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TAX LAW—I.R.C. SECTION 2032A SPECIAL USE VALUATION: ESTATE OF THOMPSON v COMMISSIONER, 864 F.2D 1128 (4th Cir. 1989)

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NOTES AND COMMENTS


INTRODUCTION

In 1976, Congress enacted a provision as part of the Tax Reform Act\(^1\) which was designed to assist the agricultural sector of the national economy and reduce the exodus of farmers from farming.\(^2\) This provision incorporated section 2032A, "special use valuation," into the Internal Revenue Code ("I.R.C."). Section 2032A allows "qualified" farms and small businesses to save federal estate taxes by valuing the farm or business at its current use, rather than the "highest and best" use.\(^3\)

The legislative history of section 2032A indicates that the preservation of family farms and businesses was a primary concern of the drafters.\(^4\) However, as seen in the recent case of Estate of Thompson v. Commissioner,\(^5\) differing interpretations of the statute and its legislative history have led to confusing and contradictory applications. In particular, courts have struggled to resolve conflicts arising in situations where some component of the family farm belongs to non-family members. In those situations, the question arises whether the existence of this non-family component disqualifies an otherwise qualified,
predominantly family-owned farm from the benefits of special use valuation. Courts have attempted to protect the predominantly family-owned farm without expanding the application of special use valuation beyond its intended scope.

In determining eligibility for special use valuation, courts must initially determine if the family farm was "acquired from or passed from the decedent to a qualified heir of the decedent."\(^6\) This Note will discuss and evaluate the dilemma faced by the judiciary in applying conflicting interpretations of "qualified heir" under section 2032A. Section I discusses the legislative history of the statute, the specific eligibility requirements, and the judicial interpretations of special use valuation. Section II presents the *Estate of Thompson*\(^7\) case, in which the United States Court of Appeals for the Fourth Circuit allowed special use valuation to be applied proportionally to that portion of the family farm that passed into the hands of a qualified heir. This is in contrast to the alternative approach, based on a strict reading of the statute, that would allow special use valuation only if the entire estate passed to qualified heirs.\(^8\) Section III examines the contrasting views regarding the relative importance of the legislative intent versus the statutory language in the interpretation of section 2032A. In addition, section III balances the concerns expressed by the majority and dissenting opinions. Ultimately, section III makes a recommendation for a legislative amendment to section 2032A which will allow an estate to pass a statutorily defined "minor interest" to a non-qualified heir yet remain eligible for special use valuation.

I. SPECIAL USE VALUATION—SECTION 2032A

A. The Structure of Section 2032A

The Tax Reform Act of 1976, which created the original section 2032A,\(^9\) introduced a change in the valuation area of federal estate taxation. The change was embodied in section 2003 of the Act, which was incorporated in the Internal Revenue Code as section 2032A. Section 2032A involves the valuation for estate tax purposes of certain real property devoted to farming or closely held businesses.\(^10\) In order for an estate to qualify for section 2032A special use valuation, the


\(^7\) 864 F.2d 1128.

\(^8\) See *Estate of Cowser v. Commissioner*, 736 F.2d 1168, 1171-72 (7th Cir. 1984).


\(^10\) *Id.*
following requirements must be met:\footnote{11}

1. The decedent must have been a United States citizen or resident at the time of his death;\footnote{12}

2. The executor had to elect the application of section 2032A\footnote{13} and file a written agreement signed by every individual who had an interest in the property\footnote{14} consenting to the application of the recapture provisions;\footnote{15}

3. The real property must be located in the United States;\footnote{16}

4. On the date of the decedent's death, the property must have been used by the decedent or a member of the decedent's family\footnote{17} for a qualified use;\footnote{18}

5. Fifty percent or more of the adjusted value of the gross estate\footnote{19} must consist of the adjusted value of real or personal property which, at the time of decedent's death, was used for a qualified use and was acquired from the decedent or passed from the decedent to a qualified heir;\footnote{20}

6. Twenty-five percent or more of the adjusted value of the gross estate must consist of the adjusted value of real property being used for a qualified use on the date of the decedent's death;\footnote{21}

7. During an eight-year period prior to the decedent's death, an aggregate period of five years or more must exist during which time (a) the property was owned by the decedent or a member of the dece-
dent's family and was used for a qualified use, and (b) the decedent or a member of the decedent's family materially participated in the operation of the farm or other business.\textsuperscript{22}

Section 2032A on its face, therefore, requires that certain requirements must be met prior to eligibility for special use valuation. While the statute specifies that the property must pass to a qualified heir,\textsuperscript{23} it does not describe the outcome in a situation where some portion of the farm or other qualified property passes to a non-qualified heir. As a result, it is helpful to examine the subsequent amendments to section 2032A and its legislative history in order to determine how the courts have resolved this dilemma.

