

DESCRIPTION OF ADDITIONAL  
ESTATE AND GIFT TAX BILLS  
(S. 23, S. 557, AND S. 955)

SCHEDULED FOR A HEARING  
BEFORE THE

SUBCOMMITTEE ON ESTATE AND GIFT TAXATION  
OF THE  
SENATE COMMITTEE ON FINANCE

ON JUNE 5, 1981

PREPARED BY THE  
STAFF OF THE JOINT COMMITTEE ON TAXATION

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## INTRODUCTION

The Senate Finance Committee's Subcommittee on Estate and Gift Taxation has scheduled a hearing on June 5, 1981, regarding particular problems of the estate and gift tax laws, including the special use valuation for farm property and the interaction of the estate tax laws with the gift tax. This hearing is a continuation of the Subcommittee's review of the estate and gift tax laws that it began with its hearing on May 1, 1981. A staff pamphlet (JCS-16-81) was prepared in connection with the May 1, 1981, hearing, which contained a brief description of present law, background information on estate and gift tax laws, a discussion of the issues involving modifications to the estate and gift tax laws, and a description of four bills, S. 404, S. 858, S. 395, and S. 574.

The hearing to be held on June 5, 1981, will continue the Subcommittee's review of these four bills and, in addition, will review two other bills (S. 23 and S. 557) that address technical problems with the provision that permits special use valuation (Code section 2032A) and a bill (S. 955) that provides for the filing of gift tax returns, and payment of gift taxes, on an annual basis. This document, prepared in connection with the June 5 hearing, provides a description of the three additional bills (S. 23, S. 557, and S. 955) and supplements the pamphlet prepared for the May 1 hearing (JCS-16-81). The description of each bill contains a summary of present law, a description of the issues raised by the bill, a description of the bill, an estimate of the revenue effect of the bill, and a description of any prior Congressional action.



## I. SUMMARY

### 1. S. 23--Senators Dole, Percy, Kassebaum, and Hatfield

#### USE OF NET SHARE RENTAL INFORMATION TO VALUE FARM AND BUSINESS REAL PROPERTY ON THE BASIS OF CURRENT USE

For estate tax purposes, real property must ordinarily be valued at its highest and best use. If certain requirements are met, however, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at current use value rather than full fair market value, provided that the gross estate may not be reduced more than \$500,000 (Code sec. 2032A). In general, the current use valuation may be determined under a "multiple factor" approval or by a capitalization of income formula that is primarily based on cash rentals for comparable farm land.

The bill would provide that if there is no comparable land from which to determine the average gross cash rental, then the average net share rental could be substituted for the average gross cash rental in applying the formula method of valuation.

### 2. S. 557--Senator Cochran

#### TRANSITIONAL RULE FOR ELECTION OF CURRENT USE VALUATION OF FARM OR OTHER BUSINESS REAL PROPERTY

For estate tax purposes, real property must ordinarily be valued at its highest and best use. If certain requirements are met, however, present law allows family farms and real property used in a closely held business to be included in a decedent's gross estate at current use value rather than full fair market value, provided that the gross estate may not be reduced more than \$500,000 (Code sec. 2032A).

The election for special valuation must be made not later than the due date for the estate tax return (Code sec. 2032A(d)(1)). It is to be made in the manner as prescribed under Treasury regulations.

The bill provides a special rule for returns required to be filed before July 13, 1978. Under this special rule, an election could be made by an estate required to file before such date no later than the 90th day after the later of the date of enactment of the bill. In addition, the bill extends the statute of limitations to allow claims for refund to be made until 90 days after the end of this special election period.



3. S. 955--Senators Byrd (of Virginia) and Packwood

ANNUAL PAYMENT OF GIFT TAX

Under present law, a gift tax generally is required to be filed, and any gift tax paid, on a calendar quarter basis if the sum of (1) the taxable gifts made during the calendar year (and for which a return has not yet been required to be filed) exceeds \$25,000. However, if all transfers made in a calendar year that are subject to the gift tax filing requirements do not exceed \$25,000 in taxable gifts, a return must be filed, and the gift tax paid, by April 15 of the following year.

The bill would provide that gift tax returns are to be filed, and any gift tax paid, on an annual basis.



## II. DESCRIPTION OF BILLS

1. S. 23--Senators Dole, Percy, Kassebaum, and Hatfield

### USE OF NET SHARE RENTAL INFORMATION TO VALUE FARM AND BUSINESS REAL PROPERTY ON THE BASIS OF CURRENT USE

#### Present law and background

##### In general

For estate tax purposes, real property must ordinarily be included in a decedent's gross estate at its fair market value based upon its highest and best use. If certain requirements are met, however, present law allows family farms and real property used in a closely held business to be included in a decedent's estate at its current use value, rather than its full fair market value, provided that the gross estate may not be reduced by more than \$500,000 (Code sec. 2032A).

