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A Proposal to Amend Section 2032A to Reduce Restrictions on Cash Leasing of Farm Property

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A Proposal to Amend Section 2032A to Reduce Restrictions on Cash Leasing of Farm Property

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I. INTRODUCTION

In the United States, one of the primary goals of agricultural policy has long been, and continues to be, saving the "family farm."¹ Section 2032A of the Internal Revenue Code, which reduces the estate tax burden for agricultural land owners, is one example of this type of agricultural policy.² Congress' desire to save the family farm through estate tax relief may be a worthy goal. However, the restrictions that section 2032A places on cash leasing of farmland lead to outcomes inconsistent with that goal. This Article describes these inconsistencies and proposes amendments to the statute that would align the effects of the statute with Congress' stated goal of saving the family farm.

First, the Article presents a brief background to the passing of section 2032A. Second, the Article summarizes generally the application of the statute. Third, the Article introduces cash leases and describes how Congress, the Treasury Department, and federal courts have interpreted the statute to restrict cash leasing. Fourth, the Article analyzes the congressional purpose behind section 2032A, describes the

1. Examples of laws enacted at least in part to save the "family farm" include Chapter 12 of the Bankruptcy Code, 11 U.S.C. §§ 1201-31 (1988), anti-corporate farm statutes enacted in at least nine states, *see, e.g.*, KAN. STAT. ANN. § 17-5904 (1988), and the 1990 Farm Bill, *see* Food, Agriculture, Conservation and Trade Act of 1990, Pub. L. No. 101-624, 104 Stat. 3359 (codified as amended in scattered sections of 7 U.S.C. and 16 U.S.C.)(extending federal crop subsidies through 1995). *See* JOHN C. ANDERSON & JEFFREY W. MORRIS, CHAPTER 12 FARM REORGANIZATIONS (1987)(discussing Chapter 12 of the Bankruptcy Code); Brian F. Stayton, *A Legislative Experiment in Rural Culture: The Anti-Corporate Farming Statutes*, 59 UMKC L. REV. 679 (1991)(discussing anti-corporate farming statutes); Jonathan K. Van Patten, *Chapter 12 in the Courts*, 38 S.D. L. REV. 52 (1993)(discussing Chapter 12 of the Bankruptcy Code).

2. I.R.C. §§ 2032A(a)-(i)(1988).

real world effects of the restrictions on cash leasing, and demonstrates why these effects are contrary to the congressional purpose. Finally, the Article proposes amendments to section 2032A that would align more closely the effects of the statute with the purpose behind it.

II. GENERAL BACKGROUND

Generally, for purposes of estate taxes, a decedent's property is taxed at its fair market value at the time of death.³ As a result, prior to 1976, heirs were often forced to sell family farms because the farms could not produce sufficient profits to pay the estate taxes.⁴

In most cases, the value of property based on its use as agricultural property is substantially lower than the fair market value of the property, which is based on its highest and best use. This disparity in values exists because assets invested in agriculture traditionally have a relatively low rate of return,⁵ while assets invested in urban development, which is often the highest and best use of agricultural property, have a substantially higher rate of return. The comparatively higher rate of return from urban development has increased the demand for agricultural property and, therefore, increased the fair market value of such property.⁶

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3. I.R.C. § 2031 (1988). The Treasury Regulations define fair market value as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts." Treas. Reg. § 20.2031-1(b)(as amended in 1965).
 4. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 22 (1976), *reprinted in* 1976 U.S.C.C.A.N. 2897, 3356, 3376. The House Report noted that "[i]n some cases, the . . . [fair market value] estate tax burden makes continuation of farming, . . . not feasible because the income potential from these activities is insufficient to service extended tax payments or loans obtained to pay the tax." *Id.*
 5. In an article written shortly before the passing of section 2032A, one commentator stated that the average rate of return on assets invested in agriculture is "scarcely" three percent. Donald H. Kelley, *The Farm Corporation as an Estate Planning Device*, 54 NEB. L. REV. 217, 218 (1975).
 6. The increase in fair market value resulting from urbanization of farm property is referred to as "speculative" value. *See infra* notes 142-43 and accompanying text for further discussion of speculative value. *See also* Note, *Taxation: Valuation of Farmland for Estate Tax Purposes, Qualifying for I.R.C. § 2032A Special Use Valuation*, 23 WASHBURN L.J. 638, 642 (1984)[hereinafter Note, *Taxation*](explaining that taxation based on the highest and best use would be speculative and that valuation and taxation of farmland on its actual use is more likely to avoid the forced sale of the farm); Comment, *Valuation of Farmland for Estate Tax Purposes: A Consideration of Section 2032A and the New Treasury Regulations*, 27 LOY. L. REV. 140, 142 (1981). Other factors in addition to urbanization that contribute to inflation of agricultural property include investment in land by non-farmers as an inflation hedge, and the purchase of land for psychological satisfaction. *Id.*

In 1976, Congress created an exception to the estate tax valuation rules in the hope of protecting the family farm.⁷ Congress enacted section 2032A, which permits those who inherit qualifying family farms to elect a special use valuation of the property based on the property's actual use rather than on its fair market value.⁸

By valuing farm property on the basis of its actual use for agricultural purposes rather than on its higher fair market value, section 2032A reduces the size of the gross estate from which estate taxes are calculated and, therefore, reduces the estate tax liability at the decedent's death. In turn, the chances are greater that the profits from the farm will be sufficient to pay the estate taxes, and the heirs will not have to sell all or part of the farm property to pay the taxes.

III. THE PROVISIONS OF THE STATUTE

Congress did not make it easy to qualify for the special use valuation under section 2032A. Congress carefully delineated the types of property eligible for special use valuation. Only "qualified real property" of the decedent is eligible for special use valuation.⁹ Qualified real property is defined as real property located in the United States which was acquired from or passed from the decedent to a "qualified heir" of the decedent and which, on the date of the decedent's death, was being used for a "qualified use" by the decedent or a member of the decedent's family.¹⁰

Here "qualified use" refers to pre-death qualified use.¹¹ The pre-death qualified use test requires that a qualified use must exist at the time of the decedent's death and for at least five of the last eight years prior to death.¹² The pre-death requirement can be satisfied either by a decedent or by a member of the decedent's family.¹³ The term "qual-

7. This Article discusses section 2032A only in the context of farm property. However, section 2032A also allows property used in a trade or business other than farming to be valued in accordance with its business purposes. See *Estate of Trueman v. United States*, 6 Cl. Ct. 380 (1984); Bruce W. Bringardner, *Planning to Qualify Non-Farm Business Real Estate for Special-Use Valuation*, 64 J. TAX'N, Mar. 1986, at 130; William M. Dougherty, *Application of I.R.C. Section 2032A to Business Real Estate Other than a Farm or Ranch*, 17 U. MIAMI INST. ON EST. PLAN., ¶¶ 1300-11 (1983).

8. I.R.C. § 2032A(a) (1988).

9. *Id.* § 2032A(b).

10. *Id.* § 2032A(b)(1).

11. *Id.* § 2032A(b). There is also a post-death qualified use requirement. *Id.* § 2032A(c)(1). The post-death requirement is discussed below and must be satisfied to retain special use valuation. See *infra* note 25 and accompanying text.

12. *Id.* §§ 2032A(b)(1)(A)(i) & (c)(1).

13. *Id.* § 2032A(b)(1). Initially, the pre-death qualified use requirement could only be met by the decedent. The Economic Recovery Tax Act of 1981 amended section 2032A(b)(1) to enable the decedent or a family member to satisfy the qualified use requirement. Economic Recovery Tax Act of 1981 (ERTA), Pub. L. No. 97-34,

ified use" is defined as "the devotion of the property to . . . use as a farm for farming purposes."¹⁴ The statute defines "farming purposes" quite broadly.¹⁵

In addition to the pre-death qualified use requirement, the decedent or a member of the decedent's family must meet two percentage tests¹⁶ and a pre-death material participation requirement.¹⁷ The percentage tests reflect the percentage of the gross estate that must be made up of agricultural property.¹⁸ Under the pre-death material participation requirement, the decedent or a member of the decedent's family must have materially participated in the operation of the farm for at least five of the eight years before the decedent's death.¹⁹

The term "qualified heir" refers to the member of the decedent's family who inherits the decedent's property.²⁰ Only certain relatives qualify as members of the decedent's family for purposes of the special use valuation. The term "member of the family" includes (A) an ancestor of an individual, (B) the spouse of an individual, and (C) a lineal descendant of an individual, of the individual's spouse, or of a parent

§ 421(b)(1), 95 Stat. 172 (1981)(amending I.R.C. § 2032A(b)(1)). See *infra* text accompanying notes 41-49 for a discussion of this amendment.

14. I.R.C. § 2032A(b)(2)(1988).

15. The Code defines the term "farming purposes" as:

(A) cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm; (B) handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and (C)(i) the planting, cultivating, caring for, or cutting of trees, or (ii) the preparation (other than milling) of trees for market.

Id. § 2032A(e)(5).

16. *Id.* §§ 2032A(b)(1)(A) & (b)(1)(B).

17. *Id.* § 2032A(b)(1)(C)(ii). There is also a post-death material participation requirement. *Id.* § 2032A(c)(6)(B)(ii). Because the cash lease question concerns only the pre-death and post-death qualified use requirements and not the material participation requirements, this Article does not discuss material participation. Nevertheless, it is important to note that all four requirements must be satisfied to get and keep special use valuation. See also Treas. Reg. § 20.2032A-3(a)(as amended by T.D. 7786, 1981-2 C. B. 174)(discussing the material participation requirements for special use valuation); Martin D. Begleiter, *Material Participation Under Section 2032A: It Didn't Save the Family Farm But It Sure Got Me Tenure*, 94 DICK. L. REV. 561 (1990).

18. Section 2032A(b)(1)(A) requires that the value of qualifying realty and related personal property, such as machinery and livestock, must equal at least fifty percent of the decedent's adjusted gross estate. Section 2032A(b)(1)(B) requires that at least twenty-five percent of the decedent's adjusted gross estate consist of the adjusted value of real property.

19. I.R.C. § 2032A(b)(1)(C)(ii)(1988).

20. *Id.* § 2032A(e)(1).

of the individual.²¹ If a qualified heir disposes of any interest in qualified real property to any member of his or her family, that family member is thereafter treated as the qualified heir with respect to the interest.²²

At the same time that Congress acted to give special estate tax benefits to family farms, it sought to prevent abuse of the privilege by taxpayers who may engage in family farming only long enough to reap the estate tax benefits and then convert the property to a more profitable commercial use, such as housing divisions. The House Report noted that:

[i]t would be a windfall to the beneficiaries of an estate to allow real property used for farming or closely held business purposes to be valued for estate tax purposes at its farm or business value unless the beneficiaries continue to use the property for farm or business purposes, at least for a reasonable period of time after the decedent's death.²³

Out of its desire to limit the applicability of section 2032A, Congress imposed a "recapture tax" on qualified heirs who breach certain post-death requirements. If, within ten years after the decedent's death, the heir disposes of any interest in the property (other than by disposition to a family member), or the qualified heir ceases to use the property for the qualified use, there is an additional estate tax imposed.²⁴

Here "qualified use" refers to the post-death qualified use requirement.²⁵ Unlike the pre-death test, which can be met by the decedent or a member of the decedent's family, the post-death qualified use test

21. *Id.* § 2032A(e)(2). Note that the statute treats a legally adopted child of an individual as a child of the individual by blood. *Id.*

22. *Id.* § 2032A(e)(1).

23. H.R. REP. No. 1380, 94th Cong., 2d Sess. 22 (1976), reprinted in 1976 U.S.C.C.A.N. 4030, 4041.

24. I.R.C. § 2032A(c)(1)(1988).

25. Cessation of qualified use occurs if:

(A) such property ceases to be used for the qualified use set forth in subparagraph (A) or (B) of subsection (b)(2) under which the property qualified under subsection (b), or

(B) during any period of 8 years ending after the date of the decedent's death and before the date of the death of the qualified heir, there had been periods aggregating more than 3 years during which—

(i) in the case of periods during which the property was held by the decedent, there was no material participation by the decedent or any member of his family in the operation of the farm or other business, and

(ii) in the case of periods during which the property was held by any qualified heir, there was no material participation by such qualified heir or any member of his family in the operation of the farm or other business.

