

INTERNAL REVENUE SERVICE  
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

November 24, 2008

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Index (UIL) No.: 469.08-00, 2032A.02-04, 2032A.03-00, 2032A.04-00  
CASE-MIS No.: TAM-137793-08

Taxpayer's Name:  
Taxpayer's Address:

Taxpayer's Identification No  
Years Involved:  
Date of Conference:

LEGEND:

A =  
B =  
X =  
M =  
N =  
Trust =

Date =  
Year =  
a =

ISSUE:

For purposes of determining whether A materially participated in a farming activity under § 469(h)(3), does A satisfy the requirements under § 2032A(b)(1)(C)(ii) for the years at issue if: (1) A's deceased spouse, B, materially participated in the farming activity for 5 of the 8 years preceding B's retirement; and (2) A was retired from the farming activity at the time of B's death.

## CONCLUSION:

A is deemed to materially participate in the farming activity for the years at issue under § 469(h)(3) of the Internal Revenue Code due to the fact that: (1) A's deceased spouse, B, had materially participated in the farming activity for 5 of the 8 years preceding B's retirement; and (2) A was retired from the farming activity at the time of B's death.

## FACTS:

A and B, married individuals, owned and were involved in a farming activity of raising cattle. B died on Date. The farming activity is currently conducted through a limited liability company, X, that is wholly owned by Trust. Trust is a grantor trust under §§ 671-677, and, accordingly, A is treated as the owner of X for federal income tax purposes. The farming activity is conducted at two separate locations, M and N, and is situated on approximately a acres of land. X employs foremen who live on the farm land and who are responsible for the day-to-day operations of the farming activity. A did not actively participate in the day-to-day operations or management of the farming activity in the years at issue, or in the years immediately prior to or after B's death. Both A and B began receiving Social Security retirement benefits in Year (which was more than 8 years before B's death). The facts do not indicate whether B materially participated (within the meaning of § 2032A(e)(6)) in the farming activity in any taxable years prior to B's retirement in Year. For purposes of the following analysis, however, we will assume that B materially participated (within the meaning of § 2032A(e)(6)) in the farming activity for at least 5 of the 8 years prior to his retirement in Year, even though this remains a question of fact that must be established by A.

## LAW AND ANALYSIS:

Section 469(a)(1) disallows the passive activity loss for any taxable year to any individual, estate or trust, any closely held C corporation, and any personal service corporation. The passive activity loss for a given year is the amount, if any, by which the passive activity deductions for the taxable year exceed the passive activity gross income for the taxable year. Temp. Treas. Reg. § 1.469-2T(b)(1). As relevant here, § 469(c)(1) defines the term "passive activity" to include any activity which involves the conduct of any trade or business in which the taxpayer does not materially participate.

Section 469(h)(3) provides that a taxpayer shall be treated as materially participating in any farming activity for a taxable year if paragraph (4) or (5) of section 2032A(b) would cause the requirements of § 2032(b)(1)(C)(ii) to be met with respect to real property used in such activity if such taxpayer had died during the taxable year.

Section 2032A(b)(1)(C)(ii) provides that the term "qualified real property" means real property located in the United States which was acquired from or passed from the decedent to a qualified heir of the decedent and which, on the date of decedent's death, was being used by the decedent or a member of the decedent's family, but only if during

the 8 year period ending on the date of the decedent's death there have been periods aggregating 5 years or more during which there was material participation by the decedent or a member of the decedent's family in the operation of the farm or other business.

Section 2032A(b)(4) provides that if, on the date of the decedent's death, the requirements of § 2032A(b)(1)(C)(ii) with respect to the decedent for any property are not met, and the decedent was receiving old-age benefits under title II of the Social Security Act for a continuous period on such date or was disabled for a continuous period ending on such date, then § 2032A(b)(1)(C)(ii) shall be applied with respect to such property by substituting "the date on which the longer of such continuous periods began" for "the date of the decedent's death" in § 2032A(b)(1)(C).

Section 2032A(b)(5)(A) provides that if property is qualified real property with respect to a decedent (hereinafter referred to as the "first decedent") and such property was acquired from or passed from the first decedent to the surviving spouse of the first decedent, for purposes of applying this subsection (c) in the case of an estate of such surviving spouse, active management of the farm or other business by the surviving spouse shall be treated as material participation by such surviving spouse in the operation of such farm or business.

Section 2032(b)(5)(C) provides that in any case in which to do so will enable the requirements of § 2032A(b)(1)(C)(ii) to be met with respect to the surviving spouse, this subsection shall be applied by taking into account any application of § 2032A(b)(4).

