1-13-2014

Van Alen: A Reasonable Consistency

Wendy G. Gerzog
University of Baltimore School of Law, wgerzog@ubalt.edu

Van Alen: A Reasonable Consistency

By Wendy C. Gerzog

Wendy C. Gerzog

Wendy C. Gerzog is a professor at the University of Baltimore School of Law.

In *Van Alen*, the Tax Court held that the duty of consistency required that two of the decedent's children use the section 2032A basis valuation figures to determine gain on the sale of their interest in the decedent's ranch, which was left to them in trust.

In *Van Alen*,[1] sibling beneficiaries of their father's ranch interest that was left to them in trust received a special use valuation under section 2032A. They claimed that the valuation should not be used when figuring their income tax liability on the sale of a portion of the ranch, arguing that their stepmother erroneously completed their father's estate tax return.

The siblings, California residents, were the children of their father's second marriage. They had a poor relationship with their stepmother, their father's third wife. After their father's death in May 1994, one of the siblings, Shana, lived on the ranch with her three children. Her brother, Brett, lived elsewhere and worked for other ranchers.

Their stepmother, Bonnie, was the executor of her husband's estate. The will lacked an apportionment clause regarding estate tax liability. To value the ranch interest, Bonnie hired Grey, a deputy probate referee, and he estimated the ranch interest at $1.96 million. Bonnie also hired Green, an attorney, who with her filed the decedent's estate tax return using a significantly lower value for the ranch interest — $144,823 under section 2032A(d)(2). Green determined an estate tax liability of about $100,000.

In accordance with section 2032A, Bonnie, Shana, and Brett, as qualified heirs under the statute, executed and attached to the estate tax return the agreement for the use of special valuation.[2] By signing the agreement, the heirs are deemed to have "actual or constructive understanding that completing the form is required" to obtain the lower valuation under the statute.

The government asserted that the value of the ranch interest on the return should have been $427,500; the estate countered with an even lower figure, $98,000. The government acceded to the low figure. Although it did not expressly say, the government's acceptance was probably because the estate increased its section 2032A valuations on two other properties. That resulted in the government's increasing the value of all the estate property to about $1 million.

In light of that settlement, the court found that it was the trust beneficiaries who mainly benefited from the ranch interest's low valuation. The court held that if the ranch interest had been properly valued, because the estate lacked liquidity and the will had no apportionment clause, the beneficiaries would have had to sell at least part of the ranch to pay the additional estate taxes.

In May 2007 the trust received $910,000 from the sale of an easement located on the ranch. In June 2008, after applying a basis of about $100,000 and taking deductions, the trust reported about $720,000 of income that was distributed to Shana and Brett, with each receiving a Schedule K-1 for their half, or $360,000, of the net capital gain. A few months later, the trust filed an amended return, doubling the basis originally reported and reducing each of the siblings' gain to about $310,000. However, neither Shana nor Brett reported any gain from the sale on their 2007 individual income tax returns.

In February 2009 the government sent a notice to Brett and his wife, and in August 2009 it sent one to Shana and her husband, notifying them of their income tax balance due. The notices explained that their individual returns did not match the trust's return, and proposed an accuracy-related penalty.

---

[1] *Van Alen v. Commissioner*, T.C. Memo. 2013-235.

[2] Brett's mother, Virginia, as guardian ad litem and as trustee, signed for him because he was a minor at the time. Neither Shana nor Brett claimed their mother acted improperly. *Id.*, Op. at 8.

When neither Shana nor Brett complied with the notices, the government issued notices of deficiency.

After receiving his notice of deficiency, Brett contacted a CPA, Simmons, who serendipitously called Grey. Grey told Simmons he was the original appraiser for the estate and that he had valued the ranch at almost $2 million. Simmons submitted an amended 2007 return on behalf of the trust, applying a basis of about $900,000 to Brett and Shana's ranch interest. Using that figure, Simmons determined Brett and Shana's gain to be less than $25,000. And after applying deductions, Simmons was able to eliminate all of that gain. Simmons attached an explanation that said the trust's reduced gain was attributable to a computation error in calculating Brett and Shana's basis in their ranch interest. Simmons relied on a 1954 revenue ruling[3] that he characterized as stating, ''If there was a mistake made and you could prove that the mistake was made and you had evidence that the value was wrong, then you could use [the new] value.''[4]

The government maintained that despite calculation or other errors that contributed to the lower section 2032A valuation of their ranch interest, Shana and Brett were still required by precedent to use that value to calculate their gain when a part of that interest was sold.

