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# Cases, Regulations, and Statutes

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or loss is ordinarily recognized to the subsidiary on receipt of assets from the parent corporation in exchange for stock or securities of the subsidiary.[23]

As for the various recapture possibilities —

- The rules for recapture of depreciation on real and personal property are not activated.[24]
- Soil and water conservation and land clearing expense deductions are not ordinarily recaptured.[25]
- Government cost sharing payments excluded from income are apparently not recaptured.[26]
- In the few instances in which investment tax credit is still subject to recapture,[27] recapture occurs as to the transferred assets.[28]
- The rule disallowing a deduction for production expenses for unharvested crops would appear to apply.[29]

The earnings and profits of the parent corporation must be allocated between the parent corporation and the subsidiary, usually in proportion to the fair market value of the "business" retained by the parent corporation.[30]

Ordinarily, no gain or loss is recognized to the parent corporation on transfer of an installment obligation to the subsidiary.[31]

**Tax effects on shareholders**. Ordinarily, no gain or loss is recognized to the shareholders involved.[32] The income tax basis of the stock and securities in the subsidiary is derived from the income tax basis of the stock in the parent corporation that was surrendered.[33] The available income tax basis is allocated on the basis of fair market values.[34] The holding periods are tacked on.[35] And a determination should be made as to whether a tax-free corporate division would terminate the right to pay federal estate tax in installments if such an election is outstanding.[36]

In general, a reorganization would lead to recapture of special use valuation benefits unless any new shareholders acquiring interests in land under a special use valuation election were members of the family and consented to personal liability for any recapture tax.[37]

**FOOTNOTES**

1 Tax Reform Act of 1986, Pub. L. 99-514, Sec. 631, 100 Stat. 2269 (1986).
2 *Id*., Sec. 633(d)(1).
3 See generally 9 Harl, Agricultural Law § 59.03[3] (1991).
4 I.R.C. § 368(a)(1)(D). See, e.g., Ltr. Rul. 9123027, March 8, 1991 (cattle ranch corporation reorganized into two corporations in order to avoid disputes between shareholders); Ltr. Rul. 9122058, March 5, 1991 (same); Ltr. Rul. 9008078, Nov. 30, 1989 (division of corporation into one corporation for farming and one for manufacturing); Ltr. Rul. 8942031, July 24, 1989 (reorganization of farming corporation into four corporations); Ltr. Rul. 8921093, Mar. 2, 1989 (division of corporation's cattle raising, crop farming and produce farming businesses into two corporations); Ltr. Rul. 8913047, Jan. 4, 1989 (division of corporation's two cattle businesses into two corporations).
5 See 8 Harl, *supra* note 3, § 59.07[2].
6 See I.R.C. § 355.
7 I.R.C. § 355(a)(1)(A).
8 I.R.C. § 368(c).
9 I.R.C. § 355(b)(1)(A).
10 I.R.C. § 355(b)(2)(B).
11 See Rev. Rul. 75-160, 1975-1 C.B. 112.
12 Rafferty v. Comm'r, 452 F.2d 767 (1st Cir. 1971), cert. denied, 408 U.S. 922 (1972) (land leased back to parent corporation).
13 King v. Comm'r, 458 F.2d 245 (6th Cir. 1972) (truck terminals leased to parent corporation).
14 Prop. Treas. Reg. § 1.355-3(b)(iii).
15 Rev. Rul. 86-126, 1986-2 C.B. 58.
16 I.R.C. § 355(a)(1).
17 See I.R.C. § 356(b).
18 I.R.C. § 355(a)(1)(D).
19 I.R.C. § 355(a)(1)(B).
20 Treas. Reg. § 1.355-2(c).
21 Rev. Proc. 74-26, 1974-2 C.B. 478.
22 I.R.C. § 361(a).
23 I.R.C. § 1032(a).
24 I.R.C. §§ 1245(b)(3), 1250(d)(3).
25 Treas. Reg. § 1.1252-2(c)(1), (c)(2)(iii).
26 See I.R.C. § 1255(b).
27 See 4 Harl, *supra* note 3, § 32.05.
28 SeeRev.Rul. 74-101,1974-1 C.B. 7.
29 See Treas. Reg. § 1.268-1.
30 Treas. Reg. § 1.312-10(a).
31 Treas. Reg. § 1.453-9(c)(2).
32 I.R.C. § 355(a)(1).
33 I.R.C. § 358(a).
34 Treas. Reg. § 1.358-2(a)(2), (3), (4).
35 I.R.C. § 1223(1).
36 I.R.C. § 6166(g)(1). See Ltr. Rul. 792955, April 19, 1979 (reorganization of closely-held corporation did not involve "disposition").
37 See I.R.C. § 2032A(c)(1)(A). Cf. Ltr. Rul. 8112022, Dec. 23, 1980 (no recapture where corporate stock passed to qualified heirs by gift and donees consented to personal liability for any recapture tax).