##### Qualification requirements

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at his death; (2) the value of the farm or closely held business assets in the decedent's estate, including both real and personal property (but reduced by debts attributable to the real and personal property), is at least 50 percent of the adjusted value<sup>1/</sup> of the decedent's gross estate, (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property;<sup>2/</sup> (4) the real property qualifying for current use valuation passes to a qualified heir;<sup>3/</sup> (5) such real property has been owned by the decedent or a member of his family and used or held for use as a farm or closely held business ("a qualified use") for 5 of the last 8 years prior to the decedent's death; and (6) there has been material participation in the operation of the farm or closely held business by the

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<sup>1/</sup> The "adjusted value" of the gross estate or of specific property is its gross value less any mortgages or other indebtedness, payment of which are secured by an interest in the property included in the gross estate (or by the specific property).

<sup>2/</sup> For purposes of the 50-percent and 25-percent tests, the value of property is determined without regard to its current use value.

<sup>3/</sup> The term "qualified heir" means a member of the decedent's family, including his spouse, lineal descendants, parents, and aunts or uncles of the decedent and their descendants.

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decedent or a member of his family in 5 years out of the 8 years immediately preceding the decedent's death (Code secs. 2032A(a) and (b)).<sup>4/</sup>

### Valuation methods

Under present law, the current use value of eligible real estate can be determined under either of two methods: (1) the multiple factor method or (2) the formula method.

Multiple factor method.--The current use value of all qualified real property may be determined under the multiple factor method (sec. 2032A(e)(8)). The multiple factor method takes into account factors normally used in the valuation of real estate (for example, comparable sales) and any other factors that fairly value the property.

Formula method.--If there is comparable land from which the average annual gross cash rental may be determined, then farm property may also be valued under the formula method (Code sec. 2032A(e)(7)(A)). Under the formula method, the value of qualified farm property is determined by (1) subtracting the average annual State and local real estate taxes for the comparable land from the average annual gross cash rental for comparable land used for farming, and (2) dividing that amount by the average annual effective interest for all new Federal Land Bank loans.<sup>5/</sup>

On July 19, 1978, the Department of the Treasury issued proposed regulations defining gross cash rental for purposes of the formula method. Under the proposed regulations, if no comparable farm property had been leased on a cash basis, then the formula method could be applied by converting crop share rentals into cash rentals. If the crops were sold for cash in a qualified transaction, the selling price would be considered the gross cash rental. If no qualified sale occurred, then the gross cash rental would equal the cash value of the crops on the date received on an established public agricultural commodities market.

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<sup>4/</sup> In the case of qualifying real property where the material participation requirement is satisfied, the real property which qualifies for current use valuation includes the farmhouse, or other residential buildings, and related improvements, located on qualifying real property if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.

<sup>5/</sup> Each average annual computation must be made on the basis of the 5 most recent calendar years before the decedent's death.

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On September 10, 1979, the Department of the Treasury withdrew the portion of the regulations relating to gross cash rental proposed in July and published another proposed regulation defining gross cash rental. The new proposed regulations provided that crop share rentals could not be used under the formula method. Rather, if the formula valuation method were used, the executor was required to document to the Internal Revenue Service those tracts of comparable property that were rented solely for cash.

Final regulations were published on July 31, 1980 (Treasury decision 7710).<sup>6/</sup> The final regulations adopted the definition of gross cash rental contained in the September 10, 1979, proposed regulations. Consequently, under the final regulations, if no comparable land in the same locality is rented solely for cash, the formula method may not be used and qualified farm property may be valued based on its current use only by the multiple factor method.

#### Issue

The issue is whether qualified farm property may be valued under the formula method by using crop share rentals if no comparable land is leased solely for cash but comparable land is leased partially or completely on a crop share basis.

#### Explanation of the bill

The bill would provide that if there is no comparable land in the same locality from which to determine the average annual gross cash rental, then the average net share rental could be substituted for the average gross cash rental in applying the formula method. The net share rental would be (1) the value of the produce grown on the leased land received by the lessor, reduced by (2) the cash operating expenses of growing the produce that are paid, under the terms of the lease, by the lessor.

#### Prior Congressional action

On March 4, 1980, the Subcommittee on Taxation and Debt Management of the Committee on Finance held a hearing on two bills (S. 1859, 96th Cong., and S. 2201, 96th Cong.), which were identical in substance to the present bill. No further action was taken on S. 1859 or S. 2201.

