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# Material Participation Under Section 2032A: It Didn't Save the Family Farm But it Sure Got Me Tenure

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# ARTICLES

# Material Participation Under Section 2032A: It Didn't Save the Family Farm But it Sure Got Me Tenure*

Martin D. Begleiter**

In the Tax Reform Act of 1976,[1] Congress added section 2032A to the Internal Revenue Code (Code).[2] This was done in response to perceived problems in passing family farms to the succeeding generation due to the burden of estate taxes.[3] The statute is complex and contains a number of tests. Professor Neil Harl, an expert on agricultural law and economics, stated that, "Special use valuation is on its way to becoming the most complex section in the entire Internal Revenue Code."[4] I have explored the statute and the problems it has

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 This is the fourth article I have written on this subject, in addition to lecturing on § 2032A and serving as the Vice-Chair and Chair of the Task Force on Special Use Valuation of the ABA Section of Real Property, Probate and Trust Law. In a very real sense, I believe that my work on special use valuation has been greatly responsible for my achieving tenure.

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1. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (codified as amended in scattered sections of 26 U.S.C.) [hereinafter Tax Reform Act of 1976].

2. All references to the Internal Revenue Code are to the Internal Revenue Code of 1986, as amended, unless the context otherwise requires.

3. For a discussion of this problem, see Begleiter, *Section 2032A: Did We Save the Family Farm*, 29 DRAKE L. REV. 15, 17-25 (1979).

4. Harl, *Special Use Valuation: The Complexitites of Economic Engineering*, 60 N.D.L. REV. 7, 43 (1984).

created in a series of articles, and concluded that the enactment of section 2032A has failed to save the family farm.[5] This is not, however, to deny its importance in individual cases.

Originally, many believed that the major problem of interpretation of the statute would involve the material participation requirement, one test Congress used to limit the relief provided by the statute to family farms.[6] However, due to some unanticipated regulations issued by the Internal Revenue Service (IRS) under the qualified use test,[7] the problems of material participation were sublimated to the qualified use requirement.

Nevertheless, in recent years a number of cases have discussed the material participation standard. Although no final resolution of the standard to be used for material participation has developed, the cases so far decided permit analysis of the test likely to be adopted. The purpose of this Article is to analyze these cases in an attempt to determine the standard that will ultimately emerge for determining qualification for special use valuation. Before this analysis is attempted, the background of section 2032A must be discussed, since the congressional purpose in enacting section 2032A is crucial in the analysis of the cases involving material participation. Also necessary is a discussion of how material participation is interpreted in section 1402 of the Code and section 211 of the Social Security Act.[8]

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5. Begleiter, *supra* note 3; Begleiter, *Section 2032A: Did We Really Save the Family Farm*, 5 NOTRE DAME EST. PLAN. INST. 929 (1980) [hereinafter *Really*]; Begleiter, *Special Use Valuation Nine Years Later: A Farewell to Farms*, 63 TAXES 659 (1985) [hereinafter *Farewell to Farms*].

6. Begleiter, *supra* note 3, at 37-38.

7. The qualified use test provides that in order to qualify for special use valuation, real property must be used as a farm for farming purposes. I.R.C. § 2032A(b)(2). In regulations, ironically issued under the rubric of explaining material participation, the IRS required that in order to satisfy the qualified use test the real property had to be used in an active trade or business and that the decedent or a member of his family (and after the decedent's death, the qualified heir) must own an equity interest in the farm operation and be "at risk" in the farm operation. Treas. Reg. § 20.2032A-3(b)(1) (1986). Qualified use will not be further discussed in this Article. For a discussion of the problems caused by the regulations, see *Farewell to Farms*, *supra* note 5, at 667-72.

8. 42 U.S.C. § 411 (1982). The focus of this Article is on the standard used to interpret material participation. Therefore, a number of other issues in material participation will not be discussed. For example, no attempt will be made to analyze material participation as applied to trusts, corporations, and partnerships. Nor will the requirement of payment of the self-employment tax to qualify for special use valuation be extensively treated. Finally, neither the special test available for decedents who were continuously disabled or receiving old-age benefits prior to death, nor the alternative of active management available in certain cases, will be discussed. For a discussion of these issues, see *Farewell to Farms*, *supra* note 5, at 678-83.

## I. Background of Section 2032A

### *A. The Congressional Purpose*[9]

Section 2032A was enacted to preserve the family farm from forced sale to pay estate taxes.[10] This perceived threat to the family farm was caused primarily by three factors:

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;[11]

2. The requirement that land be valued at its highest and best use for federal estate tax purposes;[12] and

3. The lack of liquid assets in the estates of most farmers.[13]

Congress intended section 2032A, however, to benefit only family farms. Many statements on the floor of Congress during the debate over section 2032A witness this limitation. 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

9. For a more extensive analysis of the problems of farmers prior to 1976 and the hearings on § 2032A, see Begleiter, *supra* note 3, at 17-26.

10. H.R. REP. NO. 94-1380, 94th Cong., 2d Sess. 21-22 (1976) [hereinafter HOUSE REPORT].

11. Begleiter, *supra* note 3, at 18.

12. *Id.* at 19.

13. *Id.* at 21.

> tax laws between our most productive citizens and those whom the law might allow, even encourage, to be completely unproductive.[14]

Congress responded to the concern over the future of family farms by enacting section 2032A. The congressional purpose was 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. However, the many requirements Congress imposed on qualification for special use valuation, as described in the House Report, show the limits of the relief granted.[15]

### *B. Structure of the Statute*

If the requirements of section 2032A are met, real property used in a farm for farming purposes is valued for estate tax purposes at its value as a farm or business.[16] The requirements for qualification are:[17]

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14. 122 CONG. REC. 25944 (1976).

15. The qualification requirements are listed in Section I.B. of this Article. The House Report states:

> Your Committee believes that, when land is actually used for farming purposes or in other closely held business (both before and after the decedent's death), it is inappropriate to value the land on the basis of the potential "highest and best use" especially since it is desirable to encourage the continued use of property for farming and other small business purposes. 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, or the closely held business activities, 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, your committee believes it unreasonable to require that this "speculative value" be included in an estate with respect to land devoted to farming or closely held businesses.
>
> However, your committee recognizes that it 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. Also, your committee believes that it would be inequitable to discount speculative values if the heirs of the decedent realize these speculative values by selling the property within a short time after the decedent's death.
>
> For these reasons, your committee has provided for special use valuation in situations involving real property used in farming or in certain other trades and businesses, but it has further provided for recapture of the estate tax benefit where the land is prematurely sold or is converted to nonqualifying uses.

HOUSE REPORT, *supra* note 10, at 21-22.

16. I.R.C. § 2032A(a)(1), (b)(2)(A).

17. For a more complete discussion of the requirements, *see* Begleiter, *supra* note 3;

1. The decedent was a United States citizen or resident at the time of his death;[18]

2. The executor must elect to have the section applied, furnish certain information, and file an agreement signed by all qualified heirs consenting to the recapture provisions;[19]

3. The real property must be located in the United States;[20]

4. The property must have been used for a qualified use on the date of the decedent's death;[21]

5. Fifty percent or more of the value of the gross estate must consist of the adjusted value of real or personal property which, at the decedent's death, was used for a qualified use;[22]

6. Twenty-five percent or more of the adjusted value of the gross estate must consist of the adjusted value of real property which was being used for a qualified use on the date of the decedent's death;[23]

7. The real property must be acquired from or have passed from the decedent to a qualified heir;[24] and

8. For five or more years during the eight year period ending on the date of decedent's death (a) the real property must have been owned by the decedent or a member of his family and used for a qualified use, and (b) the decedent or a member of his family must have materially participated in the operation of the farm or other business.[25]

In addition, the statute has a recapture provision that is activated under certain conditions. If, within ten years of the date of the decedent's death and before the death of the qualified heir, the qualified heir disposes of his interest in the qualified real property (other than by disposition to a member of the qualified heir's family), or ceases to use the property for the qualified use, an additional estate tax (or recapture tax) is imposed in order to recapture the savings made possible by special use valuation.[26] One method of ceasing to

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*Really*, *supra* note 5; *Farewell to Farms*, *supra* note 5.

18. I.R.C. § 2032A(a)(1)(A).

19. I.R.C. § 2032A(a)(1)(b), (d)(1), (d)(2).

20. I.R.C. § 2032A(b)(1).

21. *Id.* A qualified use is defined as a farm for farming purposes or a trade or business other than farming. I.R.C. § 2032A(b)(2), (b)(2)(B). For the definitions of farm and farming purposes, see I.R.C. § 2032A(e)(4), (e)(5).

22. I.R.C. § 2032A(b)(1)(A).

23. I.R.C. § 2032A(b)(1)(B).

24. I.R.C. § 2032A(b)(1)(A)(ii), (b)(1)(B). For the definitions of qualified heir and member of the family, see I.R.C. § 2032A(e)(1), (e)(2).

25. I.R.C. § 2032A(b)(1)(C).

26. I.R.C. § 2032A(c)(1). For a more extended treatment of the problems of the recapture tax, see Begleiter, *supra* note 3, at 65-71 and *Farewell to Farms*, *supra* note 5, at 683-91.

use the property for the qualified use is if, during any eight year period ending after the decedent's death, there are periods aggregating three years or more during which the decedent or a member of his family (before the decedent's death) or the qualified heir or a member of his family (after the decedent's death) failed to materially participate in the operation of the farm or the business.[27] Material participation is, therefore, important both before and after the decedent's death.

### C. *The Statutory Definition*

Section 2032A(e)(6) provides: "Material participation shall be determined in a manner similar to the manner used for purposes of paragraph (1) of section 1402(a) (relating to net earnings from self-employment)."[28] The legislative history does not elaborate on this definition. Therefore, we must turn our attention to Code section 1402(a).

## II. Code Section 1402(a)

Code section 1402(a) defines net earnings from self-employment for the purpose of imposing the tax on self-employment income.[29] In general, self-employment income means any income derived from a trade or business.[30] However, rental income from real estate is excluded from the definition unless the rental income is derived from an arrangement with the tenant which "provides . . . that there shall be material participation by the owner . . . in the production or the management of the production" in the agricultural commodities produced and such material participation actually takes place.[31] Thus, if the lease provides for material participation by the owner and the material participation actually occurs, the rental income derived is included in the owner's self-employment income and is subject to tax.

The regulations under section 1402(a) elaborate on the definition of material participation. Both an arrangement providing for material participation and actual material participation in the production or the management of production are required.[32] Services

27. I.R.C. § 2032A(c)(7)(B).
28. I.R.C. § 2032A(e)(6).
29. I.R.C. § 1401 imposes a tax on self-employment income and prescribes the rates.
30. I.R.C. § 1402(a).
31. I.R.C. § 1402(a)(1).
32. Treas. Reg. § 1.1402(a)-4(b)(1) (1986).

performed by an employee or agent are excluded for this purpose.[33] Thus, the test for material participation will focus on the meaning of production and management of production.

### *A. Production*

Production is composed of two major elements: physical work and the furnishing of resources.[34] Although physical work alone may constitute material participation, the regulation provides that the furnishing of materials and being responsible for expenses alone cannot.[35] The furnishing of resources and expenses becomes important in cases when the physical work does not rise to the level of material participation.[36]

### *B. Management of Production*

Management of production is a term employed primarily to refer to the responsibility for and the actual making of decisions, and other activities affecting the production of a commodity.[37] The regulations list a number of decisions that will be taken into account.[38]

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33. Treas. Reg. § 1.1402(a)-4(b)(5) (1986).