# CASES, REGULATIONS AND STATUTES

by Robert P. Achenbach, Jr.

## BANKRUPTCY

### GENERAL

**AVOIDABLE LIENS**. After the court had closed the Chapter 7 case, the debtor moved to reopen the case to avoid the unsecured portion of a claim against the debtor's residence under Section 506(d). The court held that because the closing of the case resulted in abandonment of the residence and, therefore, reversion of title to the debtor, the bankruptcy estate no longer had any interest in the residence and avoidance of the lien under Section 506(d) was not available. ***In re* Sills, 126 B.R. 974 (Bankr. S.D. Ohio 1991)**.

**COMMODITY BROKERS**. The debtor grain elevator had purchased soybean futures contracts for third parties. The debtor was not a licensed commodities broker and did not charge a commission for the purchases. When the contracts were closed, the proceeds were deposited in the debtor's account in a bank which held a security interest in the debtor's accounts. The bank claimed that its security interest gave it priority in the proceeds because the debtor was not a commodity broker and the futures contract buyers were not entitled to priority to the proceeds under Section 761. The court held that the debtor was a commodity broker because the futures contracts were purchased entirely for someone else. The court held that although the debtor may have violated the law by acting as a commodities broker without a license, the contract buyers' use of an unlicensed broker was not illegal and did not prevent their use of the priority provisions of Section 761. ***In re*** **Bucyrus Grain Co., Inc., 127 B.R. 45 (D. Kan. 1988),** ***rev'g*** **67 B.R. 336 (Bankr. D. Kan. 1987)**.

**DISCHARGE**. Chapter 7 husband and wife farm debtors failed to list several property interests on their bankruptcy schedules and to turn over to the trustee payments received post-petition from cooperatives for pre-petition operations. The court rejected the wife's claim that the payments were received only by the husband and should not affect the wife's discharge, where the state community property law made such payments joint property. The court revoked both debtors' discharges for failure to report property interests and pay over estate property to the trustee. ***In re*** **Bennett, 126 B.R. 869 (Bankr. N.D. Tex. 1991)**.

Prior to filing bankruptcy, the debtors sold some of their stock in a family farm corporation to the debtors' father who used the stock to borrow money to pay off personal loans for the corporation and to purchase the debtors' house. The debtors used the proceeds of the stock and house sales to purchase exempt annuities. The debtors also pledged their remaining stock as collateral for the father's loans. The court held that the pledge of the remaining stock was a gratuitous transfer made with intent to defraud creditors with security interests in that property; therefore, the debtors were denied discharge. The debtors and creditors argued that this ruling and a ruling allowing exemptions for the annuities, see *infra* under "Exemptions," were inconsistent. The court held that the exemption issue involved only the purchase of the annuities, whereas, the discharge issue involved the total transactions **Matter of Armstrong, 931 F.2d 1233 (8th Cir. 1991),** ***aff'g unrep. D. Ct. dec., aff'g*** **97 B.R. 565 (Bankr. D. Neb. 1988)**.

**EXEMPTIONS**. The debtor's interest in an ERISA qualified pension plan was included in the bankruptcy estate because the plan was not a spendthrift trust because of the debtor's control over the interest. However, the interest was exempt because ERISA provided a non-bankruptcy federal exemption. ***In re*** **Lewis, 91-1 U.S. Tax Cas. (CCH) ¶ 50,296 (Bankr. D. Colo. 1990)**.

Prior to filing bankruptcy, the debtors sold some of their stock in a family farm corporation to the debtors' father who used the stock to borrow money to pay off personal loans to the corporation and to purchase the debtors' house. The debtors used the proceeds of the stock and house sales to purchase exempt annuities. The debtors also pledged their remaining stock as collateral for the father's loans. The court held that the exemption for the annuities would be allowed because no extrinsic evidence of fraud was presented. The court found that the father paid adequate consideration for the stock and house. **Matter of Armstrong, 931 F.2d 1233 (8th Cir. 1991),** ***aff'g unrep. D. Ct. dec., aff'g*** **93 B.R. 197 (Bankr. D. Neb. 1988)**.

