994).

55. See I.R.C. § 2032A(i)(1)(B) (1994). The recaptured amount is equal to the additional estate tax that would have been imposed on the exchange, reduced by an amount computed as follows: (1) multiply the additional estate tax by the fair market value of the qualified exchange property received; and (2) divide the product by the fair market value of the qualified real property exchanged. Fair market value is determined as of the time of the exchange. See *id.*

56. See I.R.C. § 2032A(i)(3) (1994).

57. See I.R.C. § 2032A(i)(2)(A) (1994).

58. See I.R.C. § 2032A(i)(2)(B) (1994).

59. See I.R.C. § 2032A(i)(2)(C) (1994).

2. Recent Developments

In Private Letter Ruling 96-04-018,⁶⁰ the taxpayer was the beneficiary of special use valuation elected land. The land was adjacent to a landlocked college that wanted to acquire a portion of the elected farmland to provide access to the college.⁶¹ The college held other unimproved tracts of farmland and wanted to exchange one of those tracts with the taxpayer's tract that was subject to the I.R.C. § 2032A election.⁶² The taxpayer would use the land acquired from the college for farming and no cash or other property was to be involved in the exchange.⁶³ Because the exchange qualified under I.R.C. § 1031 as a tax-free exchange, the Service held that no recapture tax would be triggered.⁶⁴

In Private Letter Ruling 96-42-055,⁶⁵ a qualified heir's sale of elected land did not cause a disqualifying disposition requiring payment of recapture tax, when the qualified heir's interest was sold to two other qualified heirs who were brothers of the qualified heir and the decedent's lineal descendants. However, the two qualified heirs to whom the third heir's interest was sold had to sign an amended recapture agreement reflecting the changed ownership of the property.⁶⁶

In *Estate of Gibbs v. United States*,⁶⁷ an unpublished opinion, an estate was not liable for recapture tax upon selling a conservation servitude on elected land to the state of New Jersey. The servitude stipulated that the land was to be maintained as a farm in perpetuity. By virtue of the special use election, the value of the farmland in the decedent's estate was reduced from a fair market value of \$988,000 to a special use value of \$349,770 for estate tax purposes. The heirs sold the servitude to the state for \$1,433,493.72. The deed of easement imposed restrictions on the property that ran with the land, thereby binding the heirs and all future title holders to its provisions.⁶⁸

The Service argued that the granting of an easement to the state triggered recapture because an interest in real property was conveyed. The Service also

60. Priv. Ltr. Rul. 96-04-018 (Oct. 30, 1995).

61. *See id.*

62. *See id.*

63. *See id.*

64. *See id.*; *see also* I.R.C. § 2032A(i)(1)(A) (1994) (providing that if an interest in qualified real property is exchanged solely for an interest in qualified exchange property in a transaction which qualifies under I.R.C. § 1031, the recapture tax of I.R.C. § 2032A(c) is not imposed).

65. Priv. Ltr. Rul. 96-42-055 (July 24, 1996).

66. *See id.*

67. 98-1 U.S. Tax Cas. (CCH) ¶ 60,307 (D.N.J. Aug. 13, 1997).

68. *See id.* The deed granted a conservation servitude to the county pursuant to the New Jersey Right-to-Farm Act. *See* N.J. STAT. ANN. §§ 4:1C-32 (West Supp. 1997).

maintained that recapture tax was due because the heirs realized the developmental value of the property during the recapture period. The heirs argued that the state's acquisition of the conservation servitude was not a disqualifying disposition of an "interest" in the farm because the easement grant imposed only a contractual restriction upon the farmland's future use guaranteeing that the property would be used as farmland well beyond the recapture period.

In ruling for the estate, the court noted that New Jersey law construes land use restrictions as "equitable servitudes" involving contract rights rather than property interests. Thus, according to the court, the granting of a conservation servitude did not create a possessory interest in the burdened land because the burden imposed was enforceable only as a contract right. Accordingly, the grant of a conservation servitude was not a disposition of an interest in land resulting in recapture of estate tax under I.R.C. § 2032A(c)(1).

