

701—86.9(450) Market value in the ordinary course of trade. Fair market value of real or personal property is established by agreement or the appraisal and appeal procedures set forth in Iowa Code section 450.37 and subrules 86.9(1) and 86.9(2). If the value is established by agreement, the agreement may be to accept the values of such property as submitted on the Iowa inheritance tax return, to accept a negotiated value or to accept the values as finally determined for federal estate tax purposes. Values submitted on an inheritance tax return constitute an offer regarding the value of the property by the estate. An inheritance tax clearance that is issued based upon property values submitted on an inheritance tax return constitutes an acceptance of those values on that return. An agreement to accept negotiated values or accept values as finally determined for federal estate tax purposes must be an agreement between the department of revenue, the personal representative, and the persons who have an interest in the property. If an agreement cannot be reached regarding the valuation of real property, then the department may request, within 30 days after the return is filed, an appraisal pursuant to Iowa Code sections 450.37 and 450.27 and subrule 86.9(2). Effective for estates with decedents dying on or after July 1, 2004, if an agreement cannot be reached regarding the valuation of real property, then the department may request, within 60 days after the return is filed with the department, an appraisal pursuant to Iowa Code sections 450.37 and 450.27 and subrule 86.9(2). If an appraisal is not requested within the required period, then the value listed on the return is the agreed value of the real property. If an agreement cannot be reached regarding the valuation of personal property, the personal representative or any person interested in the personal property may appeal for a revision of the department's value as set forth in Iowa Code section 450.37 and subrule 86.9(2). Any inheritance tax clearance granted by the department may be subject to revision based on federal audit adjustments. Absent an agreement to the contrary, the six-month extension of the statute of limitations for assessing Iowa inheritance tax based on federal audit adjustments is limited to federal audit adjustments that directly affect Iowa inheritance tax and involve Iowa inheritance tax law that incorporates Internal Revenue Code provisions—see Iowa Code section 450.94(5) and *Kelly-Springfield Tire Co. v. Iowa State Board of Tax Review*, 414 N.W.2d 113 (Iowa 1987).

86.9(1) In general. With the exception of real estate which has been specially valued under Iowa Code chapter 450B, property included in the gross estate for inheritance tax purposes must be valued under the provisions of Iowa Code section 450.37 at its market value in the ordinary course of trade. See rule 701—86.10(450) for the rule governing the market value in the ordinary course of trade if the alternate valuation date is elected. “Market value in the ordinary course of trade” and “fair market value” are synonymous terms. *In re Estate of McGhee*, 105 Iowa 9, 74 N.W. 695 (1898). Fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell and both having reasonable knowledge of relevant facts. The fair market value of a particular item of property includable in the decedent's gross estate is not to be determined by a forced sale price. Nor is the fair market value of an item of property to be determined by the sale price of the item in a market other than that in which such item is most commonly sold to the public, taking into account the location of the item whenever appropriate. See federal regulation Section 20.2031(1)(b) and Iowa Code section 441.21(1)“b” for similar definitions of fair market value.

a. Values not to be used. Other kinds of value assigned to property such as, but not limited to, assessed value of real estate for property tax purposes, cost price, true value, or book value are only relevant in computing the value of the property for inheritance tax purposes, to the extent they may be properly used in the determination of fair market value or special use value. *In re Estate of McGhee*, 105 Iowa 9, 74 N.W.695 (1898). Fair market value cannot be determined alone by agreement between the persons succeeding to the decedent's property. Also, fair market value cannot be determined alone by setting out in the decedent's will the price for which property can be sold. *In re Estate of Fred W. Rekers*, Probate No. 28654, Black Hawk County District Court, July 26, 1972.

b. Date of valuation. Unless the alternate valuation date is elected under Iowa Code section 450.37, or the tax has been deferred according to Iowa Code sections 450.44 to 450.49, all property includable in the gross estate must be valued at the time of the decedent's death for the purpose of computing the tax imposed by Iowa Code section 450.2. Subject to the two exceptions listed, any

appreciation or depreciation of the value of an asset after the decedent's death is not to be taken into consideration. *Insel v. Wright County*, 208 Iowa 295, 225 N.W.378 (1929).