Section 2032A permits real property used for farming purposes\textsuperscript{24} or a closely held business to be valued for estate tax purposes on the basis of its current use as a farm or business, rather than on the basis of its fair market value.\textsuperscript{25} The legislative history reinforced that Congress, through special use valuation, attempted to alleviate the problem of farmers who were forced to sell their farms in order to pay federal estate taxes.\textsuperscript{26} The Report of the House Ways and Means Committee detailed the reasons for the change:

[W]hen land is actually used for farming purposes or in other closely held businesses (both before and after the decedent's death), it is inappropriate to value the land on the basis of its potential "highest and best use" especially since it is desirable to encourage

\textsuperscript{22} Id. § 2032A(b)(1)(C).
\textsuperscript{23} See supra note 20 and accompanying text.
\textsuperscript{24} The terms "farming purposes" and "farm" are defined in section 2033(a) of the Tax Reform Act of 1976, which was incorporated into I.R.C. § 2032A(e)(4)-(5). "The term 'farm' includes stock, dairy, poultry, fruit, furbearing animal, and truck farms, plantations, ranches, nurseries, ranges, greenhouses or other similar structures used primarily for the raising of agricultural or horticultural commodities, and orchards and woodlands." I.R.C. § 2032A(e)(4) (1988). "Farming purposes" means:

(A) cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm;

(B) handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and

(C) (i) the planting, cultivating, caring for, or cutting of trees, or (ii) the preparation (other than milling) of trees for market.

Id. § 2032A(e)(5).
\textsuperscript{25} H.R. REP. No. 1380, supra note 3, at 5, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 3356, 3359.
\textsuperscript{26} Id. at 21-22, reprinted in 1976 U.S. CODE CONG. & ADMIN. NEWS 3356, 3375-76.
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.\textsuperscript{27}

Since its original enactment in 1976, section 2032A has been amended a number of times. An understanding of the primary amendments to section 2032A is necessary in order to determine the legislative purpose, which in turn, is key to an understanding of the case law.

B. \textit{Statutory Amendments to Section 2032A}

1. The Revenue Act of 1978

The first amendment to directly affect special use valuation was contained within the Revenue Act of 1978.\textsuperscript{28} While the majority of the changes to section 2032A were technical corrections and clarifications,\textsuperscript{29} section 2032A(b)(1) was amended to apply the special election provision only to interests passing to qualified heirs.\textsuperscript{30}


The second set of amendments to section 2032A were made as

\textsuperscript{27} Id., reprinted in 1976 U.S. CODE CONG. \& ADMIN. NEWS 3356, 3375-76.
\textsuperscript{28} See Pub. L. No. 95-600, 92 Stat. 2763.
\textsuperscript{29} The Revenue Act of 1978 made further additions to section 2032A, through the adoption of sections 2032A(e)(9), 2032A(e)(10), and 2032A(c)(6). Section 2032A(e)(9) was added to clarify the criteria whereby property is considered to have been obtained from a decedent. Section 2032A(e)(10) was added for cases involving community property. Section 2032A(c)(5) was added to allow the substitution of a bond instead of personal liability of a qualified heir, in the event of recapture. Revenue Act of 1978, Pub. L. No. 95-600, §§ 701-703, 92 Stat. 2763, 2897-932, 2939-44. For a discussion of the "recapture period," see infra note 33.
\textsuperscript{30} Prior to the Revenue Act of 1978, it was unclear whether the remaining interest in a farm or business should also be valued under special use valuation if it did not pass to a "qualified heir." 65 Stand. Fed. Tax Rep. (CCH) § 515 (Nov. 2, 1978).
Both technical and substantive changes were made to section 2032A as a result of ERTA. Following ERTA, the qualified use requirement under section 2032A(b)(1) could be satisfied if either the decedent or a member of the decedent’s family actively used the property. However, the qualified heir who owned the real property following the decedent’s death must have used it personally throughout a ten year period.

Furthermore, ERTA amended the material participation requirement of section 2032A(b). Prior to 1981, section 2032A(b) required that an individual must have materially participated in the operation of the qualified property for at least five of the eight years preceding the decedent’s death. ERTA’s amendment provided that a surviving spouse who inherited real property from a decedent spouse, whose estate was valued at its current use value, may include the deceased spouse’s material participation in order to meet the active management requirement.

ERTA provided other substantive changes. One change included enlarging the definition of property acquired by the qualified heir to include property purchased by the heir from the estate. The “member of the family” definition of I.R.C. § 2032A(e)(2) was amended for special use valuation purposes to include only an individual’s ancestor, spouse, lineal descendant, lineal descendant of the indi-

32. Prior to ERTA, only active use by the decedent would be considered a qualified use. See ERTA § 421(b)(1), 95 Stat. 172, 306.
33. ERTA reduced the “recapture period” from 15 years to 10 years. S. REP. NO. 144, 97th Cong., 1st Sess. 136, reprinted in 1981 U.S. CODE CONG. & ADMIN. NEWS 105, 236. The Senate Report of the Economic Recovery Tax Act of 1981 originally discussed this “recapture period” as follows:

If, within 15 years after the death of the decedent (and before the death of the qualified heir), the property is disposed of to non-family members or ceases to be used for farming or other closely held business purposes, all or a portion of the Federal estate tax benefits obtained by virtue of the reduced valuation are recaptured by means of a special “additional estate tax” imposed on the qualified heir. Id. at 132, reprinted in 1981 U.S. CODE CONG. & ADMIN. NEWS 105, 232.
36. Among other changes, ERTA amended I.R.C. § 2032A(2)(A) to increase the maximum reduction in fair market value of qualified property. See ERTA § 421(a), 95 Stat. 172, 306. Additionally, ERTA amended I.R.C. § 2032A(c)(7), granting qualified heirs a two-year grace period to begin the qualified use, after which time the recapture tax would be imposed. See ERTA § 421(c)(2)(A), 95 Stat. 172, 307.
37. ERTA § 421(j)(2), 95 Stat. 172, 312 (amending I.R.C. § 2032A(e)(9)).
individual's spouse, lineal descendant of the individual's parent, or the spouse of any lineal descendant.\textsuperscript{38}

