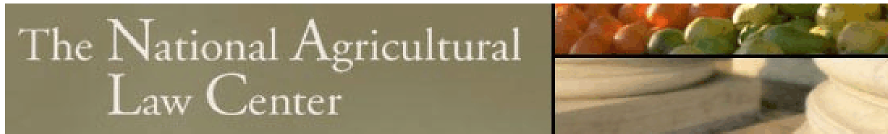

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Perfecting the Special Use Election: Congress Giveth, and the Service Taketh Away

by

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Perfecting the Special Use Election: Congress Giveth, and the Service Taketh Away

*By Mark R. Gillett**

I. BACKGROUND

Between 1970 and 1976, the value of agricultural land escalated.[1] Land located near cities came under increasing pressure from urban growth. Rural land values appreciated as a result of land speculation, fueled primarily by urban investors. By 1976, some farmers who owned relatively small acreages suddenly became wealthy.[2] However, a corresponding increase in cash flow did not accompany this new-found wealth,[3] and as a result, farmers were generally viewed as being land rich and cash poor.[4]

The lack of liquidity, combined with a substantial estate

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1. The average price of farm land in Iowa, for example, increased nearly 320 percent between 1970 and 1976. COOPERATIVE EXTENSION SERVICE, IOWA STATE UNIVERSITY, *1976 Iowa Land Value Survey* (1977) [hereinafter *Iowa Land Value Survey*]. During that same period, the consumer price index increased approximately 47 percent. COUNCIL OF ECONOMIC ADVISORS, ECONOMIC INDICATORS, 95th Cong., 2d Sess. 23 (1978).

2. In 1976, the average value of high grade farm land in central Iowa was $2,243 per acre. The state average for high grade land was $1,770 per acre. *Iowa Land Value Survey*, *supra* note 1.

3. Historically, persons purchasing farm land can anticipate a three percent return on their investment. *See* Donald H. Kelley, *The Farm Corporation as an Estate Planning Device*, 54 NEB. L. REV. 217, 218 (1975).

4. *See Federal Estate and Gift Taxes: Public Hearings and Panel Discussions Before the House Comm. on Ways and Means*, 94th Cong., 2d Sess. 356 (1976) [hereinafter *Hearings*] (comments by Robert M. Brandon). However, a study supported by the United States Department of Agriculture concluded the following:

> The findings of this study fail to bear out the existence of the liquidity problem postulated by these authorities—at least among the 64 *probate* estates which were examined. There was a *potential* liquidity problem among *living farmers*, however. But rather than indicating any pervasive dissimilarity between the two groups, this difference in liquidity appears to show merely that farm operators generally acquire greater amounts of liquid assets between retirement and death.

tax liability, caused significant problems upon a farmer's death.[5] In an effort to save the family farm from the tax collector, Congress enacted section 2032A of the Internal Revenue Code as part of the Tax Reform Act of 1976.[6] Section 2032A permits farm estates to value agricultural land for federal estate tax purposes based on its production value rather

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Contemporary Studies Project: Large Farm Estate Planning and Probate in Iowa, 59 IOWA L. REV. 794, 929 (1974).

5. Prior to 1977, an estate received a $60,000 exemption. I.R.C. § 2052 (1954), *repealed by* the Tax Reform Act of 1976, Pub. L. No. 94-455, § 2001, 90 Stat. 1525, 1846 (1976). A decedent dying in 1977 received, instead, a unified credit of $30,000 which sheltered a taxable estate of only $120,667. I.R.C. § 2010(b) (1977). If a decedent died in 1977 with a taxable estate of $600,000 (an amount which is now completely sheltered from federal estate tax by virtue of I.R.C. § 2010(a)), the estate would have paid at least $162,800 in federal estate and state death taxes. I.R.C. § 2001(c) (1977). All references to the Internal Revenue Code are to the 1988 I.R.C. unless otherwise noted.

An estate is usually limited to four sources which may provide the funds to pay the death taxes:

> The first is from farm earnings. As we know from looking at farm earnings, the production costs in the industry now are frequently higher than the income from those assets. So farm earnings cannot be counted on to supply the funds.
>
> The second is from nonfarm assets, but most farm[s] and ranches do not have sufficient nonfarm assets to pay the Federal estate tax.
>
> The third place farmers and ranchers look to pay Federal estate tax is by borrowing the money, but farm and ranch indebtedness is already at record levels. Many farms and ranches are mortgaged to the hilt and cannot borrow enough money to pay the tax.
>
> That leaves the fourth alternative. That is to sell part or all of the farm or ranchland to pay Federal estate taxes.

Hearings, *supra* note 4, at 589 (comments by Samuel P. Guyton).

6. Pub. L. No. 94-455, 90 Stat. 1525 (1976). The Joint Committee on Taxation explained the congressional purpose for enacting I.R.C. § 2032A:

> The Congress believed that, when 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 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 on loans obtained to pay the tax. Thus, the heirs may be forced to sell the land for development purposes.

STAFF OF THE JOINT COMMITTEE ON TAXATION, GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1976 (1976), 94th Cong., 2d Sess. 537 (1976), *reprinted in* 1976-3 C.B. (Vol. 2) 1, 549 [hereinafter EXPLANATION OF THE TAX REFORM ACT].

For an excellent discussion of the legislative history, see Martin D. Begleiter, *Section 2032A: Did We Save the Family Farm?*, 29 DRAKE L. REV. 15, 16-25 (1979-1980).

than its fair market value.[7] For estates that qualify, this normally results in a significant reduction in the value of the land and a corresponding reduction in the federal estate tax liability.[8]

Congress attempted to restrict this tax benefit to those estates deserving its relief. Estates that do not have liquidity problems cannot qualify for special use valuation.[9] In addition, section 2032A benefits only families actively engaged in the farming operation both before and after the decedent's death.[10] The result is an extremely complex piece of legislation designed to thwart tax practitioners' attempts to expand its scope beyond the intended beneficiaries.[11]

Congress expressly authorized the Treasury Department to promulgate regulations prescribing the manner in which es-

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7. Although there are three methods of valuing qualified property under I.R.C. § 2032A, most estates use the cash rental method. *See* I.R.C. § 2032A(e)(7)(A). For each of the five years preceding death, the estate determines the annual cash rental for comparable land, subtracts from that amount the annual real estate taxes for the comparable land, and then divides the result by the average Federal Land Bank interest rate. For a detailed explanation, see Treas. Reg. § 20.2032A-4 (1980).

8. In November 1979, the Internal Revenue Service [hereinafter Service] estimated that the average reduction in value resulting from special use elections varied from 23 to 76 percent, depending on the region. STAFF OF THE JOINT COMMITTEE ON TAXATION, 97TH CONG., 1ST SESS., BACKGROUND ON REGULATIONS UNDER SECTIONS 482, 483, AND 2032A OF THE INTERNAL REVENUE CODE, 12 (Comm. Print 1981).

9. To elect special use valuation, qualified real property must comprise 25 percent and qualified real and personal property must comprise 50 percent of the adjusted value of the gross estate. I.R.C. § 2032A(b)(1)(A) and (B).

10. The decedent (or a member of the decedent's family) must use the real property in the qualified use and must materially participate in the operation of the farm for at least five of the eight years prior to the decedent's death. I.R.C. § 2032A(b)(1)(C). In addition, for ten years after the decedent's death, the qualified heir must continue to use the property in the qualified use, and the heir (or a member of the heir's family) must materially participate in the operation of the farm to avoid recapture. I.R.C. § 2032A(c)(6). Note that for decedents dying before January 1, 1982, the recapture period was fifteen years. I.R.C. § 2032A(c)(1) (1981).

11. Neil E. Harl, *Special Use Valuation: The Standout from TRA '76*, TR. & EST., April 1983:

> From the standpoint of complexity, the consensus of many planners and those involved in probate is that special use valuation, considering the original statute, amendments, regulations and rulings, has become the most complex provision from the Tax Reform Act of 1976 and is well on its way to becoming the most complex provision in the Internal Revenue Code.

Id. at 12.

tates were required to perfect the special use election.[12] The Treasury issued the first proposed regulations in July 1978[13] and issued the final regulations in July 1980.[14] To perfect a special use election, the personal representative must attach to the estate tax return a notice of election that contains the following information:

1. The decedent's name and taxpayer identification number;
2. The relevant qualified use;
3. The items of specially valued real property;
4. The fair market value of the real property to be specially valued and its value based on the qualified use;
5. The adjusted value (as defined in section 2032A(b)(3)(B)) of all real property that is used in a qualified use and that passes from the decedent to a qualified heir and the adjusted value of all real property to be specially valued;
6. The items of personal property that pass from the decedent to a qualified heir and are used in a quali-

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12. I.R.C. § 2032A(d)(1).

13. These regulations required personal representatives who made elections on returns filed prior to September 15, 1978, to conform those elections to the requirements of the proposed regulations by January 15, 1979. 43 Fed. Reg. 30,070 (1978). If the representative failed to correct the election, it would be automatically revoked. *Id.* at 30,072. This rule penalized unwitting practitioners for the Treasury's delay in issuing the mandated regulations, and the Treasury finally capitulated.

In December 1978, the Treasury amended the proposed regulations, replacing the automatic revocation with a special transitional rule that covered all estates that made elections under I.R.C. § 2032A prior to the publication of the final regulations. *Id.* at 59,517. The transitional rule requires personal representatives to conform their elections to the final regulations, but the rule does not provide for an automatic revocation if the personal representatives fail to do so. Treas. Reg. § 20.2032A-8(d) (as amended in 1981).

Although the taxpayers won the first skirmish, the Treasury's initial attempt to automatically revoke all elections not conformed within six months of the release of the proposed regulations was a harbinger of events to come.

14. T.D. 7710, 1980-2 C.B. 254. The Treasury has been particularly dilatory in issuing regulations to guide the practitioners in this area. The Treasury has yet to promulgate regulations with respect to the corporate ownership of qualified real property. In Estate of Maddox v. Commissioner, 93 T.C. 228, 233-34 (1989), the court said the following about this "sorry situation":

> Unfortunately, the Secretary to date has not issued the regulations that he was ordered to prescribe. Some 13 years have now passed since the Congress provided that the Secretary "shall" prescribe the regulations, and at this writing he has not even submitted any proposed regulations . . . . [T]he Secretary cannot deprive a taxpayer of rights which the Congress plainly intended to confer simply by failing to promulgate the required regulations.

fied use and their adjusted value (as defined in section 2032A(b)(3)(B));

7. The adjusted value of the gross estate (as defined in section 2032A(b)(3)(A));
8. The method used in determining the special use value;
9. Copies of written appraisals of the fair market value of the real property;
10. A statement that the decedent (or a member of his or her family) has owned all specially valued real property for at least five of the eight years immediately preceding the decedent's death;
11. Any periods during the eight years preceding the decedent's death during which the decedent (or a member of the decedent's family) did not own the property, use it in a qualified use, or materially participate in the operation of the farm or other business (within the meaning of section 2032A(e)(6));
12. The name, address, taxpayer identification number, and relationship to the decedent of each person taking an interest in each item of specially valued property, and the value of the property interests passing to each such person based on both fair market value and qualified use;
13. Affidavits describing the activities constituting material participation and the identity of the material participants; and
14. A legal description of the specially valued property.[15]

In addition, the regulations require the representative to attach an agreement executed by all parties who have any interest in the real property being specially valued.[16] A qualified heir must consent to personal liability for any recapture tax imposed by section 2032A(c) in the event of an early disposition of the property or an early cessation of the qualified use. Other parties having an interest in the elected property must

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15. Treas. Reg. § 20.2032A-8(a)(3). The courts have upheld the regulations. *See* Doherty v. Commissioner, 95 T.C. 446, 453 (1990); Estate of Gunland v. Commissioner, 88 T.C. 1453, 1456-58 (1987).