86.9(2) Market value—how determined.

a. In general. The fair market value of an item of property, both real and personal, that is included in the gross estate for inheritance tax purposes is expressed in the property's monetary equivalent. The process used to determine fair market value presupposes the voluntary exchange of the item in a market for its equivalent in money. *Hetland v. Bilstad*, 140 Iowa 411, 415, 118 N.W. 422 (1908). The fact the item of property is not actually sold or exchanged or even offered for sale is not relevant. It is sufficient for establishing the item's value to arrive at the specific dollar amount that a seller would voluntarily accept in exchange for the property and the amount that a buyer would be willing to pay. *Juhl v. Greene County Board of Review*, 188 N.W.2d 351 (Iowa 1971). It is assumed when determining this specific dollar amount, which is the item's fair market value, that the seller is desirous of obtaining the highest possible price for the property and that the buyer does not wish to pay more than is absolutely necessary to acquire the property.

The item of property must be valued in a market where it is customarily traded to the public. See federal regulation 20.2031-1(b). Therefore, if an item of property is valued in a market which is not open to the general public, the party asserting the value in the restricted market has the burden to prove by a preponderance of the evidence that the value in the restricted market is the item's fair market value.

The distinction between a public and a restricted market can be illustrated by the following:

EXAMPLE 1: Under the provisions of the decedent's will, the personal representative of the estate is given the power to sell the decedent's property at either a public or private sale. Pursuant to this power, the personal representative sold the decedent's household goods at public auction held on a specific day and time which was widely advertised both in the newspaper in the locality where the decedent lived and also by sale bills posted in numerous public places in the decedent's community. The household goods sold at auction for \$2,500. The fair market value of the household goods on the day of sale is \$2,500. The public auction is a market where such items are commonly sold and the public had knowledge of the impending sale. The public was also invited to bid and the items to be sold were available for inspection.

EXAMPLE 2. Pursuant to an agreement between the beneficiaries of the estate, the personal representative sold the decedent's household goods and personal effects at an auction where only members of the decedent's family were permitted to bid. The items sold for \$2,500, which may or may not be the fair market value of the property. Family pride, sentiment, and other personal considerations may have entered into the selling price. In this type of sale the burden is on the personal representative to prove that the selling price is the fair market value of the items sold.

b. Values established by recognized public markets.

(1) Stocks, bonds, and notes. Items of personal property such as, but not limited to, corporate stock, bonds, mutual funds, notes, and commodities which are traded on one or more of the nation's stock or commodity exchanges shall be valued under the provisions of Federal Estate Tax Regulation 20.2031-2, which regulation is incorporated in and made a part of this subrule by reference.

Individuals who have a registration of a security indicating sole ownership by one individual or multiple ownership by two or more individuals with a right of survivorship and not as tenants in common, may obtain a registration in beneficiary form as provided in the uniform transfer on death security registration Act as provided in Iowa Code section 633.800. A "registering entity" under this Act must provide notice to the department of revenue of all reregistrations made pursuant to this Act. Such notice must include the name, address, and social security number of the decedent and all transferees. Until the division of the security, after the death of all the owners, multiple beneficiaries surviving the death of all the owners hold their interest as tenants in common. If no beneficiary survives the death of all the owners, the security belongs to the estate of the deceased sole owner of the estate of the last to die of the multiple owners.

(2) Local elevator and sale barn prices. The fair market value of grain and livestock may be determined either by the quoted price from the grain elevator or sale barn in the community where the grain or livestock is located or by the price quoted from the nearest commodity exchange, less the customary delivery discount.

