Estate and Income Tax Treatment of a Decedent's Farm Crops and Rents

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ESTATE AND INCOME TAX TREATMENT OF A DECEDENT'S FARM CROPS AND RENTS

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I. INTRODUCTION

This article will address itself to a problem which continues to trouble the practicing community—the proper treatment for federal estate and income tax purposes of such items as livestock, crops and crop shares (harvested and unharvested), and cash rentals in which a taxpayer had an interest at the time of his death.

At the outset it should be made clear that both the estate tax treatment and the income tax treatment depend in large measure upon whether the decedent is classified as an "owner-operator" or as a "landlord". Thus, as an initial step in approaching a problem of this nature, it is necessary to determine the decedent's proper status by exploring the relevant facts concerning the character and extent of his involvement in agricultural activities prior to his death. It is not the intent of this article to examine the tests to be applied in making such a determination.[1] However, it can be stated as a general rule that if a taxpayer, at the time of his death, was "materially participating" in the operation of his agricultural lands, he will be considered an "owner-operator", and if, at the time of his death, he was merely leasing his lands on a crop share or cash rental basis, he will be treated as "landlord." The significance of this distinction will become more apparent as the varying tax treatments are explored in the body of this article.

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1. *Ed. note:* Reference to Revenue Ruling 57-58, 1957-1 CUM. BULL. 270 may provide acceptable guidelines for determining whether an individual is materially participating in a farming operation.

The degree of difficulty which exists within just the estate tax phase of this problem can be partially illustrated by the results of a recent survey of 398 estate tax returns selected for audit by the Omaha District Office of the Internal Revenue Service. That survey produced the following statistics: (a) 66% of the returns reflected either farm land or ranch land as assets; (b) of these returns, 25% were filed for decedents considered to be owner-operators at the time of their death and the remaining 75% were filed for decedents considered to be landlords; (c) 18% of the owner-operator returns failed to reflect growing crops as an asset under circumstances indicating that such inclusion was required; and (d) 52% of the landlord returns failed to reflect either crop shares or cash rentals as assets under circumstances indicating that such items were properly includible. In other words, approximately 44% of the returns, showing either farm land or ranch land as assets, failed to reflect growing crops, crop shares or cash rentals under circumstances indicating such items should have been included as assets of the gross estate.

The purpose and design of this article is to chart an easily referable course through the labyrinth of federal rules and regulations which govern the estate and income tax treatment of such items as livestock, crops and crop shares (harvested and unharvested), and cash rentals in which the decedent had an interest at the time of his death.

II. ESTATE TAX CONSIDERATIONS: INCLUDIBILITY AND VALUATION

A. Includibility For Federal Tax Purposes

Sections 2031 and 2033 of the Internal Revenue Code of 1954 provide that the value of the gross estate of the decedent shall be determined by including the value of all property, real or personal, tangible or intangible, wherever situated, to the extent of the interest therein of the decedent at the time of his death. Section 20.2031-1(b) of the regulations provides, in part, that livestock, and harvested and growing crops must generally be itemized and the value of each item separately returned as property of the estate.

The question of whether crops growing in the field at date of death should be included in the gross estate was considered and ruled on in the case of the *Estate of Ray E. Tompkins*.[2] The facts before the Tax Court in that case were stipulated as follows: (a)

2. 13 T.C. 1054 (1949).

the decedent planted a crop of wheat on or about October 10, 1944; (b) the decedent died on December 15, 1944; (c) the subject growing crop had a value of $1,500.00 at the time of decedent's death; (d) the subject crop was plowed under and replanted to a new crop in February or March, 1945; (e) the Commissioner added to decedent's gross estate $1,500.00 representing the value of the growing crops at the date of death. The Tax Court sustained the Commissioner's determination stating, "There is no evidence that [the crop] was adjudged worthless or that, in fact, it was worthless at the date of decedent's death."[3] Thus, a crop, even though standing in the field, is an asset which must be included as part of the decedent's gross estate.

Section 20.2033-1(b) of the Regulations provides in part, that rents accrued at the date of the decedent's death constitute a part of the gross estate. Under this section, a decedent's gross estate should include such property interests as: (a) crop shares or livestock received as rent by him prior to his death and owned by him at the time of his death; (b) crop shares or livestock which a decedent had a right to receive as rent at the time of his death for economic activities occurring before his death; and (c) cash rental payments attributable to that portion of the lease term which expired prior to the death of the decedent.