3. The Tax Reform Act of 1984

The Tax Reform Act of 1984 added I.R.C. § 2032A(d)(3), which provided an estate with the opportunity to perfect a notice of special use valuation election where the estate tax return is in substantial compliance under state law, and included the signatures of all parties having a present or remainder interest.\textsuperscript{39}

Section 2032A has gone through a number of substantive changes since its original enactment in 1976. The amendments to section 2032A reflect a trend toward increased liberalization of the availability of the section. In fact, ERTA's proposed changes were designed to expand the availability of current use valuation to estates not eligible under the prior law, to enable additional farm estates to take advantage of a simplified valuation formula, and to reduce the post-death restrictions on qualified heirs who inherit specially valued real property.\textsuperscript{40} Nevertheless, the statutory language remained unclear in the situation where a percentage of the interest in a farm passed to a non-qualified heir. An examination of prior case law may therefore be helpful in resolving this dilemma.

C. Precedent

A review of the cases in which the courts have interpreted the qualified heir requirement reveals different outcomes with respect to eligibility for election of special use valuation. However, a recurring theme in the cases is the constant reference to Congress' purpose in enacting section 2032A.

In \textit{Estate of Davis v. Commissioner},\textsuperscript{41} the decedent devised a portion of his estate to two trusts. The first trust went to the decedent's widow. The second trust, which contained farm property, went to his three children, one of whom was a child by a previous marriage.\textsuperscript{42} The second trust was to terminate on the death of the last of the three children, with the corpus distributed to surviving descendants of the children or to three institutions, should the children die without

\textsuperscript{38} Id. § 421(i), 95 Stat. 172, 312 (amending I.R.C. § 2032A(e)(2)).


\textsuperscript{40} S. REP. No. 144, supra note 33, at 133, \textit{reprinted in} 1981 U.S. CODE CONG. & ADMIN. NEWS 105, 233; see supra note 36 and accompanying text.

\textsuperscript{41} 86 T.C. 1156 (1986).

\textsuperscript{42} Id.
The estate utilized special use valuation for the farm property
given to the second trust. However, the Internal Revenue Service
("I.R.S.") assessed an estate tax deficiency since all the successive
interests were not "qualified heirs." The Tax Court rejected the I.R.S.'s position, holding that the estate did qualify for special use valuation. The court reasoned that it was extremely unlikely that the non-qualified class of contingent beneficiaries would obtain the property. The court further indicated that if the I.R.S.'s estate tax regulations were applied, the legislative purpose behind the enactment of section 2032A "as a relief provision to permit continued farming or business operations by the decedent's family" could not be achieved. The court concluded that the regulation was invalid to the extent that it was inconsistent with the congressional intent of preserving family farms and businesses.

Similarly, the Tax Court in Estate of Clinard v. Commissioner allowed election of special use valuation. In Estate of Clinard, the decedent bequeathed a life interest in farmland to her two children, their spouses, and to her three grandchildren. The grandchildren had a special power of appointment over their remainder interests. Should the grandchildren not exercise their power of appointment and die without descendants, the property was to be distributed to the Univer-

43. Id.
44. Id. at 1162.
45. The I.R.S. disallowed the election because the ultimate remainder beneficiaries of the trust, i.e., the charitable institutions, did not fall within the qualified heir requirement of section 2032A(e)(1). Id.
46. Id. at 1167-68.
47. Id. at 1166-67.
48. Id. at 1163 (quoting Treas. Reg. § 20.2032A-8(a)(2) (as amended in 1963)). The Internal Revenue Service's Estate Tax Regulation section 20.2032A-8(a)(2) provides:
   If successive interests (e.g. life estates and remainder interests) are created by a decedent in otherwise qualified property, an election under section 2032A is available only with respect to that property (or portion thereof) in which qualified heirs of the decedent receive all of the successive interests, and such an election must include the interests of all those heirs. . . . Where successive interests in specially valued property are created, remainder interests are treated as being received by qualified heirs only if such remainder interests are not contingent upon surviving a nonfamily member or are not subject to divestment in favor of a non-family member.
49. Estate of Davis, 86 T.C. at 1163.
50. Id. at 1167-68.
51. 86 T.C. 1180 (1986).
52. Id.
53. Id.
sity of Illinois, an "unqualified person" within the meaning of section 2032A.\textsuperscript{54} The I.R.S. determined that the decedent's estate was not entitled to special use valuation under section 2032A since a possibility existed, however remote, that all of the successive interests might not pass to qualified heirs.\textsuperscript{55}