16. Treas. Reg. § 20.2032A-8(c)(1). Rev. Proc. 81-14, 1981-1 C.B. 669, contains a sample agreement that satisfies the requirements of I.R.C. § 2032A(d)(2). Commencing with the November 1987 version of Form 706, the Service has included an agreement on Schedule A-1.

consent to the collection of that tax from the qualified property.[17]

An estate makes an election to specially value real property on the estate tax return.[18] Thus, the burden of making the election under section 2032A and complying with the applicable regulations falls primarily on those attorneys handling farm and ranch estates, the general practitioners across rural America. Because of the nature of their practice, these lawyers are sometimes ill-equipped to handle this difficult task.

After the issuance of the regulations, all of the pieces were in place for the Service to commence a "fruitful" enforcement campaign—all it lacked was a catalyst. Perhaps the catalyst was the unexpected effect that section 2032A had on the fisc. The Joint Committee on Taxation originally projected that the enactment of section 2032A would result in an annual revenue loss of $14,000,000.[19] The Treasury soon realized, however, that the initial estimates were low, and by 1980, it acknowledged that the actual revenue loss potentially could be ten times higher than originally estimated.[20] On the other hand, perhaps the catalyst was the Service's apparent dislike for the American farmer.[21] Regardless of its motivation, the Service embarked on a campaign to limit an estate's ability to enjoy the potential tax savings available under sec-

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17. The regulations state that a person has an interest in the property if, on the date of the decedent's death, that person can affect the disposition of the specially valued property. Treas. Reg. § 20.2032A-8(c)(2).

18. I.R.C. § 2032A(d)(1).

19. EXPLANATION OF THE TAX REFORM ACT, *supra* note 6, at 597, 1976-3 C.B. (Vol. 2) at 609.

20. *Miscellaneous Tax Bills V: Hearings Before the Subcommittee on Taxation and Debt Management of the Committee on Finance*, 96th Cong., 2nd. Sess. 470 (1980) (statement of Harry L. Gutman, Deputy Tax Legislative Counsel).

21. In a recent case, an estate was denied an extension to file the federal tax return requested after the return's due date, thus invalidating its special use election under pre-1981 law. The court summarized the Service's attitude toward that particular estate as follows:

> The examining agent stated that petitioner had made a very strong case for an extension but that his supervisor would not allow him to grant it because decedent or the executrix's husband or both were farmers, and his supervisor disliked farmers, believing farmers were too rich, got away with too much already, and did not deserve any further breaks.

Estate of Gardner v. Commissioner, 82 T.C. 989, 991 (1984).

tion 2032A by strictly interpreting the statute and regulations, thus disqualifying as many elections as possible.[22]

This article examines those arguments which estates can advance for authorization to perfect defective special use elections. It also analyzes the proposed statutory solution which would liberalize the rules with respect to perfecting elections.

II. SUBSTANTIAL COMPLIANCE

The regulations require the estate to submit an unprecedented amount of information to perfect a special use election.[23] Since estates often fail to attach all of the required information, the Service and the courts frequently must decide whether an estate can perfect its election later by submitting additional data.[24]

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22. Congress and the courts appear to concur. *See infra* note 64 and accompanying text. In Prussner v. United States, 896 F.2d 218, 220 (7th Cir. 1990) (citations omitted), the Seventh Circuit discussed the Service's enforcement of the regulations: "The Internal Revenue Service, regarding lenient treatment of family businesses as a giveaway, construes these requirements strictly." In Estate of McAlpine v. Commissioner, 96 T.C. 134, 140 (1991) (citations omitted), the Tax Court echoed these sentiments: "The IRS, possibly fearing that taxpayers would attempt to take undue advantage of the relief provision, ruled time and again that a taxpayer estate did not qualify for special use valuation because of its technical failure to comply with all the requirements of the law and regulations."

The Service often fails to realize that Congress has the authority to grant taxpayers special tax benefits, and the Service's duty is to give effect to that congressional intent. However, this charge is succinctly stated in Rev. Proc. 64-22, 1964-1 C.B. 689:

> The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.
>
> With this is mind, it is the duty of the service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.
>
> At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

23. For example, the estate must attach to the estate tax return appraisals of the qualified property's fair market value. Treas. Reg. § 20.2032A-8(a)(3)(ix). This information permits the Service to compute the additional tax that may become due in the event of an early disposition or cessation of the qualified use. I.R.C. § 2032A(c). There is no similar requirement to attach appraisals of real estate that is not specially valued, even though its value directly affects the estate's initial tax obligation.

24. Prior to the issuance of the final regulations, the Service was more lenient in

The Tax Court has developed a doctrine that permits taxpayers who have substantially complied with the requirements of electing beneficial tax treatment to subsequently perfect their elections.[25] The critical consideration for determining the applicability of the doctrine is whether the requirements that the taxpayer failed to satisfy relate to the substance or essence of the statute or to procedural requirements. The Service may insist upon strict compliance with the statute and regulations if the non-compliance relates to the statute's substance or essence. However, substantial compliance will suffice when the unsatisfied requirements are procedural and the essential statutory purposes have been fulfilled.[26]

In *American Air Filter v. Commissioner*, the Tax Court examined specific factors to determine whether the election requirements are substantive or procedural:

1. Whether the regulations provide with detailed specificity the manner in which the election is to be made;
2. Whether the taxpayer's failure to comply fully defeats the purpose of the statute;
3. Whether the sanction imposed on the taxpayer for the failure is excessive and out of proportion to the default;
4. Whether the taxpayer attempts to benefit from hindsight by adopting a position inconsistent with his or her original action or omission; and
5. Whether the Service is prejudiced by the untimely

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permitting estates to perfect special use elections. For example, in Tech. Adv. Mem. 81-21-005 (Feb. 5, 1981), the Service permitted an estate to submit an agreement to special valuation after the return was filed. The Service also indicated that it would have reached a different result if the return had been filed after August 30, 1980. *See also* Tech. Adv. Mem. 81-15-001 (Dec. 31, 1980).

This was necessitated, of course, by the lack of guidance available to the practitioners and by a directive in the regulations authorizing estates to conform non-qualifying elections made prior to September 1, 1980. Treas. Reg. § 20.2032A-8(d).

25. *See, e.g.*, Sperapani v. Commissioner, 42 T.C. 308, 330 (1964). In Prussner v. United States, 896 F.2d 218, 223 (7th Cir. 1990) (citations omitted), the Seventh Circuit, in a I.R.C. § 2032A case, had the following to say with regard to the existence of this doctrine:

> The Tax Court has created a general doctrine of substantial compliance with requirements for electing favorable tax treatment, *American Air Filter Co. v. Commissioner*, 81 T.C. 709, 719-720 (1983), and the courts of appeals have assumed the validity of this federal common law doctrine, although without exploring its foundations or justifications.

26. American Air Filter Co. v. Commissioner, 81 T.C. 709, 719 (1983).

election.[27]

According to the Seventh Circuit, "[t]hese factors are linked in that the more innocent, the more excusable, the default is, the less suitable is a harsh sanction, for it is a general principle of law that the severity of the sanction should be tailored to that of the wrong being punished."[28]

The regulations under section 2032A detail with excruciating specificity that information an estate must submit to elect special use valuation.[29] As a result, the first factor in the *American Air Filter* test regarding specificity militates against allowing incomplete elections.[30]

The next three factors, on the other hand, generally favor the taxpayer. Congress enacted section 2032A to save the family farm from the tax collector.[31] As a result, the statutory purpose is not defeated by the estate's failure to comply with the intricate election requirements.[32] To the contrary, the Service's disallowance of a special use election because of minor defects defeats the congressional intent since the estate can no longer benefit from section 2032A.

At the same time, the imposition of the additional estate tax resulting from the disallowance of the election is, in most cases, undeniably disproportionate to the estate's failure that resulted in the assessment.[33] For example, in *Estate of McAlpine v. Commissioner*,[34] the Service attempted to assess more than $333,000 in additional tax for the estate's failure to obtain the signatures of three trust beneficiaries on the agree-

27. *Id.* at 719-20.

28. Prussner v. United States, 896 F.2d 218, 224 (7th Cir. 1990).

29. Treas. Reg. § 20.2032A-8(a)(3).

30. Courts which conclude that an estate has failed to substantially comply with the section 2032A regulations often recite this factor as authority. *See, e.g.*, Bartlett v. Commissioner, 937 F.2d 316, 321 (7th Cir. 1991); Estate of Strickland v. Commissioner, 92 T.C. 16, 27 (1989); Estate of Gunland v. Commissioner, 88 T.C. 1453, 1459 (1987).

31. *See* EXPLANATION OF THE TAX REFORM ACT, *supra* note 6, at 537, 1976-3 C.B. (Vol. 2) at 549.

32. With regard to that portion of the statute that protects the Service's ability to collect any recapture tax, *see infra* notes 47-53 and accompanying text.

33. A special use election can result in an aggregate decrease in the taxable estate of $750,000 for decedents dying after 1982. I.R.C. § 2032A(a)(2). When combined with the top marginal rate of 60 percent provided for by I.R.C. § 2001(c) (taking into account the phaseout of the graduated rates and the unified credit), the disallowance of an election can result in an additional assessment of $450,000 in federal estate tax.

34. 96 T.C. 134, 134 (1991).

ment to special valuation.[35]

Estates also are unlikely to file an incomplete election merely to benefit from facts discovered after the due date of the return. The regulations permit an estate to file a protective election.[36] If the estate qualifies for special use valuation based on values as finally determined for estate tax purposes, the estate has another 60 days to perfect its election.[37] As a result, an informed taxpayer never would file an incomplete election merely to obtain more time to determine whether an election would benefit the estate.[38]

The fifth factor, as to whether an incomplete election prejudices the Service, is more difficult to resolve.[39] It is necessary to first identify the Service's interests in requiring the estate to file a complete election with the initial return, and whether strict compliance with the requirements set forth in the regulations is necessary to protect those interests.

The statute requires an estate to make the election on its estate tax return,[40] and once made, the election is irrevocable.[41] As a result, the Service has a legitimate interest in prohibiting estates from making an ineffective election to re-

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35. The Tax Court permitted the estate to amend its election. *See infra* notes 96-108, 139-43 and accompanying text.

36. Treas. Reg. § 20.2032A-8(b). The proposed regulations provided that an estate could make a protective election only if it failed to qualify for an actual election. See Prop. Treas. Reg. § 20.2032A-8(b), 43 Fed. Reg. 30,070, 30,072 (1978). The final regulations eliminated this restriction. *See, e.g.*, Tech. Adv Memo. 85-32-003 (Apr. 11, 1985); Tech. Adv. Mem. 84-16-001 (Dec. 1, 1983); Tech. Adv. Mem. 84-07-005 (Nov. 8, 1983).

37. Treas. Reg. § 20.2032A-8(b).

38. An estate may elect to file a protective election if it fails to qualify for an actual election based on the values used on the return, if it is uncertain as to whether certain property qualifies for the election, or to preserve its ability to perfect its election should the Service attempt to adjust the qualified property's fair market value.

39. An estate can make a protective election even though it otherwise qualifies for special use valuation. *See supra* note 36. A superficial response would be that the Service therefore cannot be prejudiced by the estate's failure to properly make an effective election on the estate tax return. However, this response fails to address the Service's legitimate interests in requiring estates to comply with the regulations.

40. I.R.C. § 2032A(d)(1). As originally enacted, estates were required to make the election on a timely filed return. Congress modified this requirement for decedents dying after 1981. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, § 421(j)(3), 95 Stat. 172, 313 (1981) [hereinafter ERTA].

41. I.R.C. § 2032A(d)(1). However, the regulations authorize estates to revoke elections made prior to August 30, 1980, by filing a notice of revocation prior to January 31, 1981. Treas. Reg. § 20.2032A-8(d).

tain the ability to later perfect the election based on determinations made after the filing of the original return. As noted above, however, this is not a major concern since an estate can make a protective election even in those situations where the estate otherwise qualifies for an actual election.[42]

It is also unlikely that an estate would make an ineffective election to retain the ability to later claim the initial election was invalid. If a qualified heir disposes of the specially valued property or if there is a cessation of the qualified use within the recapture period, section 2032A(c) imposes an additional estate tax equal to the initial tax savings resulting from the special use election. Thus, an estate that has specially valued real property can always "elect" to pay the recapture tax.[43]

The qualified heir's basis in the property for income tax purposes is equal to its special use value determined under section 2032A.[44] Since the special use value always will be less than the fair market value, an election to specially value real property may result in the imposition of additional income tax if the qualified heir subsequently sells or disposes of the property in a taxable transaction. However, in the event the qualified heir is required to pay the recapture tax, the heir can elect to adjust the basis in the property by the difference between the property's fair market value and its special use value.[45] In exchange for this basis adjustment, the qualified heir must pay interest on the recapture tax from the due date of the decedent's estate tax return at the rate normally charged on underpayments.[46]

Thus, an estate that makes a valid election under section

42. *See supra* note 36.