B. Valuation for Federal Estate Tax Purposes

1. *Requirements of the Code and Regulations*

The regulations require the inclusion of the above property interests in a decedent's gross estate at their fair market value at the time of the decedent's death unless the executor elects the alternate valuation method under section 2032 of the Internal Revenue Code of 1954.[4] If the executor elects to value the property under the alternate valuation method, then these property interests are includible in a decedent's gross estate at their fair market value at that date with the adjustments prescribed in section 2032. Value is generally determined by ascertaining as a basis the fair market value as of the applicable valuation date of each unit of property. Harvested crops, growing crops, crop shares, cash rental payments and livestock must generally be itemized and the value of each separately returned. All relevant facts and elements of value as of the applicable valuation date should be considered.[5]

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3. *Id.* at 1058.
4. Treas. Reg. § 20.2032-1 (1958).
5. Treas. Reg. § 20.2031-1 (b) (1958).

> Section 20.2032 - 1 (a) of the Regulations provides, in part, that:
> [I]f an executor elects the alternate valuation method under section 2032, the *property included* in the decedent's gross estate on the date of his death is valued as of whichever of the following dates is applicable:
> (1) Any property distributed, sold, exchanged, or otherwise disposed of within one year after the decedent's death is valued as of the date on which it is first distributed, sold, exchanged, or otherwise disposed of;
> (2) Any property not distributed, sold, exchanged, or otherwise disposed of within one year after the decedent's death is valued as of the date one year after the date of the decedent's death; . . . .[6]

If an executor elects the alternate valuation method, all property interests existing at the date of the decedent's death which form a part of his gross estate constitute the property to be valued as of one year after the date of the decedent's death or as of the intermediate dates set forth in section 2032 of the Code.[7] These property interests are referred to as "included property" and they remain "included property" for the purpose of valuing the gross estate under the alternate valuation method even though they change in form during the alternate valuation period by being actually received, or disposed of, in whole or in part, by the estate. Property earned or accrued (whether received or not) after the date of the decedent's death and during the alternate valuation period with respect to any property interest existing at the date of the decedent's death, which does not represent "included property" itself or the receipt of "included property", is excluded in valuing the gross estate under the alternate valuation method. Such property is referred to as "excluded property." Thus rent (in cash or in kind) accrued to the date of death constitutes "included property" and is to be valued separately as of the applicable valuation date, but any rent accrued after the date of death and before the subsequent valuation date is "excluded property".[8]

For federal estate tax purposes, Revenue Ruling 58-436[9] holds that the gain or appreciation in the value of cattle sold during the alternate valuation period is not property earned or accrued and, therefore, no part of the increase in value of such property is "excluded property", but is "included property" within the meaning of

6. Treas Reg. § 20.2032-1 (a) (1958) (emphasis added). It should be noted that the Excise, Estate and Gift Tax Adjustment Act of 1970, shortened the alternative valuation period from 12 months to 6 months for decedents dying after December 31, 1970.
7. *Id.*
8. Treas. Reg. § 20.2032-1(d) (1958).
9. 1958-2 CUM. BULL. 366.

the regulations issued pursuant to section 2032. The holding is equally applicable to such items as harvested and growing crops.

Regarding the alternate valuation method, in regard to growing crops Revenue Ruling 68-154 has stated:

> Property, that is "included property" as of the date of decedent's death remains "included property" for the purposes of valuing the gross estate under the alternate valuation method *even though its form changes during the alternate valuation period* by being actually received or disposed of, in whole or in part, by the estate. The value of such "included property" is its fair market value as of the *applicable* alternate valuation date.[10]

This Ruling concerned a decedent who was a member of a general partnership which was engaged in the business of raising and marketing berries. The partnership, upon the death of either partner, was, by terms of the partnership agreement, to continue until the end of the partnership fiscal year. The executor elected to use the alternate valuation date. At the end of the annual growing season the berries were shipped to a marketing cooperative where they were commingled with berries owned by other grower-members. Payments were made to the members by the cooperative as the cooperative received payments from purchasers. At the time of decedent's death in 1966, one of the assets of the partnership was the 1966 growing crop. Prior to the termination of the partnership at the end of the fiscal year within which the decedent's death occurred, this 1966 crop was delivered to the cooperative. For federal estate tax purposes, the Ruling concluded that the value of the 1966 crop would be its value upon disposition at maturity based on the rationale that:

> [T]he value as of the alternate valuation date of decedent's partnership interest should be determined by valuing the various partnership assets owned at the date of death at their value one year later *or at the date of disposition if the disposal was within one year.*[11]

2. *Determining Fair Market Value and the Amount Includible*

In the absence of an arms-length sale or in the absence of an established daily market, the task of determining the fair market value of a commodity on any given date is, at best, a difficult one. There are, of course, daily markets for livestock and harvested crops. In determining the fair market value of such items on hand

10. 1968-1 CUM. BULL. 395, 396 (emphasis added).
11. *Id.*

at date of death, reference can be made to such markets for sales involving livestock and crops comparable to those owned by the decedent. Comparable sales generally provide an acceptable basis for establishing fair market value.