The debtor was not entitled to a homestead exemption for the debtor's interest in a residence because the debtor was single and not under an obligation to support other individuals. **In re Coker, 127 B.R. 23 (Bankr. E.D. Ark. 1991)**.

The debtor's interests in IRA and Keogh accounts were held exempt under Fla. Stat. § 222.21(2)(a). The Florida exemption was not preempted by ERISA and the ERISA qualified Keogh account was exempt under ERISA as federal nonbankruptcy law. ***In re*** **Suarez, 127 B.R. 73 (Bankr. S.D. Fla. 1991)**.

**TRUSTEE SALE OF ESTATE PROPERTY**. The trustee applied to sell the residence of the debtor owned by the debtor and nondebtor spouse as tenants by the entireties. The court held that the sale was allowable because the residence was subject to joint unsecured creditors of the debtor and nondebtor, but that the trustee must first comply with Section 363(h) before the sale would be approved. ***In re*** **Wickham, 127 B.R. 9 (Bankr. E.D. Va. 1990)**.

## CHAPTER 12

**MODIFICATION OF PLAN**. After confirmation of the debtors' Chapter 12 plan, the debtors sought court permission to sell a negative easement on most of the farmland with sufficient proceeds to pay off all secured creditors. Creditors objected to the sale, arguing that the court failed to make a finding that the plan would be feasible after the sale. The appellate court held that the lower court's finding that the sale would be in the interest of all creditors was essentially a finding that the plan would be reasonable after the sale. The court affirmed the sale of the negative easement. ***In re*** **Webb, 932 F.2d 155 (2d Cir. 1991)**.

## FEDERAL TAXATION

**ADMINISTRATIVE EXPENSES**. The debtor-in-possession incurred FICA and FUTA taxes post-petition and the IRS filed a claim for the taxes as administrative expenses. The debtor argued that Section 503(b)(1)(B) disallowed such priority to the taxes because the taxes were incurred by the debtor and not the estate. The court held that the debtor-in-possession was an entity separate from the debtor such that taxes incurred by the debtor-in-possession were not considered incurred by the debtor; thus, Section 503(b)(1)(B) did not apply to bar the administrative expense claim. In addition, interest on the taxes was also allowed administrative expense priority. ***In re*** **Lunsford, 91-2 U.S. Tax Cas. (CCH) ¶ 50,301 (Bankr. M.D. Fla. 1990)**.

**AUTOMATIC STAY**. After the debtor filed for Chapter 13, the IRS levied against the post-petition wages of the debtor's nondebtor spouse. The debtor challenged the levy because the debtor's plan already provided for full payment of the taxes and the levy would have reduced the couple's income below that necessary to meet expenses. The debtor claimed the levy violated Sections 1301(a) and/or 362(a). The court held that the levy did not violate Section 1301 because the tax claim was not a consumer debt. The court also held that the levy was prohibited by Section 362(a) because the nondebtor's spouse's income was included in the bankruptcy estate to the extent the income was subject to the income tax claim. The court found that the nondebtor's income was subject to the tax claim because the couple filed joint income tax returns and state community property law gave the debtor rights in the nondebtor's income. ***In re* Reiter, 126 B.R. 961 (Bankr. W.D. Tex. 1991)**.

**DISCHARGE**. The debtor's income tax liability for 1981 was not dischargeable where the debtor did not file an income tax return. The court held that the filing of a return by the IRS and a filing of Form 843, Claim for Refund, with a W-2 by the debtor did not constitute a filing of a return for purposes of dischargeability of the tax claim. ***In re* Cross, 91-2 U.S. Tax Cas. (CCH) ¶ 50,318 (Bankr. D. Nev. 1991)**.

The debtors listed possible gift tax liability on their bankruptcy schedules from pre-petition gifts for which federal gift tax returns were not filed. The debtors' Chapter 11 reorganization plan was confirmed but did not include any claims or payment for the disputed gift tax liability. Eight years after the confirmation, the IRS notified the debtors of a gift tax deficiency and the debtors filed a motion to have the gift tax liability declared discharged. The court held that the disputed gift tax liability was not discharged because no tax return was filed. **Grynberg v. U.S., 91-2 U.S. Tax Cas. (CCH) ¶ 60,076 (Bankr. D. Colo. 1991)**.

**JURISDICTION**. The IRS issued a notice of deficiency to the debtors for post-petition taxes. The debtors filed a petition in the Tax Court for redetermination of the tax deficiency. The court held that the automatic stay barred the debtors' petition. **Halpern v. Comm'r, 96 T.C. No. 43 (1991)**.

