

town. F supplied all machinery and equipment and assumed financial responsibility for the expenses of the farm operation. The contract specified that G was to submit a crop plan and a list of expenses and earnings for F's approval. It also called for F to inspect the farm regularly and to approve all expenditures over \$100. In practice, F visited the farm weekly during the growing season to inspect and discuss operations. He actively participated in making important management decisions such as what fields to plant or pasture and how to utilize the subsidy program. F is deemed to have materially participated in the farm operation as his personal involvement amounted to more than managing an investment. Had F not regularly inspected the farm and participated in management decisions, however, he would not be considered to be materially participating. This would be true even though F did assume financial responsibility for the operation and did review annual crop plans.

*Example (5).* Decedent I owned 90 percent of all outstanding stock of X Corporation, a qualified closely-held business which owns real property to be specially valued. I held no formal position in the corporation and there was no arrangement for him to participate in daily business operations. I regularly spent several hours each day at the corporate offices and made decisions on many routine matters. I is not deemed to have materially participated in the X Corporation despite his activity because there was no arrangement requiring him to act in the manner in which he did.

*Example (6).* Decedent J was a senior partner in the law firm of X, Y, and Z, which is a qualified closely held business owning the building in which its offices are located. J ceased to practice law actively 5 years before his death in 1977; however, he remained a full partner and annually received a share of firm profits. J is not deemed to have materially participated under section 2032A even though he still may have reported his distributive share of partnership income for self-employment income tax purposes if the payments were not made pursuant to any retirement agreement. This is so because J does not meet the requirement of actual personal material participation.

*Example (7).* K, the decedent, owned a tree farm. He contracted with L, a professional forester, to manage the property for him as K, a doctor, lived and worked in a town 50 miles away. The activities of L are not considered in determining whether K materially participated in the tree farm operation. During the 5 years preceding K's death, there was no need for frequent inspections of the property or consultation concerning it, inasmuch as most of the land had been reforested and the trees were in the beginning stages of their growing cycle. However, once every

year, L submitted for K's approval a proposed plan for the management of the property over the next year. K actively participated in making important management decisions, such as where and whether a pre-commercial thinning should be conducted, whether the timber was adequately protected from fire and disease, whether fire lines needed to be plowed around the new trees, and whether boundary lines were properly maintained around the property. K inspected the property at least twice every year and assumed financial responsibility for the expenses of the tree farm. K also reported his income from the tree farm as earned income for purposes of the tax on self-employment income. Over a period of several years, K had harvested and marketed timber from certain tracts of the tree farm and had supervised replanting of the areas where trees were removed. K's history of harvesting, marketing, and replanting of trees showed him to be in the business of tree farming rather than merely passively investing in timber land. If the history of K's tree farm did not show such an active business operation, however, the tree farm would not qualify for special use valuation. In light of all these facts, K is deemed to have materially participated in the farm as his personal involvement amounted to more than managing an investment.

*Example (8).* Decedent M died on January 1, 1978, owning a farm for which special use valuation under section 2032A has been elected. M owned the farm real property for 15 years before his death. During the 4 years preceding M's death (January 1, 1974 through December 31, 1977), the farm was rented to N, a non-family member, and neither M nor any member of his family materially participated in the farming operation. From January 1, 1970, until December 31, 1973, both M and his daughter, O, materially participated in the farming operation. The material participation requirement of section 2032A(b)(1)(C)(ii) is not satisfied because material participation did not occur for periods aggregating at least 5 different years of the 8 years preceding M's death.

[T.D. 7710, 45 FR 50739, July 31, 1980, as amended by T.D. 7786, 46 FR 43037, Aug. 26, 1981]

#### § 20.2032A-4 Method of valuing farm real property.

(a) *In general.* Unless the executor of the decedent's estate elects otherwise under section 2032A(e)(7)(B)(ii) or fails to document comparable rented farm property meeting the requirements of this section, the value of the property which is used for farming purposes and which is subject to an election under section 2032A is determined by—

(1) Subtracting the average annual state and local real estate taxes on actual tracts of comparable real property in the same locality from the average annual gross cash rental for that same comparable property, and

(2) Dividing the result so obtained by the average annual effective interest rate charged on new Federal land bank loans.

The computation of each average annual amount is to be based on the 5 most recent calendar years ending before the date of the decedent's death.

