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

Cash rental of specially valued farmland by qualified heirs triggers estate tax recapture, and the statute of limitations for assessment begins upon IRS notification, even without specific regulations.

Summary

In Stovall v. Commissioner, the heirs of Mary E. Keyes' estate leased farmland, which had been valued under IRC section 2032A, to a co-heir on a cash rental basis within 15 years of her death. The IRS argued this constituted a cessation of qualified use, triggering recapture tax. The heirs disclosed this arrangement via a questionnaire to the IRS. The court ruled that the cash rental did indeed trigger recapture but held that the IRS was notified of the cessation when it received the completed questionnaire, starting the three-year statute of limitations. Consequently, the IRS's notices of deficiency were untimely, barring assessment of additional estate taxes.

Facts

Mary E. Keyes died on March 19, 1980, leaving four parcels of farmland in Sarpy County, Nebraska, which were elected for special use valuation under IRC section 2032A. One parcel, the Stovall farm, was devised to Mary Eileen Stovall in trust, later distributed to her children, who deeded a life estate back to her. Within 15 years of Keyes' death, Stovall leased the farm to her brother, Clarence O. Keyes, under a cash rental agreement. The IRS sent a questionnaire to the heirs' designated agent, which disclosed the cash rental. The IRS later determined a cessation of qualified use but issued notices of deficiency more than three years after receiving the questionnaire.

Procedural History

The IRS issued notices of deficiency to the heirs on June 6, 1991, asserting additional estate taxes due to the cessation of qualified use. The heirs petitioned the Tax Court, which assigned the case to a Special Trial Judge. The court adopted the judge's opinion, finding for the petitioners on the statute of limitations issue.

Issue(s)

1. Whether the cash rental of the qualified real property by the heirs constituted a cessation of qualified use under IRC section 2032A(c)(1)(B), triggering additional estate tax liability.
2. Whether the IRS was notified of the cessation of qualified use under IRC section 2032A(f) when it received the completed questionnaire, thereby starting the three-year statute of limitations for assessment.

Holding

1. Yes, because the cash rental arrangement was deemed a passive rental activity, resulting in a cessation of qualified use under IRC section 2032A(c)(1)(B).
2. Yes, because in the absence of specific regulations, the completed questionnaire received by the IRS constituted notification under IRC section 2032A(f), starting the three-year statute of limitations, which had expired by the time the notices of deficiency were issued.

Court's Reasoning

The court applied IRC section 2032A(c)(1)(B), holding that a cash rental agreement is not a qualified use, following precedent from cases like Williamson v. Commissioner. For the statute of limitations issue, the court interpreted IRC section 2032A(f), which requires notification to the IRS of a cessation of qualified use. Without specific regulations defining notification, the court compared it to similar provisions in sections 1033 and 1034, which allow notification through means other than a formal return. The court concluded that the IRS was notified when it received the completed questionnaire disclosing the cash rental, despite the absence of a statement labeling it as such. This started the three-year period, which had expired by the time the notices of deficiency were issued, barring further assessment.

Practical Implications

This decision clarifies that cash rentals of specially valued property can trigger estate tax recapture, impacting estate planning strategies for farmland. It also establishes that, in the absence of specific regulations, notification to the IRS under IRC section 2032A(f) can occur through means other than formal returns, such as questionnaires. This ruling emphasizes the importance of timely and accurate disclosure of changes in property use to the IRS to avoid untimely assessments. Subsequent cases have followed this precedent, reinforcing the need for clear communication with the IRS regarding property use changes.