**SETOFF**. Prior to filing for Chapter 11, the debtor filed an Application for Tentative Refund resulting from carrybacks of net operating losses. The IRS accepted the application and reduction in taxes but offset the past overpayments against the debtor's pre-petition tax deficiencies. Secured creditors challenged the offset, claiming prior secured interests in the "refund" amount. The court held that under I.R.C. §§ 6402 and 6411, the debtor was not entitled to a "refund" because the IRS could offset the overpayment against any other taxes due before returning any left over overpayments. Thus, an overpayment was not a refund until there remains no due taxes to which the overpayment may be applied. Because no refund was due the debtor, the creditors' security interests did not attach to the overpayments. ***In re* Siebert Trailers, Inc., 91-2 U.S. Tax. Cas. (CCH) ¶ 50,308 (Bankr. E.D. Cal. 1991)**.

**STATUTE OF LIMITATIONS**. The debtor had filed a previous Chapter 7 case in which the debtor received a discharge, except as to federal tax claims. The debtor filed a subsequent Chapter 13 case and claimed that the federal tax claims were not entitled to priority because the tax returns for the taxes were due more than three years before the petition was filed. The court held that the previous Chapter 7 case tolled the statute of limitations during the case and the tax claims were entitled to priority. ***In re* Wise, 127 B.R. 20 (Bankr. E.D. Ark. 1991)**.

# COMMODITY FUTURES

**CONTRACTS**. The CFTC has issued proposed regulations amending the corn, soybean, wheat, soybean oil and soybean meal futures contracts to provide that upon request, the delivery warehouseman or shipper shall certify in writing that the product loaded is of U.S. origin. The change is effective September 1, 1992. **56 Fed. Reg. 30738 (July 5, 1991)**.

# COOPERATIVES

**STOCK**. The defendant was a farm corporation which was a member of the plaintiff cooperative. The cooperative sued the defendant for money due on an open account and the defendant counterclaimed for setoff of the value of the defendant's stock in the cooperative. The cooperative's bylaws did not provide any right of setoff. The defendant claimed that the bylaws breached the cooperative's fiduciary duty to the corporation because the bylaws provided only for priority of dividend payments to deceased natural persons and did not include dissolved corporation members. The court held that corporations were not entitled to be treated the same as natural persons; therefore, the bylaws did not breach any statutory or fiduciary duty to the corporation. The court noted that the corporation was not harmed by the bylaws because the corporation was still viable. Thus, the court held that the corporation was not entitled to an immediate redemption of its stock in the cooperative. **Mitchellville Co-op. v. Indian Creek, 469 N.W.2d 258 (Iowa Ct. App. 1991)**.

# FEDERAL AGRICULTURAL PROGRAMS

**BORROWER'S RIGHTS**. The FmHA has issued interim regulations amending the definition of property subject to the leaseback/buyback provisions of the Agricultural Credit Act of 1987. Under the new definition, the only residence which is included in leaseback/buyback property is the residence of the farm operator. Thus, if the farm owner or borrower is not the farm operator, the residence of the farm owner or borrower is not subject to the leaseback/buyback provisions. **56 Fed. Reg. 29400 (June 27, 1991)**.

**CROP INSURANCE**. The FCIC has issued an interim rule adding a three year program of crop insurance for California citrus production, effective for the 1992 through 1994 crop years. **56 Fed. Reg. 30489 (July 3, 1991)**.

**GRAIN STANDARDS-SOYBEANS**. The FGIS has issued proposed regulations amending the United States

Standards for soybeans, generally reducing the tolerance for foreign matter. **56 Fed. Reg. 30342 (July 2, 1991)**.

**GRAIN STANDARDS-WHEAT**. The FGIS has issued proposed regulations amending the United States Standards for wheat, generally reducing the tolerance for foreign matter. **56 Fed. Reg. 29907 (July 1, 1991)**.

**TOBACCO**. The ASCS has issued a notice of determination of the penalty rates for tobacco produced in excess of the marketing quotas for the 1991-1992 marketing year:

| Kind of tobacco | Cents per pound |
|---|---|
| Flue-cured | 125 |
| Burley | 131 |
| Fire-cured (type 21) | 120 |
| Fired-cured (types 22, 23) | 146 |
| Dark Air-cured | 140 |
| Virginia Sun-cured | 109 |
| Cigar filler and binder | 113 |
| Puerto Rican Cigar filler | 57 |

**56 Fed. Reg. 29617 (June 28, 1991)**.

**WAREHOUSES**. The CCC has issued proposed regulations authorizing warehousemen to store sunflowers, canola, rapeseed, safflower, mustard and flaxseed under the Uniform Grain Storage Agreement. **56 Fed. Reg. 29912 (July 1, 1991)**.