The court's opinion in *Gibbs* is questionable. Real property servitudes similar in nature to the one presented in *Gibbs* have been treated as interests in real property for tax purposes. For example, in Revenue Ruling 77-414,⁶⁹ the taxpayer sold the development rights in his farm to the county in accordance with a county statute designed to ensure the preservation of farmland. The ruling concluded that the disposition constituted the sale of an interest in real property for purposes of Sections 1221, 1231, and 453(b)(1)(A) of the Code. Similarly, in Private Letter Ruling 89-40-011,⁷⁰ the mere *donation* of a conservation easement would have restricted the use of land in perpetuity to agricultural and related uses, generally prohibiting all institutional, industrial, and commercial use of the elected land. The Service noted that even if a conservation easement in gross were classified as a restrictive covenant, such classification would not negate the characterization of the servitude as an interest in property.⁷¹ Indeed, the Uniform Conservation Easement Act specifically characterizes a conservation easement as an interest in real property.⁷² The preferatory note to the Uniform Act indicates that the drafters intentionally designated the interests covered by the Act as "easements."⁷³

Also, in Technical Advice Memorandum 87-31-001,⁷⁴ the transfer of an agricultural preservation easement for consideration resulted in recapture of estate

69. Rev. Rul. 77-414, 1977-2 C.B. 299.

70. Priv. Ltr. Rul. 89-40-011 (June 30, 1989).

71. See RICHARD R. POWELL, *POWELL ON REAL PROPERTY* § 60.01[2], at 60-10 (rev. ed. 1997). It states that "[t]he great weight of authority regards equitable restrictions as recognitions of an equitable property interest in the burdened land, appurtenant to the benefited land, similar to an easement." *Id.* (citations omitted).

72. See UNIF. CONSERVATION EASEMENT ACT § 1(1), 12 U.L.A. 170 (1996).

73. See *id.*

74. Tech. Adv. Mem. 87-31-001 (Mar. 19, 1987).

tax. Five years after the decedent's death, a qualified heir executed a deed of easement for all of the elected farmland in favor of the state for \$490,000. The easement restricted subdivision of the farm so as to preserve the farm solely for agricultural use. The Service cited Revenue Ruling 59-121⁷⁵ for the notion that consideration received for the granting of an easement with respect to land constitutes proceeds from a sale of an interest in real property. As such, the grant of the preservation easement for consideration was a disposition resulting in the imposition of recapture tax under I.R.C. § 2032A(c)(1).

However, in Private Letter Ruling 89-46-023,⁷⁶ no recapture tax was assessed when nine acres of elected land out of a 354-acre parcel was placed in a Minnesota program equivalent to the Conservation Reserve Program. Under the Minnesota program, participating landowners agreed to seed the land enrolled in the program and to establish and maintain perennial cover of either a grass-legume mixture of natural grasses, or to plant trees or carry out other long-term capital improvements for soil and water conservation or wildlife management. Participation in the program was required for at least ten years. The Service held that no recapture tax was due because the qualified heir intended to place only a small percentage of the total elected property into the Minnesota program, and the program required certain activities to be conducted which would allow the heir to satisfy the material participation test on all of the elected land. Accordingly, the entire 354-acre parcel would be treated as being used in a qualified use and the enrollment of nine acres would not result in the cessation of qualified use or failure to satisfy the material participation test.

Likewise, in Private Letter Ruling 90-35-007,⁷⁷ the granting of a subsurface pipeline easement was ruled to not be a recapture-triggering event because the easement neither interrupted nor affected the use of the elected land. Similarly, in Revenue Ruling 88-78,⁷⁸ the grant of a lease in subsurface oil and gas interests that also involved the extraction of oil and the disposition of royalty rights on elected land did not trigger recapture tax. Normally, the interest of a lessee in oil and gas in place is an interest in real property for federal income tax purposes,⁷⁹ and a royalty interest is a fee interest in mineral rights and real property.⁸⁰ Thus, the disposition of oil rights would usually be considered the disposition of an interest in real property. However, a 1976 committee report involving I.R.C. § 2032A states that "elements of value which are not related to the farm or business use (such as

75. Rev. Rul. 59-121, 1959-1 C.B. 212.

76. Priv. Ltr. Rul. 89-46-023 (Aug. 18, 1989).

77. Priv. Ltr. Rul. 90-35-007 (May 25, 1990).

78. Rev. Rul. 88-78, 1988-2 C.B. 330.

79. See, e.g., Rev. Rul. 68-226, 1968-1 C.B. 362.

80. See Rev. Rul. 73-428, 1973-2 C.B. 303.

mineral rights) are not to be eligible for special use valuation.”⁸¹ Consequently, the disposition of oil rights was ruled not to be a disposition triggering recapture tax.⁸² The ruling did state, however, that “well-drilling activity and the subsequent extraction process” would constitute a “cessation of use” for purposes of recapture because farming activity would be interrupted.

