Cases, Regulations, and Statutes

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The new limitations

Apparently, some taxpayers had been interpreting the safe harbor as permitting like-kind exchange treatment for transactions in which the taxpayer transferred property to an exchange accommodation title holder and received that same property as replacement property as a purported exchange for other property of the taxpayer. The 2004 revenue procedure also notes that in some types of “parking” transactions, the taxpayer was reinvesting the proceeds of the sale of one piece of real property in improvements to other real property already owned by the taxpayer or a related person.\(^1\)

**Change in scope of “reverse” like-kind exchanges**

In response to these types of transactions, IRS has now modified the safe harbor rules\(^2\) to provide that the safe harbor will not apply to replacement property held in a QEAA if the property is owned by the taxpayer within the 180-day period ending on the date that qualified indicia of ownership of the property are transferred to an exchange accommodation title holder.\(^3\)

This change is effective for transfers on or after July 20, 2004, of qualified indicia of ownership to exchange accommodation titleholders.\(^4\)

IRS (and the Treasury Department) indicate that they will continue to study “parking” transactions and may issue further guidance if they determine that other transactions are not consistent with the policies underlying the like-kind exchange rules.\(^5\)

**FOOTNOTES**


4. I.R.C. § 1031(a)(1). See Ltr. Rul. 9850001, Aug. 31, 1998 (liquidity of taxpayer into holding company followed by merger of holding company with another corporation did not affect requirement that replacement property be held for productive use in a trade or business or for investment); Ltr. Rul. 200131014, May 2, 2001 (transfer of S corporation’s replacement properties in like-kind exchange to its wholly-owned single member LLC did not violate requirement that replacement property must be used in trade or business after exchange; single member LLC either disregarded or reliance placed on default classification). See also Rev. Rul. 75-292, 1975-2 C.B. 333 (like-kind exchange followed by immediate transfer of replacement property by taxpayer to corporation failed I.R.C. § 1031 tests—acquired for purpose of transferring to new corporation).

5. Starker v. United States, 602 F.2d 1341 (9th Cir. 1979).


7. Id.

8. See 4 Harl, supra note 1.

9. Rev. Proc. 2000-37, 2000-2 C.B. 308 (allows accommodation party to be treated as owner of the property for tax purposes, enabling transactions to qualify as like-kind exchange).

10. Id.

11. Id.


13. Id.

14. Id.


18. Id., sec. 6.


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**CASES, REGULATIONS AND STATUTES**

by Robert P. Achenbach, Jr

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**BANKRUPTCY**

**FEDERAL TAX**

**REFUND.** The debtor filed for bankruptcy in 2002 and filed a federal income tax return which claimed a refund resulting from the child tax credit and the earned income tax credit. The debtor sought to exclude the refund from bankruptcy property as post-petition property. The court held that the child tax credit refund could not be obtained until after 2002; therefore, that portion of the refund was not included in the bankruptcy estate. The trustee conceded that the only portion of the refund which was included in the estate was that portion attributable to income earned by the debtor prior to the bankruptcy petition date. In the Matter of Schwarz, 314 B.R. 433 (Bankr. D. Neb. 2004).

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**FEDERAL AGRICULTURAL PROGRAMS**

**WETLANDS.** The Natural Resources Conservation Service had determined that the plaintiff had wetlands on the plaintiff’s property and the plaintiff had filed an appeal of that determination but later withdrew the appeal. The plaintiff claimed that a district
conservationist had told the plaintiff that the plaintiff could remove woody vegetation from the wetland property. The plaintiff removed some woody vegetation from the wetland property and planted hay and corn on the property. The district conservationist discovered the removed shrubs and woody vegetation and informed the plaintiff that the plaintiff had converted wetland in violation of 16 U.S.C. §§ 3821-3824. The plaintiff filed an appeal of the conversion determination up to the National Appeals Division, including an appeal of the original wetlands determination. The NAD upheld the converted wetlands determination and refused to rule on the wetlands determination because the plaintiff had withdrawn the original appeal. The court held that 16 U.S.C. § 3822(a)(4) allowed an appeal of a wetlands determination as part of an appeal of a converted wetlands appeal. The court remanded the case to the NAD to rule on the propriety of the original wetlands determination, noting that the evidence appeared to indicate that the original wetlands determination was incorrect. B & D Livestock Co. v. Veneman, 332 F. Supp. 2d 1200 (N.D. Iowa 2004).