34. Treas. Reg. § 1.1402(a)-4(b)(3)(ii) (1986) provides:

> The term "production", wherever used in this paragraph, refers to the physical work performed and the expenses incurred in producing a commodity. It includes such activities as the actual work of planting, cultivating, and harvesting crops, and the furnishing of machinery, implements, seed, and livestock. An arrangement will be treated as contemplating that the owner or tenant will materially participate in the "production" of the commodities required to be produced by the other person under the arrangement if under the arrangement it is understood that the owner or tenant is to engage to a material degree in the physical work related to the production of such commodities. The mere undertaking to furnish machinery, implements, and livestock and to incur expenses is not, in and of itself, sufficient. Such factors may be significant, however, in cases where the degree of physical work intended of the owner or tenant is not material. For example, if under the arrangement it is understood that the owner or tenant is to engage periodically in physical work to a degree which is not material in and of itself and, in addition, to furnish a substantial portion of the machinery, implements, and livestock to be used in the production of the commodities or to furnish or advance funds or assume financial responsibility for a substantial part of the expense involved in the production of the commodities, the arrangement will be treated as contemplating material participation in the production of such commodities.

35. This part of the regulation, however, has been rejected in dictum. Henderson v. Flemming, 283 F.2d 882, 888-89 (5th Cir. 1960).

36. Treas. Reg. § 1.1402(a)-4(b)(3)(ii) (1986).

37. Treas. Reg. § 1.1402(a)-4(b)(3)(iii) (1986).

38. These decisions and activities are:

1. "[W]hen to plant, cultivate, dust, spray, or harvest the crop";
2. "[M]aking inspections of the production activities";
3. "[A]dvising and consulting";
4. "[M]aking decisions as to matters such as rotation of crops, the type of crops to be grown, the type of livestock to be raised, and the type of machinery

The regulations single out as particularly important making inspections of the production activities and advising and consulting with the actual producer, which together will create a "strong inference" of material participation.[39] Selecting the crops, machinery, or implements and deciding on crop rotation are downplayed, but may become significant in the overall determination of material participation.[40]

### *C. Cases Under Section 1402(a)*

There is no significant case law on material participation under Code section 1402(a)(1) to aid in the determination of the standard to be employed under section 2032A. Therefore, other sources must be examined for interpretation of production and management of production.

## III. Social Security Act Section 211(a)(1)

### *A. The Statute and Regulations*

Code section 1402(a) and the regulations thereunder are designed to determine what earnings are included in the tax base used to finance the federal Old Age and Survivor Trust Fund, which was created to provide benefits primarily to the aged and disabled and the survivors of such persons who received benefits during their lives.[41] In order to receive distributions from the fund, the recipient (or, in the case of survivor benefits, the deceased) must have contributed to the fund (through deductions from wages (FICA) or the tax on self-employment income).[42] Though there is very little case law on what constitutes material participation on the collection side of social security (section 1402 of the Code), the statute governing distribution of the benefits financed by FICA and the tax on self-employment earnings contains provisions that correspond almost exactly to Code section 1402(a)(1).

Section 211(a)(1) of the Social Security Act[43] tracks the language of section 1402(a)(1) of the Code, including the material participation test. Moreover, before the Social Security Act regulations

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and implements to be furnished."
Treas. Reg. § 1.1402(a)-4(b)(3)(iii) (1986).

39. *Id.*
40. *Id.*
41. 42 U.S.C. § 401 (1983).
42. *Id.* § 401(h).
43. 42 U.S.C. § 411(a)(1) (1983).

were rewritten in 1980 to translate them from legalese into English, the regulations were almost exactly the same as those under section 1402(a)(1) of the Code.[44] The current regulations under the Social Security Act, though written in simpler terms than the treasury regulations, nevertheless contain the same explanation and tests of material participation: both require an arrangement for and actual material participation and both require participation in either production or the management of production.[45] A number of cases have involved the question of what activities constitute material participation under the Social Security Act. These cases are informative as to the standard to be used to determine material participation.

### *B. The Case Law*

The existence of material participation "is a factual determina-

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44. 20 C.F.R. § 404.1053 (1979), especially subsections (c)(3) and (4).

45. 20 C.F.R. § 404.1082(c) (1979). Subsections (1)-(3) provide:

(c) Special rule for farm rental income.—(1) In general. If you own or lease land, any income you derive from it is included in figuring your net earnings from self-employment if—

(i) The income results from an arrangement between you and another person which provides for the other person to produce agricultural or horticultural commodities on the land that you own or lease and for you to materially participate in the production or the management of the production of the agricultural or horticultural commodities; and

(ii) You actually do materially participate.

(2) Nature of arrangement. (i) The arrangement between you and the other person may be either oral or written. It must provide that the other person will produce one or more agricultural or horticultural commodities and that you will materially participate in the production or the management of the production of the commodities.

(ii) The term "production," refers to the physical work performed and the expenses incurred in producing a commodity. It includes activities like the actual work of planting, cultivating, and harvesting crops, and the furnishing of machinery, implements, seed, and livestock.

(iii) The term "management of the production," refers to services performed in making managerial decisions about the production of the crop, such as when to plant, cultivate, dust, spray, or harvest, and includes advising and consulting, making inspections, and making decisions on matters, such as the rotation of crops, the type of crops to be grown, the type of livestock to be raised, and the type of machinery and implements to be furnished.

(3) Material participation. (i) If you show that you periodically advise or consult with the other person, who under the rental arrangement produces the agricultural or horticultural commodities, and also show that you periodically inspect the production activities on the land, you will have presented strong evidence that you are materially participating.

(ii) If you also show that you furnish a large portion of the machinery, tools, and livestock used in the production of the commodities, or that you furnish or advance monies, or assume financial responsibility, for a substantial part of the expense involved in the production of the commodities, you will have established that you are materially participating.

tion that can only be made on a case-to-case consideration."[46] Moreover, the Social Security Act is to be given a liberal interpretation.[47] "Material" is to be given "its common and well-understood meaning" of "solid or weighty character; substantial; of consequence; not to be dispensed with; important."[48] As previously stated, material participation can be accomplished in either production of the commodity, management of the production of the commodity, or a combination of the two.[49]

*1. Production: Furnishing Expenses and Incurring Risk.*—The regulations indicate that some physical work is necessary to materially participate in the production of a commodity.[50] The position of the regulations was rejected in the oft-quoted dictum of *Henderson v. Flemming*:[51]

> [W]e know at least today that agriculture is or may be big business. It takes more than land and a willing hand. It takes working capital, frequently in considerable amounts. An owner of land who is required to (and does) furnish substantial amounts of cash, credit or supplies toward this mutual undertaking which are reasonably needed in the production of the agricultural commodity and from the success of which he must look for actual recoupment likewise makes a "material participation."[52]

Two other cases illustrate that no physical work is required for material participation. In *Bridie v. Ribicoff*,[53] the owner's only physical work consisted of watering the livestock on a few occasions,

46. Hoffman v. Ribicoff, 305 F.2d 1, 9 (8th Cir. 1962).

47. Foster v. Celebrezze, 313 F.2d 604, 607 (8th Cir. 1963); Harper v. Flemming, 288 F.2d 61, 64 (4th Cir. 1961); Henderson v. Flemming, 283 F.2d 882, 887 (5th Cir. 1960).

48. Foster v. Celebrezze, 313 F.2d 604, 607 (8th Cir. 1963).

49. Treas. Reg. §§ 1.1402(a)-4(b)(3)(i), 1.1402(a)-4(b)(4) (1986); 20 C.F.R. § 404.1082(c) (1979).

50. Treas. Reg. § 1.1402(a)-4(b)(3)(ii) (1986) states that production refers to "the physical work performed and the expenses incurred in producing a commodity" but further states that "the mere undertaking to furnish machinery, implements and livestock and to incur expenses is not, in and of itself, sufficient," thus implying that some physical work is required.

51. 283 F.2d 882 (5th Cir. 1960).

52. *Id.* at 888. The actual holding of the case was that the owner materially participated through an agent (her son). The physical work required by the arrangement was breaking ground and planting the crop. The court's opinion does not indicate whether the physical work required was material in itself or whether material participation was accomplished only by a combination of physical work by the agent and the furnishing of resources. For a discussion of the case see *infra* notes 68-76 and accompanying text. Both I.R.C. § 1402(a)(1) and 42 U.S.C. § 411(a)(1) (1983) were amended for taxable years beginning after December 31, 1973 to provide that activities of agents are not considered in the determination of material participation.

53. 194 F. Supp. 809 (N.D. Iowa 1961).

helping the tenant load the cattle for market, driving the tractor during haying, and helping the tenants innoculate soybeans.[54] Clearly, even in combination, these activities do not come close to being material. The plaintiff leased the farm (a livestock operation in which the crops grown on the land were fed to the livestock) on a stock share basis.[55] Although the tenant furnished the machinery, the plaintiff was required to furnish one-half of the expenses of threshing, combining of soybeans, twine, and bailing wire, corn shelling, veterinary expense and trucking, and the entire expense of grass seed.[56] Plaintiff also advanced all the money to buy the feeder cattle and sows and the tenants did not reimburse him until the animals were sold.[57] The court held that the plaintiff's furnishing of expenses and advancement of capital, combined with his periodic advice and consultation with the tenants, periodic inspection of livestock, and involvement in management decisions constituted material participation.[58] Though the court found it unnecessary to decide whether the advancement of capital alone can constitute material participation, the emphasis on that factor by the court leaves little doubt that if presented with a case in which advancement of capital and responsibility for production expenses was the sole involvement of the owner, the court would have found material participation to exist.[59]

In *Celebrezze v. Miller*,[60] plaintiff was eighty-two years old and spoke no English.[61] His physical activities had been greatly reduced seven years prior to the years in question.[62] Two tenants cultivated the cotton, corn, and sweet potatoes on the 121-acre farm and received two-thirds of the crop.[63] The oral arrangement required plaintiff to inspect the crops three or four times a month, pay one-third of the costs of fertilizer, poisons, and labor hired, absorb one-third of the losses, and advise and consult with the tenants during the inspections as to where to plant the crops and the application of fertilizer

54. *Id.* at 813.
55. *Id.* at 810.
56. *Id.* at 812.
57. *Id.*
58. Bridie v. Ribicoff, 194 F. Supp. 809, 815-16 (N.D. Iowa 1961).
59. The testimony recited by the court as to the plaintiff's involvement in management decisions is equivocal. It does not appear that the lease contemplated that plaintiff would make the final decisions; in fact, decisions were made jointly by the owner and the tenant. There was substantial evidence of advice and consultation as to the livestock and it is possible that the decision was based on this factor.
60. 333 F.2d 29 (5th Cir. 1964).
61. *Id.* at 30.
62. *Id.* at 31.
63. *Id.* at 30.

and poisons.[64] The tenants conducted the farm operation, furnished the seed, tilled the crops, arranged for additional hired labor when necessary, and applied the fertilizer and poisons.[65] In a short opinion, the court held that the plaintiff materially participated in the production.[66] Though not emphasized by the court, the fact that the owner spoke no English emerges as the most significant factor in the decision. Since it is difficult to believe that Miller's advice and consultation were of much benefit to the tenants, the decision stands for the proposition that the furnishing of one-third of the expenses, together with periodic inspection of the crop, constitutes material participation.[67]

Since the courts have been somewhat unwilling to develop numerical guidelines for material participation in production, the opinions have focused on another factor: the risk assumed by the owner. This is most often apparent in crop-share arrangements. In return for furnishing a portion of the seed, fertilizer, machinery, etc., the owner receives a portion of the crop or the proceeds of sale. He also necessarily assumes the risk of low production or losses. The courts have viewed this assumption of risk as evidence of material participation. The origin of this analysis was *Henderson v. Flemming*,[68] which involved Mrs. Poole, a ninety-one year-old invalid confined to a wheel chair. The arrangement required her to break ground and to plant the crop, which she did through her son on a contract basis.[69] The court held that the physical work could be accomplished through an agent,[70] but the physical work involved was apparently insufficient to constitute material participation.[71] The owner was required to furnish the seed, to pay one-half the cost of insecticide, to pay the fuel costs, and to absorb the depreciation on the machin-

64. *Id.* at 30-31.