How do these rulings square with *Gibbs*?⁸³ It appears that the court reached the right result in *Gibbs*, but for the wrong reason. The *Gibbs* court reached its conclusion on the narrow ground that the qualified heirs did not dispose of an interest in land because, under New Jersey law, land use restrictions are construed as “equitable servitudes” involving contract rights rather than property rights. However, as mentioned above, the rulings do not generally support that position.⁸⁴ A better reason for holding that the granting of a conservation servitude does not constitute a disqualifying disposition under I.R.C. § 2032A(c)(1) is that there was no interruption of the surface use in *Gibbs*. Revenue Ruling 88-78⁸⁵ and Private Letter Ruling 90-35-007⁸⁶ support that proposition. That is the result irrespective of whether the grant of a conservation easement involves an interest in real property under state law.⁸⁷

E. Post-Death Qualified Use Test

1. Nature of the Problem

A “qualified use” for I.R.C. § 2032A purposes is defined as use as a “farm” for “farming purposes,” or use in a trade or business other than farming.⁸⁸ Before the decedent’s death, the qualified use test must be met at the time of death *and* for five or more of the last eight years before death.⁸⁹ From mid-1980 through early 1981, the Service’s position was that a cash rent lease, even to a family member, failed to meet the test.⁹⁰ In 1981, the Service changed its interpretation of

81. See H.R. REP. NO. 1380, at 22 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3356, 3378.

82. See Rev. Rul. 88-78, 1988-2 C.B. 330.

83. See *Estate of Gibbs v. United States*, 98-1 U.S. Tax Cas. ¶ 60,307 (D.N.J. Aug. 13, 1997).

84. See, e.g., Rev. Rul. 77-414, 1997-2 C.B. 299; Priv. Ltr. Rul. 89-40-011 (June 30, 1989); Tech. Adv. Mem. 87-31-001 (Mar. 19, 1987).

85. Rev. Rul. 88-78, 1988-2 C.B. 330.

86. Priv. Ltr. Rul. 90-35-007 (May 25, 1990).

87. See, e.g., Rev. Rul. 88-78, 1988-2 C.B. 330; H.R. REP. NO. 1380 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3356.

88. I.R.C. § 2032A(b)(2) (1994).

89. See I.R.C. § 2032A(a)(1), (b)(1)(C) (1994).

90. See Treas. Reg. § 20.2032A-3(b)(1) (1980).

I.R.C. § 2032A(b)(2), permitting the qualified use test to be met by the decedent or a member of the decedent's family in the pre-death period.⁹¹ As a result, cash rent leases to members of the decedent's family satisfy the pre-death qualified use test. The Service did not mention whether its interpretation of I.R.C. § 2032A(b)(2) applied to the qualified use test in the post-death period. Congress, in 1981, passed an amendment permitting the qualified use test to be met by the decedent or a member of the decedent's family in the pre-death period, retroactive to January 1, 1977.⁹² Unfortunately, the legislation was silent concerning the post-death period. The Senate Finance Committee Report stated, "The bill does not change the present requirement that the qualified heir owning the real property after the decedent's death use it in the qualified use throughout the recapture period."⁹³ The legislation did, however, create a two-year grace period for meeting the qualified use test in the recapture period after death.⁹⁴ Thus, while the decedent-to-be can cash lease to a member of the family in the pre-death period, the rule has been that cash leasing is not permitted (even to a family member) during the post-death recapture period. Post-death cash leases are only permitted during the two-year post-death grace period,⁹⁵ and by a surviving spouse to a member of the surviving spouse's family.⁹⁶

Both the Ninth Circuit in *Williamson v. Commissioner*,⁹⁷ and the Tax Court in *Fisher v. Commissioner*,⁹⁸ *Shaw v. Commissioner*,⁹⁹ and *Stovall v. Commissioner*,¹⁰⁰ have held that property ceases to be used for a qualified use and recapture tax is triggered, when a qualified heir other than the surviving spouse leases the property on a net cash basis, even if the lessee is a member of the qualified heir's family.¹⁰¹

The Seventh Circuit Court of Appeals has held similarly to the Ninth Circuit in a case involving elected land that was leased to an outside party on a net

91. See Treas. Reg. § 20.2032A-3(b)(1) (1986). "Member of the family" refers to an individual's ancestor, spouse, lineal descendant or spouse of a lineal descendant. See I.R.C. § 2032A(e)(2) (1994).

