Cases, Regulations, and Statutes

Robert P. Achenbach Jr

Iowa State University

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arrangement was considered a lease directly to the respective heir and did not result in acceleration. The arrangement was viewed as not materially altering the business.

The ruling cites to Rev. Rul. 66-62 as authority. That ruling involved the change from a corporation to an unincorporated form with IRS holding that the transformation did not materially alter the business.

**Lease by residuary trust**

The interesting question is why the ruling did not discuss in more detail the fact situation as involving a cash rent lease by the residuary trust. The rule is well established that a cash rent lease, even to a family member of the decedent, fails the test of being a business. Thus, a cash rent lease directly to a family member as heir would ordinarily be expected to trigger acceleration. The distinction is that a cash rent lease to the owner is not considered the same as a cash rent lease to a family member.

The important point is that it is the lessor that is expected to maintain the assets involved as a business. As the lessor, the residuary trust seemingly failed to meet that requirement.

There has been an exception, at least in the pre-death qualification period, for trusts that were grantor trusts which was not the case in the 2003 letter ruling. Obviously, a residuary trust is not a grantor trust. It is noted that the residuary trust in question had three beneficiaries, only one of which was the lessee. Thus, it would appear that the trust was no longer meeting the “business” requirement in the period during which acceleration could occur.

**In conclusion**

Care is needed for all post-death leasing, entity transformations or other distributions, sales or dispositions. The latest ruling should be used carefully as authority. It provides only limited authority for post-death cash rent leasing of assets subject to an election to pay federal estate tax in installments. The safe approach is to assure that the post-death owner of the assets, including a trust, meets a “business” test during the entire period during which acceleration could occur.

**FOOTNOTES**

5. See I.R.C. § 6166(g)(1)(A).
7. See 5 Harl, supra note 1, § 41.06[1].
11. Id.
12. Id.
13. See note 6 supra and accompanying text.
16. Id.
17. 1966-1 C.B. 272.
18. Id.
19. See note 6 supra.
21. See I.R.C. § 6166(g).
SECURED CLAIMS. The debtor’s Chapter 12 plan provided for bifurcating a secured claim into secured and unsecured claims, with the secured claim to be paid in full over a period extending beyond the plan period and the unsecured claim to receive only plan payments. The plan was completed and a discharge was granted, but the debtor defaulted on two of the post-plan payments on the secured claim. The creditor, citing In re Kinder, 139 B.R. 743 (Bankr. W.D. Okla. 1992) sought to collect the entire pre-bankruptcy claim. The court held that, under Section 506(a), the secured portion of the debt was not discharged because the debt was not scheduled to be paid in full during the plan period. However, the unsecured portion of the debt was discharged with the other claims provided for during the plan period. In re Stidham, 292 B.R. 204 (Bankr. W.D. Okla. 2003).

FEDERAL TAX

NOTICE OF DEFICIENCY. The IRS has issued a revenue ruling involving the effect on the period for making an assessment where the issuance of a Notice of Deficiency occurs prior to or after the filing of a bankruptcy petition. Under I.R.C. § 6213(a), the IRS is prohibited from making an assessment until after the last day for filing a petition in the Tax Court by the taxpayer, 90 days after the Notice. Thus, the assessment cannot be made if the Tax Court petition is blocked by the bankruptcy automatic stay. Under I.R.C. § 6503(h)(1), the 90 day limitation is suspended during the automatic stay and for 60 days thereafter. The IRS interpreted this section to mean that the suspended period is added to the post-suspension 60 days. In the first example, the Notice of Deficiency is issued after the bankruptcy petition but before the automatic stay is terminated. In this case, no Tax Court petition could be filed until the automatic stay is lifted plus 60 days at which time the 90 day limitation begins to run. In the second example, the Notice of Deficiency is issued within 90 days before the bankruptcy petition. Here, the Tax Court limitation period had begun to run and the days before the bankruptcy petition count against the 90 day period but do not recommence until 60 days after the termination of the automatic stay. In the third example, the Notice of Deficiency is issued more than 90 days before the bankruptcy petition. In the third case, the 90 Tax Court period had elapsed before the petition; therefore, the IRS ruled that the assessment could be made at any time. Rev. Rul. 2003-80, I.R.B. 2003-29, 83.