The Tax Court, however, held that the special use valuation could be used as the decedent's interest in the farmland did pass to qualified heirs for the purpose of utilizing section 2032A.\textsuperscript{56} The court held that congressional concern for the effect of an estate tax upon family farms justified allowing special use valuation in this case.\textsuperscript{57} Since the congressional purpose in enacting section 2032A was to aid in the preservation of family farms, the court believed that the remote possibility of an interest passing to an unqualified heir should not defeat the decedent's dispositive scheme which, in all other respects, fits within the congressional intent.\textsuperscript{58} The court further stated that a restrictive interpretation of section 20.2032A-8(a)(2) of the Estate Tax Regulations\textsuperscript{59} would be "fundamentally unfair."\textsuperscript{60}

In contrast, the courts of appeals in both \textit{Estate of Cowser v. Commissioner}\textsuperscript{61} and \textit{Whalen v. United States}\textsuperscript{62} denied special use valuation for failing to meet the qualified heir requirement. In \textit{Estate of Cowser}, the decedent devised his farm to his deceased wife's grandniece and her husband.\textsuperscript{63} The grandniece, as executrix of the estate, attempted to elect special use valuation for estate tax purposes.\textsuperscript{64} The I.R.S. determined that she was not a "qualified heir" within the meaning of section 2032A and thus imposed a federal estate tax deficiency.\textsuperscript{65}

The Tax Court upheld the I.R.S.'s decision.\textsuperscript{66} The court of appeals affirmed, indicating that "qualified heir" under section

\begin{itemize}
\item \textsuperscript{54} \textit{Id.} at 1183. See \textit{supra} note 20 for a definition of "qualified heir" under section 2032A(b)(1)(A).
\item \textsuperscript{55} \textit{Estate of Clinard}, 86 T.C. at 1181-82. The parties agreed that the requirements for special use valuation were met, with the exception of section 2032A(b)(1), which requires that the property "was acquired from or passed from the decedent to a qualified heir of the decedent." \textit{Id.} at 1184.
\item \textsuperscript{56} \textit{Id.} at 1189-90.
\item \textsuperscript{57} \textit{Id.} at 1183.
\item \textsuperscript{58} \textit{Id.}
\item \textsuperscript{59} See \textit{supra} note 48.
\item \textsuperscript{60} \textit{Estate of Clinard}, 86 T.C. at 1189.
\item \textsuperscript{61} 736 F.2d 1168 (7th Cir. 1984).
\item \textsuperscript{62} 826 F.2d 668 (7th Cir. 1987).
\item \textsuperscript{63} 736 F.2d at 1170.
\item \textsuperscript{64} \textit{Id.}
\item \textsuperscript{65} \textit{Id.}
\item \textsuperscript{66} \textit{Id.}
2032A(e)(1) included only the lineal descendants of a decedent's grandparents, not the lineal descendants of a decedent's spouse's grandparents. Therefore, the court determined that the grandniece was not a "qualified heir" under the "plain language" of the statute. The court further stated that "[i]t is a common rule of statutory construction that when the plain language of a statute is clear, courts need look no farther than those words in interpreting the statute." However, the court did indicate that where the words of a statute are at odds with the legislative policy, courts may look beyond the words to interpret the statute in a manner which is consistent with the intent of Congress.

The court noted that allowing the appellants to take advantage of the special use valuation provision might further the congressional goal of saving family farms. However, the court was not willing to conclude that adhering to the precise language of the statute was so "plainly at variance with congressional intent that we should presume Congress did not mean what it said when it defined 'qualified heir.'"

Similarly, the court of appeals denied election of special use valuation in *Whalen v. United States*. In *Whalen*, the decedent devised farmland to her three sons and one stepdaughter. The estate elected special use valuation under section 2032A, and was allowed special use valuation for the 75% interest which was devised to qualified heirs. However, the estate was denied the special use valuation for the quarter interest devised to the stepdaughter, stating she was not a qualified heir within the meaning of section 2032A. The estate argued that section 2032A did not require property to pass to a qualified heir until the amendments were incorporated by the Revenue Act of 1978. The court of appeals dismissed this argument, stating that the 1978 amendment of section 2032A clarified a technical defect in the preexisting law, but did not alter the previous requirement that property must pass to a member of the decedent's family in order for the recipient to be classified as a qualified heir. Therefore, since a stepdaughter did not qualify as a "member of the family" under section 2032A, the court disallowed the special use valuation election on the

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67. *Id.* at 1172.
68. *Id.* at 1171.
69. *Id.*
70. *Id.*
71. 826 F.2d 668 (7th Cir. 1987).
72. *Id.*
73. *Id.* at 669.
74. *Id.; see supra* note 29.
75. *Whalen*, 826 F.2d at 669.
property interest devised to her.\textsuperscript{76} While the courts' interpretation of the "qualified heir" requirement may initially appear inconsistent, the factual distinctions between the cases may explain the differences in outcomes. In *Estate of Davis v. Commissioner*\textsuperscript{77} and *Estate of Clinard v. Commissioner*,\textsuperscript{78} the immediate heirs were all qualified heirs. There existed only a remote possibility that the non-qualified successive interest would obtain the property. As such, the court allowed special use valuation in keeping with the congressional intent of preserving the family farm. In contrast, the concurrent interests in *Estate of Cowser v. Commissioner*\textsuperscript{79} and *Whalen v. United States*\textsuperscript{80} were not all qualified heirs. Thus, a much greater possibility existed that the property would not stay within the family. The disallowance of special use valuation in those cases was nevertheless consistent with the congressional purpose, but simultaneously attempted to limit blatant disregard of the statutory language of section 2032A.