(3) Public auctions by the court. The fair market value of an item may be established in a public market other than a market which has a permanent location and which holds sales at periodic stated intervals. It is common for estates or the probate court to hold a public auction to sell estate property and if the sale meets certain criteria the selling price received in this type of public auction will establish the fair market value of the property. Factors in an estate or court sale which tend to establish the selling price as one at fair market value include but are not limited to the time and place of the sale were well advertised; the public was invited and encouraged to bid; members of the decedent's family or business associates were not given special consideration as to price or terms of sale; and the terms of sale were comparable to those offered at sales in a regularly established public market.

(4) Sales in a regularly established market. Sales made in a regularly established market pursuant to Iowa Code section 633.387 would qualify as a sale at fair market value for inheritance tax purposes.

c. Private sales that may establish fair market value. Private sales of estate assets may establish the fair market value of the item depending on the facts and circumstances surrounding each sale. Factors which tend to establish a private sale as one at fair market value include but are not limited to:

(1) Sales made by a recognized broker who receives a commission from the seller based on the selling price and who has exercised diligence in obtaining a buyer.

(2) Sales made by the personal representative to nonfamily members after a good-faith effort was made to solicit bids from persons who are known to be interested in buying that particular kind of property.

(3) Sales made by the attorney or the personal representative after the item of property was advertised for sale in a newspaper of general circulation or in trade publications and a good-faith effort was made to obtain the best possible price.

(4) Sales made by the personal representative when the sale price is the price quoted on one of the nation's stock or commodity exchanges.

(5) Private sales made by the personal representative to members of the decedent's family or business associates are suspect due to personal, family, or business reasons, but nevertheless may constitute a sale at fair market value, depending on the facts and circumstances surrounding each sale. The personal representative has the burden to establish that this kind of private sale is a sale at fair market value. Factors which have a bearing on whether this type of private sale is one at fair market value include, but are not limited to, the following: Did the decedent's will give a sale or price preference to a member of the decedent's family or business associate? Were the terms of sale more advantageous than terms that would be given to the general public? Was a good-faith effort made to solicit bids from other persons known to be interested in buying that particular kind of property? Was the sale made as part of a family settlement of a will contest or dispute on a claim against the estate?

d. Fair market value—no regularly established market.

(1) In general. Certain items of personal property such as, but not limited to, closely held corporate stock, real estate contracts of sale, private promissory notes, accounts receivable, partnership interests, and choses in action are not customarily bought and sold in a public market. Occasional sales of these items of personal property at infrequent intervals do not establish a market for this kind of personal property, but the lack of a regular market does not indicate that the item is of no value. When there is not a regularly established market to use as a reference point for value, it is necessary to create a hypothetical market to determine fair market value. The factors used to create a hypothetical market vary with the kind of property being valued and depend on the facts and circumstances in each individual case.

(2) Fair market value of closely held corporate stock. A closely held corporation is a corporation whose shares are owned by a relatively limited number of stockholders. Often the entire stock issue is held by members of one family or by a small group of key corporate officers. Because of the limited number of stockholders and due to a family or business relationship, little, if any, trading in the shares takes place. There is, therefore, no established market for the stock. Sales that do occur are usually at irregular intervals and seldom reflect all of the elements of a representative transaction as is contemplated by the term fair market value. The term "fair market value" has the same meaning for federal estate tax purposes as it does for Iowa inheritance tax purposes. As a result, the federal revenue rulings establishing the criteria for valuing closely held corporate stock are equally applicable

to inheritance tax values. Therefore, corporate stock which meets the standards for being closely held must be valued for inheritance tax purposes under the provisions of Federal Revenue Ruling 59-60, 1959-1 C.B. 237 as modified by Revenue Ruling 65-193, 1965-2 C.B. 370 and amplified by Revenue Ruling 77-287, 1977-2 C.B. 319, Revenue Ruling 80-213, 1980-2 C.B. 101, and Revenue Ruling 83-120, 1983-2 C.B. 170, which Federal Revenue Rulings are incorporated in and made a part of this subrule by reference.