CONTRACTS

HEDGE-TO-ARRIVE CONTRACTS. The Chapter 12 debtor was a farmer who had entered into several hedge-to-arrive contracts which provided for delivery of grain but allowed the debtor to rollover the delivery of the grain to subsequent years. The contracts also contained clauses which required all disputes involving the contracts to be arbitrated under the National Grain and Feed Association arbitration rules. After the debtor defaulted on the contracts, the buyer obtained a state court judgment to enforce the arbitration provisions and the parties submitted the dispute to arbitration. The arbitration panel ruled that the hedge-to-arrive contracts were enforceable and not illegal off-exchange futures contracts because actual delivery of the grain was intended. The buyer filed a claim in the bankruptcy case based on the arbitration award. The debtor sought to challenge the claim on the basis that the arbitration award was improper because of industry bias of the arbitration panel and because the hedge-to-arrive contracts were illegal off-exchange futures contracts. The court held that the debtor failed to prove that the arbitration panel was biased or exceeded its authority and also upheld the panel’s ruling that the contracts were enforceable. In re Robinson, 326 F.3d 767 (6th Cir. 2003), aff’d, 265 B.R. 722 (Bankr. 6th Cir. 2001).

FEDERAL AGRICULTURAL PROGRAMS

CROP INSURANCE. The FCIC has issued proposed regulations which add 7 CFR § 457.166 that provides for the insurance of blueberries. The provisions will be used in conjunction with the Common Crop Insurance Policy Basic Provisions, which contain standard terms and conditions common to most crops. The intended effect of this action is to convert the blueberry pilot crop insurance program to a permanent insurance program administered by FCIC for the 2005 and succeeding crop years. 68 Fed. Reg. 44668 (July 30, 2003).

FARM PROGRAMS. The FSA has issued a notice that, under the Debt Collection Improvement Act of 1996 (DCIA), a person delinquent on a non-tax debt to the federal government is ineligible for federal financial assistance, including direct loans (other than disaster loans), loan insurance and loan guarantees. Under The Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001, the DCIA excluded 2001 crop year Marketing Assistance Loans (MAL) and Loan Deficiency Payments (LDP) from the DCIA requirement. The FSA notice states that, because the 2002 appropriations act did not exempt MAL and LDP’s from the DCIA requirement, the DCIA requirement shall apply to 2003 and subsequent crop year MAL and LDP’s. Notice LP-1930.

TUBERCULOSIS. The APHIS has issued interim regulations amending the bovine tuberculosis regulations regarding state and zone classifications by removing New Mexico from the list of accredited-free states and adding it to the list of modified accredited advanced states. 68 Fed. Reg. 43618 (July 24, 2003).
FEDERAL ESTATE AND GIFT TAX

CHARITABLE DEDUCTION. The decedent had created a trust which was split into three trusts on the decedent’s death. After the death of the decedent, the net income of trust one and trust two is to be distributed 60 percent to the decedent’s child, 20 percent to one grandchild and 20 percent to another grandchild. The trustees had the sole discretion to distribute trust principal to the child for health, support and maintenance. Upon the child’s death, the remaining trust assets were to be distributed in equal shares to some charities. The third trust provided that, after the death of the decedent, all net income was to be distributed to the child for life, with the trustee having the sole discretion to distribute principal to the child for health, support and maintenance. Upon the child’s death, the remaining trust assets were to be distributed in equal shares to the charities. The trusts did not qualify as charitable remainder unitrusts (CRUTs) and the parties obtained a judicial revision of the trusts to qualify them as CRUTs. The IRS ruled that the reformed trusts satisfied the second requirement for a qualified reformation under I.R.C. § 2055(e)(3) because the child’s interest both before and after the reformation terminated at the same time. The reformation was effective as of the date of the decedent’s death; therefore, the proposed reformation satisfied the third requirement under I.R.C. § 2055(e)(3). The IRS also ruled that, based on the interest rate under I.R.C. § 7520 for the month of the decedent’s death, the actuarial value of the charitable remainder as reformed would not differ by more than 5 percent of the actuarial value of the charitable remainder interest prior to the reformation; therefore, the proposed reformation satisfied the fourth requirement under I.R.C. § 2055(e)(3) and the trusts qualified for the charitable deduction. Ltr. Rul. 200330028, April 21, 2003.