Id. § 2032A(c)(6)(1988). Note that section 2032A(c)(6) imposes, in addition to the post-death qualified use requirement, a post-death material participation test. Again, the discussion herein concerns only the qualified use test.

can only be met by the qualified heir individually, and cannot be met by a member of the qualified heir's family.

As stated by the Ninth Circuit, "[t]he recapture tax is designed to recoup tax savings inappropriately enjoyed by the qualified heir when the heir elected the special use valuation."²⁶ The result is that the total estate tax on the property will be equivalent to a tax on the property's fair market value under section 2031.²⁷ Consequently, the recapture tax can have harsh results. Heirs may have to sell all or part of the family farm in order to pay the additional taxes.²⁸

IV. CASH LEASES AND APPLICATION OF SECTION 2032A

The two most common leases used in agriculture are cash leases and crop share leases.²⁹ A cash lease is defined as a lease in which the rent is established at a predetermined amount, without regard to the income or expenses of the farm and without regard to the production or success of the farming activity.³⁰ The tenant pays for the variable inputs necessary to grow the crop, such as fertilizer, seed, herbicide, insecticide, irrigation, and cultivation. The tenant then gets the entire crop with which to do what he or she chooses. The landlord pays for no inputs and receives as rent only the predetermined cash amount. Cash leases relieve a landlord of concern over variations in prices and crop yield; the tenant bears all price, cost, and production risks. Likewise, the tenant realizes any windfall profits that result from unexpected increases in crop price or unusually favorable growing conditions which result in higher yields.

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26. *Williamson v. Commissioner*, 974 F.2d 1525, 1527 (9th Cir. 1992). *See also* I.R.C. § 2032A(c)(2)(1988) (defining the recapture tax as the excess interest over the interest based on the special use valuation); H.R. REP. NO. 1380, 94th Cong., 2d Sess. 25-26 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3379-80 (defining the amount subject to recapture as the excess tax which would have been incurred had special use valuation not been used).
 27. I.R.C. § 2031 (1988).
 28. *See Stovall v. Commissioner*, 101 T.C. 140 (1993). In *Stovall*, the petitioners argued that if the court found a cessation of qualified use, they would be forced to sell the farm that had been in their family for 50 years in order to pay the additional estate taxes. It is not clear whether the petitioners' claim was true or merely an (unsuccessful) attempt to gain sympathy from the court. Regardless, in certain cases, the recapture tax, indeed, can cause such harsh results as forced sales of farms.
 29. 2 JULIAN C. JUERGENSMEYER & JAMES B. WADLEY, *AGRICULTURAL LAW* § 36.2 (1982).
 30. A. M. Edwards, *Section 2032A: Cash Leases and Cessation of Qualified Use*, 10 VA. TAX REV. 731, 743 (1991). *See also* Priv. Ltr. Rul. 82-01-016 (Sept. 22, 1981) (defining a cash lease as a lease in which the rent is established at a specific predetermined amount that is not based on the success of the farming activity); JUERGENSMEYER & WADLEY, *supra* note 29, § 36.4 (discussing the advantages and disadvantages of cash leases).

With a crop share lease, on the other hand, the landlord normally receives as payment for use of his land a percentage of the profits or earnings from the farming operation or a percentage of the crops grown on the land.³¹ The landowner provides the real estate and may provide or share in providing other inputs such as fertilizer, seed, and insecticides.³² Because costs of inputs may be higher, and market prices and crop yields may be lower than contemplated at the time the parties entered the lease agreement, the crop share lease results in the landlord sharing with the tenant the risks of crop production. The landlord, however, also shares in higher profits resulting from any decrease in costs of inputs or any increase in market price or crop yield.

A 1993 survey of the 100 largest farm management firms in the United States gives some indication of the extent to which farmers use the two types of leases.³³ That survey indicates that out of the 15.3 million acres managed by the 100 largest farm management firms, thirty-six percent or 5.5 million acres, are subject to cash lease agreements.³⁴ Forty-seven percent, or 7.2 million acres, are subject to crop share agreements.³⁵ Note that although cash leases are not the most often used agricultural lease, they run a close second.

Notwithstanding the extensive use of cash leases in the agricultural sector, Congress, the Treasury Department, and federal courts have all opined that, with two limited statutory exceptions, the term "qualified use" does not include cash leasing of the qualified property. As a result of this interpretation of "qualified use," if, in the pre-death context, the decedent cash leases the property to anyone but a family member, no special use valuation will be allowed. In addition, if, in the post-death context, the qualified heir (other than the surviving spouse who can cash lease to family members) cash leases qualified property to *anyone*, including a family member, it is considered a cessation of qualified use, which results in a recapture tax.

A. Legislative History as it Relates to Cash Leasing

1. Original Congressional Interpretation

The language of section 2032A does not expressly address cash leasing. However, Congress made its position toward cash leasing fairly clear in reports accompanying the 1976 legislation. The House Report accompanying the 1976 legislation elaborated on the meaning

31. Edwards, *supra* note 30, at 743.

32. JUERGENSMEYER & WADLEY, *supra* note 29, § 36.5.

33. *Farm Management Firms Continue Growth*, AGRICULTURE, Oct. 1993 at 28.

34. *Id.* at 29.

35. *Id.* The remaining acres managed by these firms are leased under direct operation and management leases (10% or 1.53 million acres), custom farm leases (3% or .46 million acres), bushel rent leases (1% or .15 million acres), and other specialized leases (3% or .46 million acres).

of qualified use.³⁶ The report emphasized that qualified use requires an active farming use of the property. "The mere passive rental of property will not qualify."³⁷ However, rentals where payment is contingent upon the farm's performance, such as a crop share lease, are permissible.³⁸ The report offered an example of a permissible lease arrangement: "[I]f A, the decedent, owned real property which he leased for use as a farm to the ABC partnership in which he and his sons B and C each had a one-third interest in profits and capital, the real property could qualify for special use valuation."³⁹ Congress permitted this type of arrangement because the decedent's rental payment from the partnership is contingent upon the farm's performance and is not a predetermined amount. Therefore, the decedent is engaged in an active and not a passive use of the property.

The language of the House Report indicates that, at the time the statute was passed, any pre-death cash leasing was not a qualified use of the property and, thus, made special use valuation unavailable. The House Report and other legislative history, however, is directed only toward pre-death qualified use and offers little guidance with respect to post-death qualified use and cessation of qualified use.⁴⁰

2. Amendments Affecting Cash Leasing

Two amendments to the 1976 version of the statute created exceptions to Congress' initial prohibition against cash leasing. The first amendment, enacted in 1981, concerned the pre-death qualified use requirement.⁴¹ That amendment permitted land to qualify for special use valuation if either the decedent or a member of his or her family farmed the property prior to the decedent's death. In passing this amendment, Congress recognized that owners of farms often become ill or disabled during the closing years of their lives, and are unable to continue farming the property.⁴² As a consequence of this amendment, a net cash lease between the decedent and a member of the de-

36. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 23 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3377.

37. *Id.*

38. *Id.*

39. *Id.*

40. *See* Edwards, *supra* note 30, at 739-40.

41. Economic Recovery Tax Act of 1981 (ERTA), Pub. L. No. 97-34, § 421(b)(1), 95 Stat. 172 (1981)(amending I.R.C. § 2032(A)(b)(1)).

42. H.R. CONF. REP. NO. 215, 97th Cong., 1st Sess. 248 (1981), *reprinted in* 1981 U.S.C.C.A.N. 105, 285, 337; S. REP. NO. 144, 97th Cong., 1st Sess. 132-33 (1981), *reprinted in* 1981 U.S.C.C.A.N. 105, 233-34. *See also* T.D. 7786, 1981-2 C.B. 174 (amending Treas. Reg. 20.2032A-3(b)(1)).

cedent's family no longer precludes the heirs from subsequently invoking the special use valuation provision.⁴³

The committee reports accompanying the 1981 amendment offered more guidance than earlier reports with respect to post-death qualified use. The reports stated that the amendment did "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."⁴⁴ Additionally, the reports reiterated the notion that the qualified use be "an active trade or business use as opposed to a passive or investment use."⁴⁵ Therefore, a cash lease between a qualified heir and any other party still results in a cessation of qualified use.

The 1981 amendment contained one other exception to the prior ban on cash leases. The amendment created a two-year grace period after the decedent's death during which the qualified heir is allowed to cash lease the property.⁴⁶ Under this exception, the heir's failure to engage in a qualified use of the property after the decedent's death will not result in a recapture tax, provided the qualified heir begins the qualified use within two years of the decedent's death.⁴⁷ The ten-year recapture period is extended by the length of the period from the date of death until the date the heir begins his qualified use.⁴⁸ This two-year grace period allows the qualified heir to renegotiate a cash lease which may have been in effect at decedent's death.⁴⁹

The second significant amendment to section 2032A occurred in 1988 and concerned the post-death qualified use requirement. Congress crafted a special rule for the surviving spouse of a decedent that permitted the spouse to rent the property to a family member on a

43. S. REP. NO. 144, 97th Cong., 1st Sess. 133 (1981), *reprinted in* 1981 U.S.C.C.A.N. 233; H.R. REP. NO. 201, 97th Cong., 1st Sess. 169 (1981), *reprinted in* 1981-2 C.B. 352, 382. Consider the effect of this amendment on the ABC partnership presented in the 1976 House Report and discussed in the previous section. See *supra* text accompanying notes 36-40. In that situation the decedent's land would qualify for special use valuation even if the decedent cash leased the property to the partnership. This result occurs because the partnership leasing the property is made up entirely of members of the decedent's family as defined under the statute.

44. S. REP. NO. 144, 97th Cong., 1st Sess. 134 (1981), *reprinted in* 1981 U.S.C.C.A.N. 234; H.R. REP. NO. 201, 97th Cong., 1st Sess. 169 (1981), *reprinted in* 1981-2 C.B. 382.

45. S. REP. NO. 144, 97th Cong., 1st Sess. 133 (1981) *reprinted in* 1981 U.S.C.C.A.N. 233; H.R. REP. NO. 201, 97th Cong., 1st Sess. 169 (1981), *reprinted in* 1981-2 C.B. 382.

46. Economic Recovery Tax Act of 1981 (ERTA), Pub. L. No. 97-34, § 421(c)(1)(B)(ii)(amending I.R.C. § 2032A(c)(7)(A)).

47. I.R.C. § 2032A(c)(7)(A)(i)(1988).

48. *Id.* § 2032A(c)(7)(A)(ii).

49. Edwards, *supra* note 30, at 744.

cash basis without running afoul of the qualified use requirement.⁵⁰ This change contrasted sharply with the prior rule that cash leasing of specially valued property was not a qualified use and, therefore, was treated as a recapture event.⁵¹ Congress believed that the surviving spouse should not be subject to more onerous rules than the decedent.⁵² Moreover, Congress observed that imposing a recapture tax unless the surviving spouse uses the property in a qualified use interferes with the orderly operation of the farm.⁵³ By allowing the surviving spouse to cash lease the property to a member of the spouse's family, Congress now permits the spouse to obtain a more certain income stream than would be provided by a crop share lease.⁵⁴

The effect of the 1981 and 1988 amendments was to create two specific exceptions to the special use valuation provision where passive rental (cash leases) as opposed to active farming of the property will be deemed consistent with the qualified use requirement.⁵⁵ Generally, this Article argues that these amendments do not go far enough. Instead, the special use valuation provisions should be further amended so that both pre-death and post-death cash leasing to related and unrelated individuals is permitted.