92. See I.R.C. § 2032A(b)(1)(C)(i) (1994) (as amended by Pub. L. No. 97-34, § 421(b)(1), 95 Stat. 172, 306 (1981)).

93. S. REP. NO. 97-144, at 134 (1981), *reprinted in* 1981 U.S.C.C.A.N. 157, 234.

94. See I.R.C. § 2032A(c)(7)(A) (1994).

95. See I.R.C. § 2032A(c)(7) (1994).

96. See I.R.C. §§ 2032A(b)(5)(A), (c)(7)(E) (West Supp. 1994). Legislation was introduced (but not enacted) in 1992 to allow post-death cash rental of elected land by a qualified heir to a lineal descendant without causing recapture. See H.R. 2735, 102d Cong., § 123 (1992).

97. *Williamson v. Commissioner*, 974 F.2d 1525 (9th Cir. 1992).

98. *Fisher v. Commissioner*, 63 T.C.M. (RIA) ¶ 93,139, at 93-623 (Apr. 5, 1993).

99. *Shaw v. Commissioner*, 60 T.C.M. (RIA) ¶ 91,372, at 91-1882 (Aug. 8, 1991).

100. *Stovall v. Commissioner*, 101 T.C. 140 (1993).

101. See *Williamson*, 974 F.2d at 1528; *Fisher*, 63 T.C.M. (RIA) at 93-624; *Shaw*, 60 T.C.M. (RIA) at 91-1882; *Stovall*, 101 T.C. at 140-41.

cash rental basis for one year.¹⁰² The court held that this made the heirs passive investors for the duration of the lease.¹⁰³ Whether the farm was productive or unproductive, profitable or unprofitable, the heirs' rental income would be unaffected. Consequently, the heirs were no longer in the farming business.¹⁰⁴ Likewise, the Tax Court, in *Hight v. Commissioner*,¹⁰⁵ held that elected land ceased to be used for a qualified use even though the lessee could use the land for only part of each year.¹⁰⁶ The elected land was leased under a pasture feeding agreement on a net cash basis.¹⁰⁷ Under the terms of the lease, the lessee could graze livestock on the property from April or May through October or November.¹⁰⁸

2. Recent Developments

In *Hohenstein v. Commissioner*,¹⁰⁹ a qualified heir who received farm property from a decedent and farmed it for eight years, but after becoming physically incapacitated with a back injury sold a portion of the farm and leased the remainder to unrelated parties on a cash basis, was subjected to recapture tax with respect to the area under the cash lease for failure to use the property for its qualified use.¹¹⁰ The heir reported the sale of the other portion of the farm and paid the recapture tax due on that portion.¹¹¹ The qualified heir argued that because he had materially participated with respect to the elected land for a period of eight continuous years following the decedent's death that there could be no cessation of qualified use.¹¹² The court pointed out that the material participation and qualified use tests are separate, and that post-death cash leasing is not a qualified use.¹¹³ In addition, the court held that the issuance of a certificate releasing the estate tax lien was not an IRS concession that the leasing of property would not trigger the recapture tax.¹¹⁴ The release was issued only after the receipt of an amended Form 706-A and a check from the qualified heir for an amount

102. See *Martin v. Commissioner*, 783 F.2d 81 (7th Cir. 1986).

103. See *id.* at 84.

104. See *id.*

105. *Hight v. Commissioner*, 59 T.C.M. (RIA) ¶ 90,081, at 90-376 (Feb. 21, 1990).

106. See *id.* at 90-379.

107. See *id.* at 90-377.

108. See *id.* at 90-377.

109. *Hohenstein v. Commissioner*, 71 T.C.M. (RIA) ¶ 97,056, at 97-324 (Jan. 30, 1997).

110. See *id.* at 97-324.

111. See *id.* at 97-325.

112. See *id.* at 97-327.

113. See *id.* at 97-329.

114. See *id.*

including interest that purported to satisfy the additional estate tax owed.¹¹⁵ This amount was under-calculated as a result of the insertion of an incorrect fair market value on the amended Form 706-A, and the court held that the Service was not precluded from collecting the proper sum despite having issued a certificate of release because the liability for payment of tax continues until satisfaction of the tax in full or until the expiration of the statutory period for collection.¹¹⁶