DISCLAIMER. The decedents, husband and wife, had transferred their assets to a living trust which provided that, on the death of the first to die, the trust assets were to be divided into two trusts with all of the assets passing to the first trust, except to the extent disclaimed by the surviving spouse. The first trust was for the benefit of the surviving spouse and granted the surviving spouse a testamentary power of appointment over trust principal. The second trust was for the benefit of the surviving spouse with the remainder to pass to charitable organizations and the State of Israel. The husband died first and the wife executed a testamentary power of appointment in favor of an heir for life with the remainder to pass to charities and individuals. After the death of the wife, the executor executed a disclaimer of the wife’s interest in the first trust. The court held that the disclaimer was not effective for estate tax purposes because the wife’s execution of the testamentary power of appointment constituted an acceptance of the property. Estate of Engelman v. Comm’r, 121 T.C. No. 4 (2003).

GIFTS. The IRS has adopted as final regulations relating to the amount treated as a transfer under I.R.C. § 2519 when there is a right to recover gift tax under I.R.C. § 2207A(b) and the related gift tax consequences if the right to recover the gift tax is not exercised. The regulations affect donee spouses who make lifetime dispositions of all or part of a qualifying income interest in qualified terminable interest property. I.R.C. § 2207A(b) statutorily shifts the burden for paying the gift tax imposed on a transfer under I.R.C. § 2519 from the donee spouse to the person receiving the transferred property. The payment of gift tax by the person receiving the property benefits the donee spouse because the donee spouse is liable for the payment of this tax and, absent the right of recovery, would be required to pay the tax from the donee spouse’s own assets. The regulations amend the regulations under I.R.C. § 2519 to provide that the amount of the transfer under I.R.C. § 2519 is reduced by the amount of the gift tax that the donee spouse is entitled to recover under I.R.C. § 2207A(b). The amount of gift tax recoverable and the amount of the remainder interest treated as transferred under I.R.C. § 2519 are determined by using the interrelated computation applicable to other transfers in which the transferee agrees to pay the gift tax. See Rev. Rul. 81-23, 1981-2 C.B. 189. In addition, the regulations amend the regulations under I.R.C. § 2207A(b) to provide that if the donee spouse fails to exercise the right to recover the gift tax, the donee spouse makes a gift in the amount of the unrecovered gift tax to the person from whom the recovery of gift tax could have been obtained. The regulations also provide that if there is a delay in the exercise of the right of recovery, the delay will be treated as a below-market loan unless sufficient interest is paid by the donee. In the notes accompanying the final regulations, the IRS stated that a short delay would most likely be exempt from the below-market interest rules because of the small amount of tax involved. See Treas. Reg. § 1.7872-5T(c)(3) for the factors used to exempt loans from the below-market interest rate provisions. 68 Fed. Reg. 42593 (July 18, 2003), amending Treas. Reg. §§ 25.2207A-1, 25.2519-1.

FEDERAL INCOME TAXATION

BAD DEBT DEDUCTION. The taxpayer was a shareholder of a corporation and claimed a business bad debt deduction for amounts loaned to the corporation but not repaid. The taxpayer failed to produce any written evidence of a bona fide debt, such as a promissory note, debt instrument, or security agreement. Moreover, there was no testimony regarding payment terms, rate of interest, dates of the loans, default terms, or other indications of a loan. The court held that no bad debt deduction was allowed. Steffen v. Comm’r, 2003-2 U.S. Tax Cas. (CCH) ¶ 50,580 (Bankr. M.D. Fla. 2003).