B. Treasury Department Interpretation

The Treasury Department has promulgated a regulation that is consistent with the legislative committee reports in its treatment of cash leases.⁵⁶ Similar to the 1976 committee reports, the regulation is directed only toward pre-death qualified use and not post-death qualified use or cessation of qualified use. The IRS has announced, however, that it will issue rulings on whether proposed or actual transactions violate the post-death test, resulting in imposition of the recapture tax.⁵⁷ With respect to pre-death transactions, the regulation states that "the mere passive rental of property to a party other

50. Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, § 6151, 102 Stat. 3342, 3724 (amending I.R.C. § 2032A(b)(5)).

51. H.R. REP. No. 795, 100th Cong., 2d Sess. 590 (1988). See also Tech. Adv. Mem. 88-03-004 (October 22, 1987)(finding cessation of qualified use where decedent's son paid surviving spouse set cash rent through a trust).

52. H.R. REP. No. 795, 100th Cong., 2d Sess. 590-91 (1988).

53. *Id.*

54. *Id.*

55. See *Williamson v. Commissioner*, 974 F.2d 1525, 1528 (9th Cir. 1992)(summarizing effect of 1981 and 1988 amendments to section 2032A).

56. Treas. Reg. § 20.2032A-3 (1993)(as amended by T.D. 7786, 1981-2 C.B. 174).

57. Rev. Proc. 90-1, 1990-1 C.B. 356. The section immediately following this paragraph contains a discussion of IRS rulings on both pre-death and post-death qualified use. See *infra* text accompanying notes 62-70.

than a member of the decedent's family will not qualify.⁵⁸ The regulation requires that in order to satisfy the qualified use test the real property must be used in an active trade or business, and the decedent or a member of the decedent's family must own an equity interest in the farm operation.⁵⁹

The IRS also has drafted numerous technical advice memoranda and private letter rulings that address whether cash leasing of farm property is a qualified use under section 2032A. Although these rulings and memoranda are binding only on the particular taxpayer whose case is discussed therein, the documents are nevertheless informative as to the IRS's position on cash leasing.

There are three scenarios in which the IRS has considered the cash leasing question, one pre-death and two post-death. The first is where the decedent leased the property to an unrelated individual. The second is where a qualified heir cash leases the farm property to any relative, including another qualified heir, a member of the family, or another relative. The third is where a qualified heir cash leases the farm property to an unrelated individual. A fourth possible scenario, a pre-death scenario for which no representative IRS ruling can be found, is where the decedent cash leases the farm property to a relative who is not a member of the family under the statute.⁶⁰ As with the first three scenarios, the IRS undoubtedly would deny special use valuation in such a case.⁶¹

1. Pre-Death Scenario

a. Cash Leases to Unrelated Individuals

The IRS has consistently found that cash leases by decedents to unrelated individuals violate the pre-death qualified use requirement.

58. Treas. Reg. § 20.2032A-3 (1993). See also *Martin v. Commissioner*, 783 F.2d 81 (7th Cir. 1986). In *Martin*, the Seventh Circuit elaborated on the scope of Treas. Reg. § 20.2032A-3 and its application to qualified use:

[T]he regulation is captioned "Material participation requirements for valuation of certain farm and closely-held business real property," but the scope is broader. Subsection (b), captioned "Types of qualified property," deals with the anterior issue whether there is a qualified use (qualified property is defined as we have seen in terms of qualified use), and that is the subsection which contains the passage about passive uses.

Martin, 783 F.2d at 84.

59. Treas. Reg. § 20.2032A-3(b)(1)(1993).

60. For the definition of "member of the family," see I.R.C. § 2032A(e)(2)(1988). Because this definition does not include all relatives of the decedent, it is possible for a decedent to cash lease to an individual who does not fit under this definition yet is related to the decedent.

61. In *Heffley v. Commissioner*, 884 F.2d 279 (7th Cir. 1989), the Seventh Circuit denied special use valuation where the decedent cash leased farm property to her nephew (brother-in-law's son).

For instance, the IRS considered a case in which the decedent cash leased 1,200 acres of ranchland (out of a total of 3,124 acres owned by the decedent) to an unrelated party from his retirement to his death.⁶² The IRS found that because the decedent was involved in the "mere passive rental" of the ranchland property, none of the land was being used for a qualified use on the date of the decedent's death. Accordingly, the 1,200 acres could not be specially valued under section 2032A.⁶³

In a similar situation, a decedent, one year before his death, entered into a cash lease agreement with an unrelated third party for the majority of his farm.⁶⁴ For the approximately thirty-five years before the decedent entered this lease agreement, he had farmed the land as the sole proprietor. After entering the agreement, the decedent continued to live and perform some activities on the farm. Nevertheless, because the decedent received a predetermined cash rent of \$150 per acre, his interest was not dependent on the success or failure of the farming operation. Therefore, the IRS found that the lease was a passive rental activity and that the land was not being used for a qualified use on the date of the decedent's death. Accordingly, the decedent's farm did not qualify for special use valuation under section 2032A.

In another instance, a decedent owned ranchland which he leased to a non-family member on a cash basis.⁶⁵ The decedent acquired the ranch in 1950 and operated the ranch until he suffered a stroke in 1968. As a result of the stroke, the decedent cash leased the ranch until his death in 1982. As in similar situations, the IRS determined that a cash lease to an unrelated party was not a qualified use under the statute. Consequently, special use valuation under section 2032A was not available.

2. *Post-Death Scenarios*

a. *Cash Leases to Any Relatives*

In the post-death scenario, the IRS has found that cash leases between the qualified heir (other than a surviving spouse) and any related individuals result in a cessation of qualified use. For instance, in

62. Tech. Adv. Mem. 84-35-008 (May 10, 1984).

63. It is important to note here that the IRS and courts deny special use valuation only for that property subject to a improper cash lease. In Technical Advice Memorandum 84-35-008, only 1200 acres were subject to an improper cash lease. Therefore, the IRS denied special use valuation only for those acres. The remaining 1,924 acres were cash leased to the decedent's son, a member of the family, which is allowed under section 2032A(b). Therefore, the IRS granted special use valuation for those acres. *Id.*

64. Tech. Adv. Mem. 82-01-016 (Sept. 22, 1981).

65. Tech. Adv. Mem. 84-35-013 (May 17, 1984).

one private letter ruling, the decedent died testate and bequeathed her entire estate, including farmland, to her adult children.⁶⁶ For the sixteen years before her death, the decedent had cash leased the farmland to her half brother. For the last ten years before her death, the farm had been operated by the sons of the decedent's half brother. The decedent's children, the qualified heirs, inquired as to whether special use valuation would be available if the heirs continued to cash lease the property to the sons of the half brother.

Because the half brother, the lessee under the sixteen-year cash lease, was a member of the decedent's family under section 2032A(e)(2), the decedent met the pre-death qualified use requirement. However, the post-death qualified use requirement must be met by the qualified heir. Here the cash lease gave the qualified heirs no "equity interest" in the farming operation. Therefore, the heirs failed to meet the post-death qualified use requirement. As a result, the proposed cash lease would be a cessation of qualified use which would trigger the recapture tax.

In another private letter ruling, the taxpayer requested a ruling that the decedent's two sons, B and C, be allowed to cash lease farmland to a partnership consisting of B and D (C's son) without there being a cessation of qualified use.⁶⁷ Under section 2032A, both B and C, the two qualified heirs, must engage in a qualified use of the property (must have an equity interest in the farm operation).⁶⁸ Because C's receipts would not be based upon the production of the farm property, the IRS found that C did not meet the qualified use requirement. Therefore, the cash lease to the partnership in which only one of the two heirs participated would not meet the special use valuation requirements.⁶⁹

b. Cash Leases to Unrelated Individuals

The IRS has also found that a cash lease between a qualified heir and an unrelated individual results in a cessation of qualified use. In Technical Advice Memorandum 87-35-001,⁷⁰ the qualified heir, in this case the decedent's spouse, cash leased pasture land to an unrelated

66. Priv. Ltr. Rul. 83-07-110 (Nov. 18, 1982).

67. Priv. Ltr. Rul. 84-27-052 (Apr. 3, 1984).

68. See I.R.C. § 2032A(c)(1)(B)(1988).

69. Where two heirs lease property in the post-death context each heir must have an equity interest in the farming operation or special use valuation will be denied for the entire property. The IRS will not separate the interests of the two partners for special use valuation purposes. Compare this situation to the one in which two tracts of land are involved. An improper cash lease for one of the tracts will not make unavailable special use valuation for the other tract. The IRS will separate the two tracts of land for special use valuation purposes. See Tech. Adv. Mem. 84-35-008 (May 10, 1984).

70. Tech. Adv. Mem. 87-35-001 (Apr. 27, 1987).

third party. The qualified heir was responsible for maintaining fences, wells, and buildings on the property, but had no involvement in decisions regarding the ranching operations. The IRS found that the heir had no equity interest in the ranching operation and, therefore, had ceased to use the property for a qualified use. As a result, the heir was subject to a recapture tax under section 2032A(c).

C. Judicial Interpretation

Except for situations covered by the two amendments discussed above, courts that have addressed whether cash leasing of farm property runs afoul of the qualified use requirement have agreed with Congress and the IRS that it does. The four scenarios presented in the discussion of the IRS position toward cash leasing apply here as well.

1. Pre-Death Cases

a. Cash Leases to Relatives Who Are Not Family Members

At least one court has considered a case involving a cash lease between a decedent and a relative who is not a family member. In *Heffley v. Commissioner*,⁷¹ the decedent, through a trust with her son as trustee, leased farmland first to her husband's brother on a cash basis, then to her nephew (brother-in-law's son) under a lease requiring rental partially in cash and partially in fixed quantities of commodities. The court found that the first lease involved a mere passive rental of property to a party other than a member of the decedent's family, and, therefore, did not meet the qualified use requirement for the four years the lease was in effect.⁷² The court considered the first lease dispositive of the case.⁷³ Under section 2032A, property may be in other than a qualified use for only three of the eight years preceding the decedent's death.⁷⁴ Here there was no qualified use for all four years of the lease, each year occurring within the crucial eight year period.

Even though the first lease was dispositive, the court also discussed the second lease, which was in effect at the time of the decedent's death. To obtain special use valuation, either the decedent or a member of the decedent's family must have been engaging in a quali-

71. 884 F.2d 279 (7th Cir. 1989).

72. In *Heffley*, the court also held that there is no qualified use merely because there had been material participation in the operation of the farm while the farmland was leased on a cash basis to an outsider. *Id.* at 283-84. In so holding, the court emphasized that the qualified use and material participation requirements are separate and distinct, and must not be overlapped in such a way as to confuse the elements of one or the other. *Id.*

73. *Id.* at 283.

74. I.R.C. § 2032A(b)(1)(C)(i)(1988)(requiring qualified property to be in a qualified use for five of the eight years preceding the decedent's death).

fied use of the property on the date of the decedent's death. Here, the court found that the lease was contingent somewhat on fluctuating commodity prices, but not on the farm's production. The decedent would receive the same amounts of cash and grain regardless of the farm's production.⁷⁵ Therefore, the court held, the lease was essentially a cash lease to an unrelated party and the farm was not put to a qualified use under section 2032A(b)(2).⁷⁶

Crucial to the court's disposition on both leases was a finding that neither lessee was a "member of the family" under section 2032A(e). Section 2032A mandates such a result despite the fact that all four individuals involved (decedent, trustee, brother-in-law, and nephew) had the same last name and three of the four were blood relatives. Had the two lessees been considered members of the decedent's family or had there been no prohibition against cash leasing, the decedent's estate would have been taxed on the special use value of the property of \$90,339.50, rather than the fair market value on the date of the decedent's death of \$436,000.⁷⁷

b. Cash Leases to Unrelated Individuals

Courts have held that cash leases to non-relatives also disqualify farm property from special use valuation. In *Estate of Abell v. Commissioner*,⁷⁸ the decedent leased her ranch for a fixed sum to an unrelated third party who conducted cattle operations. Even though the decedent lived on her ranch until her death and participated in the operation of the ranch, the court held that the qualified use requirement was not satisfied. The court based its conclusion on the fact that the cash lease resulted in decedent having no equity or financial interest in the trade or business.

75. *Heffley v. Commissioner*, 884 F.2d 279, 285 (7th Cir. 1989).