65. Celebrezze v. Miller, 333 F.2d 29, 31 (5th Cir. 1964).

66. Most of the opinion was devoted to distinguishing the case from Celebrezze v. Maxwell, 315 F.2d 727 (5th Cir. 1963). In Maxwell, the owner furnished one-fourth of the cotton seed, fertilizer, and poison for that seed and only two of the five tenants grew cotton. The owner apparently furnished none of the expenses of growing corn, which four of the five tenants grew. The court found that the material participation standard was not met.

67. It is, of course, possible that Miller and the tenants spoke a common language or that Miller employed a translator to convey his advice to the tenants. However, the opinion is totally silent on this question. In view of the importance the regulations attach to advice and consultations, it is highly likely that the court would have referred to these facts if they existed.

68. 283 F.2d 882 (5th Cir. 1960).

69. *Id.* at 885.

70. This is no longer the case. *See supra* note 52.

71. Henderson v. Flemming, 283 F.2d 882, 887-88 (5th Cir. 1960).

ery.[72] These costs were substantial, especially in relation to her income from the farming operation.[73] Although the responsibility for the expenses combined with the physical work of her son could have been the basis for a finding of material participation, the court based its decision on the risk taken by the owner:

> Under the sharecropping arrangements effected in her behalf by [her son], Mrs. Poole, of course, furnished the land. But there was much more. She was required to bear a considerable financial risk and contribution. She furnished the planting seed and bore one-half the cost of insecticide which ran in the neighborhood of $1100 per year . . .[t]he charges [for] the out-of-pocket labor and fuel expense for the operation of the expensive farm machinery and depreciation thereon . . . was a substantial item and for the two years in question was in the neighborhood of $2500 to $4000. The sharecropping tenants, on the other hand, were required to bear one-half the cost of insecticides, the entire cost of fertilizer, as well as the labor and simple farm tools for harvesting. Actually, of course, Mrs. Poole had to finance the cost of fertilizer which would run several thousands of dollars and her reimbursement would come as a back-charge against the tenants' share when and as the cotton was harvested, ginned and sold. After deducting back charges due by the sharecropper tenants, the proceeds of the cotton were split 50/50.[74]

After noting the significance of capital in operating a modern farm,[75] the court emphasized the importance of this risk:

> An owner of land who is required to (and does) furnish substantial amounts of cash, credit or supplies toward this mutual undertaking which are reasonably needed in the production of the agricultural commodity and from the success of which he must look for actual recoupment likewise makes a "material participation." One is hardly a mere landlord in the traditional sense if he must risk considerable funds in addition to the land in the success of the venture. And what he gets—or hopes to get—is more than rent. It is profit from the operation of a business, a business fraught with financial risks—the business of producing agricultural commodities.[76]

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72. *Id.* at 885-86.
73. *Id.*
74. *Id.*
75. *See supra* note 52 and accompanying text.
76. Henderson v. Flemming, 283 F.2d 882, 888 (5th Cir. 1960).

*2. Management of the Production: Decision-Making.*—As discussed above, despite the emphasis of the regulations on physical work in determining material participation in production, the courts instead have focused on the furnishing of resources and the risk undertaken by the owner. A similar process has occurred in the other means of satisfying the material participation test: the management of the production. The regulations specify two factors—the making of managerial decisions relating to the production of the commodity, and advising, consulting, and inspecting the production facilities—to be considered in the decision on material participation.[77] However, the regulations clearly indicate that advice, consultation, and inspection are to be weighted more heavily than decision-making.[78] Despite the language in the regulations, the decided cases have, on the whole, taken the more logical position that the decisive factor should be who makes the final and more important decisions and that inspections, consultation, and advice are only a factor to be considered in the determination.

Perhaps the clearest case illustrating the emphasis of the courts on decision making is *McCormick v. Richardson.*[79] On his retirement,[80] McCormick became active in managing a 160-acre farm he owned in Illinois, which had become badly run down.[81] He hired a person to clear a woodland area, remove the timber and stumps, and prepare the land for planting.[82] He and the tenant (who had farmed the land under an oral arrangement with McCormick for the past seven years) agreed that modern farm machinery was required,

77. Treas. Reg. § 1.1402(a)-4(b)(3)(iii) (1986); 20 C.F.R. § 404.1082(c)(2)(iii) (1979).

78. Thus, Treas. Reg. § 1.1402(a)-4(b)(3)(iii) provides:

> The services which are considered of particular importance in making such management decisions are those services performed in making inspections of the production activities and in advising and consulting with such person as to the production of the commodities. Thus, if under the arrangement it is understood that the owner or tenant is to advise or consult periodically with the other person as to the production of the commodities required to be produced by such person under the arrangement and to inspect periodically the production activities on the land, a strong inference will be drawn that the arrangement contemplates participation by the owner or tenant in the management of the production of such commodities. The mere undertaking to select the crops or livestock to be produced or the type of machinery and implements to be furnished or to make decisions as to the rotation of crops generally is not, in and of itself, sufficient. Such factors may be significant, however, in making the overall determination of whether the arrangement contemplates that the owner or tenant is to participate materially in the management of the production of the commodities.

*See also* 20 C.F.R. § 404.1082(c)(3)(i).

79. 460 F.2d 783 (10th Cir. 1972).

80. From the I.R.S., ironically enough. Leave it to the I.R.S. to sue its own.

81. McCormick v. Richardson, 460 F.2d 783, 784 (10th Cir. 1972).

82. *Id.*

which was purchased by the tenant.[83] Under the arrangement, McCormick was responsible for the cost of furnishing and spreading lime and rock phosphate, the real estate taxes, insurance, building and fence repair, the cleaning and maintenance of a drainage ditch on the farm, the cost of clover seed, nitrogen, poison and weed killer,[84] and forty percent of the cost of fertilizer (other than nitrogen and phosphate).[85]

Although the court might have based its decision on the resources furnished by the owner, instead it emphasized McCormick's active involvement in the operation of the farm and responsibility for management in finding he materially participated in the management of the production.[86] McCormick determined when soil tests should be made and had them done, and he carefully and regularly inspected the production activities.[87] During his inspection each fall, he particularly focused on the production of each grain, how the ground was seeded, and the use of weed killer.[88] He also had aerial photographs made of the different fields.[89] From these inspections, McCormick determined a detailed plan for the following year's crops.[90] Though McCormick and the tenant usually agreed, it was understood that in the event of disagreement, McCormick reserved the right to make the final decision.[91] McCormick prepared a careful plan of crop rotation each fall, and decided whether a government crop plan should be used.[92] He also devised several innovative methods to deal with problems on the farm that greatly increased the farm's production.[93] The court ruled that McCormick made a "very substantial and helpful contribution to the management of production, which resulted in a very large increase in the amount of crops produced," which constituted material participation.[94] The court stated:

> The phrase, "the management of the production of such agricultural . . . commodities" means, we hold, the determination of what shall be done or carried out which will affect production

83. *Id.*
84. *Id.* at 785.
85. *Id.*
86. McCormick v. Richardson, 460 F.2d 783, 787 (10th Cir. 1972).
87. *Id.* at 785.
88. *Id.*
89. *Id.*
90. *Id.*
91. McCormick v. Richardson, 460 F.2d 783, 785 (10th Cir. 1972).
92. *Id.*
93. *Id.* at 785-86.
94. *Id.* at 787.

> and how and by whom it shall be done or carried out. And it does not mean the physical exertion by which the actual doing or carrying out of the operation is accomplished. Hence, physical participation is not required.[95]

The court held that McCormick had satisfied the test:

> The record clearly shows that McCormick actively participated in every important decision that was made which materially affected production; that in the event of disagreement his views were to and did prevail; that he initiated many actions and of his own volition carried out several actions, all of which materially increased production; and by planning and requiring the carrying out each year of proper crop rotation, he built the 160-acre farm up from a farm of "badly run down condition" to one of good condition and susceptible of a high level of production.[96]

Another leading case in this area is *Foster v. Celebrezze*,[97] in which the sole question was whether an arrangement for material participation by the owner existed. The lease provided that the tenants agreed "to put in such crops in such manner as the Landlord may direct."[98] The court ruled that this provision gave the owner "broad managerial powers," including the rights to direct and supervise the preparation of the seed bed, the time and method of planting the seed, the amount of seed planted, and other matters "which would appear to be substantial managerial functions which would have a material bearing upon production."[99] Together with other lease provisions that gave the owner the rights to approve seed planted, to designate the fields on which manure was spread as fertilizer, to determine which meadows and fields were to be ploughed, to direct weed cutting and clipping of clover, and to determine participation in government support programs, the court determined that the quoted provision constituted an arrangement for material participation under the normal meaning of that term.[100] Although the court mentioned that the exercise of the owner's reserved rights would require numerous and periodic advice and consultation, the decision is clearly based on the decision-making power of the owner.[101]

Perhaps the two cases most clearly illustrating the emphasis of

95. *Id.*
96. McCormick v. Richardson, 460 F.2d 783, 787 (10th Cir. 1972).
97. 313 F.2d 604 (8th Cir. 1963).
98. *Id.* at 608.
99. *Id.*
100. *Id.*
101. *Id.*

the courts on decision-making are *Hoffman v. Gardner*[102] and *Colegate v. Gardner*.[103] In *Hoffman*, the claimant lived in Missouri. His farms in Iowa were supervised by his brother-in-law, who farmed land near the claimant's farms.[104] The only evidence of advice, inspections, and consultations were that the claimant consulted periodically with his brother-in-law and occasionally with the tenants directly by telephone and letter, sometimes instructing the tenants about the crops, and that claimant and his daughter spent one week a year on the farms.[105] All other advice, consultation, and inspections were made by the brother-in-law, who kept claimant advised of conditions and relayed claimant's instructions to the tenants.[106] The leases, however, gave claimant complete managerial control; the tenants were only permitted to make suggestions.[107] The owner determined the crops to be planted, the time and location of the planting, the type of seed, the crop rotation plan, the price and time of sale of the crops, and conservation measures.[108] He kept charts showing crop information and each year sent the tenants a map showing where to fertilize, the type of fertilizer, terracing, and other matters.[109] The court had no trouble holding that the owner made important decisions concerning production and that this constituted material participation, despite the limited inspections.[110]

In *Colegate*, the claimant owned and lived on a 65-acre farm.[111] She entered into an arrangement with a neighbor to farm most of her acres. Expenses were shared equally, except that the tenant provided the machinery.[112] At planting time, claimant made two inspec-

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102. 369 F.2d 837 (8th Cir. 1966).
103. 265 F. Supp. 987 (S.D. Ohio 1967).
104. Hoffman v. Gardner, 369 F.2d 837, 839 (8th Cir. 1966).
105. *Id.* at 839.
106. *Id.*
107. *Id.*
108. *Id.*
109. Hoffman v. Gardner, 369 F.2d 837, 839 (8th Cir. 1966).
110. *Id.* at 841-42. The court stated:

> It is true that claimant here did not actually visit the farms except for a week during the growing season, but one could hardly expect a person of his age to traipse between his home in Missouri and his farms in Iowa, a round trip distance of some eight hundred miles, when he could accomplish the same thing by letter and telephonic communication with his tenants and the employment of a farmer brother-in-law who lived nearby and who actually visited the farms from two to four times a month during the growing season . . . . About the only things he did not do were to personally set foot on the farms at frequent intervals and engage in the physical farming activities, *neither of which is a requirement of the statute.*