On August 4, 1980, the Subcommittee held a hearing on another bill (S. 2967, 96th Cong.), which contained a provision identical in substance to the present bill. No further action was taken on S. 2967.

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<sup>6/</sup> 45 Fed. Reg. 50736 (1980).



Effective date

The provisions of S. 23 would apply to estates of decedents dying after the date of enactment of the bill.

Revenue effect

It is estimated that this bill would have no effect on fiscal year 1981 budget receipts and would reduce budget receipts by less than \$5 million in fiscal year 1982 and by \$25 million annually for fiscal years 1983 and thereafter.



2. S. 557--Senator Cochran.

TRANSITIONAL RULE FOR ELECTION OF CURRENT USE  
VALUATION OF FARM OR OTHER BUSINESS REAL PROPERTY

Present law and background

In general

For estate tax purposes, real property must ordinarily be valued based upon its highest and best use. If certain requirements are met, however, present law allows family farms and real property used in a closely held business to be included in a decedent's estate at its current use value, rather than its full fair market value, provided that the gross estate may not be reduced by more than \$500,000 (Code sec. 2032A).

Qualification requirements

An estate may qualify for current use valuation if: (1) the decedent was a citizen or resident of the United States at his death; (2) the value of the farm or closely held business assets in the decedent's estate, including both real and personal property (but reduced by debts attributable to the real and personal property), is at least 50 percent of the adjusted value<sup>1/</sup> of the decedent's gross estate; (3) at least 25 percent of the adjusted value of the gross estate is qualified farm or closely held business real property;<sup>2/</sup> (4) the real property qualifying for current use valuation passes to a qualified heir;<sup>3/</sup> (5) such real property has been owned by the decedent or a member of his family and used or held for use as a farm or closely held business ("a qualified use") for 5 of the last 8 years prior to the decedent's death; and (6) there has been material participation in the operation of the farm or closely held business by the decedent

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<sup>1/</sup> The "adjusted value" of the gross estate (or of specific property) is its gross value less any mortgages or other indebtedness, payment of which are secured by an interest in property included in the gross estate (or by the specific property).

<sup>2/</sup> For purposes of the 50-percent and 25-percent tests, the value of property is determined without regard to its current use value.

<sup>3/</sup> The term "qualified heir" means a member of the decedent's family, including his spouse, lineal descendants, parents, and aunts or uncles of the decedent and their descendants.

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or a member of his family in 5 years out of the 8 years immediately preceding the decedent's death (Code secs. 2032A(a) and (b)).<sup>4/</sup>

### Valuation methods

Under present law, the current use value of eligible real estate can be determined under either of two methods: (1) the multiple factor method or (2) the formula method.

Multiple factor method.--The current use value of all qualified real property may be determined under the multiple factor method (Code sec. 2032A(e)(8)). The multiple factor method takes into account factors normally used in the valuation of real estate (for example, comparable sales) and any other factors that fairly value the property.

Formula method.--If there is comparable land from which the average annual gross cash rental may be determined, then farm property may also be valued under the formula method (Code sec. 2032A(e)(7)(A)). Under the formula method, the value of qualified farm property is determined by (1) subtracting the average annual State and local real estate taxes for the comparable land from the average annual gross cash rental for comparable land used for farming, and (2) dividing that amount by the average annual effective interest for all new Federal Land Bank loans.<sup>5/</sup>

### Election of special valuation

The election for current use valuation must be made not later than the due date for the estate tax return (Code sec. 2032A(d)(1)). It is to be made in the manner prescribed under Treasury regulations.

### Background

These provisions were enacted by the Tax Reform Act of 1976 and were effective with respect to estates of decedents dying after December 31, 1976.

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<sup>4/</sup> In the case of qualifying real property where the material participation requirement is satisfied, the real property which qualifies for current use valuation includes the farmhouse, or other residential buildings, and related improvements located on qualifying real property if such buildings are occupied on a regular basis by the owner or lessee of the real property (or by employees of the owner or lessee) for the purpose of operating or maintaining the real property or the business conducted on the property. Qualified real property also includes roads, buildings, and other structures and improvements functionally related to the qualified use.

<sup>5/</sup> Each average annual computation must be made on the basis of the 5 most recent calendar years before the decedent's death.



In June 1977, the Internal Revenue Service issued a revised estate tax form (Form 706). This form indicated the manner in which the election was to be exercised.

On July 13, 1978, proposed regulations relating to the manner of exercising the election were published. Under the proposed regulations, the current use valuation provision was to be available only if there were some nonfarm use for the property. The proposed regulations also provided that elections of current use valuation were generally irrevocable. A special rule was provided, however, permitting estates making the elections before 30 days after adoption of final regulations (i.e., August 30, 1980) to revoke their elections, but only if the revocations were filed before January 31, 1981.