The risk of destruction before harvest is an additional factor involved in the valuation of growing crops. In this regard, the holding in the *Estate of Ray E. Tompkins*,[12] assumes a role of particular significance. Determining the fair market value of growing crops is made particularly difficult since there are no known markets to which reference can be made for comparable sales. There would appear, however, to be a number of ways by which that determination may be approached. For example:

(a) One approach would be to consider the cost of sowing the crop (seed, labor, fuel, wear and tear to machinery) as a minimum figure, next estimate what would be the value of the mature crop (under reasonable expectations) as a maximum figure, and then prorate the increase over the months of the growing season to the date of death, giving effect to the outlook at the time of death (weather conditions, condition of the growing crop at the time, changing economic price predictions for the harvested commodity, and additional farm expense which can be reasonably expected to bring the crop to maturity such as labor, cost of spraying, etc.);

(b) Another approach would involve utilization of the ultimate sale price as a starting point. The sale price would be reduced both by the cost of bringing the crop to maturity from date of death and by the cost of harvesting. The net proceeds would then be multiplied by a fraction of which the numerator would be the number of days in the part of the growing period which ended with the date of death and the denominator would be the total number of days in the growing period. The resulting amount would then be included in the gross estate. The relative ease of its application makes this approach particularly attractive. It may be additionally attractive to the estate of a decedent who was an owner-operator since the estate or its successors receive a stepped-up basis for income tax purposes under section 1014 of the Internal Revenue Code of 1954. There may, however, be some objection to its use since it does require consideration of certain post-death factors. In that event its only value may be as a means of verifying a determination arrived at through other valuation methods;

12. 13 T.C. 1054 (1949). *See* text at note 2 *supra.*

(c) An additional approach would be to consider the size of a loan which the farmer might have been able to negotiate at the time of his death using the growing crop as security. In using this method, it should be noted that loan value represents a highly conservative amount usually determined by a percentage of the total value of the crop and would, therefore, not reflect the true fair market value. However, if proper adjustment is made by multiplying the loan value by an appropriate factor, this figure could be used as a starting point to determine actual fair market value.

The above methods are not intended to be exhaustive. There may be other approaches incorporating sound principals of valuation which may be equally effective. The method or combination of methods which is most realistic and practical under the circumstances should be employed.

In the case of a cash basis landlord who dies owning crop shares or livestock received as rent by him prior to his death or who dies with the right to receive such commodities as rent for economic activities occurring before his death, the amount includible in his gross estate should coincide with the amount determined to be income in respect of a decedent under Revenue Ruling 64-289.[13] The reason for suggesting that the two amounts should coincide is found in section 691(c) of the Internal Revenue Code of 1954 which provides a deduction for income tax purposes to the extent of the estate tax attributable to the inclusion of this amount in the gross estate.[14] (This deduction, of course, is not allowable in determining the amount includible in the gross estate.) If the cash basis land-

13. 1964-2 CUM. BULL. 173. *See* text at notes 29 to 36 *infra.*

14. INT. REV. CODE of 1954, § 691(c)(1) states:

(1) Allowance of Deduction

(A) General Rule.—A person who includes an amount in gross income under subsection (a) shall be allowed, for the same taxable year, as a deduction an amount which bears the same ratio to the estate tax attributable to the net value for estate tax purposes of all the items described in subsection (a)(1) as the value for estate tax purposes of the items of gross income or portions thereof in respect of which such person included the amount in gross income (or the amount included in gross income, whichever is lower) bears to the value for estate tax purposes of all the items described in subsection (a)(1).

(B) Estates and Trusts.—In the case of an estate or trust, the amount allowed as a deduction under subparagraph (A) shall be computed by excluding from the gross income of the estate or trust the portion (if any) of the items described in subsection (a)(1) which is property paid, credited, or to be distributed to the beneficiaries during the taxable year. The subparagraph shall apply to the same taxable years, and to the same extent, as is provided in section 683.

lord was on a cash rental basis with his tenant, the amount includible in his gross estate should equal the cash rental payments attributable to that portion of the lease term which expired prior to his death. This is the amount that, for income tax purposes, will be treated as income in respect of a decedent and entitled to the deduction provided for in section 691(c) of the Internal Revenue Code of 1954.[15]

III. INCOME TAX CONSIDERATIONS: BASIS OR INCOME IN RESPECT OF A DECEDENT

The income tax treatment of growing and harvested crops and crop shares in the hands of an estate, trust or beneficiary receving distribution of such items depends upon the status of the decedent at the time of his death.