*Id.* (emphasis added).
111. Colegate v. Gardner, 265 F. Supp 987, 988 (S.D. Ohio 1967).
112. *Id.*

tions of the area, each lasting about fifteen minutes.[113] She made no regular inspections during the growing season, but went "around the outside of the crops."[114] When the crop was harvested, claimant made sure that her share of the crop was put in the proper place.[115] The only evidence on managerial decisions made by the owner was that she decided what she wanted planted, a subject on which there was apparently some disagreement between the owner and the tenant.[116] The court did not view the joint nature of most decisions or the near absence of disagreements between owner and tenant as unusual or as reflecting on the materiality of the owner's participation.[117] The court made short work of the argument that the claimant did not materially participate because she made only two inspections of fifteen minutes each and that consultations between the owner and the tenant took place infrequently:

> Between two old-time neighboring farmers, thoroughly familiar with the detail of the day-to-day operation of farms in a particular locality, the management decisions are, in the most part, made at the beginning and the end of the grain farm year. There is no question that the petitioner dictated what would be done at the beginning of the year, and there is no question that she participated in the determination of what to do with the crop at the end of the year.
>
> . . . .
>
> It is further the view of this Court that the evidence establishes without a shadow of a doubt that the inspections and consultations were important and material. The basic decision to farm this sixty acres was made by the petitioner. The basic decision to grain farm it was made by the petitioner. The basic decision involving the question of what acreage was to be devoted to soy beans in what year was made by the petitioner. The record establishes the same fact with respect to where to plant hay, or wheat, or corn. She superintended and directed the storage of her part of the crops and also decided when to market those crops. Her participation therefore was material. . . .[118]

## IV. Material Participation Under Section 2032A

Code section 2032A states only that material participation

113. *Id.* at 989.
114. *Id.*
115. *Id.*
116. Colegate v. Gardner, 265 F. Supp. 987, 989 (S.D. Ohio 1967).
117. *Id.*
118. *Id.* at 989, 991.

"shall be determined in a manner similar to the manner used for purposes of paragraph (1) of section 1402(a)(relating to net earnings from self-employment)."[119] The apparent purpose of this requirement was to keep the qualified real property in farm or business use in furtherance of the statute's purpose of preserving the family farm.[120] Material participation can be accomplished either by the decedent or a member of his family (prior to the decedent's death) and by either the qualified heir or a member of the qualified heir's family (after the decedent's death).[121] The Internal Revenue Service has issued regulations designed to delineate the activities that will constitute material participation.[122]

The first test is that "[a]ctual employment of the decedent (or of a member of the decedent's family) on a substantially full-time basis (35 hours a week or more) or to any lesser extent necessary to personally manage fully the farm or business in which the real property to be valued under section 2032A is used constitutes material participation."[123] The activities of agents or employees (other than family members) are not considered in the determination of material participation.[124]

If the involvement is less than full-time, the activities "must be pursuant to an arrangement providing for actual participation in *the production or management of production where the land is used by*

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119. I.R.C. § 2032A(e)(6).

120. H.R. REP. No. 94-1380, 94th Cong., 2d Sess. 22 (1976).

121. I.R.C. § 2032A(b)(1)(C)(ii), (c)(6)(B).

122. Treas. Reg. § 20.2032A-3 (1986). It should be noted that the Service has ruled that material participation is a factual determination and the Service will not issue advance rulings on whether, under a given set of facts, material participation exists. Priv. Ltr. Rul. 86-10-073 (Dec. 12, 1985).

123. Treas. Reg. § 20.2032A-3(e)(1) (1986). The regulations, specifically referring to farming activities, also provide that material participation can be present as long as all necessary functions are performed, despite the fact that little or no activity occurs during nonproducing seasons. *Id.* The regulations also require that, if the individual is self-employed with respect to the farm, his or her income from the farm must be earned income for self-employment tax purposes for the participant to be materially participating under § 2032A. Payment of self-employment tax is not conclusive evidence of material participation. However, nonpayment of the tax creates a presumption of lack of material participation and requires that the executor demonstrate to the Service that material participation occurred and explain the reason why taxes were not paid. In addition, all self-employment taxes due must be paid. *Id.* For example, lack of payment because the threshold for filing a return was not met is an adequate explanation. Priv. Ltr. Rul. 80-46-012 (Aug. 8, 1980). However, the Service has ruled that only those self-employment taxes that can be assessed and are not barred by the statute of limitations at the time of the determination of material participation must be paid. Rev. Rul. 83-32, 1983-1 C.B. 723.

124. The income tax regulations are similar. Treas. Reg. § 1.1402(a)-4(b)(5) (1986). However, this provision is not intended to disqualify farm land that is managed by a professional farm manager, if the decedent or a family member personally materially participates under the terms of the arrangement.

*any nonfamily member, or any trust or business entity, in farming or another business.*"[125] At the heart of the regulations is section 20.2032A-3(e)(2), which enumerates the factors considered in determining material participation:

> No single factor is determinative of the presence of material participation, but physical work[126] and participation in management decisions[127] are the principal factors to be considered. As a minimum, the decedent and/or a family member must regularly advise or consult with the other managing party on the operation of the business.[128] While they need not make all final management decisions alone, the decedent and/or family members must participate in making a substantial number of these decisions.[129] Additionally, production activities on the land should be inspected regularly by the family participant,[130] and funds should be advanced and financial responsibility assumed for a substantial portion of the expense involved in the operation of the farm or other business in which the real property is used.[131] In the case of a farm, the furnishing by the owner or other family members of a substantial portion of the machinery, implements, and livestock used in the production activities is an important factor to consider in finding material participation.[132] With farms, hotels, or apartment buildings, the operation of

125. Treas. Reg. § 20.2032A-3(e)(1) (1986) (emphasis added). It is important to note that the same words, production or management of the production, as are used in the regulations under § 1402 and in the Social Security Act, are used here.

126. Treas. Reg. § 1.1402(a)-4(b)(3)(ii) (1986) states that physical work is a major ingredient in the production of a commodity.

127. This is one of the important factors in determining management of the production under the Social Security Act cases. *See supra* text accompanying notes 78-118.

128. Advice and consultation is another key factor in the meaning of management of the production under the income tax regulations. Treas. Reg. § 1.1402(a)-4(b)(3)(iii) (1986).

129. This is clearly a belated recognition of the cases holding that "material" is to be interpreted as meaning important or substantial, and that, if the owner makes, or participates to a material degree in making, a substantial number of important management decisions, he materially participates. *See, e.g.*, Celebrezze v. Miller, 333 F.2d 29 (5th Cir. 1964); Foster v. Celebrezze, 313 F.2d 604 (8th Cir. 1963); Conley v. Ribicoff, 294 F.2d 190 (9th Cir. 1961); Miller v. Fleming, 215 F. Supp. 691 (W.D. La. 1963).

130. This is emphasized in Treas. Reg. § 1.1402(a)-4(b)(3)(iii) (1986) as part of the decision on management of the production. In fact, that regulation places "particular importance" on inspections, together with advice and consultation. *Id.* The emphasis in both regulations on these activities is informative.

131. This is one factor in the production of a commodity. Treas. Reg. § 1.1402(a)-4(b)(3)(ii) (1986). The assumption of financial responsibility has been a crucial factor in many of the cases. *See, e.g.*, Celebrezze v. Miller, 333 F.2d 29 (5th Cir. 1964); Celebrezze v. Wifstad, 314 F.2d 208 (8th Cir. 1963); Foster v. Celebrezze, 313 F.2d 604 (8th Cir. 1963); Henderson v. Flemming, 283 F.2d 882 (5th Cir. 1960); Miller v. Flemming, 215 F. Supp. 691 (W.D. La. 1963).

132. This is specifically stated as one factor relevant to the determination of whether an owner has materially participated in the production of a commodity. Treas. Reg. § 1.1402(a)-4(b)(3)(ii) (1986).

> which qualifies as a trade or business, the participating decedent or heir's maintaining his or her principal place of residence on the premises is a factor to consider in determining whether the overall participation is material . . . .[133]

Therefore, the same tests are used in the section 2032A regulations (participation in the production or the management of the production) as are used in the regulations under section 1402 of the Code. All of the factors enumerated in the section 2032A regulations are contained in the section 1402 regulations or have been recognized by case law under the Social Security Act. The sole difference between the regulations under section 2032A, on one hand, and the regulations under section 1402 and the Social Security Act, on the other, is that the section 2032A regulations appear to contemplate involvement in several of the enumerated activities in order to constitute material participation. The unstated requirement of the section 2032A regulations appears to be that even if, for example, the decedent and the qualified heir (or members of their families) made most final management decisions, this would not be enough to constitute material participation without inspections or advice and consultation, or the assumption of financial responsibility for a substantial portion of the risk, or the maintenance of a home on the farm. This is reinforced by the requirement of the regulations that in the absence of full-time involvement, the requirements of the section 2032A regulations *in addition to* the requirements of the section 1402 regulations must be met.[134] An example in the regulations supports this thesis.[135] It should be remembered that the same argument was attempted in many of the cases previously discussed, and the courts have unanimously rejected that position.[136]

In light of the difference in tone and emphasis between the section 2032A regulations and the section 1402 regulations and the cases under the Social Security Act, an analysis of the regulations

133. Treas. Reg. § 20.2032A-3(e)(2). This factor was important in finding material participation in Colegate v. Gardner, 265 F. Supp. 987 (S.D. Ohio 1967).

134. Treas. Reg. § 20.2032A-3(e)(1) (1986).

135. Treas. Reg. § 20.2032A-3(g) (1986). Example (4) posits a qualified heir who is a lawyer and lives 15 miles from the farm. He arranges with an unrelated party to manage the farm. Under the arrangement, the qualified heir supplies all the machinery, assumes financial responsibility for all expenses, approves a crop plan each year, is required to approve all expenses over $100, inspects the farm weekly, and actively participates in management decisions. The example states that the qualified heir materially participated, but further states that there would be no material participation if the qualified heir did not inspect the farm regularly and participate in management decisions, even if he assumed financial responsibility for the operations and approved the annual crop plan.

136. *See supra* text accompanying notes 78-118.

and cases and the purposes of the statutes is necessary in order to formulate possible hypotheses of the interpretation of material participation under section 2032A.

## V. Comparison of the Statutes: Three Hypotheses

### *A. Similar Means the Same*

The first and perhaps most logical hypothesis is that when Congress said that for section 2032A purposes material participation shall be determined "in a manner similar to the manner used for purposes of paragraph (1) of section 1402(a),"[137] it meant that the words should have the same meaning in the two Code sections. After all, that is what similar means. Moreover, the regulations under the three statutes discussed (sections 2032A and 1402(a) of the Code and section 211(a)(1) of the Social Security Act) all use the same objects (production and the management of production) to which material participation must be directed. All the statutes list similar factors to be considered in determining whether material participation has been accomplished.[138] Additionally, in the regulations under all three sections, the key words, "production or management of production," are stated in the alternative. In many cases under the Social Security Act, the government contended that the presence of all or several of the factors mentioned are necessary to satisfy the material participation standard; the courts have unanimously rejected this position.[139] The difference in tone of the section 2032A regulations described above can be viewed as merely another IRS attempt to enforce a stricter standard, which should meet with no more success than its previous attempts.

One answer to the argument (to be made in the next subsection) that the purposes of the statutes are different and should be interpreted differently, is the cogent argument that Congress was aware of the relationship between section 1402(a) of the Code and section 211(a) of the Social Security Act and the cases under the Social Security Act when it enacted section 2032A and intended the same interpretation to govern.[140] Moreover, when words are used in several places in the same statute, they should be given the same mean-

137. I.R.C. § 2032A(e)(6).

138. Since the revision in the Social Security Act regulations, one must refer to the case law to determine these factors. *See supra* Section III.