In its decision, the court said the purpose of section 2032A is to allow some property to be valued at its actual use instead of the usual fair market value that requires property to be valued at its highest and best use. ''Section 2032A is an exception to this general rule and embodies a congressional judgment that the heirs of small businesses and farms should not be forced by death to sell their family's legacy to pay the taxman,''[5] said the court. To take advantage of that reduced value provision, a decedent must be a U.S. citizen or resident; the property must be qualified real property, such as a farm, which definition includes a ranch, and that property must comprise a specific percentage of the decedent's estate; the executor must make an election to use the provision; and, most pertinent here, the qualified heirs, which include specific family beneficiaries, must sign a personal liability agreement.

As the court explained, although the basis of property received from a decedent is generally valued on the date of the decedent's death, section 1014(a)(3) requires that property valued under section 2032A use the special use value, as determined under that valuation exception, as its basis. The court was not persuaded by Brett's reliance on the 1954 revenue ruling, which it said concerned the general rule under section 1014(a)(1) and not the applicable statute, section 1014(a)(3). Moreover, the court said it preferred to base its holding on the doctrine of the duty of consistency.

Citing *Janis*,[6] the court said that the duty of consistency functions principally to preclude Brett or Shana from unfairly changing their position. An equitable, quasi-estoppel principle, the doctrine does not allow a taxpayer ''to benefit from his own prior error or omission.''[7] According to the Ninth Circuit — the circuit to which *Van Alen* is appealable — to invoke the doctrine, the government must prove three conditions: (1) taxpayer representation; (2) government reliance; and (3) after the statute of limitations has run, that the taxpayer altered his original representation, resulting in harm to the government.

Brett and Shana denied that they had made any earlier representations on their father's estate tax return. They claimed they were neither the executor nor any other fiduciary, but merely beneficiaries of the estate. However, the court held that under relevant case law,[8] the first requirement applies both to the taxpayer and to those with ''sufficiently identical economic interests.'' The court found that the siblings and the estate profited by the lower estate tax paid because of the representations made in the estate tax return. It disagreed with the siblings' argument that they could not have a ''sufficient privity of interest'' as required by *Janis*.

The court reviewed *Janis* and held that while the doctrine should not be applied to all estate beneficiaries, Shana and Brett were not only beneficiaries but had executed agreements to allow the estate to make a section 2032A special use valuation election. Even Brett, a minor at that time, was represented by his mother as his guardian ad litem, and neither sibling had ever questioned their mother's representation in that role or as trustee.

The court then discussed *LeFever*, which also involved section 2032A. Seven years after the decedent's death and after the statute of limitations had expired, when they had stopped using the property for its qualified purpose, the taxpayers argued that the property had not initially qualified for special use valuation. The Tenth Circuit held that the

---

[3]Rev. Rul. 54-97, 1954-1 C.B. 113.

[4]*Van Alen*, Op. at 14.

[5]*Id.* at 16.

[6]*Janis v. Commissioner,* 461 F.3d 1080, 1085 (9th Cir. 2006) , *aff'g* T.C. Memo. 2004-117.

[7]*Van Alen*, Op. at 23, citing *LeFever v. Commissioner*, 103 T.C. 525, 541 (1994), *aff'd*, 100 F.3d 778 (10th Cir. 1996).

[8]The court cited to *Janis*; *Estate of Letts v. Commissioner,* 109 T.C. 390, 398 (1997); and *Cluck v. Commissioner,* 105 T.C. 324, 333 (1995).

taxpayers, as qualified heirs, had the requisite privity of interest for the application of the duty of consistency doctrine. The *Van Alen* court likewise held that Shana and Brett's "affirmative consent to elect the section 2032A special use valuation as qualified heirs distinguishes them from beneficiaries that have nothing at all to do with the filing of the estate-tax return."[9] Thus, according to the court, the siblings' representations were essential for the decedent's estate tax return to apply a section 2032A special use valuation.

