

A farmer's estate plan fails

Mary and Joseph Artalls were family farmers. In 1976 Joseph created a corporation to hold the farm's land. He died in 1998. Two of their children participated in the operation of the farm. In 2001, a limited liability company (LLC) was formed to own the farm assets exclusive of the land, such as livestock, equipment and supplies. The participating children bought out the interest of the nonparticipant, so that they each owned 25% of the LLC and Mary owned 50%.

At the outset, the LLC had very little cash to work with. To allow the farm to operate, Mary made eight unsecured loans to the LLC totaling \$343,000. The debt was unpaid when Mary died in 2001.

The children, who were coexecutors of the estate, lumped together the debt, the 50% LLC interest, Mary's shares in the corporation that owned the land, and the value of farm trucks that were still in her name to come up with a total value of \$608,327 as a "qualified family-owned business interest" (QFOBI). Under the tax code in effect for 2001, up to \$675,000 in a QFOBI was exempt from federal estate tax, provided that it was greater than 50% of the adjusted gross estate. This, plus the unified credit then allowable, apparently eliminated the estate tax for Mary's estate.

That is, until the IRS audited the estate and held that the loans were not "an interest in the business" within the meaning of the statute. Only an equity interest is eligible, according to the IRS. If the \$343,000 is subtracted from the QFOBI, the 50% test is unmet. The whole \$608,327 had to be added back to the estate, triggering a federal estate tax of \$247,101.

In the Tax Court, the children argued without success that the statute does not define a business interest as an ownership or equity interest. The Fifth Circuit Court of Appeals confirmed that, whatever the literal language, Congress intended that only equity interests should qualify for the favorable estate tax treatment. The IRS' interpretation was correct.

Although Congress repealed the QFOBI exclusion for estates of decedents dying after December 31, 2003, because the exempt amount was then large enough to provide such protection to all estates, this tax break is scheduled to return for estates of decedents dying after December 31, 2010. Agricultural families take note! If Congress fails to act this year, this case will become relevant to estate planners advising farm families.

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