139. *See, e.g.*, McCormick v. Richardson, 460 F.2d 783 (10th Cir. 1972); Celebrezze v. Benson, 314 F.2d 219 (8th Cir. 1963); Henderson v. Flemming, 283 F.2d 882 (5th Cir. 1960); Bridie v. Ribicoff, 194 F. Supp. 809 (N.D. Iowa 1961).

140. *See, e.g.*, Cannon v. University of Chicago, 441 U.S. 677, 694-99 (1979).

ing unless the context clearly requires otherwise. Uniformity of meaning and interpretation is highly desirable. If material participation is given a different meaning in section 2032A, a constitutional question of the validity of the section 2032A regulations may be raised.[141]

Lastly, and perhaps most importantly, the IRS has already admitted that section 2032A is a relief provision.[142] In light of the congressional history underlying section 2032A, this conclusion is obvious.[143] This characterization was recently recognized by an appellate court in another context.[144] Relief provisions of the Code are to be given a common sense interpretation, with the focus on the congressional intent, and an overly-restrictive interpretation of such statutes is to be avoided.[145] For all these reasons, material participation should receive the same interpretation in section 2032A as it has in section 1402(a) of the Code and section 211(a) of the Social Security Act.

### *B. Similar Means Stricter*

Section 1402(a)(1) of the Code and section 211(a)(1) of the Social Security Act[146] are opposite sides of the same coin. Section 1402(a) defines net earnings from self-employment income. Section 1401 of the Code imposes a tax on such earnings. Section 211(a) of the Social Security Act defines net earnings from self-employment income in the same way as section 1402(a) of the Code, but for the purpose of determining benefits to which a person is entitled.[147] Stated differently, the tax collected from persons having self-employment income (as well as the taxes collected on wages and other forms of income) provides the funds used to pay old age, survivor, and death benefits mandated by the Social Security Act. To be eligible to receive benefits under social security, one must have contributed to the fund through taxes on wages or self-employment income. The rationale behind the benefits is that persons whose income is

141. Indeed this question has already been raised, but the courts have so far avoided resolving the question. *See infra* Section VI.

142. Priv. Ltr. Rul. 80-52-011 (Sept. 18, 1980); Priv. Ltr. Rul. 80-46-021 (Aug. 8, 1980).

143. *See* Begleiter, *supra* note 3, at 22-25.

144. Estate of Thompson v. Commissioner, 864 F.2d 1128 (4th Cir. 1989).

145. Estate of Thompson v. Commissioner, 864 F.2d 1128, 1133-34 (4th Cir. 1989); Ross v. United States, 348 F.2d 577 (5th Cir. 1965) (interpreting § 2503(c)); Estate of Davis v. Commissioner, 86 T.C. 1156 (1986); Estate of Baumgardner v. Commissioner, 85 T.C. 445 (1985) (interpreting § 6512(b)).

146. 42 U.S.C. § 411(a)(1) (1982).

147. *See* 42 U.S.C. §§ 402, 403 (1982 & Supp. 1987).

reduced due to inability to work because of age or disability should have a portion of their former income replaced. Contributions to the fund are made during a person's productive years when earning capacity is the greatest. However, income that is not subject to reduction because of age or disability (such as rents) is excluded from the definition of self-employment income because there is no need to replace such income.[148] Only income from a trade or business that depends to some extent on the activity of the owner is included.[149]

The material participation standard regarding income from farming was enacted by the Social Security Amendments of 1956.[150] The purpose of the Act was clearly stated in the Report of the Senate Committee on Finance: "The bill thus would extend coverage under old-age and survivors insurance to certain farmers, who, though not covered under the present law, have income from work and therefore are exposed to the type of income loss against which the program is designed to afford protection."[151] The Senate Finance Committee, in discussing the amendment to the Social Security Act, also formulated the basis for a liberal interpretation of material participation: "Your Committee has consistently held the view that the coverage of the program should be as nearly universal as practicable."[152] Thus, coverage under the Social Security Act was broadened by the 1956 amendment.

If material participation is to be given a broad definition, farmers who materially participate are subject to tax on the income earned from farming in cases in which such income results at least partially from their activity and, in turn, will be able to collect social security benefits based on their earnings from farming when they are no longer able to farm and their incomes (presumably) are diminished. A liberal interpretation of material participation in favor of broad coverage clearly accords with the statement of purpose in the Report of the Senate Finance Committee to tax self-employment income earned during periods of significant farming activity and pay social security benefits during periods of decreased activity and lower income. This analysis is strengthened by viewing social security benefits as, in a sense, an inexact "repayment" of the social security

148. I.R.C. § 1402(a)(1); 42 U.S.C. § 411(a)(1) (1982 & Supp. 1987).

149. I.R.C. § 1402(a); 42 U.S.C. § 411(a) (1982 & Supp. 1987).

150. Act of Aug. 1, 1956, ch. 836, tit. II, § 104(c)(2), 70 Stat. 824-25. Section 1402(a)(1) of the Code was similarly amended by Act of Aug. 1, 1956, ch. 836, tit. II, § 201(e)(2), 70 Stat. 840-42.

151. S. REP. NO. 2133, 84th Cong., 2d Sess. 8, *reprinted in* 1956 U.S. CODE CONG. & ADMIN. NEWS 3877, 3884.

152. *Id.* at 1, U.S. CODE CONG. & ADMIN. NEWS at 3878.

taxes previously paid.

Section 1402(a)(1) and section 211(a)(1) of the Social Security Act are parallel.[153] If, as has been shown, material participation in the latter is to be interpreted broadly so as to approach universal coverage (within the limits set by Congress), the same interpretation should govern that phrase in section 1402(a)(1) of the Code. Such an interpretation is consistent with the congressional purpose.

It is much more difficult to view section 2032A in such terms. Section 2032A is an exception to the normal estate tax rule valuing property at its fair market value.[154] Exceptions in tax statutes are to be strictly construed.[155] Moreover, many tests in addition to material participation must be met in order to take advantage of special use valuation.[156] In addition, section 2032A was aimed at providing relief for only one group of farmers—family farmers who were forced to sell their farms to pay estate taxes.[157] Section 2032A was intended as a solution for a narrowly defined problem, justifying the many requirements for qualification.

The type of person Congress wished to benefit was not in doubt. It was the person who lived on and farmed his own land with the help of his family and who expected his children to farm the land when he died. As Senator Nelson expressed it:

> For 100 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 came to care about their employees, their customers, their churches, schools and hospitals. They work in the local charities and clubs and are the cement of community life.[158]

Absent from the debate on special use valuation are two important policies underlying section 211(a) of the Social Security Act and Code section 1402(a)—universal coverage and a "return of past payments"—that have greatly influenced the liberal interpretation of

153. Henderson v. Flemming, 283 F.2d 882, 887 (5th Cir. 1960).

154. I.R.C. § 2031; Treas. Reg. § 20.2031-1(b) (1986).

155. Universal Oil Prods. v. Campbell, 181 F.2d 451, 457 (7th Cir.), *cert. denied*, 340 U.S. 850 (1950); Commissioner v. Swent, 155 F.2d 513, 517 (4th Cir. 1946), *cert. denied*, 329 U.S. 801 (1947); United States v. Stiles, 56 F. Supp. 881, 883 (W.D. Ark. 1944); Wallace v. United States, 50 F. Supp. 178, 179 (W.D.N.Y. 1943), *rev'd on other grounds*, 142 F.2d 240 (2d Cir.), *cert. denied*, 323 U.S. 712 (1944). *See also* United States v. Stewart, 311 U.S. 60, 71 (1940).

156. *See supra* text accompanying notes 18-25.

157. *See supra* text accompanying note 9-28; Begleiter, *supra* note 3, at 17-26.

158. 122 CONG. REC. 25948-49 (1976).

material participation in the decided cases.

Moreover, the inclusion of the material participation requirement may have had the additional purpose of confining the benefits of section 2032A to family farms.[159] Congress did not wish to benefit corporate agribusiness; rather, it desired to keep as much farmland as possible in the hands of family farmers and prevent large agricultural corporations from purchasing farmland from families of small farmers who were forced to sell the land to pay estate taxes. By requiring material participation, which had a relatively well-defined meaning by the mid-1970s, Congress attempted to ensure that farms owned by large landowners or farm corporations would not qualify.[160] The material participation requirement, particularly by its focus on decision-making, effectively eliminates the large farm corporation from qualifying under section 2032A. The narrower the reading of material participation given by the courts, the fewer the number of estates that will qualify for special use valuation. A strict interpretation of material participation for section 2032A, so the argument goes, will restrict those qualifying for its benefits to a class much closer to the congressional ideal of the family farmer.[161]

This discussion permits the section 2032A regulations to be evaluated in a different light. Possibly implicitly recognizing the strength of the foregoing argument, the regulations were deliberately conceived and developed to implement the congressional purpose. The factors to be weighed in determining material participation were deliberately made cumulative, rather than alternative.[162] Possibly the intent of the regulations is that making managerial decisions should not be sufficient to constitute material participation. More should be required.[163] The idea may be to require so much activity that most "absentee landlords" will be unable to or not attempt to fulfill the requirements, thereby restricting the benefits of special use valuation to "true family farmers," as Congress intended. Moreover, requiring several activities to satisfy the material participation test may encourage those wishing to take advantage of special use valuation to

159. HOUSE REPORT, *supra* note 10, at 5.

160. As previously stated, § 1402(a) of the Code was amended in 1974 to exclude vicarious material participation by agents. Act of Aug. 7, 1974, Pub. L. No. 93-368, § 10(b), 88 Stat. 420 (1974). It is unlikely that a large landowner or any one officer of a large corporation would be involved in sufficient activity as to any one farm to materially participate under the case law.

161. *See supra* text accompanying note 158.

162. Treas. Reg. § 20.2032A-3(e)(2) (1986).

163. For example, a combination of decision-making, advice, consultation, furnishing of resources, and physical labor.

increase their farming activities and become "family farmers" in the sense Congress envisioned. In this connection, the statement in the regulations that the maintenance of the decedent's principal place of residence on the farm is a factor in determining material participation takes on added significance.[164] Living on the farm is the essence of the congressional ideal of the family farmer.

### *C. The Middle Ground*

Despite the force of the arguments for a stricter standard, it is highly unlikely that the courts will support such an interpretation. First, the overriding statutory command that material participation is to be given a similar meaning to that term in section 1402(a)[165] of the Code carries great weight. Second, uniformity of interpretation in the tax laws, especially when clearly indicated by Congress, is highly important. Third, Congress presumably was aware of the interpretation by the courts of material participation under the Social Security Act and the parallel between section 211(a) of that Act and Code section 1402(a) when it enacted section 2032A.[166] Fourth, even though the tone of the section 2032A regulations suggests that more is required to satisfy the material participation standard under section 2032A than under section 1402, the regulations use the same general factors (production or the management of the production) as the regulations under section 1402; both regulations state these factors as alternatives; and the activities under each category in the section 2032A regulations are the same factors used in the section 1402 regulations and the case law under the Social Security Act. Cumulatively, these arguments carry great weight.