76. *Id.* The decedent's lease to the nephew in *Heffley* is similar to a hybrid lease, where part of the rent is a guaranteed cash payment and part of the rent is a percentage of profits or the crop produced. Edwards, *supra* note 30, at 749. In one private letter ruling, the IRS considered a hybrid lease agreement in which a qualified heir was entitled to the first forty bushels of corn and the first thirteen bushels of beans per acre. If production was less than the minimum, the rent would be reduced to the actual production level. The IRS ruled that the lease established an equity interest in the heir because his rent depended on the productivity of the farm. Priv. Ltr. Rul. 82-17-193 (Jan. 28, 1982). Compare that result to *Heffley*, in which the court found that the rent paid to the decedent, a fixed quantity of bushels with no variance, was not contingent upon production of the farm. *Heffley v. Commissioner*, 884 F.2d 279, 285 (7th Cir. 1989). See also *Schuneman v. United States*, 783 F.2d 694 (7th Cir. 1984) (holding that taxpayers were entitled to special use valuation for farmland in that income derived from adjustable cash rent lease of farmland was substantially dependent upon production, although there were only two possible levels of income under the lease).

77. *Heffley v. Commissioner*, 884 F.2d 279, 281 (7th Cir. 1989).

78. 83 T.C. 696 (1984).

In *Estate of Sherrod v. Commissioner*,⁷⁹ a decedent set up a trust five years before his death, with his son and daughter as trustees. In the trust there was land devoted to three purposes, timber, row crops, and pasture. The cropland and a portion of the pasture land were cash leased to an unrelated party. One of many issues in the case was whether the decedent or a member of his family engaged in a qualified use of the property subject to the cash lease. The Eleventh Circuit reversed the Tax Court⁸⁰ and held that because the crop and pasture land were "leased to unrelated parties for fixed rentals not based on the production of the land," the pre-death qualified use test was not satisfied.⁸¹ In so holding, the Eleventh Circuit stated:

The legislative history of section 2032A makes clear that, in order for land to qualify for special use valuation, a decedent's financial stake or other involvement in the land must have been more than simply that of a landlord passively collecting a fixed rental from an unrelated tenant. Whether or not the unrelated tenant ran a farm or other business on the land is irrelevant. For purposes of "qualified use" inquiry, it does not matter to what use a tenant put the land; the focus is on what the decedent did with the land. . . . In this case, it is clear from the facts that the decedent and his son were the prototype of a landlord passively collecting a fixed rental from an unrelated party.⁸²

As a result, special use valuation was not available to the decedent's estate.

2. Post-Death Cases

a. Cash Leases to Any Relatives

Numerous courts have confirmed that intra-family passive rentals fail the qualified use test of the special use valuation provisions.⁸³ For instance, in *Williamson v. Commissioner*,⁸⁴ a recent and leading case, a cash lease of farmland between a qualified heir and his nephew triggered the recapture tax. In *Williamson*, the taxpayer, the qualified heir, inherited Minnesota farmland from his mother and elected the special use valuation for purposes of calculating the estate tax. The election reduced the value of the property from \$225,247.50 to \$94,209.60, resulting in a substantial estate tax savings.⁸⁵ The taxpayer, who lived in California, then entered into a cash lease for the

79. 774 F.2d 1057 (11th Cir. 1985), *rev'g*, 82 T.C. 523 (1984).

80. *Estate of Sherrod v. Commissioner*, 82 T.C. 523 (1984), *rev'd*, 774 F.2d 1057 (11th Cir. 1985).

81. *Estate of Sherrod v. Commissioner*, 774 F.2d 1057, 1064 (11th Cir. 1985), *rev'g*, 82 T.C. 523 (1984).

82. *Id.*

83. The two limited exceptions to this rule are (1) the exception for surviving spouses under I.R.C. § 2032A(b)(5)(1988), and (2) the two-year grace period under I.R.C. § 2032A(c)(7)(1988). See *supra* text accompanying notes 41-55 for a discussion of these two statutory exceptions.

84. 974 F.2d 1525 (9th Cir. 1992).

85. *Id.* at 1529.

farmland with his nephew. The Commissioner determined that the cash lease of the property failed to satisfy the special use valuation provision's qualified use requirement and asserted a \$42,026 recapture tax. The Tax Court rejected the taxpayer's petition and sided with the Commissioner.

The Ninth Circuit upheld the Tax Court's decision, and held that the cash leasing of the farmland to the taxpayer's nephew did not constitute a "qualified use" which would entitle the taxpayer to special use valuation.⁸⁶ In so doing, the court emphasized that it "must accord deference to the balance struck by Congress," even if that balance is arbitrary.⁸⁷ Congress drew a line which permitted cash leases by some family members and not by others. The court further emphasized that the distinction by Congress is not that arbitrary. Section 2032A's conceded purpose is to protect and insulate the family farmer from excessive estate taxes. Yet the individual seeking section 2032A's shelter in *Williamson* was not engaged in family farming. The family farmer was the nephew, who was not receiving any benefits of the statute. The court summarized by stating that "section 2032A's plain language, amendments, legislative history, and policies all support the Commissioner's determination that [the taxpayer's] cash lease of the farm to his nephew constituted a cessation of qualified use, triggering the recapture tax."⁸⁸

A cash lease between a parent, who was a qualified heir, and her son, has triggered the recapture tax under section 2032A(c). In *Shaw v. Commissioner*,⁸⁹ the taxpayer, a qualified heir, inherited ranch property subject to a special use valuation election. The taxpayer subsequently leased the ranchland to her son for two dollars per acre. The court held that the taxpayer ceased to use the property for its qualified use and was liable for the recapture tax.

Cash leases have triggered the recapture tax even where a qualified heir cash leased property to another qualified heir. In *Fisher v. Commissioner*,⁹⁰ the decedent, who owned farmland in Kansas, died intestate, and her personal representative elected the special use val-

86. In addition to his qualified use argument, the taxpayer in *Williamson* alternatively argued that when he leased the property to his nephew, the nephew stepped into the taxpayer's shoes and became the new qualified heir of the property. *Id.* at 1534. See also I.R.C. § 2032A(e)(1)(1988). He argued that the nephew's farming of the land therefore satisfied the statutory requirement that a qualified heir actively farm the property. The court rejected this argument as well and held that the taxpayer's grant of a leasehold interest to his nephew did not effect a disposition under the statute. Instead, the taxpayer remained the qualified heir. *Williamson v. Commissioner*, 974 F.2d 1525, 1535 (9th Cir. 1992).

87. *Williamson v. Commissioner*, 974 F.2d 1525, 1533 (9th Cir. 1992).

88. *Id.* at 1534.

89. 62 T.C.M. (CCH) 396 (1991).

90. 65 T.C.M. (CCH) 2284 (1993).

uation authorized by section 2032A. The decedent's six children each inherited a one-sixth undivided interest in the property. Subsequently, each heir exchanged his or her one-sixth undivided interest for a separately held interest in the property. Five of the qualified heirs then cash leased the property to their brother, also a qualified heir, for use in his cattle operation.

Finding for the Commissioner and following *Williamson*, the court in *Fisher* stated:

[T]here is no provision permitting the qualified heir to cash rent the property to anyone else, even to a family member, without incurring the recapture tax. Section 2032A(c)(1)(B) provides for the imposition of the recapture tax if the qualified heir, petitioner in this case, ceases to use the property for the qualified use.⁹¹

Cessation of qualified use occurs when the heir ceases to use the property as a farm for farming purposes. Cash leasing property to someone else is using the property in a passive rental activity, not using it as a farm for farming purposes. Therefore, the court held that the cash lease to the qualified heir triggered the recapture tax.

In *Stovall v. Commissioner*,⁹² the taxpayer, a qualified heir, inherited 120 acres of farmland from the decedent. The petitioner subsequently cash leased the property to her brother, also a qualified heir. The court followed *Williamson* and held that the cash lease of farm property by the petitioner to her brother was a cessation of qualified use triggering the recapture tax.

b. Cash Leases to Unrelated Individuals

Courts consistently have held that cash leases between qualified heirs and unrelated individuals result in a cessation of qualified use. In *Martin v. Commissioner*,⁹³ seven heirs inherited a family farm. The heir who was designated personal representative filed an estate tax return showing total estate tax of \$11,000.⁹⁴ But for section 2032A, the tax would have been \$95,000.⁹⁵ One year after the decedent's death, the personal representative terminated the existing crop share lease and entered into a cash lease agreement with a neighbor.⁹⁶ The court held that leasing the farm on a net cash basis made

91. *Id.* at 2286.

92. 101 T.C. 140 (1993).

93. 783 F.2d 81, 83 (7th Cir. 1986).

94. *Id.* at 82.

95. *Id.*

96. Interestingly, a state court approved the cash lease over the objections of two heirs, who feared exactly what happened—that the cash lease would result in a loss of the estate tax breaks of special use valuation. The Seventh Circuit stated:

[I]n any case of divided ownership there is a potential for disagreement and disappointment. A majority of the heirs apparently believed that the lease represented a calculated risk that was on balance advantageous. Perhaps ex ante it was. The only recourse the dissenting heirs

the heirs passive investors removed from the farming business.⁹⁷ The cash lease was therefore a cessation of qualified use and resulted in a recapture tax.

In *Hight v. Commissioner*,⁹⁸ ten qualified heirs each inherited an undivided interest in a 5,280 acre ranch. After the decedent's death, the qualified heirs entered into an oral pasture feeding agreement with Lloyd Fox, an unrelated individual, on a net cash lease basis. The court followed *Martin* and held that, even though the ranch was used for ranching (an otherwise qualified use), the heirs were involved only in the passive rental of the ranch. Therefore, the oral cash lease was a cessation of qualified use, subjecting the heirs to a recapture tax.⁹⁹

V. OUTCOMES INCONSISTENT WITH CONGRESSIONAL PURPOSE

As stated earlier, cash leasing is not addressed specifically in the text of section 2032A. If one then looks to the legislative history of the statute, it seems that the treatment of cash leasing arrangements in the above private letter rulings, technical advice memoranda, and cases is correct. Although laced with a touch of irony, this Article proposes that by disallowing special use valuation where property is cash leased, Congress has created actual outcomes inconsistent with the stated purpose of section 2032A.

A. Congressional Purpose

The first question in the analysis is what is the congressional purpose behind section 2032A? Section 2032A was enacted to preserve the family farm from forced sale to pay estate taxes.¹⁰⁰ Three factors primarily caused this perceived threat to the family farm:

- (1) The increase in the value of farmland, the increased size of farms necessary for viability, and the low rate of return on agricultural assets;
- (2) The requirement that land be valued at its highest and best use for federal estate tax purposes; and
- (3) The lack of liquid assets in the estates of most farmers.¹⁰¹

had was to try to persuade the state court that the majority was under-rating the tax risks. They failed and we are very sorry to say, must take the consequences.

Id. at 84.

97. *Id.*

98. 58 T.C.M. (CCH) 1457 (1990).

99. *Id.* at 1459.

100. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 22 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3356, 3376.

101. Begleiter, *supra* note 17, at 563.

Many statements on the floor of Congress emphasized that section 2032A was to help only "family farms."¹⁰² Professor Begleiter believes that perhaps the best of these orations was given by Senator Gaylord Nelson:

On a strictly economic level, family farms and businesses have proven to be the most efficient producers of food, shelter, and many other basic and convenience goods and services that can be found anywhere in the world.

The bonus to our society is that what these successful entrepreneurs do for the towns and cities that prospered them.

For 200 years in this country we have had a system where farms and businesses could be passed along from one generation to another. These enterprises put down roots in their communities. Their owners come to care about their employees, their customers, their churches, schools and hospitals. They work in local charities and clubs and are the cement of community life.

Thomas Jefferson perceived this two centuries ago at the time of the Revolution when he wrote about the value of the independent freeholder with a stake in society. In this our Bicentennial Year, death levies are threatening to destroy this system by taxing it out of existence. . . .