II. ESTATE OF THOMPSON V. COMMISSIONER\textsuperscript{81}

In the recent case of *Estate of Thompson v. Commissioner*,\textsuperscript{82} the court was again faced with the problem of balancing congressional intent with apparent statutory inadequacies.

A. Factual Background

Among other assets, the decedent Thompson, at the time of his death on May 8, 1982, owned four farms in Maryland.\textsuperscript{83} He devised these farms to a trust naming a daughter, Susan Taylor, as trustee.\textsuperscript{84} The annual income of the trust was to be distributed in the following manner: 30% to each of the decedent's two daughters; the lesser of 2% or $2000 to Marie Brittingham, an individual unrelated to the decedent; and 2% to a trust advisory committee.\textsuperscript{85} The trustee was to hold in reserve the remaining net income, to be used for careful reinvestment into the operation. The trust was to remain in effect until the

\textsuperscript{76} Id.
\textsuperscript{77} 86 T.C. 1156 (1986).
\textsuperscript{78} 86 T.C. 1180 (1986).
\textsuperscript{79} 736 F.2d 1168 (7th Cir. 1984).
\textsuperscript{80} 826 F.2d 668 (7th Cir. 1987).
\textsuperscript{81} 864 F.2d 1128 (4th Cir. 1989).
\textsuperscript{82} Id.
\textsuperscript{83} Id. at 1129.
\textsuperscript{84} Id. at 1130.
\textsuperscript{85} Id.
death of the last survivor among the daughters and Brittingham. At such time, the property was to be divided equally between the two daughters' estates.86

The estate subsequently elected to utilize the special use valuation of I.R.C. § 2032A on two of the farms, reducing the fair market value from $1,027,007 to $327,307.87 On January 15, 1986, the I.R.S. rejected the election and issued a $509,957 notice of deficiency in payment.88

B. Decisions of the Tax Court and the Fourth Circuit Court of Appeals

The Tax Court sustained the I.R.S.'s determination of a deficiency in federal estate taxes, in the amount of $500,267.89 The court ruled that for an interest in qualified real property to be eligible for special use valuation under I.R.C. § 2032A, all interests must pass to qualified heirs. The court concluded that the interest which passed to Brittingham, a non-qualified heir, disqualified all of the property from special use valuation.90

The primary issue on appeal was whether real property is eligible for special use valuation when all the interests devised do not pass to qualified heirs.91 The Court of Appeals for the Fourth Circuit determined that an interest in real property was eligible for special use valuation as long as the requirements of the statute were met, and the interest was subsequently passed to and held by qualified heirs, "regardless if other minor interests in the property are passed to and held by non-qualified heirs."92 As such, the Thompson estate qualified for special use valuation on the 98% interest in the real property which passed to the decedent's daughters.93

86. Id.
87. Id.
88. Id.
89. Id. The Tax Court altered the amount of the deficiency after determining the fair market value of the farms. See id. at 1130 n.1.
90. Id. at 1130.
91. In its determination of the issue in the case, the court was concerned with both concurrent and successive interests in the real property passing to qualified heirs. Id. at 1131.
92. Id. at 1134.
93. Id. at 1135. The court also noted that qualified real property retains eligibility for election under special use valuation in situations where qualified heirs have the power to appoint their interest to non-qualified heirs. Id. at 1136.
C. Analysis by the Court of Appeals

In its analysis, the court initially examined the language of I.R.C. § 2032A(b)(1), which defines "qualified real property." The court stated that the statute imposed limitations on the transfer of qualified real property only to the extent that it comprises 50% of the adjusted value of the gross estate, that it is put to a qualified use, and that it passes to a qualified heir. A strict statutory construction could therefore result in the estate properly electing special use valuation on 98% of the value of the property.

However, the court noted that, since the language of the statute did not expressly answer the question of concurrent interests in real property, a certain deference must be given to the I.R.S., as it is the agency charged with enforcement of the Internal Revenue Code. Therefore, the court conducted a review of the legislative history in an attempt to find support for the I.R.S.'s position that "real property" as used in section 2032A means a 100% fee interest in the property. The majority opinion indicated that the congressional intent in enacting section 2032A clearly demonstrated a desire to preserve the family farm and small family-owned businesses, and that legislative intent should not be defeated by technical inadequacies. Thus, despite the deference given to the I.R.S., its statutory interpretation of section 2032A was rejected as contrary to the overriding congressional intent.