Furthermore, in another context, the Court of Appeals for the Fourth Circuit has recently recognized that section 2032A is a relief measure, "a means whereby Congress sacrifices federal tax revenues to encourage a given type of behavior,"[167] in this case, fostering family farms. The court noted that the congressional intent that "the federal estate tax should not be the ruin of legitimate family businesses" was clear.[168] In such cases, "Congress has declared that this statute be given a common sense interpretation, one with an eye towards protecting the family farm and business."[169] The court quoted

164. Treas. Reg. § 20.2032A-3(e)(2) (1986).
165. I.R.C. § 2032A(e)(6).
166. *See, e.g.*, Cannon v. University of Chicago, 441 U.S. 677, 694-99 (1979).
167. Estate of Thompson v. Commissioner, 864 F.2d 1128, 1136 (4th Cir. 1989).
168. *Id.* at 1133.
169. *Id.* at 1134.

with approval the following statement of the Tax Court: "When Congress clearly demonstrates an intent to preserve an institution, such as the family farm and family owned businesses, a common sense approach should be applied, and the technical inadequacies of the statute should be subservient to the overriding Congressional intent."[170] Under a "common sense" approach, material participation in section 2032A, in almost all cases, should be interpreted similarly to Code section 1402(a) and the cases decided under the Social Security Act.

In addition, the major argument justifying a stricter standard (that such a standard is necessary to accomplish the congressional purpose) is undermined by the fact that such a purpose can be accomplished by giving material participation a broad interpretation among the class Congress wished to benefit. Congress clearly wished to make the benefits of special use valuation available to family farmers. Consistent with this purpose, material participation could be broadly interpreted to include all family farmers who meet the other requirements of the statute. Such an interpretation would produce the same result as the stricter interpretation without raising the question of whether the section 2032A regulations are invalid by requiring greater activity than is required under Code section 1402, thus violating section 2032A(e)(6).

Under this standard, material participation would be given the same interpretation in section 2032A as it is under Code section 1402(a). The cases decided under the Social Security Act would be used as precedents, except when to do so would allow land owned by a decedent who clearly did not fit the congressional mold to qualify.

## VI. Material Participation Under Section 2032A in the Courts

### *A. The Early Cases*

*1. Estate of Coon v. Commissioner.*[171]—The most significant of the early cases is the *Coon* case. Decedent owned an interest in three farms, and her brother, on behalf of decedent, executed leases with experienced farmers. The leases were somewhat ambiguous as to participation by the landlords.[172] The system of crop rotation established by decedent's father before 1950 was generally followed, but each year decedent's brother "and the tenants discussed the

170. *Id.* (quoting Estate of Davis v. Commissioner, 86 T.C. 1156 (1986)).

171. 81 T.C. 602 (1983).

172. *Id.* at 603-05. The court did not treat this as significant, but focused on actual participation.

planned crops for the succeeding year, especially when major changes in the rotation system were contemplated."[173] Since the tenants were experienced farmers, many of the production decisions, such as when to plow, fertilize, disk, plant, and harvest, were made by the tenants without consultation. However, decedent's brother was consulted on improvements and major repairs.[174] In accordance with the custom in the area, the tenants provided all the production machinery. Neither decedent nor any member of her family resided on the farm.[175]

Although neither decedent nor her brother performed any physical work on the farm, decedent's brother maintained detailed financial records on the farm operation and prepared an annual report.[176] He consulted regularly (once or twice a week) with one of the tenants who acted as liaison between him and the other tenants.[177] He regularly inspected the farms by automobile during summer evenings, and also after major storms, when he looked for damage.[178] The landlords also paid for a portion of seed and fertilizer.[179]

Emphasizing the section 2032A regulations, the Tax Court ruled that decedent, through her brother, did not materially participate.[180] While admitting that the landlords assumed a substantial portion of the operating expenses of the farms and that decedent's brother did participate in management decisions and approve major expenditures, the court noted that the advice, consultation, and decision-making required the brother's attention on an infrequent basis.[181] Moreover, the court ruled that the estate had not established the extent to which his conversations with the liaison tenant related to the actual operations of the farms.[182] In light of the fact that the tenants made many of the operating decisions, the court concluded that decedent's brother did not participate in a substantial number of final management decisions.[183] Furthermore, the viewing of the farms on evenings and some weekends from a car and checking on

173. Estate of Coon v. Commissioner, 81 T.C. 602, 605-06 (1983).
174. *Id.* at 606.
175. *Id.*
176. *Id.*
177. *Id.*
178. Estate of Coon v. Commissioner, 81 T.C. 602, 606 (1983).
179. *Id.* at 609. The lease required the landlord to assume one-half of the cost of seed, property taxes, fire, and wind insurance on the residence and all buildings used to store grain and machinery. *Id.* at 610.
180. *Id.* at 611.
181. *Id.* at 609-10.
182. *Id.* at 612.
183. Estate of Coon v. Commissioner, 81 T.C. 602, 612-13 (1983).

damage after major storms did not constitute inspecting the production activities.[184]

The estate further argued that the section 2032A regulations are invalid to the extent that they require a higher standard of activity than the regulations under Code section 1402(a)(1).[185] The court found it unnecessary to decide this question because it decided that the activities of decedent and her brother did not satisfy the material participation standard of regulation section 1.1402(a)-4(b).[186] The court determined that the advice and consultation with the tenants was limited to crop rotation and not the production decisions, that decedent did not inspect the production activities, that the tenants furnished the machinery, but that the landlords assumed a substantial portion of the financial responsibility of producing the crops. The court concluded that this set of facts did not amount to material participation in the management of production.[187]

A number of points in the *Coon* opinion are noteworthy. First, the court gave great emphasis to the section 2032A regulations; indeed, the opinion consists entirely of an analysis of whether decedent or a member of her family satisfied the regulations. Second, the court emphasized (as do the regulations) the importance of activities related to actual production—such as plowing, planting, disking, and harvesting—and indicated that inspections must be of these activities to assume significance. Third, the court's decision that decedent did not materially participate under section 1402 made it unnecessary to determine whether regulation section 20.2032A-3 was invalid to the extent that it imposed a higher standard than the regulations under section 1402(a)(1). If the stricter standard approach previously described[188] is adopted, this becomes an extremely significant question that remains unresolved.

However, the most astounding thing about the *Coon* opinion is that the court neither cites nor discusses *any* cases in support of its conclusion that the decedent did not satisfy the material participation requirement. This is significant since there are cases finding material participation that involved each of the aspects present in *Coon*. *Bridie v. Ribicoff*[189] and *Henderson v. Flemming*[190] indicate that the

184. *Id.* at 610.
185. *Id.* at 611.
186. *Id.*
187. *Id.* at 612.
188. *See supra* Section V.B.
189. 194 F. Supp. 809 (N.D. Iowa 1961).
190. 283 F.2d 882 (5th Cir. 1960).

furnishing of a substantial amount of capital, without more, is sufficient to constitute material participation. In *Celebrezze v. Miller*,[191] the landlord spoke no English.[192] It is hard to believe that his consultation with the tenants was more productive than that of Frank Coon. In *Colegate v. Gardner*,[193] decedent made two fifteen-minute inspections during planting time and went "around the outside of the crops"[194] during the growing season, approximately what was done by Mr. Coon. In *Bridie*, the tenant furnished all the farm machinery.[195] And in both *Bridie*[196] and *Colegate v. Gardner*,[197] the owner and tenant made managerial decisions jointly, almost never disagreeing. Both courts viewed this joint decision-making as entirely natural between two experienced farmers, having no substantial influence on the material participation decision.[198] In every case cited in this paragraph, the court found that material participation existed for Social Security Act purposes. Although the lack of furnishing of farm machinery and the making of many production decisions by the tenant without consulting the landlord makes *Coon* a closer case, it is entirely possible that under the cases just discussed, the *Coon* facts constitute material participation. The failure of the court in *Coon* to discuss these cases is inexplicable and renders the decision questionable at best.

*2. Schuneman v. United States.*[199]—From the time she acquired an interest in the farm in 1956, decedent operated the farm, hiring neighboring farmers to plant and harvest the crop.[200] From 1969 to 1975, she had a crop share lease with a neighboring farmer under which decedent clearly materially participated.[201] Decedent's health deteriorated, and in 1976 she and the same tenant executed a fixed rent lease.[202] The lease was modified in 1977 to provide a rent adjustment clause. During 1976, decedent continued to advise and

191. 333 F.2d 29 (5th Cir. 1964).
192. *Id.* at 30.
193. 265 F. Supp. 987 (S.D. Ohio 1967).
194. *Id.* at 989.
195. 194 F. Supp. 809 (N.D. Iowa 1961).
196. *Id.* at 814.
197. 265 F. Supp. 987, 989 (S.D. Ohio 1967).
198. Colegate v. Gardner, 265 F. Supp. 987, 989 (S.D. Ohio 1967); Bridie v. Ribicoff, 194 F. Supp. 809, 814 (N.D. Iowa 1961).
199. 783 F.2d 694 (7th Cir. 1986), *rev'g in part and vacating in part*, 570 F. Supp. 1327 (C.D. Ill. 1983). *See also* 84-1 U.S. Tax Cas. (CCH) ¶ 13,561 (D.C. Ill. 1984).
200. 783 F.2d at 695.
201. *Id.* at 695-96.
202. *Id.* at 696.

consult with the tenant and inspect the production facilities.[203] Decedent died on April 23, 1977.[204] The major issue in the case was whether decedent was using the land for a qualified use at the date of her death.[205]

The opinion of the trial court is confusing. After correctly stating that qualified use and material participation are separate requirements,[206] the trial court held that the qualified use requirement could be satisfied by showing that the decedent materially participated in the operation of the farm during the year of her death, thus combining the two requirements.[207] On the trial of that issue, the court directed a verdict for the government, ruling that decedent did not materially participate at her death.[208] This ruling is, of course, correct in that the only activities performed by decedent under the 1977 lease were allowing the tenant to store grain in her storage bins and repairing some farm buildings.[209] However, since the requirements are separate, material participation at death does not satisfy the qualified use requirement. Moreover, there is no statutory requirement that decedent materially participate in the operation of the farm on the date of death.[210] The estate did not appeal the district court's decision that decedent failed to materially participate at her death, but did appeal the ruling that the 1977 lease was not substantially dependent on production.[211] On appeal, the government conceded that decedent satisfied all the conditions for special use valuation except for qualified use.[212] This concession removed any material participation issue from the case. The court of appeals decided that the rent reduction clause made the lease substantially dependent on production, thus satisfying the qualified use text.[213] Because decedent was clearly materially participating for five of the eight years prior to her death, *Schuneman* is of little use to an analysis of material participation.

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203. *Id.*

204. Schuneman v. United States, 783 F.2d 694, 696 (7th Cir. 1986).

205. *Id.* at 697.

206. 570 F. Supp. 1327, 1330 (C.D. Ill. 1983), *rev'd in part and vacated in part*, 783 F.2d 694 (7th Cir. 1986). *See also* Martin v. Commissioner, 783 F.2d 81, 82 (7th Cir. 1986); Burch v. United States, 86-2 U.S. Tax Cas. (CCH) ¶ 13,692 (N.D. Ind. 1986).

207. 570 F. Supp. at 1331.

208. *Id. See also* 84-1 U.S. Tax Cas. (CCH) ¶ 13,561 (D.C. Ill. 1984).

209. 570 F. Supp. at 1331.

210. I.R.C. § 2032A(b)(1)(C)(ii) requires only that material participation exist for five of the eight year period ending on the date of the decedent's death.

211. Schuneman v. United States, 783 F.2d 694, 697 (7th Cir. 1986).

212. *Id.* at 698.

213. *Id.* at 701.