In 1997, the Eighth Circuit Court of Appeals confirmed the view that it has no understanding of the difference between the pre-death and post-death qualified use tests.¹¹⁷ In 1994, the court upheld a post-death cash rental arrangement to a family corporation where each qualified heir owned a one-third interest in the leased land, but less than a six percent interest in the corporation.¹¹⁸ Because the qualified use test requires a lessor of land to bear the risk of production or the risk of price change, the court's decision is highly questionable inasmuch as the lessors bore approximately twelve percent of the risk while holding a two-thirds interest in the land. While neither the statute nor the regulations address the effect of a cash lease to an entity in which the lessor owns an interest, it seems unreasonable for a holder of a one-third interest in the land to satisfy the "at risk" requirement by owning less than six percent in the lessee. The court apparently based its approval of the post-death cash lease on a similar pre-death rental arrangement. However, pre-death case leases to family members are permissible (either the lessor or lessee family member can satisfy the test), but cash leases even to family members do not satisfy the post-death qualified use test outside of the two-year grace period. While this decision was highly suspect, the court's 1997 opinion in *Estate of Gavin v. United States*¹¹⁹ clearly demonstrates the court's misunderstanding of the pre-death and post-death qualified use tests.

In *Estate of Gavin*, upon retirement the decedent-to-be entered into a crop share lease with a son.¹²⁰ Two weeks before the decedent's death, a new lease was executed wherein the son agreed to pay cash rent or continue the current crop share arrangement.¹²¹ Under the terms of the decedent's will, the son received a one-seventh interest in the property and had the option to purchase it within one year.¹²² Six weeks after the decedent's death, the son switched from paying crop shares to the estate and began paying cash rent to the estate in the amount of \$10,000 per

115. See *id.*

116. See *id.* at 97-330.

117. See Neil E. Harl, *Post-Death Cash Leasing: One More Time*, AGRIC. L. DIG., June 13, 1997, at 89, 90.

118. See *Minter v. United States*, 19 F.3d 426, 430 (8th Cir. 1994).

119. *Estate of Gavin v. United States*, 113 F.3d 802 (8th Cir. 1997).

120. See *id.* at 804.

121. See *id.*

122. See *id.*

year for parcel one and \$10,000 per year for a second parcel.¹²³ The son purchased the second parcel within the two year grace period, but the cash rental arrangement extended beyond the two year grace period with respect to the first parcel.¹²⁴ The Service denied the special use valuation with respect to parcel one, but accepted it with respect to parcel two.¹²⁵ The district court agreed with the Service.¹²⁶

The Eighth Circuit held that the qualified use test was satisfied because the son had the *option* to pay cash rent in the amount of \$10,000 or to crop share on a 50/50 basis.¹²⁷ As such, the court determined that the son did not reduce the financial risk faced by the other heirs.¹²⁸ The court noted that had the real estate's crop or livestock sales suffered because of weather, disease, or fluctuating prices to an extent that the value of fifty percent of the sale proceeds dropped to less than \$10,000, the son would have been reasonably expected to exercise his option to pay crop share rather than cash rent. As such, the court determined that the other heirs shared the risk of farming because they were not guaranteed to receive \$10,000 in cash rent.¹²⁹ However, the fact that the tenant had the option to pay a crop share amount is wholly irrelevant. There is absolutely no statutory basis for the court's assertion. The fact is that the son paid cash rent beyond the two-year grace period after the decedent's death.

The court also noted that the son had an outstanding option to purchase parcel one which was ultimately exercised, even though the exercise occurred more than two years after the decedent's death. The court reasoned that before the son's exercise of the option to purchase, it would have been difficult for the estate to sell the real estate or do anything with the real estate other than allow the son to farm it.¹³⁰ As such, the terms of the decedent's will locked the heirs into an arrangement that was dependent on the son's decision to purchase the family farm. According to the court, the son's purchase decision was at least partially dependent upon the revenue he could earn from farming.¹³¹ However, the fact remains that the qualified heir paid cash rent to the estate outside the two-year grace period.

123. *See id.* at 805.

124. *See id.*

125. *See id.*

126. *See id.*

127. *See id.* at 808.

128. *See id.* at 807. The fact that the heir had an option to pay a crop share amount is irrelevant. In actuality, the heir paid a cash rent for the land outside of the two-year grace period. Cash leases to family members are permitted only during the pre-death period.

129. *See id.* at 807.

130. *See id.* at 808.