**FEDERAL ESTATE AND GIFT TAXATION**

**DISCLAIMERS.** The decedent’s estate included a pension plan which, under state law, passed to the decedent’s estate. The decedent’s will bequeathed the residue estate to the decedent’s three children in equal shares. The children each executed a written disclaimer of their residuary bequests, resulting in the pension plan funds being passed to the surviving spouse. The IRS ruled that the disclaimers were effective for federal estate tax purposes; therefore, the pension plan funds would be treated as passing directly from the decedent to the surviving spouse and would be eligible for the marital deduction. The IRS also ruled that the spouse could roll over the funds into an IRA with incurring income tax on the pension plan distributions. Ltr. Rul. 200447040, Aug. 24, 2004.

**FAMILY-OWNED BUSINESS DEDUCTION.** The decedent’s estate included property for which the family-owned business deduction was available. The estate hired two accounting firms to prepare the estate tax return but the return did not make the family-owned business deduction election. When the error was discovered the executor filed a request for extension of time to file the election. The IRS granted the extension of time to file the election. Ltr. Rul. 200448029, July 28, 2004.

**GROSS ESTATE.** The District Court affirmed the Magistrate’s report of the following case. The decedent was the remainder beneficiary of two trusts established by the decedent’s sister for the sister’s benefit. The trusts provided for termination of the trusts at the decedent’s death and distribution of the trust assets under the sister’s will. The sister’s will provided for distribution of the sister’s estate by passing one-half of the estate to the decedent. The sister predeceased the decedent and the decedent became the beneficiary of the trusts and one-half of the sister’s separate property. At the death of the decedent, the IRS claimed that the decedent’s estate included one-half of the trusts’ principal in that the sister’s will bequeathed one-half of her estate to the decedent. The decedent’s estate argued that the trust property did not pass to the decedent because the will bequest was to the decedent and not to the decedent’s estate and, because the decedent did not survive the termination of the trusts, the trust property passed under the trusts’ provisions to third parties. The court agreed with the estate’s argument and held that the sister did not intend for any of the trusts’ property to pass to the decedent or the decedent’s estate; therefore, none of the trusts’ property was included in the decedent’s estate for federal estate tax purposes. Cameron v. United States, 2004-2 U.S. Tax Cas. (CCH) ¶ 60,494 (W.D.Pa. 2004), aff’g, 2004-2 U.S. Tax Cas. (CCH) ¶ 60,491 (W.D. Pa. 2004).

**SPECIAL USE VALUATION.** For an estate of a decedent dying in calendar year 2005, if the executor elects to use the special use valuation method under I.R.C. § 2032A for qualified real property, the aggregate decrease in the value of qualified real property resulting from electing to use I.R.C. § 2032A that is taken into account for purposes of the estate tax may not exceed $870,000. Rev. Proc. 2004-71, I.R.B. 2004-50.

The decedent’s estate included general and limited partnership interests in a family partnership which operated a farm. The decedent’s property passed to the taxpayer’s three children directly or in trust. The estate elected special use valuation for the decedent’s interest in the partnership. The estate first determined the fair market value of the partnership interests by applying discounts for lack of marketability and for the minority interests involved. The estate then applied the maximum reduction for the special use valuation, $770,000, (870,000 in 2005, see above) to the adjusted fair market value to determine the value for estate tax purposes. The IRS noted that this method was approved in Estate of Hoover, 69 F.3d 1044 (10th Cir. 1995) and that the IRS has acquiesced to this ruling, see 1998-2 C.B. 254. The IRS also noted that applying the valuation discounts after applying the special use valuation reduction was rejected in Estate of Maddox v. Comm’r, 93 T.C. 229 (1989). Thus, the IRS ruled that the decedent’s estate had used the proper method of valuing the estate property by applying the value discounts to the fair market value of the partnership interests before applying the special use valuation reduction. Ltr. Rul. 200448006, July 19, 2004.