Similarly, the court rejected the I.R.S.'s argument that allowing special use valuation in this case would result in "larger and larger interests in family operations being left outside the family and inevitably result in the erosion of the family-owned nature of these businesses which Congress sought to protect." The court indicated that the I.R.S.'s concern was not a problem due to the "stringent" criteria that...
must be met prior to eligibility for special use valuation.102

Overall, the court did agree with the I.R.S.'s contention that a narrow statutory construction should be given when a statute grants relief from taxation.103 However, the court further pointed out that the tax relief offered under section 2032A is a means whereby Congress may strike a balance between generating tax revenue and preserving family farms and businesses. Since the I.R.S. tried to tip the scales to the benefit of enhancing revenue through "overly restrictive interpretations," the court indicated that its decision was an attempt to even the balance while still adhering to the statutory language and the legislative intent.104

The dissent in Estate of Thompson presented a different account of the congressional intent behind I.R.C. § 2032A. While agreeing that the overall purpose of special use valuation was to allow family farms to be preserved from one generation to the next, the dissent stated that the legislature did not intend for the protective provisions of section 2032A to extend to income interests bequeathed to non-qualified heirs.105 Since the statute carefully defined the categories of "qualified heirs"106 and the character of "qualified real property,"107 the dissent argued that Congress did not intend special use valuation to apply to situations where interests were proportionally devised to non-family members, as no specific language in the statute pertained to this situation.108 By allowing special use valuation for property in which a non-qualified heir retains an income interest, the dissent indicated that the congressional purpose of protecting family farms would be altered to a general tax preference for real property devised for agricultural purposes.109

Furthermore, the dissent argued that provisions for proportionality were discussed within the statute under the recapture tax and the qualified real property provision.110 The dissent indicated that the existence of these provisions "makes more glaring the absence of any provision for proportional devises to non-qualifying heirs."111 The dissent supported this interpretation of section 2032A through legisla-

102. Id.
103. Id. at 1136.
104. Id.
105. Id. at 1137 (Wilkinson, J., dissenting).
108. Estate of Thompson, 864 F.2d at 1137 (Wilkinson, J., dissenting).
109. Id.
110. Id. at 1137-38; see I.R.C. § 2032A(b), (c)(1) (1988).
111. Estate of Thompson, 864 F.2d at 1138 (Wilkinson, J., dissenting).
tive history, by indicating that the Deficit Reduction Act of 1984\textsuperscript{112} relaxed the requirements for election of special use valuation, but specifically stated that all parties with an interest in the qualified property still must be qualified heirs.\textsuperscript{113}

In addition, the dissent expressed concern over the decision by the majority to allow special use valuation "regardless if other minor interests in the property are passed to and held by non-qualified heirs."\textsuperscript{114} The dissent feared that without proper clarification of the term "minor interest," courts would be allowed to decide \textit{de minimis} exception cases on the basis of their own view of equity, rather than on the basis of the statutory requirements.\textsuperscript{115}

III. Analysis

A. Congressional Intent of Section 2032A as Interpreted by the Majority and the Dissent

The majority and the dissent based their opinions primarily on the congressional intent behind section 2032A. While both opinions agreed that the primary purpose behind the enactment of section 2032A is the preservation of family farms and businesses, their interpretations of the extent to which this purpose may be achieved varied significantly. The majority favored a broader application of section 2032A, in keeping with the overall goal of facilitating the transition of family farms and businesses from one generation to the next. The ma-

\begin{itemize}
  \item \textsuperscript{112} Pub. L. No. 98-369, 98 Stat. 494.
  \item \textsuperscript{113} \textit{Id.} The language on which the dissent relied is as follows:
    \begin{quote}
    The conferees are aware that the current use valuation provision requires that, when successive interests or concurrent interests are created in specially valued property, all parties with any interest in the property must be qualified heirs and all such parties must enter into the agreement to the election, regardless of the relative values of their interests. The de minimis rule established in this provision is intended to apply solely as a guideline in determining whether perfection of an agreement is to be permitted. The guideline is not intended to give rise to an inference that parties having an interest in specially valued property which has a relatively small value are not required to enter into the agreement or that such persons need not be qualified heirs.
    \end{quote}
  \item \textsuperscript{114} \textit{Estate of Thompson}, 864 F.2d at 1139 (Wilkinson, J., dissenting) (quoting the majority opinion).
  \item \textsuperscript{115} \textit{Id.}
\end{itemize}
The majority indicated that the legislative history did not support an "overly-restrictive interpretation of the statute."\(^{116}\) The support for this statement came from the following remarks made by Senator Dixon when he introduced the 1984 amendment to I.R.C. § 2032A:

The law and the report [the 1976 House Ways and Means Committee Report] both state the public policy issue directly and forcefully. Congress wants to continue the family farm and small family-owned enterprises. Congress does not want the death of the owner of a family farm or a small family-operated business to force the sale of that farm or business if the family wants to stay in farming or the small business. The idea was to not permit the Federal estate tax to destroy farms or small businesses.

There seem to be people at the IRS, however, who are not interested in preserving family farms and small businesses, and who want to use the slightest technicality to prevent an estate from being valued under the provisions of Section 2032A.\(^ {117}\)

Furthermore, the majority placed great emphasis upon achieving the overall goal behind the statute, despite any technical inadequacies that may exist in the requirements for election of special use valuation.\(^ {118}\) In fact, the court stated that "[w]hen 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."\(^ {119}\)

In contrast, the dissent would apparently have preferred a stricter application of special use valuation, with no allowance for de minimis exceptions. As the field of estate planning and estate taxation "depends upon clear and settled rules," the dissent feared that the majority's approach of allowing minor statutory inadequacies would lead to further litigation and would violate the legislative intent set forth in the literal language of the rule.\(^ {120}\) In addition, the majority's conclusion that the Thompson property "is eligible for the special use valuation regardless if other minor interests in the property are passed to and held by non-qualified heirs" disturbed the dissent, as no definition was provided as to the meaning of "minor interests."\(^ {121}\)

\(^{116}\) Id. at 1133.