131. *See id.*

The court clearly displayed its lack of understanding of the difference between the pre-death and post-death tests by citing a passage in *LeFever v. Commissioner*,¹³² stating that “[c]ash rental of the property to a nonfamily member is not a qualifying use.”¹³³ Unfortunately, that statement was made in reference to the pre-death test. The Eighth Circuit, in *Gavin*, was faced with a post-death rental situation. The court also referenced a 1976 committee report discussing the pre-death qualification requirements.¹³⁴ Again, however, this demonstrates the court’s misunderstanding of the difference between the pre-death and post-death test; *Gavin* involved the application of the post-death rule.

The court did uphold correctly the district court’s opinion that the estate was not entitled to a stepped-up basis in the grain and livestock that was received from the lessee-heir in satisfaction of the crop share arrangement with the decedent because the crop share was income in respect of decedent.¹³⁵ At the time of death, the decedent’s right to receive the rental income was fully vested.¹³⁶

The Taxpayer Relief Act of 1997 specifies that rental of land on a “net cash basis” by a surviving spouse or a lineal descendant of the decedent to a member of the family of such spouse or descendant does not cause recapture of special use valuation benefits during the recapture period after death.¹³⁷ A legally adopted child is treated the same as a “child of such individual by blood” for purposes of the 1997 cash rent rule.¹³⁸

132. *LeFever v. Commissioner*, 100 F.3d 778 (10th Cir. 1996).

133. *Id.* at 783 (citations omitted).

134. See H.R. REP. NO. 94-1380, at 23 (1976), reprinted in 1976 U.S.C.C.A.N. 3356, 3377.

135. See *id.* at 809; see also I.R.C. § 1014(c) (1994) (denying a stepped-up basis for property that is income in respect of decedent under I.R.C. § 691).

136. See *Estate of Gavin v. United States*, 113 F.3d 802, 809 (8th Cir. 1997).

137. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 504(a), 1997 U.S.C.C.A.N. (111 Stat.) 788, 853-54 (amending I.R.C. § 2032A(c)(7) (1994), by adding a new paragraph (E)). The provision is made retroactive to leases entered into after December 31, 1976. See *id.* The situation presented in *Estate of Gavin v. United States*, 113 F.3d 802 (8th Cir. 1997), would not come within the new exception. The lease involved in *Gavin* was a cash lease with the decedent’s estate not a cash lease by a surviving spouse or lineal descendant of the decedent to a family member. See *id.* at 809.

138. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 504(a), 1997 U.S.C.C.A.N. (111 Stat.) 788, 853-54 (amending I.R.C. § 2032A(c)(7) (1994), by adding a new paragraph (E)).

F. *Perfecting a Protective Special Use Valuation Election After a Final Determination of Values*

1. *Nature of the Problem*

A protective use value election may be made with a timely filed federal estate tax return, pending a final determination of property values.¹³⁹ If, after the filing of a protective election, it is determined that the estate qualifies for special use valuation based on values as finally determined (or agreed to following examination of a return), an additional notice of election must be filed within sixty days after the date of the determination.¹⁴⁰ This notice must set forth the information required to be included in an actual notice of election.¹⁴¹ The additional notice and the special use valuation agreement must be attached to an amended estate tax return and filed with the I.R.S. office where the original return was filed.¹⁴²

2. *Recent Caselaw Development*

In *Kokernot v. Commissioner*,¹⁴³ the court held that a protective election could not be perfected after a settlement agreement was entered into with the Service.¹⁴⁴ The decedent died in 1990, leaving a large Texas cattle ranch.¹⁴⁵ The estate tax return reported the fair market value of the ranch as \$2.7 million.¹⁴⁶ The estate tax return included a Schedule A-1 on which the executor made a protective election under Treasury Regulation Section 20.2032A-8(b).¹⁴⁷ The Service audited the return with the issue being the ranch's value.¹⁴⁸ The Service issued a deficiency notice in June of 1994 and the estate made no mention of the protective election at that time, instead opting to file a Tax Court petition, which also did not mention the

139. See Treas. Reg. § 20.2032A-8(b) (1988). The protective election is made by attaching an abbreviated notice of election to the federal estate tax return and must include the decedent's name and taxpayer identification number, the relevant qualified use, and the items of real and personal property shown on the estate tax return which are used in a qualified use and that pass to qualified heirs. See *id.*

140. See Treas. Reg. § 20.2032A-8(b)(3) (1988).

141. See *id.*

142. See *id.*

143. *Kokernot v. Commissioner*, 112 F.3d 1290 (5th Cir. 1997).