43. I.R.C. § 2032A(c)(1). For example, the failure of a qualified heir (or a member of the heir's family) to materially participate in the operation of the farm for periods aggregating more than three years in any eight-year period or the cash rental of the qualified property to a member of the decedent's family (other than a cash rental within two years of the decedent's death within the meaning of I.R.C. § 2032A(c)(7)(A) and other than the cash rental by a surviving spouse to a member of the spouse's family within the meaning of I.R.C. § 2032A(b)(5)(A)) results in the recapture of the estate tax saved by virtue of the special use election. I.R.C. § 2032A(c). It is unlikely that the Service would object to a "voluntary" payment of the recapture tax.

44. I.R.C. § 1014(a)(3).

45. I.R.C. § 1016(c). This section applies to decedents dying after 1981. ERTA, *supra* note 40, at § 421(g) 95 Stat. at 312.

46. I.R.C. § 1016(c)(5).

2032A and later pays the recapture tax may be placed in the same position as an estate that intentionally makes a defective election to preserve the right to later claim that the initial election was invalid. In both cases, the qualified heir can receive a basis in the property equal to its fair market value at the decedent's death. The cost of obtaining that basis adjustment is the payment of the tax savings resulting from the special use election, together with interest from the due date of the decedent's return.

The Service also has a legitimate interest in ensuring that it can collect any recapture tax in the future. The recapture tax reflects the tax savings attributable to the special use election.[47] The recapture tax is not an estate tax imposed by section 2001, but rather is a separate and distinct tax imposed by section 2032A(c).[48] The qualified heirs are personally liable for the payment of any recapture tax,[49] and they signify their consent to that liability by signing the agreement to special use valuation.[50] As a result, all parties having an interest in the specially valued property must sign the agreement to special use valuation.[51]

However, the Service's interests are protected by requir-

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47. I.R.C. § 2032A(c)(2).

48. *See* EXPLANATION OF THE TAX REFORM ACT, *supra* note 6, at 541-42, 1976-3 C.B. (Vol. 2) at 553-54.

49. I.R.C. § 2032A(c)(5).

50. It is unclear whether the qualified heirs would be liable for the recapture tax in the event they fail to sign the agreement. The Joint Committee on Taxation made the following observations:

> One of the requirements for making a valid election is the filing with the estate tax return a written agreement signed by each person in being who has an interest (whether or not in possession) in any qualified real property with respect to which the use valuation is elected . . . . The Congress believed that each person receiving an interest subject to potential recapture should agree to this potential liability, especially since that person may not have received the tax benefits from the special use valuation (because, for example, the estate tax burden is borne by a residuary legatee who did not receive farm property).

EXPLANATION OF THE TAX REFORM ACT, *supra* note 6, at 542-43, 1976-3 C.B. (Vol. 2) at 554-55. However, I.R.C. § 2032A(c)(5) states that the qualified heir shall be personally liable for the additional tax without reference to the recapture agreement. *See also* McDonald v. Commissioner, 89 T.C. 293, 305 (1987), *rev'd on other grounds*, 853 F.2d 1494 (8th Cir. 1988), *cert. denied*, 490 U.S. 1005 (1989).

51. I.R.C. § 2032A(d)(2). The regulations state that an interest in property is any interest that, on the date of the decedent's death, can be asserted to affect the disposition of the specially valued property. Treas. Reg. § 20.2032A-8(c)(2). However, the courts have disagreed with this broad interpretation. *See, e.g.*, Estate of Pullin v. Commis-

ing those interested parties who fail to sign the original agreement to subsequently signify their consent to the election.[52] If qualified heirs refuse to consent to personal liability for the recapture tax, or if other interested parties refuse to consent to the collection of the recapture tax from the property, the Service can then disallow the election and collect from the estate the additional tax imposed under section 2001.[53]

The estate's failure to supply all of the required information with the estate tax return does place an additional administrative burden on the Service. However, this burden is similar to the Service's obligations in other audit settings and is secondary to the primary goal of granting effect to congressional intent. The original election should clearly evidence the estate's desire to make an election and indicate which property it will specially value.[54] Permitting estates to supply the remaining information during audit does not compromise any of the Service's legitimate interests.

Although it is easy to identify the relevant principles in the abstract, courts have struggled with the application of the common law doctrine of substantial compliance in the context of special use elections. In *Prussner v. United States*, the Seventh Circuit observed:

> The distinction between "essential" (or "relating to substance or essence") on the one hand and "procedural" or "directory" on the other—an incomplete dichotomy that the Tax Court commonly uses to frame the issue of substantial compliance—is neither satisfactory on its own terms nor integrated with the five-factor test of *American Air Filter*.
>
> Reading the Tax Court's decisions on the subject of

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sioner, 84 T.C. 789 (1985), *acq. in result*, 1988-2 C.B. 1 (holding that surviving cotenants were not interested parties and were not required to sign the agreement).

52. *See, e.g.*, Estate of McAlpine v. Commissioner, 96 T.C. 134, 148 (1991) (holding that the fisc is protected by the subsequent execution of the agreement by the proper parties).

53. In the event that the Service does not audit the return or otherwise fails to discover the deficiency, an incorrectly executed agreement may jeopardize the Service's ability to collect the recapture tax. *See supra* note 50. This result is not changed, however, by automatically disallowing those elections the Service audits and that are not accompanied by an agreement signed by all interested parties.

54. This satisfies the statutory directive that the estate make the election on its estate tax return. I.R.C. § 2032A(d)(1).

> substantial compliance is enough to make one's head swim. Tax lawyers can have no confidence concerning the circumstances in which non-compliance with regulations governing the election of favorable tax treatment will or will not work a forfeiture.[55]

No cases decided prior to 1984 discuss the application of common law substantial compliance with respect to correcting deficient special use elections.[56] However, the Service released a number of private rulings after the issuance of the final regulations that clearly indicated its intention to interpret the regulations strictly. For example, the regulations provide that all persons receiving contingent interests in the qualified property must execute the agreement to special valuation.[57] Based on this requirement, the Service disallowed elections where contingent beneficiaries failed to sign the agreement, even though the possibility of their taking was remote.[58]

The regulations also provide that a minor or incompetent can enter into the agreement only through a "representative authorized under local law."[59] Based on this requirement, the Service disallowed an election where a parent signed on behalf of minor children, even though the parent's actions later were ratified by the probate court.[60] The Service also rejected an election where the estate failed to obtain the signature of a legal representative of a minor grandchild, even though the estate was unaware of the grandchild's existence because the child was born only three months before the decedent's

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55. 896 F.2d 218, 224 (7th Cir. 1990) (citations omitted).

56. This probably is attributable to the fact that the final regulations were promulgated in July 1980. T.D. 7710, 1980-2 C.B. 254. If the Service disallowed an election based on the final regulations, it would take more than four years to reach a resolution in court. However, *see* Estate of Gunland v. Commissioner, 88 T.C. 1453, 1456-59 (1987), where the Tax Court only addressed the applicability of common law substantial compliance even though the case was decided after the enactment of I.R.C. § 2032A(d)(3).

57. Treas. Reg. § 20.2032A-8(c)(2).

58. *See, e.g.*, Tech. Adv. Mem. 84-16-002 (Dec. 14, 1983); Tech. Adv. Mem. 83-52-112 (Aug. 29, 1983). *But see* Estate of Davis v. Commissioner, 86 T.C. 1156 (1986), discussed *infra* note 208.

59. Treas. Reg. § 20.2032A-8(c)(3).

60. Tech. Adv. Mem. 84-26-004 (Mar. 9, 1984). In this ruling, the father obtained a court order appointing him guardian and ratifying his actions nearly two years after the filing of the agreement. Because the Service determined that, under state law, such an order did not have retroactive effect, it held that the agreement was fatally defective.

death.[61]

This strict interpretation of the regulations prompted Congress, in 1984, to enact section 2032A(d)(3) with the hope of liberalizing the procedure for perfecting special use elections. It provides as follows:

> (3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED. —The Secretary shall prescribe procedures which provide that in any case in which—
>
> (A) the executor makes an election under paragraph (1) within the time prescribed for filing such election, and
>
> (B) substantially complies with the regulations prescribed by the Secretary with respect to such election, but —
>
> (i) the notice of election, as filed, does not contain all required information, or
>
> (ii) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not included on the agreement as filed, or the agreement does not contain all required information,
>
> the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or agreements.[62]

The provision is applied retroactively to the original enactment of section 2032A.[63]

Illinois Senator Alan Dixon, a farmer advocate and proponent of section 2032A reform, succinctly expressed the feelings on Capitol Hill during the Senate debate:

> The law and the report both state the public policy issue directly and forcefully. Congress wants to continue

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61. Tech. Adv. Mem. 83-52-112 (Aug. 29, 1983).

62. Deficit Reduction Act of 1984, Pub. L. No. 98-369, § 1025(a), 98 Stat. 494, 1030-31 (1984) [hereinafter Deficit Reduction Act].

The Secretary has failed to issue regulations with respect to certain aspects of I.R.C. § 2032A as originally enacted in 1976. *See, e.g.*, I.R.C. § 2032A(g) (directing the Secretary to prescribe regulations setting forth the application of I.R.C. § 2032A to corporations and partnerships). It therefore is not surprising that the Secretary has failed to prescribe procedures with respect to the implementation of I.R.C. § 2032A(d)(3) within the seven years since its passage.

63. Deficit Reduction Act, *supra* note 62, at § 1025(b), 98 Stat. at 1031.

> 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 family 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 . . . .
>
> . . . .
>
> Mr. President, as I read subsection (D) of section 2032A, the IRS already has sufficient discretion to permit parties to correct any good faith technical mistakes they make when filing applications for this special valuation treatment. However, the service seems to take the opposite view. Clarification of congressional intent by amending the section is therefore necessary.[64]

Dixon believed that the amendment would direct the Secretary of the Treasury "to develop a procedure to allow an estate to correct simple errors in a filing for section 2032A valuation treatment,"[65] and that "simple technical flaws would no longer destroy that election."[66]

However, the amendment was eviscerated by the 1984 Conference Report, which included the following explanation:

> The conferees wish to reiterate that, as under the Senate amendment, perfection of notices of election and of agreements to current use valuation elections is to be permitted only in cases where the estate tax return, as filed, evidences substantial compliance with the requirements of the Treasury regulations . . . . Both a notice of election and an agreement that themselves evidence substantial compliance with the requirements of the regulations must be included with the estate tax return, as filed, if the estate is to be permitted to perfect its election.
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> Illustrations of the type of information that may be

64. 130 CONG. REC. S4318 (daily ed. Apr. 11, 1984) (statement of Sen. Dixon) [hereinafter Senate Floor Debate on 1984 Act].

65. *Id.*

66. *Id.*

> supplied after the initial filing of a notice of election are omitted social security numbers and addresses of qualified heirs and copies of written appraisals of the property to be specially valued. This provision does not, however, permit such appraisals to be obtained only after the estate tax return is made . . . .
>
> . . . The right to perfect agreements is intended to be limited to cases where, for example, a parent of a minor remainderman, rather than a *guardian ad litem* as required under State law, signs the agreement. Similarly, failure to designate an agent in the agreement as filed may be corrected under this provision.[67]

Senator Dixon no doubt believed that section 2032A(d)(3) was a broad relief provision. The section clearly requires the Service to accept an amended agreement in one abusive case to which Dixon referred in the floor debate, where a parent signed the agreement on behalf of a minor child without court authorization.[68] However, it is unclear whether the provision compels the Service to accept an amended agreement in the second case to which Dixon referred, where the estate failed to obtain the signature of a grandchild even though the estate was unaware of the grandchild's existence.[69] Section 2032A(d)(3), as tempered by the 1984 Conference Report, forces the Service to accept amended elections in limited situations where the estate omits only ministerial material from the original election or agreement.