(b) *Gross cash rental*—(1) *Generally.* Gross cash rental is the total amount of cash received for the use of actual tracts of comparable farm real property in the same locality as the property being specially valued during the period of one calendar year. This amount is not diminished by the amount of any expenses or liabilities associated with the farm operation or the lease. *See*, paragraph (d) of this section for a definition of comparable property and rules for property on which buildings or other improvements are located and farms including multiple property types. Only rentals from tracts of comparable farm property which are rented solely for an amount of cash which is not contingent upon production are acceptable for use in valuing real property under section 2032A (e) (7). The rentals considered must result from an arm's-length transaction as defined in this section. Additionally, rentals received under leases which provide for payment solely in cash are not acceptable as accurate measures of cash rental value if involvement by the lessor (or a member of the lessor's family who is other than a lessee) in the management or operation of the farm to an extent which amounts to material participation under the rules of section 2032A is contemplated or actually occurs. In general, therefore, rentals for any property which qualifies for special use valuation cannot be used to compute gross cash rentals under this section because the total amount received by the lessor does not reflect the true cash rental value of the real property.

(2) *Special rules*—(i) *Documentation required of executor.* The executor must identify to the Internal Revenue Serv-

ice actual comparable property for all specially valued property and cash rentals from that property if the decedent's real property is valued under section 2032A(e)(7). If the executor does not identify such property and cash rentals, all specially valued real property must be valued under the rules of section 2032A(e)(8) if special use valuation has been elected. *See*, however, §20.2032A-8(d) for a special rule for estates electing section 2032A treatment on or before August 30, 1980.

(ii) *Arm's-length transaction required.* Only those cash rentals which result from a lease entered into in an arm's-length transaction are acceptable under section 2032A(e)(7). For these purposes, lands leased from the Federal government, or any state or local government, which are leased for less than the amount that would be demanded by a private individual leasing for profit are not leased in an arm's-length transaction. Additionally, leases between family members (as defined in section 2032A(e)(2)) which do not provide a return on the property commensurate with that received under leases between unrelated parties in the locality are not acceptable under this section.

(iii) *In-kind rents, statements of appraised rental value, and area averages.* Rents which are paid wholly or partly in kind (*e.g.*, crop shares) may not be used to determine the value of real property under section 2032A(e)(7). Likewise, appraisals or other statements regarding rental value as well as area-wide averages of rentals (*i.e.*, those compiled by the United States Department of Agriculture) may not be used under section 2032A(e)(7) because they are not true measures of the actual cash rental value of comparable property in the same locality as the specially valued property.

(iv) *Period for which comparable real property must have been rented solely for cash.* Comparable real property rented solely for cash must be identified for each of the five calendar years preceding the year of the decedent's death if section 2032A(e)(7) is used to value the decedent's real property. Rentals from the same tract of comparable property need not be used for each of

these 5 years, however, provided an actual tract of property meeting the requirements of this section is identified for each year.

(v) *Leases under which rental of personal property is included.* No adjustment to the rents actually received by the lessor is made for the use of any farm equipment or other personal property the use of which is included under a lease for comparable real property unless the lease specifies the amount of the total rental attributable to the personal property and that amount is reasonable under the circumstances.

(c) *State and local real estate taxes.* For purposes of the farm valuation formula under section 2032A(e)(7) state and local taxes are taxes which are assessed by a state or local government and which are allowable deductions under section 164. However, only those taxes on the comparable real property from which cash rentals are determined may be used in the formula valuation.

(d) *Comparable real property defined.* Comparable real property must be situated in the same locality as the specially valued property. This requirement is not to be viewed in terms of mileage or political divisions alone, but rather is to be judged according to generally accepted real property valuation rules. The determination of properties which are comparable is a factual one and must be based on numerous factors, no one of which is determinative. It will, therefore, frequently be necessary to value farm property in segments where there are different uses or land characteristics included in the specially valued farm. For example, if section 2032A(e)(7) is used, rented property on which comparable buildings or improvements are located must be identified for specially valued property on which buildings or other real property improvements are located. In cases involving multiple areas or land characteristics, actual comparable property for each segment must be used, and the rentals and taxes from all such properties combined (using generally accepted real property valuation rules) for use in the valuation formula given in this section. However, any premium or discount resulting from the presence of multiple uses or other characteristics in one farm is also to be re-

flected. All factors generally considered in real estate valuation are to be considered in determining comparability under section 2032A. While not intended as an exclusive list, the following factors are among those to be considered in determining comparability—

(1) Similarity of soil as determined by any objective means, including an official soil survey reflected in a soil productivity index;

(2) Whether the crops grown are such as would deplete the soil in a similar manner;

(3) The types of soil conservation techniques that have been practiced on the two properties;

(4) Whether the two properties are subject to flooding;

(5) The slope of the land;

(6) In the case of livestock operations, the carrying capacity of the land;

(7) Where the land is timbered, whether the timber is comparable to that on the subject property;

(8) Whether the property as a whole is unified or whether it is segmented, and where segmented, the availability of the means necessary for movement among the different segments;

(9) The number, types, and conditions of all buildings and other fixed improvements located on the properties and their location as it affects efficient management and use of property and value per se; and

(10) Availability of, and type of, transportation facilities in terms of costs and of proximity of the properties to local markets.