144. See *id.* at 1291.

145. See *id.* at 1292.

146. See *id.*

147. See *id.*

148. See *id.*

protective election.¹⁴⁹ The parties stipulated that the entire ranch should be valued at \$80 per acre (with an additional twenty percent discount).¹⁵⁰ However, the stipulation agreement did not refer to either the I.R.C. § 2032A or the protective election.¹⁵¹

During discussion concerning administrative expenses, the estate's attorney informed the Service that the estate intended to pursue the protective election.¹⁵² In August of 1995, the estate filed an amended estate tax return, making an election under I.R.C. § 2032A.¹⁵³ The estate later sought to raise the issue at trial.¹⁵⁴ The Service motioned for an entry of decision in accordance with the stipulation without the application of I.R.C. § 2032A.¹⁵⁵ The Tax Court granted the Service's motion, holding that the estate had not preserved its claim to I.R.C. § 2032A.¹⁵⁶

On appeal, the estate argued that the Service had not made a "final determination" with respect to the ranch's value until the settlement agreement and that, therefore, the sixty day timeframe for filing an additional notice of election in accordance with the protective election had not begun to run until the settlement agreement was reached.¹⁵⁷ The Service maintained that its issuance of a deficiency notice triggered the running of the sixty day period.¹⁵⁸

The Fifth Circuit affirmed the Tax Court and held that the Service renders a "final determination" when it issues a deficiency notice.¹⁵⁹ As such, the estate waived its ability to claim valuation under I.R.C. § 2032A.¹⁶⁰

149. *See id.*

150. *See id.* at 1292-93.

151. *See id.* at 1293.

152. *See id.*

153. *See id.*

154. *See id.*

155. *See id.*

156. *See id.*

157. *See id.* at 1295.

158. *See id.*

159. *See id.*

160. *See id.* at 1296. Estate counsel may want to consider advising an executor to have both a fair market value appraisal and an appraisal of special use value conducted before filing the estate tax return. Once both of those appraisal figures are obtained, counsel can then make an informed decision concerning whether to make a protective special use valuation election on the return, and the special use value appraisal will be readily available for perfecting the election, if the Service issues a closing letter without auditing the return.

G. Miscellaneous Developments

1. Malpractice Claims and the Statute of Limitations

Because of the highly technical requirements of the special use valuation statute, malpractice liability is a real concern for practitioners making a special use valuation election in an estate. In the event a professional malpractice claim is filed against a practitioner arising out of a special use value election, one possible defense may be the statute of limitations. Because a malpractice claim frequently constitutes both a tort and a breach of contract, an important question is to determine which statute of limitations applies. In general, a legal action is contractual when the act complained of is a breach of specific terms of a contract. Conversely, an action lies in tort if the allegation is of a breach of a legal duty imposed upon the attorney-client relationship. In Kansas, for example, a three-year statute of limitations applies for oral contracts,¹⁶¹ and a five-year statute applies for written contracts.¹⁶² Tort actions in Kansas are subject to a two-year statute of limitations.¹⁶³

Another important question is when the statute of limitations begins to run. Under the minority view, the statute of limitations period begins to run on the date of the attorney's negligent act.¹⁶⁴ As applied, this rule is very favorable to practitioners because malpractice often occurs many years before the client dies and the problem is discovered. The majority view, however, suspends the period of limitations until the plaintiff discovers or reasonably should have discovered the negligent act.¹⁶⁵

In *Sass v. Hanson*,¹⁶⁶ a legal malpractice claim was filed against an attorney for an estate electing special use valuation upon the assessment of recapture tax. The qualified heirs alleged that recapture tax would not have been assessed had proper legal advice been given. The court of appeals upheld a lower court finding that the action was barred by the statute of limitations and dismissed the lawsuit.¹⁶⁷ The decedent died in early 1980 and the defendant sent a letter to the heirs which advised them that they needed to maintain material participation in the farming

161. See KAN. STAT. ANN. § 60-512 (1996).

162. See KAN. STAT. ANN. § 60-511(1) (1996).

163. See KAN. STAT. ANN. § 60-513(a)(4) (1996).

164. See *Wilcox v. Plummer*, 29 U.S. (4 Pet.) 172, 172 (1830); *Sullivan v. Stout*, 199 A. 1, 3 (N.J. 1938); *Master Mortgage Corp. v. Byers*, 202 S.E.2d 566, 568 (Ga. Ct. App. 1973).

