Martin v. Commissioner, 84 T. C. 620 (1985)

A cash lease of farm property by heirs can trigger estate tax recapture if it deviates from the qualified use established at the time of the decedent's death.

Summary

The heirs of John A. Fischer inherited a family farm and initially continued its qualified use under a sharecrop lease. However, the personal representative later entered into a one-year cash lease with a third party, which the court found to be a cessation of the qualified use, triggering estate tax recapture under IRC Section 2032A. The court emphasized that the cash lease, unlike the sharecrop arrangement, did not maintain the farm's use as a farming business, which was essential for continued qualification under the special use valuation rules. This case underscores the importance of maintaining the same qualified use post-death to avoid recapture tax.

Facts

John A. Fischer died in 1978, leaving a 209-acre family farm to his seven heirs. At his death, the farm was under a sharecrop lease with his son-in-law, Anthony Martin. The estate elected special-use valuation under IRC Section 2032A. In 1979, the personal representative, John R. Fischer, terminated the sharecrop lease and entered into a one-year cash lease with Droege Farms, an unrelated third party. This lease was opposed by two heirs and approved by the local probate court.

Procedural History

The Commissioner of Internal Revenue determined deficiencies in estate tax against each heir due to the alleged cessation of qualified use. The Tax Court reviewed the case and held that the cash lease constituted a cessation of qualified use, triggering additional estate tax under IRC Section 2032A(c)(1)(B).

Issue(s)

1. Whether the cash lease of the farm to Droege Farms constituted a cessation of qualified use by the heirs under IRC Section 2032A(c)(1)(B).

Holding

1. Yes, because the cash lease to Droege Farms was a cessation of the qualified use as it was not a continuation of the farming business that qualified the property for special use valuation.

Court's Reasoning

The court applied IRC Section 2032A, which requires continued qualified use post-

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death to avoid recapture tax. The court distinguished between a sharecrop lease, which involves an equity interest in farming, and a cash lease, which does not. The court cited Estate of Abell v. Commissioner, where a similar cash lease did not qualify for special use valuation. The court rejected the heirs' arguments that the cash lease was necessary under state law or that their participation in farm maintenance constituted qualified use. The legislative intent behind Section 2032A was to encourage continued farming, not passive rental, as noted in the court's reference to the House Ways and Means Committee report.

Practical Implications

This decision emphasizes the need for heirs to maintain the same qualified use of property post-death to avoid estate tax recapture. Attorneys advising estates should ensure that any lease agreements post-death continue the same qualified use that qualified the property for special valuation. The ruling impacts estate planning for family farms, highlighting the risks of switching from sharecrop to cash leases. Subsequent cases have followed this precedent, reinforcing the importance of maintaining active farming operations to retain special use valuation benefits.

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