\(^{117}\) Id. (quoting 130 CONG. REC. S4318 (daily ed. Apr. 11, 1984)).

\(^{118}\) Id. at 1134.

\(^{119}\) Id. (quoting Estate of Davis v. Commissioner, 86 T.C. 1156 (1986)).

\(^{120}\) Id. at 1139 (Wilkinson, J., dissenting).

\(^{121}\) Id. (quoting the majority opinion).
B. Historical Trend in Favor of Allowing Special Use Valuation
Despite Potential Statutory Pitfalls

The somewhat liberal statutory interpretation adopted by the majority in Estate of Thompson appears to continue the trend of relying on congressional intent to uphold election of special use valuation. The Tax Court allowed special use valuation in both Estate of Davis v. Commissioner and Estate of Clinard v. Commissioner despite what might be interpreted as "technical inadequacies" in the requirements of section 2032A. In these cases, a remote possibility existed that an interest in the estate might eventually pass to a non-qualified heir. A literal interpretation of the qualified real property requirement of section 2032A(b)(1) stating that property "was acquired from or passed from the decedent to a qualified heir of the decedent" would not have been met in either case. Nevertheless, the courts allowed the election of special use valuation and refused to apply a restrictive interpretation of the statute which would violate the congressional intent.

Moreover, an apparent distinction between concurrent and successive interests was partially resolved by the Seventh Circuit Court of Appeals in Smoot v. United States. In Smoot, a case decided after Estate of Thompson, the court held that the term "qualified heir" applied to qualified heirs with successive interests, regardless of whether they had powers of appointment which were capable of being exercised in favor of persons who were not qualified heirs. The decedent in Smoot devised real estate to her husband for life, with a power to appoint by will to anyone except himself, his estate, or his creditors. Should Mr. Smoot choose not to exercise the power, the remainder interest would be divided among the decedent's then surviving children and the descendants of any deceased children. If no descendants of the deceased should survive Mr. Smoot, a one-half interest would be distributed among Mr. Smoot's heirs, and a one-half interest would be distributed to the decedent's heirs. Therefore, the possi-

122. See id. at 1128-36.
123. 86 T.C. 1156 (1986); see supra notes 46-47 and accompanying text.
124. 86 T.C. 1180 (1986); see supra notes 56-60 and accompanying text.
126. Estate of Clinard, 86 T.C. at 1187; Estate of Davis, 86 T.C. at 1167.
127. 892 F.2d 597 (7th Cir. 1989).
128. Id. at 605.
129. Id. at 598.
130. Id. at 598-99.
131. Id. at 599.
bility existed that Mr. Smoot could die within fifteen years of his wife, having exercised his power of appointment in favor of persons who were not "qualified heirs." The court in Smoot emphasized the importance of the congressional purpose behind the enactment of section 2032A, and stated that "[t]he power of appointment creates only a possibility that a disqualifying transfer would happen, while denying the special use valuation creates the certainty of a heavy burden on the farm." In addition, the court noted that under the recapture provision of section 2032A(c)(1), Congress embodied a "wait and see" approach toward the possible disqualification of the property by the qualified heir. Thus, the court saw "no reason to assume that Congress intended to deny election of special use valuation outright to those estates subject to the possibility that an appointment power holder will make a transfer to someone not a family member."

In Whalen v. United States, the same court had determined two years earlier that a stepdaughter was not a qualified heir for special use valuation purposes. However, instead of disallowing election of section 2032A on the entire estate, the court only denied special use valuation on the quarter interest devised to the stepdaughter. By allowing special use valuation for the part of the estate which "qualified" while disallowing special use valuation on the "non-qualified" portion, the Whalen court introduced an approach that had not previously been taken by the courts.

Although no specific explanation was given as to why this proportional system of allocation was used, the court of appeals applied the statutory requirements of section 2032A, but in a less restrictive manner than the all-or-nothing approach favored by the dissent in Estate of Thompson.

132. See supra note 33 and accompanying text for a discussion of the "recapture period," which ERTA reduced from 15 years to 10 years.
133. Smoot, 892 F.2d at 599.
134. Id. at 601.
135. Id. at 602.
136. Id.
137. 826 F.2d 668 (7th Cir. 1987).
138. Id. at 669.
139. Whalen may be distinguished from Estate of Cowser, in which special use valuation was completely denied, in that the entire estate in Estate of Cowser was devised to a non-qualified heir. See Estate of Cowser v. Commissioner, 736 F.2d 1168 (7th Cir. 1984).
C. Balancing the Concerns of the Majority and the Dissent

The concerns expressed by the majority and dissenting opinions in *Estate of Thompson* must be reconciled in order to avoid further confrontations over the qualification for special use valuation when a minor interest is passed to a non-qualified heir. The all-or-nothing approach favored by the dissent would provide a "bright-line" rule, making application of the doctrine straightforward. However, such a restrictive interpretation may accomplish exactly what the statute was designed to prevent, the destruction of the family farm.