# FEDERAL ESTATE AND GIFT TAX

## PROPOSED TAX LEGISLATION

New tax legislation introduced in the House and Senate include:

• Amendment of the definition of QTIP to specify that an income interest is not disqualified from QTIP merely because the accumulated income is not required to the distributed to the surviving spouse.

• Transfers made from revocable trusts within three years of death would not be included in the gross estate of the grantor.

• Allowing estates to perfect an incomplete special use valuation election, which did not substantially comply with the regulations, if the executor submits a signed recapture agreement within 90 days after a request for missing information by the IRS.

**DISCLAIMERS**. An irrevocable trust was created in 1917 and terminated in 1979 when the last income beneficiary died. The trust property was then to be distributed to the taxpayer as one of the remainder holders. The taxpayer disclaimed the interest in the trust property within two months after the death of the last income beneficiary. The court held, under pre-1977 law, that the disclaimer was untimely because not made within a reasonable time after the taxpayer learned about the remainder interest, when the taxpayer reached age 21 in 1931. **Irvine v. U.S., 91-2 U.S. Tax Cas. (CCH) ¶ 60,074 (8th Cir. 1991), *rev'g* 1989-2 U.S. Tax Cas. (CCH) ¶ 13,818 (D. Minn. 1989)**.

**GENERATION SKIPPING TRANSFERS**. The taxpayer was a beneficiary of a marital trust which was irrevocable before 1985 and released a portion of a general power of appointment over the trust corpus prior to 1985 such that the taxpayer held only a special power of appointment over trust corpus. The IRS noted that under Treas. Reg. § 20.2041-3(d)(1), the trust corpus would still be included in the taxpayer gross estate as if the taxpayer still had a general power of appointment over trust corpus. However, the IRS ruled that for GSTT purposes the taxpayer would be considered to have a special power of appointment over trust corpus and the release of a portion of the general power of appointment would not be considered an addition to the trust under Temp. Treas. Reg. § 26.2601-1(b)(1)(v) and the trust would not be subject to GSTT. **Ltr. Rul. 9125018, March 22, 1991**.

The taxpayer was a beneficiary of a trust which was irrevocable before 1985 and the beneficiary had a special power of appointment over trust corpus. The taxpayer exercised the power of appointment by appointing the trust corpus in trust for the taxpayer's children with such trusts to terminate within 21 years after the death of all beneficiaries in being when the trust was established. The IRS ruled that the exercise of the power of appointment did not subject the trust to GSTT. **Ltr. Rul. 9125042, March 28, 1991**.

**MARITAL DEDUCTION**. The taxpayer's will included bequests of estate property to a marital trust. The taxpayer's estate would consist primarily of improved commercial real property which would require a lengthy administration to liquidate. The marital trust provided for distribution of income at least quarterly and a general power of appointment in the surviving spouse. The IRS ruled that the marital trust was eligible for the marital deduction, although distribution of income could be delayed because of the nature of the estate property. The taxpayer expressed concern that the property would be valued for estate tax purposes as future interests because of the long administration period. The IRS ruled that the property would be valued at fair market value as of the date of the taxpayer's death or the elected alternate valuation date. **Ltr. Rul. 9125016, March 21, 1991**.

The decedent and surviving spouse had executed reciprocal wills and reciprocal revocable trusts, each with the survivor as successor trustee and beneficiary. The surviving spouse, as trustee of the decedent's trust, had a general power to appoint trust income and principal. The court held that the surviving spouse's interest in the decedent's trust was eligible for the marital deduction. **Est. of Parry v. U.S., 91-2 U.S. Tax Cas. (CCH) ¶ 60,075 (D. Utah 1991)**.

**POWER OF APPOINTMENT**. The decedent received an interest in trust in a predeceased spouse's entire estate. The decedent was a co-trustee and had the power to distribute trust principal to the decedent for the decedent's health, support and reasonable comfort, best interest and welfare. The decedent's estate representative claimed that the decedent was incompetent from the moment of creation of the trust to the decedent's death. The IRS ruled that because the trustees were not limited by an ascertainable standard in the distribution of trust principal to the decedent, the decedent had a general power of appointment over trust principal and the trust property was included in the decedent's gross estate. The IRS also ruled that the decedent's claimed incompetency did not prevent inclusion of the trust property in the gross estate. The IRS also ruled that although the trust assets had not been accepted by the trustees before the decedent's death, under state law, the trust assets passed to the trustees upon the predeceased spouse's death. **Ltr. Rul. 9125002, no date given**.