C CORPORATION

SHAREHOLDER BASIS. The taxpayer claimed a $50,000 basis in a corporation and presented evidence of the investment contract, cancelled checks and bank statements. No stock
allocate the depreciation allowance for that MACRS property first day of the month in which the use changes and would on this rule and on a potential alternative rule that would treat on the first day of the year of change. The IRS invites comments though the change in the use of the MACRS property occurred precedent taxable year. If a change in the use of MACRS property for the year of change is determined as if a taxpayer changes the use of the property after the property's placed-in-service year but the property continues to be MACRS property for the year of change and subsequent taxable years. If a change in the use of MACRS property results in a shorter recovery period and/or a more accelerated depreciation method, the adjusted depreciable basis of the property as of the beginning of the year of change is depreciated over the shorter recovery period and/or by the more accelerated depreciation method beginning with the year of change as though the MACRS property is first placed in service in the year of change. Under certain circumstances, this rule may adversely affect taxpayers. For example, under this rule, if a change in the use of MACRS property results in a shorter recovery period, a taxpayer must depreciate that MACRS property over the new shorter recovery period even if the remaining portion of the original longer recovery period is less than the new shorter recovery period. To avoid this adverse effect, the proposed regulations allow a taxpayer to elect to continue to depreciate the MACRS property for which the new recovery period is shorter or a more accelerated method is allowed as though the change in use had not occurred.

If a change in the use of MACRS property results in a longer recovery period and/or slower depreciation method, the adjusted depreciable basis of the property is depreciated over the longer recovery period and/or by the slower depreciation method beginning with the year of change as though the taxpayer originally placed the MACRS property in service with the longer recovery period and/or slower depreciation method. Accordingly, the adjusted depreciable basis of the MACRS property as of the beginning of the year of change is depreciated over the remaining portion of the new, longer recovery period as of the beginning of the year of change.

For MACRS property depreciated under the optional depreciation tables in Rev. Proc. 87-57, 1987-2 C.B. 687 before the change in use, the taxpayer may (but is not required to) continue to depreciate the property under the tables after the change in use. If the taxpayer desires to use the optional depreciation tables after a change in the use of the MACRS property as of the beginning of the year of change, the adjusted depreciable basis of the property is depreciated over the new longer recovery period and/or by the slower depreciation method. If the change in use results in a longer recovery period and/or a slower depreciation method, the proposed regulations also provide guidance on choosing the applicable optional depreciation table. If the change in use results in a longer recovery period and/or a slower depreciation method, the proposed regulations provide guidance on choosing the applicable optional depreciation table. If the change in use results in a longer recovery period and/or a slower depreciation method, the proposed regulations also provide guidance on how to modify the calculation involved to compute the depreciation allowances beginning in the year of change.

If a change in the use of MACRS property results in a shorter recovery period and/or more accelerated depreciation method, the taxpayer may use the optional depreciation table that corresponds to the applicable depreciation method, recovery period, and convention, determined as though the property is placed in service in the year of change. Taxpayers should be aware that using this table will result in less depreciation than using the formulas, because the convention is factored into the optional depreciation tables, and taken into account in determining for the year of change based on the number of full months of the old use and of the new use of the MACRS property during the year of change.

The proposed regulations also provide rules for determining the applicable depreciation method, recovery period, and convention used to determine the depreciation allowances for the MACRS property for the year of change. For each of these provisions, a child reaches an age on the anniversary of the date of the child’s birth, e.g., a child born on January 1, 1987, is 17 on January 1, 2004. Rev. Rul. 2003-72, I.R.B. 2003-33.

DEPRECIATION. The IRS has issued proposed regulations which provide rules for determining the annual depreciation allowance under I.R.C. § 168 for property for which the use changes in the hands of the taxpayer. Changes in use include a conversion of personal use property to a business or income-producing use, a conversion of MACRS property to personal use, or a change in use of MACRS property that results in a different recovery period, depreciation method, or both. The proposed regulations provide that personal use property converted to business or income-producing use is treated as being placed in service by the taxpayer on the date of the conversion. Thus, the property is depreciated by using the applicable depreciation method, recovery period, and convention prescribed under I.R.C. § 168 for the property beginning in the taxable year the change of use occurs. The depreciable basis of the property for the year of change is the lesser of its fair market value or adjusted depreciable basis at the time of the conversion. A conversion of MACRS property from business or income-producing use to personal use is treated as a disposition of the property. Depreciation for the year of change is computed by taking into account the applicable convention. No gain, loss, or depreciation recapture is recognized upon the conversion. See Rev. Rul. 69-487, 1969-2 C.B. 165.