Under present law, owner-operators are accorded a treatment which differs from treatment of the landlord. An owner-operator is any person actively engaged in the business of farming and includes a tenant.[16] A landlord is any person not actively engaged in the operation of a farm or ranch and is receiving as rent, cash or a share of the crops produced by a tenant.[17] The distinction as to tax treatment accorded the recipients of these items received from the estate of a decedent owner-operator or landlord has not always been made. The development of this distinction is discussed below.

A. Revenue Ruling 58-436[18]

In 1958, the Internal Revenue Service was asked for advice as to the treatment, for federal income tax purposes, of the value of unsold livestock and farm crops which a decedent, who reported his income on the cash method of accounting, owned at the time of his death. The decedent, at the time of his death, owned livestock, and farm crops consisting of growing and harvested crops and crops received from tenants as rent. Some of the livestock and crops were being held for sale at a time when the market was more desirable and some of the crops were held to be used as feed for the livestock.

The Ruling held that livestock and farm crops, whether harvested or unharvested, raised by a decedent prior to his death or received from tenants as rent for farm lands, which a cash basis decedent owned at date of death, constituted items of property or inventory and were not rights to, or items of income in respect of a

15. *See* text at notes 29 to 38 *infra.*
16. *See* note 1 *supra.*
17. *See* note 1 *supra.*
18. 1958-2 Cum. Bull. 366.

decedent. Hence, the Ruling permitted the distributees of livestock, growing and harvested crops and crops received as rent for farm lands to claim a stepped-up basis for the items received from a decedent for income tax purposes.[19]

B. THE ESTATE OF HELEN DAVISON V. UNITED STATES[20]

In 1961, the Court of Claims rejected the holding of Revenue Ruling 58-436, as it pertains to crop rentals and proceeds of crops sold and paid as rent to an estate of a landlord decedent.

The decedent in *Davison* died on December 24, 1952, owning two tracts of farm land consisting of 320 acres and 640 acres which were leased to tenants. The lease on the 320 acre tract provided a rental of one-fourth of all crops grown. The lease on the 640 acre tract provided a rental of one-half of the net proceeds of all crops grown. Prior to date of death, decedent was paid $6,415.01 as part rental for the 320 acre tract. In February, 1953, subsequent to the date of death, her estate was paid the balance of the rent in the amount of $14,137.14. The lessee of the 640 acre tract paid the estate $14,429.43, between January 27 and February 27, 1954. Both payments were included as property in the gross estate of the decedent on the federal estate tax returns. Neither of the sums was reported as income to the estate. The Commissioner of Internal Revenue adjusted the estate's income tax return to show each of these amounts as income in respect of a decedent.[21] The taxpayer paid the asserted deficiency and filed a timely claim for refund which was disallowed.

The question before the court was whether the rents received in money and the rents received in crops were taxable to the estate as income in respect of a decedent.

The court held that both the crop shares and the net proceeds from the sale of crop shares were rent due and must be treated as

19. For the valuation of such items for estate tax purposes, see text at notes 12 to 15 *supra*.

20. 292 F.2d 937 (Ct. Cl.), *cert. denied*, 368 U.S. 939 (1961).

21. Income in respect of a decedent is defined in Treasury Regulation § 1.691(a)-1(b) as follows:

> In general, the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent. . . .

As stated by the United States Supreme Court in Helvering v. Estate of Enright, 312 U.S. 636, 644 (1941), the purpose of this section is "to cover into income the assets of decedents, earned during their life and unreported as income. . . ."

income in respect of a decedent. As to the cash rent the court stated, ". . . we find it indistinguishable from any other kind of cash rent that might have arisen, as under a residential or commercial lease. . . . we find that this rent, collected by the estate, is income in respect of a decedent and taxable as such."[22] In regard to the crop share to be paid in kind the court cited section 61 of the 1954 Code as specifically including rents in gross income and referred to the regulations thereunder which state that crop shares shall be included in gross income as of the year in which they are reduced to money or its equivalent.[23] The court stated:

> The decedent's estate comprised among other things a right to collect crop-rents that had been earned prior to decedent's death. As rents these crops were income in respect of a decedent . . . . As crop-rents they first became recognized as income and taxable when they were sold for the account of the estate. At that point the income-producing potential of the crops had been fully achieved and was taxable. . . . The privilege of not recognizing the crop-rents as income until their sale is extended from the decedent to her estate, but what is in reality earned income does not escape its intended proportionate burden of taxation.[24]

The Court of Claims noted that its view of the law was not in accord with Revenue Ruling 58-436 but the court stated, "We believe that ruling . . . is not a correct exposition of the law."[25] Subsequently the Internal Revenue Service modified Revenue Ruling 58-436 with the issuance of another ruling which was in accord with the *Davison* case.