**TRUSTS**. The taxpayers created ten trusts for grandchildren in 1985. Income and principal were distributable at the discretion of the trustee until a beneficiary reached age 21. After a beneficiary reached age 21, income was to be distributed at least annually and corpus remained a discretionary distribution. The trusts terminated and trust corpus was to be distributed when a beneficiary died or reached age 35. Each beneficiary had a testamentary limited power of appointment over trust corpus. In 1988, ten additional similar trusts were created for the same beneficiaries, but each beneficiary had a testamentary general power of appointment over trust corpus. The trustee proposed to merge the trusts for ease of administration. The IRS ruled that the grantors' contributions to the trusts in amounts less than the annual exclusion amount generated an inclusion ratio of zero for GSTT purposes, and the merger of the trusts did not result in an addition to corpus for GSTT purposes and did not result in a taxable gift. **Ltr. Rul. 9124018, March 14, 1991**.

**VALUATION**. The decedent's estate included a 26 percent interest in a corporation and the estate valued the decedent's stock using the corporation's net value of assets less a 40 percent discount for a minority interest and a 20 percent discount for lack of marketability. The estate cited *Est. of Andrews v. Comm'r, 79 T.C. 938 (1986)* to support the discount amounts. The court held that the IRS appraisals, allowing 20 and 10 percent discounts respectively, were more accurately based on comparable stock holdings. The court also held that the estate's reliance on the court case was unreasonable without more specific evidence to support the discounts claimed and upheld the IRS penalty of 10 percent for substantial undervaluation of estate property. **Est. of Berg v. Comm'r, T.C. Memo. 1991-279**.

# FEDERAL INCOME TAXATION

**ACCORD AND SATISFACTION.** In settlement of a tax case, the taxpayers and IRS reached an agreement for "final civil settlement of taxes due for the years in issue." The IRS later assessed the taxpayers for interest on the taxes which were settled in the agreement. The court held that case law and the Section 6601(e)(1) definition of taxes included interest on the taxes; therefore, the agreement determined the amount of taxes and interest owed by the taxpayers and the IRS was prohibited by the agreement from further claims for interest on the amounts paid under the agreement. The court also found that the IRS agents involved in the case had told the taxpayers that the taxes involved included the interest on those taxes. **Anthony v. U.S., 91-2 U.S. Tax Cas. (CCH) ¶ 50,309 (D. Colo. 1991)**.

## CORPORATIONS

REORGANIZATION. The stock of a farm corporation and its subsidiary farm corporation were transferred to a holding corporation in exchange for the holding corporation stock. The IRS ruled that no gain or loss would be recognized from the transaction and the basis of the holding company stock would be the same as the shareholders' basis in the farm corporations. **Ltr. Rul. 9125020, March 25, 1991**.

**DISCHARGE OF INDEBTEDNESS**. The taxpayer had negotiated a debt settlement with a creditor resulting in release of indebtedness for less than fair market value. The taxpayer had not filed for bankruptcy. The IRS ruled that the value of the taxpayer's personal and real property exempt under state law was not included in determining the taxpayer's insolvency for purposes of the insolvency exclusion of I.R.C. § 108(a)(1)(B). **Ltr. Rul. 9125010, March 19, 1991**.

**EMBRYO TRANSPLANT ACTIVITY**. A college professor and registered nurse were disallowed depreciation and investment tax credit for breeding cows purchased as part of an investment in an embryo transplant cattle breeding activity. The court found that the embryo transplant activity was a sham and the investment constructed for the purpose of creating tax deductions. The business operator had no facilities or equipment for transplanting embryos, had fewer cattle than claimed and retained possession and control of the cattle the taxpayers claimed to have purchased and for which the taxpayers claimed deductions. ***In re* Gran, 91-2 U.S. Tax Cas. (CCH) ¶ 50,312 (E.D. Ark. 1991), *aff'g* 108 B.R. 668 (Bankr. E.D. Ark. 1989)**.

**EMPLOYEE PLANS**. The IRS has issued procedures for the issuance of determination letters on the qualified status of pension, profit-sharing and annuity plans which meet the design based safe harbors in proposed regulations under Section 401(a)(4) as amended by TRA 1986. **Rev. Proc. 91-41, I.R.B. 1991-28, June 25, 1991**.