There always is a danger that the committee reports might not reflect the understanding of Congress or that Congress is unaware of the wording in the reports.[70] However, the statute controls over contradictory language in the committee

67. H.R. CONF. REP. NO. 861, 98th Cong., 2d Sess. 1240-41 (1984), *reprinted in* 1984-3 C.B. (Vol. 2) 1, 494-95 [hereinafter 1984 CONFERENCE REPORT].

68. Senate Floor Debate on 1984 Act, *supra* note 64. Dixon referred to the facts in Tech. Adv. Mem. 84-26-004 (Mar. 9, 1984). *See supra* note 60 and accompanying text.

69. Senate Floor Debate on 1984 Act, *supra* note 64. Dixon also referred to the facts in Tech. Adv. Mem. 83-52-112 (Aug. 29, 1983). *See supra* note 61 and accompanying text. Since no one signed the original agreement on behalf of the grandchild, the Service can argue that I.R.C. § 2032A(d)(3) does not apply. *See, e.g.*, Tech. Adv. Mem. 85-28-003 (Mar. 22, 1985) (refusing to permit the amendment of an agreement where the elected property passed into a trust for the benefit of a minor child and the trustee signed the agreement, but no one signed on behalf of the minor child).

70. *See, e.g.*, Martin v. Commissioner, 783 F.2d 81, 82-83 (7th Cir. 1986). The

reports only if the statute is clear and unambiguous.[71]

Although the committee reports appear to conflict with Senator Dixon's interpretation of the statute as demonstrated by his comments on the Senate floor, it is not apparent that they conflict with the statute itself. However, it is not necessary to muse over the effect of the committee reports since the statute itself refers to amending an election that "substantially complies" with the regulations,[72] and it is that language which

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following discussion occurred in a Senate floor debate in connection with an unrelated provision:

> Mr. ARMSTRONG . . . . My question, which may take [the chairman of the Finance Committee] by surprise, is this: Is it the intention of the chairman that the Internal Revenue Service and the Tax Court and other courts take guidance as to the intention of Congress from the committee report which accompanies this bill?
> Mr. DOLE. I would certainly hope so . . . .
> Mr. ARMSTRONG. Mr. President, will the Senator tell me whether or not he wrote the committee report?
>
> . . . .
>
> Mr. DOLE. No; the Senator from Kansas did not write the committee report.
>
> . . . .
>
> Mr. ARMSTRONG. Does the Senator know of any Senator who wrote the committee report?
> Mr. DOLE. I might be able to identify one, but I would have to search . . . .
> Mr. ARMSTRONG. Mr. President, has the Senator from Kansas, the chairman of the Finance Committee, read the committee report in its entirety?
> Mr. DOLE. I am working on it. It is not a bestseller, but I am working on it.
> Mr. ARMSTRONG. Mr. President, did members of the Finance Committee vote on the committee report?
> Mr. DOLE. No.
> Mr. ARMSTRONG. Mr. President, the reason I raise the issue is not perhaps apparent on the surface, and let me just state it: . . . The report itself is not considered by the Committee on Finance. It was not subject to amendment by the Committee on Finance. It is not subject to amendment now by the Senate.
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> . . . .
>
> . . . If there were matter within this report which was disagreed to by the Senator from Colorado or even by a majority of all Senators, there would be no way for us to change the report . . . .
> . . . [F]or any jurist, administrator, bureaucrat, tax practitioner, or others who might chance upon the written record of this proceeding, let me just make the point that this is not the law, it was not voted on, it is not subject to amendment, and we should discipline ourselves to the task of expressing congressional intent in the statute.

128 CONG. REC. 16,918-19 (1982).

71. *See, e.g.*, Estate of Doherty v. Commissioner, 95 T.C. 446, 456 (1990). Most courts hold that the legislative history is helpful in interpreting "substantial compliance" since the term is not defined in the statute. *See, e.g.*, McDonald v. Commissioner, 853 F.2d 1494, 1498 (8th Cir. 1988), *cert. denied*, 490 U.S. 1005 (1989): Estate of Doherty v. Commissioner, 95 T.C. 446, 456 (1990).

72. I.R.C. § 2032A(d)(3)(B).

returns the analysis to the common law doctrine of substantial compliance.

Courts seldom discuss whether a different standard applies under section 2032A(d)(3) and the common law doctrine. The Seventh Circuit, however, has examined whether section 2032A(d)(3) has liberalized the common law doctrine of substantial compliance. In *Prussner v. United States*,[73] the estate failed to attach an agreement to its special use election. The Seventh Circuit narrowed the scope of common law substantial compliance as applied by the Tax Court:

> We think the doctrine should be interpreted narrowly, and point out that the courts of appeals owe no special deference to the Tax Court's legal views; indeed our review of its legal rulings is plenary. The common law doctrine of substantial compliance should not be allowed to spread beyond cases in which the taxpayer had a good excuse (though not a legal justification) for failing to comply with either an unimportant requirement or one unclearly or confusingly stated in the regulations or the statute.[74]

So narrowed, the court concluded the following with regard to the relationship between the common law doctrine and section 2032A(d)(3):

> [The common law doctrine] is broader in scope, but less forgiving, than section 2032A(d)(3). It is not limited to the specific requirements made curable by subsections (B)(i) and (B)(ii), but there must be a showing that the requirement is either unimportant or unclearly or confusingly stated; no such showing is required by those subsections.[75]

In other words, the *Prussner* court determined that "substantial compliance" as used in the statute is a less rigorous standard than the common law doctrine.[76] However, the *Prussner* court still held that an estate that failed to attach any

73. 896 F.2d 218 (7th Cir. 1990).

74. *Id.* at 224 (citations omitted).

75. *Id.* at 224-25.

76. It is unclear whether the errors that the 1984 Conference Report concludes are correctable under I.R.C. § 2032A(d)(3) are broader in scope than the Seventh Circuit's view of common law substantial compliance. The Report states that the failure to submit social security numbers and addresses of qualified heirs, the failure to submit copies of written appraisals, and the failure to have a guardian ad litem sign on behalf of a minor child on whose behalf the parent has already signed are correctable defects. *See*

agreement to the special use election could not avail itself of either common law substantial compliance or section 2032A(d)(3) to cure the deficiency.[77]

Since the Tax Court interprets its common law doctrine more broadly than the Seventh Circuit, it makes little distinction between common law substantial compliance and the relief that section 2032A(d)(3) provides. The Tax Court has made the following observation:

> [T]he purpose of section 2032A(d)(3) is not to provide relief from the statutory requirements on timeliness but from excessively onerous enforcement of regulations; the purpose is not to give vitality to untimely or improper elections, but to permit the perfection of timely made elections which *substantially* comply with the requirements of the regulations.[78]

It is difficult to envision a situation in which the Tax Court would permit a taxpayer to perfect an election under section 2032A(d)(3) as a result of the Service's overzealous enforcement and that also would not meet its requirements of common law substantial compliance.[79]

The majority of the cases have addressed the failure to attach the agreement to the federal estate tax return or the failure to have all of the qualified heirs and interested parties sign that agreement.[80] The agreement is an integral part of the statutory scheme since qualified heirs must agree to be personally liable for the potential recapture tax and since other interested parties must consent to the recapture tax be-

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supra note 67 and accompanying text. These errors likely would fall within the "unimportant" category of the common law doctrine as interpreted by the Seventh Circuit.

77. The *Prussner* court granted the estate relief, however, under § 1421 of the Tax Reform Act of 1986. Pub. L. No. 99-514, § 1421, 100 Stat. 2085, 2716 (1986) [hereinafter Tax Reform Act]. *See infra* notes 144-54 and accompanying text.

78. Estate of Grimes v. Commissioner, T.C.M. (P-H) ¶ 88,576, at ¶ 88-2980 (1988), *aff'd*, 937 F.2d 316 (7th Cir. 1991).

79. The Tax Court has decided only one case in favor of the estate pursuant to I.R.C. § 2032A(d)(3). *See* Estate of McAlpine v. Commissioner, 96 T.C. 134 (1991), discussed *infra* notes 96-107 and accompanying text. However, the court specifically failed to address whether the estate satisfied its common law criteria.

80. The agreement is mandated by I.R.C. §§ 2032A(a)(1)(B) and 2032A(d)(2) and by Treas. Reg. § 20.2032A-8(c). Beginning with the November 1987 version of Form 706, an agreement is part of Schedule A-1, making it difficult for an estate to overlook the requirement.

ing collected from the qualified property.[81]

Since the promulgation of the regulations, the Service has consistently refused to permit estates that have failed to submit an agreement with the original return to correct the deficiency.[82] The courts also have held that the submission of the agreement is a substantive, rather than a procedural, requirement and have not permitted estates to perfect their elections.[83] The 1984 Conference Report clearly supports this holding.[84]

A closer question occurs when the estate has submitted an agreement, but has failed to obtain the signatures of all the qualified heirs or other interested parties. Prior to the enactment of section 2032A(d)(3), the Service consistently ruled that all qualified heirs and interested parties were required to sign the original agreement and that the estate could not subsequently add names.[85] However, section 2032A(d)(3) expressly provides for the addition of signatures after the original agreement has been filed.[86] In two cases considering this issue, the courts determined that the persons who failed to sign the original agreement held more than minor interests in the elected property. As a result, the original agreement failed to substantially comply with the regulations, and the courts

81. *See supra* notes 47-51 and accompanying text.

82. *See, e.g.*, Tech. Adv. Mem. 84-11-007 (Nov. 29, 1983); Tech. Adv. Mem. 83-09-006 (Nov. 17, 1982); Tech. Adv. Mem. 82-46-015 (July 28, 1982).

83. *See, e.g.*, Prussner v. United States, 896 F.2d 218 (7th Cir. 1990); Foss v. United States, 865 F.2d 178 (8th Cir. 1989); Estate of Merwin v. Commissioner, 95 T.C. 168 (1990); Estate of Gunland v. Commissioner, 88 T.C. 1453 (1987). In Estate of Grimes v. Commissioner, T.C.M. (P-H) ¶ 88,576, at 88-2980, *aff'd*, 937 F.2d 316 (7th Cir. 1991), the qualified heirs executed the agreement prior to filing Form 706, but the attorney failed to attach it to the return.

84. "Both a notice of election and an agreement that themselves evidence substantial compliance with the requirements of the regulations must be included with the estate tax return, as filed, if the estate is to be permitted to perfect its election." 1984 CONFERENCE REPORT, *supra* note 67, at 1241, 1984-3 C.B. (Vol. 2) at 495.

85. *See supra* note 58 and accompanying text. In rulings involving estate tax returns filed before the issuance of the final regulations in July 1980, the Service frequently allowed the taxpayers to amend the agreement. In Tech. Adv. Mem. 80-42-009 (June 30, 1980), the Service allowed a qualified heir who received a 25 percent interest in the property, but whose interest was not specially valued, to sign the agreement after the due date of the return, stating: "If an agreement is filed within the required period with all signatures initially believed to be necessary, that agreement may be perfected as to manner at a later date."

86. I.R.C. § 2032A(d)(3)(B)(ii).

refused to permit the estates to perfect their elections.[87] Again, the decisions were supported by the committee reports.[88]

Estates also have rarely succeeded in amending elections that fail to provide the other information that the regulations require. Two cases demonstrate how restrictively the courts have interpreted the substantial compliance doctrine. In *Estate of Strickland v. Commissioner*,[89] the estate supplied all of the necessary information other than adequate documentation required to substantiate the special use value that the estate assigned to the qualified property.[90] In holding that the estate failed to substantially comply with the regulations, the Tax Court concluded:

> However, in the present factual situation, we are not dealing with a technical mistake or omission in the notice of election. The omission of the method used in determining the special value based on use, and the elements used in calculation of such is not the type of minor omission or mistake addressed in section 2032A(d)(3).
>
> . . . .
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> We do not hold that the failure to submit 1 out of 14 items in a notice of election will never meet the "substantial compliance" standard of section 2032A(d)(3).