In my view, the preservation of small family enterprises, which embody so many of the basic traditional values of this country, is an adequate reason for distinguishing in the estate tax laws between our most productive citizens and those whom the law might allow, even encourage, to be completely unproductive.¹⁰³

Congress responded to the concern expressed by Senator Nelson and others by enacting section 2032A. In enacting that section, Congress intended "not only to provide relief for a class of estates facing severe liquidity problems, but to minimize the possibility that farmland would be removed from agricultural production and from family ownership."¹⁰⁴ In other words, Congress had three main goals for section 2032A. First, Congress wanted to provide a reduction in estate

102. *Id.*

103. *Id.* at 563-64 (quoting 122 CONG. REC. 25944 (1976)).

104. *Id.* See also STAFF OF JOINT COMM. ON TAXATION, 94TH CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, at 536 (Comm. Print 1976). The Joint Committee summarized the purpose of § 2032A as follows:

Valuation on the basis of highest and best use, rather than actual use, may result in the imposition of substantially higher estate taxes. In some cases, the greater estate tax burden makes continuation of farming . . . not feasible because the income potential from these activities is insufficient to service extended tax payments or loans obtained to pay the tax. Thus, the heirs may be forced to sell the land for development purposes. Also, where the valuation of land reflects speculation to such a degree that the price of the land does not bear a reasonable relationship to its earning capacity, the Congress believed it unreasonable to require that this "speculative value" be included in an estate with respect to land devoted to farming. . . .

Id. at 537. See also Priv. Ltr. Rul. 80-41-016 (June 30, 1980). There the IRS stated that the two primary purposes of section 2032A were (1) to encourage the continuation of the family farm by basing its value at its use value, and (2) to provide a relief measure so that the estate does not have to sell the farm due to the lack of liquidity. *Id.*

taxes for farmers, who, as a class, disproportionately experience cash flow problems. Second, Congress wanted land currently being used for agricultural production to continue being used for agricultural production. Third, Congress wanted farmland currently owned by family farmers to continue to be owned by family farmers. As discussed below, many of the real world effects of the restrictions on cash leasing are contrary to Congress' goals in enacting the statute.¹⁰⁵

B. Effects of Restrictions on Cash Leasing

What are the real world effects of cash leasing not being a "qualified use" under section 2032A, and why are those effects inconsistent with the congressional purpose behind the statute?

1. *Overabundance of Litigation*

First, there are a substantial number of family-owned farms not qualifying for special use valuation under the statute. This is evident by the extensive case law summarized above on an issue that is seemingly a narrow one, and one that no one initially thought would be controversial.¹⁰⁶ Indeed, according to Professor Begleiter, because of the "unanticipated" regulations issued by the IRS under the qualified use test,¹⁰⁷ the problems of material participation, which many believed would provide the major interpretation problem of section 2032A, were sublimated to the problems with the qualified use requirement.¹⁰⁸

Moreover, the vast majority of opinions involving a question of qualified use have centered around whether pre-death or post-death cash leasing is a qualified use. In each of these cases, the taxpayers have lost and the government has won. The number of written opinions on this issue is no accurate indication of how much litigation has occurred. It is common knowledge in the legal world that for every case on a particular issue in which an opinion is written, there are

105. Not all commentators agree that saving the "family farm" is desirable. See, e.g., Harry L. Gutman, *Reforming Federal Wealth Transfer Taxes After ERTA*, 69 VA. L. REV. 1183 (1983). There Gutman states that:

Congress also assumed that the encouragement of "family farming" was sound economic policy and that the "family farm" was or should be encouraged as a significant component in domestic agriculture. Had the legislators sought expert guidance, they would have discovered that the majority of agricultural economists have concluded that farm efficiency tends to increase with size. Thus, if Congress intended to perpetrate "small" family farms, it has arguably chosen to subsidize inefficient farm production.

Id. at 1266-67.

106. Martin D. Begleiter, *Special Use Valuation Nine Years Later: A Farewell to Farms*, 63 TAXES 659, 666 (1985).

107. Treas. Reg. § 20.2032A-3(b)(1)(1986).

108. Begleiter, *supra* note 17.

several that do not make it that far in the process. Based on what seems to be a relatively large number of cases involving the qualified use test and cash leases, this statute has impacted negatively many of those who Congress intended for it to help.¹⁰⁹

One may argue that the landowners on the losing end of these cases really did not have anything taken away from them; they merely failed to receive special treatment. Nevertheless, these individuals incurred the substantial costs of litigation, including attorneys fees, court fees, and costs of delay. In certain cases, the landowners may have had to sell part or all of the land to pay the recapture tax or the increased estate tax obligations.¹¹⁰ At a minimum, even if the individuals did not have to sell any property, as a result of an increased tax burden, they suffer a competitive disadvantage as to their fellow farm owners for whom crop share leases are the best option. Such results are completely contrary to Congress' express goals.¹¹¹ In these situations, farmers are not benefitting from lower estate tax burdens, some of the farmland may be converted into higher grossing nonagricultural uses,¹¹² and the farmland may be sold to non-family entities.

One may attack the above position by pointing out that because the case law is clear on the issue, landowners and their attorneys now have no excuse for using cash lease arrangements. They should just use crop share arrangements, under which real property qualifies for special use valuation.¹¹³ Yet, in many situations, cash leasing is the most effective, the most productive, or the only available lease option.

109. This result confirms Professor Begleiter's prediction in 1979 that "[b]ecause of the restrictions on qualifications, the effect of the recapture tax and the unresolved questions raised by the statute, it will be beneficial to a relatively small percentage of farm estates." Martin D. Begleiter, *Section 2032A: Did We Save the Family Farm?* 29 *DRAKE L. REV.* 15, 110 (1979). In that same article, Begleiter further states that section 2032A "may have created more problems for farmers than it solved." *Id.* at 111.

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

111. *See STAFF OF JOINT COMM. ON TAXATION, 94TH CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976*, at 536 (Comm. Print 1976).

112. A note on section 2032A suggests the statute may have been enacted largely because of the growing concern of the loss of America's prime farmland to urban development. Note, *Taxation, supra* note 6, at 643 n.22. The note explains that in 1981, over twelve square miles of U.S. farmland were paved over each day. *Id.* (citing Kenneth R. Sheets, *Is U.S. Paving Over Too Much Farmland?* *U.S. NEWS & WORLD REP.*, Feb 2, 1981, at 47, 47). This means that approximately five million acres of farmland are lost each year. At this rate, "prime farmland equivalent in area to the entire state of Indiana may be withdrawn from agricultural production between the years 1980 and 2000." *Id.* (quoting 1 JULIAN C. JUERGENSMEYER & JAMES B. WADLEY, *AGRICULTURAL LAW* § 4.1, at 67 (1981)).

113. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 23 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3377.

2. "Forced Partnerships"

a. *Personal Conflicts Between Landlord and Tenant*

One of the most widely recognized advantages of cash leases for both the landlord and the tenant is the reduced possibility of friction between landlord and tenant.¹¹⁴ This reduction in potential conflicts stems from reduced landlord involvement in the farming operation. The landlord can relax in knowing that he or she will receive a predetermined rent amount, while the tenant does not have to worry constantly about the landlord looking over his or her shoulder. Instead, the tenant is free to make daily management decisions on his or her own. Only major decisions, concerning things such as the types of crops to be planted and the terms of the lease, require landlord involvement. Section 2032A's bias against cash leasing overlooks the fact that many family-owned farming operations run more effectively under cash lease agreements.

The disfavorable treatment given cash leases under section 2032A results in forced partnerships. By disallowing cash leases in certain pre-death and nearly all post-death situations, section 2032A forces individuals to enter into crop share lease agreements, which are essentially partnerships.¹¹⁵ If two individuals want to enter a lease agreement for agricultural property, the statute forces the individuals to share risk at each stage of production, and it does so without regard to potential or already existing conflicts between the landlord and tenant. As stated above, cash leasing was developed in part to alleviate these conflicts. Cash leasing offers the opportunity for land to be owned by a family and put to an agricultural use without personal conflicts destroying the effectiveness of the operation.

Consider *Heffley v. Commissioner*,¹¹⁶ a pre-death case in which the court denied special use valuation. Hypothesize that the decedent, as landlord, and her brother-in-law, as tenant, had never gotten along with each other. Assume that the last thing either of them wanted was to be risk-sharing partners with each other. Further assume that the brother-in-law was the only one interested in leasing the property. Neither the landlord nor any other family members currently had the means nor the desire to farm the land themselves.

What are the landlord's options? She could cash lease the property to the brother-in-law regardless of the tax implications. However, cash leasing to the brother-in-law would (and did in the real case) result in more than a four-fold increase in the size of the taxable es-

114. JUERGENSMEYER & WADLEY, *supra* note 29, § 36.4.3.

115. From a conceptual point of view, crop share agreements can be considered a limited joint venture. JUERGENSMEYER & WADLEY, *supra* note 29, § 36.5.

116. 884 F.2d 279 (7th Cir. 1989). See *supra* notes 71-77 and accompanying text for a discussion of this case.

tate.¹¹⁷ With such a consequence, no one would enter into a cash lease agreement.

Alternatively, the landlord could sell the property, the exact consequence which section 2032A was designed to prevent.¹¹⁸ If the landlord sells the property, the property could be put to a non-agricultural use, such as housing. Even if it remains in agricultural production, it could be purchased by a non-family entity, such as a large agribusiness firm. Notwithstanding these two possibilities, it is unlikely that the landlord will sell the farmland. First, there is an inherent desire of family farmers to keep the land in the family.¹¹⁹ Second, if the landlord sells the land, the cash received will become part of her gross estate. A sales price above the special use value will only increase her gross estate.¹²⁰

The one remaining alternative is to enter into some sort of share lease with the brother-in-law so the lower special use valuation will be available. In other words, the landlord's only realistic possibility is to enter reluctantly into a partnership with her brother-in-law, an individual with whom she does not want to be a partner. Section 2032A has resulted in a forced partnership in this case.

The forced partnership problem occurs in other situations as well. For example, there may be post-death intrafamily personal conflicts that make partnerships completely ineffective. Qualified heirs, whether brothers and sisters or parents and adult children, may not get along and may not want to enter into partnerships with each other.¹²¹ In such cases, allowing use of the cash lease would minimize the contact among the heirs but would keep the land under family ownership and in agricultural production.

Personal conflicts between decedents or heirs and unrelated individuals are also possible. Despite personal differences, the landlord

117. In *Heffley*, the fair market value of the farm property on the date of the decedent's death was \$436,000, while the special use value was only \$90,339. *Heffley v. Commissioner*, 884 F.2d 279, 281 (1989).

118. See STAFF OF JOINT COMM. ON TAXATION, 94TH CONG., 2D SESS., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976, at 536 (Comm. Print 1976); Begleiter, *supra* note 17.

119. See MARTY STRANGE, FAMILY FARMING: A NEW ECONOMIC VISION 49 (1988). Strange explains how farmers want to hold on to their land even if they no longer farm it because of retirement, inadequate returns, or a desire to move to the city. Rather than sell the land in those situations, farmers are instead more likely to seek renters.

120. I.R.C. § 2031(a)(1988).

121. Some may believe that serious, personal conflicts among family members are, although possible, quite rare. On the contrary, disputes among family members regarding inherited property are common and can be quite severe. In fact, these disputes sometimes escalate into costly legal battles, which can result in the loss of entire family farm estates. See DONALD J. JONOVIC & WAYNE D. MESSICK, PASSING DOWN THE FAMILY FARM: THE OTHER FARM CRISIS (1986).

and tenant may nevertheless see the benefit of a lease agreement for farmland. Maybe the tenant is the only available lessor, or the landlord considers the tenant a skilled farmer even though the landlord does not like the tenant personally. If a cash lease could be used, the landlord could negotiate a satisfactory annual rental payment, while leaving the tenant to manage the operation as he sees fit. The minimal role of the landlord in the management of the operation lessens the potential for personal conflict.