**FORMS.** The IRS has issued a proposed revision of Form 3115, Application for Change in Accounting Method. **Ann. 91-91, I.R.B. 1991-25, 49**.

**HOME OFFICE**. The taxpayer was an anesthesiologist who worked at three hospitals, none of which provided an office. The taxpayer used a room in an apartment for recordkeeping, scheduling and research. The court affirmed the Tax Court's "facts and circumstances" test to allow the taxpayer to deduct expenses resulting from the use of the room as an office because the office was the main headquarters of the taxpayer's business, even though most of the taxpayer's work was done outside of the office. **Soliman v. Comm'r, 91-1 U.S. Tax Cas. (CCH) ¶ 50,291 (4th Cir. 1991), *aff'g* 94 T.C. 20 (1989)**.

**INVESTMENT TAX CREDIT**. The taxpayer purchased compressed gas cylinders and leased the cylinders to unrelated parties under leases of a set term. The taxpayers were denied investment tax credit where the leases could be continued until terminated by the parties. **Russell v. Comm'r, T.C. Memo. 1991-269**.

## PARTNERSHIPS

STATUTE OF LIMITATIONS. The court held that the statute of limitations of Section 6501(a) did not apply to partnerships at the partnership level because the return filed by the partnership was informational only and did not contain sufficient information to make assessments. Thus, the assessments against the individual partners was not barred by Section 6501(a). **Stahl v. Comm'r, T.C. Memo. 1990-320, *reh'g denied* 96 T.C. No. 37 (1991)**.

### SAFE HARBOR INTEREST RATES

### JULY 1991

| | Annual | Semi-annual | Quarterly | Monthly |
|---|---|---|---|---|
| | | **Short-term** | | |
| AFR | 6.69 | 6.58 | 6.53 | 6.49 |
| 110% AFR | 7.37 | 7.24 | 7.18 | 7.13 |
| 120% AFR | 8.06 | 7.90 | 7.82 | 7.77 |
| | | **Mid-term** | | |
| AFR | 8.02 | 7.87 | 7.79 | 7.74 |
| 110% AFR | 8.85 | 8.66 | 8.57 | 8.51 |
| 120% AFR | 9.66 | 9.44 | 9.33 | 9.26 |
| | | **Long-term** | | |
| AFR | 8.43 | 8.26 | 8.18 | 8.12 |
| 110% AFR | 9.30 | 8.09 | 8.99 | 8.92 |
| 120% AFR | 10.06 | 9.91 | 9.79 | 9.71 |

## S CORPORATIONS

ADMINISTRATIVE ADJUSTMENTS. Although the S corporation had not designated a tax matters person, the shareholder with the largest profits interest signed, as the tax matters person, a Form 872-R, Special Consent to Extend the Time to Assess Tax Attributable to Items of an S Corporation. The court held that the consent was valid and binding on the corporation and other shareholders. **Modern Computer Games, Inc. v. Comm'r, 96 T.C. No. 40 (1991)**.

S corporations with less than 10 shareholders are not exempt from the unified audit and litigation procedures as a small S corporation for a taxable years with a tax return due date prior to January 30, 1987. **Cichy v. Comm'r, T.C. Memo. 1991-270; Twenty-Three Nineteen Creekside, Inc. v. Comm'r, T.C. Memo. 1991-271, *reaff'g* T.C. Memo. 1990-649**.

CLASS OF STOCK. An S corporation with three shareholders redeemed a small portion of the stock of one shareholder each year until the shareholder's interest was decreased from 33 1/3 to 20 percent. The redemptions were treated as distributions under Section 301 and were not made under a plan to equalize the interests of all shareholders. The IRS ruled that the redemption did not create a second class of stock causing termination of the S corporation election. **Ltr. Rul. 9124009, March 11, 1991**.

DIVIDENDS. The taxpayer was a lawyer who had formed a solely-owned professional corporation for the practice of law. The taxpayer received several distributions from the corporation which the taxpayer characterized on the corporate books as loans but no terms were set or interest rate charged. The court held that the distributions were taxable dividends. **Jaques v. Comm'r, 91-1 U.S. Tax Cas. (CCH) ¶ 50,292 (6th Cir. 1991), *aff'g* T.C. Memo. 1989-673**.

REORGANIZATION. A cattle ranch corporation was reorganized into two corporations in order to avoid disputes between the shareholders. The IRS ruled that the reorganization qualified as a "type D," Section 368(a)(1)(D), reorganization with carryover of basis and holding periods for the assets. **Ltr. Rul. 9123027, March 8, 1991**.