C. Revenue Ruling 64-289[26]

Revenue Ruling 58-436 had held that livestock and farm crops, harvested or unharvested, raised by the decedent prior to his death or received from tenants as rent for farm lands and held for sale or feeding purposes constituted items of property or inventory and not rights to, or items of, income in repect of a decedent.

In order to bring this Ruling into accord with *Davison*, Revenue Ruling 64-289 was issued which modified the earlier position. This later Ruling held that crop shares or livestock received as rent by a decedent (who had employed the cash method of accounting prior to death) and owned by him at the time of death, as well as crop

22. 292 F.2d 937, 942.
23. Treas. Reg. 1.61-4 (1957).
24. 292 F.2d 937, 943.
25. *Id.*
26. 1964-2 Cum. Bull. 173.

shares or livestock which he had a right to receive as rent at the time of death for economic activities occurring before death, constitute income in respect of a decedent and is required to be included in gross income, for federal income tax purposes, in the year in which these items are sold or otherwise disposed of.

If the decedent dies during a rent period, only the amounts attributable to the portion of the rent period ending with his death are income in respect of a decedent. If rents in kind for a rental period within which the decedent's death occurred prior to the end of the period are received by the decedent, the executor, or by a beneficiary who acquired the property by inheritance, and are later sold, the proceeds from the sale should be allocated between income in respect of a decedent and income under section 61 of the Code.

The Ruling sets out the method of allocating the proceeds between income in respect of a decedent and section 61 income. The amount of income in respect of a decedent is determined by multiplying the proceeds by a fraction of which the numerator is the number of days in the rental period ending with the date of death and the denominator is the total number of days in the total rental period. This may be illustrated by the following example:

> Jones a cash basis farmer leased some land for the period of January 1 to December 31, 1969. Jones died on October 13, 1969. Crop shares were paid to him in kind prior to date of death, and were sold subsequent to death by the executrix for $2500.00. He was alive 286 days of the rental period. Therefore, 286/365 of $2,500.00 or $1,959.00 was income in respect of a decedent. The remainder is income under section 61 of the Code.[27]

The Ruling makes it clear that it is applicable only to crop shares or livestock received as rent and does not apply to items received in a sharing arrangement in which the landowner and tenant participate materially in the farming operation.

D. Summary

The present law differentiates between the owner-operator and the landlord decedent in regard to the tax treatment to be accorded the recipient of growing or harvested crops and crop shares. The basis rules of section 1014(a) and (b) of the Code apply to the owner-operator situation. Hence, recipients of growing or harvested crops receive a new basis when such items are included in a decedent's gross estate. When the items are sold by the estate, trust, beneficiary or other person to whom the items are distrib-

27. For a more comprehensive example see text at notes 41 to 45 *infra*.

uted, section 1014 permits the recipient to use the value reported for estate tax purposes as a basis.

This is not true of the landlord situation. While accrued rents such as crop shares, harvested or unharvested, are included in a decedent's gross estate for estate tax purposes, these items retain the same characteristic as they would have had in the hands of the decedent had he lived.[28] Thus rent retains its characteristic of ordinary income in the hands of the recipient and must be included in the gross income of the estate, trust, beneficiary or other person who receives distribution and later sells the items. This result is required by section 691 of the Internal Revenue Code which governs the inclusion and treatment of income in respect of a decedent.

IV. INCOME TAX TREATMENT OF INCOME IN RESPECT OF A DECEDENT

A. Inclusion in Gross Income by Recipients

Income in respect of a decedent is defined in the Regulations in the following manner:

> In general, the term "income in respect of a decedent" refers to those amounts to which a decedent was entitled as gross income but which were not properly includible in computing his taxable income for the taxable year ending with the date of his death or for a previous taxable year under the method of accounting employed by the decedent.[29]

The term not only includes the accrued income of a decedent who reported his income by the use of the cash receipts and disbursements method, but also income accrued solely by reason of the decedent's death in the case of a decedent who reported his income by use of an accrual method of accounting. In addition, the term included income to which the decedent had a contingent claim at the time of his death,[30] and, under certain conditions, also includes

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28. Section 691(a)(3) of the Internal Revenue Code of 1954 states that the right to receive income in respect of a decedent

> shall be treated, in the *hands of the estate of the decedent or any person who acquired such right* by reason of the death of the decedent, or by bequest, devise, or inheritance from the decedent, *as if it had been acquired by the estate or such person in the transaction in which the right to receive the income was originally derived* and the amount includible in gross income under paragraph (1) or (2) shall be considered in the hands of the estate or such person to *have the character which it would have had in the hands of the decedent* if the decedent had lived and received such amount (emphasis added).