*3. Estate of Sherrod.*[214]—In this case, most of the land owned by the decedent was in timber, the remainder was cropland and pasture.[215] From 1952 to 1972, decedent personally inspected the timberland several times a year, paid the taxes on the land, negotiated the contracts for selective cutting of the timber over the years, and supervised the cutting.[216] The cropland and pasture were rented to an unrelated third party for a cash rental.[217] The rental agreements were negotiated and supervised by decedent.[218] Decedent and his son maintained regular contacts with the tenants of the cropland and pasture.[219] When decedent entered a nursing home in 1972, he conveyed the land to a revocable trust with his two children as trustees.[220] From 1972 until decedent's death in 1977, decedent's son, as trustee, performed the managerial services his father had performed until 1972.[221] The court held that these activities constituted material participation by the decedent and by his son, as trustee.[222]

The court's main emphasis was that decedent had managed an active farming business and made every management decision with respect to the property.[223] The government argued that decedent's activities did not take a great deal of time and that decedent failed to construct fire trails, prune dead and undesirable growth, and thin the timber from time to time.[224] The court rejected that argument, ruling that the nature of timber farming does not require a great deal of time or labor.[225] Decedent devoted the time necessary to perform all managerial functions and made every management decision, which was sufficient to constitute material participation.[226] On appeal, this portion of the decision was affirmed.[227]

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

215. *Id.* at 525.

216. *Id.* at 533.

217. *Id.*

218. *Id.*

219. Estate of Sherrod v. Commissioner, 82 T.C. 523, 533 (1984), *rev'd on other grounds*, 774 F.2d 1057 (11th Cir. 1985).

220. *Id.* at 528.

221. *Id.* at 528-29.

222. *Id.* at 534-35.

223. *Id.* at 534.

224. Estate of Sherrod v. Commissioner, 82 T.C. 523, 535 (1984), *rev'd on other grounds*, 774 F.2d 1057 (11th Cir. 1985).

225. *Id.* at 535-36.

226. *Id.* at 535-36.

227. 774 F.2d at 1063. The appellate court, however, found that the qualified use standard was not met as to the crop and pasture land. The estate had argued, and the Tax Court agreed, that all decedent's eligible land could be combined into one business based on the custom of the locality to do so and that such combination was consistent with good management practices. *Id.* at 1065. The Court of Appeals disagreed, ruling that nonqualifying prop-

The main importance of *Sherrod* lies with the court's affirmance of the principle of the regulations that year-round activity is not necessary during periods when the nature of the business does not require a great deal of activity[228] and its emphasis on the making of managerial decisions as satisfying the material participation regulations.

### *B. The Recent Cases*

*1. Estate of Heffley v. Commissioner.*[229]—This was the easiest of the recent cases to decide. From 1972 to 1976, decedent's farm was rented to her brother-in-law under a crop share arrangement.[230] From 1976 to 1980, it was rented to him for a cash rent.[231] In 1981, the year of decedent's death, after decedent had conveyed the land to a revocable trust, the trustee leased the land to a cousin under a cash rent lease.[232] Under all the leases, the tenants had full responsibility for the management of the farm.[233] None of the leases called for any participation by the decedent or the trustee.[234] For the entire period, decedent's poor health prevented her from performing any work on the farm.[235] Although her son performed occasional minor chores, these were not sufficient to constitute material participation.[236] Neither decedent nor her son made any management decisions nor advised or consulted with the tenants as to these decisions.[237] Neither inspected the crops nor assumed financial responsibility for the farm operations.[238] The decedent did not treat the farm income as self-employment income on her tax returns.[239] Given these facts, the Tax Court could only reach the conclusion that neither decedent nor any member of her family materially participated.[240]

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erty must be functionally related to qualifying property to qualify. *Id.* at 1066. The crop and pasture land were not functionally related to the timber business conducted by the decedent. *Id.* at 1067. Since the fair market value of the timberland constituted only 26% of the adjusted gross estate, the 50% test of I.R.C. § 2032A(b)(1)(A) was not met. *Id.*

228. Treas. Reg. § 20.2032A-3(e)(1) (1986).
229. 89 T.C. 265 (1987).
230. *Id.* at 267.
231. *Id.*
232. *Id.* at 268.
233. *Id.* at 267-68.
234. Estate of Heffley v. Commissioner, 89 T.C. 265, 267-68 (1987).
235. *Id.* at 272.
236. *Id.* at 274.
237. *Id.*
238. *Id.*
239. Estate of Heffley v. Commissioner, 89 T.C. 265, 274 (1987).
240. *Id.* at 275.

*2. Estate of Coffing v. Commissioner*[241] and Estate of Ward v. Commissioner.[242]—In two cases decided on the same day with opinions written by the same judge, the Tax Court continued its practice of relying almost exclusively on the section 2032A regulations. In *Coffing*, decedent never resided on either farm for which a section 2032A election was made.[243] About twelve years prior to her death, decedent contracted with a corporate farm operator to manage one of the farms.[244] Beginning three years before decedent's death, the hired farm operator also managed decedent's other farm.[245] Decedent took extended trips from Indiana to Texas to visit her brother during the eight year period preceding her death; she also spent significant periods in hospitals and nursing homes.[246] The lease provided that decedent maintain a bank account to be drawn on by the managers to pay taxes, insurance, management charges, and other expenses.[247] The manager studied the property, selected tenants (subject to the owner's approval), and managed the farms completely.[248] The only duties and rights of the owner under the lease were to approve major capital expenses, tenants, and the type of tenure.[249] The decedent furnished one-half of most expenses, but no machinery.[250] In 1965, shortly after signing the farm service contract, decedent and a representative of the manager discussed and selected the basic plan of operating the farm, which did not change until decedent's death.[251] The farm manager did discuss the farm operation with decedent about once a month, and took decedent to inspect the farms monthly. The visits lasted about one hour. Decedent did inspect the quarterly and yearly reports provided by the corporate manager, but rarely vetoed its recommendations.[252] The farm income was not reported as self-employment income on decedent's tax returns.[253]

The court found that decedent did not materially participate.[254]

241. 53 T.C.M. (CCH) 1314 (1987).
242. 89 T.C. 54 (1987).
243. Estate of Coffing v. Commissioner, 53 T.C.M. (CCH) 1314, 1314 (1987).
244. *Id.* at 1316.
245. *Id.* at 1319.
246. *Id.* at 1315.
247. *Id.* at 1316.
248. Estate of Coffing v. Commissioner, 53 T.C.M. (CCH) 1314, 1316 (1987).
249. *Id.* at 1315-16.
250. *Id.* at 1316-18.
251. *Id.* at 1317-18.
252. *Id.* at 1318.
253. Estate of Coffing v. Commissioner, 53 T.C.M. (CCH) 1314, 1319 (1987).
254. *Id.* at 1323.

In an opinion strikingly similar to *Coon*[255] (and which, indeed, spent most of its time comparing the facts to those in *Coon*), the court concluded that although decedent did inspect the production activities to a greater extent than did the decedent in *Coon*, she was less involved in decision-making.[256] Overall, the court found no significant difference between the cases that would necessitate a different result.[257]

The decision in *Coffing* is subject to the same criticisms as *Coon*, on which it is based. Granting that because most of the decisions were made by the representative of the farm manager the case becomes close, decedent occasionally did reject the recommendations of the manager, inspected the farms periodically, and assumed significant financial responsibility for the farm operation. Again, the decision neither cited nor discussed the cases under the Social Security Act. The case represents the Tax Court's adoption of the view that material participation in section 2032A should be interpreted more strictly than under section 1402.

In *Ward*, decedent resided on the farm.[258] For the eight years prior to her death, the farm was operated by a tenant under a crop share arrangement.[259] Under the arrangement, the tenant furnished all the equipment, decedent furnished the entire cost of liming the soil and the installation of drainage tile, and they split the cost of seed, fertilizer, herbicide, and insecticide.[260] The court noted that a grain farm the size of decedent's farm requires only about three weeks of working days during the year to plow, plant, spray ditches, mow roadsides, and harvest.[261] Decedent observed the operation of the farm daily from her residence, consulted with the tenant once or twice a week on production activities, inspected the fields, maintained books of farm income and expenses, subscribed to several farm publications, and followed the daily market reports.[262]

The Tax Court, in an opinion similar in form to *Coon*[263] and

255. Estate of Coon v. Commissioner, 81 T.C. 602 (1983). *See supra* notes 171-98 and accompanying text.

256. Estate of Coffing v. Commissioner, 53 T.C.M. (CCH) 1314, 1323 (1987).

257. *Id.* at 1322-23.

258. Estate of Ward v. Commissioner, 89 T.C. 54, 54-55 (1987).

259. *Id.* at 64. The tenant had share cropped the farm with decedent and her husband since 1940. Prior to her husband's death in 1970, decedent was actively involved in the farming operation. *Id.* at 55-57.

260. *Id.* at 56.

261. *Id.*

262. *Id.* at 57-58.

263. Estate of Coon v. Commissioner, 81 T.C. 602 (1983). *See supra* notes 171-98 and accompanying text.

*Coffing*,[264] found that decedent had materially participated.[265] The court noted that the farming operation was entirely mechanized, which was common in the area.[266] The court also noted that the tenant picked his corn early and dried it with drying equipment he owned.[267] Decedent, who did not own such equipment, left the corn in the field until the moisture content and market prices were best for harvesting and sale.[268] The court emphasized this as evidence of decedent's independent decision-making, supporting it with the fact that decedent usually sold her portion of the crop immediately, whereas the tenant sometimes stored his portion of the crop or sold it on the futures market.[269] This evidence of decision-making, coupled with the decedent's residence on the farm and her frequent advice, consultation, and inspections, and her assumption of financial responsibility, convinced the court that the material participation standard was satisfied.[270] The court also emphasized that decedent consulted with the tenant directly, rather than using a farm manager or other agent.[271]

Therefore, at this point we have the Tax Court in a series of decisions insisting on a stricter standard under section 2032A than under section 1402 and refusing to consider the Social Security Act cases. The few decisions of other federal courts show no common thread and appear to rest on the facts of each case.

*3. Mangels v. United States.*[272]—For at least two reasons, *Mangels* is probably the most important material participation case decided. First, it is the first case decided by a court of appeals on close facts. Second, and more important, it changed the analysis used in determining material participation under section 2032A. Therefore, a rather extensive recitation of the facts is appropriate.

Decedent, Luella Mangels, died in 1980. From 1966 until her death, decedent was physically and mentally incapacitated and unable to handle her own affairs.[273] She was a ward of a voluntary conservatorship. From 1974 until her death, Northwest Bank served as

264. Estate of Coffing v. Commissioner, 53 T.C.M. (CCH) 1314 (1987). *See supra* notes 241-57 and accompanying text.
265. Estate of Ward v. Commissioner, 89 T.C. 54, 65 (1987).
266. *Id.* at 63.,
267. *Id.* at 64-65.
268. *Id.* at 56-57.
269. *Id.* at 64-65.
270. Estate of Ward v. Commissioner, 89 T.C. 54, 65 (1987).
271. *Id.*
272. 828 F.2d 1324 (8th Cir. 1987), *rev'g*, 632 F. Supp. 1555 (S.D. Iowa 1986).
273. *Id.* at 1325.

decedent's court-appointed conservator, with Lage, a vice-president of the bank, performing all acts for the conservator relating to the management of the farm.[274] Neither decedent nor any member of her family resided on the farm during the eight years preceding her death.[275] The farm income was not reported as self-employment income on decedent's tax returns because the conservator did not understand the "complex provisions of the Internal Revenue Code and related regulations."[276] The farm was leased to two tenants who were experienced farmers.[277] All machinery and implements used on the farm were furnished by tenants, but decedent, through the conservator, paid one-half of the cost of fertilizer, seed, pesticide, and herbicide and the full cost of installing tile lines.[278] From 1974 until 1980, Mr. Lage's activities respecting the farm were:

1. Giving daily attention to farm market reports for about fifteen minutes a day.

2. Execution of futures contracts to market the decedent's share of grain for about three and one-half hours a year. This was necessary because the farm had no on-site storage facilities.

3. Physical inspection of the growing crop and farm ground for fence and tile repairs once each quarter for about two hours each inspection.

4. Contact with tenant once a month concerning progress of the crop, cultivation, herbicide, and pesticide decisions lasting approximately one hour each consultation.