(e) *Effective interest rate defined*—(1) *Generally.* The annual effective interest rate on new Federal land bank loans is the average billing rate charged on new agricultural loans to farmers and ranchers in the farm credit district in which the real property to be valued under section 2032A is located, adjusted as provided in paragraph (e)(2) of this section. This rate is to be a single rate for each district covering the period of one calendar year and is to be computed to the nearest one-hundredth of one percent. In the event that the district billing rates of interest on such new agricultural loans change during a year, the rate for that year is to be

weighted to reflect the portion of the year during which each such rate was charged. If a district's billing rate on such new agricultural loans varies according to the amount of the loan, the rate applicable to a loan in an amount resulting from dividing the total dollar amount of such loans closed during the year by the total number of the loans closed is to be used under section 2032A. Applicable rates may be obtained from the district director of internal revenue.

(2) *Adjustment to billing rate of interest.* The billing rate of interest determined under this paragraph is to be adjusted to reflect the increased cost of borrowing resulting from the required purchase of land bank association stock. For section 2032A purposes, the rate of required stock investment is the average of the percentages of the face amount of new agricultural loans to farmers and ranchers required to be invested in such stock by the applicable district bank during the year. If this percentage changes during a year, the average is to be adjusted to reflect the period when each percentage requirement was effective. The percentage is viewed as a reduction in the loan proceeds actually received from the amount upon which interest is charged.

(3) *Example.* The determination of the effective interest rate for any year may be illustrated as follows:

*Example.* District X of the Federal land bank system charged an 8 percent billed interest rate on new agricultural loans for 8 months of the year, 1976, and an 8.75 percent rate for 4 months of the year. The average billing rate was, therefore, 8.25 percent [(1.08 × 8/12) + (1.0875 × 4/12)=1.0825]. The district required stock equal to 5 percent of the face amount of the loan to be purchased as a precondition to receiving a loan. Thus, the borrower only received 95 percent of the funds upon which he paid interest. The applicable annual interest rate for 1976 of 8.68 percent is computed as follows:

8.25 percent × 1.00 (total loan amount)=8.25 percent (billed interest rate) divided by 0.95 (percent of loan proceeds received by borrower)= 8.68 percent (effective interest rate for 1976).

[T.D. 7710, 45 FR 50742, July 31, 1980]

**§ 20.2032A-8 Election and agreement to have certain property valued under section 2032A for estate tax purposes.**

(a) *Election of special use valuation—*  
 (1) *In general.* An election under section 2032A is made as prescribed in paragraph (a)(3) of this section and on Form 706, United States Estate Tax Return. Once made, this election is irrevocable; however, see paragraph (d) of this section for a special rule for estates for which elections are made on or before August 30, 1980. Under section 2032A(a)(2), special use valuation may not reduce the value of the decedent's estate by more than \$500,000. This election is available only if, at the time of death, the decedent was a citizen or resident of the United States.

(2) *Elections to specially value less than all qualified real property included in an estate.* An election under section 2032A need not include all real property included in an estate which is eligible for special use valuation, but sufficient property to satisfy the threshold requirements of section 2032A(b)(1)(B) must be specially valued under the election. If joint or undivided interests (e.g. interests as joint tenants or tenants in common) in the same property are received from a decedent by qualified heirs, an election with respect to one heir's joint or undivided interest need not include any other heir's interest in the same property if the electing heir's interest plus other property to be specially valued satisfy the requirements of section 2032A(b)(1)(B). If successive interests (e.g. life estates and remainder interests) are created by a decedent in otherwise qualified property, an election under section 2032A is available only with respect to that property (or portion thereof) in which qualified heirs of the decedent receive all of the successive interests, and such an election must include the interests of all of those heirs. For example, if a surviving spouse receives a life estate in otherwise qualified property and the spouse's brother receives a remainder interest in fee, no part of the property may be valued pursuant to an election under section 2032A. Where successive interests in specially valued property are created, remainder interests are treated as being received by qualified