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87. In McDonald v. Commissioner, 853 F.2d 1494 (8th Cir. 1988), *cert. denied*, 490 U.S. 1005 (1989), the spouse signed the original agreement, but the property passed to the decedent's children as the result of the spouse's qualified disclaimer. In Estate of Nesselrodt v. Commissioner, T.C.M. (P-H) ¶ 88,489 (1988), the decedent's spouse signed the agreement, but the estate failed to obtain the signatures of the decedent's daughter and grandchildren, who were beneficiaries or potential beneficiaries of a trust that the decedent established. The facts fail to indicate the value of their interests. *But see* Estate of McAlpine v. Commissioner, 96 T.C. 134 (1991), discussed *infra* notes 96-107 and accompanying text.

88. "To be eligible for perfection, the agreement as originally filed must at a minimum be valid under State law and must include the signatures of all parties having a present interest or a remainder interest other than an interest having a relatively small value." 1984 CONFERENCE REPORT, *supra* note 67, at 1241, 1984-3 C.B. (Vol. 2) at 495.

89. 92 T.C. 16 (1989).

90. The regulations require that the estate identify the comparable real estate used to calculate the special use value and submit information with respect to the past rental history of that property. Treas. Reg. §§ 20.2032A-4(b)(2)(i), -8(a)(3)(viii). The estate submitted a lease on comparable pasture land for only the year of the decedent's death, an opinion letter from a bank officer with respect to the rental value of cultivated land for a period subsequent to the decedent's death, and tax information with respect to the qualified property for three of the five years preceding death.

> Although section 20.2032A-8(a)(3), Estate Tax Regs., is not a "procedural" or "directory" regulation, there are certain informational items that do not relate to the substance or essence of the statute.[91]

In *Estate of Doherty v. Commissioner*,[92] the estate failed to obtain and submit a written appraisal of the fair market value of the elected property. The Tax Court held that the failure to submit an appraisal at the time of the original election was a curable defect. However, the court held that the estate failed to substantially comply with the regulations since it failed to obtain an appraisal prior to making its election.[93] As a result, it was not permitted to cure its election. The court again relied on the restrictive 1984 Conference Report.[94]

The courts have acknowledged that there are certain items contained in the regulations that do not relate to the substance or essence of the statute.[95] However, only one litigant has convinced a court that it substantially complied with the regulations. In *Estate of McAlpine v. Commissioner*,[96] the qualified property passed into a trust for the benefit of the decedent's grandchildren.[97] The decedent's daughter was the trustee and signed the agreement individually and as trustee.[98] However, the estate failed to obtain the signatures of the three grandchildren who were the trust's beneficiaries.[99] Within ninety days of being notified of the deficiency, the estate provided the necessary signatures.[100]

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91. 92 T.C. at 28-29.

92. 95 T.C. 446 (1990).

93. *Id.* at 456-57.

94. *Id.* "[I.R.C. § 2032A(d)(3)] does not, however, permit such appraisals to be obtained only after the estate tax return is made. Rather, the provision simply permits the submission of previously obtained appraisals." 1984 CONFERENCE REPORT, *supra* note 67, at 1241, 1984-3 C.B. (Vol. 2) at 495. The uninitiated (as well as the initiated) must ask themselves whether it could possibly make any difference to Service.

95. *See* Estate of Doherty v. Commissioner, 95 T.C. 446, 455 (1990); Estate of Strickland v. Commissioner, 92 T.C. 16, 29 (1989). However, the items not related to the substance or essence may be limited to the specific items enumerated in the 1984 CONFERENCE REPORT. *See supra* note 67 and accompanying text.

96. 96 T.C. 134 (1991).

97. *Id.* at 136.

98. *Id.* at 135-36.

99. *Id.* at 136.

100. *Id.* at 137. Two grandchildren were adults and signed individually. The trustee signed on behalf of the minor grandchild as guardian ad litem and pursuant to court order.

The estate argued that under state law, the trustee was the only interested party required to sign the agreement. However, the majority opinion did not reach this issue.[101] The court, relying on both section 2032A(d)(3) and section 1421 of the Tax Reform Act of 1986,[102] held that Congress intended relief to be granted in situations such as this where it is not entirely clear who must sign the agreement.[103] The Tax Court distinguished many of its previous holdings,[104] basing its decision primarily on the clear language of the statute that authorizes the estate to add the signatures of qualified heirs.[105]

The court failed to discuss whether the original agreement substantially complied with the regulations as required by the statute.[106] Since the statute does not define "substantial

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101. *Id.* at 142.

102. Tax Reform Act, *supra* note 77, at § 1421, 100 Stat. at 2716. *See infra* notes 119-62 and accompanying text.

103. 96 T.C. at 147. A concurring opinion correctly placed a portion of blame for uncertainty in this area on the Service:

> Thus, section 2032A(d)(3) makes two things clear;
>
> 1. The Secretary was instructed by Congress to prescribe procedures permitting the executor to supply certain information up to 90 days after being notified of the need to do so.
>
> 2. One item expressly allowed to be supplied late was the "signatures of 1 or more persons required to enter into the agreement."
>
> The mandate to promulgate these procedures was enacted in 1984 . . . . To date these regulations have not been issued, which prevents the petitioner here from pointing to prescribed procedures for supplying signatures after filing the election. However, it would be bizarre to hold that the Treasury Department's failure to comply with the Congress' mandate somehow bars petitioner from claiming the relief provided by the statute.

Id. at 149 (Colvin, J., concurring) (citations omitted).

104. It is easy to distinguish those cases in which no agreement was filed with the original return. *See, e.g.*, Estate of Gunland v. Commissioner, 88 T.C. 1453 (1987). The court found it more difficult to distinguish cases such as McDonald v. Commissioner, 89 T.C. 293 (1987), *rev'd on other grounds*, 853 F.2d 1494 (8th Cir. 1988), *cert. denied*, 490 U.S. 1005 (1989), where the agreement submitted with the return was executed by the decedent's spouse who had already disclaimed her interest in the qualified property. *See supra* note 87 and accompanying text. The *McAlpine* court said that in *McDonald*, the original agreement was not executed by anyone having an interest in the property and the names of the qualified heirs were not disclosed on the return. 96 T.C. at 146.

105. A concurring opinion in which ten other judges joined also found that I.R.C. § 2032A(d)(3) applied. 96 T.C. at 148-51. Their concurrence was based, in part, on the fact that there was a legitimate issue as to whether the trustee was the only person required to sign the agreement. *Id.* at 151. These judges may have sided with the dissent if the qualified heirs who failed to sign the agreement had received outright ownership of the property.

106. *See supra* note 72 and accompanying text.

compliance," the dissent, relying on the 1984 Conference Report, determined that not all signature omissions are curable under section 2032A(d)(3).[107] This position, of course, is more consistent with the earlier decisions.

McAlpine may indicate that the Tax Court is becoming more willing to ignore the restrictive legislative history in applying section 2032A(d)(3):

> Congress has emphasized its intent to grant the relief where it was deserved by amending the law from time to time to ease the legal requirements and the method of complying therewith. It seems obvious that Congress intended to make these relief provisions available to deserving estates.[108]

It still is apparent that section 2032A(d)(3) has added little to the common law doctrine of substantial compliance and has not curbed the abuses it was intended to prevent.

Before leaving this topic, it is instructional to mention some of the private rulings that the Service has issued after the adoption of the final regulations.[109] The Service has allowed estates to submit additional information to comply with the following regulatory provisions:

1. Treas. Reg. § 20.2032A-8(a)(3)(iii) which requires the estate to list that property which is specially valued;[110]
2. Treas. Reg. § 20.2032A-8(a)(3)(vi) which requires the estate to list personal property which is used in the qualified use and which passes to qualified heirs;[111]
3. Treas. Reg. § 20.2032A-8(a)(3)(viii) which requires the estate to describe the method used in determining the special use value;[112]

107. 96 T.C. at 158-59 (Nims, C.J., dissenting). "To be eligible for perfection, the agreement as originally filed . . . must include the signatures of all parties having a present interest or a remainder interest other than an interest having a relatively small value." 1984 CONFERENCE REPORT, *supra* note 67, at 1241, 1984-3 C.B. (Vol. 2) at 495.

108. 96 T.C. at 140 (citations omitted).

109. These rulings may indicate the Service's interpretation of "substantial compliance" outside the litigation setting.

110. *See, e.g.*, Tech. Adv. Mem. 82-22-018 (Feb. 26, 1982) (permitting an estate to specially value property included in the gross estate under I.R.C. § 2035 even though that property was not included on the original return or in the original election).

111. *See, e.g.*, Tech. Adv. Mem. 87-49-003 (July 24, 1987); Tech. Adv. Mem. 86-17-005 (Dec. 31, 1985).

112. If the valuation rules in I.R.C. § 2032A(e)(7)(A) are not applicable, the estate

4. Treas. Reg. § 20.2032A-8(a)(3)(ix) which requires the estate to submit appraisals of the fair market value of the qualified property;[113]
5. Treas. Reg. § 20.2032A-8(a)(3)(x) which requires the estate to submit a statement relating to the past ownership of the property;[114]
6. Treas. Reg. § 20.2032A-8(a)(3)(xi) which requires the estate to submit a statement setting forth any period during the eight years preceding the decedent's death during which the decedent or a member of his or her family did not own the property, use it in a qualified use, or materially participate in the operation of the farm;[115]
7. Treas. Reg. § 20.2032A-8(a)(3)(xiii) which requires the estate to submit affidavits describing the material participation;[116] and
8. Treas. Reg. § 20.2032A-8(a)(3)(xiv) which requires the estate to submit a legal description of the qualified property.[117]

These rulings clearly indicate that the Service has some flexibility in this area. However, other estates cannot rely upon

must value the land pursuant to I.R.C. § 2032A(e)(8). Estates that have used the I.R.C. § 2032A(e)(8) method on the original election have been permitted to change to the I.R.C. § 2032A(e)(7)(A) method under limited circumstances. *See, e.g.*, Tech. Adv. Mem. 82-46-017 (July 16, 1982). *See also* Tech. Adv. Mem. 91-17-006 (Apr. 26, 1991); Tech. Adv. Mem. 86-17-005 (Dec. 31, 1985). *But see* Estate of Strickland v. Commissioner, 92 T.C. 16 (1989).

113. *See, e.g.*, Tech. Adv. Mem. 87-25-002 (Mar. 18, 1987) (permitting appraisals prepared prior to the filing of the original election to be submitted late); Tech. Adv. Mem. 88-02-010 (Oct. 14, 1987) (permitting estate to submit appraisals which may have been prepared after the original election). *Cf.* Estate of Doherty, 95 T.C. 446, 449 (1990) (denying amendment since there were no appraisals in existence at the time of the election).

114. *See, e.g.*, Tech. Adv. Mem. 89-26-002 (June 30, 1989); Tech. Adv. Mem. 88-02-010 (Oct. 14, 1987); Tech. Adv. Mem. 87-49-003 (July 24, 1987); Tech. Adv. Mem. 86-17-005 (Dec. 31, 1985).

115. *See, e.g.*, Tech. Adv. Mem. 89-26-002 (June 30, 1989); Tech. Adv. Mem. 88-02-010 (Oct. 14, 1987); Tech. Adv. Mem. 86-19-012 (Dec. 30, 1985); Tech. Adv. Mem. 86-17-005 (Dec. 31, 1985).

116. *See, e.g.*, Tech. Adv. Mem. 89-26-002 (June 30, 1989); Tech. Adv. Mem. 88-02-010 (Oct. 14, 1987); Tech. Adv. Mem. 87-49-003 (July 24, 1987); Tech. Adv. Mem. 86-47-002 (Aug. 6, 1986); Tech. Adv. Mem. 86-19-012 (Dec. 30, 1985); Tech. Adv. Mem. 86-17-005 (Dec. 31, 1985).