The proposed regulations provide rules for MACRS property if a taxpayer changes the use of the property after the property’s placed-in-service year but the property continues to be MACRS property in the hands of the taxpayer. In general, the proposed regulations provide that a change in the use of MACRS property occurs when the primary use of the MACRS property in the taxable year is different from its primary use in the immediately preceding taxable year. If a change in the use of MACRS property has occurred, the depreciation allowance for the MACRS property for the year of change is determined as though the change in the use of the MACRS property occurred on the first day of the year of change. The IRS invites comments on this rule and on a potential alternative rule that would treat a change in the use of MACRS property as occurring on the first day of the month in which the use changes and would allocate the depreciation allowance for that MACRS property

The proposed regulations provide rules for MACRS property if a change in the use occurs during the taxable year the property is placed-in-service and the property continues to be MACRS property in the hands of the taxpayer. If the use of MACRS property changes during its placed-in-service year, the depreciation allowance generally is determined by the primary use of the property during that taxable year. However, in determining whether MACRS property is used within or outside the United States during the placed-in-service year, the predominant use, instead of the primary use, of the MACRS property governs. Further, in determining whether MACRS property is tax-exempt use property or imported property covered by an executive order during the placed-in-service year, the use of the property at the end of the placed-in-service year governs.

Finally, the proposed regulations amend the final regulations under I.R.C. § 168(i)(4) for property accounted for in a general asset account for which the use changes, resulting in a different recovery period and/or depreciation method. While this change in use does not cause or permit the revocation of the election to account for the property in a general asset account, the property generally is removed from its existing general asset account and placed in a separate general asset account. 68 Fed. Reg. 43047 (July 21, 2003).

The taxpayers were partnerships which claimed depreciation for natural gas pipelines owned and operated by the partnerships. The partnerships’ operations did not involve any production of the natural gas. The District Court had held that under Rev. Proc. 87-56, 1987-2 C.B. 674, pipeline transportation was a separate business and the assets were properly classified under Class 46.0 as 15-year property for depreciation purposes. The appellate court reversed, holding that, although the taxpayer was not a producer of gas and did not own an interest in the gas wells, the systems were primarily used by gas producers who entered into contractual arrangements with the taxpayer. Thus, for purposes of the modified accelerated cost recovery system, the systems fell within asset class 13.2 of Rev. Proc. 87-56, 1987-2 C.B. 674, which does not include an ownership requirement. Saginaw Bay Pipeline Co. v. United States, 2003-2 U.S. Tax Cas. (CCH) (6th Cir. 2003), rev’g, 2001-2 U.S. Tax Cas. (CCH) ¶ 50,642 (E.D. Mich. 2001).

**DISASTER LOSSES.** On July 2, 2003, the President determined that certain areas in Kentucky were eligible for assistance under the Disaster Relief and Emergency Assistance Act, 42 U.S.C. § 5121, as a result of severe storms, flooding, mud and rock slides, and tornadoes beginning on June 14, 2003. FEMA-1475-DR. On July 11, 2003, the President determined that certain areas in Indiana were eligible for assistance under the Act as a result of severe storms, tornadoes and flooding that began on July 4, 2003. FEMA-1476-DR. On July 14, 2003, the President determined that certain areas in Arizona were eligible for assistance under the Act as a result of the Aspen Fire that began on June 17, 2003. FEMA-1477-DR. On July 15, 2003, the President determined that certain areas in Ohio were eligible for assistance under the Act as a result of severe storms and flooding that began on July 4, 2003. FEMA-1478-DR. Accordingly, taxpayers who sustained losses attributable to the disaster may deduct the losses on their 2002 federal income tax returns.

