

**UNITED STATES BANKRUPTCY COURT**

**DISTRICT OF SOUTH DAKOTA**

**ROOM 211**

**FEDERAL BUILDING AND U.S. POST OFFICE**

**225 SOUTH PIERRE STREET**

**PIERRE, SOUTH DAKOTA 57501-2463**

**IRVIN N. HOYT**  
**BANKRUPTCY JUDGE**

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December 12, 1989

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Re: Clarence J. Hurn  
Chapter 12 89-30038

Dear Counsel:

The Court has before it two issues relating to the confirmation of debtor C.J. Hurn's Chapter 12 plan of reorganization. The first issue, raised by Trustee John Lovald, concerns the propriety of considering a special use tax lien filed by the Interval Revenue Service against 's undistributed one-fifth interest in the A.D. Trust. The second issue, likewise raised by Trustee Lovald, concerns the accuracy of 's estimation that his 1989 income taxes would total approximately \$15,000.00.

FACTS

Hurn owns and operates 310 acres in Hughes County, South Dakota and rents an additional 2687 acres of land from the A.D. Trust. The trust, created by his mother, Anna, named and his four siblings as the beneficiaries. Mrs. died in 1981. The trust thereafter elected a special use valuation under § 2032A of the Internal Revenue Code for federal estate tax purposes. The special use election reduced the value of the farm land held by the trust (and thus the attendant estate tax which would be due thereon) from \$642,361.00 to \$480,000. 00. The IRS then filed a lien for the difference between the two valuations (\$162,361.00) against the property. This lien is designed to recapture the

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entire amount of estate tax which would be due and owing if the trust would use the specially valued property in a manner inconsistent with § 2032A. The lien would be released fifteen years after Anna 's death, the holding period required by § 2032A for those decedents who died in 1981. Seven years currently remain on this holding period.

C.J. Hurn filed for protection under Chapter 12 of the Bankruptcy Code on April 28, 1989. His Chapter 12 plan of reorganization was filed July 19, 1989. Section VII of 's plan constituted his liquidation analysis. On August 8, 1989, Trustee Lovald filed his objection to 's plan, claiming inter alia that 's liquidation analysis was insufficient in its description of 's interest in the A.D. Trust and the IRS's secured claims against that trust. Trustee Lovald also objected to the inclusion of certain priority expenses (i.e. income taxes) which he claims should not be deducted in 's liquidation analysis.

A hearing on the confirmation of 's Chapter 12 plan was held on September 13, 1989. At the hearing, Trustee Lovald called Kevin Stulken, a local certified public accountant and a specialist on estate tax matters. In his testimony, Stulken summarized the requirements of qualifying for the § 2032A special use valuation and for remaining so qualified. Stulken also described various scenarios where a transfer of the trust property would not trigger the imposition or recapture of the additional estate tax, including a transfer of the property to a Chapter 7 trustee or to another qualified heir, so long as the transferee otherwise complied with the requirements of the tax code.

Attorney Gary Colwill, representing creditor Fisher's, ~Enc., called Trustee Lovald and examined him concerning Lovald's plans for administering 's interest in the trust in the event that the case would be converted to a Chapter 7 liquidation. (Trustee Lovald serves as both a Chapter 7 and a Chapter 12 trustee.) Lovald testified that he would attempt to avoid the imposition of the additional estate tax by (1) negotiating an agreement with the IRS to avoid the recapture or (2) negotiating the sale of the property to another qualified heir, or (3) holding the property and farming it under a material participation lease for the remainder of the fifteen year period. After hearing the testimony and arguments of counsel, the Court took these matters under advisement.

DECISION

1. Federal Estate Tax

The first question posed is whether may deduct from his share of the trust that portion of the special use tax which is secured by the lien and which would be due and owing if the trust property were used in a manner inconsistent with Internal Revenue Code § 2032A. If so, would have \$58,883.00 in equity in the trust for liquidation analysis purposes. If not, he would have \$91,355.00 in equity for such purposes. (Hurn currently owes \$3,840.00 as his share of the estate tax that is currently payable on the trust and \$805.00 in state real property taxes on his share of the trust. These amounts are not in dispute.)

Section 2032A of the Internal Revenue Code permits real property used for "farming purposes" to be valued for estate tax purposes on the basis of its use as a farm or business rather than upon some speculative use. In *me Moellenbeck*, 83 B.R. 630 (Bkrcty. S.D. Ia. 1988) (citing *Bagleiter*, § 2032A: *Did We Really Save the Family Farm?*, 29 *Drake L.Rev.* 15 (1979-80)). I.R.C. § 6324B creates a lien in favor of the United States on any property which qualifies under § 2032A. The lien is designed to protect the government's interests in the event that a recapture tax or an additional estate tax is imposed. The lien will become unenforceable after fifteen years provided that a qualified heir continues to employ the property for a qualified use.