117. The Service has permitted an estate to submit the legal description of the qualified property if the original election described that property in a manner which clearly identified it. *See, e.g.*, Tech. Adv. Mem. 87-49-003 (July 24, 1987); Tech. Adv. Mem. 86-47-002 (Aug. 6, 1986). *See also* Rev. Rul. 85-84, 1985-1 C.B. 326.

them for support of their positions.[118]

III. SECTION 1421 OF THE TAX REFORM ACT OF 1976

In 1986, Congress intervened for a second time with respect to the Service's disallowance of special use elections. The June 1982 version of Form 706[119] contained incomplete instructions with respect to perfecting special use elections. Specifically, Form 706 failed to refer to the complete instructions contained in a separate pamphlet enumerating additional requirements for electing to specially value qualified property. As a result, nothing on Form 706 indicated that the estate was required to attach an agreement to special valuation. However, the Service continued to deny elections that failed to satisfy all of the requirements set forth in the regulations.[120]

Congress attempted to curb this abuse by including the following provision in the Tax Reform Act of 1986:

> Sec. 1421. INFORMATION NECESSARY FOR VALID SPECIAL USE VALUATION ELECTION.
>
> (a) IN GENERAL.—In the case of any decedent dying before January 1, 1986, if the executor—
>
> (1) made an election under section 2032A of the Internal Revenue Code of 1954 on the return of tax imposed by section 2001 of such Code within the time prescribed for filing such return (including extensions thereof), and
>
> (2) provided substantially all the information with respect to such election required on such return of tax,such election shall be a valid election for purposes of section 2032A of such Code.
>
> (b) EXECUTOR MUST PROVIDE INFORMATION. — An election described in subsection (a) shall not be valid if the Secretary of the Treasury or his delegate after the date of the enactment of this Act requests information from the executor with respect to such election

118. I.R.C. § 6110(j)(3). The court rebuked an estate's attempt to rely on a technical advice memorandum in Estate of Doherty v. Commissioner, 95 T.C. 446, 456 (1990).

119. Form 706 is the Unites States Estate (and Generation-Skipping Transfer) Tax Return which estates file pursuant to I.R.C. § 6018 (1988).

120. *See, e.g.*, Tech. Adv. Mem. 86-38-001 (June 4, 1986).

and the executor does not provide such information within 90 days of receipt of such request.

(c) EFFECTIVE DATE. — The provisions of this section shall not apply to the estate of any decedent if before the date of the enactment of this Act the statute of limitations has expired with respect to —

(1) the return of tax imposed by section 2001 of the Internal Revenue Code of 1954, and

(2) the period during which a claim for credit or refund may be timely filed.[121]

The provision expressly applies to the estates of all decedents dying before January 1, 1986.[122] However, the 1986 Conference Report appears to limit the provision to correcting errors in a specific version of Form 706:

> [T]he March [sic] 1982 edition of Form 706, Federal Estate Tax Return, did not specify that the required agreement had to be submitted with the estate tax return. This provision, therefore, permits late filing of the required agreements for estates that used the March [sic] 1982 edition of Form 706.[123]

As a result, at least one case appears to have limited the relief granted by section 1421 to those estates that filed the June 1982 version of Form 706.[124]

However, if Congress intended to limit the provision to those estates that used the June 1982 version of Form 706, it clearly could have so provided. On the contrary, the statute expressly applies to all decedents dying before January 1, 1986. Since the June 1982 version of Form 706 was superseded on January 1, 1985, the period expressly covered by the statute includes decedents dying both before and after the

121. Tax Reform Act, *supra* note 77, at § 1421, 100 Stat. at 2716. A special transitional rule in § 1421(d) that pertains to a specific estate has been omitted.

122. § 1421(a).

123. H.R. CONF. REP. NO. 841, 99th Cong., II-770-71 (1986), *reprinted in* 1986-3 C.B. (Vol. 4) 1, 770-71 [hereinafter 1986 CONFERENCE REPORT]. The report references the March 1982 version of Form 706. Since there is no March 1982 version and since the described error appeared in the June 1982 version, the courts have agreed that the reference was incorrect. *See, e.g.*, Prussner v. United States, 896 F.2d 218, 226 (7th Cir. 1990); Estate of Merwin v. Commissioner, 95 T.C. 168, 178 (1990).

124. *See* Killion v. Commissioner, T.C.M. (P-H) ¶ 88,244, at 88-1255 (1988). However, it is unclear whether the *Killion* court denied relief on the basis that the estate did not file the June 1982 version or that the estate failed to provide most of the information requested on the form.

availability of the June 1982 version of Form 706.[125]

This inconsistency was analyzed in *Prussner v. United States.*[126] The Seventh Circuit determined that the reference in the 1986 Conference Report to the June 1982 version of Form 706[127] merely provides an example of the possible application of the statute and that Congress evidently was concerned about the possibility that (1) the June 1982 version was not the only version that may have contained errors; (2) the June 1982 version may not have been the offending form; or (3) the language in the statute was chosen to camouflage the special interest nature of the legislation.[128] The *Prussner* court added:

> Any of these reasons is sufficient to explain why the statute is drafted in general terms and to avoid the violent dislocation of statutory language that would be necessary to confine the protection of the statute to users of a single form nowhere mentioned in the statute and miscited in the only pertinent legislative history.[129]

Assuming that either the estate filed the June 1982 version of Form 706 or the court refuses to limit the application of section 1421 by contradictory language in the 1986 Conference Report, an additional issue arises as to the nature of the deficiencies an estate may cure. The statute requires that an estate is entitled to relief only if it submits "substantially all" the information required on Form 706.[130]

The courts generally equate "substantially all" to "substantial compliance."[131] As a result, the primary difference between section 2032A(d)(3) and section 1421 is that the lat-

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125. The Instructions for Form 706 limited the use of the June 1982 version to decedents dying after December 31, 1981, and before January 1, 1985.

126. 896 F.2d 218 (7th Cir. 1990).

127. *See supra* note 123 and accompanying text.

128. 896 F.2d at 227. For an example of special interest tax legislation, see § 1421(d), which provides special transitional relief for the estate of a specific decedent who died on January 30, 1984, and whose estate tax return was filed on October 30, 1984.

129. 896 F.2d at 227.

130. § 1421(a)(2).

131. *See, e.g.*, McDonald v. Commissioner. 853 F.2d 1494, 1498 (8th Cir. 1988); Estate of Doherty v. Commissioner, 95 T.C. 446, 458-59 (1990); Estate of Nesselrodt v. Commissioner, T.C.M. (P-H) ¶ 88,489, at 88-2512 (1988); Estate of Killion v. Commissioner, T.C.M. (P-H) ¶ 88,244, at 88-1255 (1988).

ter focuses on the information requested by Form 706 rather than by the regulations. Furthermore, the legislative history indicates that estates need only furnish substantially all of the information requested by Form 706 to qualify for relief under section 1421, even though the instructions accompanying the form contain a more extensive list.[132]

The courts agree that section 1421(a) will validate an election if the only transgression is the failure to attach a recapture agreement to the return and the estate filed the June 1982 version of Form 706.[133] From this point, the courts deviate with respect to their interpretation of the intended scope of section 1421. In its earlier decisions, the Tax Court interpreted the provision restrictively and may have even added a mens rea requirement.

According to the Tax Court, the purpose of section 1421 is to provide relief to those estates misled by Form 706. In *Estate of Doherty v. Commissioner*,[134] the estate failed to obtain an appraisal of the property before filing the estate tax return, but its election indicated that it was cognizant of the requirement.[135] The court attributed this failure to the estate's mistaken interpretation of the requirement, not to ignorance of its existence.[136] As a result, the court refused to allow relief under section 1421, finding the estate was not misled by Form 706.[137] It seems unlikely, however, that other courts will em-

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132. The Senate Report states:

> The bill provides that, if an estate . . . provided substantially all the information elicited by Form 706, the Federal Estate Tax Return, the election is valid if the estate provides the Treasury Department with additional information necessary to perfect the election within 90 days after such additional information is requested. (This provision permits notices of election and agreements to the election to be filed late where the estate timely filed those documents to the extent requested and described on Form 706.)

S. REP. NO. 313, 99th Cong., 2nd Sess. 876 (1986), *reprinted in* 1986-3 C.B. 1, 876. In addition, the 1986 Conference Report also refers to the "requirements enumerated on the Federal Estate Tax Return." 1986 CONFERENCE REPORT, *supra* note 123, at II-770, 1986-3 C.B. (Vol. 4) at 770.

However, if Form 706 refers to specific references in the Instructions for Form 706, the estate also must provide substantially all of the information that the instructions request. *See* Estate of Merwin v. Commissioner, 95 T.C. 168, 179-81 (1990).

133. Estate of Merwin v. Commissioner, 95 T.C. 168, 178 (1990).

134. 95 T.C. 446 (1990).

135. *Id.* at 449.

136. *Id.* at 458.

137. *Id.* at 458-59.

brace the holding in *Doherty*. Requiring an estate to establish that it was misled by the form adds an important condition not contained in the statute. It also requires the court to examine the taxpayer's state of mind, an issue usually limited to tax cases involving civil and criminal penalties.[138]

There are only two cases in which the courts have granted relief pursuant to section 1421. In *Estate of McAlpine v. Commissioner*,[139] the estate filed the June 1982 version of Form 706 and submitted an agreement signed by the trustee, but not by the trust's beneficiaries.[140] The majority of a sharply-divided court held that section 1421 authorized the estate to add the beneficiaries' signatures to the agreement.[141] Based on its reading of the 1986 Conference Report,[142] the court concluded that the statute was intended precisely for taxpayers who failed to file the recapture agreement on time.[143]

The most important holding for taxpayers, however, is *Prussner v. United States*.[144] In *Prussner*, the estate failed to attach the agreement to Form 706, including instead a letter stating that the agreement was not fully executed and would be submitted at a later time.[145] The Seventh Circuit refused to

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138. In fact, it is unclear whether the Tax Court is following its own lead, established in *Doherty*. *See* Estate of McAlpine v. Commissioner, 96 T.C. 134 (1991), discussed *infra* notes 139-43 and accompanying text. In *McAlpine*, the Tax Court grants relief under both I.R.C. § 2032A(d)(3) and § 1421, permitting the estate to supplement the agreement with additional signatures. *Id.* at 147-48. The dissent observes that any support that the majority draws from § 1421 is misplaced since the signatures were not omitted from the agreement as the result of a misleading Form 706. *Id.* at 160 (Nims, C.J., dissenting).

139. 96 T.C. 134 (1991).

140. The decedent died on February 25, 1984, and the estate filed the return on November 20, 1984. *Id.* at 134-36.

141. *Id.* at 147-48. The court also held that relief should be granted under I.R.C. § 2032A(d)(3). *See supra* notes 96-107 and accompanying text. A concurring opinion joined by ten judges discussed only the applicability of I.R.C. § 2032(d)(3). *Id.* at 148-51 (Colvin, J., concurring). Six judges dissented on both grounds. *Id.* at 151-61 (Nims, C.J., dissenting).

142. *See supra* note 123 and accompanying text.

143. *Id.* at 147. Since the estate filed an agreement with the original election, it is clear that it was aware of the requirement, and at least to that extent, was not mislead by the form. *Id.* at 160 (Nims, C.J., dissenting). *See supra* note 138.

144. 896 F.2d 218 (7th Cir. 1990). The Tax Court views *Prussner* as the "current high-water mark in terms of eligibility for section 1421 relief." Estate of Merwin v. Commissioner, 95 T.C. 168, 178 (1990).

145. 896 F.2d at 221.

grant relief under section 2032A(d)(3).[146] However, it concluded that the estate was entitled to relief under section 1421, notwithstanding the Eighth Circuit's rejection of similar claims in *Foss v. United States*[147] and *McDonald v. Commissioner*.[148]

To reach this result, the *Prussner* court first determined that the relief granted by section 1421 was not limited to the June 1982 version of Form 706.[149] The *Prussner* court also ignored the fact that the estate failed to attach the recapture agreement and that the January 1979 version of Form 706, which the estate filed, made reference to the recapture agreement.[150] Rather, the court unpersuasively held that the "information" required on the return within the meaning of section 1421(a)(2) does not include the "agreement."[151] This distinction, together with the committee reports specifically referring to the failure to attach an agreement[152] and the fact that the form does not contain any warning that the failure to file the agreement is fatal to the election,[153] persuaded the court to permit the estate to perfect its election.[154]

The Tax Court already has announced its refusal to follow *Prussner*. In *Estate of Merwin v. Commissioner*,[155] in addition to omitting other information required to be contained in the notice of election, the estate failed to attach an agree-

146. *See supra* notes 76-77 and accompanying text.