Finally, the court determined that the government relied on the representations in the election made in the decedent's estate tax return and that the statute of limitations on the estate tax return had run. The harm to the government by the change in Shana and Brett's representations was that the value from the section 2032A election significantly reduced the decedent's estate taxes. The court also said it would be unfair, and contrary to the clear language of section 1014(a)(3), for the siblings to use a different basis to calculate income tax gain from the value asserted on the decedent's estate tax return when they made their special use valuation election. The court imposed section 6662 accuracy-related penalties because Shana and Brett did not prove they had relied on professional advice before they filed their returns. Indeed, they did not contact Simmons until more than a year later.

Janis

Janis, like *Van Alen*, involved two siblings who had their case tried in the Tax Court, but unlike in *Van Alen*, the siblings were both co-executors and sole beneficiaries who were subject to two different jurisdictions, the Second[10] and the Ninth circuits. The Ninth Circuit relied on the duty of consistency as the basis for affirming the Tax Court's decision in favor of the government. The Second Circuit more narrowly affirmed the Tax Court decision, holding that as admitted by the taxpayers, the valuation for estate tax purposes was accurate.

The siblings contended that their father's artwork, a major asset of his estate, was entitled to a blockage discount. After negotiations with the government, each piece of the artwork was valued with a 62 percent discount using the Art Advisory Panel's valuation figures. That valuation markedly reduced the decedent's estate value and estate taxes. After the statute of limitations on the decedent's return expired, the siblings amended several years of the gallery's income tax returns and used the undiscounted value of the artwork as the artworks' basis to produce net operating losses that inured to the benefit of the siblings and their spouses.

Having satisfied the Ninth Circuit's three-part test for the application of the duty of consistency, the court held that Conrad, the sibling who was subject to Ninth Circuit jurisdiction, was estopped from using a value different from the estate tax value as the artwork's basis for income tax purposes. The siblings had represented the value of the artwork in their agreement with the government that was memorialized in their completed waiver Form 890. The court stated that "Conrad had overlapping and co-extensive interests as a beneficiary and co-executor of the estate."[11] Finally, the Ninth Circuit characterized the Tax Court's analysis as a question of fact, and it held that the lower court's determination was not clearly erroneous.

Analysis and Conclusion

The duty of consistency is rooted in the estoppel principles articulated in a 1934 Supreme Court case, *R.H. Sterns Co.*[12] In its relevance to tax matters, "the doctrine thus prevents a taxpayer from claiming that he or she should have paid more tax before and so avoiding the present tax."[13]

As described by the Ninth Circuit in *Janis,* the second and third requirements for imposing that duty are clearly present in *Van Alen.* In *Van Alen*, the Tax Court extended the first requirement — that of taxpayer representation — to the two main beneficiaries of their father's ranch left to them in trust, although they were not fiduciaries on his estate tax return and although Brett, one of the siblings, was a minor. It did that because both Shana and Brett had significantly benefited from the lower section 2032A valuation in the form of paying less estate tax and had signed the requisite election agreement.

The court separately held that section 1014(a)(3) required Shana and Brett to use the special use value as the basis for their ranch interest for income tax purposes. Indeed, the statute unambiguously requires the siblings in *Van Alen* to adopt as their income tax basis the value used in making the decedent's section 2032A election. While *Van Alen* could have simply been based on section 1014(a)(3),

[9]*Van Alen,* Op. at 31.

[10]*Janis*, 469 F.3d 256 (2d Cir. 2006). *See* Wendy C. Gerzog, "*Janis*: Two Perspectives of Basis," *Tax Notes*, Mar. 26, 2007, p. 1265.

[11]*Janis*, 461 F.3d 1080, 1085 (9th Cir. 2006), citing *LeFever*, 100 F.3d at 788.

[12]*R.H. Sterns Co. v. United States,* 291 U.S. 54 (1934) ("He who prevents a thing from being done may not avail himself of the non-performance which he has himself occasioned." *Id.* at 61. In that same vein, "no one shall be permitted to found any claim upon his own inequity or take advantage of his own wrong." *Id.* at 61-62.).

[13]*Estate of Letts v. Commissioner,* 109 T.C. 290, 296 (1997). *See* Gerzog, "Duty of Consistency and the Marital Deduction: Horse and Carriage," *Tax Notes*, Sept. 19, 2005, p. 1463.

the court also relied on the duty of consistency, finding that Shana and Brett were precluded from applying a higher basis to a trust distribution that they should have paid more estate taxes on the ranch earlier in order to evade their current capital gains income tax liability on the sale of a portion of that ranch.