(3) Fair market value of real estate contracts, notes, and mortgages. The fair market value of promissory notes, secured or unsecured, contracts for the sale of real estate, and other obligations to pay money which are included in the gross estate is presumed to be the amount of the unpaid principal plus the amount of interest, if any, accrued to the day of the decedent's death. If the asset is not reported on the return at face value plus accrued interest, the burden is on the party claiming a greater or lesser value to establish that face value plus accrued interest is not the asset's fair market value.

Factors which have a bearing on whether the fair market value of an asset is greater or less than face value include, but are not limited to, the rate of interest charged on the obligation; the length of time remaining on the obligation; the credit standing and payment history of the debtor; the value and nature of the property, if any, securing the obligation; the relationship of the debtor to the decedent; and whether the obligation is to be offset against the debtor's share of the estate. See Iowa Code section 633.471 and *Welp v. Department of Revenue*, 333 N.W.2d 481 (Iowa 1983). This subrule can be illustrated by the following:

EXAMPLE 1. The decedent at the time of death owned a seller's interest in an installment sale contract for the sale of a 160-acre farm. The contract contained a forfeiture provision in the event the buyer failed to make the payments and further provided that the purchase price was to be paid in 20 equal annual principal payments plus interest at 7 percent per year on the unpaid principal balance. At the time of the decedent's death, the contract of sale had ten years yet to run and the current federal land bank interest rate for farm land loans was 12 percent. Assuming in this example that other valuation factors are not relevant, the fair market value of the contract is the face amount of the contract, plus interest, discounted to reflect a 12 percent interest return on the outstanding principal balance. A prudent investor would not invest at a lower rate of interest when a comparable investment with equal security would earn 12 percent interest.

EXAMPLE 2. A tenant of the decedent owed the decedent \$5,000, which was evidenced by a promissory note, payable on demand, drawing 6 percent interest, and which was executed in 1992, a year prior to the decedent's death. Assuming no other valuation factors are relevant, the fair market value of the \$5,000 promissory note is its face value, plus accrued interest. The less than market interest rate on the note does not affect its fair market value because the note is due on demand and, as a consequence, there is no loss of a higher rate of interest which would be the case if the note specified a future payment date.

EXAMPLE 3. Decedent A died intestate July 1, 1993, survived by two nephews, B and C. The estate consisted, after debts and charges, of \$300,000 in cash and U.S. Government bonds and a noninterest bearing promissory note for \$10,000 executed by nephew B in 1975 for money borrowed for his college education. No payments were ever made on the note. The note is outlawed by the statute of limitations and would be worthless if anyone other than nephew B or C had executed the note. However, since nephew B inherits one-half of A's estate, and is required under the law of setoff and retainer to pay the note before he can participate in the estate, the fair market value of the note in this particular fact situation is \$10,000 because it is collectible in full. Each nephew's share of the estate is \$155,000. Nephew C receives \$155,000 in cash and nephew B receives \$145,000 in cash plus his canceled note for \$10,000. In this example, the statutory right of setoff and retainer supersedes other factors which are relevant in determining the fair market value of the asset. See Iowa Code section 633.471; *In re Estate of Farris*, 234 Iowa 960, 14 N.W.2d 889 (1944); *Indiana Department of Revenue v. Estate of Cohen*, 436 N.E.2d 832 (Ind. App. 1982); *Gearhart's Ex'r and Ex'x v. Howard*, 302 Ky. 709, 196 S.W.2d 113 (1946).

(4) Fair market value of a sole proprietorship or partnership interest. The fair market value of the decedent's interest in a business, whether a partnership or a proprietorship, is the net amount a willing buyer would pay for the interest to a willing seller, neither being under any compulsion to buy or to sell

and both having reasonable knowledge of the relevant facts. Relevant factors in determining net value include but are not limited to the following: a fair appraisal as of the applicable valuation date of all of the assets of the business, tangible and intangible, including goodwill; the demonstrated earning capacity of the business; and the other factors in rule 701—89.8(422), to the extent they are applicable, that must be considered in valuing closely held corporate stock.