147. 865 F.2d 178 (8th Cir. 1989). In *Foss*, the estate failed to attach both a notice of election and an agreement. *Id.* at 180.

148. 853 F.2d 1494 (8th Cir. 1988), *cert. denied*, 490 U.S. 1005 (1989). In *McDonald*, the estate attached an agreement signed by the decedent's spouse. *Id.* at 1495. However, because of a disclaimer, the qualified property passed to the decedent's children. *Id.*

149. *See supra* notes 126-29 and accompanying text.

150. Prussner v. United States, 896 F.2d 218, 226 (7th Cir. 1990).

151. "The agreement itself is not information, but commitment. And it is not 'on' the return, but attached to it—unless 'return' includes everything required to be filed with it. But the government does not argue that 'return' is to be understood so broadly." *Id.*

152. "This provision, therefore, permits late filing of the required agreements for estates that used the March [sic] 1982 edition of Form 706." 1986 CONFERENCE REPORT, *supra* note 123, at II-771, 1986-3 C.B. (Vol. 4) at 771.

153. 896 F.2d at 227-28.

154. The court failed to discuss whether § 1421 requires a mens rea requirement as suggested by Estate of Doherty v. Commissioner, 95 T.C. 446 (1990). *See supra* notes 134-38 and accompanying text.

155. 95 T.C. 168 (1990).

ment to the March 1985 version of Form 706.[156] The court found the Seventh Circuit's reasoning unpersuasive[157] and held as a matter of law:

> If the face of the applicable Form 706, including directions thereon, refers to a necessary "agreement" (or "agreements") or refers to specific "instructions" that describe a necessary recapture agreement, then an estate that fails to attach a recapture agreement to the return has not provided "substantially all the information . . . required on such return of tax" within the meaning of section 1421(a)(2).[158]

Ignoring the omission of the recapture agreement, the Tax Court also found that the estate failed to supply substantially all of the other information requested by Form 706 since it failed to provide miscellaneous information with the return, including information with respect to the property's fair market value.[159]

The Seventh Circuit should be commended for its willingness to alleviate a harsh result by using an admittedly imaginative interpretation of section 1421. It is unclear whether other courts will follow the Seventh Circuit's lead.[160] Even if *Prussner* retains its vitality, its holding is limited primarily to the failure to attach a fully-executed recapture agreement to a special use election. With respect to other omissions, section 1421(a)(2) still requires the estate to attach substantially all of the information requested by the return.[161] More important, section 1421 relief is temporal since it applies only to dece-

156. *Id.* at 169-70. The March 1985 version of Form 706 directed the estate to attach an agreement to Form 706 in two separate locations. *Id.* at 183.

157. Since the *Merwin* case was not appealable to the Seventh Circuit, the court was not bound by the *Prussner* decision. *Id.* at 179.

158. *Id.* at 180-81. The court reached this conclusion after a rather painful analysis of the various uses of the word "information" in § 1421 and in the committee reports. *Id.* at 179-83.

159. *Id.* at 183-84. In addition, it appears as though the estate was not in possession of an appraisal of the qualified property's fair market value until after it filed the return. *Id.* at 184. *See supra* notes 92-94 and accompanying text.

160. In a subsequent case, an estate failed to submit any agreement with the estate tax return. The Seventh Circuit refused to permit the estate to amend its election under § 1421 since it failed to raise the issue in lower court. *See* Bartlett v. Commissioner, 937 F.2d 316 (7th Cir. 1991).

161. Because "substantially all" is equated with "substantial compliance," § 1421 can only provide estates limited relief. *See supra* notes 130-31 and accompanying text.

dents dying before 1986.[162]

IV. OTHER POSSIBLE ARGUMENTS

The proposed regulations permitted an estate to make a protective election under section 2032A, only if the estate did not qualify to make an actual election, based on the facts in existence at the time it filed its return.[163] However, the Treasury eliminated this constraint in the final regulations.[164] As a result, estates have argued that the Service should treat an ineffective actual election as a protective election which the estate can later perfect.

Since the adoption of the final regulations, this argument has met with little success.[165] The regulations provide that an estate must indicate whether it is making a protective election: "The protective election is to be made by a notice of election filed with a timely estate tax return stating that a protective election under section 2032A is being made pending final determination of values."[166] In addition, since the release of the November 1987 version of Form 706, the estate tax return has included a separate box which must be checked if the estate desires to make a protective election.

Since the right to make a protective election exists only by regulatory grace and since the regulations provide that the estate must indicate an intent to make a protective election, the Service refuses to view the failure to make an effective actual election as an attempted protective election.[167] The courts that have addressed the issue agree.[168] The fact that taxpayers seldom raise the issue at the trial court level is indicative of their concession on this point.[169]

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162. § 1421(a).

163. Prop. Treas. Reg. § 20.2032A-8(b), 43 Fed. Reg. 30,070, 30,072 (1978).

164. Treas. Reg. § 20.2032A-8(b). *See supra* note 36.

165. Earlier rulings permitted estates to perfect elections during audit by treating ineffective elections as protective elections. *See, e.g.*, Tech. Adv. Mem. 81-21-005 (Feb. 5, 1981); Tech. Adv. Mem. 81-15-001 (Dec. 31, 1980).

166. Treas. Reg. § 20.2032A-8(b).

167. *See, e.g.*, Tech. Adv. Mem. 86-38-001 (June 4, 1986); Tech. Adv. Mem. 83-52-003 (Sept. 8, 1983); Tech. Adv. Mem. 83-46-009 (Aug. 4, 1983); Tech. Adv. Mem. 82-46-015 (July 28, 1982).

168. *See, e.g.*, Estate of Gunland v. Commissioner, 88 T.C. 1453 (1987).

169. For example, see Estate of Merwin v. Commissioner, 95 T.C. 168, 171 (1990), and McDonald v. Commissioner, 89 T.C. 293, 302 (1987), *rev'd on other grounds*, 853

A much closer question arises if an estate makes an actual and protective election with respect to the same real property with the intent of perfecting the protective election in the event that the actual election is deficient. Not surprisingly, the Service rules that the estate cannot later perfect the protective election.[170] The regulations, however, do not support the Service's position. Furthermore, since the estate can file a protective election even though it qualifies for special use election,[171] there is no valid reason, policy or otherwise, to deny the estate the right to perfect its protective election if the Service later determines that the actual election was defective.[172] The courts have not addressed this issue.

In 1959, the Treasury adopted regulations authorizing the Service to grant taxpayers reasonable extensions of time for making elections and applications for relief.[173] The Service only could grant relief upon a showing of good cause[174] and examined the following factors in making that determination:

> 1. Due diligence of the taxpayer to determine the existence of and requirements for the election;
> 2. Prompt action by the taxpayer in requesting an extension within a reasonable time after passage of the deadline;
> 3. Demonstrated intent on the part of the taxpayer to make the election on time;
> 4. Lack of prejudice to the interests of the government; and
> 5. The consistency of the extension with the objectives of the underlying statute and regulations.[175]

F.2d 1494 (8th Cir. 1988), *cert. denied*, 490 U.S. 1005 (1989), where the estates conceded the issue.

170. *See, e.g.*, Tech. Adv. Mem. 87-36-001 (Mar. 10, 1987).

171. *See supra* note 36.

172. The only argument that can be advanced to support the Service's position is that an actual election must be made on the estate's first estate tax return and, once made, is irrevocable. *See* I.R.C. § 2032A(d)(1). It follows that an estate should not be permitted to combine a protective election with an ineffective election to extend the time within which to make the election. However, if the protective election is conditioned on the actual election being deficient, the technique would not invite abuse. Furthermore, the estate could have obtained the same benefit by making only a protective election in the first instance.

173. Treas. Reg. § 1.9100-1, 24 Fed. Reg. 1,178, 1,206 (February 17, 1959) (as amended by 35 Fed. Reg. 17,840 (1970)).

174. Treas. Reg. § 1.9100-1(a).

175. *See* Rev. Proc. 79-63, 1979-2 C.B. 578.

In addition, the regulations expressly limited relief to the income tax provisions of the Internal Revenue Code.[176]

In April 1991, the Treasury adopted temporary regulations extending the relief provision to estate taxes.[177] However, the Service cannot grant an extension when the statute establishes the time for making the election.[178]

Originally, an estate had to make a special use election not later than the time prescribed for filing the federal estate tax return.[179] In 1981, Congress amended section 2032A(d)(1) to provide that the election "shall be made on the

176. Treas. Reg. § 1.9100-1(a).

177. Temp. Treas. Reg. § 301.9100-1T, T.D. 8342, 56 Fed. Reg. 14,023 (1991). The relevant portion provides as follows:

> 301.9100-1T Extension of time for making certain elections (temporary).
>
> (a) *In general.* The Commissioner in his discretion may, upon good cause shown, grant a reasonable extension of the time fixed by regulations or by a revenue ruling, a revenue procedure, a notice, or an announcement published in the Internal Revenue Bulletin for the making of an election or application for relief in respect of tax under all subtitles of the Internal Revenue Code except subtitles E, G, H, and I, provided—
>
> (1) The time for making such election or application is not expressly prescribed by statute;
>
> (2) Request for the extension is filed with the Commissioner before the time fixed for making such election or application, or within such time thereafter as the Commissioner may consider reasonable under the circumstances; and
>
> (3) It is shown to the satisfaction of the Commissioner that the granting of the extension will not jeopardize the interests of the Government. For purposes of this section, an application for an extension of time for filing a return under section 6081 is not an application for relief in respect of tax.
>
> (b) *Special transitional rule for elections under subtitles B, C, D, and F required to be made prior to Apr. 5, 1991.* Taxpayers may request relief under this paragraph (b) for elections or applications for relief under subtitles B, C, D, and F required to be made prior to Apr. 5, 1991, for any year as to which the period of limitations has not expired. Requests for relief must be filed with the Commissioner by the later of Oct. 2, 1991, or the date that is one year after the date the election or application was required to be made. In addition to satisfying all other requirements for relief, a taxpayer must demonstrate clear evidence of intent to make the specific election or application at the time it was required to be made.

178. Temp. Treas. Reg. § 301.9100-1T(a)(1).

179. I.R.C. § 2032A(d)(1) (1976). Under the original provision, the time for making the election is clearly established by statute and falls outside the scope of Temp. Treas. Reg. § 301.9100-1T. For example, see Tech. Adv. Mem. 85-26-004 (Feb. 27, 1985), where I.R.C. § 404(a)(6) required that the taxpayer make a contribution to a pension plan "not later than the time prescribed by law for filing the return." The Service ruled that Treas. Reg. § 1.9100-1 was not applicable.

return of the tax imposed by section 2001."[180] The purpose of the amendment was to permit an estate to make an election on a late return if that return is the first return that the estate files.[181] The issue, therefore, becomes whether section 2032(d)(1) establishes the time within which to make the special use election for purposes of applying the section 9100 regulations.

In Rev. Rul. 86-104,[182] a corporation failed to pay dividends to its shareholders, resulting in undistributed personal holding company income. The statute permitted the corporation to make a deficiency dividend within ninety days of the "determination" of liability for the personal holding company tax.[183] The statute defines "determination" to be either a Tax Court decision, a closing agreement, or an agreement signed by the Secretary and the taxpayer relating to the tax liability.[184] In determining that the section 9100 regulations did not apply, the Service stated:

> Section 547(d) of the Code sets a fixed period (90 days) within which the taxpayer must act following any of three types of determination, as defined in section 547(c). Section 1.547-2(b)(1) of the regulations merely clarifies when the determination occurs. Thus, it is the statute and not the regulations that fixes the time within which the dividend must be distributed if the personal holding company tax is to be avoided.[185]

This holding would seem to apply to special use elections. Although the statute does not specify a fixed day that can be readily ascertained, it clearly associates the election with a specified event.