**DISCHARGE OF INDEBTEDNESS.** The IRS has issued temporary regulations governing the application of the tax reduction rules. I.R.C. § 108(b)(4)(A), under the discharge of indebtedness rules where the taxpayer has acquired the assets of another corporation during the year of discharge of indebtedness. In particular, the temporary regulations involve the problem that arises from application of Treas. Reg. §§ 1.381(c)(1)-1, 1.381(c)(3)-1 which govern the carryover of tax items from the acquired corporation to the acquiring corporation and which require that the transfer ends the transferee corporation’s tax year. The temporary regulations clarify that, in the case of a transaction described in I.R.C. § 381(a) that ends a year in which the distributor or transferor corporation excludes discharge of indebtedness income from gross income under I.R.C. § 108(a), any tax attributes to which the acquiring corporation succeeds and the basis of property acquired by the acquiring corporation in the transaction shall reflect the reductions required by I.R.C. §§ 108, 1017. For this purpose, all attributes listed in I.R.C. § 108(b)(2) of the distributor or transferor corporation immediately prior to the transaction described in I.R.C. § 381(a), including the basis of property, but after the determination of tax for the year of the discharge, are available for reduction under I.R.C. § 108(b)(2). These temporary regulations also clarify that the tax attributes subject to reduction under I.R.C. § 108(b)(2) that are carryovers to the taxable year of the discharge, or that may be carried back to taxable years preceding the year of the discharge, are first taken into account by the taxpayer for the taxable year of the discharge or the preceding years, as the case may be, before such attributes are reduced pursuant to I.R.C. § 108(b)(2). 68 Fed. Reg. 42590 (July 18, 2003).

**EDUCATION IRA.** The IRS has issued guidance regarding reporting requirements and transition rules applicable to Coverdell Education Savings Accounts (CESAs) where a trustee or custodian is unable to calculate the earnings and basis portions of a gross distribution from a CESAs made in 2003. Notice 2003-53, I.R.B. 2003-__.

**HOME OFFICE EXPENSES.** The taxpayer was an insurance agent who lived with the taxpayer’s girlfriend and paid her a monthly amount for use of the residence. The taxpayer claimed a deduction for use of a portion of the residence as an office; however, the taxpayer did not keep any records of personal and business use of the residence or how the money was spent. The court upheld the IRS disallowance of the deduction for lack of substantiation. Diers v. Comm’t, T.C. Memo. 2003-229.

**INCOME.** The taxpayer was an insurance agent who received advances on commissions from the employer insurance company. When the taxpayer left that employment, the taxpayer had outstanding advances and the company sued to recover the
advances. The taxpayer also had renewal commissions which were to be paid in the future from past insurance sales. The parties reached a settlement where the taxpayer released any right to the future commissions in exchange for forgiveness of the advances which had not been repaid. The court held that the agreement produced taxable income to the taxpayer in the amount of the forgiven advances. Diers v. Comm’r, T.C. Memo. 2003-229.

INSTALLMENT SALES. Legislation has been introduced in the U.S. House of Representatives that would clarify that installment sales treatment shall not fail to apply to property acquired for conservation purposes by a state or local government or certain tax-exempt organizations merely because purchase funds are held in a sinking or similar fund pursuant to state law. The use of the sinking fund would, under current law, deny the use of the installment method of reporting the gain from the sale because payments may not be made in the year of sale. H.R. 2830.

MILEAGE EXPENSES. The taxpayer was an insurance agent who claimed a deduction for automobile mileage. The taxpayer supported the deduction amount by using the annual odometer reading and claiming 90 percent of the annual miles as for business use. The taxpayer did not keep any written logs of the amount or purpose of each use of the automobile. The court upheld the IRS disallowance of the deduction for lack of substantiation. Diers v. Comm’r, T.C. Memo. 2003-229.

S CORPORATIONS

PASSIVE ACTIVITY LOSSES. The taxpayer owned 90 percent of an S corporation which operated a business that provided flight training, aircraft rental, charter services, and aircraft sales. The taxpayer participated in the business on a full-time basis as a manager, flight instructor, and mechanic, while also holding the corporate offices of president, treasurer, and assistant secretary. The taxpayer purchased equipment which was leased to the corporation, although the corporation failed to make all lease payments. The corporation also leased equipment from third parties. The taxpayer argued that the leasing activity was insubstantial in relation to the entire corporation’s business; therefore, under Treas. Reg. § 469-4(d)(1)(A), the leasing and corporation’s businesses could be combined with the result that the leasing activity would be considered non-passive and would allow the taxpayer to carry over losses. The court held that in ascertaining whether the leasing activity was insubstantial in relation to the corporation’s activity, the most significant fact was that taxpayer created and operated the leasing activity solely for the corporation’s benefit; therefore, the court held that the leasing activity was insubstantial in relation to the corporation’s activity and the losses were not passive losses. Schumacher v. Comm’r, T.C. Summary Op. 2003-96.