(5) Fair market value of choses in action. The fair market value of the decedent's interest in a right to sue for a debt or a sum of money often cannot be determined with certainty at the time of the decedent's death. The value of this right is dependent on many factors which include, but are not limited to, the following: the strength and credibility of the decedent's evidence; the statutory and case law supporting the decedent's claim or position; the ability of the opposing party to pay a judgment; the extent, if applicable, of the decedent's contributory negligence; and the other normal hazards of litigation. However, this lack of certainty does not mean the right to sue has no value at the time of the decedent's death. Evidence of what was actually received for this right by the decedent's estate or its beneficiary is evidence of the fair market value of the right at death.

This subrule can be illustrated by the following example:

The decedent died in a fire of uncertain origin that destroyed his dwelling. Due to the circumstances surrounding the fire, the estate's right of recovery from the fire insurance carrier was speculative and, therefore, the value of this right at death was unknown. After the estate was closed, the beneficiary of the estate settled the fire insurance claim for \$15,000. The amount received in settlement of the claim can be considered as evidence of the fair market value of the right of action at death. *Bair v. Randall*, 258 N.W.2d 333 (Iowa 1977). In addition, interest on the unpaid tax begins and continues to accrue from the date of the decedent's death.

(6) Wrongful death proceeds are not included in the gross estate. *Estate of Dieleman v. Department of Rev.*, 222 N.W.2d 459 (Iowa 1974).

e. By agreement between the department, the estate and its beneficiaries. Iowa Code section 450.37 provides that the market value in the ordinary course of trade is to be determined by agreement between the estate and its beneficiaries and the department. The term "agreement" when used with reference to the value of an asset, whether it is real or personal property, has the same meaning as the term is used in the law of contracts. The agreement between the department, the estate and its beneficiaries may be contained in a single written instrument, or it may be made by an offer submitted by the estate and its beneficiaries and its acceptance by the department. The agreement establishing values for computing the tax may specify that the values as finally determined for federal estate tax purposes on all or a portion of the assets will be the values used in computing the tax.

(1) Offer by the estate and the beneficiaries. It is the duty of the taxpayer to list on the inheritance tax return the values of the assets in the gross estate which the estate and those beneficially entitled to the decedent's property are willing to offer as the values for computing the taxable shares in the estate. The value of the assets listed on the return will constitute an offer for the department to accept or reject. Counteroffers may be made in the event an offer is rejected. This rule applies equally to real and personal property.

(2) Acceptance of values by the department. The values offered on the inheritance tax return by the estate and its beneficiaries are accepted by the department when:

1. The department has accepted the offered values in writing, or
2. A clearance certifying full payment of the tax due or a clearance certifying no tax due is issued by the department, or

3. The department does not request an appraisal within 30 days after the return has been filed in the case of the value of real estate. Notice of appraisal must be served by certified mail and the notice is deemed completed when the notice is deposited in the mail and postmarked for delivery. However, see 86.9(2)"e"(3) for the rule governing values listed as "unknown" or "undetermined." See Iowa Code sections 622.105 and 622.106 for the law determining the filing date of a tax return that is mailed.

(3) Values listed on the return as "undetermined" or "unknown." If at the time the inheritance tax return is filed the information necessary to determine the value of an asset cannot be presently ascertained, the taxpayer may list the value of that asset as "unknown" or "undetermined." The return

must contain a statement signed by the taxpayer on behalf of the estate and the beneficiaries with an interest in the property granting the department an extension of time for requesting an appraisal until 30 days after an amended return is filed listing a value for the real estate. Failure to grant an extension of time will subject the real estate to an immediate request for an appraisal. The amended return shall be accompanied with sufficient facts and other information necessary to substantiate the value offered. An agreement concerning the value of an asset presupposes that both the department, the beneficiaries and the estate have knowledge of the relevant facts necessary to determine value. There can be no meaningful agreement or appraisal until the relevant facts relating to value are known. See *Bair v. Randall*, 258 N.W.2d 333 (Iowa 1977), regarding the criteria that may be used to determine the value of an asset which was unknown at the time of the decedent's death.

f. Values established—no agreement.