TRUSTS. The decedent bequeathed shares of an S corporation to a trust for one beneficiary. The trust provided for distribution of income to the beneficiary annually and distribution of trust principal at the discretion of the trustee for the beneficiary's support, care, maintenance and education. One third of trust principal was to be distributed when the beneficiary reached ages 21, 26 and 30. The IRS ruled that the trust was a qualified Subchapter S trust. **Ltr. Rul. 9124015, March 14, 1991**.

The decedent bequeathed shares of an S corporation to a trust with three beneficiaries. One beneficiary received 50 percent of trust income and the other two beneficiaries received 25 percent of trust income each. The trustee had no power to distribute trust corpus. At the death of the major beneficiary, the trust continued for each of the other beneficiaries until the beneficiary reached age 33, when 50 percent of trust corpus was to be distributed to that beneficiary. The IRS ruled that under Section 663(c), the interest of each beneficiary was considered a separate trust; therefore, each beneficiary's interest in the trust was considered a qualified Subchapter S trust. **Ltr. Rul. 9124017, March 14, 1991**.

**TAX LIENS**. The IRS has issued proposed regulations providing procedures for taxpayer notification of a failure by the IRS to release a lien and administrative remedies which must be exhausted prior to filing a civil cause of action for failure to release a lien. **56 Fed. Reg. 28839 (June 25, 1991)**.

**TRUSTS**. The existence of two family estate trusts for income tax purposes was disregarded and the taxpayer was liable for taxes on dividends and capital gains from property transferred to the trusts where the taxpayer's relationship to the property did not change after the transfer of the property to the trusts, the taxpayer did not adhere to the fiduciary responsibilities as trustee, and the taxpayer did not act as though the trusts were separate entities. **Harrold v. Comm'r, T.C. Memo. 1991-274**.

The taxpayers were grantors and trustees of trusts used to conduct personal and investment activities. The trusts were held to be shams because the taxpayers had complete control over the trust assets and activities; therefore, the taxpayers were personally liable for taxes on trust income and were denied deductions resulting from transactions between the trusts. The taxpayers were also liable for additions to tax for substantial understatement of tax liability and for fraud for use of the trusts as a scheme to evade tax. **Dahlstrom v. Comm'r, T.C. Memo. 1991-264; T.C. Memo. 1991-265**.

**UNAUTHORIZED COLLECTIONS**. The IRS has issued proposed regulations providing administrative remedies which must be exhausted prior to filing a civil cause of action for an unauthorized tax collection. **56 Fed. Reg. 28842 (June 25, 1991)**.

**AGRICULTURAL LAW DIGEST**
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# STATE TAXATION

**AGRICULTURAL USE**. This case involved the appeal of two cases. In the first case, the landowner sought an agricultural use exemption from ad valorem property taxes for two calendar years. In the first year, the landowner began preparation for planting barley on land which had not been planted for many years. The court held that because no crop was planted on January 1 of that year, the agricultural use exemption was not allowed. In the second year, a barley crop was planted but the court held that the exemption was not allowed because the dry farming method of raising barley was too precarious for a reasonable expectation of profit from the crop. In the second case, the landowner established a goat ranch on the subject property. The court held that the goat ranch had a reasonable expectation of profit and was a reasonable use of the property. However, the landowner was entitled to the agricultural use exemption only for the land within a reasonable distance of available water for the goats because land away from the water was too dry to sustain a goat ranch without the piped-in water. **Title USA v. Maricopa County, 810 P.2d 633 (Ariz. Tax 1991)**.

The landowners leased a portion of their farmland for mining purposes and the county auditor assessed as nonagricultural the entire parcels of land which contained the leased portions. The court agreed with the landowners that the auditor could separate the leased portions from the parcels and revalue only the leased portions. However, the landowners were not entitled to reduction in the value of the non-leased portions because the landowners failed to provide sufficient evidence of the boundaries of the leased portions. **Renner v. Tuscarawas County Bd. of Revision, 59 Ohio St.3d 142, 572 N.E.2d 56 (1991)**.

# CITATION UPDATES

**Tecumseh Corrugated Box Co. v. Comm'r, 932 F.2d 526 (6th Cir. 1991),** ***aff'g*** **94 T.C. 360 (1990)** (involuntary conversion) see p. 104 *supra*.

**Muserlian v. Comm'r, 932 F.2d 109 (2d Cir. 1991)** (loans as gifts) see p. 93 *supra*.

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