In this case, Hurn is a qualified heir under § 2032A. If he continues to farm the property until 1996, the estate tax lien will become unenforceable. Likewise, by operation of Internal Revenue Code § 1398(f) (1), the trustee as custodian of the bankruptcy estate could take Hurn's position as a qualified heir. Thus the trustee could continue to qualify the land under I.R.C. § 2032A so long as he employed the property for a qualified use.

The purpose of a liquidation analysis in a plan of reorganization is to insure that the unsecured creditors do not receive less under the plan than they would in a Chapter 7 liquidation. See e.g. *Bankruptcy Code* § 1225(a)(4). This District's Local Rules of Bankruptcy Procedure require that such an analysis be incorporated into the debtor's plan for the purpose of making this determination. See L.B.R. 309. However, the contingent nature of the IRS claim for additional estate tax leads the Court to conclude that it should not be included within the liquidation analysis.

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The testimony adduced at the hearing and at C.J. 's 2004 examination, taken July 21, 1989, was that intended to keep farming the land in a qualified manner for the remaining seven years of the special use holding period. Trustee Lovald likewise testified at the hearing that in a hypothetical Chapter 7 he would employ the land in a manner consistent with § 2032A if he could not otherwise negotiate a favorable agreement on this issue with the Internal Revenue Service. This testimony makes it unlikely at this point that the IRS lien will ever be enforced.

Because of the circumstances and the unlikelihood that the lien will never be enforced, this Court, like the Court in Moellenbeck, believes that general equitable principles prevent from using a "vanishing lien" to skew the results of his liquidation analysis. Moellenbeck, supra; see also In re Mays, 85 B.R. 955 (Bkrtcy. E.D. Pa. 1988). Further, the best interests of the bankruptcy estate require that the property be managed in such a way as to avoid the imposition of the additional estate tax. In me A ~T Trailer Park, Inc., 53 B.R. 144 (Bkrtcy. D. Wy. 1985). The hasty liquidation of the special use property without consideration for the tax would be inconsistent with this principle. While the trustee theoretically could be engaged in operating Hurn's farm for a substantial period of time, the Court believes that this is one of those cases where circumstances would warrant such a result. A & T Trailer Park, supra. The trustee's objection will thus be sustained. In the event that the enforcement of the estate tax lien is triggered before 1996, the relative positions of the parties could be reassessed by this Court (if Hurn's plan has not been completed) or by the appropriate non-bankruptcy court (if 's case has been closed).

## 2. Income Tax

The second question posed concerns the calculation of the 1989 federal income tax which would be payable by the debtor. 's liquidation analysis estimated this tax liability would be approximately \$15,000.00.

Trustee Lovald and Attorney Gors both appear to concede that 's 1989 income taxes are properly includable in s liquidation analysis. At the hearing they also agreed that Kevin Stulken's

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services could be used to accurately estimate Hurn's 1989 income tax. On September 21, 1989, CPA Stulken notified Lovald and Coins that 's tax liability for 1989 would total \$10,207.00 if his wife's income was included in the calculation or \$9,267.00 if her income was excluded.

As Mrs. is not a party to the bankruptcy, the Court finds that may include \$9,267.00 in 1989 income tax liability in his liquidation analysis pursuant to Bankruptcy Code §503.

Trustee Lovald also urges that the Court adopt an interest rate of ten and one-half percent as the market mate for plan purposes. As this issue has not been fully developed, the Court would suggest that the parties attempt to reach a satisfactory agreement on this point. If such cannot be reached, then the issue could be presented for the Court's determination.

This constitutes the Court's findings of fact and conclusions of law in this matter. This is a core proceeding under 28 U.S.C. §157(b). The Court will enter an appropriate order.

Very truly yours,

Irvin N. Hoyt

Chief Bankruptcy Judge

INH/sh

CC: Bankruptcy Clerk

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF SOUTH DAKOTA

IN RE: )  
CLARENCE J. HURN, )  
Debtor. )  
CASE NO. 89-30038  
CHAPTER 12  
ORDER SUSTAINING  
TRUSTEE'S OBJECTION  
TO CONFIRMATION

Pursuant to the letter memorandum executed by the Court this same date, it is hereby

ORDERED that the trustee's objection to the inclusion of debtor's contingent federal estate tax liability is hereby sustained.

IT IS FURTHER ORDERED that the debtor may include in his liquidation analysis the sum of \$9,267.00 for his federal income tax liability for 1989.

Dated this 12th day of December, 1989.

BY THE COURT:

Irvin N. Hoyt  
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By: \_\_\_\_\_  
Deputy

(SEAL)