An argument can be advanced, however, that the statute only requires the estate to make the election on the first return filed and does not require the estate to file the return at any specific time. It follows that the statute directs where the es-

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180. ERTA, *supra* note 40, at § 421(j)(3), 95 Stat. at 313.

181. H.R. CONF. REP. NO. 215, 97th Cong., 1st Sess. 249 (1981), *reprinted in* 1981-2 C.B. 481, 508.

182. 1986-2 C.B. 80.

183. I.R.C. § 547(a), (d)(1) (1988).

184. I.R.C. § 547(c).

185. Rev. Rul. 86-104, 1986-2 C.B. 80, 81.

tate must make the election, but not when.[186]

In a similar setting, an entity is required to elect to be treated as a real estate mortgage investment conduit (REMIC) "on its return for such 1st taxable year."[187] The temporary regulations add the requirement that the taxpayer make the election on a timely filed return and expressly provide for the applicability of the section 9100 regulations.[188] The Service has applied the 9100 regulations to permit entities to make REMIC election on a late return.[189] However, it is unclear whether the Service will permit the entity to rely on the 9100 regulations when it fails to make the election on its first return.

Another potential problem with respect to seeking relief under the 9100 regulations is that the Service has discretion in determining whether to grant an extension of time to make the election.[190] Based on the Service's past performance in the special use arena, one has to be skeptical as to whether the Service regularly will exercise that discretion to benefit estates making defective elections.

V. PROPOSED LEGISLATION

Corrective legislation recently has been introduced jointly by the House Ways and Means Committee Chairman, Dan Rostenkowski, and the Senate Finance Committee Chairman, Lloyd Bentsen.[191] The act would amend section 2032A(d)(3) to read as follows:

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186. In a similar setting, it is claimed that the Service informally has indicated its intent to apply the 9100 regulations with respect to elections concerning qualified terminable interest property as provided in I.R.C. § 2056(b)(7)(B)(v). *See* Kathleen Ford Bay, *Prescription to Cure a Defective QTIP Election: (If Taken Before October 2, 1991)*, PROB. & PROP., September/October 1991, at 30.

187. I.R.C. § 860D(b)(1).

188. "See § 1.9100 for rules regarding extensions of time for making elections." Temp. Treas. Reg. § 1.860D-1T(d)(1) (1991).

189. *See, e.g.*, Priv. Ltr. Rul. 91-11-057 (Dec. 18, 1990); Priv. Ltr. Rul. 91-08-008 (Nov. 19, 1990); Priv. Ltr. Rul. 90-06-009 (Feb. 9, 1990).

190. Temp. Treas. Reg. § 301.9100-1T(a). For the criteria to be applied in exercising this discretion, see *supra* note 175 and accompanying text.

191. Tax Simplification Act of 1991, H.R. 2777, 102nd Cong., 1st Sess. (1991), S. 1394, 102nd Cong., 1st Sess. (1991). *See also* STAFF OF THE JOINT COMMITTEE ON TAXATION, 102ND CONG., 1ST SESS., TECHNICAL EXPLANATION OF THE TAX SIMPLIFICATION ACT OF 1991 (HR 2777 & S 1394) (Comm. Print 1991).

> (3) MODIFICATION OF ELECTION AND AGREEMENT TO BE PERMITTED.—The Secretary shall prescribe procedures which provide that in any case in which the executor makes an election under paragraph (1) (and submits the agreement referred to in paragraph (2)) within the time prescribed therefor, but —
>
> (A) the notice of election does not contain all required information, or
>
> (B) signatures of 1 or more persons required to enter into the agreement described in paragraph (2) are not included on the agreement as filed, or the agreement does not contain all required information,
>
> the executor will have a reasonable period of time (not exceeding 90 days) after notification of such failures to provide such information or signatures.[192]

Since the drafters have not limited relief to those estates that have substantially complied with the requirements,[193] this provision, if enacted, would enable the vast majority of estates to perfect their elections.[194] Congress, however, should consider two changes to the legislation.

First, the legislation requires an estate to file a recapture agreement with its original estate tax return, even though it can later add one or more names to the agreement.[195] However, there are many rulings and cases where estates have failed to file any recapture agreement.[196] The Service can argue that it is imperative that all qualified heirs (except those holding insubstantial interests) sign the original agreement to ensure that it can collect the recapture tax from the qualified heirs in the event of a disposition of the qualified real property or a cessation of the qualified use.[197] However, since the only

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192. Tax Simplification Act of 1991, H.R. 2777, 102nd Cong., 1st Sess. (1991), S. 1394, 102nd Cong., 1st Sess. (1991).

193. Compare the proposed legislation with current I.R.C. § 2032A(d)(3); *see supra* note 62 and accompanying text.

194. This assumes, of course, that the provision is not limited by restrictive committee reports.

195. There is no requirement in the proposed legislation that those persons to be added possess only interests "with relatively small value" as required by the 1984 Conference Report interpreting I.R.C. § 2032A(d)(3) as currently enacted. 1984 CONFERENCE REPORT, *supra* note 67, at 1241, 1984-3 C.B. (Vol. 2) at 495.

196. *See supra* notes 82-83 and accompanying text.

197. For a discussion of the merits of this argument, see *supra* notes 47-53 and accompanying text.

requirement under the proposed legislation is that the estate submit an agreement, the proposed legislation fails even to accomplish this questionable objective.[198] As a result, no valid purpose is served by requiring the estate to file any agreement with the original election.

In addition, the proposed legislation applies only to the estates of decedents dying after the date of enactment.[199] When Congress enacted the current section 2032A(d)(3),[200] it applied the legislation retroactively to decedents dying after 1976, giving estates one year from the date of enactment to apply for a refund.[201] Section 1421[202] applied to all estates with respect to which the statute of limitations for assessment or refund of tax had not expired prior to the date of enactment.[203]

Congress understandably may be reluctant to retroactively apply the proposed legislation to all decedents dying after 1976. The number of estates affected by the change would be substantial, and it could place an unreasonable burden on the Service to process a large number of refund claims within a fairly short period of time. In addition, Congress also has to consider the deleterious effect that a retroactive application would have on the budget deficit.[204]

However, there is less concern about applying the amendment to those estates for which the statute of limitations remains open. This compromise would limit both the administrative burden on the Service and the negative impact on the budget, while permitting some estates to receive the

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198. Since an agreement has been part of Schedule A-1 of Form 706 since the release of the November 1987 version, perhaps the submission of a blank agreement satisfies the statutory requirement.

199. Tax Simplification Act of 1991, H.R. 2777, 102nd Cong., 1st Sess. § 505(b) (1991), S. 1394, 102nd Cong., 1st Sess. § 505(b) (1991).

200. *See supra* notes 62-63 and accompanying text.

201. Deficit Reduction Act, *supra* note 62, at § 1025(b), 98 Stat. at 1031.

202. *See supra* notes 121-22 and accompanying text.

203. Tax Reform Act, *supra* note 77, at § 1421(c), 100 Stat. at 2716.

204. It is impossible to determine the amount of tax that would have to be refunded. It is instructive to note, however, that if the Service disallowed a special use election filed in October 1977 that would have saved $100,000 in estate tax, the estate would be entitled to receive that amount as a refund, together with interest in excess of $275,000, computed in accordance with I.R.C. § 6611 (1988).

benefit of the special use election as originally intended by Congress.

VI. CONCLUSION

The Service is not entirely to blame for the current status of the law with respect to perfecting special use elections.[205] Congress is responsible for enacting an extremely complex piece of legislation and authorizing the Treasury to develop regulations to prescribe the manner in which the election should be made.[206]

The Treasury should garner a large portion of the blame. In accordance with statutory authority, the Treasury promulgated regulations directing estates to furnish fourteen categories of information, together with an agreement signed by the qualified heirs and all other persons having any interest in the elected property.[207] Besides taking extremely restrictive positions with respect to the eligibility to make the election,[208] the regulations require estates to submit an unprecedented amount of information to perfect a special use election.

Congress, in an attempt to rein in the Service's strict enforcement of the regulations, passed two provisions intended to liberalize the election procedure.[209] These provisions were

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205. In fact, the Service should be commended for amending Form 706 to make it easier for estates to file special use elections.

206. I.R.C. § 2032A(d)(1).

207. Treas. Reg. § 20.2032A-8(a)(3), (c)(1).

208. Since the enactment of the regulations, the courts have invalidated at least four separate provisions. *See* Smoot v. United States, 892 F.2d 597 (7th Cir. 1989) (invalidating that portion of Treas. Reg. § 20.2032A-8(a)(2) that prohibited an estate from electing special valuation when a life tenant had the ability to divest ownership of the qualified property away from the qualified remaindermen by virtue of the exercise of a limited power of appointment); Miller v. United States, 680 F. Supp. 1269 (C.D. Ill. 1988) (invalidating that portion of Treas. Reg. § 20.2032A-8(a)(2) that added an additional threshold requirement for electing to specially value property which was not contained in the statute); Estate of Davis v. Commissioner, 86 T.C. 1156 (1986) (invalidating that portion of Treas. Reg. § 20.2032A-8(a)(2) that prohibited an estate from electing special valuation when there was even a remote possibility that the qualified property might pass to a non-qualified heir); Estate of Pullin v. Commissioner, 84 T.C. 789 (1985), *acq. in result*, 1988-2 C.B. 1 (invalidating that portion of Treas. Reg. § 20.2032A-8(c)(2) that required tenants in common with the decedent to sign the recapture agreement as other interested parties).

It is unlikely that the courts have found any other single set of regulations to be so contrary to congressional intent.

209. I.R.C. § 2032A(d)(3) enacted by the Deficit Reduction Act, *supra* note 62, at

well intended, but ineffective.[210]

The courts also must shoulder some responsibility. It is clear that, from the beginning, Congress attempted to provide the American farmer with a targeted tax break.[211] Although sometimes constrained by committee reports, the courts consistently have failed to give section 2032A and the corrective legislation the effect Congress intended.[212]

Finally, it is impossible to ignore the practitioners' share of the responsibility. All professionals in the estate area have been aware for over a decade that the Service strictly construes the requirements set forth in the regulations. Yet they continue to file elections that fail to comply with those regulations.

The only parties who are blameless are the nation's farmers. Unfortunately, the farmers must shoulder the financial burden resulting from this debacle.[213]

It is apparent that the only solution to the problem is a comprehensive amendment to section 2032A(d)(3) that liberalizes the rules with respect to perfecting deficient elections. The legislation recently proposed in both the House of Representatives and the Senate is a promising first step. With only minor modification, it could become the needed response to a fifteen-year-old problem.

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§ 1025(a), 98 Stat. at 1030, and § 1421 enacted by the Tax Reform Act, *supra* note 77, at § 1421, 100 Stat. at 2716.

210. A large portion of the problem, particularly with respect to I.R.C. § 2032A(d)(3), may be attributable to the committee reports that accompanied the statute.

211. In this regard, note the Seventh Circuit's well-intentioned opinion in Prussner v. United States, 896 F.2d 218 (7th Cir. 1990). However, the Seventh Circuit seemed insensitive to the farmer's plight when it stated:

> Ben Franklin once said that in this world, nothing can be said to be certain but death and taxes. This case calls for a variation on the old adage. Add some unfortunate mistakes by a well-meaning lawyer to the picture and the saying becomes: nothing can be said to be certain but death and higher taxes.

Bartlett v. Commissioner, 937 F.2d 316, 317 (7th Cir. 1991).

212. *But see* Prussner v. United States, 896 F.2d 218 (7th Cir. 1990); Estate of McAlpine v. Commissioner, 96 T.C. 134 (1991).

213. The possibility exists, of course, that estates can recoup their losses from the attorney preparing the estate tax return. *See, e.g.*, Foss v. United States, 88-1 U.S.T.C ¶ 13,762 (D.C. Minn. 1987), *rev'd*, 865 F.2d 178 (8th Cir. 1989).