29. Treas. Reg. § 1.691(a)-1(b) (1957).

30. Treas. Reg. § 1.691(a)-1(b)(3) (1957).

the amount of all items of gross income in respect of a prior decedent.[31]

Under section 691(a) of the Internal Revenue Code of 1954 and applicable regulations, the amount of all items of gross income in respect of a decedent is required to be included in the gross income for the taxable year when received by an estate, trust or beneficiary. If an estate or trust acquired the right to receive the amount from the decedent, it is included in gross income on the fiduciary income tax return for the taxable year when received.[32] If the estate or trust is required to distribute the amount to the beneficiary, it is included in the gross income of the beneficiary for the taxable year when distributed to him.[33] If a person acquired the right to receive the amount by reason of the death of the decedent and the decedent's estate did not acquire the right to receive the amount from the decedent, then the amount is included in the gross income of such person in the taxable year when received.[34]

Income in respect of a decedent must be treated by an estate or by the person entitled to receive such amount by bequest, devise, or inheritance from the decedent, as if it had been acquired in the transaction by which the decedent acquired such right and must have the same character as it would have had if the decedent had lived and received such amount.[35] If such amount had been capital gain, interest or rental income to the decedent, it will retain that character when received by the estate, trust, or beneficiary. Thus, for example, rental income received in the form of crop shares would retain its same character in the hands of the beneficiary or other recipient and should be reported as income, as would have been required of the decedent had he lived, in the year in which the crop share is reduced to money or the equivalent of money.[36] Section 1014(a) of the Internal Revenue Code of 1954 relating to basis of property acquired from a decedent, therefore, does not apply to amounts determined to be income in respect of a decedent.

B. Deductions in Respect of a Decedent

An estate, trust or beneficiary is allowed to claim certain deductions in respect of a decedent when paid. Deductions of a decedent are treated in the same manner as income items. With respect to

31. Treas. Reg. § 1.691(a)-1(c) (1957).
32. Int. Rev. Code of 1954, § 691(a)(1)(A).
33. Int. Rev. Code of 1954, § 691(a)(1)(C).
34. Int. Rev. Code of 1954, § 691(a)(1)(B).
35. Int. Rev. Code of 1954, § 691(a)(3).
36. *See* Treas. Reg. § 1.61-4 (1957).

deductions in respect of a decedent, the regulations provide in part:

> Under section 691(b), the expenses, interest, and taxes described in sections 162, 163, 164, and 212 for which the decedent (or a prior decedent was liable, which were not properly allowable as a deduction in his last taxable year or any prior taxable year, are allowed when paid—
>
> (1) As a deduction by the estate; or
>
> (2) If the estate was not liable to pay such obligation, as a deduction by the person who by bequest, devise, or inheritance from the decedent or by reason of the death of the decedent acquires, subject to such obligation, an interest in property of the decedent (or the prior decedent).[37]

The deductions referred to in this section include trade or business expenses, state and local real and personal property taxes, sales taxes, interest or indebtedness and expenses incurred in the production of income. If the deductions should exceed the income items which were included in the gross estate, there would then be no deduction for the estate tax attributable to income in respect of a decedent as provided for in section 691(c). It should be noted that the section 642(g) prohibition against double deductions is inapplicable to these deductions.[38] For estate tax purposes they are deductible under section 2053(a)(3) as claims against the estate. And, for income tax purposes they are also allowable as deductions in respect of a decedent.