**FEDERAL INCOME TAXATION**

**CHARITABLE DEDUCTION.** Under the American Jobs Creation Act of 2004 (P.L. 108-357), charitable deductions for contribution of automobiles made after December 31, 2004 are subject to new rules. See page 165 supra. The IRS has issued a reminder to taxpayers that the charitable deduction over $500 may be limited to the proceeds received by the charity when it sells the car unless the charity uses the car or makes improvements before the sale. The IRS cautioned taxpayers that the value listed in a car buyer’s guide may not be sufficient to determine the value
of the car. IR-2004-142.

The taxpayer formed a family trust which reached an agreement with a charitable organization for the organization to pay the premiums on a life insurance policy owned by the family trust on the life of the taxpayer. The taxpayer made the payment to the charity without restrictions but the charity used the contribution to pay the premium on the insurance policy. The taxpayer made additional payments the following years and the charity again made the premium payments. The trust and charity agreed to split the proceeds of the insurance upon the death of the taxpayer. The transactions were halted after Congress passed legislation requiring charities to pay an excise tax on split-dollar insurance premiums. The court held that the taxpayers received something of value in exchange. When the payments were made, the charity supplied the taxpayers with a receipt stating that no consideration was paid for the contributions, which was false. The court held that the false receipt resulted in the taxpayers failing to have sufficient substantiation of the contributions to support a deduction. See also Addis v. Comm’r, 2004-2 U.S. Tax Cas. (CCH) ¶ 50,291 (9th Cir. 2004), aff’d, 118 T.C. 528 (2002). Roark v. Comm’r, T.C. Memo. 2004-271.

DEATH OF COMBAT SOLDIERS. The taxpayer was the spouse of a soldier who was killed in combat operations in Afghanistan. The taxpayer claimed that the soldier had served in several combat zones prior to Afghanistan. The IRS noted that I.R.C. § 692 provides that where a taxpayer is killed in a combat zone while in the armed services, the taxpayer is excused from taxation for all years after and including the first year the taxpayer served in a combat zone. The IRS noted the example of a taxpayer who first served in Korea in 1950 but was killed in Vietnam in 1966. That taxpayer income for 1950 through 1966 was not taxable. Thus, the taxpayer was eligible to file for a refund for those years in which taxes were paid but later, because of the taxpayer’s death in a combat zone, became refundable, subject to the three year limitation period of I.R.C. § 6511(a) for filing refund claims. CCA Ltr. Rul. 200447035, Aug. 16, 2004.

DISCHARGE OF INDEBTEDNESS. A limited partnership had two corporations as partners. The partnership borrowed funds to build a commercial building and the limited partner had signed a guaranty of the loan and was required to make some early payments on the loan when the partnership failed to make timely payments. Eventually, the limited partner paid off the loan in order to get a release of its guaranty agreement. The partnership argued that the payment was a contribution to the partnership but the court held that the payment resulted in recognition of discharge of indebtedness income to the partnership. Mas One Limited Partnership v. United States, 2004-2 U.S. Tax Cas. (CCH) ¶ 50,413 (6th Cir. 2004).

INNOCENT SPOUSE. While the taxpayer was married, the taxpayer and spouse invested in sheep breeding tax shelter partnerships. The loss deductions and other tax benefits of the partnerships were denied by the IRS and the taxpayer was assessed taxes resulting from the disallowed tax benefits. The taxpayer innocent spouse relief from the taxes, arguing that the investments were made by the ex-spouse. The court found that the taxpayer had actively participated in the investments and was, or should have been, aware that the tax benefits were not legitimate. The court held that the taxpayer’s knowledge and involvement in making the investments made the taxpayer ineligible for innocent spouse relief. Barnes v. Comm’r, T.C. Memo. 2004-266.

INTEREST RATE. The IRS has announced that, for the period January 1, 2005 through March 31, 2005, the interest rate paid on tax overpayments is 5 percent (4 percent in the case of a corporation) and for underpayments is 5 percent. The interest rate for underpayments by large corporations is 7 percent. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 is 2.5 percent. Rev. Rul. 2004-111, I.R.B. 2004-50.