5. During the winter, counseling the tenant concerning crop decisions for the next year and the next year's operating plans and operating loan application for one and one-half to two hours.

6. Analyzing the cash equivalent rental of the crop-share proceeds to evaluate the advisability of renewal of the lease for about four hours.

7. Undertaking extraordinary projects such as the construction of drainage tile in 1979. This project occupied twenty to twenty-five hours.[279]

Almost all decisions regarding the operation of the farm were

274. Mangels v. United States, 632 F. Supp. 1555, 1556 (S.D. Iowa 1986), *rev'd*, 828 F.2d 1324 (8th Cir. 1987).

275. *Id.* at 1555.

276. *Id.*

277. *Id.* at 1559.

278. *Id.* at 1557, 1560.

279. Mangels v. United States, 632 F. Supp. 1555, 1556-57 (S.D. Iowa 1986), *rev'd*, 828 F.2d 1324 (8th Cir. 1987).

made jointly by Mr. Lage and the tenants.[280] Major conservation practice decisions, the marketing of the conservator's share of the crop, and installation of tile lines were the exclusive responsibility of the conservator.[281] Mr. Lage stated that though there were few disagreements with the tenant as to operating decisions, the conservator did override the tenant's suggestions on occasion.[282]

In a short opinion, the District Court held that the conservator's activities did not constitute material participation, emphasizing that the frequency of consultation with the tenant was low, the inspections did not take much time, and that no agent of the conservator lived on the farm, did any physical work on the farm, or furnished any machinery used in production.[283] The court stated: "In short, the conservator's participation appears to have been no greater than that of the landlord in the typical crop-share lease arrangement. That is not enough to constitute 'material participation' under the statute."[284]

The court of appeals reversed and remanded for entry of a judgment in favor of the estate.[285] The court stated that the major factors in determining material participation were advising and consulting with the tenant on the operation of the farm and participation in a substantial number of final management decisions.[286] The court found that the monthly and annual conferences between the conservator and the tenant and the joint decision-making process as to crop patterns and rotation, fertilizer application, chemical, weed, and insect control, fence repair, plowing and minimum tillage techniques, seed purchasing, and crop planting and harvesting met these minimum standards.[287] The court further noted that of the four other factors listed in the section 2032A regulations, two were present in this case.[288] To the IRS's contention that the inspections were inade-

280. *Id.* at 1557.
281. *Id.*
282. *Id.* at 1558.
283. *Id.* at 1559-60.
284. Mangels v. United States, 632 F. Supp. 1555, 1560 (S.D. Iowa 1986), *rev'd*, 828 F.2d 1324 (8th Cir. 1987).
285. 828 F.2d 1324, 1325-26 (8th Cir. 1987).
286. *Id.* at 1327.
287. *Id.* at 1327-28.
288. *Id.* The four factors mentioned by the court are:
1. Regular inspection of production activities;
2. Advancement of funds and assumption of financial responsibility for a substantial portion of the farm's operating expense;
3. Furnishing of a substantial portion of the machinery, implements, and livestock; and
4. Maintenance of a principal residence on the farm.

quate because they took only two hours each, the court responded that the sufficiency of the inspections is to be measured against the need for inspections; regularity does not necessarily mean time-consuming.[289] Here, since the inspections related to less than a quarter section, the total time necessary was minimal.[290] The court also ruled that the failure to pay self-employment taxes on the farm income was not fatal when the failure was explained and material participation is demonstrated.[291]

Perhaps most importantly, the court of appeals repudiated the district court's statement that the typical activities of a landlord under a crop-share lease are insufficient to constitute material participation, stating that the regulation requires no such comparison and that to make such a comparison imposed a burden of proof "greater than necessary to effectuate the purpose of the statute."[292] In a footnote, the court strongly implied that the cases under the Social Security Act would be relevant in determining material participation under section 2032A.[293]

The court then ruled that acts of a conservator would be considered to be acts of the decedent for purposes of section 2032A.[294] To do otherwise, the court noted, would yield the "absurd consequences" of discouraging creation of conservatorships—which should be encouraged as in the best interests of the ward's estate—by imposing a higher estate tax for a person placed in a conservatorship.[295]

The *Mangels* case is vitally important in the quest for a standard of material participation under section 2032A. The court clearly stated that in order to materially participate, a decedent need

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The court ruled that the first two factors were present in this case. *Id.* at 1328. *See* Treas. Reg. § 20.2032A-3(e)(2) (1986).

289. 828 F.2d at 1328.

290. Mangels v. United States, 828 F.2d 1324, 1328 (8th Cir. 1987).

291. *Id.* The explanation was the failure of the conservator to understand the complicated provisions of the Code. *Id.* at 1325. The estate also agreed to pay any tax due, together with interest and penalties. *Id.* at 1328.

292. *Id.* at 1327.

293. The court's footnote stated:

> Section 211(a)(1) of the Social Security Act provides replacement income to farm owners and tenants who materially participate in the production or management of production of agricultural or horticultural commodities. *Although case law interpreting that section is not necessarily applicable in analyzing I.R.C. § 2032A*, this court has determined that landlord participation beyond the normal amount is an improper standard for determining material participation under the Social Security Act. *Foster v. Celebrezze*, 313 F.2d 604, 607-08 (8th Cir. 1963) (emphasis added).

*Id.* at 1327 n.7.

294. *Id.* at 1329-30.

295. Mangels v. United States, 828 F.2d 1324, 1329-30 (8th Cir. 1987).

not perform acts exceeding those of a landlord in a typical crop-share lease. This is clearly consistent with the case law under the Social Security Act previously discussed. And, although it was unnecessary to determine the extent of the applicability of the Social Security Act cases to section 2032A, the court's footnote clearly indicates that the principles of these cases will be utilized to determine material participation for the purposes of special use valuation.[296] Indeed, in evaluating the facts of the *Mangels* case, the court used the standards of the Social Security cases.[297]

*4. Estate of Donahoe v. Commissioner.*[298]—The new mode of analysis was immediately reflected in the Tax Court. Decedent's husband (until his death in 1968), daughter (Brockman), son-in-law, and grandchildren farmed the land owned by the decedent in a family farm operation.[299] During the relevant period, three of the tracts were actively farmed by decedent's daughter, the daughter's husband, and decedent's grandchildren.[300] The fourth tract was used as pasture for the family's beef cattle operation.[301] For five of these years, this tract was leased to a neighbor because there was not enough cattle owned by the family to utilize all the pastureland of this tract. The rental was for cash.[302] Under the lease, the daughter's husband agreed to build new fences and replace old fences to protect against damage to his property by the tenant's cattle.[303] The lease, which was oral, was expressly only for summers (May-June through October-November).[304] The plot was not used by anyone during the winter months because there was no grass remaining on it.[305] Decedent's family pastured their cattle on the remainder of this tract and used the cattle barn and storage barns on the tract for the family farming operation.[306] Decedent resided in the house on that tract until her death.[307] During two of the years in question, decedent's daughter, son-in-law, and grandchildren constructed new fences, repaired other fences, and monitored and repaired drain tiles on the

296. *Id.* at 1327 n.7.
297. *See id.* at 1326-30.
298. 56 T.C.M. (CCH) 271 (1988).
299. *Id.* at 272.
300. *Id.*
301. *Id.*
302. *Id.*
303. Estate of Donahoe v. Commissioner, 56 T.C.M. (CCH) 271, 272 (1988).
304. *Id.* at 272.
305. *Id.*
306. *Id.* at 273.
307. *Id.*

entire tract.[308]

Noting that the statute was a relief measure, the court ruled that the material participation standard was satisfied by use in the winter months of the lease periods.[309] During these months, the tenants did not and could not use the property.[310] The decedent's family had exclusive control over the property, maintained a presence on the property, and took care of the upkeep.[311] Citing and discussing *Mangels* extensively, the court ruled that by taking control of and maintaining the land, building and repairing fences, mowing weeds, putting in and monitoring drain tiles, and maintaining the land in a satisfactory state, the decedent's family materially participated.[312] Decedent's son-in-law was on the tract, if not the specific acres, at least once a week during both the winter and summer months,[313] and decedent's family assumed the financial risk of any damage to the property.[314] The court concluded:

> In short, the Brockman's participation in the upkeep of the farmland during the winter months was adequate to maintain this land as farmland during the nonproducing, or in this case nonproductive season. Thus, the Brockmans were materially involved with the physical upkeep and management of the land during the qualified winter months while the lessees had no contact with the pasture land during these months in any way, shape or form. We therefore do not agree with respondent's contention that the activities on the property must be viewed in the context of decedent's and Brockman's participation in the lessee's cattle operation. The focus of this discussion is the material participation of the decedent or the Brockmans in the winter months because the summer months are not the "qualified period" at issue.[315]

Comparing this case with the same court's discussion in *Coon* reveals a startling transformation in analysis. Gone is the restrictive tone. Gone is the emphasis on production activities. Gone is the emphasis on a restrictive interpretation. Emphasized is the relief nature of the statute and the family farm operation. The influence of the *Mangels* approach is clear. *Donahoe* indicates that future cases will

308. Estate of Donahoe v. Commissioner, 56 T.C.M. (CCH) 271, 273 (1988).
309. *Id.* at 273-74.
310. *Id.* at 275.
311. *Id.*
312. *Id.* at 274-75.
313. Estate of Donahoe v. Commissioner, 56 T.C.M. (CCH) 271, 275 (1988).
314. *Id.*
315. *Id.*

be analyzed under a much more liberal and less restrictive standard.

## VII. Conclusion

Section 2032A requires that material participation be determined "in a manner similar to the manner used for the purposes of section 1402(a)."[316] The Internal Revenue Service, in an attempt to limit the number of estates able to elect special use valuation, issued regulations[317] that appear to require a higher standard of activity than the regulations under section 1402 and the cases decided under the parallel section of the Social Security Act. The purpose of section 2032A, as described in the congressional hearings and reports, is ambiguous on this question. The early cases appear to adopt, at least in part, the IRS position. The *Mangels*[318] case, however, represents a turning point in the interpretation process. The court in *Mangels* clearly stated that material participation could be satisfied by the activity required under the normal crop share lease.[319] *Mangels* and *Sherrod*[320] emphasize a common sense interpretation of the statute consistent with its purpose. This is exactly the approach taken by the cases under the Social Security Act. *Mangels* strongly implies that the Social Security Act cases are relevant to the interpretation of material participation under section 2032A and will be regarded as precedents in such cases.[321] This analysis was used by the Tax Court (which had decided *Coon*,[322] the most important case prior to *Mangels*) in *Donahoe*,[323] which represented a marked shift in the analysis used by the Tax Court. The recent cases indicate that the interpretation of material participation to be employed in future cases under section 2032A will be the same as and rely on the Social Security Act cases, except where to do so would violate the congressional purpose of preserving the family farm. Such an interpretation will conform to the congressional ideal, eliminate the problem of whether the section 2032A regulations are void because they conflict with the statute, and offer practitioners a clear guide to determine

316. I.R.C. § 2032A(e)6).
317. Treas. Reg. § 20.2032A-3 (1986).
318. Mangels v. United States, 828 F.2d 1324 (8th Cir. 1987).
319. *Id.* at 1327.
320. Estate of Sherrod v. Commissioner, 82 T.C. 523 (1984), *rev'd on other grounds*, 774 F.2d 1057 (11th Cir. 1985).
321. Mangels v. United States, 828 F.2d 1324, 1327 n.7 (8th Cir. 1987).
322. Estate of Coon v. Commissioner, 81 T.C. 602 (1983).
323. Estate of Donahoe v. Commissioner, 56 T.C.M. (CCH) 271 (1988).

whether the leases they draw satisfy the material participation requirement and whether the estates they handle will qualify for special usevaluation.