C. Deduction for Estate Tax Attributable to Income in Respect of a Decedent

Any person required to include in gross income assets of an estate which are determined to be income in respect of a decedent under section 691(a) is permitted a deduction for estate tax under section 691(c). The deduction is available to the estate, trust or beneficiary. The amount of income in respect of a decedent received by an estate in a taxable year that is properly paid, credited or required to be distributed by an estate or trust to a beneficiary

37. Treas. Reg. § 1.691(b)-1(a) (1957).

38. Section 642(g) of the Internal Revenue Code of 1954 provides:
(g) Disallowance of Double Deductions.—Amounts allowable under section 2053 or 2054 as a deduction in computing the taxable estate of a decedent shall not be allowed as a deduction in computing the taxable income of the estate or of any other person, unless there is filed, within the time and in the manner and form prescribed by the Secretary or his delegate, a statement that the amounts have not been allowed as deductions under section 2053 or 2054 and a waiver of the right to have such amounts allowed at any time as deductions under section 2053 or 2054. *This subsection shall not apply with respect to deductions allowed under part II (relating to income in respect of decedents)* (emphasis added).

for the same taxable year must be considered income in respect of a decedent for purposes of allowing the deduction to such beneficiary. However, income in respect of a decedent that is received by an estate or trust and distributed to a beneficiary in a subsequent year is not income in respect of a decedent to the beneficiary.[39] In that event the deduction is allowable only to the estate or trust. The deduction also applies in cases of income in respect of prior decedents permitting the estate taxes on the first transferor's estate to be taken into account following the death of a second decedent who had received the right from the prior decedent.[40]

The deduction is determined by ascertaining the net value in the decedent's estate of the items included under section 691 in computing gross income. The net value is the excess of the value included in the gross estate of items of gross income in respect of a decedent over the deductions from the gross estate for claims which represent deductions and credits in respect of a decedent. The estate tax attributable to the inclusion in the gross estate of the net value is the excess of the estate tax over the estate tax computed without including the net value in the gross estate. In this computation any estate tax deduction (such as the marital deduction) which may be based upon the gross estate must be recomputed to take into account the exclusion of the net value from the gross estate.

The mechanics involved in applying the aforegoing principles to a case involving growing crops, cash rents and crop shares can be illustrated by the following example.

D. ILLUSTRATION

1. *Factual Situation*

Jones, a cash basis farmer, owned 800 acres of farm land only 320 acres of which he actually farmed. Of the remaining 480 acres, 160 acres were leased to Smith on the basis of a 2/5th's crop share rental, 160 acres were leased to Lewis on the basis of a 2/5th's crop share rental and 160 acres were leased to Brown for an annual cash rental of $2,000.00. The lease period was from January 1, 1969 through December 31, 1969.

In September 1969, Jones harvested the corn crop growing on the 320 acres which he was actively farming and planted a winter wheat crop. He stored one-half of the corn crop and sold the other one-half on October 2, 1969 for $10,000.00. On October 10, 1969, Smith delivered to Jones

39. Treas. Reg. § 1.691(c)-2(a)(3) (1957).
40. Treas. Reg. § 1.691(c)-1(b) (1957).

2/5th's of his harvested crop. Jones died on October 13, 1969 leaving only a spouse surviving him. His will bequeathed his entire estate to her.

Jones' gross estate included the following items: (a) the stored corn at a value of $10,000.00, (b) the 2/5th's crop share from Smith which was on hand at date of death at a value of $3,526.00[41]; (c) the 2/5th's crop share due from Lewis for unharvested milo at a value of $1,959.00,[42] (d) the cash rental due from Brown at a value of $1,567.00[43]; (e) the growing wheat at a value of $350.00. Debt and expenses of the estate amounted to $25,000.00 which amount included $2,552.00 in delinquent real estate taxes. The taxable estate amounted to $120,000.00 (gross estate of $385,000.00 less debts and expenses of $25,000.00 less marital deduction of $180,000.00 less specific exemption of $60,000.00). The net estate tax was determined to be $25,820.00 (gross estate tax of $26,700.00 less state death tax credit of $880.00). For income tax purposes, the estate elected a fiscal year beginning November 1, 1969.

Lewis delivered 2/5th's of his milo crop to the executrix on November 15, 1969. The executrix paid the delinquent real estate taxes on December 15, 1969. On December 20, 1969 the executrix distributed part of the Smith crop share to the beneficiary (the surviving spouse) who sold it for $2,000.00. Brown's $2,000.00 cash rental was paid over to the executrix on December 31, 1969 and it was distributed to the beneficiary (the surviving spouse) on the same day. Lewis' crop share was distributed in February 1970 to the beneficiary (the surviving spouse) who sold it for $2,500.00. The executrix sold the $10,000.00 worth of stored corn and the remaining $2,500.00 worth of the Smith crop share on March 15, 1970 but did not distribute the proceeds. The executrix sold the winter wheat in June 1970 for $3,000.00.