In each of the above scenarios, forced partnerships worsen existing personal conflicts and lead to others. The land owners' inability to solve certain of these conflicts and the desire to avoid these partnerships may lead to the sale of the property. There is also a greater chance of the parties filing lawsuits against one another, the cost of which requires the land to be sold. At a minimum, the stress surrounding the operation will increase. This can lead to ill-advised decisions being made by one person merely to gain an advantage over the other. The farm's productivity and the individuals' health may suffer. Clearly, such results are contrary to those intended by Congress in passing section 2032A.

b. Management Disagreements Between Landlord and Tenant

There may be management-related disagreements rather than personal conflicts that prevent parties from wanting to engage in partnerships with each other. The parties involved may get along personally but disagree as to management strategies. In such scenarios, the forced partnerships mandated by section 2032A can have the same negative results as with personal conflicts.

One can imagine examples in all the pre-death and post-death scenarios described above where management disagreements exist. A case involving a cash lease between heirs may best demonstrate the situation. Consider the recent post-death qualified use case *Fisher v. Commissioner*.¹²² In that case, the decedent's six children each inherited a one-sixth undivided interest in the decedent's farmland. Five of the qualified heirs then cash leased the property to their brother, also a qualified heir, for use in his cattle operation. The court found the cash lease to be a cessation of qualified use.

Hypothesize that the five *Fisher* heirs loved their brother but thought he was a poor manager. They believed that if they placed themselves "at-risk"¹²³ with their inept brother, he would most likely

122. 65 T.C.M. (CCH) 2284 (1993). See *supra* text accompanying notes 90-91 for a discussion of this case.

123. The heirs could use a livestock share lease on the property to meet the post-death qualified use requirement. With a livestock share lease, the rent typically is calculated as a percentage of gain in herd size or a percentage of the sale of livestock

cause them, as a result of his mismanagement, to lose or have to sell their shares of the property. Other than selling their pieces of the property, the heirs may have considered their only option to be a cash lease agreement.¹²⁴ Each sibling could negotiate a fair rental price for their property, and the brother's mismanagement would only affect himself, not the other heirs. The cash lease keeps the land in the Fisher family and in an agricultural use without forcing the heirs to enter what they believe to be an unreasonably risky partnership.¹²⁵ Such a result is consistent with the statute, where forced partnerships are not. Landowners who cannot farm the land themselves and do not want to put their money into risky management situations will simply sell the land, breaking up the family farm and running roughshod over Congress' goals.

3. *Risk Allocation Discourages Most Profitable Use of Property*

Because of climate, markets, topography, or other factors, certain agricultural land is particularly well-suited for high-risk, high-return crops. Fruits and vegetables commonly fit into this category. By rewarding the use of crop share leases and penalizing the use of cash leases, section 2032A discourages landlords from planting land to these riskier, and more profitable, crops.

Land ties up money; it is an investment. All things considered, landlords prefer a fixed or nearly fixed level of income from their investment.¹²⁶ With low-risk crops, such as wheat or alfalfa, a crop share lease can offer the landowner a fairly secure income stream. With high-risk crops, however, a crop share lease does not offer the landowner an income stream that is as secure. Admittedly, even with low-risk crops, the landlord must contend with the risks of bad weather and poor market prices. Nevertheless, high-risk crops, such as fruits and vegetables, are so categorized because of their tendency

or livestock products. Ordinarily, both the landlord and tenant share production expenses on an agreed-upon percentage basis. JUERGENSMEYER & WADLEY, *supra* note 29, § 36.7.

124. Not only does cash leasing solve the heirs concerns over management, it is also a more simple option where so many heirs are involved. A predetermined cash payment is normally calculated on a per head/per month basis, on a per acre basis, or as a percentage of the gain in value of the livestock during the rental period. *Id.* The parties do not share any production expenses.
125. This case demonstrates the inconsistency of section 2032A: it allows the decedent or a family member to farm the property under a cash lease before the decedent's death, but the same lease agreement between the heirs and that family member results in cessation of qualified use. See *infra* text accompanying notes 144-148 for a discussion of this inconsistency.
126. The cash lease is preferred by farm owners who want a fixed annual income from the property sufficient to meet fixed annual expenses such as taxes, insurance, and outstanding property loan payments. JUERGENSMEYER & WADLEY, *supra* note 29, § 36.4.

to be more sensitive to pests, freezing, and other natural phenomena. Moreover, because the costs of inputs required to produce high-risk crops typically are much higher than the costs to produce low-risk crops, the possible dollar losses on the high-risk crops are likewise much higher, in some cases devastating.

Because of the increased risk of devastating losses, a landlord is understandably reluctant to enter into a crop share lease for the production of high-risk crops. The landlord's reluctance is no doubt enhanced by the fact that he or she is most likely not the one doing the farming or tending to the crops on a daily basis. In other words, the landlord is not really in the best position to control the risks of production. Of the two parties, the tenant, largely as a result of proximity, is in the best position to control these risks.

Assuming a landlord desires the estate tax benefits of section 2032A, he or she will forego cash leases for crop share leases.¹²⁷ However, because the landlord desires a fairly secure income stream, he or she will avoid high-risk crops which decrease this security. As a result, land that is well-suited for high-risk crops may not be put to that use.

The avoidance of high-risk crops is bad for various reasons. First, it is inefficient and a waste of resources. The areas where high-risk crops thrive are limited. Efficiency mandates that these limited areas be put to their most profitable use. Planting wheat where strawberries are the most profitable crop is inefficient. Second, even if one professes no concern for an overall efficient allocation of resources, the avoidance of high-risk, high-return crops reduces the profitability of individual farmers. Leases under which low-risk, low-return crops are produced result in lower cash receipts and, thus, lower return on investment for landlords. In turn, lower return on investment can result in the landowner having to sell the land, possibly to non-family or non-agricultural interests. These results are contrary to Congress' purposes in enacting section 2032A.

The cash lease addresses the landlord's concerns about high-risk crops and places into high-risk production land that is suited for it. The cash lease guarantees the landlord a fixed income stream, while placing the production risks on the tenant.¹²⁸ By placing the risk on the tenant, cash leases make the landlord more willing to produce high-risk, high-return crops. The higher return will strengthen the landlord's financial position, making a liquidation of assets less likely.

127. *Martin v. Commissioner* demonstrates the sizable tax savings under section 2032A. In *Martin*, the estate tax on the special use value of the farmland was only \$11,000, while the estate tax on the fair market value of the farmland was \$95,000. *Martin v. Commissioner*, 783 F.2d 81, 82 (7th Cir. 1986).

128. *JUERGENSMEYER & WADLEY*, *supra* note 29, § 36.4.3.

Why would a tenant want to shoulder a disproportionate amount of risk? The tenant will shoulder more risk because the cash lease rewards the tenant for bearing this risk. Because the tenant takes all the crop, he or she alone benefits from any increase in production over the expected. These benefits provide the incentive for the tenant to manage the crop meticulously and to strive for higher yields.¹²⁹ Rather than working for the landlord, the tenant is working for him or herself.

It is apparent, then, that both the landlord and the tenant can benefit from cash leases. At the same time, cash leases contribute to the societal goal of efficient resource allocation and the congressional goals of maintaining both the use of land for agriculture and family ownership of agricultural land.

In its legislative reports, however, Congress expressed a desire to align the risks of farming with the tax breaks afforded by section 2032A.¹³⁰ In other words, the landlord should not be able to place production risks on the tenant, while the landlord or his heirs benefit from section 2032A.¹³¹ At least one commentator agrees with Congress.¹³² A. M. Edwards, in referring to post-death cash leasing, stated:

If the heir is going to benefit by the special use valuation, he should have to bear the economic risks of farming, rather than be guaranteed an income. Limiting the qualified use test and disallowing cash rentals does not place an undue burden on the qualified heir. The qualified heir is not denied the right to lease the farm property, but instead he must lease on a crop share basis to maintain an equity interest in the property. Since one of the purposes of special use valuation is to encourage the continued use of the property for farming, requiring the qualified heir's income from the farm to be dependent upon the success of the actual farming operation is consistent with the purposes of section 2032A.¹³³

This idyllic desire to align the risks of farming with the tax breaks of section 2032A is based on incorrect assumptions. First, this view

129. *Id.*

130. See H.R. REP. NO. 1380, 94th Cong., 2d Sess. 23 (1976), reprinted in 1976 U.S.C.C.A.N. 3377.

131. See *Williamson v. Commissioner*, 974 F.2d 1525, 1533 (9th Cir. 1992). In that case, the Seventh Circuit expressed its agreement with Congress' goal of aligning benefits with risks by stating that:

[t]he person seeking section 2032A's shelter here is not engaged in family farming. The family farmer here is the nephew, a person not receiving any of section 2032A's benefits. Williamson's relationship to the land is that of a landlord and passive investor. Congress never intended such persons to reap the benefits of section 2032A. . . . Placing Williamson within section 2032A would effectively let him have his cake and eat it too. He would enjoy the special tax benefits of section 2032A without incurring any of family farming's concomitant costs or risks.

Id.

132. Edwards, *supra* note 30, at 761.

133. *Id.* (footnotes omitted).

assumes that allowing cash leasing does not encourage the continued use of the property for farming.¹³⁴ This assumption overlooks the fact that by guaranteeing an individual farm owner a satisfactory income, cash leasing does encourage the use of property for farming. As explained above, in certain situations, tight restrictions on cash leasing can result in the production of other than optimal crops, decreased returns for farm owners, and eventual liquidation of farm property. If Congress truly wants to maintain individual ownership of property and agricultural use of that property, it should create a doctrine that makes farming a safe investment, one that allows farm owners to obtain the greatest return on their investment through cash leases. High returns for an owner encourage that owner to keep the land in agriculture and to forego non-agricultural opportunities.

Second, the view that risks and benefits should be aligned improperly assumes that the tax breaks of section 2032A benefit only owners of land and their heirs. On the contrary, these tax breaks also benefit tenants, who are allowed to continue their businesses, remain in communities to which they and their families have ties, and provide for their families. In turn, by decreasing the likelihood that tenant farmers will be displaced from the land they farm, the tax breaks benefit the rural communities of which the tenants are members. The communities will likely experience an increase in both economic stability and the standard of living if tenants maintain their family farming operations.¹³⁵

In passing section 2032A, Congress, too, emphasized the positive economic and social impact family farms have on rural communities. Senator Nelson remarked that "[t]hese enterprises put down roots in their communities. Their owners come to care about their employees, their customers, their churches, schools and hospitals. They work in local charities and clubs and are the cement of community life."¹³⁶ Senator Nelson's statement implies that *owners* of farms who are actively engaged in farming are more likely to create permanent ties to rural communities than are tenants who lease farm property. This simply is not true. In order to be financially successful, a tenant who bears any of the risks of farming must become involved in his community. The tenant must form relationships with local businesses in order to get the lowest available cost on inputs such as fertilizer, seed, and herbicide. The tenant must negotiate with the local cooperative for the highest market price on his commodities. He or she must borrow operating capital from the bank and purchase fuel from the local

134. *Id.*

135. See Note, *Taxation*, *supra* note 6, at 639 n.7, 640 n.8. (explaining the vital role that family farms have in maintaining a high standard of living and economic prosperity in rural communities).

136. 122 CONG. REC. 25,944 (1976).

gas station owner. In short, it is to the tenant's economic advantage to become active in the local business community. As a tenant becomes more involved in the business community, his or her family will likewise become more involved in the local school, church, hospital, or charities.

Because tenants contribute substantially to the welfare of rural communities, Congress should try to minimize displacement of tenants as a result of the sale of farm property. Obviously, farm property can only be sold by the owner of the property. As long as the owner is receiving a high return on the investment in the farm property, he or she will not sell the property. Therefore, Congress should allow owners to receive a high return by allowing them to cash lease their property. By forcing landlords to share production risks (and therefore risks of devastating loss) with tenants, not only is section 2032A inefficient, it also increases the likelihood that property will be sold and removed from agricultural production, displacing tenants and causing unnecessary economic and social stress on rural communities.