PARTNERSHIPS. TRANSACTIONS WITH PARTNERS. Under I.R.C. § 707(a)(2)(B) transfers to and by a partnership that are more properly characterized as transactions between the partnership and one who is not a partner or between two or more partners acting other than in their capacity as partners shall be treated as such transactions. Regulations have been issued under this section for recharacterization of “disguised” sale of property to and from a partnership. The IRS has now issued proposed regulations governing the recharacterization of disguised sale of partnership interests. 69 Fed. Reg. 68838 (Nov. 26, 2004).


RETURNS. The IRS is requesting applications to participate in the e-file program from commercial businesses, nonprofit organizations and state or local governments. The annual program covers January 2005 through October 15, 2005. All prior-year partners must reapply for filing season 2005. A major area of emphasis for participants in the 2005 program will be to reach taxpayers who continue to file computer-prepared paper returns to convert those taxpayers to e-filing. Applications to participate in the program should be submitted through e-mail to e-filepartners@irs.gov. Applications may also be sent to: Internal Revenue Service, 5000 Ellin Road, Lanham, Md. 20706, Attn: Karen Bradley, SE:W:CAR:SPEC:FO:IMS, C5-351. Ann. 2004-93, I.R.B. 2004-49.

The IRS has issued Publication 503 (2004), Child and Dependent Care Expenses; Publication 554 (2004), Older Americans’ Tax Guide; Publication 969 (2004), Health Savings Accounts and Other Tax-Favored Health Plans; Publication 1494 (2005), Table for Figuring Amount Exempt from Levy on Wages, Salary, and Other Income — Forms 668-W(c), 668-W(c)(DO) and 668-W(ICS). The IRS notes that publication 1494 is temporarily published with both the 2004 and 2005 figures. The IRS states that the 2005 revision of Publication 1494 is used to compute the amount exempt from levies on wages, salaries, and other income.
paid in 2005. For levies issued in earlier years, if the taxpayers give new statements of exemption and filing status to their employers in 2005, the revised publication should be used to recompute the exempt amount. Taxpayers should use the January 2004 revision for levies issued in 2004, and if new exemption statements are received in that year. The forms are available on the IRS web site, www.irs.gov/formspubs/index.html, in the Forms & Pubs section. The documents are available at no charge and can be obtained (1) by calling the IRS’s toll-free telephone number, 1-800-TAX-FORM (1-800-829-3676); (2) through FedWorld on the Internet; or (3) by directly accessing the Internal Revenue Information Services bulletin board at (703) 321-8020.

SOCIAL SECURITY PAYMENTS. The taxpayer was a retired truck driver who received pension plan payments and social security payments. After retirement, the taxpayer became an associate pastor with a church without salary. The taxpayer did not file income tax returns for the years involved, arguing that the pension plan and social security payments were exempt from tax, under Treas. Reg. § 31.3401(a)(9)-1, as amounts paid to a minister. The court held that the pension plan and social security payments were subject to income tax because the amounts were not paid for the taxpayer’s services as a minister. Buras v. Comm’r, T.C. Summary Op. 2004-161.

TAX RATES. The standard deductions for 2005 are $10,000 for joint filers, $7,300 for heads of households, $5,000 for single filers and $5,000 for married individuals who file separately. The income limit for the maximum earned income tax credit is $14,550 for taxpayers with no children, $17,450 for taxpayers with one child, and $21,000 for taxpayers with two or more children. The IRS also announced the inflation adjusted tax tables and other inflation adjusted figures for 2005. The personal exemption is $3,200. For taxable years beginning in 2005, the personal exemption amount begins to phase out at, and is completely phased out after, the following adjusted gross income amounts:

<table>
<thead>
<tr>
<th>Filing Status</th>
<th>AGI – Beginning of Phaseout</th>
<th>AGI Above Which Exemption Fully Phased Out</th>
</tr>
</thead>
<tbody>
<tr>
<td>I.R.C. § 1(a)</td>
<td>$218,950</td>
<td>$341,450</td>
</tr>
<tr>
<td>I.R.C. § 1(b)</td>
<td>$182,450</td>
<td>$300,950</td>
</tr>
<tr>
<td>I.R.C. § 1(c)</td>
<td>$145,950</td>
<td>$268,450</td>
</tr>
<tr>
<td>I.R.C. § 1(d)</td>
<td>$109,475</td>
<td>$170,725</td>
</tr>
</tbody>
</table>

For taxable years beginning in 2005, the expense method depreciation limit is increased to $105,000, with the limitation reduced if more than $420,00 of Section 179 property is placed in service in 2005. Rev. Proc. 2004-71, I.R.B. 2004-50.