The broader application of section 2032A advanced by the majority appears consistent with the policy favoring the preservation of the family farm. But, this approach of allowing non-qualified *de minimis* exceptions introduces further confusion as to when election of special use valuation is permitted.

In an attempt to reconcile the problem, the term "minor interest" must be defined. Definitions from prior case law as to what constitutes a "minor interest" are limited, as such an exception was only utilized by the courts in *Whalen v. United States*141 and *Estate of Thompson*.142 While the court in *Whalen* allowed special use valuation despite a 25% interest devised to a non-qualified heir,143 the dissent in *Estate of Thompson* was concerned that a 25% interest would be considered "minor."144 Therefore, it appears that a smaller interest percentage passing to non-qualified heirs may be more appropriate. While the determination of any fixed percentage would be arbitrary, nevertheless, the policies advanced by both the dissent and majority would be better served if a "reasonable" percentage were specified. An examination of I.R.C. sections which parallel section 2032A may provide some guidance in the determination of a "reasonable" number.

While analogous sections are somewhat limited, I.R.C. § 2037145 does provide some guidance. Similar to section 2032A, section 2037 involves determining the value of a gross estate for estate tax purposes in property transfers taking effect at death. Under section 2037(a)(2), the value of the gross estate will include the value of the interest retained by a decedent in transferred property if the decedent has retained a reversionary interest in the property that exceeds 5% of the

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141. 826 F.2d 668.
142. 864 F.2d 1128.
143. *Whalen*, 826 F.2d at 670.
145. I.R.C. § 2037 (1988); see infra note 147.
value of such property.¹⁴⁶

Both section 2037(a)(2) and section 2032A involve a possible avoidance of estate taxation under certain circumstances. In order to curtail abuse of such a tax advantage, the tax code incorporates certain requirements which must be met prior to eligibility under the sections.¹⁴⁷ Section 2037 utilizes a figure of 5% for the reversionary interest which must be retained by a decedent in order to qualify for section 2037(a)(2). The similarities between section 2037(a)(2) and section 2032A suggest that a 5% figure might also be considered "reasonable" in determining a "minor interest" for section 2032A purposes.


¹⁴⁷. See supra notes 12-22 and accompanying text for the requirements of section 2032A. Section 2037 reads as follows:

(a) General Rule
The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time after September 7, 1916, made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, if—

(1) possession or enjoyment of the property can, through ownership of such interest, be obtained only by surviving the decedent, and

(2) the decedent has retained a reversionary interest in the property (but in the case of a transfer made before October 8, 1949, only if such reversionary interest arose by the express terms of the instrument of transfer), and the value of such reversionary interest immediately before the death of the decedent exceeds 5 percent of the value of such property.

(b) Special Rules
For purposes of this section, the term "reversionary interest" includes a possibility that property transferred by the decedent—

(1) may return to him or his estate, or

(2) may be subject to a power of disposition by him,

but such term does not include a possibility that the income alone from such property may return to him or become subject to a power of disposition by him. The value of a reversionary interest immediately before the death of the decedent shall be determined (without regard to the fact of the decedent's death) by usual methods of valuation, including the use of tables of mortality and actuarial principles, under regulations prescribed by the Secretary. In determining the value of a possibility that property may be subject to a power of disposition by the decedent, such possibility shall be valued as if it were a possibility that such property may return to the decedent or his estate. Notwithstanding the foregoing, an interest so transferred shall not be included in the decedent's gross estate under this section if possession or enjoyment of the property could have been obtained by any beneficiary during the decedent's life through the exercise of a general power of appointment (as defined in section 2041) which in fact was exercisable immediately before the decedent's death.

Congress should resolve the confusion through an amendment to section 2032A which precisely defines what constitutes a "minor interest." The proposed "minor interest" amendment could be added to section 2032A(e) which provides definitions and special rules for purposes of utilizing section 2032A.

A precise definition of what constitutes a minor interest would provide an objective measurement for determining the acceptable statutory limits. In addition, such a definition would provide greater flexibility and certainty in estate planning as estate planners could more easily elect special use valuation. Above all, the congressional purpose behind section 2032A of preserving family farms and businesses could be achieved while simultaneously adhering to the statutory language.

CONCLUSION

Through the enactment of I.R.C. § 2032A, family farms and businesses are able to value land at its current use, rather than its "highest and best use" value. The estate tax savings resulting from this special use valuation was an attempt by the legislature to save family farms and businesses from the forced sales which were often required to pay estate taxes. However, judicial interpretation of the requirements for special use valuation has not always achieved the objective set forth by Congress. The United States Court of Appeals for the Fourth Circuit in *Estate of Thompson v. Commissioner* attempted to broaden the application of special use valuation by allowing a minor interest to pass to a non-qualified heir, while still allowing election for the remaining 98% interest. To alleviate the problems this *de minimis* exception may provide in future judicial interpretation of the special use valuation requirements, Congress should amend section 2032A to provide a statutory definition of a "minor interest." Only through such legislative action will the congressional intent behind section 2032A and the sanctity of statutory construction be assured.

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149. *See supra* note 27 and accompanying text.
150. 864 F.2d 1128, 1136 (4th Cir. 1989).