On July 19, 1978, the Department of the Treasury issued additional proposed regulations interpreting the material participation qualification requirements (Code secs. 2032A(b)(1)(ii), (c)(7)(B), and (e)(6)), and defining gross cash rental for purposes of the formula valuation method (Code sec. 2032A(e)(7)(A)). These proposed regulations, like those of July 13, 1978, provided that the current use valuation provision was to be available only if the real property had a higher use than farming.

The proposed regulations also provided that if no comparable farm property in the locality of the decedent's property had been leased on a cash basis, then the formula method could be applied by converting crop share rentals into cash rentals. If the crops were sold for cash in a qualified transaction, the selling price would be considered the gross cash rental. If no qualified sale occurred, then the gross cash rental would equal the cash value of the crops on the date received on an established public agricultural commodities market.

On September 10, 1979, the Department of the Treasury withdrew the proposed definition of gross cash rental and published another proposed regulation defining gross cash rental. The new proposed regulation provides that crop share rentals could not be used under the formula method. The Internal Revenue Service also issued on that date a news release indicating that current use value would be available with respect to any real property which satisfied the requirements of section 2032A, even if there were no other highest and best use for the property.

Final regulations were published July 31, 1980 (Treasury decision 7710).<sup>6/</sup>

#### Issue

The issue is whether special transitional rules should be provided to permit special valuation elections to be made after the time prescribed under present law with respect to certain estates.



Explanation of the bill

The bill would provide a special rule for estate tax returns required to be filed before July 13, 1978 (the date on which the first proposed regulations were published). Under this special rule, an estate required to file its estate tax return before July 13, 1978 (without regard to any extensions of time to file) could make or revoke a current use valuation election during the 90-day period after the date of enactment of the bill. In addition, the bill would extend the statute of limitations to allow claims for refund to be made until 90 days after the end of this special election period.

Effective date

The provisions of the bill would be effective with respect to estates of decedents dying after December 31, 1976, whose estate tax returns were required to be filed before July 13, 1978 (without regard to extensions of time to file).

Revenue effect

It is estimated that this bill would reduce budget receipts by \$15 million in fiscal year 1981 and by less than \$5 million in fiscal year 1982.



3. S. 955--Senators Byrd (of Virginia) and Packwood

ANNUAL PAYMENT OF GIFT TAX

Present law

Prior to 1971, gift tax returns were required to be filed, and any gift tax liability paid, on an annual basis. The due date for filing this return, and for payment of any gift tax, was the April 15 following the calendar year in which the gift was made.

The Excise, Estate and Gift Tax Adjustment Act of 1970 changed these requirements so that gift tax returns be filed, and any gift tax paid, on a quarterly basis. The due date for filing the quarterly return was the 15th day of the second month following the close of the calendar year (e.g., May 15 for gifts made in the first calendar quarter).

The Tax Reform Act of 1976 further modified these rules so that a quarterly gift tax return is required only if the sum of (1) the taxable gifts made during the calendar quarter plus (2) all other taxable gifts made during the calendar year (and for which a return has not been required to be filed) exceeds \$25,000. If a quarterly return is required, the due date for filing this return, and for payment of any gift tax, is the 15th day of the second month following the close of the calendar quarter for which a return is required. If all taxable transfers made in a calendar year do not exceed \$25,000, a gift tax return must be filed, and any gift tax paid, by the filing date for gifts made during the fourth calendar quarter of the calendar year (i.e., February 15th of the following calendar year).

In 1979, P.L. 96-167 provided that the due date for an annual return (in cases where gifts are less than \$25,000) or a return for the fourth calendar quarter is April 15th of the following calendar year. This is the same due date for filing individual income tax returns for calendar year taxpayers.

Issue

The issue is whether gift tax returns should be filed, and any gift tax paid, on an annual basis.

Explanation of the bill

The bill provides that gift tax returns are to be filed, and any gift tax paid, on an annual basis. In general, the due date for filing the annual gift tax return would be the April 15th of the following calendar year. However, for a calendar year in which the donor dies, the gift tax return for that year is required to be filed no later than the due date for filing the donor's estate tax return (including extensions).



Effective date

The bill would apply with respect to gifts made after December 31, 1981.

Revenue effect

It is estimated that this bill would reduce budget receipts by \$20 million in fiscal year 1981, by \$65 million in fiscal year 1982, and by less than \$5 million annually each fiscal year thereafter.

Prior Congressional action

In the 96th Congress, the Finance Committee reported, and the Senate passed, a provision (sec. 6 of H.R. 5505) substantially identical to S. 955. This provision was deleted from H.R. 5505 by the House of Representatives.