SALE OF FARM REAL PROPERTY. Legislation has been introduced in the U.S. Senate and House of Representatives which would exclude from taxable income the gain from the sale of qualified farm property. All of the gain, up to $500,000 ($250,000 for single taxpayers) would be excluded for first-time farmers who certify that the property will be used for farming for not less than 10 years after the sale. For other persons, 50 percent of the gain, subject to the limits above, is excluded if the taxpayer certifies that the property will be used for farming for not less than 10 years after the sale and 25 percent of the gain is excluded without the certification of farm use. Qualified farm property is property in the United States which is used for farming for three of the previous five years and the taxpayer or member of the taxpayer’s family materially participated in the operation of the farm. The legislation provides rules for recapture of the tax benefits if the property is not actually used for farming purposes during the 10-year certification period. S. 1464; H.R. 2978.

SALE OF PROPERTY. The taxpayers were partners in a partnership which owned real property subject to a mortgage. The partnership defaulted on the mortgage and reached an agreement with the creditor to transfer the property in satisfaction of the mortgage, resulting in recognition of gain to the partnership. The taxpayers argued that the gain was realized in the tax year in which the execution of the grant deed and covenant not to sue agreement occurred, December 15, 1993. The partnership issued a Form 1099-A showing the date of the acquisition by the creditor as December 15, 1993. However, the transaction did not close until May 1994 when the title company issued a title policy to the creditor. The court held that the gain would not be recognized until 1994 with transfer of the title. Lowry v. Comm’r, T.C. Memo. 2003-225.

SOCIAL SECURITY BENEFITS. The taxpayer received income from a pension plan and social security benefits of less than $25,000 in 1999. The taxpayer claimed to have lived apart from the taxpayer’s spouse for all of 1999 and was eligible for a I.R.C. § 86(c)(1)(A) base amount of $25,000 for purposes of taxation of the social security benefits. The taxpayer filed a 1999 form 1040A using the status of “married filing separate return” and listed an address separate from the spouse. The IRS had sent the Form 1040A to the taxpayer’s residence. The pension payments were reported on Form 1099-R which was sent to the taxpayer’s residence. The taxpayer had gambling winnings in 1999 and the race track used the spouse’s address to report those winnings because the racetrack used the taxpayer’s license to determine the taxpayer’s address. The court held that the taxpayer had sufficiently demonstrated that the taxpayer had lived separate from the spouse during all of 1999 and was eligible for the $25,000 base amount. DuBois v. Comm’r, T.C. Memo. 2003-222.

THEFT LOSS. The taxpayer was a shareholder of a corporation which contracted for interior design services from a third party. The shareholder obtained a state court judgment against the third party under a Florida civil theft statute and filed a claim against the interior designer in the interior designer’s bankruptcy case. The court found that the judgment and bankruptcy claims were not shown to be without value. The court disallowed the theft loss deduction because (1) the original contract was between the corporation and the designer and did not involve the taxpayer, and (2) the taxpayer failed to demonstrate the amount of the loss or that it occurred from a theft. Steffen v. Comm’r, 2003-2 U.S. Tax Cas. (CCH) ¶ 50,580 (Bankr. M.D. Fla. 2003).
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“Farm Income Tax and Estate and Business Planning”

by Dr. Neil E. Harl and Roger A. McEowen

January 5-9, 2004  Waikoloa Beach Marriott Resort, Big Island of Hawaii

We are beginning to plan for another “Seminar in Paradise” in Hawaii in January 2004, if there is enough interest. The seminars run from 8am to Noon each day. The Monday and Tuesday seminars will cover Farm Income Tax; the Wednesday and Thursday seminars will cover Farm Estate Planning; and the Friday seminar will cover Farm Business Planning. The registration fees are $645 for current subscribers and $695 for nonsubscribers. Early registrants will be able to pay a non-refundable (unless we cancel) deposit of $100 in exchange for a $50 reduction of the registration fee. If you are interested and want more information, call Robert at 541-302-1958 or e-mail at robert@agrilawpress.com.