UNRELATED BUSINESS INCOME. This ruling involved two situations. In the first situation, a trade association received revenue from a web site which existed during a trade show and involved activities of exhibitors in conjunction with the trade show. The IRS ruled that the income from the web site was a trade show activity and was not unrelated business income. In the second situation, the trade association web site was not available during a trade show but was run for a limited time independent of any trade show. The IRS ruled that the web site was not a trade show activity, therefore, the revenue from the web site was unrelated business income. Rev. Rul. 2004-112, I.R.B. 2004-50.

WAGES. The taxpayer was employed under a written employment contract for a term of years. The taxpayer and employer negotiated an early termination of the contract and the taxpayer received a payment from the employer in consideration for the taxpayer’s relinquishment of the remainder of the contract rights. The IRS ruled that the payment was taxable as ordinary income and was subject to FICA and FUTA taxes and income tax withholding. Rev. Rul. 2004-110, I.R.B. 2004-50.

The taxpayer was a baseball player who signed a contract with a baseball organization. The contract provided for a sign-up bonus if the taxpayer shows up for spring training as requested. The IRS ruled that the bonus was taxable as ordinary income and was subject to FICA and FUTA taxes and income tax withholding. In a second situation, the contract was negotiated by the taxpayer’s union and the contract contained a bonus to be paid upon ratification of the contract by the union players. The IRS ruled that the bonus was taxable as ordinary income and was subject to FICA and FUTA taxes and income tax withholding. Rev. Rul. 2004-109, I.R.B. 2004-50.

NEGLIGENCE

ASSUMPTION OF RISK. The plaintiff was nine years old when the plaintiff and family vacationed at the ranch operated by the defendant. The plaintiff was injured while riding a pony supplied by the defendant. The plaintiff’s parents had signed a stable sign-in sheet which listed the other guests and contained language that the signers held the defendant harmless for injury from the use of the horses. The defendant raised the defense of assumption of risk and the plaintiff argued that the defendant was negligent in creating a dangerous condition which exceeded the normal risks of horse riding because the horse was too young for a child, the defendant failed to properly teach the plaintiff how to stop the horse and the defendant failed to properly supervise the riding. The court denied summary judgment for the defendant because the plaintiff had raised sufficient issues of fact as to the possible negligence of the defendant in excess of the normal risks from horse riding. In addition, the court held that the hold harmless language on the sign-in sheet was insufficient notice to bar a suit for negligence by the defendant in excess of the normal risks from horse riding. Applbaum v. Golden Acres Farm and Ranch, 333 F. Supp.2d 31 (N.D. N.Y. 2004).

SECURED TRANSACTIONS

PERFECTION. The plaintiff loaned money to a farmer for the purchase of a tractor. The farmer granted a security interest in the tractor as collateral and the plaintiff filed a financing
statement. The financing statement misspelled the farmer’s name as Roger instead of the accurate Rodger. The farmer also borrowed money from the defendant bank which also obtained a security interest in the farmer’s equipment, including the tractor. The bank’s financing statement included the accurate spelling of the farmer’s first name. When the farmer filed for bankruptcy, the lenders both claimed a security interest in the tractor. The bank argued that the plaintiff’s security interest was unperfected because the financing statement was seriously misleading since it did not contain the debtor’s accurate name. The court held that, because a standard search of the debtor’s correct name would not find the plaintiff’s security interest in the state’s database, the plaintiff’s security interest was unperfected. The court noted that this placed the burden on the creditor to list the correct debtor’s name on the financing statement and did not require that a searching creditor use variants of the debtor’s name in any security interest search. Pankratz Implement Co. v. Citizens Nat’l Bank, 2004 Kan. App. LEXIS 1173 (Kan. Ct. App. 2004).