165. See *Mumford v. Staton, Whaley & Price*, 255 A.2d 359, 364-68 (Md. 1969); *Heyer v. Flaig*, 449 P.2d 161, 166-67 (Cal. 1969); *Cameron v. Montgomery*, 225 N.W.2d 154, 155-56 (Iowa 1975); *Dolce v. Gamberdino*, 376 N.E.2d 273, 275-77 (Ill. App. Ct. 1978); *Greene v. Greene*, 436 N.E.2d 496, 500-01 (N.Y. 1982); *Pizel v. Zuspahn*, 795 P.2d 42, 54-57 (Kan. 1990).

166. *Sass v. Hanson*, 554 N.W.2d 642 (Neb. Ct. App. 1996).

167. See *id.* at 648.

operation if the elected land was leased to an unrelated third party. However, the letter did not specifically state that cash leasing should be avoided.¹⁶⁸ A second letter was mailed to the heirs in conjunction with the decedent's federal and state income tax returns and the attorney once again reiterated the necessity of the heirs to maintain material participation with respect to the farmland subject to the election.¹⁶⁹ Again, no specific mention of the avoidance of cash leasing was included in the letter. The court, in noting that the Nebraska statute of limitations for professional negligence utilized the "occurrence rule" rather than the "damage rule," held that the statute was triggered when a party knows of injury or damage and not when the party has a legal right to seek redress in court.¹⁷⁰ The court ruled that although the letters did not expressly state that cash leasing was to be avoided, the heirs understood the nature of the problem and that cash leasing would cause recapture.¹⁷¹ As such, the cause of action accrued not when the IRS assessed recapture taxes, but rather in late 1980 and early 1981 when the letters were sent to the heirs.¹⁷²

In *LeFever v. Commissioner*,¹⁷³ upon the imposition of recapture tax against the estate (for cash rental of pastureland), the qualified heirs argued that the special use valuation election was invalid because the land had never been put to a qualified use.¹⁷⁴ The heirs also asserted that the Service's determination of recapture liability was barred by the statute of limitations because the estate tax return put the Service on notice that the election was invalid.¹⁷⁵ The Tenth Circuit upheld the Tax Court in rejecting both of the qualified heirs' arguments.¹⁷⁶

In holding that the heirs could not disavow the special use valuation election, the court rejected the heirs' contention that the "duty of consistency doctrine" required a finding that the taxpayer made an intentional misrepresentation or wrongful misleading silence, instead of holding that their representations in the election were conclusions of law.¹⁷⁷ The court also noted that the applicable statute of limitations gave the Service three years from the time of discovery of a disqualifying event to assert recapture tax rather than three years from filing of the return.¹⁷⁸ In this case, recapture tax was asserted ten years after death, and the

168. See *id.* at 645.

169. See *id.* at 645-46.

170. See *id.* at 646.

171. See *id.* at 647-48.

172. See *id.* at 648.

173. *LeFever v. Commissioner*, 100 F.3d 778 (10th Cir. 1996).

174. See *id.* at 782.

175. See *id.* at 790.

176. See *id.* at 792.

177. See *id.* at 788.

178. See *id.* at 790.

court found nothing in the estate tax return, election, or supporting documents that should have put the Service on notice that the election was invalid.¹⁷⁹

In *LeFever*, both pastureland and cropland were subjected to recapture. The Service prevailed in asserting that an average fair market value figure was to be used when the estate failed to present any evidence that the cropland had a higher value than the pasture for commercial development purposes.¹⁸⁰ The highest and best use was as commercial development.

2. *Indexation of Amount of Aggregate Reduction in Fair Market Value*

The special use valuation provisions place a limit on the amount by which a decedent's gross estate may be reduced by making the election.¹⁸¹ For deaths after 1982, and before 1999, the amount is \$750,000.¹⁸² The Taxpayer Relief Act of 1997 indexes this \$750,000 amount for inflation for deaths after 1998.¹⁸³

III. CONCLUSION

The special use valuation provisions continue to be a viable option for reducing the value of qualified real property included in an estate subject to federal estate taxation. However, the technical requirements of the statute remain, and practitioners must exercise great care to properly plan for utilization of the statute and avoid recapture after death.

179. *See id.* at 783.

180. *See id.* at 791.

181. *See* I.R.C. § 2032A(a)(2) (1994).

182. *See id.*

183. *See* Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 501(b)(3), 1997 U.S.C.C.A.N. (111 Stat.) 788, 845-46 (adding I.R.C. § 2032A(a)(3)).