2. *Computations*

a. *Deduction Computed for Spouse for 1969 Taxable Year:*

(1) (i)	Value of income described in section 691 (a) (1) included in computing gross estate[44]	$ 7,052.00
(ii)	Deductions in computing gross estate for claims representing deductions described in section 691 (b)	2,552.00

41. Determined in accordance with the allocation formula set forth in Rev. Rul. 64-289, 1964-2 CUM. BULL. 173.

42. *Id.* *See* computation in text at note 27 *supra.*

43. *Id.*

44. Determined by adding 2/5ths crop share ($3526.00) on hand at

(iii)	Net value of items described in section 691 (a) (1)	$ 4,500.00
(2) (i)	Estate Tax	$25,820.00
(ii)	Less: Estate tax computed without including $4,500.00 in gross estate ($385,000.00 – $4,500.00 = $380,500.00). $380,500.00 – ($25,000.00 + $177,750.00 + $60,000.00) = $117,750.00 taxable estate. Net estate tax on $177,750.00	$25,181.00
(iii)	Portion of estate tax attributable to net value of items described in section 691 (a) (1)	$ 639.00
(3) (i)	Value in gross estate of items described in section 691 (a) (1) received in taxable year[45]	$ 3,134.00
(ii)	Value in gross estate of all items described in section 691 (a) (1)	$ 7,052.00
(iii)	Part of estate tax deductible on account of receipt of $4,000.00 rentals ($3,134/7,052 of $639)	$ 283.98

b. *Deduction Computed for Spouse for 1970 Taxable Year:*

(i)	Value in gross estate of items described in section 691 (a) (1) received in taxable year	$ 1,959.00
(ii)	Value in gross estate of all income items described in section 691 (a) (1)	$ 7,052.00
(iii)	Part of estate tax deductible on account of receipt of $2,500.00 rental ($1,959/7,052 of $639)	$ 177.51

c. *Deduction Computed for Executrix's 1970 Fiduciary Income Tax Return:*

(i)	Value in gross estate of items described in section 691 (a) (1) received in taxable year	$ 1,959.00

date of death, 2/5ths crop share due at date of death ($1959.00), to cash rental received on 12/31/69 ($1567.00).

45. Determined by applying the allocation formula of 286/365 (refer to note 27 *supra*) to the $4000 total ($2000 Smith crop share + $2000 cash rents from Brown).

(ii) Value in gross estate of all income items described in section 691(a)(1)	$ 7,052.00
(iii) Part of estate tax deductible on account of receipt of $2,500.00 rental ($1,959/7,052 of $639)	$ 177.51

The stored corn and the winter wheat sold by the executrix in March 1970 and in June 1970 respectively would be considered under Revenue Ruling 58-436 as items of property or inventory and would, therefore, be accorded basis treatment for income tax purposes. The gain from the sale of the wheat ($3,000.00 - $350.00 or $2,650.00) would be reportable on the fiduciary return (Form 1041) since the executrix sold the wheat but did not distribute. Since the stored corn sold for an amount equivalent to its estate tax value, there would be no reportable gain or loss.

V. CONCLUSION

To the extent of his interest therein at the time of his death, the gross estate of an owner-operator should include all items such as livestock, harvested and unharvested crops. These items are includible at their fair market value either on the date of death or as of the alternate valuation date. In the hands of his estate or other successor(s) in interest, these items receive a stepped-up basis for income tax purposes. Therefore, any gain or loss reportable by his estate or other successor(s) is limited to the difference between the estate tax value and the sale price of such items.

To the extent of his interest therein at the time of his death, the gross estate of a cash basis landlord should include such items as crop shares or livestock received as rent prior to his death and held in kind at the time of his death, accrued rents in the form of growing crops and livestock, and accrued cash rentals. The amount includible in his gross estate should equal the amount determined by reference to Revenue Ruling 64-289 to be income in respect of a decedent. For income tax purposes, this amount is also includible in the gross income of its recipient (decedent's estate or other successor in interest). In the case of accrued cash rentals, the amount determined to be income in respect of a decedent is includible in the recipient's gross income in the taxable year in which such items are sold or otherwise disposed of. And, in the case of crop shares of livestock, the amount determined to be income in respect of a decedent is includible in the recipient's gross income in the taxable year in which such items are sold or otherwise disposed of.

In either case, the recipient is entitled to a deduction for the estate tax attributable to income in respect of a decedent.

This article has endeavored to clarify a particularly difficult area of the tax law in order to insure the correct reporting for federal tax purposes of a decedent's farm crops and rents. It is hoped that this explanation will provide assistance to those charged with the duty of accurately preparing estate tax returns and the income tax returns of estates, trusts and beneficiaries.