Section 2032A(e)(6) provides that, for purposes of § 2032A, material participation shall be determined in a manner similar to the manner used for purposes of § 1402(a)(1) (relating to net earnings from self-employment). See Treas. Reg. § 1.1402(a)-4(b)(4).

Section 2032A(b)(5)(C) was enacted as part of The Technical Corrections Act of 1982 (Pub. L. 97-448) (the 1982 Act), which statute provided technical corrections with respect to the Economic Recovery Tax Act of 1981 (Public Law 97-34) (ERTA). The House Committee report underlying ERTA provides the following regarding certain proposed legislative changes to section 2032A:

Active management treated as material participation for certain surviving spouses. The committee recognizes that some surviving spouses may be unable to materially participate in farm operations following the death of the first spouse to die. Therefore, the bill provides an alternative to the material participation requirement for qualification of real property for current use valuation in the estate of surviving spouses who receive the property from a decedent spouse in whose estate it was eligible to be valued based on its current use. The bill provides that the spouse will be treated as having materially participated during periods when the spouse (but not a family member) engaged

in active management of the farm or other business operation. The bill contains a special rule for tacking material participation by a decedent spouse in the case of a surviving spouse who dies within eight years of the decedent spouse's death. This rule is illustrated by the following example.

Assume that B dies two years after A (B's spouse) in whose estate Whiteacre was eligible for current use valuation. B engaged in the active management of Whiteacre during the two years following A's death. A was retired for the five years immediately following A's death [sic]. A was retired for the five years immediately before A's death, but had materially participated in Whiteacre's operation for eight years before his retirement. The six most recent of the eight years before A's retirement will be considered with B's two years of active management for purposes of satisfying the five years of an eight-year period pre-death material participation requirement for B's estate.

H. Rep. No. 97-201, 97<sup>th</sup> Cong. 1<sup>st</sup> Sess. 170. However, as indicated, section 2032A(b)(5)(C) the tacking provision referenced in the legislative history above, was not enacted as part of ERTA. Rather the provision was enacted as part of the 1982 Act. The legislative history underlying the 1982 Act provides the following:

The bill allows "tacking" of material participation by a retired spouse with active management by the surviving spouse to qualify property for current use valuation in the surviving spouse's estate where the spouse survives the first decedent by fewer than eight years.

H. Rep. No. 97-794, 97<sup>th</sup> Cong. 2d Sess. 19.

In the present case, § 2032A(b)(4) provides relief from the pre-death material participation requirement if the decedent's retirement precludes the decedent from meeting the material participation requirement. Under § 2032A(b)(5)(C), this relief provision is also to apply "in any case" that will enable the surviving spouse to satisfy the material participation requirements. Further, § 2032A(b)(5)(C) is to be applied by taking into account "any" application of § 2032A(b)(4). Thus, we believe that in view of the broad language of § 2032A(b)(5)(C) effectively incorporating the relief contained in § 2032A(b)(4), just as B's status as a retiree at the time of B's death would not preclude B from satisfying the pre-death material participation requirements, likewise A's status as a retiree would not preclude A from satisfying the material participation requirement. The legislative history discussed above addresses a spouse that actively manages the property, but does not address a retired spouse. Nevertheless, we believe the broad language of § 2032A(b)(5)(C) incorporating the § 2032A(b)(4) relief provision contemplates similar relief for a retired spouse.

We conclude that A will satisfy the requirements under § 2032A(b)(1)(C)(ii) for the years at issue if: (1) A's deceased spouse, B, materially participated (within the meaning of

§ 2032A(e)(6)) in the farming activity for 5 of the 8 years preceding B's retirement; and (2) A was retired from the farming activity at the time of B's death. Therefore, to the extent that the requirements of § 2032A(b)(1)(C)(ii) are satisfied, A will be treated as materially participating in the farming activity for the years at issue under § 469(h)(3).

CAVEAT(S):

Temporary or final regulations pertaining to one or more of the issues addressed in this memorandum have not yet been adopted. Therefore, this memorandum will be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusions in the memorandum. See section 13.03 of Rev. Proc. 2008-2, 2008-1 I.R.B. 90, 106 (or any successor). However, a technical advice memorandum that modifies or revokes a letter ruling or another technical advice memorandum generally is not applied retroactively if the taxpayer can demonstrate that the criteria in section 13.02 of Rev. Proc. 2008-2, are satisfied.

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.