4. *Share Leases Not Workable*

Certain types of agricultural operations simply do not lend themselves to "share" leases. In these instances, only cash leases are effective. For instance, certain agricultural operations that qualify as a use for "farming purposes" under the statute¹³⁷ do not produce any output which may be split between partners under some sort of share arrangement. Probably the best example is grain storage.¹³⁸ Grain storage produces nothing; it merely holds inventory for a period of time. Because grain storage produces no product, a share lease makes no sense. A cash lease is the only logical lease arrangement,¹³⁹ but use of a cash lease would violate the special use valuation requirements of section 2032A. This result greatly limits the availability of special use valuation for land on which grain storage facilities rest. To acquire special use valuation, a decedent and his or her spouse can only lease the property to a family member, and a qualified heir cannot lease the property at all. If a qualified heir cannot personally use

137. I.R.C. § 2032A(e)(5)(1988)(defining "farming purposes").

138. Included in the definition of "farming purposes" is the "storing on a farm any agricultural or horticultural commodity in its unmanufactured state . . ." I.R.C. § 2032A(e)(5)(B)(1988).

139. One can imagine an agreement whereby a tenant "pays" for use of the grain storage with bushels of grain, rather than with set cash payments. Under this type of agreement, however, the landlord's only risk is the risk of fluctuating commodity prices. In *Heffley v. Commissioner*, 884 F.2d 279, 285 (7th Cir. 1989), however, the Seventh Circuit denied special use valuation where the rental amount was contingent somewhat on fluctuating commodity prices, but not on the farm's production.

the grain storage facilities and cannot lease them, he or she will most likely sell the land on which the facilities are located.

As with grain storage, other farming operations listed in the statute produce no commodities. Some examples include the training of animals¹⁴⁰ and the grading, handling, and packing of agricultural or horticultural commodities in their unmanufactured state.¹⁴¹ Land used for these purposes does not lend itself to share leases. The availability of special use valuation, therefore, is severely limited.

A limit on the availability of special use valuation where legitimate family farming operations are involved is contrary to Congress' express goal of providing relief for family farms. Likewise, giving qualified heirs the incentive to sell their agricultural property, because they cannot lease it, is inconsistent with the statute. Although the amount of property dedicated to uses for which share leasing is inappropriate may be small, the property may be located close to metropolitan areas and have a high "speculative" value.¹⁴² Speculative value occurs where the "highest and best use" of the property would be its value as residential property.¹⁴³ Estate taxes based on this speculative value could be quite high, so high as to make liquidation of the property the only option if special use valuation is unavailable.

5. *Inconsistency Between Pre-Death and Post-Death Qualified Use*

Section 2032A's disallowance of cash leases between a qualified heir and a family member creates a particularly bizarre result in the real world. The same cash lease between the decedent and a family member that is allowed before the decedent's death is disallowed when the decedent dies. The facts of *Williamson v. Commissioner*¹⁴⁴ demonstrate this point. In that case, Harvey Williamson, the decedent's grandson, farmed the property in question both before and after the decedent's death. Because Harvey is a member of the family under section 2032A(e)(2), a cash lease between the decedent and Harvey before the decedent's death would not make special use valuation unavailable.¹⁴⁵ When the decedent died, she bequeathed the farmland to her son.

140. I.R.C. § 2032A(e)(5)(A)(1988).

141. *Id.* § 2032A(e)(5)(B).

142. See Note, *Taxation*, *supra* note 6, at 643 n.22 (describing speculative value of farmland and citing Stephen F. Matthews & Randall Stock, *Section 2032A: Use Valuation of Farmland for Estate Tax Purposes*, 14 IDAHO L. REV. 341, 356-57 (1978)).

143. *Id.*

144. 974 F.2d 1525 (9th Cir. 1992).

145. I.R.C. § 2032A(b)(1988). In the actual case, the pre-death lease was a crop-share lease and not a cash lease. *Williamson v. Commissioner*, 974 F.2d 1525, 1528

Suppose the son, the qualified heir, and Harvey want to continue the same cash lease. A continuation of the cash lease would result in a cessation of qualified use and in a recapture tax.¹⁴⁶ This result occurs despite no material changes in the use of the land. The land is still being used for farming purposes. The same individual, a family member, is still farming the property under the same terms as before. The property is still owned by the Williamson family. A denial of special use valuation here makes no sense.¹⁴⁷ The increased taxes may force the son to sell the property to a developer or use it himself for a more lucrative purpose. These results are directly contrary to the congressional purpose and indicate that, at a minimum, section 2032A should allow qualified heirs to lease to family members.¹⁴⁸

6. *Inconsistent Treatment of Retired Individuals*

Another troubling aspect of section 2032A's treatment of cash leases is its inconsistent treatment of retired individuals. Imagine the following variation on the *Heffley* hypothetical.¹⁴⁹ Assume that the landlord is retired and has no harsh feelings toward any potential tenants. She merely desires, as a retiree, to maintain the current size of her estate. She may feel she is beyond the time in her life where she wants to risk everything on the performance of a tenant or to farm the

(9th Cir. 1992). Both leases, however, would have been allowed under the statute.

146. The court in *Williamson* found the post-death cash lease to be a cessation of qualified use. *Williamson v. Commissioner*, 974 F.2d 1525, 1536 (9th Cir. 1992). See also S. REP. NO. 144, 97th Cong., 1st Sess. 134 (1981), reprinted in 1981 U.S.C.C.A.N. 234; H.R. REP. NO. 201, 97th Cong., 1st Sess. 169 (1981), reprinted in 1981-2 C.B. 382. These reports emphasized that the qualified heir owning the real property after the decedent's death must use it in the qualified use throughout the recapture period.

147. In a lengthy dissent, Judge Reinhardt expressed his disapproval with the bizarre outcome in the actual case. *Williamson v. Commissioner*, 974 F.2d 1525, 1538 (Reinhardt, J., dissenting). There he stated:

[I]t would be surprising if the property nevertheless became subject to the "recapture tax" provided by that section while Harvey continued to farm the land. After all, nothing of any significance changed: the property was "qualified real property" under § 2032A when Elizabeth owned it as well as when Beryl owned it, Beryl was a qualified heir, and both the actual use and the actual user of the property remained the same at all times. Contrary to the conclusion reached by my colleagues, I believe that the clear language of § 2032A necessitates a holding that the property is not subject to the recapture tax so long as Beryl owns it and Harvey continues to farm the land.

Id. (footnote omitted).

148. Other commentators have likewise expressed the need for this amendment to the post-death qualified use requirement. See Robert M. Bellatti, *Special Use Valuation: How Will It Be Affected By the Tax Act?*, 120 Tr. & Est., Dec. 1981, at 44, 45.

149. *Heffley v. Commissioner*, 884 F.2d 299 (7th Cir. 1989). See *supra* note 116 and accompanying text for discussion of the initial hypothetical.

land herself. She does not want to deal with marketing crops or livestock, and does not want to engage in the day to day management of the operation.¹⁵⁰ Currently, no family members, as defined under the statutes are able to engage in a qualified use of her property. Therefore, a cash lease to a non-relative is the best option.

Under the 1981 amendment to section 2032A, cash leases from the decedent to a member of the family do not preclude the heirs from subsequently invoking the special use valuation provision.¹⁵¹ However, because there are no family members available in this hypothetical, the retiree must enter a farming partnership with the unrelated individual. The 1981 amendment was a realization that advanced age, disability, or the desire to retire may make a farmer unable to engage in a qualified use of the property herself.¹⁵² There is no reason why the retiree whose family members are currently not available to farm her property should have to risk her retirement savings in a partnership with an unrelated individual or, alternatively, to experience a severe increase in her estate taxes.

The treatment of post-death cash leases is more troublesome. As stated above, in the post-death context, a qualified heir may not cash lease to anyone, even a family member, without losing the benefits of section 2032A. This position assumes all qualified heirs are young. It assumes that heirs will not have to face retirement, disability, or their accompanying limitations that make cash leasing the most appropriate option and that led to the 1981 amendment. The fact is, all qualified heirs are not young. Qualified heirs may be brothers or sisters of the decedent and, therefore, be close in age to, or maybe even older than, the decedent. In other cases, the decedent may have lived long enough to have adult children close to retirement age. Although the majority of qualified heirs may be younger than the decedent, there are exceptions where heirs face retirement or disability.¹⁵³ As with

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150. For landlords who are retirees, cash leases offer several widely recognized advantages. Cash leases eliminate the bother of dividing crops or the income from the sale of crops, require less managerial input from the landlord, and reduce the risk that the landlord will be considered a "participating landlord" for Social Security purposes. JUERGENSMEYER & WADLEY, *supra* note 29, § 36.4.3. In addition, because cash leases generally only involve a single payment during the year, they are much simpler than most crop share leases.
 151. S. REP. NO. 144, 97th Cong., 1st Sess. 134 (1981), *reprinted in* 1981 U.S.C.C.A.N. 234; H.R. REP. NO. 201, 97th Cong., 1st Sess. 169 (1981), *reprinted in* 1981-2 C.B. at 382.
 152. H. CONF. REP. NO. 215, 97th Cong., 1st Sess. 248 (1981), *reprinted in* 1981 U.S.C.C.A.N. 285, 337; S. REP. NO. 144, 97th Cong., 1st Sess. 132-33 (1981), *reprinted in* 1981 U.S.C.C.A.N. 233-34.
 153. *But see* Edwards, *supra* note 30. There, in referring to the reasons that the 1981 amendment was passed, Edwards states that "[t]hese reasons are not applicable to the qualified heir. Because the qualified heir will normally be younger than the decedent, retirement or disability is not likely." *Id.* at 761.

the instances discussed in the immediately preceding section, these instances demonstrate yet another reason why, at a minimum, Congress should eliminate the discrepancy between pre-death and post-death qualified use.

VI. A CALL TO AMEND SECTION 2032A

As shown above, the limits that section 2032A currently places on cash leasing produce results contrary to those Congress intended. Restrictions on cash leasing have resulted in an abundance of litigation and the failure of many family farmers to obtain special use valuation. The restrictions force individuals to be partners with each other despite serious personal conflicts or management disagreements. The restrictions also discourage the most profitable agricultural use of farmland and take no account of agricultural operations that do not lend themselves to share leasing. The statute makes unavailable after the death of the decedent the same cash leases allowed before death. Finally, the statute distinguishes unfairly between similarly situated retired or disabled individuals. In the end, the restrictions on cash leasing can result in family farmland being sold to urban developers and removed from agricultural production.

These results indicate the need for Congress to amend section 2032A in some way to make special use valuation available to more owners of farmland. Because cash leases are a common and effective tool in the agricultural sector, Congress should lessen the restrictions on their use and create a statute that reflects the real-world needs of farmers.

A. How Far Should Congress Go?

Assuming that Congress should do something to lessen the restrictions on cash leasing, an assumption with which some disagree,¹⁵⁴ how far should Congress go? Some commentators have suggested that Congress should bring the post-death qualified use test in line with the pre-death test by allowing qualified heirs to cash lease to family members.¹⁵⁵ Based on the bizzare results of the current rule,¹⁵⁶ this

154. See, e.g., *id.*

155. See Bellatti, *supra* note 148, at 45. At least one member of the House of Representatives has also recognized the need to amend section 2032A in this manner. Representative Barrett of Nebraska has introduced a bill to amend section 2032A to allow post-death cash leases between qualified heirs and family members. H.R. 817, 103d Cong., 1st Sess. (1993). The bill was referred to the Committee on Ways and Means, which has taken no further action on it. The proposed amendment would bring the post-death qualified use test in line with the pre-death test. However, the amendment would not affect pre-death or post-death cash leases to unrelated individuals, both of which should also be allowed under section 2032A.

156. See *supra* text accompanying notes 144-153.

position makes sense. But what about pre-death and post-death cash leases to unrelated individuals? Is Congress justified in distinguishing between cash leases to related and unrelated individuals? Or should it allow decedents and qualified heirs to cash lease property to both family members and unrelated individuals?