(1) Real estate. If the department, the estate and the persons succeeding to the decedent's property have not reached an agreement as to the value of real estate under 86.9(2) "e," the market value for inheritance tax purposes will be established by the appraisal proceedings specified in Iowa Code sections 450.27 to 450.36. For the purposes of appraisal, "real estate or real property" means the land and appurtenances, including structures affixed thereto. Use of the inheritance tax appraisers to determine value for other purposes such as, but not limited to, determining the share of the surviving spouse in the estate or for determining the fair market value of real estate for the purposes of sale, is not controlling in determining values for inheritance tax purposes. *In re Estate of Giffen*, 166 N.W.2d 800 (Iowa 1969); *In re Estate of Lorimor*, 216 N.W.2d 349 (Iowa 1974). Appraisals of real estate must be made in fee simple including land, all appurtenances and structures affixed to the real estate. Discounts in the value of real estate are not to be considered in the valuation of real property for the purposes of an appraisal. Such discounts in valuation are to be resolved by mutual agreement through informal procedures between the personal representative of the estate and the department. If an agreement between the personal representative of the estate and the department cannot be obtained, then the valuation placed on the property by the department may be appealed by the personal representative of the estate pursuant to the procedures set forth in rule 701—86.4(450). If either the department or the estate does not agree with the results of an appraisal that is conducted pursuant to Iowa Code sections 450.27 through 450.36, either the department or the estate may file an objection to the appraisal pursuant to Iowa Code section 450.31. See 701—subrule 86.9(2) for additional factors to assist in the determination of fair market value of real property.

(2) Personal property. Effective for estates of decedents dying on or after July 1, 1983. If an agreement is not reached on the value of personal property under 86.9(2) "e," the estate or any person beneficially receiving the personal property may appeal to the director under Iowa Code section 450.94, subsection 3, for a resolution of the valuation dispute, with the right of judicial review of the director's decision under Iowa Code chapter 17A.

g. Amending returns to change values.

(1) Amendment permitted or required. Unless value has been established by the appraisal or administrative proceedings, the inheritance tax return may be amended by the estate to change the value of an asset listed on the return as long as the amendment is filed before an agreement is made between the estate and the department as to the asset's value. The return must be amended to list the value of an asset omitted from the original return or to assign a value for an item listed on the original return as "unknown" or "undetermined."

If the facts and circumstances surrounding the value agreement would justify a reformation or rescission of the agreement under the law of contracts, the return may be amended by the estate, and must be amended at the department's request, to change the value of the item to its correct fair market value or its special use value as the case may be.

(2) Amendment not permitted. A return cannot be amended:

1. To change the agreed value of an asset, if the facts and circumstances surrounding the agreement would not justify a reformation or rescission of the agreement,
2. To change a real estate value that has been established by the appraisal proceedings under Iowa Code sections 450.31 to 450.33, *Insel v. Wright County*, 208 Iowa 295, 225 N.W. 378 (1929), or

3. To change the value of an item of personal property that has been established by the department's administrative procedure under 701—Chapter 7, or, if an appeal is taken from the director's decision, by judicial review under Iowa Code chapter 17A. Provided, in no event may the return be amended to lower the value of an asset that would result in a refund of tax more than three years after the tax became due or one year after the tax was paid, whichever time is the later. Iowa Code section 450.94, *Welp v. Department of Revenue*, 333 N.W.2d 481 (Iowa 1983).

This rule is intended to implement Iowa Code sections 450.27 to 450.37, 450.44 to 450.49, and 633.800 to 633.811.