The answers to these questions depend substantially on one's definition of "family farm." After all, Congress' ultimate purpose in enacting section 2032A was to save the family farm.¹⁵⁷ What is it that Congress was intent on saving? Congress' treatment of cash leases in the post-death context suggests that an operation is no longer a family farm once a qualified heir fails to bear the risks of the operation. In the pre-death context, the operation is no longer a family farm if the decedent cash leases to an unrelated individual. Congress gives family farm status, and therefore the benefits of section 2032A, only to owners who bear the risks of the farming operation. Is such a characterization of "family farm" correct?

The term "family farm" has been defined in different ways.¹⁵⁸ For example, "[t]he Jeffersonian ideal of the family farm was one in which the farmer was basically a subsistence operator, the farmer did his or her own work, the farmer made his or her own managerial decisions, and he or she owned the land."¹⁵⁹ The United States Department of Agriculture has offered a more modern definition, describing a "family farm" as "a primarily agricultural business in which the operator is a risk-taking manager, who with his or her family does most of the farmwork and performs most of the managerial activities."¹⁶⁰ The Jeffersonian definition is dependent on the person who is doing the farmwork owning the land. If one chooses this definition, special use valuation would only be available to those who own the land and do most of the work on that land. Congress had no intention of using such a narrow definition of "family farm." This is evident by its allowance of crop share leases, which often involve little or no physical labor on the part of the owner of the land, and by its 1981 and 1988 amendments, which allow cash leases in limited circumstances.

The USDA definition of "family farm" is a more appropriate choice. That definition is not dependent upon the owner of the farmland bearing the risk of or doing the work on the farm. What is crucial to that definition is that the *operator* bears the risk of the operation and that

157. Section 2032A was enacted to preserve the family farm from forced sale to pay estate taxes. H.R. REP. NO. 1380, 94th Cong., 2d Sess. 22 (1976), reprinted in 1976 U.S.C.C.A.N. 3356, 3376.

158. See Note, *Taxation*, supra note 6, at 639 n.5.

159. *Id.*

160. *Id.* (quoting James B. Wadley, *Small Farms: The USDA, Rural Communities and Urban Pressures*, 21 WASHBURN L. J. 478, 482 (1982)).

his or her family performs most of the work. These ideals can be met by a tenant as well as by the owner of the land.

Congress, too, should embrace the USDA definition of "family farm." Congress should realize that as long as individuals and their families, even if tenants, are using land for agricultural purposes and bearing the accompanying risk, the ultimate goals of the statute are realized. The land remains in agricultural use by individuals, and is not being sold to corporate entities for urban development.

If Congress accepts the USDA definition of "family farm," it is no longer justified in distinguishing between cash leases to family members and those to unrelated individuals. Instead, its concern becomes who is farming the land and taking the risk, an individual and his or her family or a large corporation. If it is an individual and his or her family, special use valuation should be granted. Contrary to Congress' and some courts' assertions,¹⁶¹ the tax breaks of section 2032A, do not benefit only owners of land and their heirs. As summarized above,¹⁶² they also benefit tenants and the communities in which tenants play an active business and social role. Allowing cash leases to related and unrelated individuals would also substantially alleviate the negative results outlined above that occur in both situations.¹⁶³ Therefore, Congress should amend section 2032A to allow cash leasing in both situations.

B. Proposed Amendment to Section 2032A

The amendment to section 2032A should not only allow cash leasing by decedents and qualified heirs to both related and unrelated individuals. It should also contain restrictions to prevent a severe decrease in tax revenues.¹⁶⁴

1. *Pre-Death Qualified Use Requirement*

First, in the pre-death context, Congress should amend the language of section 2032A(b)(1)(A) to read:

For purposes of this section, the term 'qualified real property' means real property located in the United States which was acquired from or passed from the decedent to a qualified heir of the decedent, and which, on the date of the

161. See, e.g., *Williamson v. Commissioner*, 974 F.2d 1525, 1533 (9th Cir. 1992)(expressing Congress' belief that section 2032A only benefits the owner and not the tenant of the property).

162. See *supra* text accompanying notes 135-136.

163. See *supra* text accompanying notes 106-153.

164. See *Williamson v. Commissioner*, 974 F.2d 1525, 1533 (9th Cir. 1992) ("While Congress's purpose in enacting section 2032A was no doubt beneficial, that same Congress intentionally chose to circumscribe narrowly the availability of the tax benefit in the face of a competing concern for maximizing tax revenues.").

decedent's death, was being used for a qualified use by the decedent or a *qualified entity*. . . .¹⁶⁵

Congress would also have to change the other language that makes up the pre-death qualified use requirement by substituting "qualified entity" for "member of decedent's family."¹⁶⁶ Congress could limit the definition of "qualified entity" however it sees fit, possibly to include only family-oriented entities. For instance, "qualified entity" could be defined to include any sole proprietorship, family farm partnership, family farm corporation, or family trust.¹⁶⁷

Both family members of the decedent and unrelated individuals who are farmers would fit under this proposed definition of "qualified entity." As a result, the proposed amendment would allow pre-death cash leases between the decedent and related or unrelated individuals. However, by limiting the entities which can satisfy the pre-death qualified use requirement to family-based entities, this amendment assures that it is indeed family farmers who are farming the property. Although the amendment would increase the number of landowners eligible for special use valuation, this result is consistent with the congressional goal of giving more family farmers estate tax relief. Furthermore, the loss in revenue the Treasury would experience as a result of the amendment could be limited by narrowing the proposed definition of "qualified entity."¹⁶⁸

165. I.R.C. § 2032A(b)(1)(1988) (proposed amended language in italics).

166. *Id.* §§ 2032A(b)(1)(A)(i) & (b)(1)(C)(i).

167. As a result of the corporate threat to the family farm, many states have imposed restrictions on the formation of farm corporations. Note, *Taxation, supra* note 6, at 639 n.6. See also Stayton, *supra* note 1, at 679. Congress could look to such statutes to determine which entities should be included in the definition of "qualified entity." For example, Congress could look to a Kansas statute which states: "No corporation, trust, limited corporate partnership or corporate partnership, other than a family farm corporation, authorized farm corporation, limited liability agricultural company, limited agricultural partnership, family trust, authorized trust or testamentary trust shall, either directly or indirectly, own, acquire or otherwise obtain or lease any agricultural land in this state." KAN. STAT. ANN. § 17-5904 (Cum. Supp. 1993).

Notice that the Kansas statute lists both a family farm corporation and a family trust, two entities included in the proposed definition of "qualified entity," as permissible land owners. See KAN. STAT. ANN. § 17-5903 (Cum. Supp. 1993)(defining "family farm corporation" and "family trust").

Congress could either use definitions found in the anti-corporate farming statutes or it could devise more restrictive definitions. For instance, it could define a "family farm partnership" as one in which all the partners are related, either by blood or by marriage, a "family farm corporation" as one in which all shareholders are related by blood or by marriage, and a "family trust" as one in which all the beneficiaries of the trust are related by blood or by marriage. These definitions would assure that only family-oriented entities and not large corporations are receiving the benefits of section 2032A.

168. For example, Congress could limit the definition of "qualified entity" to include only sole proprietorships and family farm partnerships.

2. *Post-Death Qualified Use Requirement*

Congress could amend section 2032A(c)(1)(B) to read

If within 10 years after the decedent's death and before the death of the qualified heir—(B) the qualified heir *or a qualified entity* ceases to use for the qualified use the qualified real property which was acquired (or passed) from the decedent, then there is hereby imposed an additional tax.¹⁶⁹

Again, in order to restrict who farms the property, the definition of "qualified entity" could be limited to family-oriented entities or in some other appropriate manner.¹⁷⁰ This amendment would bring the post-death qualified use requirement in line with the amended pre-death requirement in that a qualified heir could cash lease to a relative or an unrelated individual. Consequently, any cash lease allowed under the pre-death qualified use test would also be allowed under the post-death qualified use test. The amendment would also allow a decedent's spouse, as a qualified heir, to lease to related or unrelated parties. This change would require the deletion of the last sentence of section 2032A(b)(5)(A).¹⁷¹

3. *Other Possible Amendments to Limit Benefits*

The suggested amendments to the pre-death and post-death qualified use requirements would result in more landowners qualifying for special use valuation. To offset the resulting decrease in tax revenues, Congress could amend other parts of section 2032A.

For instance, the statute currently provides for a two-year grace period after the decedent's death during which a failure of the qualified heir to use the property for a qualified use will not result in a recapture tax.¹⁷² The proposed qualified use amendments make this grace period unnecessary. First, because the proposed amendment allows cash leasing throughout the recapture period, the heir would no longer have any need for time to renegotiate existing cash leases. Second, because of the increased ease with which heirs can meet the qualified use requirement, there is no reason why the heir's obligation to use the property for a qualified use should not begin immediately after

169. I.R.C. § 2032A(c)(1)(1988) (proposed amended language in italics).

170. See *supra* note 166 and accompanying text. See also *Martin v. Commissioner*, 783 F.2d 81, 82 (7th Cir. 1986). In *Martin*, a post-death case in which special use valuation was denied, the qualified heirs decided to lease the farm to the highest bidder on a pure cash basis. A corporation was the highest bidder and cash leased the farm. Because the definition of "qualified entity" would not include normal corporations, the proposed amendment to the statute would also result in denial of special use valuation in that case.

171. I.R.C. § 2032A(b)(5)(A)(1988). The sentence to be deleted currently reads: "For purposes of subsection (c), such surviving spouse shall not be treated as failing to use such property in a qualified use solely because such spouse rents such property to a member of spouse's family on a net cash basis." *Id.*

172. *Id.* § 2032A(c)(7)(A).

the decedent's death. The grace period allows heirs to leave the property completely idle or place it in a non-agricultural use for the two years following decedent's death. By beginning the heir's qualified use obligation immediately after death, the amendment will prevent farmland from sitting idle or being put to a nonfarm use for two years or will deny benefits to those who fail to comply.

Congress could also amend the definition of "qualified real property" to further offset the decrease in revenue caused by the qualified use amendments. Currently, there must have been a qualified use for five of the eight years preceding the decedent's death in order to qualify for special use valuation.¹⁷³ Because of the ease with which a decedent could meet the amended qualified use requirement, Congress could require that qualified use be met for all eight years (or at least more than five of the eight years) preceding the decedent's death.¹⁷⁴

Similarly, Congress could lengthen the recapture period for post-death qualified use under current section 2032A(c)(1).¹⁷⁵ That time period could be changed from ten to twelve, fifteen, or even twenty years.¹⁷⁶ Lengthening the recapture period may discourage some landowners from seeking the benefits of the statute and, thus, help offset the increased benefits resulting from the proposed amendment. However, before Congress lengthens the recapture period, it should determine whether discouraging individuals from seeking the benefits of section 2032A is consistent with the purpose behind the statute.¹⁷⁷

VII. CONCLUSION

Section 2032A is an attempt by Congress to save the family farm through a reduction in estate tax burden. Not all agree that this is a worthy goal.¹⁷⁸ Nevertheless, it is the goal Congress was trying to meet in passing the statute. By placing tight restrictions on cash leasing, however, Congress is taking away with one hand what it is giving with the other. As demonstrated above, cash leases are effective instruments in, and widely used throughout, the agricultural sector. If Congress indeed wants to save the family farm, it should endorse a statute which places few restrictions on farmers' ability to use these effective instruments. Therefore, Congress should amend section 2032A to allow pre-death and post-death cash leasing to both related

173. *Id.* § 2032A(b)(1)(C)(i).

174. This Article does not address whether the pre-death material participation requirement, which also must be met for five of the eight years preceding decedent's death, should be similarly amended.

175. I.R.C. § 2032A(c)(1)(1988).

176. Originally, the qualified use requirement extended for fifteen years. H.R. REP. No. 1380, 94th Cong., 2d Sess. 25 (1976), reprinted in 1976 U.S.C.C.A.N. 3379.

177. See *supra* text accompanying notes 100-105.

178. See, e.g., Gutman, *supra* note 105, at 1266-77.

and unrelated individuals. In addition, by requiring all lessees to be family-oriented entities, Congress can prevent the amendment from greatly decreasing estate tax revenues. By keeping land in agricultural production and under family ownership, the proposed amendment would help advance Congress' goal of saving the family farm.